Can Behavioural Economics Help Explain Gender Disparities in Labour Markets?

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Abstract

The presence of pervasive gender disparities integrated into our labour market outcomes (of promotion, pay, and hiring) poses a threat to our current market functions. This paper determines the potential of behavioural economics in bridging these disparities in the context of labour market outcomes. Drawing on insights from the subject, the paper argues that gender disparities in labour market outcomes can be a result of a variety of behavioural biases and heuristics that lead to sub-optimal decision-making.

Using the behavioural lens the paper identifies and focuses on three cognitive biases: the endowment effect, the overconfidence bias and the status quo bias. The paper intends to propose interventions and policy modifications to overcome such ubiquitous biases and correct the present labour market climate.

1 INTRODUCTION

Two hundred eighty-six years is the daunting estimate given by the World Economic Forum's Global Gender Gap Report 2021 for women to achieve economic parity with men. (World Economic Forum, 2021). This staggering and stagnated number when it comes to labour outcomes re-emphasizes the irrationality of the ever-widening gender gap.

To account for this, significant data across the field helps us ascertain how women in higher roles of leadership strongly correlate with firm growth, market share, revenues, return on investment, productivity and profitability. Failing to hire and promote women is irrational and inefficient (Martha Fineman & Terence Dougherty, 2005). Among companies surveyed by the ILO that track the impact of gender diversity in management, over two-thirds of companies report 5-20% profit increases (ILO, 2019). Catalyst points out that companies

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with women on their boards outperformed companies with zero women board directors; by 84% return on sales, 60% return on invested capital, and 46% return on equity (Catalyst, 2021). Even enterprises report improvement in business outcomes due to gender diversity initiatives, over 60% report higher profitability and productivity, 56.8% report increased ability to attract and retain talent, 54.4% report greater creativity, innovation and openness, 54.1% say that their company's reputation has been enhanced, and 36.5% are better able to gauge consumer interest and demand (ILO, 2019).

The inference of these statistics clarifies that hiring, promoting and retaining more women in the existing competitive global market is of the utmost importance. It is imperative for organisations to view gender balance as a bottom-line issue, not just a human resource issue (Deborah France-Massin, Director of the ILO Bureau for Employers' Activities, 2019).

Additionally, the International Labour Organization estimates that closing the gender gap in participation by 25% before 2025 could increase global GDP by US$5.3 trillion. Every 1% of female employment growth is associated with, on average, annual GDP growth of 0.16% (Women in Business and Management: The Business Case for Change. ILO, 2019).

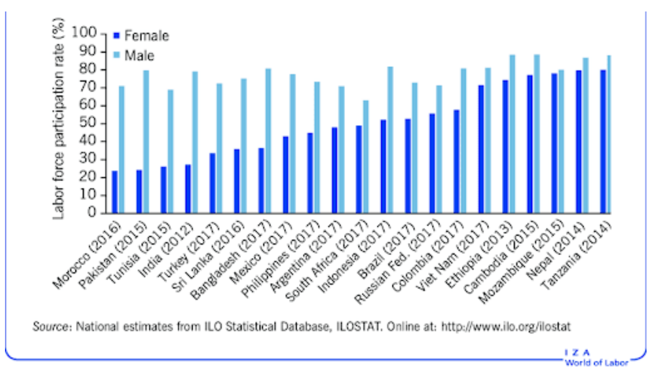

Figure 1: Labour force participation in various countries

Among those aged 25 to 54, the gender gap in labour force participation stood at 29.2% in 2022, with female participation at 61.4% and male participation at 90.6% (ILO, 2022). Globally, only about 18% of firms have a female manager (Esteban Ortiz-Ospina and Max Roser, 2018) and on an overall scale, women hold 19.7% of seats worldwide with only 6.7% chairing boards (Deloitte, 2021).

With the evidence of these arguments and statistics, two vital points have been established. Firstly, the proliferation of women's labour force participation has created a significant impact on organisations by contributing to an increase in profitability and the global GDP. Secondly, hindrances to the advancement of women due to unstructured and loosely targeted policies towards attaining the required gender parity in current labour markets, organisations and economies seem to be exhibiting irrational behaviour.

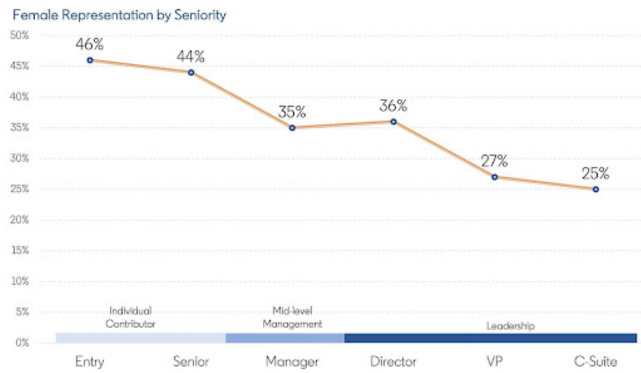

Figure 2: Source: Global Gender Gap Report, 2022.

The rethinking of neoclassical economic theories, such as rationality, is the central theme of behavioural economics; using a behavioural lens to understand and analyse this irrationality is essential to curbing the problem at hand. This paper utilises the study of behavioural economics to provide an in-depth analysis of how gender disparities in the labour market outcomes for women have come to exist. The paper in its first section analyses the existing literature on behavioural economics and cognitive biases and heuristics. Next, the paper identifies the behavioural biases and heuristics, namely: the endowment effect, the overconfidence bias, and the status quo bias, commonly seen in the labour market that create gender disparities. Similarly, the paper uses insights from behavioural economics to suggest behavioural nudges and interventions to heal this gender gap in labour markets.

2 LITERATURE REVIEW

2.1 Behavioural Economics- The Psychological Branch of Economics

The long-standing assumption of human rationality made by neoclassical economists to simplify their models was challenged by Daniel Kahneman and Amos Tversky leading to the revolutionary foundation of a much more complex, comprehensive and intricate branch of study. The amalgamation of psychology, neuroscience, and economics, behavioural economics is an attempt to put the study of economic decision-making onto a firm scientific basis. (David Orrell, 2021). "Behavioural Economics is the study of how people make decisions, not how they should make decisions" (Thaler, 2015). This branch of economics dimensionalized the study of economics, expanding the horizons of human understanding of the act of taking decisions and making choices. Human behaviour, contrary to the neoclassical economic theory, is not always motivated by rationality. The human mind eludes certain cognitive heuristics and biases that pose limitations to our decision-making. The gender disparities that we see today in the labour market are evidently irrational as seen through the tangible data presented earlier. This application of a behavioural economic approach helps us discern the outcomes caused by cognitive biases when observed through women's labour force participation.

3 BEHAVIOURAL ECONOMICS ANALYSIS

3.1 The Endowment Effect

People often demand much more to give up an object than they would be willing to pay to acquire it (Thaler, 1980).

Kahneman, Knetsch, and Thaler (1990) ran a new series of experiments to determine whether the endowment effect survives when subjects face market discipline and have a chance to learn. To sum up the experiment, the participants were divided into two groups of buyers and sellers; both groups were asked to set a selling price and a buying price respectively. The experiment revealed that the median selling price was almost twice the median buying price and the volume of trade was less than half of the expected (Kahneman, Daniel, Jack L. Knetsch, and Richard H. Thaler, 1991). Kahneman and Richard Thaler's experimentation with something as trivial as brief ownership of coffee mugs shows that humans would resist giving up their entitlement in rational exchanges, at least in part because of loss aversion, as well as status quo bias (Heckbert, 2018). The main effect of the endowment is not to enhance the appeal of the good one owns, only the pain of giving it up (Kahneman, Daniel, Jack L. Knetsch, and Richard H. Thaler, 1991).

Something as insignificant as the ownership of a mug raised such fervent feelings of endowment, one can only imagine what it would be like to give up leadership roles that come with privileged, wealth and advancement opportunities. Historically, under the status quo, white males are more likely to occupy or advance into leadership roles. This is why the endowment effect may help explain why progress toward gender parity in leadership is stalling or stalled. (Heckbert, L, 2018)

The endowment effect and bounded rationality seem to be interconnected in this instance. Some people lack awareness of the extent and severity of the gender gap in advancement. This bounded rationality impedes their capacity to question the status quo or challenge the endowment effect. (Heckbert. L, 2018). Misjudged and uninformed people might take this pursuit to attain gender parity as a fight that has been started against them. This leads to men exhibiting unwanted reluctances and insecurity when it comes to hiring or promoting more women to roles they traditionally held. McKinsey and Company's 2017 report finds that women are 18 per cent less likely to be promoted than their male peers globally, as women fall behind early and lose ground with every step of the pipeline (Krivkovich et al., 2017). Some men even feel that gender diversity efforts disadvantage them: 15 per cent of men think their gender will make it harder for them to advance, and white men are almost 50 per cent more likely than men of colour to think this"(Women and Workplace, 2017).

Men feel threatened by efforts towards gender parity due to their ignorance; their fear of being replaced and facing losses lead to implicit biases creeping in on the part of men and affecting the outcome. These implicit biases men conceive have a significant impact on outcomes for women since they are the ones present more prominently in higher managerial and leadership roles, accounting for 62% of C-suite roles and about 70% of senior management. An instance of implicit bias creeping into decisions, strengthening the feeling of the endowment, is when a manager might view a male employee who is assertive and self-promoting as having "leadership potential," while viewing a female employee who exhibits the same behaviours as "pushy" or "abrasive."(Rudman, L. A., & Glick, P., 2010) Similarly, research on gender and leadership has found that female leaders who attempt to establish their authority in a traditionally masculine (e.g., authoritative or directive) manner are evaluated more harshly than their male peers (Eagly, Makhijani, & Klonsky, 1992). Perhaps in response to this resistance, women have tended to develop a more participative leadership style, which is correspondent with prescriptive gender roles for women (Eagly & Johnson, 1990) and is more effective for them than traditionally male leadership styles (Eagly, Johannesen-Schmidt, & van Engen, 2003; Eagly, Karau, & Makhijani, 1995).

Men often see the issue of the gender gap framed as their need to protect themselves against losses. Particularly when added to the other two bounds, namely, bounded rationality and bounded willpower, the cumulative effect of these cognitive and behavioural factors underscores how crucial it is to intervene to correct this gender gap and the perceptions and behaviours surrounding it (Heckbert. L, 2018).

3.2 The Overconfidence Bias

"Overconfidence bias refers to the tendency of individuals to overestimate their abilities or the accuracy of their beliefs and judgments. This bias can lead individuals to take on more risk than is warranted, to make overly optimistic predictions, and to overestimate their performance on tasks. (Kahneman, D., & Tversky, A., 1973)."

In the light of social norms and stereotypes associated with behaviours and expectations from women, they show a stark overconfidence bias in undervaluing their work and skills. Studies have shown that, compared to men, women are less likely to initiate salary negotiations and ask for higher pay (e.g., Small et al., 2007). According to gender role congruence theory, the female gender role is inconsistent with the negotiator role so women may believe asking for higher pay would violate the social expectations that "good girls don't ask" (Babcock and Laschever 2003; Eagly and Sczesny, 2019).

The analysis of the working of this bias becomes imperative while talking about the gender pay gap. Globally, women made only $0.68 for every dollar men made in 2020 (World Economic Forum, 2020). Women's reluctance in asking for higher pay due to the undervaluation of their skills results in low starting salaries. The gender gap in starting salaries is then amplified over years through pay raises that mostly use starting salaries as a base and consequently lead to larger gender pay gaps in the long run.

Previous studies on gender differences in initiating salary negotiation find that, compared to men, women are more likely to feel anxious and less entitled during negotiations (Bowles, Babcock and McGinn, 2005). If the expected economic gains were large enough to outweigh the social costs, then the rational course of action would be to initiate negotiations, in spite of the social costs (Bowles, Linda Babcock, and Lei Lai, 2007). Referring to the study: "Social Incentives for Gender Differences in the Propensity to Initiate Negotiations: Sometimes It Does Hurt to Ask", by Bowles, Hannah Riley, Babcock, Linda, and Lai, Lei, there are two things that can be inferred. Firstly, women are overconfident in undervaluing their potential economic gains which could be a result of defying social norms. Secondly, women's reluctance in comparison to men's to initiate negotiations over resources, such as compensation, may be traced to the higher social costs that they face when doing so. A possible explanation for the lack of entitlement women feel during a salary negotiation is the serious undervaluation of their work. They tend to be overconfident in their inference of their work's worth. This cognitive bias, like many other biases, stems from social norms and stereotyping. Social norms play essential roles in people's economic behaviours (Kray, Galinsky, and Thompson, 2002; Li, De Oliveira, and Eckel, 2017). Traditional social norms prescribe that women are generally expected to demand and accept less and give away more (Bowles, Babcock, and Lai, 2007).

Individuals who believe their performance is better than others are more likely to ask for a pay raise. Equity theory suggests that people compare their own input/outcome ratios with others' input/outcome ratios, and would try to restore the balance if their ratios are higher than others (Huseman, Hatfield and Miles, 1987). Rationally, women should be negotiating for their work's worth, but overconfidence bias amalgamated with social norms, becomes a cognitive hindrance for women to do so. This identification of this bias and using behavioural interventions to fix it can result in a significant improvement in labour market outcomes for women concerning the reduction of the gender pay gap.

3.3 The Status Quo Bias

Status quo bias refers to the tendency to favour or maintain the current state of affairs, even in the presence of good reasons to change it. This bias can affect human behaviour in various situations, sometimes with beneficial effects but often with deleterious ones. It is often difficult to determine whether a particular status quo is worth preserving or whether a change would be beneficial, and there is no simple answer to this question. However, it is clear that people have a strong preference for the current state of affairs, and that this preference can have important consequences for decision-making and behaviour (Samuelson, *W., & Zeckhauser. R, 1988).*

The working of this bias is most at play for women's labour outcomes when it comes to their promotion to higher levels of leadership roles. According to a Peterson Institute for International Economics study, only 5% of CEOs in the S&P 500 are women. Similarly, a 2019 survey by McKinsey & Company found that women hold only 21% of C-suite positions in the United States.

According to social role theory, women face stereotyping perceptions because of their multiple social roles. The social role theory examines the causes of sex differences and similarities in social behaviours. It also argues that gender division of labour leads to the gender stereotypes which characterise a society (Eagly, 1987). The inherent status quo becomes the ideologies of patriarchy and separate spheres leading to the underrepresentation of women in roles of leadership that they are more than competent of holding. The failure of organisations to budge from their stance on these outdated notions and not taking into account the multifaceted roles that women play in societies not only causes significant economic and social costs for women but also results in a huge loss of economic opportunity for organisations.

If decision-makers have a preference for promoting individuals who resemble those who have been successful leaders in the past (i.e., the status quo), this can lead to disproportionate and underrepresentation of women in leadership positions as well as leave little to no room for women to be considered for higher-level promotions.

Merit-based pay and promotion programs or meritocracy have long been used by organisations as affirmative action for diversity policies. Meritocracy has been culturally accepted as a fair and legitimate distributive principle in many advanced capitalist countries and organisations (Scully, 1997, 2000; McNamee and Miller, 2004). However, a study by Castilla and Benard (2010), found that companies that emphasised meritocracy in their promotion decisions actually exhibited more significant bias against women and minority groups than those that did not emphasise meritocracy. The key hypothesis of the study establishes that managers making decisions on behalf of organisations that emphasise meritocracy ironically showed more significant bias in favour of men over equally performing women. This happens in part because the culture of meritocracy unintentionally triggers managers' stereotypes and other schemata while making employment decisions (Swidler, 1986; DiMaggio, 1997). This paradoxical finding suggests that the emphasis on meritocracy may actually reinforce the status quo bias. When an organisation is explicitly presented as meritocratic, individuals in managerial positions favour a male employee over an equally qualified female employee by awarding him a larger monetary reward (Castilla, E. J., & Benard, S, 2010).

The patriarchal notion of men being perceived as the ultimate leader of society, and consequently businesses, set the status quo bias in place that now women need to fight in order to climb up the corporate ladder to reach higher-level positions, such as that of directors or CEOs. Female candidates do not resemble the stereotypical notion of directors and leaders. Schein's research has shown that, in the UK, Germany, China, Japan and the US, men associate the attributes needed for leadership with men but not with women (Schein, Virginia E., et al., 2000). This was dubbed the "think manager, think male" phenomenon. These ideologies are also repeatedly seen in the form of glass ceilings. Glass ceiling implies blockages or barriers so invisible that they create obstacles for females and other minority groups as they try to rise to upper management positions (Morrison, 1980).

4 BEHAVIOURAL INTERVENTIONS

Keeping in mind the heuristics identified that play a significant role in the gender disparities of labour markets, this section of the paper suggests behavioural interventions that can potentially be used to curb, or at least, nudge the problem at hand.

Firstly, this paper suggests the use of explicit rules during the hiring process. As discussed in section III of the paper, women hesitate to lead or even initiate negotiations for their salaries. They fear that their outwardness and bold ask for their work's worth would make them less likeable, less hirable and rude. An experimental study (Lin Xiu et al., 2022) examined how explicit pay raise rules affect men's and women's initiations of salary negotiation differently. Their results showed that when pay raise rules are explicitly stated, women are less reluctant to ask for a pay raise. The explicit rule effect seems to work well, particularly for women with above-average task performance. A clearly stated rule frees women from concerns that their asking decisions might be perceived as socially less acceptable and that starting salary negotiations conflicts with their internalised social norm. (Lin Xiu et al., 2022). This would finally let women infer the value of their work without the constraints of social and gender norms. Using the behavioural tactic of framing and explicitly stating that wages are up for negotiations, organisations can not only empower women to start salary negotiations but also increase women's trust in the organisation's pay raise process, thereby retaining talent longer. Women would be certain that their work and talent are valued and that their future career advancements are assured.

Secondly, acknowledging the endowment effect, it is crucial that organisations carefully depict their stances on diversity and gender parity. This pursuit is for equality. Women's better labour market outcomes do not mean adverse outcomes for men. These two events are not mutually exclusive. "If men believe their organisations prioritise gender diversity because it leads to better business results, they are significantly more likely to think it matters. ... [W]hen men think companies prioritise gender diversity because it is 'fair to all people,' they are more likely to be personally committed."(Women and Workplace, 2017) It is important that organisations make active efforts to curb any ignorance and misinformation on the part of their male employees.

The most ideal way to strive for better labour outcomes for women is through gender parity and inclusion, yes, but also by making sure that the competent human capital is fully at use to accelerate economic development and amplify economic prosperity. This could potentially be a better way of framing the pursuit of gender parity in labour markets. If businesses provided concrete examples of economic results achievable with increased diversity and then described that economic opportunity in a manner that activated employees' loss aversion biases, this could help increase male employees' prioritisation of diversity in leadership (Heckbert. L, 2018). There are numerous studies and reports to support the claims that increased women's participation in the labour market leads to astounding outcomes. Through these studies, organisations can successfully disguise gender parity advancement as economic opportunities and business output advancements.

Thirdly, joint evaluation employees could help nudge out implicit biases that people tend to harbour due to social norms. These evaluations could potentially provide evidence-based rebuttals to any inherent stereotypical ideologies one must possess. Bohnet et al's research applied the behavioural economics finding that "people make more reasoned choices when examining options jointly rather than separately" to the process of employee evaluations. They found that when jointly evaluated, individual performance drives evaluation decisions; when separately evaluated, group stereotypes drive such decisions. Businesses could opt for joint evaluation at each of the hiring, review and promotion stages as a normative best practice and fairness mechanism.

Organisations could frame it as helping managers maximise profits and team results, by ensuring consistent selection of higher-performing candidates. Framing such a procedure as a fairness mechanism should appeal to individuals' bounded self-interest. Governments could nudge businesses toward adopting joint evaluation procedures. This could be incorporated in a "comply or explain" regulation, using an information-based strategy to indirectly alter business behaviour (Heckbert, L. (2018).

5 CONCLUSION

Through the behavioural economics lens approach that the paper has taken, the three heuristics and their respective arguments have reinstated the irrationality of the gender gaps in labour market outcomes.

Zooming into the endowment effect, it clarifies that paving the path to positions of authority for women or at the least considering competent women for these roles is felt as a devastating loss to those already concentrated in high numbers at the top of the ladder. As suggested in the intervention, this can be solved by framing the promotion and advancement of women as business and economic opportunities.

This paper takes a unique approach to the application of the overconfidence bias in the context of gender disparity in labour market outcomes. Historically, women have been economically disadvantaged due to the patriarchal norms embedded in the very essence of society. In a situation such as this, where social norms are against your favour, it's difficult to value one's work and skills, especially if one has been conditioned to downplay their achievements and never demand more. It is also seen that women are hesitant to negotiate their compensations in situations where they believe that the value of their economic gains is less than that of the social cost that comes with defying social norms. Organisations can assist women in being better negotiators by imposing the usage of explicit rules.

The resistance to hiring, promoting, and equitably compensating women within organisations highlights the persistence of patriarchal notions that reinforce men's leadership dominance. This section emphasises the critical need for organisations to overhaul their policies and strategies, embracing gender diversity as a fundamental aspect of their organizational culture.

Behavioural economics is the solution to understanding irrationality through structured and well-defined heuristics and biases. The overlap of this study ensures the problem at hand is understood from all different perspectives, offering reasons for the inherent issue of gender disparities in labour markets. Once issues at hand are understood vastly, the curbing and fixing become much more simplified.

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