Pay at the Top

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OUTLINE

1. Trends in Top Pay over the Century and Decade

2. Who are the Top Paid?

3. Is the UK different?

4. Why?

5. Conclusions
The Richest 1% take about 13% of all income – highest since WW2 (but lower than interwar period & less than US)

Source: World Top Incomes Database
THE LAST DECADE

• Overall wage inequality grew faster in 1980s than 1990s & 2000s, but in 2000s big winners were those in top 1%

• The top 1% of earners increased their share of the total wage bill by 2.8 percentage points.
  – Other 9% of the top decile, increased their share by 1.1pp.
  – Most of gains were for employees not entrepreneurs or non-labour income such as savings and dividends.

• But who are these top earners?
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## PAY OF TOP WORKERS: DIFFERENT PROFESSIONS

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**AVERAGE WORKER**

| £23,925                           | £33,288       | 39%          |
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**Notes:** PwC data relate to the average profit available for distribution to partners. Top Barrister earnings are mean earnings from OME survey. Premier League Footballer salary from SportingIntelligence.com and Global Sports Salaries Survey.
BANKERS AND BONUSES

• Those at the top of most professions/industries saw relative gains during the last decade
• 5% of people work in finance (~1m), but they accounted for around two-thirds of the gains in income share for the top 1% (and the top 10%) over the last decade
• Particular concern because of incentives in financial sector to take on too much risk
• See Bell and Van Reenen (2014, The Economic Journal)
INCREASE IN THE SHARE OF THE WAGE BILL GOING TO TOP WORKERS IN WHOLE ECONOMY AND IN FINANCE

Top 1% got an extra 1.6% of the wages “pie” 1998-2008: but this was almost all workers in finance sector
Top 1% got an extra 1.6% of the income pie: but this was almost all finance workers.
INCREASE IN THE SHARE OF THE WAGE BILL GOING TO TOP WORKERS IN WHOLE ECONOMY AND IN FINANCE

Source: Bell and Van Reenen (2014)
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Change in Top 1% Shares, 1979-2007

- US: 10.1%
- UK: 9.4%
- Canada: 6.1%
- Australia: 5.1%
- Italy: 3.1%
- Sweden: 2.5%
- Japan: 2.3%
- Germany: 2.0%
- France: 1.5%
- Spain: 1.3%

Percentage Point Change

0 2 4 6 8 10 12
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Globalization and Size

• Suppose we could identify the best CEO – defined as the CEO who can increase the value of the firm the most in terms of shareholder value.

• In a competitive equilibrium, this CEO should work for the biggest firm. His pay should be scaled by the size of the firm.

• As market capitalization increases, so does pay.

• This is an example of a ‘Superstar’ effect.
WHY HAS CEO PAY INCREASED SO MUCH?

Executive Compensation and Market Capitalization of the Top 500 Firms

Notes.

The FS compensation index is based on Frydman and Saks (2005). Total Compensation is the sum of salaries, bonuses, long-term incentive payments, and the Black–Scholes value of options granted. The data are based on the three highest-paid officers in the largest 50 firms in 1940, 1960, and 1990. The JMW Compensation Index is based on the data of Jensen, Murphy, and Wruck (2004). Their sample encompasses all CEOs included in the S&P 500, using data from Forbes and ExecuComp. CEO total pay includes cash pay, restricted stock, pay-outs from long-term pay programs, and the value of stock options granted from 1992 onward using ExecuComp's modified Black–Scholes approach. Compensation prior to 1978 excludes option grants and is computed between 1978 and 1991 using the amounts realized from exercising stock options. Size data for year t are based on the closing price of the previous fiscal year. The firm size variable is the mean of the largest 500 firm asset market values in Compustat (the market value of equity plus the book value of debt). The formula we use is \( \text{mktcap} = (\text{data199} \times \text{abs(data25)} + \text{data6} - \text{data60} - \text{data74}) \). To ease comparison, the indices are normalized to be equal to 1 in 1980. Quantities were first converted into constant dollars using the Bureau of Economic Analysis GDP deflator.

Another way to look at the question is to reestimate \( \gamma \) from the 1970–2003 time-series evidence and test whether the constant-returns-to-scale hypothesis (\( \gamma = 1 \)) is rejected. We need some assumptions. Assume that the distribution of talent for the top, say, 1,000 CEOs has remained the same (so that \( D(n^\ast h a s \text{remained} \text{constant}) \). The nas implie consis t estimate of \( \gamma \) is offered by looking at the respective increase in

Source: Gabaix and Landier (2008, QJE)
Rent-Extraction

• CEOs (and top earners more generally) have enormous bargaining power – firm’s don’t like losing their CEO, banks don’t like losing their top traders etc.

• This allows them to extract rents in the form of higher pay – when the firm does well, the top workers bargain some of the excess profits for themselves (at the expense of shareholders, tax-payers...)

• Firms that have poor corporate governance and weak shareholders are more likely to give in to such pressure.

• Unions used to fulfil the same role for ordinary workers...
Oil Company CEO Pay and the Oil Price
(Bertrand & Mullainathan, 2001)
Top Taxes & Bargaining

Elasticity = 0.47 (0.11)
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