UNDERSTANDING PAY EQUITY

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I. Introduction

In July of 1985, the Manitoba Government passed *The Pay Equity Act*[1] covering 60,000 employees in the public sector, with the intent of increasing the wages of employees in "undervalued" jobs. The government is committed to extending this legislation to the private sector. This *Act* will have profound consequences for the labour market and the general economy of Manitoba; yet there has been very little public debate on the issue, resulting in lack of understanding about what pay equity means, how it works, or how it will affect the business community. The purpose of this paper is to examine the issues and possible consequences which attend pay equity.

According to the Pay Equity Bureau, the goal of pay equity is to eliminate sex discrimination from the wage setting process. Implicit in this statement is the idea that the gender wage gap of approximately 34% is solely due to market imperfections and discriminatory attitudes that have led to the undervaluation of women's work. The Bureau also claims that the wage gap would not exist if men were doing these jobs.[2]

In order to eliminate the wage gap, the *Act* requires the development or selection of a job evaluation system (JES). The JES involves a process of comparing dissimilar jobs to determine both the relative position of one job to another in a wage or salary hierarchy and a job's value. A job evaluation system considers only certain aspects of jobs, such as skill, effort, responsibility and working conditions in determining their value. The JES does not consider the performance of individuals or innate abilities of particular workers. The Pay Equity Bureau claims that the JES can be used to detect sex discrimination in wage setting and thus eliminate it.

II. The Market and Wage Determination

The central issue is how the worth of a particular job is determined. First of all it is instructive to consider the role of the market in setting a pay schedule.

The relative worth of any item in the marketplace lies in a composite of individual values and choices that are ultimately translated into market prices which allow for exchange to take place. Similarly, in the labour market, the price fetched by a resource is determined by the interaction of the demand and supply for that resource. Hence, the owner of a labour resource is paid a wage because he or she possesses intelligence, ability to reason, business acumen, muscle power, and all the other qualities that constitute a labour force. Generally, a higher wage is due to higher demand *vis-à-vis* supply. For example, Wayne Gretzky earns more than a university

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1. *The Pay Equity Act*, S.M. 1985-86, c. 21, C.C.S.M. P13.
2. Pay Equity Bureau, *Pay Equity and Job Evaluation* (Winnipeg, February 1986).

professor, not because scoring goals is necessarily more difficult or more valuable to society than disseminating knowledge, but because fewer people have perfected that particular skill. However, sudden shortages in supply will cause noticeable increases in market prices for either hockey players or professors. Labour market values react to forces of supply and demand thereby altering the value of a particular job over time. A sudden shortage of hockey players or professors will cause a noticeable increase in market prices. The labour market is the only device that can efficiently sort out the many millions of workers with varying skills and interests among the multitude of different jobs. Any attempt to do this by administrative methods such as the Pay Equity Bureau, would be inefficient, cumbersome and would encroach on personal freedom.

While it is not the purpose of this paper to examine the various theories of wage determination, there are nevertheless certain relevant market factors that influence wages. Generally, people differ in their capacities to provide potential service. They vary in skill, experience, and their willingness to take risks. This differentiation extends to physical strength and willingness to put forth physical effort, and to their tastes for various kinds of jobs. Armed with certain skills and qualifications, workers choose to be employed in certain geographical locations, at certain jobs, according to their own unique tastes, preferences, values and wants. When these factors are totalled, they constitute the supply side of the market. In a market system, workers' mobility and choices are significant factors underlying pay rate differentials, since they create either an oversupply or undersupply in certain occupations.

The other influence on wage structure is of course the demand for labour resource. Quantitatively, two factors are of paramount importance: contributions to output, i.e., marginal productivity, and the price of the product produced. Together they influence the firm's revenues and profits, which in turn dictate the survival of the firm. The firm has little control over either factor.

In addition to the quantitative factors mentioned above, the demand for labour also has a qualitative side to it. That is, workers are not homogeneous. A worker may not be a duplicate of another in terms of dependability, trustworthiness, co-operativeness, flexibility, mobility and commitment. The differences in employee work behaviour does influence the overall productivity of the enterprise and therefore does account for some of the differences in wages. Institutional constraints such as the seniority system, unions, and rules and regulations established by the government also influence the demand for labour.

In conclusion, wage rates and employment are jointly determined by the interaction of supply and demand. Market wages can change in the same way prices of goods and services change. The wage differences can be partly explained by worker choice, age, marital status, inherited characteristics, an individual worker's investment in human capital and by market imperfections such as monopolies, union policies, government mandated minimum wages, licensing requirements and certification.

Advocates of pay equity suggest that the gender wage gap is due to societal discrimination against women that is inherent in the market wage setting process. The earnings data that are presented in their arguments are aggregates, unadjusted for such differences as work experience, marital status, occupation and education. The earnings reported do *not* represent pay for women and men performing the same job. They are simply the average pay of all men performing all jobs, and the average pay of women performing all their jobs. Also, there is no accounting of the fact that men and women are not evenly distributed among the different occupations. Therefore, the extent of gender discrimination cannot be measured by the differences between the average earnings of men and women because these averages do not take into account differences in marginal productivity. It is interesting to note that the courts in the United States have generally found arguments linking wage gaps to sex discrimination unpersuasive.[3]

III. Questions Relating to Women's Earnings

A. Why Are Women Paid Less?

The statistic that has received the most attention is the overall ratio between average male and female earnings. According to the Pay Equity Bureau, women earn only 66 cents for every $1.00 men earn. The Bureau claims that this disparity is due to sex discrimination which undervalues women's jobs.[4] Research has indicated that sex discrimination cannot be measured by merely using aggregated average earnings of men and women.[5] Studies do indicate, however, that productivity factors are generally responsible for the wage gap.[6] For example, women as a labour group have less work experience. Women tend to enter and leave the labour force more frequently than men, the major reason being childbearing and the raising of children. The result is that women acquire less seniority in their jobs than men and seniority is a major determinant of pay.

Another factor contributing to lower pay for women is their rate of participation in the labour force. In 1941 only four percent of married women were in the labour force. In 1951 they constituted 22% and by 1971 that percentage increased to 33%. In 1985, 43% of the Canadian labour force were women.[7] Such a significant increase in the participation rate creates an oversupply of labour resources and, given the type of demand conditions in the marketplace, results in lower wages. The concentration of women in a small variety of jobs increases the oversupply in these jobs and further contributes to a lower wage rate. Sex discrimination occurs because many of these jobs require fewer skills, have more flexible hours or have career ladders unaffected by leaves of absence. The concentration of women in certain jobs is also explained by the lack of job training, job searches, and the lack of proper parental counselling regarding career opportunities.

3. Equal Employment Advisory Council, *Comparable Worth Briefing Papers* (Washington D.C., 1984) at 236.
4. *Supra*, note 2. See also Statistics Canada News Release, *Globe and Mail* (13 March 1987) 2.
5. L. Z. Lorber et als.,*Sex and Salary* (Washington D.C.: ASPA Foundation, 1985) at 7.
6. Albert Rees, *The Economics of Work and Pay*, 2nd ed. (New York: Harper & Row, 1979) at 153.
7. "Whence Pay Equity," *Western Report* (9 June 1986) at 9.

The conclusion is that numerous factors give rise to the wage differential. However, even after taking account of quantity and quality of schooling, other training, number of years in the labour force, and so on, a small unexplained differential still remains. What is at issue is how much of that differential is caused by sex discrimination. The studies to date have been inconclusive.[8]

B. Is The Wage Gap Narrowing?

Even if unadjusted aggregate data is used, the gender wage gap has narrowed in the last fifteen years from 40% to 34%.[9] However, if comparisons are made on the basis of age, particular occupations, and marital status, the wage gap is approximately nine percent.[10]

In the United States women under 25 years of age make 90% of what men make in the same age group. The wage gap is the same for women between 25 and 34 years of age who were never married.[11] The Rand Institute study has shown that wages of women who were never married and have been continuously employed earn 100% of what men earn.[12]

In Canada, a Fraser Institute study has revealed that in 1982 the never married women's average earnings were $16,323 while the never married men's average earnings were $18,164—a wage gap of 10.1%. Furthermore, for those never married with a university degree, the male/female earnings ratio was 93.4%. This is significant since this ratio considers only education and marital status, not age, experience, continuity in the labour force and career choice.[13]

Based on these results, it can be concluded that the solution is not pay equity, but recognition by women of the costs of choosing a career.

C. Why Is The Pay Gap Narrowing?

The closing of the wage gap in recent years can be ascribed to the equal pay for equal work and equal opportunity legislation. In addition to these factors, counselling has given rise to a movement of women out of traditional jobs. More women now achieve higher education which qualifies them for higher paying non-traditional jobs.

IV. Pay Equity and Job Evaluation

The advocates of pay equity claim they can evaluate very dissimilar jobs by adopting a job evaluation system. A JES is a set of factors by which they believe all jobs can be evaluated and compared. Furthermore, they claim that the content of jobs is more important than the performance of

8. R. E. Williams and L. L. Kessler, *A Closer Look at Comparable Worth* (Washington D.C.: National Foundation for the Study of Equal Employment Policy, 1984) at 23.
9. R. E. Robb, *Equal Pay for Work of Equal Value: Issues and Policies* (Toronto: Ryerson, March 5, 1986) at 2.
10. *Ibid.* at 3.
11. J. P. Smith and M.P. Ward, *Women's Wages and Work in the Twentieth Century* (The Rand Corporation, 1984) at 31.
12. *Ibid.* at 46.
13. W. Block and M. Walker, *Focus on Employment Equity: A Critique of the Abella Royal Commission Report* (Vancouver: The Fraser Institute, 1985) at 42-49.

individuals or the innate abilities of particular workers. The inherent assumption in the above statement is that all workers are homogeneous with respect to capability, experience, motivation and marginal productivity. Furthermore, the advocates assume that workers attain the same level of satisfaction or dissatisfaction from the same type of work. It is common knowledge that all evidence refutes these assumptions.

Job evaluation systems can and do serve as valuable tools for managers in both private and public sectors. Properly designed and administered, a job evaluation system can provide a valid, non-discriminatory basis for an individual employer's decisions regarding pay rates for his or her own employees. One of the major reasons why many employers adopt such systems is to try to achieve internal equity in pay rates. This use of a JES creates a perception among employees that each job is fairly compensated in comparison with other jobs within the same plant or business. However, internal equity is not the only goal of a compensation system. Equally significant for most businesses is the need to maintain external competitiveness, i.e., paying enough to attract, retain, and motivate employees without incurring excessive labour costs. If a job evaluation system reduces the external competitiveness, there would ultimately be business failure and loss of jobs.

Job evaluation systems have a tendency to equate jobs with a constant, quantifiable entity, irrespective of business conditions or company objectives. It is a known fact that the level of compensation for specific jobs will vary depending on business profits, the nature and extent of competition within a particular industry and the organization's strategy for achieving its business or operational goals. For example, a company may decide to pay low wages, even at the expense of high employee turnover so as to be able to compete by providing low priced products. A job evaluation system that focusses solely on internal equity may not be compatible with non-discriminatory business objectives in a highly competitive economy.

Furthermore, no matter how objective and quantitative the results of any job evaluation system may appear to be, they are, in fact, largely derived from subjective value judgments. The subjectivity of JES is illustrated by comparing the job rankings produced by pay equity studies in Wisconsin, Iowa, Minnesota and Washington. For example, using electricians as a basis for comparison, Minnesota believes that licenced practical nurses should be paid considerably less than they make in the other three states. In contrast, Wisconsin thinks that dental assistants should be paid more than do the other three states.[14]

The job evaluation system as proposed by pay equity advocates ignores two very important components. First, private businesses do not attempt to evaluate all jobs in one survey. They do not compare sales jobs with janitorial positions; nor do they compare clerical positions with machinist's positions. Instead they conduct separate studies within each major job class

14. Wisconsin Association of Manufacturers and Commerce, *Special Report on Comparable Worth* (Wisconsin, January 1985) at 4.

to avoid having to compare very dissimilar jobs. Secondly, private sector job evaluation studies are always tied to market wages. The pay equity studies ignore this important link. In order for the job evaluation process to be a valuable management tool, it cannot be a market-blind process. Without the tie in to the market, job evaluations would serve no practical purposes. The labour market still dictates at least the minima that most employers have to pay to attract and retain workers with the needed skills, and the economic position of the firm relative to its competition generally dictates the maxima it can pay. Without some mechanism for reconciling internal job value determinants with external market rates, few businesses could survive indefinitely. They would eventually either lose essential workers to higher paying firms or destroy their competitive position because of excessive labour costs. Job evaluations must be tied into the market to serve any purpose.

V. Potential Unintended Consequences of Pay Equity

Since pay equity legislation is a direct intervention in the labour market, careful thought must be given to the potential impact of such a policy on the economic viability of firms as well as on the employment opportunities for women. Because of the complexity of the market process, actions intended to have one result may turn out to have perverse consequences in other areas.

First of all, it must be recognized that a pay equity policy will require more than just a one-time intervention into the labour market. Initially there would be an evaluation of all jobs and an upward wage adjustment in every predominantly female job. This wage adjustment would lead to alterations in the wage relationships among jobs which would lead inevitably to changes in supply and demand which in turn would cause shortages of supply in specific job classifications. This result would necessitate additional increases in wages in order to attract workers with needed skills. But under pay equity such increases would then force equivalent increases in other equally rated jobs. The result would further distort the supply and demand conditions.

Job content seldom remains static. To maintain pay equity, employers would have to re-evaluate jobs and adjust wages continuously as products, workloads, and operating methods change.

Secondly, even though pay equity would provide immediate benefits for women in certain jobs, unemployment may result. Higher wages normally would lead to a lower demand for workers. In a competitive market wage increases cannot be passed on to consumers. Even if increases could be incorporated into higher product prices, the higher prices would decrease consumer demand and result in less production and therefore less jobs.

Pay equity is analogous to minimum wage laws. Pay increases with no increases in productivity usually result in lay-offs to keep costs down. However, unlike minimum wages, pay equity would affect many more workers. Bankruptcy or closing of small businesses that could not implement pay equity would result. On the other hand, pay equity would give large firms an incentive to substitute capital or raise hiring standards so that fewer workers of either sex who were more productive could replace a larger number of workers.

Furthermore, pay equity could destabilize internal wage relationships, i.e., a bargaining process could break down as negotiators become inundated with complaints by individuals regarding their compensation.

Pay equity legislation may also affect the competitive position of Manitoba firms in international markets. There is no question that increases in wage rates without increasing productivity would put Manitoba products at a disadvantage in the world markets.

VI. The Costs of Pay Equity

At this time it is difficult to estimate the potential costs of pay equity because there are no specific details on how the theory might be put into practice. The cost of administering a system based on pay equity would depend substantially on the extent to which that system required the government to oversee or supplant the wage-setting practices of private and public employees. It is fair to assume that decisions on the relative worth of different jobs necessarily will involve more administrative complexity than a straightforward decision as to whether two jobs involve equal work, but the degree of complexity is unknown. For example, potential administrative costs could include the time managers, consultants and employee representatives spend in initially evaluating all jobs, and the cost of re-evaluating jobs each time a change of duties occurred or each time a labour market variation forced a wage adjustment. There is also the administrative cost of explaining and defending job evaluations whenever an employee challenged a decision. Such tasks and the accompanying expenses are likely to be substantial when viewed in light of the unlimited variations of jobs that exist in the Manitoba economy.

Pay equity would change the relative wages of men and women even though there is no direct evidence that women's wages are the result of sex discrimination. The real issue is whether pay equity provides a practical and effective way of identifying and eliminating unfair and discriminatory wage-setting practices. If it does, costs should not be an objection. But effective remedies for sex discrimination in wage-setting already exist without the need for pay equity.[15]

VII. Foreign Experience with Pay Equity Legislation

In attempting to forecast the consequences of pay equity policy, it is sometimes useful to look at the experiences of foreign countries that have adopted the same type of policy.

The Australian experience (a pay equity policy was implemented there in 1972) is often cited as an example of successful implementation. A 1981

15. Federal and Provincial governments should be more diligent in enforcing equal pay for equal work and equal opportunity legislation. Better career counselling should be provided to ecourage women to enter non-traditional careers. More women have entered universities and are effectively competing for higher-paying jobs. Development of new technologies and industries will also provide opportunities for women who desire new career alternatives.

study by Gregory and Duncan showed that increases in women's wages attributable to the new pay policy led to a reduction in female employment. This reduction was below the level that would be expected from business cycle factors. This reduction was most pronounced in the manufacturing sector where employment fell 17%.[16] Only in the public and community services sectors did the policy have a negligible effect on women's employment.

In the United States, several states have implemented pay equity policies; however, it is too early to tell whether the policy has been a success.

VIII. Conclusion

The pay equity issue has tended to focus on the existence of the male/female wage gap and the demand that it be eliminated, rather than on the causes of the gap and the best methods for dealing with those causes. It is essential that these basic issues be given greater attention by examining the causes of the pay gap and the extent to which the gap is the result of discrimination by employers. All evidence suggests that non-discriminatory factors are the causes of the wage gap. Pay equity legislation is not the solution because the concept of pay equity has at least five fundamental flaws:

(1) It assumes that the average earnings gap is a simple employment discrimination issue and fails to deal with the real causes of that gap;

(2) It assumes that universal standards of job worth can be established even though, in fact, jobs have no intrinsic value;

(3) It assumes that market forces of demand and supply can be replaced by a government-imposed system for determining and enforcing job worth. Such a system is incompatible with a market economy and is administratively impractical;

(4) It assumes that wages for predominantly female jobs can be increased significantly without either decreasing wages for other workers or increasing costs of goods and services to consumers; and,

(5) It assumes there will be no adverse effect on the number of job opportunities available to the workers it is supposed to help.

16. R.G. Gregory and R. Duncan, "Segmented Labour Market Theories and the Australian Experience of Equal Pay For Women" (Spring, 1981) *Journal of Post Keynesian Economics* 403 at 413.