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The CEO-Worker Pay Gap

U.S. corporations have now begun reporting ratio data for the first time ever.

NEW FEDERAL CEO-WORKER PAY RATIO DISCLOSURE REGULATION NOW IN EFFECT

After years of corporate resistance, Americans will soon finally have an opportunity to see how much more top executives make than the workers their own companies employ.

Eight years ago, as part of the Dodd-Frank financial reform, Congress required publicly traded U.S. corporations to annually report the ratio between their CEO and median worker compensation. Corporate lobby groups and allied Republicans fought hard to repeal this mandate — or water it down in the SEC rule-making process.

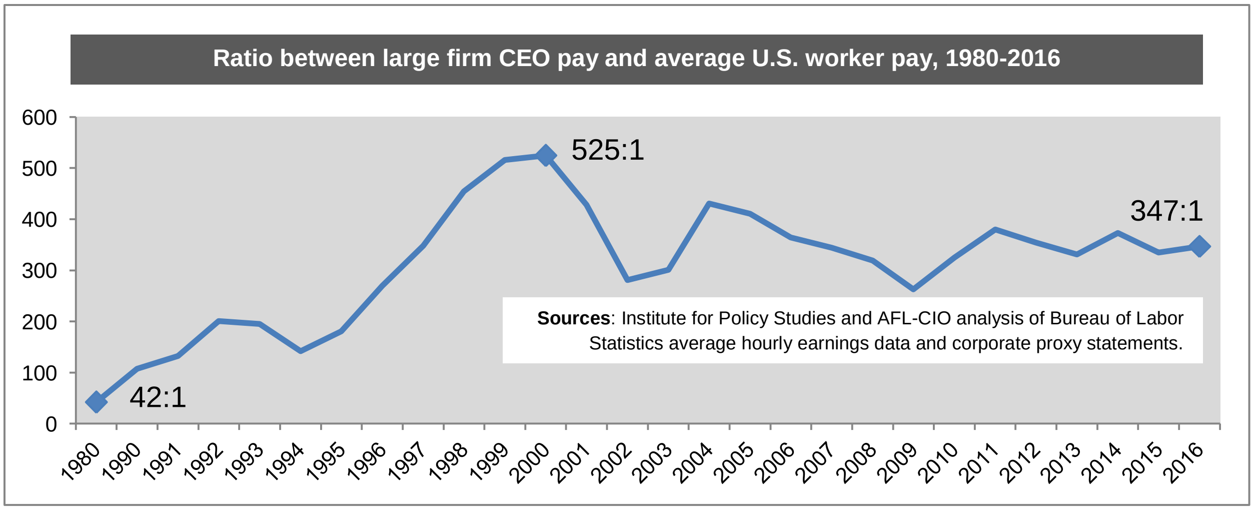
But institutional investors weighed in heavily to defend ratio disclosure reform, as did over 280,000 individual Americans outraged about the extreme pay gaps that large U.S. corporations on average display. These gaps have the vast majority of Americans deeply concerned about executive pay excess. A 2016 Stanford University poll found that 74 percent of Americans see CEOs as overpaid relative to their workers.

The HR Policy Association, the body that represents the chief human resource officers at America's largest corporations, expects the ratio data to start appearing in time for early April corporate annual meetings. The data will reflect 2017 pay levels. The first major disclosure came February 16 — from Honeywell — and revealed a 333:1 ratio between CEO and median worker pay.

WHY THE PAY RATIO INDICATOR MATTERS

►Corporate pay gaps help drive America's extreme inequality.

Worker wages in the United States have largely stagnated since the 1970s. But the top 1 percent of U.S. income earners have more than doubled their share of the nation's income over the same span. Corporate executives head about two-thirds of America's top 1 percent households. As of 2016, the ratio between S&P 500 CEO and



average U.S. worker pay stood at 347 to 1, over eight times as wide as the gap in 1980.

New Bloomberg comparative executive pay data from 22 major countries active in global markets reveal that CEO pay in the United States now quadruples average chief executive compensation in America's peer nations. No nation has a gap between average CEO and worker pay anywhere near as large as the divide in the United States.

►Wide pay gaps are bad for business.

Academic research indicates that extreme gaps undermine worker morale. Lower morale, in turn, reduces productivity and increases turnover. A Glassdoor analysis of data from 1.2 million employed individuals suggests a statistical link between high CEO pay and low CEO approval ratings among employees. Peter Drucker, widely known as the father of modern management science, believed that the ratio of pay between worker and executive can run no higher than 20-to-1 without inflicting damage on a corporation's internal dynamics.

In 2017, the new Trump administration acting SEC chief re-opened public comment on pay ratio disclosure, a move widely seen as a White House maneuver to derail this transparency reform. But the move backfired. Numerous institutional investors submitted letters underscoring the importance of the disclosure mandate.

Among these investors: state treasurers from four states, 100 investors representing $3 trillion in assets under management, CALSTRS, the Network for Sustainable Financial Markets, the Religious Society of Friends, SharePower Responsible Investing, Inc., Trillium Asset Management, the US Social Investment Forum, and Walden Asset Management.

►Runaway CEO pay endangers democracy and the broader economy.

The reckless "bonus culture" of the early 21st century, many observers believe, contributed mightily to the 2008 financial crisis. Outrageous levels of compensation give executives an incentive to behave outrageously, to "cook the books" and engage in all sorts of other reckless risks.

Current executive compensation patterns, observers agree, often leave long-term damage to company and country, everything from slashed payrolls and R&D budgets to an increasing oligarchic tilt to our democracy. In 2016, America's top 100 donors to political campaigns generated 14 percent of the political contributions that came from the nation's 250 million adults. Current and former top executives made up 87 of these top 100 donors.

BUILDING ON PAY RATIO DISCLOSURE

The new federal pay ratio data will likely boost ongoing reform efforts to leverage the power of the public purse against the extreme economic inequality that existing corporate pay practices so routinely generate.

The following reform proposals could be implemented at the federal level and in many states and cities. None of them aim to dictate to corporate boards exactly how much companies can pay their top executives. But they would provide an incentive for corporations to reduce executive pay—and lift up pay for workers at the bottom end of corporate payrolls.

►Ratio-linked business tax rates

In 2016, the city council in Portland, Oregon, became the first locality anywhere to set a tax penalty on publicly traded companies with wide gaps between their executive and worker paychecks. Starting in 2018, the city will apply a surtax on its business license tax to companies with pay gaps that run higher than 100 to 1.

The Portland license tax has been 2.2 percent of adjusted business net income. The surtax will increase the business tax liability by 10 percent for companies with CEO-worker pay ratios of more than 100-to-1 and 25 percent for companies with ratios of more than 250-to-1. In other words, a large company that owes the city $100,000 for its business license tax and has a pay ratio of 175-to-1 would pay an additional $10,000 in surtax.

Portland city officials have identified more than 500 corporations that do enough business in the city to be affected by the surtax, including many companies that regularly appear on lists of America's highest-paid CEOs, firms that include Goldman Sachs, Oracle, Honeywell, Wells Fargo, and GE.

Legislators in five other states — Minnesota, Rhode Island, Connecticut, Illinois, and Massachusetts — have introduced similar tax legislation, while San Francisco officials are seeking to place the issue on the November 2018 ballot.

Such initiatives may now gain more traction as a result of the new federal tax code provisions enacted this past December. Many state governments will be facing demands to reduce their own income and property taxes to offset the impact of new federal tax changes that cap state and local tax deductions. State and local lawmakers seeking alternative sources of revenue to pay for critical public programs may well begin considering excessive pay gap taxes.

In the current U.S. Congress, the pending CEO Accountability and Responsibility Act (H.R. 6242) proposes to increase the corporate tax rate by as much as three points for firms that pay their CEOs over 400 times their median worker pay.

► *Ratio-linked procurement reform*

In Rhode Island, a pending Senate bill would give preferential treatment in state contracting to corporations that pay their CEOs no more than 25 times their median worker pay. The measure's sponsors see this legislation as a sensible "good government" reform that would reduce taxpayer subsidies for top executives and encourage more efficient and effective pricing and services from companies truly interested in serving the public.

In past congressional sessions, Rep. Jan Schakowsky has also introduced a "Patriot Employer Tax Credit Act," legislation that would extend tax breaks and federal contracting preferences to companies that meet a variety of responsible behavior benchmarks, including CEO-worker pay ratios of 100-1 or less.

Under existing law, the U.S. government denies contracts to companies that discriminate by race and gender in their employment practices. Our tax dollars, Americans believe, should not subsidize racial or gender inequality. Our tax dollars, procurement reformers believe, should also not subsidize companies that increase economic inequality.

► *A ratio approach to corporate welfare*

In November 2015, then Republican congressman Mick Mulvaney from South Carolina authored an amendment designed to prevent the U.S. Export-Import Bank from subsidizing any U.S. company with annual CEO pay over 100 times median worker pay. Mulvaney currently directs the Office of Management and Budget.

Other forms of federal corporate welfare, such as the support the Overseas Private Investment Corporation provides, could also be required to incorporate pay ratio guidelines in their qualification standards.

CONCLUSION

The Dodd-Frank ratio disclosure mandate initially drew little attention back in 2010. But the reform ripples now emerging from this mandate may well impact CEO pay — and inequality — more significantly than any other recent proposals.

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