Spontaneous Discrimination[*]

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Abstract

This paper considers a dynamic economy in which agents are repeatedly matched with one another and decide whether to enter into profitable partnerships. Each agent has a physical colour and a *social colour*. The social colour of an agent acts as a signal about the physical colour of agents in his partenrship history. Before an agent makes a decision, he observes his match's physical and social colours. Neither the physical colour nor the the social colour is payoff-relevant.

We identify environments where, in some equilibria, agents condition their decisions on the physical and social colours of their potential partners. That is, they discriminate. The main result of the paper is that, in these aforementioned environments, every *stable* equilibrium must involve discrimination. In particular, the colour-blind equilibrium is unstable.

1 Introduction

Consider a town in the southern United States with a mix of non-white and white residents, some of whom are members of the Ku Klux Klan. These Klan members dislike their non-white neighbours, and are willing to punish those who even *associate* themselves with non-whites. The townspeople are otherwise tolerant, having no bias on the basis of skin colour. Each individual observes, perhaps imperfectly, social interactions within the community. Suppose now that a non-white community member is in search of employment. Klan members will obviously refuse to hire him. However, even an unbiased white employer, acting out of fear of punishment from the Klan, might refuse to hire a non-white applicant. In the end, this unfortunate job-seeker might face discrimination from the entire white community, and thus remain unemployed. Crucial in this story is the fact that individuals obtain some information about the interactions of others, for if hiring decisions weren't observed unbiased employers would be unafraid of hiring non-whites. But how many local