Institute for Policy Studies

Policy Brief

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The CEO-Worker Pay Gap

U.S. corporations are 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 now 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.

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.

Bloomberg 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

10 Largest CEO-Worker Pay Gaps in the Fortune 500

Company	CEO Pay	Median Worker Pay (global)	Pay Ratio
Mattel	$31,275,289	$6,271	4,987 to 1
McDonald's Corporation	$21,761,052	$7,017	3,101 to 1
Gap	$15,587,186	$5,375	2,900 to 1
Aptiv PLC	$13,800,347	$5,464	2,526 to 1
Hanesbrands	$9,581,986	$5,237	1,830 to 1
TJX Companies	$16,880,171	$11,243	1,501 to 1
Yum! Brands	$12,368,607	$9,111	1,358 to 1
V.F. Corporation	$13,736,655	$10,151	1,353 to 1
Ross Stores	$12,400,574	$9,437	1,314 to 1
Kohl's Corporation	$11,339,206	$8,975	1,264 to 1

Source: AFL-CIO Paywatch.

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

Policymakers should ensure that taxpayers are not subsidizing extreme CEO-worker pay gaps in any way, whether through tax, contracting, or subsidy policies. The new pay ratio data make it much easier to implement policies that leverage the power of the public purse to narrow these dangerous divides.

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

► ***Ratio-linked business tax rates***

U.S. corporations received a massive windfall from the 2017 Republican tax reform, which slashed the corporate tax rate from 35 to 21 percent while maintaining many of the most egregious business tax loopholes. Lawmakers at the state, local, and federal levels seeking to recoup some of these windfalls should consider excessive pay gap taxes.

In 2016, Portland became the first locality anywhere to set a tax penalty on publicly traded companies with wide gaps between their executive and worker paychecks. Starting this year, the Oregon city is applying a business license tax "surtax" on companies with pay gaps that run higher than 100 to 1.

The Portland license tax sets a 2.2 percent levy on adjusted business net income. The surtax will increase this 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. Many of these 500 companies regularly appear on lists of America's highest-paid CEOs, most notably 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. Such initiatives may now gain more traction as a result of the new federal tax code provisions enacted this past December.

In the current U.S. Congress, the CEO Accountability and Responsibility Act (H.R. 6242) proposes to increase the corporate tax rate on firms that pay their CEO more than 100 times the pay of their median employee.

►*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*

All forms of federal, state, and local corporate welfare could be required to incorporate pay ratio guidelines in their qualification standards. 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. The amendment did not become law, but Mulvaney's proposal suggests potential for bipartisan action.

The European Union already applies such pay ratio standards to state aid for failing banks. Bailed-out banks operating within the EU have to cap their executive pay at no more than 15 times the national average salary or 10 times the wage of the average worker at the bank. A recent Institute for Policy Studies/Public Citizen report reveals that among the nation's top 10 U.S. banks, those that pose the greatest risks to our financial system, the average pay gap stood at 265 to 1 in 2017. Among the four giants at the top, the ratio averaged 319 to 1.

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Pay ratio resources:

https://inequality.org/action/corporate-pay-equity/

Weekly inequality newsletter:

https://inequality.org/resources/inequality-weekly/

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