

## Waging a Ratio

Federal policy could set self-adjusting pay equity standard. Albany Times Union, Perspective section, B1-B2, 5 June 2005.

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Congress recently debated and rejected an increase in the Federal minimum wage. The defeat of the hike was not surprising -- Congress has raised the minimum wage only twice since 1980, the last time in 1997, and there are always strong feelings on either side of the debate. This time Democrats urged a near fifty percent increase, restoring the wage to the purchasing power it enjoyed in its heyday of the 1970s and 80s. Republicans expressed fears that such a rise would price minimum wage labor out of the market, unemployment would increase, and jobs would go wanting.

But it is time to recognize that the minimum wage is really a low leverage policy. There's a much better way to accomplish the various goals people have for equity and efficiency in wages, and it involves not just the minimum wage folks, but high-paid executives too.

The minimum wage was first established in 1938, starting at \$.25 an hour. Congress has increased it eleven times in the 65 years since its inception. It now stands at \$5.15 an hour, a bit more than twenty times its initial value.

Between increases, inflation drags down the purchasing power of any wage. In real dollar terms, the equivalent of 2004 dollars, the annual minimum wage began in the Great Depression at about \$7,000. Congress increased it several times in the 1940s and 50s, reaching \$15,000 in 1961. Thanks to six hikes in the 60s and 70s, the minimum wage stayed between \$14,000 and \$16,000 all through that period.

But beginning in 1978 its purchasing power entered a long period of inflation-induced decline, during which Congress declined to increase it. Its value in 2004 dollars dropped to \$10,615 by 1989. There have been two increases since then, the last taking effect in 1997, each increase followed by the inexorable inflationary decline in the wage's purchasing power. In 2004, the annual minimum wage stood at \$10,712. Before 1989, the last time it was that low in real

### DATA SOURCES

#### *Minimum wage*

U.S. Department of Labor:  
<http://www.dol.gov/esa/minwage/cove>  
rage.htm

#### *Federal Poverty Thresholds*

Census Bureau:  
<http://www.census.gov/hhes/poverty/t>  
hreshld/thresh04.html

#### *Consumer price index*

Bureau of Labor Statistics:  
<ftp://ftp.bls.gov/pub/special.requests/c>  
pi/cpia.txt

#### *Top management compensation*

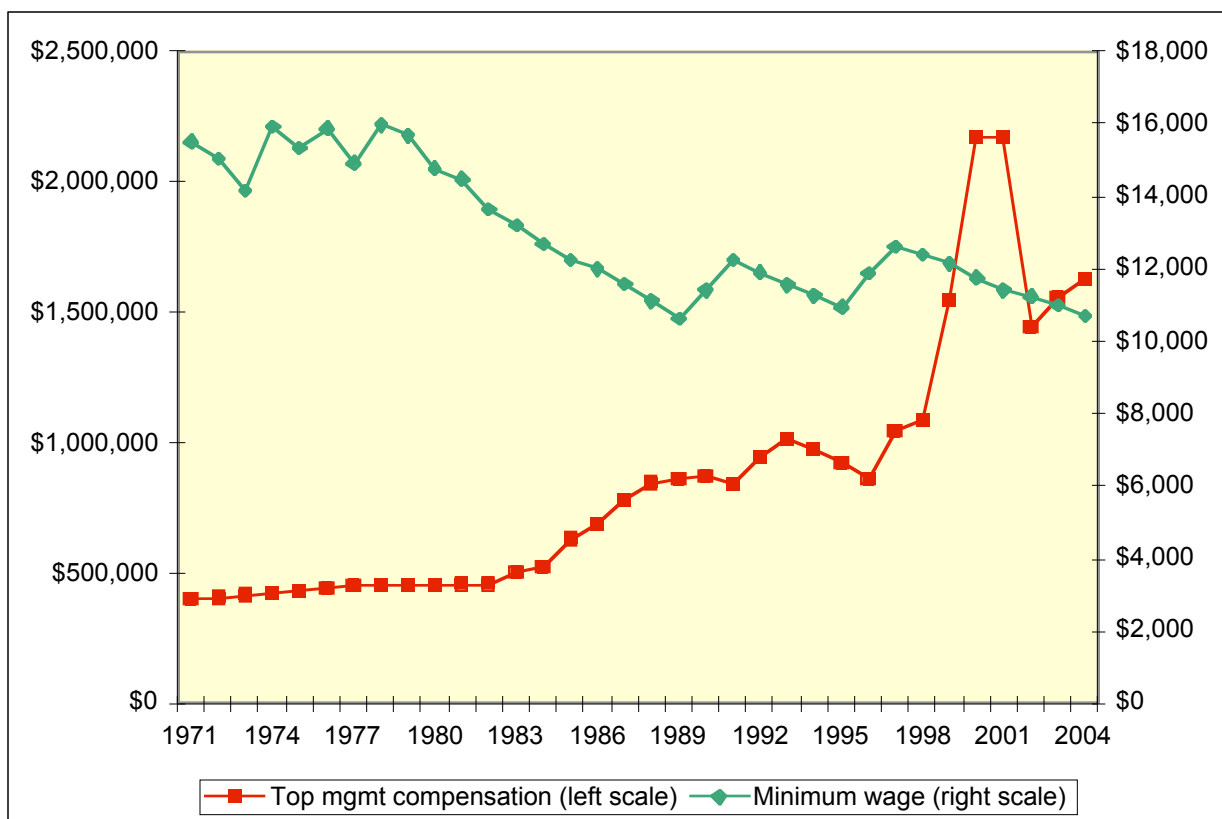
The Conference Board, Inc. reports  
573, 706, 753, 793, 827, 840, 854,  
875, 889, 935, 983, 1016, 1053,  
1099-94-RR, 1138-95-RR, 1204-97-  
RR, 1227-98-RR, 1258-99-RR  
[Some years are interpolated because  
of missing data]

These data were compiled by Kara  
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dollar terms was 1948. It is now less than the Federal government’s poverty threshold for a family of two.

The story of top management salaries is quite different. All through the 1970s, CEO compensation packages averaged between 26 and 30 times the minimum wage of the time. In the 1980s that ratio began to rise, reaching 80 in 1989. Through the mid-1990s, the ratio of CEO compensation packages to the minimum wage hovered around 80. Then it began to grow, reaching 190 by 2001. CEO compensation took a hit in 2002, dropping the ratio to 129, but resumed its rise again the next year. In 2004 the ratio reached 152 and is certain to rise further, as CEO compensation surges and inflation continues to erode the minimum wage.



So why have CEO compensation packages continued to rise in real dollar terms, and rise dramatically, while the minimum wage has eroded to historic lows? Cynics might argue that it’s because people don’t vote -- dollars vote -- and they always vote to preserve themselves. Dollars fuel campaign contributions, and contributions steer Congress toward legislation that protects, if not favors, the wealthy. Minimum wage earners, so the argument goes, don’t have that clout.

But that may not be the big engine of CEO compensation growth. More likely, it is “competitive escalation.” Each firm wants the best top management money can buy, so each tries to set its compensation packages above its competitors. Firm A hires Sam at \$2,000,000; firm B sees that and goes after Brenda with total compensation of \$2,400,000; firm C feels forced to make a still

higher offer; and so on. When firm A enters the CEO market again, it sees it has to reach more than \$3,000,000 to compete. That's an escalation phenomenon, and nothing stops it now except the ability of firms to pay compensation packages that big. There is even evidence that firms that can't afford such pay scales rearrange things so it looks like they can.

There are those who are troubled by soaring top management salaries while the purchasing power of average and minimum wages erode. It seems both immoral and unstable for a society to drive such a growing gap between its rich and poor. And it is a dramatic example of a kind of market failure: top management compensation appears to be a runaway cost. The phenomenon cries out for solutions that help to control the growing disparity between rich and poor and reduce the compensation strains on corporations without harming the strength of our economy.

So what should Congress do? Rather than focusing on short-term, stopgap maneuvers increasing the minimum wage by \$1 or \$2, or even \$3, Congress should reach for a policy that solves both the minimum wage problem and the inequity problem once and for all, without constraining the ability of anyone to make as much money as possible. The solution is to substitute for the minimum wage a "minimum wage ratio," or if you prefer, a "maximum compensation ratio."

Here's how it might work: Congress could establish a standard for the maximum ratio of top corporate compensation to the wage and benefits package of the lowest paid worker in a firm. We could take the standard that existed in the 1970s and say the maximum compensation ratio in every firm cannot exceed, say, thirty. If that's perceived as too low (so twentieth century), set the maximum ratio to forty, or even fifty. But set it, and enforce it through the income tax machinery. We would then have a Federally mandated "minimum wage ratio."

To raise top management compensation, a firm would have to raise the wages paid to its lowest paid workers. There would be no limit, of course, to how high any wages could go. The lowest and the highest would just have to stay within the ratio. Congress could set the ratio and forget it. No need for periodic updates, as with the minimum wage. No periods of declining purchasing power for those on the minimum wage, unless everyone is experiencing that. The policy is self-adjusting.

There are problems to work out about how such a policy could be implemented -- how to value stock options, how to handle sports and entertainment salaries, how to prevent corporations from gaming the policy, and so on. But it is time to recognize that periodic boosts to the minimum wage are like pushing on a string. They don't solve many problems in the short run and may even create some. It's time to stop thinking about pushing on that string, and switch to pulling on it from the other end. We should work through the implementation puzzles and set a Federal *minimum wage ratio* policy -- a *maximum compensation ratio* -- and set a self-adjusting standard for wage equity that reestablishes rationality in wages and compensation packages and is a model for equity and efficiency for the world's economies.