EXECUTIVE BARGAINING: CEOS NEGOTIATING THEIR PAY WITH EMPLOYEES FOR CORPORATE EFFICIENCY

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I. INTRODUCTION

Rising executive pay is a significant problem that points to a structural flaw in American corporations. This article presents a solution to that flaw through which Chief Executive Officers (CEOs) negotiate their pay in company resources with lower-paid employees. Exploring this solution also unearths an explanation for capitalism's apparent drive toward inequality and examines the historical development of corporations and trade unions in the United States.

The problem is that managers and corporate directors will raise pay at the top so long as that pay-setting process does not consider the pay of average- and low-wage workers. The solution is that CEOs and other top executives negotiate their pay in company resources with employees in a process that determines the pay and bonuses of both sides. Microeconomic theory indicates that confronting the tradeoffs of raising executive compensation with other potential corporate expenditures—by negotiating this compensation with workers from different parts of the company—will make executive compensation more efficient.[1] Also, historical analysis indicates a pattern in which executive compensation became aligned with public interest only during the period in which workers had significant power to negotiate their wages and

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[1] N. GREGORY MANKIW, PRINCIPLES OF MICROECONOMICS 4 (6th ed. 2012) (describing the first principle of microeconomics as centered on trade-offs). Many basic microeconomic models involve trade-offs between potential allocations of resources to achieve efficiency. *See* DAVID BESANKO & RONALD R. BRAEUTIGAM, MICROECONOMICS 206–07 (5th ed. 2014).

benefits. This is not to say that the solution to executive compensation is a return to unions, which developed as a separate organizational structure with their own flaws and inefficiencies. Rather, a corporation that synthesizes the inputs of all its employees will be able to maximize efficiency and productivity, producing profits for shareholders and growth for the overall economy.

This article will proceed in several parts. Part II will explain the core idea of this proposal, which is that executive pay is systematically excessive because the current pay-setting process for CEOs does not consider alternative corporate expenditures. Because employees from various levels and departments would be informed and motivated advocates for these alternative corporate expenditures, CEOs should negotiate their pay (in company resources) with these employees to reach efficient compensation decisions. Part III will examine the problem of CEO pay that does not confront the tradeoffs of alternative expenditures. Unrestrained compensation is not necessary to motivate executives, is inefficient for the corporation, leads to negative externalities for society, slows economic growth, saps employee morale, and interferes with the motivation and prosocial tendencies of executives.[2] Part IV will then present policy proposals for CEOs negotiating their pay with lower-paid workers and the proposed benefits of these executive bargaining processes. Though these particular proposals are currently untested, historical analysis of trends in U.S. executive compensation and comparative analysis of corporations in other countries indicate that regular negotiations with workers restrains executive compensation. Having presented the effects of escalating executive pay and a promising mechanism for restraining it, Part V then analyzes why current approaches to executive compensation produce wage inflation. Part VI concludes with a theory of how capitalism's drive toward efficiency would lead to inevitable inequality and employee backlash unless corporations take steps such as having CEOs negotiate their pay with lower-paid workers.

II. THE CORE IDEA OF A NEGOTIATED EXECUTIVE COMPENSATION PROCESS

The core argument behind executive bargaining is this: if corporations set executive compensation in a separate process from the budgeting of other corporate expenditures, spending on executives will not confront the tradeoffs of alternative uses of those resources.[3] In economies where individual

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[2] These assertions summarize the arguments presented in the subsections of Part III. *See infra* text accompanying notes 9–123.

[3] Douglas C. Michael, *The Corporate Officer's Independent Duty as a Tonic for the Anemic Law of Executive Compensation*, 17 J. CORP. L. 785, 797 (1992) ("[T]here is nothing approaching a

shareholders do not have the information or capacity to sit across from CEOs in considering these tradeoffs,[4] employees are in the best position to confront executives with alternative expenditures.[5]

This executive bargaining process primarily seeks to achieve economic efficiency, which should subsequently lead to higher profits for shareholders.[6] However, there may be other benefits of requiring CEOs to negotiate their pay with employees. First, it may improve morale for employees and lead to better alignment within each company.[7] With better understanding and communication between the bottom and top of the corporation, managers at all levels will have better incentives to listen to and work with their direct reports. Second, to the degree that this structure leads to a greater dispersion of wages, it may help to grow the economy by increasing the spending power of regular workers.[8]

The process of allocating company resources to the pay of top executives should not be divorced from considerations of alternative uses of these resources. Before this article proposes mechanisms for executive bargaining, the next section will explore current trends in unchecked executive pay and how they indicate an ignorance of the tradeoffs or alternative uses of these significant CEO pay packages. Readers who already believe that escalating executive compensation is an existing and harmful trend may wish to skip to the description of, and the case for, executive bargaining in Part IV.

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competitive market for chief executives where supply and demand can exert their traditional moderating pressures.").

[4] Martin Gelter, *Taming or Protecting the Modern Corporation? Shareholder-Stakeholder Debates in a Comparative Light*, 7 N.Y.U. J.L. & BUS. 641, 646 (2011) ("Today, the US and the UK are normally thought to be characterized by dispersed ownership, while in most other countries' economies concentrated ownership persists even in most of the largest firms.").

[5] Robert J. Rhee, *Intrafirm Monitoring of Executive Compensation*, 69 VAND. L. REV. 695, 734 (2016) ("The advantage of employees as monitors compared to shareholders becomes apparent when we consider the question of information through the lens of market efficiency."); Wanjiru Njoya, *The Problem of Income Inequality: Lord Wedderburn on Fat Cats, Corporate Governance and Workers*, 44 INDUS. L.J. 394, 423 (2015) ("[W]orker participation in setting levels of executive pay may help to advance the efficiency goals of company law.").

[6] *See infra* Section III.B.1; *see also* Brett H. McDonnell, *Employee Primacy, or Economics Meets Civic Republicanism at Work*, 13 STAN. J.L. BUS. & FIN. 334, 336 (2008) ("Employee primacy is likely to create the most surplus within a corporation due to incentive effects and the wealth of information that employees possess.").

[7] *See infra* Section III.B.3; *see also* Jim Harter & Annamarie Mann, *The Right Culture: Not Just About Employee Satisfaction*, GALLUP WORKPLACE (Apr. 12, 2017), https://www.gallup.com/workplace/236366/right-culture-not-employee-satisfaction.aspx [https://perma.cc/S3DX-9N4A] (presenting evidence that engaged employees consistently correlate with better business outcomes and that "common philosophies and practices" of engaged workplaces involve corporate leaders having regular, open communication with employees).

[8] Njoya, *supra* note 5, at 407 ("It is clear that extreme income inequality is harmful to economic growth and the integrity of economic institutions.").

III. THE PROBLEMS WITH UNRESTRAINED EXECUTIVE COMPENSATION

There is a growing consensus that the process of executive compensation in the United States is problematic.[9] Even those who celebrate the American tradition of exalting captains of industry and those who are not uncomfortable with significant wage inequality "are somewhat taken aback by today's executive compensation practices."[10] A significant consequence of this problem, and an indicator of its severity, is that pay for other employees has stagnated over time while executive compensation has escalated.[11]

According to the many commentators who have studied the ratio between the average pay for CEOs of large companies and the average pay of workers, this ratio was between twenty and thirty-to-1 in the 1960s and early 1970s, between forty and 50-to-1 in the 1980s, more than 100-to-1 in the 1990s, more than 300-to-1 in the 2000s[12] and currently at 278-to-1 after a decline during the 2008 financial crisis.[13] This growth is such that an infamously excessive corporate pay package of $10 million, considered an outlier in 1998,[14] is only

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[9] Steven A. Bank et al., *Executive Pay: What Worked?*, 42 J. CORP. L. 59, 61 (2016) (noting the "substantial consensus that something is seriously amiss with executive pay . . . ."); Robert C. Downs, *Executive Compensation: In a Culture of Greed and Selfishness Is There Room for a Theory of "Enough"*, 4 FAULKNER L. REV. 35, 36 (2012) (describing CEO compensation as having "run amuck"); Rhee, *supra* note 5, at 702–03 (noting the empirical literature on the subject); Susan J. Stabile, *Viewing Corporate Executive Compensation Through a Partnership Lens: A Tool to Focus Reform*, 35 WAKE FOREST L. REV. 153, 153 (2000) [hereinafter Stabile, *Viewing Corporate Executive Compensation*] (noting that criticizing executive compensation has become "something of a national pastime.").

[10] David A. Westbrook, *Notes Toward a Theory of the Executive Class*, 55 BUFF. L. REV. 1047, 1049 (2007).

[11] Stephen Plass, *Wage Compression as a Democratic Ideal*, 25 CORNELL J.L. & PUB. POL'Y 601, 602–03 (2016) (noting the disparity between lavish pay packages at the top and the fight for a living wage at the bottom); Njoya, *supra* note 5, at 424 ("[W]ages for ordinary workers continue to decline in real terms while managerial remuneration soars.").

[12] Bank et al., *supra* note 9, at 68–69; Downs, *supra* note 9, at 35–36, 63; Erica Beecher-Monas, *The Risks of Reward: The Role of Executive Compensation in Financial Crisis*, 6 VA. L. & BUS. REV. 101, 103 (2011); Peter M. Cicchino, *The Problem Child: An Empirical Survey and Rhetorical Analysis of Child Poverty in the United States*, 5 J.L. & POL'Y 5, 72–73 (1996); John W. Hennessey, Jr., *The Ethics of Business Decision-Making*, 27 VT. L. REV. 833, 836 (2003); Nathan Knutt, *Executive Compensation Regulation: Corporate America, Heal Thyself*, 47 ARIZ. L. REV. 493, 500 (2005); Rhee, *supra* note 5, at 704; Alberto R. Salazar & John Raggiunti, *Why Does Executive Greed Prevail in the United States and Canada but Not in Japan? The Pattern of Low CEO Pay and High Worker Welfare in Japanese Corporations*, 64 AM. J. COMP. L. 721, 721–22 (2016); David I. Walker, *Who Bears the Cost of Excessive Executive Compensation (and Other Corporate Agency Costs)?*, 57 VILL. L. REV. 653, 659 (2012).

[13] Lawrence Mishel & Julia Wolfe, *CEO Compensation Has Grown 940% Since 1978*, ECON. POL'Y INST. (Aug. 14, 2019) https://www.epi.org/publication/ceo-compensation-2018/ [https://perma.cc/QN4N-M6NP].

[14] Stabile, *Viewing Corporate Executive Compensation*, *supra* note 9, at 161, 161 n.25 (reporting

slightly above the *median* pay for the CEO of a large firm fifteen years later.[15] In absolute terms, this is an annual transfer of $25 billion to the top 10,000 executives[16] while "many corporations pay their CEOs more than they pay in federal income taxes."[17] Also, because this quantification of rising executive pay does not count executives beyond a handful of high-earners at these predominantly large companies, the above numbers understate the larger problem.[18]

If the rise in executive compensation tracked the productivity of executives or allowed for a rising standard of living for lower-paid workers, this trend might not be problematic. However, when executive compensation far outpaces growth of the entire economy,[19] while inflation-adjusted wages for lower-wage workers are declining,[20] there is a sense that wealth is being transferred from low-income to high-income individuals.[21] The following sections will explore whether this transfer is productive for companies, impactful on worker wages, or detrimental to the larger economy and society.

A. *Rising Executive Compensation is Unnecessary*

First, system-wide escalation in executive compensation is not necessary because it does not convey useful information about the value of any given executive/firm or serve as motivation for executives. This is similar to how everyone in a stadium standing up to see better leaves no one able to see better (or able sit down, for that matter).[22]

Executive pay has the same motivational power whether all similarly-

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Jack Welch made $2.8 million in salary and $7.2 million in bonuses in 1998, earning him "significant publicity").

[15] Plass, *supra* note 11, at 606 (noting that the median compensation for CEOs of large companies was $9.7 million in 2012).

[16] Walker, *supra* note 12, at 658.

[17] Rhee, *supra* note 5, at 705.

[18] *See* Walker, *supra* note 12, at 660–61 (noting that the above figures only count the top five executives at each company and do not count second-tier vice presidents).

[19] Michael B. Dorff, *The Group Dynamics Theory of Executive Compensation*, 28 CARDOZO L. REV. 2025, 2027 (2007) (noting that CEO pay has outpaced inflation); Rhee, *supra* note 5, at 697, 704 (noting and listing the disparate growth rates between CEO pay and worker pay).

[20] Cicchino, *supra* note 12, at 72–73 ("After-tax income for CEOs during the 1980s increased in inflation adjusted terms by 66%. During the same period, production workers' real hourly pay decreased by 7%."); Grant Crandall et al., *Hiding Behind the Corporate Veil: Employer Abuse of the Corporate Form to Avoid or Deny Workers' Collectively Bargained and Statutory Rights*, 100 W. VA. L. REV. 537, 538–39 (1998) (noting the decline in real wages for most workers in the 1980s and 1990s, with a decline of 16.3% for blue-collar male employees).

[21] Plass, *supra* note 11, at 604 ("[W]age growth for senior managers continue to outpace that of other workers thereby pushing wage divergence to a historical high mark.").

[22] THOMAS SOWELL, BASIC ECONOMICS 370–71 (4th ed. 2011) (describing the fallacy of composition).

situated CEOs make $250,000 per year, $2.5 million per year, or $25 million per year. Psychological studies show that increases in pay past a comfortable wage do not boost motivation; however, being paid less than peers causes a decline in motivation.[23] Defenders of high CEO pay point to the individual effects of executives being paid less than peers[24] while ignoring the system-wide effects of annual pay raises that keep each CEO above the reported median executive pay.[25] In other words, paying each CEO more does not have any productive effects on the economy and only results in a greater transfer of wealth to high-income earners.

Empirical studies support these ideas by demonstrating that large increases in pay for top-income earners did not lead to improved economic performance.[26] Comparisons of conditions for the top one percent of earners with economic growth indicate that the rising share of overall income accruing to top earners is not correlated with growth of the overall economy and is, furthermore, correlated with a decline in growth for middle-income workers.[27] Differences in pay practices in other countries provide concrete, anecdotal support. For example, the CEO of Toyota received less than one-tenth the pay of the highest-paid CEO in the auto industry and generated the highest return among the five largest automakers.[28]

Furthermore, because low-wage, blue-collar workers are struggling to maintain a living wage, there is much more room for a de-escalation in wages at the executive level than elsewhere in companies.[29] So, given that CEOs are motivated by their amount of pay relative to peers, and given that this pay is currently much higher than alternative uses of executive skills, a systematic reduction of executive compensation would not affect the economic or

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[23] Katie Johnston, *Efforts to Regulate CEO Pay Gain Traction*, BOS. GLOBE (Oct. 25, 2014, 6:24 PM), https://www.bostonglobe.com/business/2014/10/25/growing-effort-limit-ceo-pay/1VKKZCuZMkXJvaQRmUb4RN/story.html [https://perma.cc/D86D-G4JT] (citing the work of Harvard Business School professor Michael Norton).

[24] Bengt Holmstrom, *Pay Without Performance and the Managerial Power Hypothesis: A Comment*, 30 J. CORP. L. 703, 707 (2005) ("Paying CEOs less than they think they are worth based on comparative data is demoralizing.").

[25] *Id.* at 705 ("Currently, we pay him in the top quartile, because we think it is important that he feels appreciated.").

[26] Josh Bivens & Lawrence Mishel, *The Pay of Corporate Executives and Financial Professionals as Evidence of Rents in Top 1 Percent Incomes*, 27 J. OF ECON. PERSPECTIVES 57, 63–64 (2003) (citing research).

[27] *Id.* at 72–73 (citing research by Piketty, Saez, and Stantcheva, Jencks and Leigh, and Thompson and Leight).

[28] Salazar & Raggiunti, *supra* note 12, at 722.

[29] KEN JACOBS ET AL., PRODUCING POVERTY: THE PUBLIC COST OF LOW-WAGE PRODUCTION JOBS IN MANUFACTURING 3 (2016) (finding that thirty-four percent of blue-collar families are enrolled in one or more public safety net programs).

psychological incentives for executives.[30] All of the reasons that escalating executive pay is unnecessary support the implementation of a process whereby CEOs negotiate their pay with employees.

B. *Rising Executive Compensation is Inefficient*

Next, escalating executive compensation is an inefficient allocation of corporate resources.[31] The inflation of CEO pay is inefficient because it does not respond well, let alone optimally, to CEO performance,[32] the market,[33] or a judicious budget for the company.[34] Efficiency is the optimal use of resources[35] and requires available information about the value of alternatives and competition in terms of the quality and price of the service rendered.[36] Contrast the current executive compensation process with boards of directors, the body responsible for negotiating compensation with top executives, asking for bids each year to see if a junior or outside executive could do the job of the CEO at a lower cost. Instead, executive compensation decisions purportedly focus on avoiding tensions among leaders[37] and hiding any insecurities about

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[30] Bivens & Mishel, *supra* note 26, at 63 ("[W]e are making a positive argument, not a normative one, that the rise in income for the top one percent income was not necessary to entice the people in that group to seek those jobs nor to provide effort in those jobs.").

[31] Rhee, *supra* note 5, at 758 ("[T]he extreme pay of a single senior employee in a corporation raises the issue of corporate efficiency and income inequality.").

[32] Michael, *supra* note 3, at 792 ("[C]ompensation of the chief executive has little if any correlation to performance on the job, by any conventional measure."); Beecher-Monas, *supra* note 12, at 103 (noting the "disconnect between firm performance and executive pay").

[33] Salazar & Raggiunti, *supra* note 12, at 728 (noting that executive compensation remained high during the 2008 financial crisis). In fairness, average executive compensation did decline in the aftermath of the financial crisis; however, it remained high compared to inflation-adjusted 20th-century executive compensation. Also, this temporary decline in executive compensation. *See* Walker, *supra* note 12, at 659 ("The ratio declined as executive pay moderated during the financial crisis, but even in 2009 it continued to exceed 250 to 1.").

[34] Steven Clifford, *How Companies Actually Decide What to Pay CEOs*, ATLANTIC (June 14, 2017), https://www.theatlantic.com/business/archive/2017/06/how-companies-decide-ceo-pay/530127/ [https://perma.cc/G4HM-BZSX] (noting that "tying bonuses to budgets," while common, is a bad idea because it incentivizes the executive to use information asymmetry to produce a budget projecting low expectations to beat).

[35] MANKIW, *supra* note 1, at 5 (defining efficiency as getting the most out of resources); BESANKO & BRAEUTIGAM, *supra* note 1, at 207 (defining technical efficiency as optimal output given limited inputs).

[36] Andrew C. Sobel, *Rosy Expectations, Cloudy Horizons*, 4 COLUM. J. EUR. L. 453, 455 (1998) (noting that economic efficiency requires full information, competition, and a lack of price manipulation); Lary Lawrence, *Toward a More Efficient and Just Economy: An Argument for Limited Enforcement of Consumer Promises*, 48 OHIO. ST. L.J. 815, 834 (1987) (noting that value should be measured by what consumers would be willing to pay when they have complete information).

[37] Holmstrom, *supra* note 24, at 705–06 ("[M]ost importantly, we want to avoid arm's-length bargaining. Compensation is a sensitive matter.").

company leadership.[38]

Therefore, critics[39] and defenders[40] of current executive pay practices agree that the market for executive talent is not competitive.[41] This means that market forces do not moderate executive pay,[42] creating conditions in which the rewards for corporate output increasingly collect at the top of the income bracket[43] while economic competitiveness declines.[44] These problems could be mitigated if CEOs negotiated their pay with other employees. A decision process that confronted all employees with the tradeoffs of alternative uses of corporate resources would involve competition among motivated and informed individuals. However, because it would be distractingly chaotic for all employees to agree on the allocation of all resources, it may be better to have executives decide on corporate expenditures and negotiate their pay with non-executives from across the company.

While inefficiency is a problem for firms and the economy, the inequity of this situation is that regular workers are exposed to the competitive pressures in a way that executives are not.[45] The next section therefore explores the degree to which these inefficiencies in executive compensation are paid for by consumers, shareholders, or employees.

C. *Rising Executive Compensation Is Largely Paid for by Employees*

Intuitively, an increase in executive compensation that outpaces executive output and firm growth would result in higher prices for consumers, lower profits for shareholders, or lower wages for other employees.[46] As "a very

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[38] *Id.* at 707 (describing a thought experiment in which the departure of a CEO signals something to investors, causing a devaluation in stock). This reflects back to the fallacy of composition. If CEOs were regularly reevaluated and replaced, this move would not send the same negative signal.

[39] Downs, *supra* note 9, at 65.

[40] Holmstrom, *supra* note 24, at 707 ("The executive market is not competitive in the normal sense.").

[41] Michael, *supra* note 3, at 795 (1992) (noting "significant imperfections in the 'market' for chief executives of large corporations"); Beecher-Monas, *supra* note 12, at 107 (finding the idea of a competitive market for executive talent "questionable at best").

[42] Michael, *supra* note 3, at 797 ("[T]here is nothing approaching a competitive market for chief executives where supply and demand can exert their traditional moderating pressures.").

[43] Rhee, *supra* note 5, at 698 (summarizing analyses of economists studying the effects of large income disparities).

[44] Michael, *supra* note 3, at 795 (noting that Japanese firms have identified high executive compensation as "a key non-tariff barrier" to the competitiveness of American firms).

[45] Plass, *supra* note 11, at 647 ("Corporate regulations to rein in excessive pay have also failed to incorporate the interests of the larger workforce so median and low-wage workers have been left in the competitive labor marketplace.").

[46] Jim Staihar, *Income Inequality and Pay Ratio Disclosure: A Moral Critique of Section 953(B)*, 19 U. PA. J. BUS. L. 457, 488 (2017) ("Presumably, excessive CEO pay could otherwise be used

significant fraction of corporate earnings," excessive executive compensation could be meaningfully redirected to these other stakeholders.[47] However, if high CEO pay resulted mainly in higher prices for consumers or lower returns for shareholders, then employees might not be the best group to sit on the other side of the table in negotiating executive compensation. Two theories indicate that this is not the case.

First, Professor David Walker analyzes the burden of executive compensation by considering the difference between high CEO pay in an individual company and high CEO pay across comparable companies in an economy.[48] If high executive pay occurred at a small fraction of firms, "it would be difficult for existing shareholders to pass on such firm-specific costs to consumers or employees."[49] However, if high CEO pay occurred systematically across all comparable firms, it could be passed from the shareholders who ultimately own the corporation to other stakeholders (in higher prices or lower wages).[50] This theory suggests that employees and consumers will bear the higher cost of excessive executive compensation when those excesses occur systematically.

The questionable assumptions behind this theory are that shareholders cannot also avoid the cost of high CEO pay at a single company by selling shares (i.e., devaluing the company) and also that funds used for high CEO pay could not also be potential profits for shareholders even when the high CEO pay is systematic. Notwithstanding these uncertainties, there is value in the insight that it may be harder for certain groups to avoid bearing the costs of rising executive compensation when it is systematic and not an aberration.

To determine how the cost of inefficient CEO pay is divided among consumers, shareholders, or other employees, it is useful to apply incidence theory to Walker's tax analogy. Incidence theory "is the economic study of how costs, particularly taxes, are passed from one market participant to another."[51] Under this economic model, an imposed cost is divided among market participants[52] depending on how likely they are to change behaviors in

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to increase shareholder value, raise other workers' wages, or reduce prices charged to consumers."); Kristopher Yingling, *Pay Ratio Disclosure: Another Failed Attempt to Curtail Executive Compensation*, 18 U. PA. J. BUS. L. 203, 206 (2015).

[47] Walker, *supra* note 12, at 658 (Professor Walker teaches at Boston University School of Law, where he focuses on taxation and executive compensation).

[48] *Id.* at 657.

[49] *Id.* at 661.

[50] *Id.*

[51] Herbert Hovenkamp, *The Indirect-Purchaser Rule and Cost-Plus Sales*, 103 HARV. L. REV. 1717, 1721 n. 29 (1990).

[52] In this case, market participants are the consumers, the executives of the corporation, the shareholders supplying capital to the corporation, and the workers supplying labor to the corporation.

response to changes in price (their "price elasticity").[53] The reason costs are divided by elasticities is that participants who are able to avoid costs by changing what they buy or sell (high elasticity) will do so, while participants who cannot easily change what they buy or sell (low elasticity) will pay more in a free market.[54]

Compared to consumers and shareholders, employees would have the most difficult time changing their behavior in response to higher CEO pay. Employees invest nontransferable human capital into a company and may have to move or accept a lower standard of living when forced to change jobs. Meanwhile, consumers can respond to higher prices by purchasing substitutes or leaving the market for that particular good, and shareholders can sell their shares and invest in other markets. The resulting free market outcome is that, when rising CEO pay is allocated through rising prices, lower shareholder returns, or cuts in pay and benefits to employees, the brunt of that cost will fall on the employees because they cannot as easily leave the market.

Because employees are more rooted in a company than transactional consumers and shareholders, they bear more of the cost of rising executive compensation. Having this skin in the game makes employees the ideal party to sit across the table from the CEO in negotiating the use of company resources for executive compensation.

D. *Rising Executive Compensation Has Negative Effects on the Economy*

Because systematically excessive executive compensation channels income from lower-wage to higher-wage individuals,[55] it creates larger effects on the economy.[56] Macroeconomic theory suggests that these effects will include not only increasing wealth inequality but also declining growth for the entire economy.[57]

The key reason that concentrated economic power slows growth is that high-income people tend to save a greater share of their income rather than

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[53] Jerry Brito & Jerry Ellig, *A Tale of Two Commissions: Net Neutrality and Regulatory Analysis*, 16 COMMLAW CONSPECTUS 1, 35 n.168 (2007) ("The incidence of the tax—who really pays—depends on the elasticities of supply and demand . . . .").

[54] Olga V. Kotlyarevskaya, *Bmg Canada, Inc. v. Doe & Society of Composers, Authors & Music Publishers of Canada v. Canadian Ass'n of Internet Providers: Why the Canadian Music Compensation System May Not Work in the United States*, 20 BERKLEY TECH L.J. 953, 968 n.88 (2005) (citing J. BRUCE LINDEMAN, MICROECONOMICS 140 (1992)).

[55] Walker, *supra* note 12, at 658 ("Top executive pay represents a very significant fraction of corporate earnings . . . .").

[56] Rhee, *supra* note 5, at 698 (noting that concentrated wealth has macro-level effects on the economy).

[57] Njoya, *supra* note 5, at 407 ("It is clear that extreme income inequality is harmful to economic growth and the integrity of economic institutions.").

spending it.[58] The diminishing utility of additional dollars means that people with more dollars will find fewer uses for additional dollars, and therefore save, rather than spend them.[59] In contrast, poor and middle-class earners tend to spend what they earn, circulating wealth back into production.[60] Therefore, when an increasing share of income is allocated to top earners, less is spent on the products that companies make.[61]

The resulting dynamic is a prisoner's dilemma among corporations. Each company relies on consumers having enough income to buy their products, and all will suffer if employees do not make a living wage.[62] Because employee pay is set by individual companies, if one company decides to pay its workers more, it will lose more in profits or executive pay that it will gain in higher sales. But if all companies systematically raised worker wages, there would be higher growth.[63] This systematic change in wage-setting behavior would appear to require a process imposed on all players to direct them to act in their mutual best interest. However, a process that offers each company the benefits of an internally aligned workforce, while also motivating a more even distribution of company resources across employees, may overcome this prisoner's dilemma.

Rising executive pay is therefore a danger to the larger economy.[64] If CEOs across firms had to negotiate their pay with employees, the resulting systematic dispersion of resources would appear to promote economic growth.

E. *Rising Executive Compensation Creates Negative Political and Social Effects*

Systematically increasing the pay of top earners also creates larger costs

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[58] Jeff Desjardins, *How Americans Make and Spend Their Money*, VISUAL CAPITALIST (Mar. 19, 2019), https://www.visualcapitalist.com/how-americans-make-spend-money/ [https://perma.cc/NB39-RXSF] (citing information from the U.S. Census Bureau).

[59] Joseph Bankman & Daniel Shaviro, *Piketty in America: A Tale of Two Literatures*, 68 TAX L. REV. 453, 503 (2015) (describing the Diamond-Saez view of the marginal value of consumption for top earners).

[60] Karen E. Dynan et al., *Do the Rich Save More?*, 112 J. POL. ECON. 397, 398 (2004) (citing Greenhouse).

[61] Salazar & Raggiunti, *supra* note 12, at 729 (noting that the overall economy does not function well when income is concentrated at the top).

[62] Beecher-Monas, *supra* note 12, at 108–09 (explaining when "workers do not make sufficient wages to buy the widgets produced by society's firms, the firms will suffer").

[63] *See generally* TOMMASO CIARLI ET AL., STRUCTURAL CHANGES AND GROWTH REGIMES (2017).

[64] Njoya, *supra* note 5, at 403 (warning that income inequality should not reach levels that harm the economy); Beecher-Monas, *supra* note 12, at 102 ("Curbing executive pay is vital to controlling risk and preventing economic collapse.").

for society.[65] First, it should be noted that this is not a necessary reality—a concentration of wealth in the hands of our wisest and most capable citizens could allow our society to overcome collective action problems.[66] However, many modern executives appear to be more akin to token philanthropists and tax-dodgers[67] rather than the public benefactors who led U.S. corporations in the 1950s.[68]

Recent research across countries finds that economic inequality contributes to political instability.[69] One reason is that excessive CEO pay creates a pervasive sense of unfairness and undermines public faith in capitalism.[70] Another reason is that widespread economic struggles fuel grievances that politicians then play to, leading to divisive rather than unitary social movements.[71]

In fact, even critics of the executive compensation literature who argue that excessive executive compensation is economically insignificant still acknowledge that it has symbolic, social significance.[72] This is likely because class-based animosity poses a danger for the wealthiest Americans,[73] especially when the large portion of Americans who consider themselves to be

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[65] Robert E. Wagner, *Mission Impossible: A Legislative Solution for Excessive Executive Compensation*, 45 CONN. L. REV. 549 (2012) (noting the workplace hostility and social animosity that accompanies excessive executive pay).

[66] For example, if our wealthiest citizens were combating climate change rather investing in technology that will allow them to live off-planet.

[67] ANAND GIRIDHARADAS, WINNERS TAKE ALL: THE ELITE CHARADE OF CHANGING THE WORLD 255–63 (2018).

[68] Harwell Wells, *"Corporation Law Is Dead": Heroic Managerialism, Legal Change, and the Puzzle of Corporation Law at the Height of the American Century*, 15 U. PA. J. BUS. L. 305, 330 (2013) (citing criticism of 1950s corporate America as focusing more on being great innovators and public benefactors rather than maximizing profit) [hereinafter Wells, *"Corporation Law Is Dead"*].

[69] *See generally* Mark J. Roe & Jordan Siegel, *Political Instability: Effects on Financial Development, Roots in the Severity of Economic Inequality*, 39 J. COMP. ECON. 279 (2011).

[70] Rhee, *supra* note 5, at 697 ("The compensation problem has created a public perception of pay uncoupled from performance and a broad sense of social inequity."); Michael, *supra* note 3, at 794 ("[S]ocial morals are offended by such corporate largesse").

[71] Susan B. Glasser, *Our President of the Perpetual Grievance*, NEW YORKER (Mar. 29, 2019), https://www.newyorker.com/news/letter-from-trumps-washington/our-president-of-the-perpetual-grievance [https://perma.cc/2BH8-UZQN]; William Falk, *The Politics of Grievance*, WEEK (Oct. 5, 2018), https://theweek.com/articles/799887/politics-grievance [https://perma.cc/ABA2-AHVF].

[72] Susan J. Stabile, *My Executive Makes More Than Your Executive: Rationalizing Executive Pay in A Global Economy*, 14 N.Y. INT'L L. REV. 63, 70 (2001) [hereinafter Stabile, *My Executive Makes More Than Your Executive*] (noting "noneconomic reasons" to care about pay disparity).

[73] Westbrook, *supra* note 10, at 1062 (the author is a defender of high CEO pay but also notes that class-based politics "is probably not a good thing").

middle class realize that they are not making middle-class wages.[74]

Furthermore, concentrations of wealth are associated with widespread corruption.[75] One reason for this link is concentrations of economic power leading to concentrations of political power pursued to maintain that wealth.[76] Another reason is that the vast majority of behaviors are not directly monitored by law-enforcement officials and therefore governed by social norms.[77] If there is a pervasive sense that the economic system is not fair, norms break down and people feel justified in stealing, cheating, and undermining the system.[78]

Therefore, a concentration of income among top earners imposes other costs on the larger society. Alternatively, a greater dispersion of income—one that at least aligns pay with performance[79]—is a public good which public policy should promote.[80] A policy of CEOs negotiating their pay with employees should thereby promote public welfare.

F. *Rising Executive Compensation Reduces Motivation for Workers and Executives*

Many commentators have noted that allocating a rising amount of firm wages to executives lowers employee morale.[81] A sense of disconnect between compensation and productivity undermines the motivation of individuals and the cohesion within teams.[82] Declining employee morale and cohesion, in turn, leads to a decline in output and shareholder profits.[83] Because corporate pay-setting processes have systematically ignored employee interests, even during times of financial health and competitive advantage,[84] a process whereby

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[74] Plass, *supra* note 11, at 606.

[75] Njoya, *supra* note 5, at 407.

[76] *As Inequality Grows, so Does the Political Influence of the Rich*, ECONOMIST (July 21, 2018), https://www.economist.com/finance-and-economics/2018/07/21/as-inequality-grows-so-does-the-political-influence-of-the-rich [https://perma.cc/AV6U-L79K].

[77] Daron Acemoglu & Matthew O. Jackson, *Social Norms and the Enforcement of Laws*, 15 J. EUR. ECON. ASS'N 245, 247 (2014).

[78] *See id.*

[79] Michael, *supra* note 3, at 799 ("[M]ost public outrage is the lack of any coordination of pay with performance . . . .").

[80] Thomas C. Grey, *Property and Need: The Welfare State and Theories of Distributive Justice*, 28 STAN. L. REV. 877, 887 (1976) ("[S]ome degree of economic equality is a public good.").

[81] Rhee, *supra* note 5, at 697–98; Michael, *supra* note 3, at 793; Stabile, *Viewing Corporate Executive Compensation*, *supra* note 12, at 164–65.

[82] Alfred F. Conard, *Theses for a Corporate Reformation*, 19 U.C. DAVIS L. REV. 259, 266 (1986) ("[A]buses of control undermine the faith of workers that their productivity contributes proportionately to their own rewards and destroy the perception of commonality in objectives and benefits that gives dignity to work.").

[83] Salazar & Raggiunti, *supra* note 12, at 733–34 (linking morale and productivity); Beecher-Monas, *supra* note 12, at 103.

[84] Plass, *supra* note 11, at 613 (using Verizon and Caterpillar as examples).

CEOs negotiate their pay with employees should advance overall corporate interests.

However, excessive executive pay also arguably reduces the motivation of executives. Microeconomic models indicate that wages that rise too high will motivate individuals to choose leisure activities in which they spend income over working harder to get more income.[85] The reason for this counterintuitive outcome is that, while a higher hourly wage makes labor more valuable, there is a limit to the amount of time available to any individual. Therefore, having a large amount of money to spend will tempt a rational person from additional hours of work and toward hours of leisure. This is consistent with prior arguments about economic concentration slowing the overall economy[86] because this model concerns marginal units of leisure versus overall spending[87] and high-earners spend money during leisure time on fewer high-end goods rather than a large amount of consumer goods.[88]

One apologist for current executive compensation practices noticed this phenomenon and used it to defend current treatment of executives. In response to arguments that corporations appear to promote conspicuous consumption by executives, this commentator argued that corporations encouraging executives to lead lavish lifestyles serves the bottom line by preventing executives from having enough money to retire in luxury.[89] Of course, it would be more efficient (and, in turn, less harmful to the morale of lower-wage employees) to pay executives a wage that motivates performance without creating a distracting amount of wealth in the first place.[90]

Furthermore, psychological research indicates that rising executive pay, as an extrinsic reward, is a less effective motivator than a connection to the company and its employees, which is an intrinsic reward.[91] More importantly,

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[85] BESANKO & BRAEUTIGAM, *supra* note 1, at 189–90.

[86] *See supra* Section III.D.

[87] Because marginal (i.e., incremental adjustments to) leisure is not the same as overall spending, top earners can have higher incremental amounts of leisure at higher incremental amounts of compensation while still spending a lower fraction of their earnings than lower-paid workers.

[88] LaVaughn M. Henry, *Income Inequality and Income-Class Consumption Patterns*, ECON. COMMENT., Oct. 2014, at 1, 1–2 (noting that higher income quintiles spend a greater fraction of their income on luxuries than lower income quintiles).

[89] Stephen M. Bainbridge, *Executive Compensation: Who Decides*, 83 TEX. L. REV. 1615, 1630–31 (2005) (citing Henderson and Spindler, who hypothesize that firms encourage conspicuous consumption by their executives to prevent them from being able to "accumulate sufficient wealth to fund a luxurious retirement").

[90] This is the concept of "screw-you money" (the real term is more vulgar). *See* Ethan Wolff-Mann, *How Much Money Would You Need to Ditch Your Job Forever?*, MONEY (Oct. 17, 2016), http://money.com/money/4187538/f-u-money-defined-how-much-calculator/ [https://perma.cc/T4UW-S7F2].

[91] Susan J. Stabile, *Motivating Executives: Does Performance-Based Compensation Positively Affect Managerial Performance?*, 2 U. PA. J. LAB. & EMP. L. 227, 245 (1999) [hereinafter

extrinsic motivators can crowd out the intrinsic motivation that can remain effective even when the agent is not being directly monitored.[92] This often leads to selfish, opportunistic actions rather than behaviors that support the mission and institution of the corporation.[93] Rising executive pay is therefore more likely to isolate the CEO from other employees and incentivize a transactional, rather than loyal, mindset among executives.

A process for CEOs to negotiate their pay in company resources with other employees may improve workplace morale by placing reasonable restrictions on wage inequality. However, because it would also give the CEO significant incentives to appeal to workers and foster understanding between the top and bottom of a company, it could also improve the company culture.

G. *Responses to Alternative Explanations for Rising Executive Compensation*

Arguments that the pay-setting process for executives is not broken are not able to explain the continuing escalation of executive compensation or fall apart when applied to lower-wage employees. The defenses of current executive compensation practices therefore do not argue against an executive bargaining process whereby CEOs negotiate their pay with other employees.

First, tournament theory explains high executive compensation as not only compensation for executive efforts but, more importantly, as a motivator for other employees to perform well and thereby rise in the ranks at the company.[94] While it may motivate employees within the company (skeptics disagree[95]), it does not explain the continued rise of executive pay across companies because employees are not becoming systematically less ambitious and therefore in greater need of a big, tournament prize.[96]

Second, defenders of high executive pay argue that it is a status symbol or

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Stabile, *Motivating Executives*].

[92] Kristen Underhill, *When Extrinsic Incentives Displace Intrinsic Motivation: Designing Legal Carrots and Sticks to Confront the Challenge of Motivational Crowding-Out*, 33 YALE J. ON REG. 213, 215 (2016).

[93] *See generally* Lynn A. Stout, *Killing Conscience: The Unintended Behavioral Consequences of "Pay for Performance"*, 39 J. CORP. L. 525 (2014) (contrasting selfish incentives to prosocial incentives in the workplace).

[94] Iman Anabtawi, *Explaining Pay Without Performance: The Tournament Alternative*, 54 EMORY L.J. 1557, 1559 (2005); Westbrook, *supra* note 10, at 1052.

[95] Bank et al., *supra* note 9, at 99; Downs, *supra* note 9, at 67.

[96] *See Nothing Special: MBAs are No Longer Prized by Employers*, ECONOMIST (June 13, 2016), https://www.economist.com/whichmba/nothing-special-mbas-are-no-longer-prized-employers [https://perma.cc/NL4H-YA58] (indicating that the supply of MBA graduates is so large to have caused the value of the degree to decline).

instance of costly signaling rather than motivation for performance.[97] While this argument appears to abandon the tenets of capitalism,[98] it could potentially explain an escalation in highly visible CEO pay packages designed to attract attention of investors.[99] However, this does not explain why such corporate generosity is directed only at executives and not other employees.[100] If anything, a large display of financial strength through raising median wages would best benefit the company by showing corporate social responsibility rather than a desire to resurrect the aristocracy.[101]

Third, rising executive pay is attributed to increasing bargaining power for executives attributed to their power to step down.[102] However, there is no reason for companies to only raise executive compensation as lower-wage workers have become increasingly likely to change jobs for better opportunities.[103] Also, CEOs in industries where their skillsets are more transferrable are easier to replace for the same reasons, making it easier for them to leave.[104] Alternatively, a rise in a CEO's bargaining power could derive from an increase in the firm's size and market power.[105] Though firm size is correlated with CEO pay[106] (in the United States[107]), this does not inevitably lead to income disparities; dominant firms could outcompete rivals by raising industry wages for workers.[108]

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[97] *See* Westbrook, *supra* note 10, at 1049.

[98] *Id.* at 1049–51, 1056.

[99] *See* Beecher-Monas, *supra* note 12, at 108 (noting "hidden pay common in executive pay packages"); Bank et al., *supra* note 9, at 91; Walker, *supra* note 12, at 654–55.

[100] If signaling were the only consideration, the company could just as well throw stockholders a big party where they set fire to a large pile of cash.

[101] Jason Brandenberger, *Best-Laid Plans: Corporate Social Responsibility Often Goes Awry*, 3 ARIZ. J. ENVTL. L. & POL'Y 1041, 1042–43 (2013) (noting that socially responsible expenditures encourage customer loyalty and public goodwill).

[102] Randall S. Thomas, *Explaining the International CEO Pay Gap: Board Capture or Market Driven?*, 57 VAND. L. REV. 1171, 1177 (2004) (describing Opportunity Cost Theory) [hereinafter Thomas, *Explaining the International CEO Pay Gap*].

[103] John Zogby, *Employment 2.0: The Transient Age*, FORBES (Sept. 10, 2009, 12:00 AM), https://www.forbes.com/2009/09/09/temporary-employment-new-job-opinions-columnists-john-zogby.html#6166e48715c2 [https://perma.cc/HUG3-PDVT].

[104] *See generally* Robert Parrino, *CEO Turnover and Outside Succession: A Cross-Sectional Analysis*, 46 J. FIN. ECON. 165 (1997) (reporting that CEOs in industries of homogenous companies have greater rates of turnover and succession).

[105] Walker, *supra* note 12, at 660 (describing the research of Gabaix and Landier, though also noting that their findings were contradicted by Bebchuk and Grinstein).

[106] Michael, *supra* note 3, at 801.

[107] Robert J. Jackson, Jr. & Curtis J. Milhaupt, *Corporate Governance and Executive Compensation: Evidence from Japan*, 2014 COLUM. BUS. L. REV. 111, 114 (2014) (noting that the relationship between CEO pay and firm size only occurs in Japanese firms that set CEO pay with American-style compensation committees).

[108] *See generally* Lauren Thomas, *Amazon's Minimum Wage Hike Puts the Pressure on Walmart, Target and Others to Follow*, CNBC (Oct. 2, 2018, 3:35 PM), https://www.cnbc.com/2018/10/02/

Therefore, defenders of high executive compensation cannot explain both why it is systematically rising in the United States and why the causes of its rise do not apply to non-executive employees. While these questions are addressed below, at this juncture, it is sufficient to note that CEOs would have difficulty justifying current pay levels to lower-wage employees, indicating that these employees would be apt negotiators against excessive executive compensation. Defenders of executive compensation practices are correct in arguing that market forces are needed in setting executive pay,[109] and the proposal described in this article aims to implement a better market mechanism than current executive pay-setting processes.

H. *Rising Executive Compensation Indicates a Flawed CEO Pay-Setting Process*

Effective executive compensation should attract talent and reward performance,[110] while excessive executive compensation is an amount that is not necessary to achieve these goals or signal anything meaningful to investors.[111] Because economic theory indicates that a free market would not produce such inequities,[112] the prevalence and acceleration of excessive executive pay indicates a pay-setting process that is unrestrained.[113]

The core process behind effective compensation is not market actions of consumers and shareholders but rather a negotiation between the CEO and the board of directors.[114] As indicated above, the board has failed to act as a negotiating partner.[115] This system is frustrating for shareholders who are too dispersed and distant to negotiate directly with CEOs. But this does not mean a better negotiating partner does not exist.

One successful investor asked about high-paid CEOs, "How can they look their employees in the eye?"[116] The answer is that they do not.[117]

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amazons-minimum-wage-hike-puts-pressure-on-walmart-target-to-follow.html [https://perma.cc/WFP9-KMDA].

[109] Thomas, *Explaining the International CEO Pay Gap*, *supra* note 102, at 1176.

[110] Beecher-Monas, *supra* note 12, at 106–07.

[111] Staihar, *supra* note 46, at 488.

[112] Njoya, *supra* note 5, at 400–01 (describing Adam Smith's theories on a well-ordered market).

[113] *Id.* at 395 (noting "unconstrained managers").

[114] Michael, *supra* note 3, at 802.

[115] *See* Beecher-Monas, *supra* note 12, at 107–08; Stabile, *Viewing Corporate Executive Compensation*, *supra* note 14, at 220 ("We do not have the functional equivalent of arm's length negotiation in a corporation . . ."); Westbrook, *supra* note 10, at 1056.

[116] Downs, *supra* note 9, at 64.

[117] Walker, *supra* note 12, at 655 (noting that labor does not participate in the executive pay-setting process).

IV. HOW AND WHY CEOS SHOULD NEGOTIATE THEIR PAY WITH OTHER EMPLOYEES

The previous sections indicate that the current system allows for an increasingly problematic escalation of executive pay. This trend suggests that current CEO pay-setting processes do not confront company decision-makers with the tradeoffs of alternative uses for the resources that otherwise go into executive compensation. If companies had to face the alternative uses of company resources used in executive pay packages, large companies would become more efficient. This article suggests that the ideal process for considering alternative uses involves lower-wage employees negotiating executive compensation directly with the CEO. Because this inserts the perspectives of the broader corporation, it may also lead to more equitable pay practices. Also, regular discussions between management and workers about each side's contributions and remunerations could improve the culture of participating companies.

This part will propose ideas for how this executive bargaining process could occur, present theoretical benefits of this process, and then point to evidence that these benefits would occur in practice. Further, this part will demonstrate that small changes to key parts of corporate governance could produce significant positive benefits for the private sector.

A. *How CEOs Could Negotiate Their Pay with Other Employees*

Under current practices, corporations allocate executive pay through a process that is detached from other expenditures by the corporation. The board of directors chooses the top executives and the pay packages for the very top few,[118] and then those executives decide all of the other expenditures for the companies that employ them.[119] The board of directors allocates resources for CEO pay through the compensation committee.[120] This body is composed of directors who are not managers in the corporation and informed by an outside expert.[121] To encourage the board to negotiate CEO pay in the interests of shareholders, corporations have implemented every precaution to prevent a cozy relationship between compensation committees and CEOs.[122] As will be

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[118] Michael, *supra* note 3, at 802 (describing the pay decisions made by directors).

[119] Staihar, *supra* note 46, at 492 (noting that pay for rank-and-file employees is decided by executives and not by the board of directors).

[120] Beecher-Monas, *supra* note 12, at 119–20 (noting that compensation committees were introduced to prevent the CEO from having undue influence over executive compensation).

[121] Michael, *supra* note 3, at 797–99 (describing compensation committees and compensation consultants, noting their relationship with the CEO).

[122] Stabile, *Viewing Corporate Executive Compensation*, *supra* note 14, at 222 (noting of structured independence in executive compensation bodies, "[t]here simply does not seem to be

explained in greater detail later, the resulting separation of executive compensation decision-makers from the people with knowledge of the corporation and an interest in its future success has created an apathetic negotiation process, leading to a steady uptick in CEO pay.[123]

The pay of every employee of a company—including the CEO—should be determined through fair and informed negotiation.[124] If the current system of negotiated executive compensation by outside board members does not produce efficient executive pay, perhaps the corporation could involve lower-wage employees in the process.[125] This does not mean lower-wage workers giving non-binding opinions,[126] conducting protest or traditional collective bargaining actions,[127] or serving on boards within current pay-setting processes.[128] Rather, this article proposes processes whereby CEOs engage in meaningful negotiations over executive pay with employees.

The vision for this process is one in which lower managers and employees, who believe that their individual or department contributions to the corporation have not been rewarded, will be able to ask the CEO to justify the requested amount of executive compensation. This can take the form of an elected body of employee representatives that decide by majority vote or an open process of dialogue with decisions approved by a vote among all employees. Either way, this process needs to be transparent to prevent deal-making that benefits participants in the process rather than the interests they stand for. Also, employee participation in these negotiations, whether through elected representatives or open forums, should be a voluntary process that attracts those most interested in, and capable of, advocating for valuable alternative uses of corporate resources.

If executives cannot justify their requested pay packages through this negotiation, they trigger an impasse[129] or accept a lesser amount, which leaves the company with more resources and leaves the CEO with insight about types

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more that can be done to make the board a better representative of shareholder interests.").

[123] *See infra* Section V.A.

[124] Staihar, *supra* note 46, at 487 ("The pay to each worker in a company should be the outcome of a fair process of bargaining.").

[125] Plass, *supra* note 11, at 641 (noting that workers can point out the unfairness of high CEO pay if their output has not been similarly rewarded).

[126] Rhee, *supra* note 5, at 722 (describing a process of regular non-binding votes by employees on executive pay packages).

[127] Plass, *supra* note 11, at 601 ("[W]age compression can be achieved through unrepresented worker protest and collective bargaining practices that link the plight of workers to the overall compensation practices of their employers . . . .").

[128] Njoya, *supra* note 5, at 394 (describing a proposal for workers to sit on compensation committees).

[129] The response to impasse in executive bargaining would depend on whether the process is voluntary or obligatory, as described below.

of workers who are underpaid. If executives can justify their requested pay packages, then the company moves forward as usual but with employees who understand and support the amount of resources allocated to executive compensation.

As a precaution and side-note: executive bargaining should be restricted to company resources and not stock options. Many executives are paid in stock options, which give preferential treatment to option-holders and dilute the value of shares for common shareholders.[130] Employees would have few incentives against giving stock options, so the board of directors should continue to be the body that negotiates stock options with the CEO.[131]

Also, to be clear, this proposal does not radically restructure corporate law. The board of directors will remain ultimately responsible for the functioning of the corporation.[132] However, instead of continuing to use an ineffective pay-setting process for top executives, the board would oversee a process in which employees act as informed and motivated representatives of various parts of the corporation in negotiating executive pay with the CEO. In implementing one of the processes proposed below, the board of directors would use assets available to the company (the employees) to regulate executive compensation. This executive-employee negotiation could be either voluntary or obligatory.

1. Voluntary Executive Bargaining: Incentives for Good-Faith Negotiation

A voluntary process would involve the board facilitating a negotiation over executive compensation between the CEO and employees but then deciding executive compensation through the normal process if the two sides are not able to reach an agreement. The first reason a CEO might take these negotiations seriously is for public-facing corporate social responsibility purposes. Corporate leaders are undertaking voluntary actions and commitments that seem to work against short-term company interests but are increasingly seen as attracting customer loyalty and supporting long-term sustainability for the business.[133] Companies are finding that designations such as benefit corporation and B Corp certification attract a ready supply of

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[130] Rick Wayman, *Should Employees Be Compensated With Stock Options?*, INVESTOPEDIA (June 25, 2019), https://www.investopedia.com/articles/analyst/091202.asp [https://perma.cc/TYH8-B3C4].

[131] *See generally id.* The author would note, however, that the practice of granting stock options is fraught with unproductive incentives.

[132] Rhee, *supra* note 5, at 722 ("[U]nder state corporate law, the board has the ultimate authority to manage the business and affairs of the corporation, including setting compensation.").

[133] Brandenberger, *supra* note 101, at 1041–42 (defining corporate social responsibility and noting the theory behind it).

consumers looking to support the public good.[134] Along similar lines, corporations that negotiate executive compensation with their own employees will be able to stand out as taking action against the widely perceived problem of income inequality.[135]

The second reason a CEO might voluntarily negotiate his or her wage with employees involves the enactment of new tax incentives to specifically support executive bargaining. As discussed previously, rising income inequality harms the larger economy and society.[136] Conversely, a greater degree of wage compression is a public good, justifying government intervention in economic theory[137] and public opinion.[138] Though a systematic shift in resources from executive compensation to worker compensation would benefit the economy and society, individual companies may perceive a prisoner's dilemma in taking the first step.[139] Governments could take action to coordinate this private provision of an important public good (wage equality) by offering tax incentives to companies that can demonstrate that they have negotiated their CEO pay with employees.[140] Though a reduction in corporate taxes for companies implementing executive bargaining imposes its own

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[134] *See generally* Janine S. Hiller, *The Benefit Corporation and Corporate Social Responsibility*, 118 J. BUS. ETHICS 287, 287–301 (2013) (noting that a benefit corporation is a business entity incorporated under a mandate to pursue the public good and not only shareholder profits); *see generally* John Sensiba, *Becoming a B Corp Validates Long-Held Culture of Community and Environmental Stewardship*, 42 PUB. ACCT. REP., Nov. 2018, at 1, 5–7 (describing B Corp certification as a third-party designation of socially responsible business, analogous to Fair Trade certification as an indicator of socially responsible coffee-production).

[135] *Most See Inequality Growing, but Partisans Differ over Solutions*, PEW RES. CTR. (Jan. 23, 2014), https://www.people-press.org/2014/01/23/most-see-inequality-growing-but-partisans-differ-over-solutions/ [https://perma.cc/EX9R-EZ9P].

[136] *See supra* Sections II.D. and II.E.

[137] Daphna Lewinsohn-Zamir, *Consumer Preferences, Citizen Preferences, and the Provision of Public Goods*, 108 YALE L.J. 377, 377 (1998); JONATHAN GRUBER, PUBLIC FINANCE AND PUBLIC POLICY 4–7 (4th ed. 2013) (describing market failures and redistribution as the two theoretical justifications for government intervention in a market). Here, the market failures are negative externalities rooted in a concentration of earnings among the wealthy. *Id.* Also, executive bargaining indirectly pursues redistribution by moderating wages between the top and bottom of large companies. *Id.*

[138] *Most See Inequality Growing, but Partisans Differ over Solutions*, PEW RES. CTR. (Jan. 23, 2014), https://www.people-press.org/2014/01/23/most-see-inequality-growing-but-partisans-differ-over-solutions/ [https://perma.cc/Y7AP-WGAH] (noting that sixty-nine percent of surveyed Americans agreed that the government should do "A lot/Some" to address economic inequality).

[139] Cynthia A. Williams, *Icarus on Steroids*, 94 GEO. L.J. 1197, 1220 (2006) (indicating a prisoner's dilemma in reducing executive compensation that merits government coordination); Christopher Saverino, *Full Disclosure: Moving Beyond Disclosure Regulations to Affirmative Regulation of Executive Compensation*, 11 BROOK. J. CORP. FIN. & COM. L. 541, 549–50 (2017).

[140] To demonstrate to regulators that a good faith negotiation occurred, it may be necessary to include some type of oversight or sanctions for tampering with the employee vote.

tradeoffs,[141] this could be handled through bipartisan negotiation[142] or as part of a larger legislative effort that increases tax burdens on companies that do not implement executive bargaining.

A third reason a CEO might voluntarily negotiate his or her wage with employees is visionary leadership.[143] A number of companies have developed a reputation for focusing on employee interests and also enjoy reputations for enhanced quality, greater customer satisfaction, better retention, and overall profitability.[144] Ignoring short-term interests in cutting costs and boosting shareholder value have allowed such well-run companies to avoid the often underestimated costs of employee turnover and benefit from higher rates of innovation associated with internal training and promotion.[145] Justifying executive compensation to other employees after hearing about their aspirations, contributions, and remuneration could be an act of inspirational leadership and not only an approach to setting CEO pay.

2. Obligatory Executive Bargaining: Using the Board as an Arbiter

The flaw with voluntary negotiations over executive compensation is that CEOs can walk away if they believe their compensation committee would give them a better deal. This article therefore proposes the following idea for compelling a CEO to negotiate in good faith with other employees.[146] If the CEO and employees are not able to agree on an executive pay package, then each will submit an alternative pay package to the board of directors for a vote.[147] Because the employees may submit a figure the CEO is not willing to accept, they will also likely need to propose a new CEO who is willing to take their compensation package. Giving the board alternatives to consider is important because competition among alternatives creates efficiency, and members of compensation committees often do not know who in the

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[141] It is axiomatic that reducing taxes requires a higher government deficit or fewer public services.

[142] Both progressives and conservatives could find value in executive bargaining as a measure that seeks to both reduce economic inequality and offer lower corporate tax burdens.

[143] Michael, *supra* note 3, at 819 ("But did the executive consider the impact of the compensation, under all the circumstances, on the corporation's public image, workers, or shareholders?").

[144] Theresa M. Neff, *What Successful Companies Know That Law Firms Need to Know: The Importance of Employee Motivation and Job Satisfaction to Increased Productivity and Stronger Client Relationships*, 17 J.L. & HEALTH 385, 402–04 (2002) (describing the approach of Southwest Airlines).

[145] William Craig, *Making Strategic Investments in Employee Development is Crucial for Success*, FORBES (July 31, 2018, 9:14 AM), https://www.forbes.com/sites/williamcraig/2018/07/31/making-strategic-investments-in-employee-development-is-crucial-forsuccess/#2adda910140c [https://perma.cc/ADU4-ARNL].

[146] Though other mechanisms are surely possible.

[147] This is analogous to final offer arbitration. *See generally* Donald Wittman, *Final-Offer Arbitration*, 32 MGMT. SCI. 1551 (1986).

corporation could replace the CEO.[148] While there will be concerns of retaliation for any lower manager who challenges the CEO, this could be handled by keeping the employee bid available only to the board.[149] At the same time, giving ambitious junior managers with the backing of other employees the ability to replace the CEO could create a greater likelihood of fresh and inspired leadership.

But because the board would make the ultimate decision between the proposal of the CEO and the proposal of the employees, two likely effects would occur. First, the impending board decision will incentivize each side to submit more moderate proposals (for fear of being judged less reasonable than the other side).[150] Second, because the potential board decision removes control from both sides, this process also incentivizes a negotiated settlement.[151] Either way, there will be a moderating effect on executive compensation while basing the final amount on the combined wisdom of all employees and maintaining final authority in the board of directors.

Therefore, it is entirely possible to incentivize a manageable and meaningful negotiation over executive pay between the CEO and employees. Boards of directors have the obligation to manage the corporation in the interest of shareholders, and if the potential benefits of this process outweigh the costs, then one of the proposed modifications to executive pay practices are worth considering.

B. *The Potential Benefits of CEOs Negotiating Their Pay with Other Employees*

Because employees are knowledgeable about the corporation's inner workings and are motivated to deter any corporate waste that detracts from their career success, they are the players who can best negotiate with the CEO at arm's length. Executive bargaining therefore offers a promising solution to the current problems with executive compensation.[152]

To be clear, this process is not opening a floodgate of employee input into the management of the corporation. Instead, this process only concerns itself

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[148] Holmstrom, *supra* note 24, at 707 ("[T]here are many close CEO substitutes . . . but the board does not know who and where they are.").

[149] Rhee, *supra* note 5, at 729 (noting confidentiality as a remedy to concerns of retaliation in corporate politicking).

[150] Brian Broughman, *Independent Directors and Shared Board Control in Venture Finance*, 9 REV. L & ECON. 41, 42 (using the analogy of final offer arbitration to propose how a forthcoming decision by an independent board can moderate disputes in corporate governance).

[151] Paul Perlman, *Final Offer Arbitration: A Pre-Trial Settlement Device*, 16 HARV. J. ON LEGIS. 513, 526 (1979) (noting that final offer arbitration "would provide an incentive for the parties to reach an equitable division on their own").

[152] Knutt, *supra* note 12, at 516 (citing Miske's postulation).

with arriving at a pay package for the CEO and top executives that a compensation committee would normally handle. However, this process does give underappreciated departments and employees a platform to air their complaints about remuneration as a lens to reflect on the reasonableness of the pay package requested by the executives. In addressing executive compensation, this process therefore presents benefits in efficiency, equity, and corporate culture.

1. Efficiency Gains of CEOs Negotiating Their Pay with Other Employees

CEOs negotiating their pay in company resources with workers should increase efficiency for participating corporations.[153] While other have not implemented the process described in this article, advocates for industrial democracy have long predicted that employee participation on corporate boards would improve efficiency.[154] Efficiency gains from executive bargaining should arise from the information held by employees, their motivation to compete for resources otherwise going to CEO pay, and the personal impact they experience from corporate waste.[155]

First, non-executive employees have a "wealth of information" about the inner workings of the company.[156] Non-executive employees[157] spend their entire working week on the company's front lines, interacting with customers, suppliers, and competitors. In contrast, shareholders are not as informed[158] because, in dispersed shareholding economies like the United States, they have multiple shareholdings to research,[159] "face a collective action problem,"[160] and only have access to public information.[161] Board members similarly dedicate part of their time to advising the corporation,[162] and independent

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[153] Rhee, *supra* note 5, at 734 ("The advantage of employees as monitors compared to shareholders becomes apparent when we consider the question of information through the lens of market efficiency."); Njoya, *supra* note 5, at 423 ("[W]orker participation in setting levels of executive pay may help to advance the efficiency goals of company law.").

[154] Njoya, *supra* note 5, at 401 (describing the recommendations of the Bullock Committee of Inquiry on Industrial Democracy).

[155] Loretta M. Kopelman & Michael G. Palumbo, *The U.S. Health Delivery System: Inefficient and Unfair to Children*, 23 AM. J.L. & MED. 319, 321 (1997) (noting three elements needed for an efficient market mechanism).

[156] McDonnell, *supra* note 6, at 334; *see also* Rhee, *supra* note 5, at 695 ("Employees possess the corporation's entire information content . . . .").

[157] Employees from across the organizational structure, including workers, supervisors, and middle management.

[158] Rhee, *supra* note 5, at 699–700 ("Employees possess the firm's entire information. Shareholders cannot claim the same . . . .").

[159] Stabile, *Viewing Corporate Executive Compensation*, *supra* note 12, at 223–24.

[160] Yingling, *supra* note 46, at 216.

[161] Rhee, *supra* note 5, at 700 (noting that stock prices only reflect publicly-available information).

[162] Amy Fontinelle, *How Much Board of Directors Members Get Paid and What They Do*,

board members do not work inside the company at all.[163] Therefore, bringing the collective wisdom of lower workers and managers to the table[164] will increase efficiency by better aligning executive compensation with reality.[165]

Second, employees should be motivated to negotiate executive compensation downward. Boards of directors are composed of other executives and operate in a culture that promotes consensus rather than competition.[166] Meanwhile, employees are paid from the same pot of company resources as executive compensation, and they are therefore motivated to reduce excessive CEO pay as a contributor to downsizing, reduction in benefits, and stagnant wages.[167]

Finally, boards of directors do not fight for resources like company employees and departments.[168] Many directors are not employees or stockholders of the company and are therefore not affected by the long-term health of the company.[169] Because they do not experience rewards or punishments for their decisions, they act like they are spending other people's money when setting executive compensation.[170]

This is not to say that board members are not talented managers that bring valuable insight from a variety of perspectives in advising the corporation. However, employees possess more information, motivation, and skin in the game to negotiate across from top executives over the use of company resources in executive compensation.[171]

INVESTOPEDIA (June 25, 2019), https://www.investopedia.com/articles/wealth-management/040416/retired-execs-what-do-corporate-boards-pay.asp [https://perma.cc/WZZ8-4V3D].

[163] Jackson, Jr. & Milhaupt, *supra* note 107, at 120 (citing a study that concluded, among other things, that the percentage of outside directors on a board was correlated with higher executive compensation).

[164] Rhee, *supra* note 5, at 728 ("Senior and middle managers collectively know . . . more than their individual superiors.").

[165] Aaron Byrkit, *Reforming Foreclosure Disposition: A Tool for Tempering the Financial Meltdown*, 63 CONSUMER FIN. L.Q. REP. 275, 289 (2009) (noting that imperfect information indicates sources of inefficiency).

[166] Michael, *supra* note 3, at 798 ("The culture of a corporate board or committee is not designed to support debate and contention, but rather to build or ratify consensus.").

[167] Walker, *supra* note 12, at 654 (noting that agency costs such as excessive executive compensation are borne by workers and shareholders as the suppliers of labor and capital).

[168] Yingling, *supra* note 46, at 215 (noting that, in overseeing executive compensation, that the board "is an unreliable supervisor").

[169] Jackson, Jr. & Milhaupt, *supra* note 107, at 118 ("[T]hese directors own very little of the company's stock, and thus internalize very little of the costs of executives' compensation.").

[170] Downs, *supra* note 9, at 65 ("[D]irectors are not spending their own money and thus do not have the same incentive to be careful or frugal as when their own assets are being utilized.").

[171] Rhee, *supra* note 5, at 699–700 (noting the motivation and private information possessed by employees).

2. Equity Gains of CEOs Negotiating Their Pay with Other Employees

A process whereby executives negotiated their pay with lower-wage employees would also improve equity within companies. Because a corporation is inherently a collective endeavor, it is often difficult to determine the work being rewarded, especially at the executive level where output is intangible and long-term.[172] Determining what is a fair amount to pay an executive might therefore appear to be an uncertain undertaking.[173] However, one way to determine a fair wage, in general, is through arm's length negotiations.[174] Therefore, companies can identify equitable amounts of executive compensation through executive bargaining, as an informed, motivated, and competitive negotiation of wages.

Another determinant of an equitable wage negotiation is whether pay reflects value added to the company.[175] There is a thoroughly argued literature demonstrating that pay is not linked to performance for corporate executives, so there is much room for improvement in this regard.[176] In a pay-setting system that has excluded workers,[177] it is predictable that executives will ask employees to shoulder some of the burden during tough times[178] but fail to distribute gains and lay claim to much of the returns.[179] This inequitable outcome would be less likely if and when executives negotiate their pay with employees. Under this process, executives, who ask employees to bear part of the burden of downturns, will be held to that standard in asking for their own pay, and executives who boast of current or future profits to shareholders will have to answer as to why they should receive a share of this gain when other employees have not seen a rise in pay or benefits.

Furthermore, the very fact that rank-and-file employees negotiated with executives and approved the executive pay package would signal the pay's fairness to shareholders, customers, and others who do not participate in the

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[172] Stabile, *Motivating Executives*, *supra* note 91, at 263 (noting the collective and intangible nature of executive output).

[173] Daniel J. Gifford, *Labor Policy in Late Twentieth Century Capitalism: New Paradoxes for the Democratic State*, 26 HOFSTRA L. REV. 85, 96 (1997) (arguing that the rhetoric of distributional fairness is indeterminate).

[174] Lawrence, *supra* note 36, at 834 (noting that the value of an item is only able to be determined by observing the actions of buyers and sellers).

[175] Gifford, *supra* note 173, at 97 (noting that fairness requires that the pay reflect productivity).

[176] *See generally* LUCIAN BEBCHUK & JESSE FRIED, PAY WITHOUT PERFORMANCE: THE UNFULFILLED PROMISE OF EXECUTIVE COMPENSATION (2004).

[177] Rhee, *supra* note 5, at 701 (noting that employees have had "virtually no formal role in the internal affairs under U.S. corporate law").

[178] Plass, *supra* note 11, at 644 (arguing that, because companies ask employees to make concessions in downturns, they should share in the gains of their successes).

[179] *Id.* at 613 ("Companies seek the lowest possible compensation scales even when their profits are soaring and their competitive positions are secure.").

process.[180] Otherwise, the only information with which to judge the fairness of executive compensation is the size of the disparity between this pay and the pay for other employees.[181] And psychological theory indicates that people judge the fairness of their own compensation based on the disparities with the pay of others.[182] This ties into the next aspect of wage equity.

The proposed process would also enhance equity by reducing the wage disparity that occurs with escalating executive compensation. The growing gap between the rich and poor in the American workplace derives from the escalating pay packages that top executives receive.[183] To repair this growing division in classes and resources, companies should give employees greater voice through processes such as executive bargaining in which they act as proxies for the people like them in the larger community.[184] Hopefully, reducing the runaway pay gap will enhance equity by restoring a sense of societal fairness in the capitalist system.[185]

3. Morale/Culture Gains of CEOs Negotiating Their Pay with Other Employees

Finally, CEOs negotiating their pay with ordinary workers should also improve company culture and employee morale. First, the very act of consulting employees about executive pay—taking the time to explain what the executive does and why they are paid more—should have a positive impact on employee morale.[186] Also, working as a team to make an impact on the company and save the jobs of coworkers by trimming corporate excesses should significantly enhance employee morale.[187] Enhanced employee morale

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[180] Rhee, *supra* note 5, at 695 (arguing that employee voice in executive compensation "would politically legitimize executive compensation and income disparity at both the firm and political levels").

[181] Staihar, *supra* note 46, at 491 (noting that the gap between worker pay and executive pay is a signal of fairness or unfairness).

[182] Stabile, *Motivating Executives*, *supra* note 91, at 257 (describing equity theory).

[183] Plass, *supra* note 11, at 640 ("Data showing that extreme wage disparity is caused primarily by the growth of senior managers' pay . . . ."); Njoya, *supra* note 5, at 404 (noting that the wages of senior executives are a key driver in rising income inequality).

[184] McDonnell, *supra* note 6, at 334 (noting fewer externalities coming from these companies).

[185] Rhee, *supra* note 5, at 697–98 ("A public sense that wages are not fairly allocated affects morale and social cohesion at both firm and societal levels."); *see* Maxim Lott, *American Warming to Socialism Over Capitalism, Polls Show*, FOX NEWS (Jan. 4, 2019), https://www.foxnews.com/politics/americans-warming-to-socialism-over-capitalism-polls-show [https://perma.cc/72UU-L8QK].

[186] *See* Naz Beheshti, *10 Timely Statistics About the Connection Between Employee Engagement and Wellness*, FORBES (Jan. 16, 2019, 12:12 PM), https://www.forbes.com/sites/nazbeheshti/2019/01/16/10-timely-statistics-about-the-connection-between-employee-engagement-and-wellness/ [https://perma.cc/6L7B-YGJQ].

[187] McDonnell, *supra* note 6, at 336 (claiming "incentive effects" of companies with employee primacy).

is then also associated with engagement, performance, and profitability.[188]

However, this process could benefit more than individual employees. It could also improve company culture by opening lines of communication between the bottom and the top of the organization. Managers reporting to the CEO may be less likely to mistreat employees when employee satisfaction has a direct impact on CEO pay. Also, a process for critical feedback from employees who work on the front lines of the business will give executives the perspectives and incentives to become a better leader for the company. In the 1950s, when many CEOs saw their role as public benefactor,[189] a study of executives found that pride in their job rather than incentive-based pay was their chief motivator.[190]

Rising wage disparities and a focus on shareholders may increasingly drive a wedge between executives and employees. Therefore, instituting a process in which the CEO is answerable to employees from across the company should improve employee morale, company culture, and the performance of the corporation.

C. *Evidence of the Benefits of the Proposed Process*

While logical arguments support a process of deciding executive compensation through negotiation with non-executive employees, it is important to explore evidence refuting or confirming the value of this proposed process. To test the concept of executive bargaining, this article analyzes historical, economic, empirical, comparative, and psychological evidence.

The common trend emerging from these modes of analysis is that executive pay is kept in check by processes compelling negotiations between management and labor, by company blockholders[191] deciding on executive pay, and by corporate leaders focusing on the wellbeing of the company as an organization. Conversely, executive compensation escalates when power shifts away from workers, when shareholders become numerous and transactional, and when the focus of the executives shifts toward efficiency. Because mass shareholding dominates the U.S. economy, a clear preponderance of the available evidence supports a process whereby executives negotiate their pay with other employees.

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[188] Theresa M. Neff, *What Successful Companies Know That Law Firms Need to Know: The Importance of Employee Motivation and Job Satisfaction to Increased Productivity and Stronger Client Relationships*, 17 J.L. & HEALTH 385, 411 (2002) (noting that motivated employees have a positive impact on the company's profitability).

[189] Wells, *"Corporation Law Is Dead"*, *supra* note 68, at 330.

[190] Bank et al., *supra* note 9, at 104 (citing Newcomer).

[191] These are owners of larger percentages of company stock—not the dispersed shareholders common to the American and British economies.

1. Historical Evidence of Effective Constraints on Executive Compensation

The historical analysis of the systematic fluctuations in executive pay reveals important events and conditions that preceded these changes. The overall story is that executives were paid a reasonable wage when a small number of company owners decided executive pay.[192] Executive pay rose with mass shareholding in the 1920s, paralleling current trends.[193] Executive pay then fell in the 1940s when companies capitulated to increasingly powerful labor unions, and then began a consistent rise after 1980 as unions became less powerful and companies focused more on maximizing shareholder returns.[194] The observations in this section support a process of executives negotiating their pay with workers.

Two graphs lay out a general roadmap for this history. Thomas Piketty reports that the top ten percent of income-earners captured forty percent of U.S. national income between 1910 and 1920[195] and that this share rose to forty-five percent of national income from 1920 to 1940.[196] Earnings for the top ten percent then dropped sharply after 1940, were less than thirty-five percent of national income from 1940 to 1980, and ticked up toward fifty percent national income after 1980 with dips marking the bursting of the dot-com bubble and real estate bubble.[197] The graph complementing this roadmap indicates that seven to eight percent of the U.S. workforce belonged to a union in the early 1930s.[198] Union membership jumped sharply to twenty percent in the late 1930s and again to above twenty-five percent in the mid-1940s, remaining at or above twenty-five percent until it began a steady decline after 1970.[199] The sharp increase in union membership followed by a sharp decrease in income for the top ten percent and the steady decline of union membership followed by a steady rise of top incomes are likely not coincidences. A comparison of these trends and observations of other commentators indicate that compelling regular arm's length negotiations between workers and managers tended to keep executive compensation in check.[200]

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[192] This subsection describes this history in detail, but the following source includes a compelling visualized description. *See* THOMAS PIKETTY, CAPITAL IN THE TWENTY-FIRST CENTURY 299 (2013).

[193] *Id.*

[194] *Id.*

[195] For reference, highly egalitarian societies see the top ten percent of income-earners capturing twenty percent of the national income. *See* Plass, *supra* note 11, at 641.

[196] PIKETTY, *supra* note 192, at 299.

[197] *Id.*

[198] GERALD MAYER, UNION MEMBERSHIP TRENDS IN THE UNITED STATES 11 (2004).

[199] *Id.*

[200] Bank et al., *supra* note 9, at 94 (citing a study from 1951 and an observation by a compensation consultant in 1970).

The detailed history of executive compensation indicates the importance of dispersed shareholders and labor power. Up until the turn of the 20th-century, owners ran their corporations.[201] This meant that professional managers did not start to run companies for shareholder-owners until the late 1800s.[202] Limited information from this time indicates that "little thought was given to whether senior executives needed to be compensated differently from other employees."[203] A survey of the largest corporations between 1900 and 1914 indicates that salaries were kept to a moderate or modest amount[204]—equivalent to approximately $250,000 in 2019 dollars[205]—subject to reasonable profit-sharing for good performance and quick termination for bad performance.[206] This efficient and effective decision-making by shareholders was likely the result of the agility of decision-making within small groups.

The stock market boom in the 1920s caused a shift in corporate ownership from small numbers of organized blockholders with concentrated ownership to large numbers of decentralized investors with dispersed ownership.[207] The collective action problem that prevented shareholders from being able to monitor executives led to bonus plans aimed at incentivizing performance by top managers.[208] Despite, or because of these plans, executive compensation became systematically excessive in the 1920s.[209] But when a decline in material wellbeing for most coexisted with unrestrained corporate compensation practices in the 1930s, executive pay became a dominant, public issue.[210]

While unions had little legal power against corporations prior to the Great

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[201] Harwell Wells, *"No Man Can Be Worth $1,000,000 a Year": The Fight over Executive Compensation in 1930s America*, 44 U. RICH. L. REV. 689, 695 (2010) (describing "an era of proprietary management") [hereinafter Wells, *The Fight over Executive Compensation*].

[202] William W. Bratton, Jr., *The New Economic Theory of the Firm: Critical Perspectives from History*, 41 STAN. L. REV. 1471, 1487 (1989) (describing the rise of management corporations around 1890); *Id.* at 695 (noting the invention of the modern business executive).

[203] Wells, *The Fight over Executive Compensation*, *supra* note 201, at 697.

[204] Frank W. Taussig & W. S. Barker, *American Corporations and Their Executives: A Statistical Inquiry*, 40 Q. J. ECON. 1, 44 (1925).

[205] *CPI Inflation Calculator*, BUREAU OF LABOR STATISTICS, https://data.bls.gov/cgi-bin/cpicalc.pl [https://perma.cc/CXF3-SGBB].

[206] Taussig & Barker, *supra* note 204, at 44–45.

[207] June Carbone & Nancy Levit, *The Death of the Firm*, 101 MINN. L. REV. 963, 983 (2017) (describing the rise of small investors in the 1920s stock market boom).

[208] Wells, *The Fight over Executive Compensation*, *supra* note 201, at 700 (describing the bonus plans that emerged in the 1920s).

[209] Carbone & Levit, *supra* note 207, at 983 (noting outsized executive salaries in the 1920s).

[210] Bank et al., *supra* note 9, at 64; Wells, *The Fight over Executive Compensation*, *supra* note 201, at 689 ("Executive compensation first took the national stage in the 1930s."); Taussig and Barker reported that the average salary of executives between 1904 and 1914 was $9,958. *See* Taussig & Barker, *supra* note 204, at 19. This figure adjusts through inflation between January 1914 and August 2019 to $255,480.46.

Depression,[211] they grew in size as executive compensation rose[212] and public policy began to support unions.[213] This movement produced the National Labor Relations Act (NLRA) or Wagner Act of 1935—federal legislation intended to redistribute income from the executive to the working classes[214] by enhancing the bargaining power of workers.[215] This law simply made it illegal for employers to refuse to bargain with worker representatives,[216] protecting worker interests through adversarial negotiations.[217] This legislation did not immediately impact executive wages. Instead, the newly empowered unions intensified labor unrest in the late 1930s and during the 1940s.[218]

Then, after World War II, American business elites abandoned their aggressive stance toward organized labor and adopted a moderate approach that involved accommodating labor interests.[219] Under this arrangement, unions would maintain an orderly workplace, and corporate leaders would share in the returns of productivity gains.[220] In this way, organized labor became a significant force to restrain the actions of corporate leaders.[221] This

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[211] Todd A. Smith, *A Comparative Analysis: The Effect of American and Canadian Labor Laws and Economic Conditions on Union Participation*, 24 GEO. WASH. J. INT'L L. & ECON. 691, 691–92 (1991) (noting the unrestrained power of employers at the time); *see also* Katherine V. W. Stone, *Procedure, Substance, and Power: Collective Litigation and Arbitration Under the Labor Law*, 61 UCLA L. REV. DISCOURSE 164, 174 (2013).

[212] Harry Hutchinson, *Toward A Critical Race Reformist Conception of Minimum Wage Regimes: Exploding the Power of Myth, Fantasy, and Hierarchy*, 34 HARV. J. ON LEGIS. 93, 119 (1997) (reporting that union membership doubled between 1917 and 1933, though it declined during the Great Depression).

[213] Stone, *supra* note 211, at 175 (noting "mounting political pressure" from unions in the early 1930s); Smith, *supra* note 211, at 693 (noting the shift in public policy marked by the Norris-LaGuardia Act).

[214] Gifford, *supra* note 173, at 88 (noting one of the purposes of the NLRA).

[215] Richard A. Bales, *The Discord Between Collective Bargaining and Individual Employment Rights: Theoretical Origins and a Proposed Reconciliation*, 77 B.U. L. REV. 687, 688 (1997) (noting the strategy of the NLRA for protecting employees).

[216] Plass, *supra* note 11, at 618 (defining unfair labor practice under the NLRA).

[217] Roger I. Abrams, *Post-Modern Labor-Management Relations: The Southwestern Bell/Communications Workers Strategic Alliance*, 12 HOFSTRA LAB. & EMP. L.J. 321, 321–22 (1995) (describing the legal paradigm under the NLRA).

[218] Gifford, *supra* note 173, at 89 (noting that the passage of the NLRA was followed by a wave of strikes); Mark S. Mizruchi & Daniel Hirschman, *The Modern Corporations Social Construction*, 33 SEATTLE U. L. REV. 1065, 1088 (2010) (noting wartime labor unrest); Wells, *"Corporation Law Is Dead"*, *supra* note 68, at 321–22 (describing labor conflict in the 1940s).

[219] Mizruchi & Hirschman, *supra* note 218, at 1067 (describing the moderate, pragmatic approach of business elites); Wells, *"Corporation Law Is Dead"*, *supra* note 68, at 322 (describing the "labor-management concordat").

[220] Mizruchi & Hirschman, *supra* note 218, at 1088.

[221] JOHN K. GALBRAITH, AMERICAN CAPITALISM: THE CONCEPT OF COUNTERVAILING POWER (1952); Carbone & Levit, *supra* note 207, at 986–87; Mizruchi & Hirschman, *supra* note 218, at 1083.

period of labor unrest and eventual accord marked the sharpest recorded decline in executive compensation,[222] in which the top ten percent of earners went from earning forty to forty-five percent of the nation's income to thirty percent.[223] For the subsequent thirty years ending in the mid-1970s, executive compensation was relatively modest while U.S. businesses experienced growth and prosperity.[224]

However, changes in executive compensation practices were not only imposed exogenously—striking an accord with workers meant adopting a different approach to management. During this same period of restrained executive compensation from the 1940s to the 1970s, stewards of corporations—who found fulfillment in company success rather than excessive private gain—replaced early tycoons.[225] Because these new corporate leaders were focused on the company's wellbeing,[226] the job of the executive became a balancing and accommodation of various interest groups such as stockholders, customers, employees, and communities.[227] As a result, the corporation and the executive became very powerful likely because the corporation was enmeshed into an ecosystem of people supporting its growth and development.[228] So, while executives were powerful, they were more interested in equitably sharing corporate gains with this ecosystem than with maximizing profits.[229] Therefore, corporate executives from the 1940s to the 1970s acted as "quasi-public servants"[230] by operating the corporation in the interest of the community.[231] To the degree that this leadership style appears to be an idealistic goal relative to the excesses of current corporate leaders, remember that this approach to corporate governance occurred during a period of time in which business leaders found it to be in their interests to accommodate their

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[222] Carola Frydman & Raven Molloy, *Pay Cuts for the Boss: Executive Compensation in the 1940s*, 72 J. ECON. HIST. 225, 225 (2012).

[223] Thomas Piketty & Emmanuel Saez, *Income Inequality in the United States, 1913-1998*, 118 Q. J. ECON. 1, 7 (2003).

[224] Bank et al., *supra* note 9, at 59 (noting the contrast between modest CEO salaries and thriving corporations between 1940 and the 1970s); Wells, *"Corporation Law Is Dead"*, *supra* note 201, at 694 (noting a political and economic environment that muted the growth of executive compensation from the 1940s to the 1970s).

[225] Carbone & Levit, *supra* note 207, at 990 (noting that large corporations replaced individual entrepreneurs).

[226] Bank et al., *supra* note 9, at 83 (describing boards as "company protective" rather than "executive protective").

[227] Crandall et al., *supra* note 20, at 538 (quoting an executive in 1951 and commenting on the pervasiveness of his views).

[228] Gelter, *supra* note 4, at 671 (noting Galbraith's "technostructure" argument).

[229] Wells, *"Corporation Law Is Dead"*, *supra* note 68, at 327 (noting comments by economist Edward S. Mason).

[230] William W. Bratton & Michael L. Wachter, *Shareholder Primacy's Corporatist Origins: Adolf Berle and the Modern Corporation*, 34 J. CORP. L. 99, 136 (2008).

[231] Mizruchi & Hirschman, *supra* note 218, at 1094 (responding to Zeitlin's critique).

worker's interests.

But while unions were widely seen as an essential part of this economic and social order in the 1950s,[232] unions are problematic institutions and eventually declined in effectiveness.[233] Unions not only apply downward pressure on the excesses of management, but they also demand structural wage increases[234] and inflexible work rules[235] that do not respond efficiently to market pressures.[236] Therefore, when unions were influential in the 1960s and 1970s, the key economic policy problems were the inflation created by wage rates exceeding productivity[237] and stagnant economic growth under corporations that were financially overburdened.[238] Unions became seen as rent-seeking interest groups that were destroying jobs and reducing American competitiveness.[239] While there were other contributors, such as rising government spending[240] and a growing skepticism of large institutions[241] and corporations,[242] the social order of cooperative relationships comprising the American corporation in the middle decades of the twentieth century began to

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[232] Gifford, *supra* note 173, at 90 (noting public perception of unions in the 1950s).

[233] MAYER, *supra* note 198, at 11 (referencing Figure 1); Marion Crain, *Feminism, Labor, and Power*, 65 S. CAL. L. REV. 1819, 1835 (1992) (describing unions as a hierarchical, bureaucratic organization that restricts the rights of members); Amanda McHenry, *The NLRB Wields Its Rulemaking Authority: The New Face of Representation Elections*, 62 CASE W. RES. L. REV. 589, 601 (2011) (noting that the "current system has become a broken, bureaucratic maze"); Staihar, *supra* note 46, at 494 ("Union leaders can also fall prey to corruption."); A. B. Cochran, III, *We Participate, They Decide: The Real Stakes in Revising Section 8(a)(2) of the National Labor Relations Act*, 16 BERKELEY J. EMP. & LAB. L. 458, 460 (1995) (noting that the mainstream view of labor-relations in the United States is that the adversarial model is outdated); *id.* at 142 (arguing that union wage rates place U.S. firms at a disadvantage competing with foreign companies).

[234] Gifford, *supra* note 173, at 140 (noting the difficulty of reversing wage increases).

[235] John A. Litwinski, *Regulation of Labor Market Monopsony*, 22 BERKELEY J. EMP. & LAB. L. 49, 90 (2001) (arguing that unions bargain for inefficient rules).

[236] Gifford, *supra* note 173, at 143 (noting that wage increases, benefits, and work rules are demanded without consideration for the inefficiencies they bring).

[237] *Id.* at 95.

[238] Jeffrey N. Gordon, *The Rise of Independent Directors in the United States, 1950-2005: Of Shareholder Value and Stock Market Prices*, 59 STAN. L. REV. 1465, 1521 (2007) (noting that the U.S. economy floundered in the 1970s); Charles B. Craver, *The Labor Movement Needs a Twenty-First Century Committee for Industrial Organization*, 23 HOFSTRA LAB. & EMP. L.J. 69, 80 (2005) (referencing that "business opposition to unions grew exponentially during the inflationary years of the 1970s").

[239] Plass, *supra* note 11, at 636; Gifford, *supra* note 173, at 92–93.

[240] Mizruchi & Hirschman, *supra* note 218, at 1096 (noting spending on Johnson's Great Society and the Vietnam War).

[241] *Id.* at 1097 (noting the crisis of legitimacy for American institutions).

[242] Wells, *"Corporation Law Is Dead"*, *supra* note 68, at 308 (noting that corporations were seen as imposing a "conformist straitjacket" on American society).

unwind.[243] As a result, businesses organized a political movement against unions[244] and pay equality began to recede.[245]

As economic pressures and foreign competition drew attention to inefficiencies in U.S. corporations, the movement toward efficiency took the form of a hostile takeover movement in the 1980s[246] and the subsequent, indefinite return to the goal of maximizing shareholder value.[247] Though the hostile takeover was soon deemed too costly of a process for resolving disputes in corporate governance and was replaced by a framework of incentive-based pay,[248] neither prevented the rise of excessive executive compensation practices.[249]

Quantitative research supports the observation that rising power for workers at the bottom of a company impacts the compensation of executives at the top. Unionized workers consistently have higher pay than similarly-situated nonunion workers[250]—a five to twenty percent pay increase by one estimate.[251] Though unionized workers have always been a minority of the overall workforce,[252] researchers argue that union power raises wages of nonunion

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[243] Bank et al., *supra* note 9, at 101–02 (noting unraveling norms in the 1970s); Crandall et al., *supra* note 20, at 538 (1998) (noting that the "social compact has unraveled").

[244] Mizruchi & Hirschman, *supra* note 218, at 1097 (identifying the movement described as a counteroffensive).

[245] Bank et al., *supra* note 9, at 101–02.

[246] Mizruchi & Hirschman, *supra* note 218, at 1100 (describing the emergence of "an acquisition wave of unprecedented proportions").

[247] Sarah Coleman & Jonathan Friedler, *The Road to Reform in the Wake of Kiobel: Multinational Corporations and Socially Responsible Behavior*, 13 J. INT'L BUS. & L. 191, 202 (2014) (noting that modern corporations exist for their shareholders as owners); Ronald J. Colombo, *The Corporation as a Tocquevillian Association*, 85 TEMP. L. REV. 1, 6–7 (2012) (describing the current "nexus of contracts" conception of the corporation as being run for the benefit of shareholders); Gordon, *supra* note 238, at 1520 (claiming that the focus on shareholder value resulted from the hostile takeover movement).

[248] Gelter, *supra* note 4, at 653 (noting the decline of hostile takeovers replaced by incentive-based pay in the 1990s); Gordon, *supra* note 238, at 1527 (noting that hostile corrections were criticized as a business strategy).

[249] Bank et al., *supra* note 9, at 67 (noting the "golden parachutes" that spared fired CEOs from pain when workers were being laid off); Gordon, *supra* note 238, at 1526–27 (noting that the move to incentive-based pay produced escalating levels of CEO compensation); Holmstrom, *supra* note 24, at 707–08 (noting that much of the growth in CEO pay resulted from stock options that were used as incentives for performance).

[250] RICHARD B. FREEMAN & JAMES L. MEDOFF, WHAT DO UNIONS DO? 43–60 (1984); Trina Jones, *A Different Class of Care: The Benefits Crisis and Low-Wage Workers*, 66 AM. U. L. REV. 691, 747 (2017) ("[U]nionized workers receive higher earnings and better benefits than their non-unionized counterparts.").

[251] Craver, *supra* note 238, at 47 (2013) (noting a five-twenty percent pay increase for workers represented by a union).

[252] Bank et al., *supra* note 9, at 96 ("[E]ven at the peak of labor power, only a minority of the workforce was unionized.").

workers because the possibility of unionizing pressures employers to keep nonunion workers happy.[253] The question is then whether pay increases at the bottom had an impact on pay at the top. Even though labor unions negotiated pay for low level workers, regression analysis indicates that declining executive pay was more strongly associated with unionization than with government regulation.[254] In other words, changes in wage regulation across industries and across time were not as strongly associated with declining executive pay as was rising levels of unionization.[255] However, the exertion of worker power does not necessarily place downward pressure on executive compensation—higher worker wages could result in cuts to profits, research and development spending, or capital investment. This article would therefore suggest that the association between collective bargaining and reduced executive compensation is at least partially explained by corporate leaders being compelled to listen to their workers.

The key lessons from this historical analysis are that unionization and a corporate focus expanding beyond shareholders restrain executive compensation. Compelling managers to bargain with workers reduced executive compensation[256] likely because it confronts highly-paid executives with pressure to share with workers or otherwise face an increasingly aggressive and powerful labor force.[257] Also, the focus on shareholder value in the 1920s that returned in the 1980s allowed for an unchecked escalation in executive compensation. The reason is that, in economies where the shareholders of large firms are numerous, there is a collective action problem[258] in monitoring executive compensation (*i.e.*, the owners of company

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[253] FREEMAN & MEDOFF, *supra* note 250, at 731–33 (describing the indirect impact of unions on nonunion wages); Bank et al., *supra* note 9, at 96 (noting a "spill-over effect").

[254] Frydman & Molloy, *supra* note 222, at 239–47 (describing the association between unionization and executive compensation and noting that unionization was more important than government regulation); Tali Kristal, *The Capitalist Machine: Computerization, Workers' Power, and the Decline in Labor's Share within U.S. Industries*, 78 AM. SOC. REV. 361, 382–83 (2013) (arguing that the decline in unionization had the greatest empirical effect on the decline in labor's share of productivity gains, and then explaining that worker compensation was linked to productivity from 1948 to 1973 but that executives have captured most of the income from productivity gains since then).

[255] Frydman & Molloy, *supra* note 222, at 246–47 (examining how industries were regulated differently during WWII and at changes in regulation after the war and found that these regulatory changes had only a modest effect; also examining the correlation between firm characteristics and executive pay and found that levels of unionization were more strongly correlated to declines in executive compensation).

[256] Raj Salhotra, *Growing Inequality of Opportunity in Texas: Causes and Solutions*, 51 J. MARSHALL L. REV. 309, 337–38 (2018) (listing a reduction in executive compensation as one of the key roles of unions).

[257] John Balkcom & Roger Brossy, *Executive Pay - Then, Now and Ahead*, DIRECTORS & BOARDS 63 (1997).

[258] Beecher-Monas, *supra* note 12, at 118 (noting the collective action problem presented by

assets are not the people spending those assets on executive compensation).[259] Because boards of directors have failed to represent shareholder interest with regard to executive compensation, empowering workers to negotiate this compensation may produce this benefit for shareholders. Confronting the CEO with workers may also reintroduce the company-oriented thinking that transcends short-term shareholder profits to pursue worthwhile long-term projects. Historical analysis of the rise, fall, and rise again of executive compensation indicates that a process compelling top executives to negotiate their pay with workers should reduce executive compensation and perhaps better align incentives within companies.

2. Comparative Evidence of Effective Constraints on Executive Compensation

To examine the effects of current corporate governance rules on executive compensation, it is useful to examine differences in executive pay practices in developed countries and how they relate to corporate rules and structure. Developed and competitive economies outside of the United States currently have systematically lower levels of executive compensation.[260] The United States leads the world in pay ratios between average CEO and average worker, with the second-highest ratio less than half as large.[261] These foreign executive pay practices highlight the unnecessary, unique, and modifiable nature of executive pay practices in the United States.

First, Germany has achieved a smaller pay gap than exists in U.S. corporations while remaining competitive on the global market.[262] One unique aspect about German corporations is codetermination—the practice of including workers from within the corporation on the corporate board.[263] This practice allows the workers to have a voice in corporate management while

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dispersed institutional investors as shareholders).

[259] Downs, *supra* note 9, at 65 (arguing that directors are not spending their own money when making compensation decisions).

[260] *Id.* at 66 (noting that high-quality goods are made in countries with lower executive pay levels); Kevin J. Murphy, *Explaining Executive Compensation: Managerial Power Versus The Perceived Cost of Stock Options*, 69 U. CHI. L. REV. 847, 866 (2002).

[261] *Ratio Between CEOs and Average Workers in World in 2014, By Country*, STATISTICA (Sept. 25, 2014), https://www.statista.com/statistics/424159/pay-gap-between-ceos-and-average-workers-in-world-by-country [https://perma.cc/RDK5-QXRX].

[262] Stabile, *My Executive Makes More Than Your Executive*, *supra* note 72, at 84 (noting that German pay differences are more compressed); Beecher-Monas, *supra* note 12, at 103 (comparing the United States to Germany in terms of pay ratios between executives and workers).

[263] *See generally* Ewan McGaughey, *The Codetermination Bargains: The History of German Corporate and Labor Law*, 23 COLUM. J. EUR. L. 135 (2016) (describing the origins of codetermination practices and law in Germany); Stabile, *My Executive Makes More Than Your Executive*, *supra* note 72, at 85 (noting that labor gets have the seats on the German supervisory board).

arguably allowing for efficient decision-making.[264] These practices may be spreading to Nordic countries and the European Union.[265]

Second, Japan has also fostered the growth of efficient corporations while maintaining executive compensation that is lower in absolute terms and lower relative to their workers than the compensation paid to U.S. CEOs.[266] While the average U.S. CEO made 354 times the wage of the average U.S. worker in 2014, the average Japanese CEO made sixty-seven times the wage of the average Japanese worker.[267] Two factors stand out in explaining the low pay relative to high performance of Japanese executives. First, Japanese business culture and society oppose individual excesses in favor of the collective good.[268] These norms tend to focus corporate leaders on the health of the overall company and therefore on stakeholders such as employees.[269] Second, Japanese executives make an explicit practice of maintaining close relationships with their own employees[270] and taking worker wages into account when setting executive compensation.[271] The effective performance of Japanese firms compared to their low pay ratios between executives and employees lends support to the concept of compelling executives to negotiate their wages with employees.

Obviously, such egalitarian practices without an explicit executive bargaining process arise from cultural factors that would not translate perfectly into the American context. However, the point of this comparison is not to argue that Americans should be as egalitarian as the Japanese or Europeans—though there are many segments of American society that desire less economic disparity.[272] Rather, the point is that fostering closer ties between executives

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[264] Njoya, *supra* note 5, at 401 (noting that a codetermination approach to executive compensation is more efficient than other forms of regulation).

[265] *See* Jeff Wheeler, *Employee Involvement in Action: Reviewing Swedish Codetermination*, 26 LAB. STUD. J. 71 (2002); Njoya, *supra* note 5, at 397 (describing the political negotiation over the E.U. Directive on Worker Participation).

[266] Salazar & Raggiunti, *supra* note 12, at 734 (noting the competitive nature of Japanese firms and their executive compensation); Jackson, Jr. & Milhaupt, *supra* note 107, at 114 (finding that Japanese executives are paid "considerably less" than their U.S. counterparts).

[267] STATISTICA, *supra* note 261.

[268] Salazar and Raggiunti, *supra* note 12, at 735 (describing Japanese business culture); Jackson, Jr. and Milhaupt, *supra* note 107, at 156 (noting pervasive norms favor social equality in Japan).

[269] Salazar and Raggiunti, *supra* note 12, at 737 (noting what Japanese school children are taught about corporate responsibilities).

[270] Jackson, Jr. and Milhaupt, *supra* note 107, at 124 (noting that boards closely identify with employees); Salazar & Raggiunti, *supra* note 12, at 740 (noting "interests of workers are given significant consideration").

[271] Salazar and Raggiunti, *supra* note 12, at 741 (reporting that 70% of surveyed Japanese firms report this practice).

[272] Frank Newport, *Americans Continue to Say U.S. Wealth Distribution is Unfair*, GALLUP (May 4, 2015), https://news.gallup.com/poll/182987/americans-continue-say-wealth-distribution-unfair

and workers should keep business culture aligned with wider social norms. Therefore, American norms will likely tolerate pay for U.S. company executives that is higher than foreign executive compensation, but only through executive bargaining practices will the norms of the larger society be able to take hold.

Another difference between U.S. firms and those in Germany and Japan are that corporations in the latter countries are partially owned by large blockholders—single shareholders that own a significant percentage of firm shares.[273] Because large blockholders are significantly invested in certain companies, they overcome the collective action problem of dispersed, institutional investors to apply constraints to executive compensation.[274] It may be this reason that the explosion in income inequality has most effected Anglo countries with dispersed shareholders, such as the United States and Britain (the top one percent earns roughly seventeen percent and fifteen percent of all wages in the United States and Britain, respectively, compared to roughly eleven percent in Germany and ten percent in Japan).[275] To the degree that British executives are paid less than their American counterparts,[276] it may be that corporate law in the United States provides for weaker shareholder rights and greater autonomy for the board.[277] While board autonomy is attractive for corporate governance and is a reason that businesses prefer to incorporate in America,[278] requiring executives to negotiate their pay with workers may pinpoint pressure on executive pay in countries with weak shareholders without restricting the freedom of the larger corporate board.

Therefore, observations from corporate practices in other countries indicates that intentionally confronting highly paid executives with their workers could reign in excessive executive compensation.

.aspx [https://perma.cc/37TT-4RC2] (reporting that sixty-three percent of Americans say that money and wealth should be more evenly distributed).

[273] Randall Morck et al., *Banks, Ownership Structure, and Firm Value in Japan*, 73 J. BUS. 539, 541 (2000) (these large blockholders are in the form of large financial institutions).

[274] Gelter, *supra* note 4, at 646 (noting that large blockholders monitor corporate boards).

[275] PIKETTY, *supra* note 192, at 316–17 (providing a comparison of income inequality in the Anglo countries to France, Sweden, Germany, and Japan).

[276] Martin J. Conyon et al., *Are U.S. CEOs Paid More Than U.K. CEOs? Inferences from Risk-adjusted Pay*, 24 REV. FIN. STUD. 402, 404 (2011).

[277] Blake H. Crawford, *Eliminating the Executive Overcompensation Problem: How the SEC and Congress Have Failed and Why the Shareholders Can Prevail*, 2 J. BUS. ENTREPRENEURSHIP & L. 273, 288–89 (2009).

[278] *Id.* at 289.

V. FLAWS IN EXECUTIVE COMPENSATION PRACTICES THAT EXCLUDE EMPLOYEE VOICES

The systematic rise in pay for executives that outpaces their productivity gains and foreign competitors indicates a problem with executive compensation practices in the United States. Defenders of executive compensation practices, however, will argue that we do not know what causes escalating executive compensation[279] and that these pay practices must be fair for companies to continue to approve them.[280]

This section will therefore examine the determinants of escalating executive compensation. This analysis essentially shows that the people who set executive compensation in the United States are not corrupt or coerced, but they are instead disinterested because they do not confront the tradeoffs of alternative uses of the company resources used for executive compensation. Meanwhile, CEOs are not greedy or ill-intentioned[281] but are rather participating in a system that heaps praise on them for not wrecking the company while keeping them far enough from the pay-setting process that they can disavow responsibility for excessive executive compensation. This analysis supports the role of company employees to negotiate the amount of company resources used in executive pay directly with those executives.

A. *The Flawed Process of Setting Executive Compensation*

The flaws in U.S. executive compensation begin with the board of directors. Because the legal tradition in the United States favors adversarial interactions and independent decision-makers to avoid undue influence,[282] legal analysis of executive compensation looks to whether these pay packages were negotiated between the executives and sufficiently independent decision-makers.[283] These assumptions about the effects of independence on decision-makers set the debate over the board of directors as either optimally

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[279] Thomas, *Explaining the International CEO Pay Gap*, *supra* note 102, at 1173 ("One of the most puzzling aspects of executive compensation is the pay gap that exists between American and foreign Chief Executive Officers (CEOs).").

[280] Westbrook, *supra* note 10, at 1057 ("[I]f these rates of executive compensation are, by widespread consensus, excessive, and not in the interest of shareholders, why are boards still approving them?").

[281] Bainbridge, *supra* note 89, at 1631 ("Franklin Snyder concludes that 'most of the results that [Bebchuk and Fried] see as requiring us to postulate managerial dominance turn out to be consistent with a less sinister explanation.'").

[282] *See* Nathan Witkin, *Dependent Advocacy: Alternatives to Independence Between Attorneys*, 32 OHIO ST. J. ON DISP. RESOL. 111, 112–14 (2017).

[283] Michael, *supra* note 3, at 786 (describing the legal focus on sterilizing the process from executive influence).

contracting with the CEO[284] or acting under the control of the CEO[285] in setting executive compensation.[286]

However, both perspectives miss the possibility that disinterested decision-makers have very little incentive to negotiate a competitive wage with company executives. So, while giving decision-making power over executive compensation to increasingly independent and removed directors was seen as a solution,[287] it is allowing them to set executive pay as if they were spending other people's money.[288] In contrast, corporate boards in the 1950s were composed primarily of corporate insiders and outsiders with very close ties to the company,[289] but then they shifted to being dominated by board members with little direct personal investment in the company.[290] This shift was not the product of business acumen or an interest in efficient decision-making but was instead legal protection against the hostile takeover movement in the 1980s.[291] However, as the previous section illustrated, executive compensation was only restrained before the hostile takeover movement, even though management was essentially setting its own wages.[292]

The reason that executives were frugal in setting their own wages in the 1950s was likely that they had an overarching loyalty to the company. The executives in the middle decades were described as having worked their way up through the company, with much social capital entwined within the corporation and continuing interactions with its lower levels.[293] For this class of executive, excessive compensation would be like taking money from friends and family. While it is possible to explain these behaviors as a product of their

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[284] *See* Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 310–11 (1976).

[285] BEBCHUK & FRIED, *supra* note 176, at 61–79.

[286] Walker, *supra* note 12, at 655–58 (describing the debate between optimal contracting and managerial power).

[287] Beecher-Monas, *supra* note 12, at 118–19 (noting the trend towards more independent boards because "the role of independent directors has been seen as the solution.").

[288] Downs, *supra* note 9, at 65 ("[D]irectors are not spending their own money and thus do not have the same incentive to be careful or frugal."); Jackson, Jr. & Milhaupt, *supra* note 107, at 118 (noting that U.S. directors "internalize very little of the costs of executives' compensation").

[289] Bank et al., *supra* note 9, at 81 (noting the description of the 1950s corporate board).

[290] Gordon, *supra* note 238, at 1465 ("Between 1950 and 2005, the composition of large public company boards dramatically shifted towards independent directors, from approximately twenty percent independents to seventy-five independents.").

[291] *Id.* at 1522–23 (noting the link between the hostile takeover movement in the shift toward independent directors).

[292] Bank et al., *supra* note 9, at 82 (citing sources from the 1940s and 1950s indicating that corporate executives were the people setting executive compensation).

[293] Arch Patton, *Those Million-Dollar-a-Year Executives*, 63 HARV. BUS. REV. 56, 60 (1985) (contrasting the transactional executive, emerging in the 1980s, to the prior executive archetype that was deeply ingrained into the corporation).

era, this pattern is currently reflected in how Japanese board members, who set reasonable executive compensation, have risen through the ranks at their company[294] and are therefore all non-independent insiders with a close and loyal relationship to the corporation.[295]

In contrast, U.S. board members on compensation committees are not drawn from within the company for the most part[296] and have little interaction with the company stakeholders such as employees.[297] The information they use to judge the CEO performance does not come from workers implementing the company strategy on the frontlines[298] but rather from personal interactions between the board members and the CEO.[299] The end result of this reliance on independent directors to set executive compensation is that "having a high level of independence appears (counter-intuitively) correlated with high executive compensation."[300] This is a key reason that giving employees, as company stakeholders, the power to negotiate executive compensation will prevent the dynamic whereby executive compensation decision-makers act as though they are spending other people's money.

Because members of U.S. compensation committees face such low personal stakes, their stronger connection[301] and sense of identification[302] with the CEO than with company stakeholders creates social pressures toward consensus and conflict-avoidance in setting executive pay.[303] Without information about the company coming from people other than the CEO,[304]

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[294] Jackson, Jr. & Milhaupt, *supra* note 107, at 123–24 (describing Japanese boards as populated from the ranks of senior management).

[295] Salazar & Raggiunti, *supra* note 12, at 726 (noting that Japanese boards have "very little influence from 'outsiders'").

[296] Michael, *supra* note 3, at 797–98; Rhee, *supra* note 5, at 717 (noting that public companies must have independent board members on the compensation committee).

[297] Beecher-Monas, *supra* note 12, at 126 (noting the weak contact between the compensation committee and other people in the company).

[298] Rhee, *supra* note 5, at 758 ("Employees can monitor senior executive performance better than shareholders because they possess inside information, and they have direct incentives to monitor.").

[299] Beecher-Monas, *supra* note 12, at 119 (observing that the CEO provides the compensation committee with the information it uses); Michael, *supra* note 3, at 797.

[300] Beecher-Monas, *supra* note 12, at 121.

[301] Michael, *supra* note 3, at 798–99 (noting the interrelationships between CEO and "independent" board members); Staihar, *supra* note 46, at 489–90.

[302] Beecher-Monas, *supra* note 12, at 120 (noting that compensation committee members are often CEOs from other companies).

[303] Staihar, *supra* note 46, at 489–90 ("Directors can have an interest in promoting an atmosphere of congeniality."); Michael, *supra* note 3, at 798 ("The culture of a corporate board or committee is not designed to support debate and contention, but rather to build or ratify consensus."); Holmstrom, *supra* note 24, at 705–06 (admitting, as a sitting board member, that he places no downward pressure on executive compensation in order to avoid contention).

[304] Beecher-Monas, *supra* note 12, at 119 (observing that the CEO provides the compensation

"groupthink" processes such as herding and social cascades tend to take hold in these decision-making environments.[305] Also, collective decision-making can exacerbate mental heuristics,[306] such as overvaluing the current CEO for fear of changing to a different, unknown CEO.[307] Such mental heuristics are even more powerful when groups evaluate the price of something with indeterminate value[308] such as the contribution of an executive.[309] Finally, this process also likely allows the executive to accept escalating pay because it is coming from objective outsiders.

While current corporate rules and practices promote CEO pay-setting by outside directors,[310] the evidence does not indicate that they are effective guardians of efficient, competitive executive compensation packages. In Japan, companies that switched from company leaders setting executive pay to compensation committees were more likely to see a rise in executive compensation, especially for large firms.[311] In the United States, the percentage of outside directors on compensation committees has been associated with higher CEO pay.[312] Though there is some disagreement among researchers on this point,[313] one of the most solid conclusions was that independent directors

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committee with the information it uses); Michael, *supra* note 3, at 797–98.

[305] Dorff, *supra* note 19, at 2029–30 (describing "groupthink" processes such as social cascades, which occur when opinions expressed first sway others without much critical thought); Beecher-Monas, *supra* note 12, at 129 (describing herding as following the group against better judgment).

[306] Beecher-Monas, *supra* note 12, at 125 ("[C]ollective processes tend to magnify systematic errors.").

[307] Robert W. Hahn & Robert N. Stavins, *The Effect of Allowance Allocations on Cap-and-Trade System Performance*, 54 J.L. & ECON. 267, 276 (2011) (describing the endowment effect); F. Gregory Lastowka & Dan Hunter, *The Laws of the Virtual Worlds*, 92 CAL. L. REV. 1, 36 (2004) (noting that people overvalue what they have).

[308] Beecher-Monas, *supra* note 12, at 123 ("[G]roup processes may skew the decision away from the optimal solution when there is no clear right answer.").

[309] Westbrook, *supra* note 10, at 1052 (arguing that evaluating the value of a CEO is as difficult as evaluating the impact of a political leader); Stabile, *Motivating Executives*, *supra* note 91, at 263 (noting that executive output is difficult to ascertain because it is collective and intangible).

[310] Michael J. Segal, *2017 Compensation Committee Guide*, HARV. L. SCH. F. CORP. GOVERNANCE & FIN. REG. (Mar. 29, 2017), https://corpgov.law.harvard.edu/2017/03/29/2017-compensation-committee-guide/ [https://perma.cc/DDW2-GZRP] (noting the NYSE rules proposing the appointment of independent directors to compensation committees).

[311] Jackson, Jr. & Milhaupt, *supra* note 107, at 114 (finding that Japanese firms switching to compensation committees experienced a stronger relationship between firms size and CEO pay).

[312] John Core et al., *Corporate Governance, Chief Executive Officer Compensation, and Firm Performance*, 51 J. FIN. ECON. 371, 372 (1999); Alan Dignam, *Remuneration and Riots: Rethinking Corporate Governance Reform in the Age of Entitlement*, 66 CURRENT LEGAL PROBS. 401, 409 (2013) (arguing that independent/non-executive directors create distance between people who decide executive compensation and company stakeholders with interest in limiting executive compensation).

[313] Ian Gregory-Smith, *Chief Executive Pay and Remuneration Committee Independence*, 74 OXFORD BULL. ECON. & STAT. 510, 520–21 (2012) (reporting no relationship between CEO pay

vary in quality, with those who have many other obligations and social networks mainly at the top of companies providing systematically higher executive compensation.[314] A prominent defender of free market institutions has therefore commented that "relations among managers, outside directors, and compensation consultants tend to inflate executive compensation."[315]

The flaws in the process of setting executive compensation are that the decision-makers have nearly no information about the inner-workings of the company, little motivation to limit spending, and significant social pressures against critical thinking.[316] This analysis indicates that executive compensation would be much more efficient if CEOs negotiated their pay directly with other employees.

B. *The Flawed Reasoning in Setting Executive Compensation*

The flaws in the executive pay-setting process inevitably lead to problematic reasons for setting certain amounts of executive pay. These flawed reasons include the Lake Wobegon effect, pay for value threatened rather than for value created, and executive pay as a Veblen good—all of which explain the escalation we see in executive compensation practices.

First, the social pressures, limited information, and lack of consequences facing outside directors allow compensation committees to fall victim to mental heuristics. The human tendencies to overvalue the things we have[317] and believe our performance is better than others[318] likely lead board members to believe their CEO is above average.[319] This "Lake Wobegon Effect" (valuing your CEO as above-average) is often defended as a calculated move to avoid signaling inept leadership or financial problems to investors.[320]

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and director independence); Paul M. Guest, *Board Structure and Executive Pay: Evidence from the UK*, 34 CAMBRIDGE J. ECON. 1075, 1077 (2010) (reporting a link between independent/non-executive directors and the link between pay and performance—however, this may only indicate a greater proportion of stock options as payment, which increase wage inequality during economic good times).

[314] *See generally* Luc Renneboog & Yang Zhao, *Us knows us in the UK: On director networks and CEO compensation*, 17 J. CORP. FIN. 1132 (2011) (summarizing findings).

[315] George W. Dent, Jr., *The Essential Unity of Shareholders and the Myth of Investor Short-Termism*, 35 DEL. J. CORP. L. 97, 145 (2010) (quoting Richard Posner).

[316] Salazar & Raggiunti, *supra* note 12, at 723 (arguing that the problems of executive compensation will continue until incentives change).

[317] Hahn & Stavins, *supra* note 306, at 276–77 (describing the endowment effect).

[318] Sean H. Williams, *Sticky Expectations: Responses to Persistent Over-Optimism in Marriage, Employment Contracts, and Credit Card Use*, 84 NOTRE DAME L. REV. 733, 742–43 (2009) (describing the pervasiveness of the optimism bias).

[319] Beecher-Monas, *supra* note 12, at 121–22 (noting that all directors want to believe that their CEO is at least average, if not above average).

[320] Walker, *supra* note 12, at 657 (arguing that no board wants to admit that their CEO is below

However, these considerations are not applied to the pay of regular workers. A more likely explanation is therefore that conflict-avoidant directors with no personal stakes in the decision set above-average executive compensation because they have no incentive or ground to be critical of the CEO.[321]

While individual instances of the Lake Wobegon Effect may appear relatively harmless, setting above-average CEO pay leads to problematic escalation when all companies benchmark CEO pay against the executive compensation of competitors.[322] Systematically setting annual CEO pay above the typical rate leads to an "endless upward spiral in CEO pay"[323] and is a key reason that executive compensation exploded in the 1990s.[324] If non-executive workers do not also have their pay set above the industry average each year, then having the CEO negotiate executive compensation with employees will likely end this benchmarking practice.

The next flawed reason for escalating executive pay is payment for value threatened rather than for value added. While all employees should be compensated based on the value they add to the company,[325] directors place much focus on shareholder value when considering executive compensation.[326] These incentives lead to a mode of thinking in which a sudden or noisy departure of a CEO from the company would portend negative nonpublic information and lead to a short-term decline in stocks.[327] When directors focus on short-term stock prices[328] for companies whose stock is worth billions, they can enter a mode of thinking in which the CEO is "worth" billions of dollars.[329] This mode of thinking does not measure the CEO's worth through

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average); Staihar, *supra* note 46, at 491 (adding that below average CEO pay could signal financial problems).

[321] Observe the flippant, breezy manner in which a commentator describes the rationale going into setting executive pay: "we pay him in the top quartile, because we think it is important that he feels appreciated." *See* Holmstrom, *supra* note 24, at 705 (defending this comment, the author notes that "we want to avoid arm's-length bargaining. Compensation is a sensitive matter.").

[322] Walker, *supra* note 12, at 657 (describing benchmarking as "ubiquitous").

[323] Dent, Jr., *supra* note 315, at 145.

[324] Holmstrom, *supra* note 24, at 707 ("Benchmarking is an essential piece of the puzzle of why executive pay rose so dramatically in the 1990s.").

[325] Plass, *supra* note 11, at 615 ("[F]irms view a competitive wage as one the worker individually negotiates that corresponds to his productive output.").

[326] Segal, *supra* note 310 (describing the NYSE rules for long-term incentives as requiring the committee to consider shareholder returns, wages of CEOs at comparable companies, and pay packages from prior years). While NYSE rules do require the compensation committee to consider goals and CEO performance, researchers argue that executive compensation are based on stock prices more than performance. *See* Bivens & Mishel, *supra* note 26, at 63.

[327] Holmstrom, *supra* note 24, at 707 (describing a thought experiment involving Lord John Brown leaving BP).

[328] Salazar & Raggiunti, *supra* note 12, at 737 ("[I]f corporations are run exclusively in the interests of shareholders, the business will be driven to pursue short-term profit . . . .").

[329] Holmstrom, *supra* note 24, at 707.

value added but rather through short-term value threatened.[330] This also explains why the size of firms are the best predictors of executive compensation[331] for companies that use compensation committees[332]—the larger the firm, the greater the value threatened. In this way, rather than indicating harder work or greater ingenuity, higher pay for CEOs of larger companies becomes the product of disinterested directors having access to more wealth to transfer to executives.[333] Because other workers are evaluated based on their value added, they would not likely allow such a measure to stand if they negotiated executive compensation with the CEO.

Another flawed reason escalating executive pay is the perception that executives, unlike other employees, are a Veblen good. A Veblen good, or luxury good, is an item that experiences higher demand because it has a high price, contrary to the laws of supply and demand.[334] Executive compensation is treated like a Veblen good when it is used to signal financial strength to shareholders rather than signaling the executive's actual performance.[335] However, actual Veblen goods are scarce and purchased to demonstrate the buyer's ability to purchase such rarities.[336] Commentators ignore this point when they assume that a small number of highly paid executives means that top executives are themselves scarce and not the product of increasing economic concentration into fewer companies.[337] The problem with paying the CEO a lavish amount in order to demonstrate status and financial strength is that this rationale is not applied to lower-paid employees. In other words, defenders of current CEO pay practices do not argue that companies should

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[330] Please note that the author does not subscribe to this mode of thinking. The point of this section is to show that this mode of thinking is adopted by reputable defenders of current executive compensation practices.

[331] Michael, *supra* note 3, at 801 (pointing out that the single best predictor of executive compensation is not CEO performance but firm size); Jackson, Jr. & Milhaupt, *supra* note 107, at 119 (noting the correlation between CEO pay and firm size).

[332] Jackson, Jr. & Milhaupt, *supra* note 107, at 114 (finding that Japanese firms switching to compensation committees experienced a stronger relationship between firms size and CEO pay).

[333] Thomas, *Explaining the International CEO Pay Gap*, *supra* note 102, at 1211 (noting that CEOs at larger firms are paid more because "bigger firms have more resources." Though the author explains this with tournament theory, he does not argue that an executive would need greater motivation to become CEO of a large company—if anything, the prestige of such a position could effect a pay cut for many talented executives).

[334] Paul F. Campos, *The Extraordinary Rise and Sudden Decline of Law School Tuition: A Case Study of Veblen Effects in Higher Education*, 48 SETON HALL L. REV. 167, 174 (2017) (describing a Veblen good).

[335] Westbrook, *supra* note 10, at 1060 (admitting that CEOs are treated as Veblen goods in order to create the appearance of status).

[336] Jeremy N. Sheff, *Veblen Brands*, 96 MINN. L. REV. 769, 797 (2012) (noting the role of scarcity in the purchase of Veblen goods).

[337] Dorff, *supra* note 19, at 2029 (arguing that CEOs are highly paid because executive talent is rare, as if the MBA was not the most popular graduate degree).

demonstrate their financial strength by raising pay for median or low-wage workers.[338] CEOs negotiating their pay with workers would likely change this thinking.[339]

The key problem with the motivations and incentives produced by our flawed executive compensation process is that it ignores alternative company uses for those resources. Outside directors pinning company successes—but not failures[340]—on only the top executive ignores the reality that corporations are collective endeavors, with contributions by lower-paid employees.[341] If these non-executive employees were given the power to negotiate executive compensation, then the CEO's performance would be directly compared to the performance of other employees. Also, additional money in CEO pay would need to outweigh the potential value of other employees' unfunded project ideas.

Without these constraints, CEOs face incentives in the form of higher pay for cutting company expenditures on the pay and projects of other employees.[342] This all supports a larger theoretical point of this article, describing the tendency of imperfect capitalist institutions to expand economic inequality.

VI. DOING MORE WITH LESS AS THE LINK BETWEEN CAPITALISM AND INEQUALITY

Though Adam Smith theorized that a well-ordered market would not produce rising inequality,[343] there is a growing sense that the unchecked tendency of capitalism is toward rising inequality as the rich get richer.[344] To contribute to this discourse, this article presents a simple and compelling explanation for why capitalism produces inequality in an economy with large corporations: under capitalist incentives for efficiency, people who can do

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[338] Westbrook, *supra* note 10, at 1060 (arguing that CEO pay is based on what is "prestigious" rather than what is "reasonable").

[339] As a note of a positive example, Jeff Bezos raised the minimum wage of his employees as a challenge to other retailers because it was the right thing to do. Jeff Bezos, *2018 Letter to Shareholders*, ABOUT AMAZON (Apr. 11, 2019), https://blog.aboutamazon.com/company-news/2018-letter-to-shareholders [https://perma.cc/VJ2J-EH2U].

[340] Beecher-Monas, *supra* note 12, at 110 ("[A]djusting pay downward for poor performance is a rare phenomenon.").

[341] Rhee, *supra* note 5, at 708 (noting the collective nature of the corporation).

[342] Plass, *supra* note 11, at 609 (noting executive incentives, how resources are increasingly channeled to executives, and how executive performance does not need to be linked to productivity gains).

[343] Njoya, *supra* note 5, at 400–01 (describing Adam Smith's theories on a well-ordered market).

[344] Geoffrey M. Hodgson, *How Capitalism Actually Generates More Inequality*, EVCONOMICS (Aug. 11, 2016), http://evonomics.com/how-capitalism-actually-generates-more-inequality/ [https://perma.cc/33P9-BP8T].

more with less will do more with less.

This section will first explain how economic organizations doing more with less links capitalism to inequality. It will then explore how the evolution of corporations—contributing to inequality by rewarding people for doing more with less—paralleled and contributed to the evolution of the labor union as the organization balancing efficiency with concerns for equality. Finally, this section concludes with a reprisal of the theory of doing more with less to show how future developments in the economy might temper inequality outside of the work of large economic organizations.

A. *Capitalism and Inequality Within a Company*

Under the drive toward efficiency, capitalism will tend toward inequality as businesses find ways to do more with less. The reason for this is that, within economic organizations such as corporations, doing more with less rewards employees for reducing the economic power of other employees at or below their level. This argument proceeds in three steps.

First, doing more with less concentrates economic power in efficient units of the corporation, as a capitalist organization.[345] The reason for this is that efficiency is rewarded with promotions or pay increases that are less expensive than the inefficiency replaced.[346] For example, doing more with less often means finding ways to increase labor productivity while reducing labor costs. Employees of a corporation who find ways to replace other employees will gain economic power at the expense of the economic power of others.

This tendency for economic power to concentrate in efficient workers and units does not inherently lead to inequality within organizations. If employees were able to reduce inefficiency in their higher-ups, then organizations could tend toward efficiency in all directions. This would involve, for example, employees terminating an overpaid boss by dividing up the boss's work or replacing the boss with an employee on their level. However, this is not how corporate hierarchies work.

Therefore, the second part of the argument for how doing more with less in an economic organization leads to inequality is that employees are only able to create efficiencies at or below their respective positions in the organization. By doing more with less only at or below their own level, participants in capitalist corporations will reduce resources at lower levels and gain rewards

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[345] Mark J. Perry, *Why Socialism Failed*, FOUND. FOR ECON. EDUC. (May 31, 1995), https://fee.org/articles/why-socialism-failed/ [https://perma.cc/Z2M7-ZB34] ("[I]t is essential for an economic system to be based on a clear incentive structure to promote economic efficiency.").

[346] Amy Gallo, *When to Reward Employees with More Responsibility and Money*, HARV. BUS. REV. (Jan. 12, 2011), https://hbr.org/2011/01/when-to-reward-employees-with.html [https://perma.cc/H92Q-PESY].

for efficiency at higher levels. Each instance of employees creating efficiency allows for a marginally unequal distribution of resources.

Third, a system that allows participants to do more with fewer resources at or below—but not above—each participant's level in the corporation will systematically tend toward concentrating economic power upwards in the hierarchy. As the following section explores, this tendency toward inequality within large organizations encouraged the rise of countervailing power structures to express repulsion for unjust inequality and the need for group cohesion.

B. *Corporations and Labor Unions: Efficiency vs. Fairness and Cohesion*

The parallel histories of corporations and labor unions in the United States tell a story of the tension between efficiency in hierarchical capitalist corporations and the human drives for fairness and cohesion. This historical analysis describes corporations concentrating wealth in fewer and fewer hands, leading to opposition by state regulation and organized workers.

Corporations are primarily economic organizations that bind individual contributors into indivisible units.[347] This involves shareholders providing the funding, directors representing shareholders as the ultimate corporate authority, and executives hired by the directors to manage the corporation.[348] Notably, employees do not have a formal position in this structure.[349] Though corporations were originally required to serve a public purpose, they now act primarily in the interests of shareholders as owners of the corporation.[350] As creations of the state, corporations are limited in their ability to combine the economic power of individuals based on their political power,[351] which derives from their social support in democracies.[352] The social support for corporations tends to follow their economic power, which derives from the societal need for

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[347] Robert L. Raymond, *The Genesis of the Corporation*, 19 HARV. L. REV. 350, 352 (1906) ("The germ of the corporate idea lies merely in a mode of thought; in thinking of several as a group, as one."); David Ciepley, *The Corporation Is Always Already Government-Supported, and So Is Bankruptcy*, 11 GEO. J.L. & PUB. POL'Y 349, 364 (2013) (describing asset lock-in and entity shielding as the essential elements of a corporation).

[348] Rhee, *supra* note 5, at 700–01 (noting the "triad of the board, management, and shareholder").

[349] *Id.* ("Employees have virtually no formal role in the internal affairs under U.S. corporate law.").

[350] Coleman & Friedler, *supra* note 247, at 202 (noting that corporations must satisfy their shareholders as owners).

[351] *See* Bratton, Jr., *supra* note 202, at 1526 (describing the fluctuations between legal treatment of corporations as collectives or aggregations of individuals based on the economic and social needs of the public).

[352] Wells, *"Corporation Law Is Dead"*, *supra* note 68, at 314 (describing the social mistrust corporations needed to overcome).

large-scale organized activity in the economy.[353] In this way, the power of corporations to channel and combine the wealth of many people depends on the good they can do for the broader society.

Labor unions similarly bind individuals into collective organizations.[354] Union power depends on its ability to attract members with collective benefits,[355] at the risk sacrificing individual self-interest.[356] To achieve this support, unions pursue a mission to claim a greater share of corporate earnings for their members.[357] The legal power of unions have depended on the societal perception that unrestrained corporations are not producing fair outcomes.[358] This social support for unions, therefore, depends on a sense that legal protections for unions would serve the larger society, which depends on their ability to represent worker interests effectively.[359]

The parallel histories of corporations and unions demonstrate how concentrated power in either corporations or labor organizations can encourage rising power in the other and how shared power benefits both sets of interests.

Before the development of industrialization in the 19th- century, the economy was "atomistic" with the brunt of economic activity conducted by smaller organizations[360] while large corporations were rarer public endeavors requiring a public purpose and specific authorization by the government.[361]

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[353] *Id.* at 312 (noting that the corporation as individualistic or collectivist institution tends to change with the surrounding economic environment).

[354] Michael J. Yelnosky, *What Do Unions Do About Appearance Codes?*, 14 DUKE J. GENDER L. & POL'Y 521, 531 (2007) ("Unions exist to aggregate the preferences of their members . . . ."); Melvyn Dubofsky, *Legal Theory and Workers' Rights: A Historian's Critique*, 4 INDUS. REL. L.J. 496, 499 (1981) (describing unions as contradictions of disciplining members and inviting their participation).

[355] Plass, *supra* note 11, at 626 (noting that increasing membership allowed unions greater economic power).

[356] Crain, *supra* note 233, at 1832–33 (describing the commitment of members as the source of union power).

[357] Craver, *supra* note 238, at 72 (noting that an early labor organization stated its goal as giving workers "'a proper share of the wealth that they create . . . .'"); Cochran, III, *supra* note 233, at 472 (describing a key goal of the NLRA as relieving "the maldistribution of wealth"); Gifford, *supra* note 173, at 141 (describing the goal of the labor union is "the economic betterment of its members").

[358] Gifford, *supra* note 173, at 98 (arguing that twentieth century societies believe that free market wages are unfair).

[359] Brent Radcliffe, *Unions: Do They Help or Hurt Workers?*, INVESTOPEDIA (June 25, 2019), https://www.investopedia.com/articles/economics/09/unions-workers.asp (noting that unions claim to raise wages and improve working conditions) [https://perma.cc/A28Q-ABCT].

[360] Bratton, Jr., *supra* note 202, at 1483 (describing preindustrial economies as "atomistic"); Colombo, *supra* note 247, at 10 ("Prior to the twentieth century, corporations were generally smaller, and still often governed by their owners.").

[361] Raymond, *supra* note 347, at 362–64 (describing the fifteenth century conception of the corporation as sovereign concession).

Unions at this time were craft guilds that focused on professional standards[362] because economic activity was too disjointed for collective bargaining.[363]

Then, industrialization in the late nineteenth century allowed for the rise of both large corporations and powerful labor unions.[364] The scale and complexity of economic activity under developing industrial technologies[365] made large public corporations an efficient organization of economic activity.[366] This economic need for corporate organization led to social demand for easier access to legal incorporation.[367] Rising union power followed the rise of large-scale corporations as industrial technology allowed for more demanding working conditions[368] and collective work stoppages created larger economic impacts.[369]

In the early 20th- century, the modern corporation emerged as a hierarchy of operational divisions, staffed by increasingly specialized management and labor functions.[370] While the captains of industry that were the owners and operators of large companies were seen as paternal, public benefactors,[371] workers likely saw managers as fellow employees who were paid more. The rise of highly-paid managers,[372] especially amid the Great Depression, created

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[362] Craver, *supra* note 238, at 71 (describing the origins of labor unions in the craft guilds of the late eighteenth and early nineteenth century).

[363] Matthew Dimick, *Productive Unionism*, 4 UC IRVINE L. REV. 679, 683 (2014) (noting that the local nature of early markets meant that strikes and collective bargaining were not union tools).

[364] Steven R. Morrison, *Requiring Proof of Conspiratorial Dangerousness*, 88 TUL. L. REV. 483, 496 (2014) (noting the simultaneous rise of corporations and labor unions).

[365] David E. Bernstein & Thomas C. Leonard, *Excluding Unfit Workers: Social Control Versus Social Justice in the Age of Economic Reform*, 72 L. & CONTEMP. PROBS. 177, 178–79 (2009) (describing the development of transportation and communication infrastructure that made industrialization possible); Coleman & Friedler, *supra* note 247, at 195–96 (noting that increasing size and scale of business activity makes the corporate form attractive).

[366] Lyman Johnson, *Law and Legal Theory in the History of Corporate Responsibility: Corporate Personhood*, 35 SEATTLE U. L. REV. 1135, 1144 (2012) (noting that the corporate form proliferated in the early 19th- century).

[367] *Id.* at 1145–46 (describing the spread of general incorporation statutes); Coleman & Friedler, *supra* note 247, at 194–95 (noting the social acceptance of corporations as industrialization progressed).

[368] Bernstein & Leonard, *supra* note 365, at 178–79 (describing the technological and social changes that contributed to the rise of labor unions).

[369] Morrison, *supra* note 364, at 491 (noting "for the first time, large combinations of workers could apparently affect large swaths of the economy" through collective action).

[370] Bratton, Jr., *supra* note 202, at 1488–89 (describing the economic advantages created by the emergence of the modern management corporation); Wells, *The Fight over Executive Compensation*, *supra* note 201, at 692–93 (describing why executive management replaced proprietary management).

[371] James N. Gilbert, *John Steinbeck and the Law: Literary Cause and Judicial Effect*, 10 S. CAL. INTERDISC. L.J. 1, 5 (2000) (describing the social conception of industrial leaders prior to the Great Depression).

[372] Carbone & Levit, *supra* note 207, at 983 (noting that the stock market boom of the 1920s

public support for a mechanism that would more evenly divide wages among corporate employees.[373] After Congress declared collective bargaining as the national strategy for reducing income inequality,[374] organized labor grew in power[375] eventually leading to capitulation and a truce by corporate elites.[376]

Under this national labor-management accord, unions would maintain an orderly workforce and management would divide the rewards of capitalism more evenly.[377] In an environment of minimal foreign competition[378] and social togetherness following the victory of World War II and the threat of the Cold War,[379] management chose to adopt a collectivist mindset[380] and public role.[381] Though managers could have opted to wield their post-war economic power to conduct prolonged industrial warfare with labor, they instead decided to cooperate with labor unions,[382] which were then also seen as an essential part of the economy and society.[383] The result was an economy that likely grew faster than it would have if corporate executives opted to continue to resist the collective bargaining rights of workers, as reasonably-paid managers worked alongside employees who could afford a middle-class lifestyle.[384]

But, labor unions did not turn out to be the effective structure to advocate for fair wages within economic organizations in the long run. Unions became

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coincided with the rise of executive compensation).

[373] Bank et al., *supra* note 9, at 64 ("Executive pay became a public issue as the 1930s began due to revelations that cast a harsh light on compensation practices during difficult economic times."); Wagner, *supra* note 65, at 553 (reporting a 1936 poll indicating that most Americans believed that corporate executives are paid too much).

[374] Gifford, *supra* note 173, at 88 (noting the purpose of the NLRA "to facilitate a redistribution of income to the working classes"); Smith, *supra* note 211, at 693 (noting the change in public policy "from repression to strong encouragement of union activity").

[375] Mizruchi & Hirschman, *supra* note 218, at 1087–88 (noting the "broad increase in unionization" in the 1930s).

[376] *Id.* at 1067 (describing how post-war business elites accommodated government intervention and labor power).

[377] *Id.* at 1088 (describing the cooperative arrangement between labor and management).

[378] Gifford, *supra* note 173, at 116–17 (noting post-war economic conditions).

[379] *See* Wells, *"Corporation Law Is Dead"*, *supra* note 68, at 319 (describing the social cohesion of the middle decades of the twentieth century).

[380] *Id.* at 310 (noting the overriding loyalty to the corporation represented by managerialism).

[381] Bratton, Jr., *supra* note 202, at 1497 (noting that large corporations in the middle decades of the twentieth century were seen as public in nature).

[382] Carbone & Levit, *supra* note 207, at 990 (describing executives in the 1940s to the 1970s focused more on company loyalty than lucrative pay packages).

[383] Gifford, *supra* note 173, at 90 (noting that labor unions were seen as an essential part of society in the 1950s); Wells, *"Corporation Law Is Dead"*, *supra* note 68, at 325 (noting that unions and corporations were both seen as social institutions).

[384] Beecher-Monas, *supra* note 12, at 135 (linking pay disparities between executives and workers as eroding the middle class and encouraging excess debt).

bureaucratic,[385] corrupt,[386] and inflexible in the face of changing economic conditions.[387] The reinforcing feedback loop of economic power and political power of unions then created a death spiral in which decreased effectiveness in representing and organizing workers led to greater opposition by management,[388] fewer rewards for members,[389] less support by workers and society,[390] and weakening legal powers,[391] which further decreased union effectiveness.

This led corporate America to focus on efficiency and shareholder value rather than wage equity.[392] With wage inequality increasing in the absence of a mechanism to place reasonable limitations on executive compensation, the above history describes society's inevitable drive to balance the increasing economic inequality that occurs within capitalist business organizations. If unions have proven ineffective in moderating wage inequality, the above trends indicate that society will search for another solution to the problem.

One unexpected source of solutions could be the business elites themselves. Recognizing company benefits of employee empowerment and company culture,[393] managers may embrace new ways of demonstrating commitment to their employees.[394] This will become important as increasingly sophisticated ways of doing more with less will allow those with less to do

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[385] Crain, *supra* note 233, at 1835 (describing unions as a hierarchical, bureaucratic organization that restricts the rights of members); McHenry, *supra* note 233, at 601 (noting the "current system has become a broken, bureaucratic maze").

[386] Staihar, *supra* note 46, at 494 ("Union leaders can also fall prey to corruption . . . .").

[387] Cochran, III, *supra* note 233, at 460 (noting that the mainstream view of labor-relations in the United States is that the adversarial model is outdated).

[388] Katherine Van Wezel Stone, *The Legacy of Industrial Pluralism: The Tension Between Individual Employment Rights and the New Deal Collective Bargaining System*, 59 U. CHI. L. REV. 575, 579–80 (1992) (describing the employer-opposition theory for the decline of unions).

[389] Plass, *supra* note 11, at 634 (noting that unions have had trouble attracting new members and thereby improving their economic power under current laws).

[390] *Id.* at 635–36 (noting that union wage premiums are blamed for reducing the economic power of U.S. firms, unions, and workers).

[391] Van Wezel Stone, *supra* note 388, at 584 ("Legal rules not only determine power, but are also a result of power.").

[392] Gordon, *supra* note 238, at 1520 (noting that the 1980s marked the return of corporations to focusing on maximizing shareholder value); Jones, *supra* note 250, at 747–48 (stating that unions have been under attack in the United States since the late 1960s).

[393] Mike Kappel, *How To Establish A Culture Of Employee Engagement*, FORBES (Jan. 4, 2018, 11:00 AM), https://www.forbes.com/sites/mikekappel/2018/01/04/how-to-establish-a-culture-of-employee-engagement/#dea06ff8dc47 [https://perma.cc/D9YW-ESQ8] (recognizing the link between employee engagement and company success).

[394] *Business Roundtable Redefines the Purpose of a Corporation to Promote 'An Economy That Serves All Americans'*, BUS. ROUNDTABLE (Aug. 19, 2019), https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans [https://perma.cc/8RQS-JWQP].

more.

C. *Capitalism and Inequality Redux*

While doing more with less inside a hierarchical corporation leads to rising levels of income inequality, this is not the case for the larger economy. Technologies and skills that allow people to do more with less also means that people with less will be able to do more. While an industrial economy centers on large corporations to facilitate intricate levels of cooperation on a national scale, the rise of a service and knowledge economy could mean a return to, or a reintegration of, an atomistic economy. As skills and expertise spread more easily and sophisticated technologies become more affordable, doing more with less can mean recording studio-quality music in basements, creating tech startups in garages, and producing novel research with only a laptop and an internet connection.

However, this productive (as opposed to the reductive) side of doing more with less could emerge within corporations. Encouraging employees to do more with less means allowing them to start projects, pursue training, and lead from the bottom. While the concept of CEOs negotiating pay with lower-paid employees would more directly impact the inflation of executive compensation, it may also serve as a tool for employee engagement and empowerment.

Under a process of executive bargaining, the average employee would have an opportunity to present alternative uses for company funds that would otherwise go into executive compensation. This could be part of an overall strategy of allowing efficient employees to do more with less, not by having them take on additional work from their inefficient, expendable colleagues, but rather by empowering them to use their extra capacity to start projects and acquire skills. Just as business elites accommodated their workers in the middle decades of the 20th- century, they could renew this effort with new and better mechanisms for workplace cooperation.

VII. CONCLUSION

Executive compensation would be more efficient and equitable if CEOs faced incentives for negotiating their pay in company resources with employees from across the corporation. The problem with the current CEO pay-setting process is that compensation committees, unlike lower-paid employees, do not have the information or incentives to negotiate competitive wages for executives. Historical and comparative analysis indicates that executive compensation has tended to be reasonable in systems where management regularly negotiates with and has a closer relationship with workers. One potential avenue for the reasonable use of company resources in executive compensation is for CEOs to negotiate their pay with lower-paid

employees.

The other core theoretical proposal in this article is an explanation for why unrestrained corporations will tend toward income inequality over time. The capitalist drive toward efficiency will incentivize people to do more with less. Doing more with less means that efficient employees will draw economic power and responsibility away from less efficient employees. Because corporate hierarchies only allow employees to create efficiencies at or below their respective levels, the economic power in a company will accumulate toward the top over time. While this same force may help people with less to do more, so long as large corporations occupy a significant position in the economy, it will be important to adopt mechanisms that place reasonable and flexible constraints on income inequality in large, public companies.

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