

The Politics of Upward (Re-?) Distribution:

Political Causes and Consequences of CEO Pay across Advanced Democracies

By Renira C. Angeles

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Supervisor: Achim Kemmerling

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Declaration

I hereby declare that no parts of the thesis have been accepted for any other degrees in any other institution. This thesis contains no material previously written and / or published by another person, except where appropriate acknowledgment is made in the form of bibliographical reference.

Renira C. Angeles

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Abstract

Since the 1970s, top income concentrations escalated, and generous bonus rewards appeared more frequently, though, this trend was more widespread in some democracies more than others. Why did some advanced democracies experience growth in top income share more so than others? The thesis disentangles the political causes and consequences of CEO pay. In doing so, it goes beyond current research, frequently using top income shares, by forming new political hypotheses tested with CEO pay data. The thesis exhibits three main findings and contributes to the political science debate on the politics of top income earnings, economic inequality, and the highly salient CEO compensations. First, across 17 OECD countries, controlling for firm size and economic variables, traditional re-distributional tools such as the power of labour and progressive taxation affects levels of top executive compensation. The effect varies across pay components and firm size. The analyses also show that traditional re-distributional tools exert a stronger moderation effect compared to emerging corporate governance regulations. Secondly, while there is evidence that left parties moderate pre-tax top income distribution, it lacks an encompassing explanation on the effect of over time regulatory changes such as financialization and market liberalization on pre-tax top income distribution. Using Swedish micro and macro dataset on high income earners, I found that left governments acquire a conditional positive effect on pre-tax income at the top. Third, while top managers supporting Conservatives in the UK donate more in values, during the sample period, the responsiveness to donate with respect to top executive compensation is higher for CEOs supporting Labour. The sensitivity is particularly high with respect to the value of stock options and restricted stocks granted. The analyses display further that it is the increase in the value of equity based pay for CEOs supporting Labour, which generates increasing return, causing inequality in political contribution. The findings in the thesis exert that variations in top executive compensations across advanced economies are connected to political institutions. And further, in the age of high top income concentrations and generous compensation schemes, political party preferences and strategies are considerably driven by political engagement of wealthy elites, suggesting declining relevance of mass politics relative to special interests in 21st century democracies. The findings bring forth several implications. An important one is that regulators have to acknowledge the significant connection between political and democratic institutions, and compensation of top managers. I have also discussed, how my research can pave the way for further studies on the politics of high earnings.

Keywords: top executive compensation, redistribution, economic inequality, top 1 %, varieties of capitalism, government partisanship, political inequality

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LIST OF ABBREVIATIONS

ADF	Augmented Dickey–Fuller Test
CEO	Chief Executive Officer
CME	Coordinated Market Economies
CPE	Comparative Political Economy
EU	European Union
FDI	Foreign Direct Investment
FE	Fixed Effects
FTSE	Financial Times Stock Exchange
GBP	Pound Sterling
GDP	Gross Domestic Product
ICC	Intra-class Correlation
LME	Liberal Market Economies
LTIP	Long Term Incentive plans
MCMC	Markov Chain Monte Carlo
OECD	Organization for Economic Cooperation and Development
OLS	Ordinary Least Square
PPP	Purchasing Power Parity
PTTID	Pre-tax Top Income Distribution
RE	Random Effects
RILE	Right-left Index (from the Manifesto dataset)
S&P	Standard and Poor's
SEB	Swedish Statistics Bureau
SEC	Securities & Exchange Commission
UK	United Kingdom
US	United States
VOC	Varieties of Capitalism
WDI	World Development Index
WWID	World Wealth and Income Database

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The thesis is devoted to understanding the political underpinnings of the increasingly salient high-income earnings across advanced democracies. In my dissertation I have been concerned about why there are so much inconsistencies in CEO reward schemes and share of top incomes across capitalist democracies. After 6 long years, the research finally got to an end, and it would not have been able to do so without the support from my supervisor Achim Kemmerling. In the process of drafting and re-drafting papers, testing and re-testing hypotheses, numerous emails, meetings, and Skype talks, Achim was generous with his astute thoughts, sharp feedback, comments and suggestions on how to progress with the research. I have learned from Achim how to communicate scientific contributions in an intelligible way. I am also grateful to Álmos Telegdy and Nick Sitter for stimulating discussions, and helpful feedback during our meetings. The foundation of the project is the CEO compensation database, and I thank Tom Kirchmaier from the Financial Group at LSE for lending me the data. I was adept to extend it with more recent data, thanks to Lukas Linsi and Jonathan Hopkin. To carry out a project in such scope requires endurance. I would not have acquire the capacity to stick to it if it were not for the eternal support from my parents and safe harbor, Corazon Soriano-Angeles and Felipe Angeles. I also thank Katrin and Philip Angeles, and my family in Manila. During the research, I crossed paths with scholars in my field, whom definitely formed many of the ideas in the thesis. Many also read early versions of my work, and provided generously suggestions on how to further advance my papers. I thank Katharina Hecht, Sandy Hager and again Lukas Linsi. The project also benefitted from PERG seminars at CEU; over the years I received helpful comments from Bastian Becker, Anna Burger, Abel Bojar and Anita Halász. I visited the Corpnet team at the Political Science Department at the University of Amsterdam, fall 2015. I thank the team,

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Chapter 1 - Introduction

1.1 Background

Since the 1970s, advanced democracies have experienced an increasing concentration of top incomes and scandals of managerial bonuses, which both reveal generous reward systems for top executives (Piketty 2014; Fernandes et al. 2009; Frydman and Saks 2010; Piketty, Atkinson, and Saez 2011; Culpepper 2011). Accumulating evidence led the Clinton administration in 1993 to impose a cap on CEO compensations. In his 2012 campaign, Obama suggested a pay cap for firms covered by a bailout program, and a raise of the marginal tax rates. Although, excessive bonuses already inflicted concerns before the 2001 Enron scandal, it exacerbated, together with the 2008 financial crisis, public resentment against the elites. In 2011, the Occupy Wall Street movement emerged, and spread worldwide, including Europe's financial center; London. The fiscal crisis in the Eurozone intensified these resentments towards the banking sector, leading to the first EU level suggestion on putting a cap on bonuses as part of the bank bailout programs. Beyond these regulatory efforts, the problem with high concentrations of top incomes, and generous bonus and stock options seem to have been repudiated. Revelations of the disproportionate shares of top incomes and the pay levels of top managers were coupled with stagnation in average worker income growth, high rates of unemployment, income inequality, cuts in public spending and marginal tax rates, and a shift to the service economy bolstering the power of the financial sector. Citizens expressed discontent of democracy and there were widespread beliefs that modern democracy has been unable to generate socioeconomic equality, making people feel that their political participation is effective (Przeworski 2016). Yet, even where there were endeavors of regulation, it was dismissed by popular votes, or the regulation failed to hit the core of the problem. For instance, the Swiss rejected a 12:1 CEO-worker-pay

ratio, and the Labour Prime Minister Gordon Brown's promise to remedy skyrocketing bonus payouts went awry. Further, in the US Dodd-Frank regulations, executive compensation went nearly untouched (Bonica et al. 2013, 109; Murphy 2011).

In spite of these trends, concentrations of top incomes and considerate levels of bonus payouts varies across countries, where some countries have experienced a sharp increase more than others. Why did some democracies go through fierce upward pre-tax top income distribution (PTTID) and levels of top executive compensation (TEC) more than others? Despite politicians acknowledging the problem of economic inequality, high concentrations of top incomes and over compensation of top managers, governments show relatively little effort to regulate incomes at the top of the wage hierarchy, compared to average or low wages. More importantly, regulation varies considerably across advanced economies, despite experiencing similar economic trends. What explains these different policy strategies in the age of economic inequality, concentration of top incomes and a generous reward systems for the managerial occupation? Why have the wealthiest groups been rewarded more so than the poor and the middle class in some democracies more than others? Why do democracy and top income concentration co-exist in some countries? The thesis seeks answers to these questions, and, in doing so, it attempts to elucidate the political causes and consequences of upward PTTID and levels of TEC across advanced democracies.

Studying top income shares and CEO pay can provide illuminating insights for building new reforms that support untraditional coalitions. It is a good object to study to get a grip on how power is organized in the 21st century capitalism, adapting democratic institutions to stabilize democracy and equalize economic as well as political power. Studying TEC and PTTID is not only a question about economic equality, but it also relates to intrinsic concerns. Economic

inequality, frequently associated with high concentrations of top incomes and excessive bonus payouts of top executive compensations, is invoked as an explanation for a number of crucial issues in political science. It may lead to a decline in electoral turnout (Solt 2010; Rosenone and Hansen 1993), an increase in support for extreme right parties (Betz 1994), and even inequality in health (Bergh, Nilsson, and Waldenström 2016). High concentration of income has an impact on how politics work, e.g. by converting income inequality into inequality in political influence (Bonica et al. 2013; Gilens 2012; Hacker and Pierson 2010; Bartels 2008). Moreover, recent research demonstrate that concentration in top incomes have a significant impact on welfare state generosity (Scruggs and Hayes 2017), corroborating the research linking high top income concentration and political inequality.

There are, hitherto, many economic explanations on the causes and consequences of the varieties of top income concentration and high earnings across developed economies that have shaped the scholarly debates. However, we know less about the political dimensions of the causes and consequences across countries and over time. Current political science research offer some evidence on the political underpinnings of TEC and PTTID, yet, the results are mixed and most studies have focused on the extreme case of US. Moreover, as institutions of advanced economies are less coherent than assumed, understanding the conflict structures and government constraints in the age of high top income concentration is therefore anything but straightforward. We are also left with very little knowledge on the political determinants in a European context which consist of a different political culture and historical institutional legacy. The thesis follows and contributes to this line of research.

1.2 Reader's guide

Chapter 2 will show the empirical panorama of TEC in OECD countries. For this purpose, I collected information on TEC for 17 countries over 15 years. I will provide descriptive statistics of top executive compensation data and compare it to top income shares across OECD countries. The chapter also addresses questions of data validity, technical data issues, uncertainties in their compatibility, and also, how they relate to other income inequality measurements used in comparative political economy. The chapter also flags out attainable benefits of applying TEC data compared to the widely used PTTID data. This chapter, together with chapter 3 constitute as introductory chapters for the papers presented in chapter 4, 5 and 6.

Chapter 3 presents a critical review essay. This chapter provides a literature review of theoretical and empirical approaches about the top income share and executive compensation levels, and presents key criticisms. It discusses the plausibility of each theory, both in isolation, but also in relation to each other. The chapter then discusses the main contributions of the thesis, in light of the critical view of previous theories.

Chapter 4 titled; *Shift in Market Regulation, Social Democrats and Top Incomes in Sweden* starts our discussion by looking at the Swedish case. The paper proposes, contrary to the classic literature on government partisanship, that a shift in economic strategies of parties on the left have been key factors behind increasing concentrations of top incomes since the 1970s in egalitarian Sweden. The chapter employs two types of data to support the argument: macro-aggregate data for a longer time series, and micro-level data on TEC for the last decades.

Chapter 5 exhibits the paper *The Political Struggle about a Maximum Wage and Labour's Role in Moderating Executive Compensation in Advanced Economies*. Co-written with Achim

Kemmerling, we present theories on why we should expect that organized labour still exert a moderating effect on levels of top executive compensation across advanced economies. We show that this effect of labour depends on firm size, i.e. moderation is relatively stronger for larger companies. We also elaborate why we think this has a more moderating effect than current regulation and focus on good corporate governance. To test our claims we run a number of multilevel regressions across 17 OECD.

Chapter 6 moves from the political origins of higher TEC to its political consequences. Titled *From CEO Pay to Inequality in Political Party Contribution?* Chapter 6 elaborates theoretical expectations about the political behavior of economic elites, whether it depends on loyalty to different parties, or rather on individual prosperity. Matching data on British TEC with information about campaign contributions, I test if higher income is linked to inequality in contribution, and how this is linked to the two main political parties. The empirical analyses show that donations to Labour and the Conservatives differ in how much they depend on a manager's income. They also show that not all types of income are the same.

Chapter 7 summarize the thesis and draw concluding remarks with implications. This chapter highlights the limitation of the data and empirical analysis, and in more general the obstacles when looking at the larger issue of growing top-income inequality. Lastly, the chapter provides policy recommendations accordance to the main findings, and suggest avenues for future research.