Have and Have Not: The Widening Gap

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The late Peter Drucker is widely viewed as the inventor of modern corporate management, although before his death he was discouraged by the short-sightedness of many business leaders. He was especially concerned about the widening pay gap between CEOs and the average worker—a trend he had observed with alarm for decades. As far back as 1984, Drucker had warned that the pay gap should not exceed 20-to-1. Anything beyond that, he believed, would foster mistrust and resentment and erode the kind of teamwork needed for long-term growth.

The actual pay gap today is 354-to-1.

So why aren't workers marching and picketing and otherwise complaining about this inequity? Sure, there were some small worker protests and strikes last year in cities like Detroit and Seattle, but the minimum wage has hardly budged, and efforts to cap executive pay have been ineffective.

The fact is, little is known about people's thoughts about wages and fairness. In general, people favor some threshold of fairness, but what is this threshold—and how widely is it shared? Two psychological scientists have recently begun exploring these important questions. Using survey data from 40 countries, Michael Norton of the Harvard Business School and Sorapop Kiatpongsan of Chulalongkorn University in Bangkok gathered people's estimates of existing pay—for CEOs and high government officials and unskilled workers—and their beliefs about what these workers *should* be paid. From this data, this scientists calculated pay ratios, both estimated and ideal—which they then compared to actual wages and pay gaps in the real world.

The findings are enlightening. Across all 40 countries, people guessed that the pay ratio for CEOs to unskilled workers is about 10-to-1, but they believed that in fairness it should be less than half that. Both estimated and ideal wage gaps were higher for CEOs than for cabinet officials—indicating a general belief that business leaders should be paid relatively more than government officials—and both should be paid less than they actually are paid.

But here's the startling part. Americans in the survey believed that CEOs should make about seven times what the unskilled worker makes, but guessed that the ratio was closer to 30-to-1. That is, they drastically underestimated the real income gap of 354-to-1. Translated into dollars, that means that the typical CEO of a big company makes $12.3 million a year, compared to the average worker's $30,000. And it's not just Americans: In all 16 countries for which actual pay ratios are available, people significantly underestimated the gap.

The scientists also gathered demographic information, and this revealed some interesting variation in estimated and ideal pay ratios. For example, those who put themselves at the bottom socioeconomically—these workers, compared to the better off, guessed that the pay gap between CEO and average worker was larger, and believed it should be smaller. In other words, the most disadvantaged are less satisfied with current pay gaps—although even the highest earners thought the gap should shrink.

Overall, people believe the pay gap between skilled and unskilled workers should be much less than they believe it to be—which is less than it is in fact. There is consensus on this view, across countries, socioeconomic status, and political beliefs. Notably, both people who believe the gap is too wide and those who strongly disagree with this—both think the ratio ought to be just under 5-to-1.

The bottom line? There is a common desire for smaller gaps between skilled and unskilled workers' pay, one that knows no national or demographic boundaries. This desire for greater equity—between CEOs and unskilled workers, and government officials and unskilled workers—is evident in all 40 countries studied.

These findings, reported in a forthcoming issue of the journal *Perspectives on Psychological Science*, offer some guidance for policymakers. Although it is highly unlikely that the existing pay ratio in the U.S. will fall from 354-to-1 to the ideal 7-to-1 in the short term, citizens would almost certainly support efforts—such as one underway at the Securities and Exchange Commission—to make companies' actual income ratios transparent. Workers may know in a vague way that wages are unfair, but such changes would illuminate the disparity, company by company.

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