The Weakness of Weak Ties in Referrals: An Obstacle for the Upwardly Mobile Black Men in the Private Sector

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1 Introduction

For many years, social scientists and policy makers have tried to understand factors that determine the racial wage gap between blacks and whites in the United States.\(^1\) From a policy point of view, it is especially important to understand the underlying mechanisms through which these factors operate. Two seemingly related factors are the education level (high school, college, post graduate, etc) and the mean occupational earnings. In particular for men, the racial wage gap is decreasing in the education level (appendix of Neal and Johnson (1996) and Lang and Manove (2011)) but increasing with the mean occupational earnings in the private sector (Kaufman (1983), Grodsky and Pager (2001), and Huffman (2004)). These two findings seem contradictory in that the education level and the mean occupational earnings should be positively related. Lang and Manove (2011) argue that the informational asymmetries likely decrease for college graduates because education acts as a “signal". However, it remains unclear how the racial wage gap increases with the mean occupational earnings in the private sector. Gaining a better understanding of the underlying mechanisms that can reconcile these two facts is of paramount importance in forming public policy and the subject of this paper.

I consider the widespread use of employee referrals by firms in the labor market to reconcile these two seemingly contradictory findings. There is an empirical consensus, both in economics and in sociology, on its use.\(^2\) Researchers have argued that employee referrals are a useful device for screening job applicants because employees can convey some information to the firm about the abilities of their job seeking contacts. The quality of such information will depend on the

\(^1\) For an excellent review in the economics literature, see Altonji and Blank (1999).
type/strength of relationship between the job seeking worker and his employed tie, but for two very different reasons. On the one hand, strong employed ties (such as family members or close friends) are more informative about the true ability of their job seeking contacts than weak employed ties (such as acquaintances), so they can provide better information. On the other hand, strong employed ties also have a higher incentive to get their job seeking contacts a high wage offer because they care more about the well being of their contacts, so they can provide worse information by exaggerating about their abilities. However, the extent to which such exaggeration will take place depends on their reputation costs of referring a low ability worker. The firm can take this into account and select only those employees to be referrers that have high enough reputation costs at stake, and therefore the referrers will not exaggerate very much about the abilities of their job seeking contacts. In equilibrium, stronger employed ties will provide better information due to firm only selecting those employees to be referrers that have high enough reputation costs. Moreover, I find that the higher is the skill level of the job seeking worker, the stronger the tie he needs to get a “good” wage offer (wage at least as high as the wage firm will offer to a worker of his skill level). Since blacks are a minority, there are fewer employed people of the same race with whom they can form ties, presenting a structural impediment to the formation of same-race ties. Because same-race ties are likely to be stronger than cross-race ties, job seeking blacks are likely to have fewer strong employed ties. In addition, blacks are less likely to be employed compared to whites and therefore less likely to be referrers. Thus, the job seeking blacks are less likely to have employed familial ties as well. For minorities that have strongly connected communities with low unemployment rates, they are more likely to have strong ties and may not face this disadvantage. The rest of the arguments simply follow from this idea that blacks are less likely to have access to strong employed ties, and I will discuss it next.

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3See Rees (1966) and Montgomery (1991) for some early references on reputation costs. See Garth Saloner (1985) for an early model. Smith (2005) and Smith (2010) examines the referring behaviors of racial/ethnic minorities in high-poverty urban areas and finds employed workers with job opportunity information are quite concerned with the reputational impacts of their referrals. Recent research showing employers engage in shared wage punishment of referrers and referrals (Heath (2013)) suggests that such reputational concerns are justified. In Beaman and Magruder’s (2012) experiment in the Kolkata labor market for experiment subjects, subjects generated other subjects via referring and under a variety of manipulated scenarios. They found that referrers are aware of their contacts’ likely productivity, and will select referral applicants on this worker quality dimension only if the incentives are constructed such that the referral’s performance affects the referrer directly.

4Homophily is the principle that a contact between similar people occurs at a higher rate than among dissimilar people. If frequent interaction indicates strong ties, then we can derive from the homophily principle the proposition that strong ties are among people of similar attributes such as race. See McPherson, Smith-Lovin and Cook (2001) for a survey on homophily. It highlights that homophily by race and ethnicity is particularly important in the US and other ethnically diverse societies. See Homans (1950), Laumann (1966), Laumann and Senter (1976), Verbrugge (1979) for the relation between homophily and strength of ties. See Tsui and O’Reilly (1989), and Thomas (1990) for some further evidence in the management science literature.

5See Lang & Lehmann (2012) for a brief review of unemployment differentials between blacks and whites in the US.
2 Reconciling the Two Facts

Suppose the firm uses education as a signal to infer high skill workers (above average productivity). There are two types of occupational sectors, high skill sector only includes high skill workers (workers with a degree), and low skill sector can include both low skill and high skill workers. The low skill sector will have relatively lower mean earnings (or wage) as a consequence. In the high skill sector, there are only high skill workers and they require strong ties to get a good wage offers. Since blacks don’t have access to strong ties, the wage gap between blacks and whites exist for all skill levels in the high skill sector. On the other hand, in the low skill sector, there are many low skill workers and they require weak ties to get good wage offers. Since blacks have access to weak ties, the wage gap between the blacks and whites only exist for high skill workers. As long as the number of high skill workers is not much higher than the number of low skill workers in the low skill sector, on average the wage gap between blacks and whites will be smaller in the low skill sector than the high skill sector. At the same time, a high skill black worker in the low skill sector gets a lower wage than his white counterpart (same skill level) because he doesn’t have access to strong ties. These high skill black workers would gain substaintially by getting an education and moving to the high skill sector, because the firm will then recognize that they are above average productivity. While their white counterpart would only gain marginally by getting an education and moving to the high skill sector, because the firm already knew that they are above average productivity through their strong ties. Thus, the racial wage gap decreases with education because high skill black workers gains much more by getting an education than their white counterparts.
References


4