RESEARCH NOTE/NOTE DE RECHERCHE

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When public-sector salaries become public knowledge: Academic salaries and Ontario's Public Sector Salary Disclosure Act

Abstract: The effects of salary disclosure on public-sector compensation have long been a source of controversy in political and academic circles. Some commentators suggest that because of political pressure and closer public scrutiny, salary disclosure is a good thing because it results in pay that is both lower than it would otherwise be and more sensitive to performance. On the other hand, disclosure raises serious privacy considerations and could also have an inflationary effect on salaries unless all elements in a causal chain linking public knowledge and lower pay are firmly in place. In this study, the authors examine the implications of Ontario's Public Sector Salary Disclosure Act with respect to university-sector salaries. The main conclusions are that salary disclosure, in general, and in the academic sector in particular, has never fully accounted for proper comparability issues and has not been updated to reflect adjustments for inflation. The act also raises important questions of privacy that have not been fully addressed. Perhaps most notably, there is no evidence suggesting that salary disclosure has much of an influence in off-setting other factors affecting salary growth.

Sommaire: Depuis longtemps, les effets de la divulgation de la rémunération des salaires dans le secteur public sont une source de controverse dans les cercles politiques et universitaires. Certains commentateurs laissent entendre qu'en raison de pressions politiques et d'un examen plus minutieux de la part du public, la divulgation des salaires est une bonne chose car elle entraîne une rémunération à la fois inférieure à ce qu'elle serait autrement et plus sensible à la performance. D'un autre côté, la divulgation soulève de graves considérations au sujet de la vie privée et pourrait aussi avoir un effet inflationniste sur les salaires, à moins que tous les éléments d'un enchaînement causal liant les connaissances du public et des salaires inférieurs soient

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fermement en place. Dans cette étude, les auteurs examinent les implications de la Loi sur la divulgation des traitements dans le secteur public de l'Ontario en ce qui concerne les salaires du secteur universitaire. Les principales conclusions sont que la divulgation des traitements en général, et dans le secteur universitaire en particulier, n'a jamais pleinement pris en compte les questions de comparabilité requises et n'a pas été mise à jour pour refléter les ajustements dus à l'inflation. Cette loi soulève également d'importantes questions relatives à la vie privée qui n'ont pas été abordées à fond. Peut-être plus important encore, est le manque de preuve suggérant que la divulgation des traitements a une grande influence pour compenser d'autres facteurs qui affectent sur l'augmentation des salaires.

There are other initiatives we will take to encourage smarter spending. Performance bonuses for all public servants will be based on both results and savings to the taxpayer, and senior civil servant salaries and benefits would be disclosed to encourage greater accountability and restraint (The Common Sense Revolution, Harris 1994)

The impact of salary disclosure legislation on public-sector wages has long been a source of controversy in both political and academic circles. For example, the 1995 election platform of the Ontario opposition Conservative party, dubbed the ''Common Sense Revolution'' (CSR), contained the promise to disclose the salaries and benefits of senior civil servants (see the text of the party's platform at http://web.archive.org/web/20030831162726/http:/www.ontariopc.com/feature/csr/csr_text.htm). Shortly after the Conservatives came to power and formed the Ontario government, the Public Sector Salary Disclosure Act (S.O. 1996, c. 1, Sch. A) was enacted. This legislation, which is still in place today, requires that organizations receiving public funding from the Province of Ontario disclose the names, positions, salaries and taxable benefits of employees who are paid annual salaries of \$100,000 or more.[1] At present, this act covers the Government of Ontario, Crown agencies, municipalities, hospitals, public health and school boards, universities, colleges, Hydro One, Ontario Power Generation, and other public-sector employers who receive a significant level of funding from the province.

There were a number of motivations for the Public Sector Salary Disclosure Act, including rectifying a perceived imbalance between the treatment of private- and public-sector executives (arising out of actions of the previous NDP-led government), providing support for the government's agenda of reducing the size of the Ontario government (the CSR envisaged cutting 13,000 positions from the government payroll) and most obviously restraining the growth of public-sector salaries (Ibbitson 1997). While this latter motivation is not explicit in the legislation itself – although it was in the CSR – it was the interpretation reached by many. For example, the provincial director of the Ontario branch of the Canadian Taxpayers Federation stated that ''[d]isclosure is the only way that public pressure can be brought to bear when spending is out of line'' (Tasha Kheiriddin [CTF director and spokesperson], cited in Canadian Taxpayers Federation 2005). Or, as articulated by then–Management Board Chair Chris Hodgson, ''The more informed the taxpayer, the more efficient government will have to be'' (Ontario, Ministry of Finance 1998: http://www.news.ontario.ca/archive/en/2008/03/31/c868997cd-27996-tpl.html).

Though this perception is still widely held, at the time, some predicted that salary disclosure would in fact be a ''boon'' to highly paid civil servants (Cook 1996; Fennel 1996). Academic analyses (available at the time) also provided mixed evidence for the overall wage impacts (Iacobucci 1998). Moreover, there was already some limited empirical evidence based on Ontario's private-sector experience that disclosing executive compensation results in salary increases (MacDonald 1995), as well as some speculation within previous Ontario legislative debates that wage inflation would ensue (Ontario, Legislative Assembly 1993b).

The aim of this article is to assess these contrasting views of salary disclosure and to examine which proved the more accurate. More specifically, we are interested in whether disclosure restrained salaries in Ontario, as the drafters of the CSR envisaged, or whether it turned out to be a boon for high-end public-sector workers, as many compensation experts predicted. Despite the existence of this legislation for over a decade, this article, to our knowledge, represents the first attempt to assess the legislation and ascertain the potential impacts of Ontario's public-sector salary disclosure experiment.

Unlike other legislative or tax provisions (e.g., minimum wage laws, tax credits), inflation has increased the importance of the Public Sector Salary Disclosure Act over time, since the $100,000 threshold introduced in 1995 has not been altered. So, while part of the increase in the number of disclosed salaries from 1,200 in 1995 (Fennel 1996) to 36,000 in 2007 (Ferguson and Benzie 2007) is due to the thirty-per-cent increase in the size of Ontario's public sector,[2] a major reason for the twenty-eight–fold increase in the number of disclosed salaries is simply inflation. The fact that this legislation – in its present form at least – becomes increasingly important each year makes its evaluation a pressing issue.

We evaluate the act in two different ways. First, we document the history of salary disclosure in Ontario through an examination of legislative debates and other public documents. This discussion is complemented and contextualized with a review of the theoretical impacts of salary disclosure. While there are some reasons to believe that disclosure restrains salary growth, we contend that in the public sector there are more compelling reasons to expect the opposite. We identify a three-step causal chain that is required in order for public salary disclosure to restrain pay as intended.

Our second approach is empirical in nature. Specifically, we document the earnings growth and convergence of Ontario university presidents since the legislation was implemented.[3] These parameters provide illustrative evidence of whether the legislation, in broad terms, has worked in the manner suggested by its initial proponents (i.e., did the act in fact restrain the growth of some of the most visible of public-sector salaries?) or whether the predictions of many critics of the legislation have been realized (i.e., did upward salary convergence mitigate any restraining forces caused by the legislation?). We also contrast changes in professorial salaries in Ontario with salary changes in jurisdictions without similar legislation in order to evaluate whether the act displays any evidence of greater wage restraint.

This article is organized in the following way. In the next section, we present a historical background of public-sector salary disclosure in Ontario. This is followed by a discussion of the theoretical impacts of the disclosure process and a statement of the conditions necessary if salary disclosure is going to affect public-sector salaries in the manner envisaged by proponents. Given the dearth of research involving public-sector disclosure, experience in disclosure in the private-sector will serve as a basis for this discussion. Finally, we present detailed data and explore trends in the salaries of university faculty and presidents. The concluding section of the article summarizes and proposes amendments to the legislation.

Historical and comparative background

Enacted in 1996, the Public Sector Salary Disclosure Act fulfilled a campaign promise contained within the Ontario Progressive Conservative party's election platform. While the broad coverage of the act is certainly unprecedented, Ontario did have a limited form of public-sector salary disclosure in existence until 1987. Specifically, in that final year of disclosure, the salaries of civil servants working directly for Ontario government ministries were revealed in the Public Accounts if they exceeded an annual rate of $50,000 (Ontario, Ministry of Treasury and Economics 1987). In the following year, only aggregated salaries and wages of ministry employees appear in the Public Accounts (Ontario, Ministry of Treasury and Economics 1988).

A bill similar to the current legislation was proposed, but not enacted, in 1993, when the Conservatives were in opposition. Bill 114 was envisaged to rectify a perceived inequity in the treatment of public-sector executives vis-à-vis their private-sector counterparts. In October 1993, when the NDP was in power in Ontario, legislation was enacted requiring companies traded publicly to disclose the annual payments to their CEOs and their four most highly paid executive officers if they exceeded $100,000 (Zhou 2000). Prior to that point, the Ontario Personal Property and Security Act (R.S.O. 1990, c. P10) required disclosure of aggregate compensation of executives (Zhou 1997). The retributive nature of the proposed Bill 114 is quite evident from Conservative member Chris Stockwell's comments during the debate on the first reading of his proposed "Public Sector Executive Compensation Disclosure Act, 1993": "I think everyone would be in support of this, considering the announcement made by the government just recently with respect to compensation review for the private sector, so I would ask for unanimous consent for second reading (Ontario, Legislative Assembly 1993a: http://www.ontla.on.ca/web/house-proceedings/house_detail.do?Date=1993-11-01&Parl=35&Sess=3&locale=en#P303_94466, at time 15:10).

When the Public Sector Salary Disclosure Act was ultimately enacted in 1996, there was virtually no relevant debate in the Ontario legislature. The lack of debate stems in large part from its relative insignificance in Bill 26, the Savings and Restructuring Act. Bill 26 – better known as the ''Omnibus Bill'' – was far-reaching and affected forty-four separate acts, created three new acts, and repealed three others, and covered areas such as health care, pay equity, municipal affairs, public employee contracts, environmental laws and freedom of information laws (Bezanson and Valentine 1998). Opposition members lamented that there was simply inadequate time for consideration. According to Frances Lankin of the NDP, ''When you have very, very large public policy issues in discrete areas of legislation being strung together in an omnibus bill like this – and of course we know the timetable that had been originally attached to it – you deprive all of us in this House and the public of Ontario of an opportunity to understand the legislation that's being proposed'' (Ontario, Legislative Assembly 1995: http://www.ontla.on.ca/web/house-proceedings/house_detail.do?locale=en&Date=1995-12-12&Parl=36&Sess=1&detailPage=/house-proceedings/transcripts/files_html/1995-12-12_L038b.htm, at time 17:53).

A second factor contributing to the lack of debate on this particular component of the bill was that some opposition members were rather supportive of many of its proposed measures. Liberal deputy leader Sean Conway stated that ''[t]here is, as I say, a sweeping series of measures here that touch on everything from letting the sunshine in to certain public sector salaries – and boy, give me that bill like now and I want to vote for that; I want to vote for that so fast I can hardly contain myself (Ontario, Legislative Assembly 1995: http://www.ontla.on.ca/web/house-proceedings/house_detail.do?locale=en&Date=1995-12-12&Parl=36&Sess=1&detailPage=/house-proceedings/transcripts/files_html/1995-12-12_L038b.htm, at time 18:40).

While the act has remained in place since its introduction, two developments since 1996 are noteworthy. First, similar provisions that were in existence with respect to union executives from 2000 to 2005 have been repealed, while consistent with Liberals' support of the act during their time in opposition, the scope of the legislation was extended by the McGuinty Liberal government in 2003 to include Hydro One and Ontario Power Generation (Ontario, Ministry of Energy 2003).

Unlike the introduction of the act in 1996, there was significant debate surrounding both the amendments to Bill 139, the Labour Relations Act (S.O.

2000, c. 38), which introduced salary disclosure in the union sector as well as the reversal of these provisions. Interestingly, Sean Conway, who expressed enthusiastic support for the Public Sector Salary Disclosure Act, argued against similar provisions within Bill 139:

> Let me take for a moment the issue about disclosure of $100,000 salaries. Any fair-minded person would have to ask themselves, ''Is that not provocative?'' Are we here to suggest that executives in the labour movement should not be paid a reasonable executive salary? . . . I would suggest that that section of Bill 139, the so-called sunshine provision, is clearly provocative, and I suspect that it will have the desired effect (Ontario, Legislative Assembly 2000: http://www.ontla.on.ca/web/houseproceedings/hansard_search. jsp?locale=en&go=AdvancedSearch, at time 20:10).

New Democratic Party member David Christopherson also criticized the sunshine law as being part of a very one-sided attack on unions: ''The first thing you do is you spread the myth that union bosses are in this for their own personal gain . . . and you promote that by talking about divulging – like it's some big, deep, dark secret – how much money labour leaders receive (Ontario, Legislative Assembly 2000: http://www.ontla.on.ca/web/house-proceedings/hansard_search.jsp?locale=en&go=AdvancedSearch, at time 18:45).

When this legislation was in force, there were complaints that it was applied in an arbitrary manner. For example, the Ontario Confederation of University Faculty Associations was required to disclose salaries of its staff and elected officials, while there was no similar requirement of the Council of Ontario Universities or of the Ontario Medical Association (Ontario Confederation of University Faculty Associations 2001). When in power, the Liberal party undid this requirement (Ontario, Ministry of Labour 2005).

In light of the Liberal party's reversal of salary disclosure of union staff, it is surprising that the Public Service Salary Disclosure Act was not also amended. In the same way that the disclosure of union staff salaries can be viewed as an element in a broader legislative ''attack'' on unions, the act could be viewed with similar suspicion since it was an element of the Conservatives' Common Sense Revolution, which many viewed as an ''attack'' on the public sector. Indeed, the CSR was premised on the notion that ''Canadians are probably the most over-governed people in the world'' (Harris 1994: http://web.archive.org/web/20030831162726/http:/www.ontariopc.com/feature/csr/csr_text.htm). Additionally, the same argument put forth to justify repealing the disclosure of union salaries exists; public-sector legislation is also one-sided in nature as compared to the legislation governing private-sector executives in publicly traded companies, which mandates the disclosure of only the top-five executives' pay where those salaries exceed $100,000 (Zhou 2000).

Presently, other provinces, such as British Columbia and Alberta, have their own versions of public-sector salary disclosure. However, Ontario's legislation surpasses those in two fundamental ways. First, it is more far-reaching, with more employees affected. Under Alberta's Treasury Board Directive 12/98, only compensation of the top echelon of staff is disclosed. As applied to Alberta universities, for instance, this typically entails releasing the salaries of the president and vice-presidents. The second major difference is that the list of Ontario salaries (current and archived) appears in one location on the government's web site. Other provinces disclose information via their financial statements or have procedures more akin to freedom-of-information requests. British Columbia allows interested parties to view disclosed salaries of academics in person at the institution in question. Thus, not only are many more workers in Ontario subject to salary disclosure (e.g., 1,892 University of Toronto employees' salaries were disclosed in 2006, compared to only six at the University of Alberta), but the release of all affected salaries at one time and on one central location attracts significantly more attention. This attention, however, raises privacy concerns and calls into question the intent of the data as a tool for monitoring ''top official'' pay. These issues are addressed below.

Inflation adjustments and privacy concerns

The manner in which the legislation has been drafted and enforced makes it much broader than a disclosure of senior salaries and this problem is aggravated each year. Not only is the threshold too low to cover only senior officials, but inflation has continually eroded this threshold. The $100,000 threshold originally passed in 1995 would have been raised to $130,752 in 2009 to be equivalent in real terms. Or, looked at from another perspective, a threshold of $76,481 should have been introduced in 1995 in order to grow to the current $100,000 level if it was actually indexed to changes in the Consumer Price Index.[4] If the Public Sector Salary Disclosure Act is to be retained, this matter has to be addressed or, quite obviously, every public-sector salary would eventually be disclosed. Ontario's private-sector disclosure and comparable disclosure legislation in other provinces are much narrower in terms of coverage, and by restricting disclosure to a number of employees, the problem of updating a threshold for inflation is circumvented.

This latter point raises another key difference between the Public Sector Salary Disclosure Act and private-sector disclosure – namely, there is no context in which to compare public-sector pay levels with organizational performance. Consequently, it does not provide much insight into how efficiently or wisely tax dollars are spent. Basically, there is simply too much breadth and not enough depth in disclosure to render it meaningful.

There is also the question of the invasion of privacy that such legislation entails. There are potentially better ways to disclose salary information without revealing lists of individuals' names. A more discrete and meaningful disclosure would include salary averages for positions and recent growth rates but no names. At present, the act is diametrically opposed to other government protocols (e.g., Statistics Canada conventions) that quite rightly go to great lengths to protect individuals' private data – especially when it involves something as personal as earnings.

These are some of the ''costs'' of salary disclosure legislation that could be mitigated or measured against the ''benefits'' in terms of financial accountability and wage restraint for taxpayers. These arguments are now assessed below.

Theoretical background

There are a number of reasons why salary disclosure could result in either upward or downward pressure on wages. Upward pressure could come from disclosure's impact on bargaining leverage, compensating wage differentials, perceived ''underpayment'' of public-sector executives, survey ratcheting and reputational impacts. There are also ways in which disclosure can restrain wages, including institutional activism and greater transparency regarding compensation strategy formulation. We argue that because these latter forces are largely absent in the public sector, the inflationary impacts of salary disclosure in Ontario are more prominent. We begin with the case for upward pay bias and examine why disclosure may not work in the way the drafters of the legislation envisaged.

Disclosure and the ''race to the top''

First, it is well known that wage reductions in nominal terms are rare occurrences (Bewley 1999). When the disclosure process reveals anomalously high salaries, it is therefore more likely that pressure ensues to raise the salaries of the lower-paid employees in order to achieve some sense of parity or equity (Cook 1996). After the initial salary disclosure in Ontario, the chair of the Hospital for Sick Children stated that when disclosure revealed pay disparities, he didn't think that ''the higher people are going to be saying they should take a cut'' (Fennel 1996: http://www.thecanadianencyclopedia.com/index.cfm?PgNm=TCE&Params=M1ARTM0010647). One reason for the resistance of pay reductions is due to the so-called ''endowment effect'' whereby one has a bias towards retaining what one possesses. According to the endowment effect, it is the adverse psychological impact of giving up what one already has that creates the resistance to a salary reduction (Iacobucci 1998). Additionally, salary reductions resulting from the disclosure process are essentially admissions of error by wage-setting bodies and hence there is an incentive for avoidance from their perspective as well.

The provision of accurate, comprehensive salary data therefore endows employees with better information and greater leverage during the negotiation process (Cook 1996). Once ''anomalously'' high salaries are disclosed, lower-paid counterparts have much more credibility in demanding raises. Numerous quotes of individuals involved in the public-sector salary determination process in Ontario are consistent with this view. As an illustrative example, London Ontario Health Science Centre vice-president Brian Orr stated, ‘‘Employees who learn they are being paid less than peers demand more . . . . Last year that led to raises for pathologists’’ (London Free Press 2006).

Second, to the extent that individuals do not like having their names published in an annual list that is scrutinized by the public and potentially subject to public scorn, individuals may command a salary premium in compensation for this unpleasant job attribute that is largely absent in other jurisdictions and in the private sector. A survey of individuals from an American university whose salaries were disclosed and subsequently published in a local campus newspaper, provides evidence that disclosed salaries are indeed negative attributes that potentially result in compensating wage premiums. Many agreed with the statement that ‘‘the recent pay disclosure has negatively affected my overall job satisfaction level’’ and a non-trivial number said that as a result of the disclosure they would leave their jobs (Manning and Avolio 1985). Elinor Caplan, a Liberal member of the Ontario government, argued during a debate on disclosure of public-sector salaries in 1993, that the proposed legislation ‘‘if it were to go forward intact without thoughtful discussion and debate as to what the policy implications would be, could well have an inappropriate and negative impact on individuals’’ (Ontario, Legislative Assembly 1993b: http://www.ontla.on.ca/web/house-proceedings/house_detail.do?Date=1993-1104&Parl=35&Sess=3&locale=en#P545_171626, at time 10:40). There were even some suggestions that, as a result of having their salaries disclosed, ‘‘this will pose a significant risk to [civil servants] because they might be kidnapped as a result of [the legislation]’’ (Ontario, Legislative Assembly 1993b: http://www.ontla.on.ca/web/house-proceedings/house_detail.do?Date=1993-11-04&Parl=35&Sess=3&locale=en#P545_171626 [Turnbull], at time 10:50). While some of these statements verge towards hyperbole, these individuals’ privacy concerns cannot be entirely dismissed.

Third, salary disclosure might reveal the extent to which high wage-earners in the public sector are actually underpaid relative to their counterparts in other jurisdictions or in the private sector. Publicizing such underpayments might therefore result in support for increasing public spending and might also render it more difficult to retain workers that appear like public-sector ‘‘bargains.’’ Looking at the salary that an ex-university president earns subsequently as a CEO in the private sector is potentially insightful regarding the magnitude of the pay gap. Specifically, whereas Robert Prichard earned $250,000 during his last year as president of the University of Toronto, his total compensation as CEO of Torstar only two years later was $1.3 million (Torstar Corporation 2007). Similarly, as justification for the remuneration of the president of McMaster University – which topped the presidential pay list in 2005 with combined salary and benefits of $420,315 – the chair of the board of governors stated that his salary is reviewed carefully every year against competition, past history, and length of service and that, compared to those in industry, his salary is actually low (Whitwell 2007). Thus, to the extent that relatively highly paid public-sector workers can earn more in other jurisdictions or in the private sector, retention is clearly compromised by the public-sector salary disclosure process.

Fourth, in his examination of executive compensation, Graef Crystal describes the ‘‘survey ratcheting’’ effect. This effect results from most institutions wanting to pay above-average wages to their executives because they perceive themselves as being above-average in quality:

> Companies have . . . institutional pride and consciously paying a CEO below the average constitutes a blow to that . . . pride. Talk to a member of the board . . . and he'll . . . tell you that ‘‘our company is as good as anyone else's, and therefore we're not going to be cheap and pay below average.’’ This . . . thinking leads to a phenomenon called ‘‘survey ratcheting.’’ If a company [is] below the average, the CEO is given a raise to the average, or . . . at least an outsized raise. Unless CEOs who are being paid above the average are given pay cuts . . . these raises cause the survey average to rise . . . and to contribute to another round of the same behaviour. And, of course, it is virtually unheard of for a CEO to take a pay cut (1991: 15).

This type of logic is clearly evident in comments from public-sector institutions such as universities. In response to the University of Toronto having more than half of Ontario's disclosed university employees, the then president stated that ‘‘the high number of U of T employees on the list is an indication of the university's commitment to attracting the best academics’’ and governing council vice-chair Wendy Cecil-Cockwell stated that she wished they had ‘‘more on the list’’ (Bridges 1997).

In his examination of the disclosure of publicly listed CEO compensation, Edward Iacobucci (1998) also points out that to the extent that pay is seen to proxy ability, achieving high rates of pay takes on heightened importance when salaries are disclosed. That is, in order to earn higher income in the future, it is more important to seek greater pay to signal high ability. Moreover, if pay indicates ability, it is disclosure that enables this upward ratcheting to take place since ‘‘without disclosure, obviously, there is no indication of ability from pay since outsiders do not know the pay’’ (Iacobucci 1998: 495).

Disclosure and the case for wage restraint

Given the sheer weight of evidence in favour of wage inflation following on from disclosure, can a case be made for the original intent of the legislation, which was to limit wage growth and restrain average pay in the public sector? Disclosure in the private sector (among publicly listed firms) can be expected to restrain pay if it leads to ‘‘institutional activism’’ and greater transparency in how compensation strategy is formulated. Translating these mechanisms to the public sector implies the placing of taxpayers in the role of investors and other third parties such as lobby groups and public watchdogs in the role of ‘‘implicit regulators’’ (Jensen and Murphy 1990). Unfortunately, the logic of collective action (Olsen 1965, 2000) works against a diffuse body of concerned citizens becoming effective upholders of the public interest. While groups such as advocacy organizations (e.g., the Canadian Taxpayers Federation), student federations, unions, opposition political parties and the media could potentially act in the guardian role, these bodies have not proven to be an active restraining mechanism in the case of Ontario.

We contend that disclosure legislation largely fails to restrain public-sector salaries as intended because successful wage restraint necessitates the presence of a number of ‘‘links’’ in a causal chain. If any of the following three links are absent, the extent to which disclosure will actually restrain salaries is doubtful:

1. Disclosed salaries are scrutinized and assessed with respect to individual attributes, organizational performance, and relative pay, and a view that salaries are excessive develops.
2. Public displeasure with salary levels is conveyed to wage-setting bodies both indirectly through their transfer payment partners (e.g., province, municipalities) and directly (e.g., universities, hospitals).
3. Wage-setting bodies respond to pressure and are successful in limiting salary growth or achieving salary reductions.

In our analysis of the Public Sector Salary Disclosure Act, we found many instances where various aspects of these linkages are absent. We discuss the failure of these restraint mechanisms in turn.

First, our recent examination of official Ontario government web sites, major newspapers and student newspaper publications shows that salary information is still well publicized even more than a decade after the act was first implemented. It is, however, very difficult to judge the merit and legitimacy of the compensation received. Unlike private-sector salary disclosure, there is no information provided regarding rationales for compensation packages, comparisons with individuals in similar positions, changes over time, or composition of salary between incentive-based pay and regular remuneration. Moreover, there is a complete lack of individual-level information with which to judge someone’s pay. For example, there is no information about such basic ‘‘input’’ variables as years of experience, hours worked, job duties, etc. In our examination of university faculty pay, we discovered that institutions do not report job titles in a consistent manner; some report departmental affiliation and administrative duties whereas others do not. Organizational performance is also lacking; there are simply no institutional data provided that relate individual pay to organizational performance.

One by-product of this limited information is the inability to judge whether public-sector pay is actually excessive. This opinion was reached by the former leader of the Ontario Progressive Conservative Party, John Tory. When questioned about the $1.6-million salary of Hydro One CEO Tom Parkinson, Tory stated that he has ‘‘no ability to judge whether he earned that or not and that’s not right – he’s a public sector employee.’’ Tory also added, ‘‘In some ways this [list] is all about voyeurism . . . because it really doesn’t tell you anything about whether anybody did a good job (London Free Press 2006).

Notwithstanding the point above, another possibility is that disclosed salary information does not contribute to the view that salaries need to be restrained because they are, in fact, not actually excessive when compared to the private sector or that salary restraint has little instrumental value. For example, after consideration of the initial list of disclosed academic salaries, Michael Mancinelli, the deputy chair of the Canadian Federation of Students, said his members were not critical of public academic salaries and stated, ‘‘A lot of people realize the cutbacks and tuition increases are not due to salaries’’ and therefore concluded that their ‘‘focus has to be elsewhere’’ (Lewington 1996: PA55). This is unlike private-sector executive disclosure, where institutional shareholders have obvious financial incentives for firms to curb wasteful spending (Iacobucci 1998).

Second, we found relatively few instances of stated public displeasure with public-sector wages. Even advocacy groups such as the Canadian Taxpayers Federation do not present compelling arguments that public-sector remuneration is, in fact, excessive. While they suggest that the increase in public-sector employees earning $100,000 per year results in ‘‘bigger tax bills,’’ they also add that disclosure has not really added much to our understanding of the appropriateness of public-sector pay levels: ‘‘Unless government takes a hard look at whether these salaries make sense, the sun can shine all it wants, yet taxpayers will still be left in the shadows’’ (Tasha Kheiriddin, cited in Canadian Taxpayers Federation 2005).

Finally, with respect to the third link in the chain, we found no public statements about disclosure leading to pressure to restrain salary growth. In fact, the only public statements found were from university administrators wishing that they had more employees on the list (Bridges 2007). These statements, of course, do not preclude the possibility that the greater transparency of public-sector salaries has created a chilling effect of limiting salary growth. Therefore, to analyse this last link in the above causal chain more closely, we turn to the data. Given the very minimal academic attention paid to the salary implications of Ontario’s pay disclosure experiment, we focus on salaries in one particular sector affected by the Public Sector Salary Disclosure Act – namely, the university system in Ontario. Our choice of university-sector salaries is explained below, along with a discussion of the evidence and limitations of this data.

What has happened to university salaries in Ontario since disclosure?

Our examination of the empirical evidence focuses on Ontario's publicly funded university system. This is done for several reasons. First, universities are important, comprising a very large share of high-income earners in Ontario. In terms of the volume of salaries disclosed, universities are roughly twice as important as the civil service, defined narrowly as those working directly for Ontario ministries (e.g., In 2006, there were 158 pages of disclosed salaries for university staff compared to 80 for ministries). A second and more pragmatic reason for analysing the academic sector is that data from various sources can be used for inter-provincial as well as inter-temporal comparisons, because academic occupations are well-defined and fairly homogeneous (Martinello 2006). Finally, by focusing on the university sector, we can observe the entire ‘‘population'' of academic presidents in Ontario over the full period, since all (full-year) presidential salaries have exceeded the $100,000 threshold since 1996. The examination of university president salaries also offers a close comparison with discussions of the effect on CEO salaries emanating from Ontario's 1993 ‘‘sunshine law,'' which applied only to senior management in publicly listed firms.

The salaries of university presidents

We begin by analysing the remuneration of Ontario university presidents for the period 1996—2006. Presidential salaries share some similarities with that of private-sector CEO salaries in that compensation is set by boards of governors, and both CEOs and presidents sit at the top of their respective institutions. The ratcheting effect caused by public disclosure (and mentioned earlier as a potential cause of upward wage growth) clearly suggests that salaries below the average will receive above-average increases in remuneration (upward convergence) and that pay cuts at the top (downward convergence) are not likely to occur.

Based on information that is publicly disclosed by the Ontario government, presidential salaries (excluding benefits) for Ontario universities from 1996 to 2006 displayed an average annual growth rate of 6.5 per cent (data available upon request). While there were some slow rates of year-over-year increases over this period (e.g., 0.8 per cent in 1997), this was offset by some fairly rapid increases (e.g., 12.1 per cent in 1998). At first glance, it does not appear that salary disclosure is restraining the salaries of those at the top of the university pay structure, because growth in presidential pay greatly exceeded changes in average public-sector pay in Ontario, which, depending on the specific data source, grew roughly 3 per cent over the same period.[5]

Anomalies in this data related to changes in presidents during the calendar year and the setting of pay for an interim president only. In order to

Table 1. Growth Rates of Disclosed Salaries of Ontario University Presidents, Excluding Interim and Acting Presidents, from 1996 to 2006

	Salary level		Growth rates (%)	
University ranking in 1996	1996 ($000s)	2006 ($000s)	Positional	Individual
Wilfrid Laurier	224.0	339.6	4.2	6.0
Western Ontario	203.1	328.8	4.9	4.9
Toronto	200.5	374.2	6.4	4.6
Queen’s	196.6	329.4	5.3	5.6
McMaster	193.9	422.9	8.1	8.1
Waterloo	186.7	416.2	8.3	7.8
Guelph	178.7	329.4	6.3	7.9
Windsor	176.0	292.1	5.2	7.8
York	175.0	351.6	7.2	7.6
Lakehead	167.5	236.0	3.5	4.2
Ottawa	160.0	310.9	6.9	6.3
Ryerson	156.0	295.4	6.6	6.6
Trent	151.9	278.7	6.3	6.3
Laurentian	145.8	260.4	6.0	8.3
Nipissing	115.4	233.4	7.3	6.6
Carleton	111.8	—	12.0	12.0
Brock	—	—	9.3	9.3
Average salary	171.4	319.9	6.7	7.1
Above average salary growth	—	—	6.2	6.7
Below average salary growth	—	—	7.2	7.4

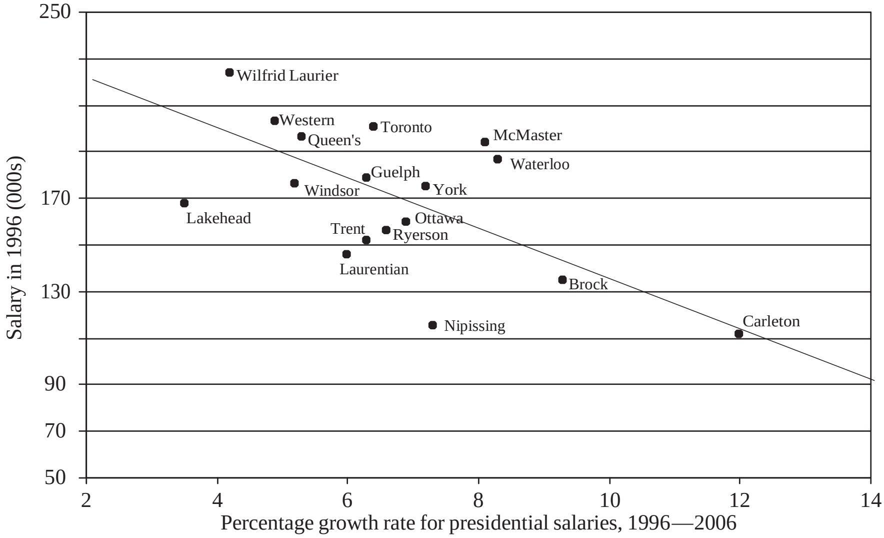
Source: Ontario, Ministry of Finance, at www.fin.gov.on.ca/en/publications/salary disclosure/2009/index.html.
Note: There is a missing entry in 2006 because Carleton president Mahmoud commenced his term on 20 November 2006. For Brock, there are two missing entries because, in 1996, the president was serving in an acting capacity, and, in 2006, president Lightstone commenced his term on 1 July.

provide a bit more insight into the presidential salaries that were disclosed, we excluded all the salaries of presidents who served on an acting basis and those whose salary reflected partial-year employment. Table 1 shows such salaries for the beginning and ending years that were available and are ranked in descending order based on 1996 data. Table 1 also depicts growth in presidential salaries based on full-year salary data. The positional growth rate is compound growth based on the last year of complete data compared to the first year of complete data, whereas the individual growth rates are annual compound rates calculated using changes in the same individual’s salary. Where there are multiple presidents for the same university, a weighted average of individual growth rates is taken.[6] These individual growth rates can be viewed as incorporating returns to tenure and experience as the only variable that is changing is the time spent with the university.

The data in Table 1 are consistent with a survey ratcheting effect. Specifically, below-average salaries grew at a faster rate than above-average salaries (based on 1996 levels) and both high- and low-end salaries were drifting upward as opposed to converging to the (lower) starting level mean. The two schools at the top of the pay scale experienced the slowest rates of salary growth, while pay at Carleton (the bottom school in terms of presidential pay) grew at an annual rate of twelve per cent, which was the most rapid. So, while the growth of pay at the very top of the pay hierarchy was slower post-disclosure, it appears that there is faster convergence to the highest salaries rather than downward convergence to the lowest. This pattern is displayed in Figure 1, which shows that average (positional) growth rates are inversely related to presidential salary levels in 1996.

A regression of the average annual growth in salaries on the initial presidential salary level (both in natural logarithms) yields a similar conclusion; the estimated coefficient implies that a ten-per-cent-lower initial salary

Figure 1. Average Annual Growth Rate of University Presidential Salaries, 1996–2006, as a Function of Initial Salary



Note: A linear regression estimation where the growth rate in salaries depends on the starting salary in 1996 yielded a co-efficient of -0.87, which was significant at the five-per-cent level.

results in an 8.96-per-cent-higher growth rate on average (regression results available upon request).

Several caveats should be mentioned at this stage concerning these data. First, one potential drawback is the lack of complete revelation concerning all non-disclosed aspects of university presidential salary data. To the extent that public disclosure is a factor conditioning pay, it could lead to a shifting of pay towards unmeasured or deferred components less scrutinized by public eyes. The recent uproar in the deferred payout (totalling $1.4 million) negotiated between McMaster University and its president is an example of this potential (Walters 2008). Second, in order to ‘‘identify’’ a true restraining effect from the Public Sector Salary Disclosure Act, we would require data on control variables that may have affected presidential salaries over this same period, such as data on levels and growth of government funding, the size and growth of individual universities, the overall size and government priority of the sector, and the effect of the double cohort over this period. In short, one of the major deficiencies in the act is that it does not provide associated data in order to make fruitful comparisons. By excluding all other controlling factors and simply publishing salaries free of individual or institutional qualifiers, it implicitly assumes everything is constant when comparing and looking at salaries across sectors or institutions. Finally, there is also no counterfactual or control group present in the act's data. There are fewer than twenty universities in Ontario so it is likely that even without the act, universities would have known of the salaries of their counterparts. In short, it is not possible to tell whether the salaries of university presidents would have behaved in the same way (i.e., no salary cuts and convergence to the top) in the absence of this act. To partly correct for this and other omissions, we compare data for professors across Canada, for which we do have inter-provincial comparability stretching back to 1990 (i.e., before and after the introduction of the Public Sector Salary Disclosure Act).

Professorial salaries in Ontario and the rest of Canada

Table 2 presents data on full-time professors from the Canadian census. These are professors of all ranks (e.g., assistant, associate and full) who worked forty-nine to fifty-two weeks in a calendar year and for more than thirty hours per week on average. The table shows that salaries of Ontario professors grew at 2.5 per cent when salaries were disclosed compared to a drop of 5.5 per cent in the five years prior to disclosure. As a simple difference in growth rates (third column), this corresponds to an 8.1 percentage-point increase in Ontario, which is the largest figure in Canada and much larger than the all-Canadian average (excluding Canada) found in the last row.

Table 2. Changes in Average Annual Salaries of Professors, Ontario versus Selected Provinces

	Percentage change(s)			
Province	[1] Pre-disclosure 1990–95	[2] Post-disclosure 1995–2000	[3] Change in rates [2]-[1]	[4] Difference-in-differences*
Ontario	−5.5	2.5	8.1	–
Newfoundland	−2.7	−4.8	−2.2	7.3
Nova Scotia	−2.0	−0.2	1.8	2.7
New Brunswick	1.4	−8.1	−9.5	10.6
Quebec	−4.0	0.4	4.4	2.1
Manitoba	−0.1	4.9	5.0	−2.4
Saskatchewan	−3.4	1.1	4.5	1.4
Alberta	−3.8	3.5	7.3	−1.0
British Columbia	0.8	−0.2	−1.0	2.7
Canada excl. Ontario	−2.3	0.3	2.6	2.2

Note: Data for PEI were suppressed due to small sample sizes. These are professor salaries of full-year, full-time workers (i.e., worked mainly full-time for forty-nine to fifty-two weeks per year). These data are at the four-digit occupational level (NOC E111).

*The difference-in-differences calculation is made using the following formula, where Y is the average salary

$$Diff_{it} = \left(\log Y_{2000} - \log Y_{1995}\right)_{Ontario} - \log\left(Y_{2000} - \log Y_{1995}\right)_{Canada=province}$$

Source: Canadian census for 1991, 1996, 2001.

When measured as a difference-in-differences in the fourth column, in which changes in rates of salary growth post-sunshine law in Ontario are taken between Ontario (the ‘‘treatment’’ group) and each province/rest of Canada (the ‘‘control’’ groups), as well as between Canada excluding Ontario, we find positive changes in almost every row. While this does not prove that disclosure in Ontario has led to upward pressure on wages, it certainly suggests that the act, as a stand-alone legislative mechanism, has not achieved its intention of restraining salary growth even relative to other provinces. Other factors are clearly at work in affecting wages (Martinello 2008).[7]

There are several reasons, therefore, why the act could not have provided the intended wage restraint trumpeted by its supporters. The legislation does not go far enough in providing comparability and standardizing of professors by rank and age across institutions, because it simply lists names and does not even enforce standardized job titles across departments. We have tried to provide some basis for standardization by isolating university presidents and by comparing the university sector in Ontario with other provinces that lack salary disclosure. But even here, data stretching back to the early 1990s that include all ranks of professors separately are not provided publicly either by Ontario's Public Sector Salary Disclosure Act or Statistics Canada.

Conclusion

At the most fundamental level, our assessment of Ontario's experiment with salary disclosure reveals that, in the academic sector at least, disclosure has not been associated with restrained salaries. Instead, if any tentative conclusion can be reached, it appears that salary disclosure has most likely been inflationary. This is consistent with numerous theoretical propositions that contend that disclosure puts more upward than downward pressure on wages. It appears that disclosure is at best a fairly weak instrument for restraining public-sector wage growth. This is because many of the necessary restraining mechanisms of disclosure are absent in the public sector. Most notably, a public-sector equivalent to vocal institutional shareholders is lacking.

In terms of the stated principles of the legislation, while the Public Sector Salary Disclosure Act does achieve the laudable goal of increasing transparency with respect to public-sector pay, it raises serious concerns about privacy, and one must question whether the costs of this increased transparency outweigh the benefits. While we have enumerated the costs with the present form of the legislation, the benefits are less clear. For any beneficial impacts from this legislation to emerge, it must be amended so that it indeed discloses information of truly senior officials, that the existence of inflation is acknowledged, that context and control variables are provided to allow the evaluation of public-sector remuneration, and that some attempt to protect individual privacy is made.

Notes

1 The Ontario Ministry of Finance web site (http://www.fin.gov.on.ca/en/publications/salary disclosure/2009/index.html), containing the disclosed salaries (except 1995), outlines the purpose of this legislation: ''[T]his law is to provide a more open and accountable system of government. It lets taxpayers compare the performance of an organization with the compensation given to the people running it. People paid $100,000 or more a year are usually the senior employees in an organization. It also provides taxpayers with more details on how their tax dollars are spent.''

2 Based on Statistics Canada (2007) Labour Force Survey (change from 1995 to 2006)

3 Data from 1996 onwards is available on the Ontario Ministry of Finance web site. Data for 1995 were, instead, available for viewing by the public at various locations depending on the sector in question (e.g., specific university libraries had lists for the institution in question). Thus, for the most part, we examine data from the years 1996 to 2006.

4 Calculated with the Bank of Canada's inflation calculator using the national CPI. See http://www.bankofcanada.ca/en/rates/inflation_calc.html.

5 For example, based on SEPH data, public servants' wages increased by 2.1 per cent (CANSIM series V1741891), while based on LFS data of full-time public administrators in Ontario,

weekly wages increased by an average of 3.7 per cent between 1997 and 2006 (CANSIM series V2153285), and salaries of Ontario professors (all ranks combined excluding deans) between 1995–96 and 2004–05 increased from $75,642 to $94,794, representing an annual growth rate of about 2.5 per cent (COU data based on UCASS surveys). Presidential salaries in comparison grew at a rapid clip compared to growth in wages of senior management occupations in Ontario (CANSIM series V2258061), which increased by 3.4 per cent between 1997 and 2006.

6 For example, the 4.2-per-cent positional growth rate for Wilfrid Laurier is calculated as $[(339.6/224.0)^{0.1}] - 1$, whereas the 6.0-per-cent individual growth rate is calculated as $[(339.6)/(213.0)^{0.125}]$-1.

7 The results also have to be qualified by the fact that the 1990—95 period was perhaps unique in the recession of the early 1990s, and the public-sector salary restraints imposed by the NDP-led Social Contract in Ontario may be compromising the use of this period as our baseline. Having said this, other provinces experienced recessions of equal or greater magnitude and their own version of public salary restraint.

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Director Notes

Peer Groups

Understanding CEO Compensation and a Proposal for a New Approach

by Charles M. Elson and Craig K. Ferrere

Nearly all large public companies currently rely on a comparative peer benchmarking approach to design their executive compensation packages. We believe that such an approach is based on a flawed assumption and suggest that boards instead consider an internally focused approach.

Peer Benchmarking

In setting CEO pay, boards, often with a compensation consultant's assistance, assemble a "peer group" composed of companies in similar lines of business that are of comparable size and complexity and have other characteristics the board believes are pertinent. The consultant gathers data specifying the level of compensation at each company.

This *Director Notes* is based on and partly excerpted from Charles M. Elson and Craig K. Ferrere, "Executive Superstars, Peer Groups, and Over-Compensation—Cause, Effect, and Solution," *Journal of Corporation Law*, 37 (forthcoming in 2013) (http://ssrn.com/abstract=2125979). For an opposing viewpoint, as well as additional discussion, debate, and resources on this topic, see The Conference Board Director Roundtable: Executive Compensation and the Utility of Peer Groups (www.conference-board.org/directorroundtables/peergroups).

Then, to complete this process of "competitive benchmarking," the board decides where in the distribution they wish to target the total compensation of their CEO. Most companies choose to target the median level (50th percentile). Others choose to target the 75th or 90th percentiles. Companies rarely target below the median. The typical justification for these targets is that the company must pay to "attract and retain" highly talented executives. In marketing parlance, the targets represent "good," "better," and "best." Below median pay would evidently suggest "worse."

Benchmarking is not only a significant factor in the process of determining executive compensation, it is currently seen as the essential element. Developing this comparative group is the first task assigned to the consultant by the compensation committee. Once a target is chosen, it

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becomes the anchor for the subsequent design. An endless variety of possible apportionment between long- and short-term incentives, bonus structures, cash, or whatever other components are desired can be devised to meet the prespecified numerical target for the value of actual, expected pay. To be sure, when all is said and done, a compensation committee member's ultimate concern is whether the target has been met. A study by John Bizjak, Michael Lemmon, and Lalitha Naveen in the *Journal of Financial Economics* confirms the significance of peer groups. The authors found that peer groups had a greater effect on changes in pay than CEO performance. A CEO whose pay fell below peer group medians received a raise the next year that was, on average, $1.3 million more than a CEO who was above the median.[1]

The influence of benchmarking does not stop there. It provides the frame of reference by which external constituents evaluate and rationalize compensation awards. The Securities and Exchange Commission mandates disclosure and discussion of peer groups and targeted percentiles.[2] The major proxy voting advisory firms have gone so far as to create their own peer groups.[3] Rather than having a frank discussion of the actual dollar amounts of compensation and whether they are appropriate, the exercise turns into a battle of the peer groups, with a proxy advisor and a company, each equipped with their own peer groups, debating which companies can be used for comparison in some abstract, objective universe. Presumably, the purpose of this exercise is to achieve the board's stated desire to "attract and retain" talented individuals capable of effectively running large and complex businesses. For this reason, it is seen as critical that Pepsi be included in Coca-Cola's peer group, Microsoft be included in Apple's, and Exxon be included in the peer group of a newly public company that hasn't yet recorded a profit. Otherwise, the argument goes, the CEO will leave to take a better offer at a competitor's shop.

In our recent paper, and also in other preliminary and subsequent work, we evaluated this process and the assumptions that underpin it, and we found that, contrary to the standard belief, a CEO's skills are specific to his/her company and therefore are not transferable.[4] If this is true, then external benchmarking comparisons, which are made under this assumption of transferability, must be rethought.

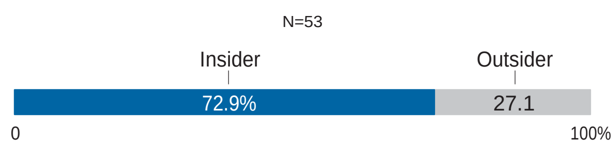
A myth about "superstar" CEOs has woven its way into the fabric of American corporate lore. The concept is best summed up by the noted and controversial corporate "icon" Al Dunlap, who once wrote that the "best bargain is an expensive CEO."[5] The thinking is that a talented CEO is a precious commodity worth paying dearly for because he or she will deliver tremendous returns for shareholders. Based on this logic, boards believe that if they do not pay the "market rate" reflected in the peer benchmarking data, their own superstar CEO will be lured away. This myth is simply not consistent with the reality. More often than not, the CEOs of large public companies are long-time insiders rather than the more recognized external hires. The operation of a successful business requires intimate knowledge of its operations that goes beyond the simple, general management talent that can be transferred from company to company. The data show that companies hire a CEO from outside only when forced to by poor performance or changing industry structures that necessitate a dramatic turnaround, restructuring, or sale. The executives who are recruited for this messy and risky task are rarely sitting CEOs, but are more often their junior reports. According to our research, it is quite rare for a CEO to jump from one company to another. Opportunities to do so simply do not exist in any significant respect. Therefore, the retention concern commonly cited as a justification for widespread peer benchmarking is unfounded.

CEO Successions in 2012

The Conference Board annually tracks CEO succession events among the S&P 500.[6] In 2012, there were 53 CEO transitions. Of those, 72.9 percent involved insiders. In the 2009–2011 period, approximately 75 percent of incoming CEOs were inside hires.[7] High-profile successions involving outside hires included Yahoo! and Avon, both of which experienced significant turmoil and were reportedly in need of "change agents."

Chart 1

Inside CEO promotions and outside hires



Source: Jason D. Schloetzer, Matteo Tonello and Melissa Aguilar, *CEO Succession Practices: 2013 Edition*, The Conference Board, Research Report 1520, forthcoming, 2013.

Marissa Mayer, formerly a vice president at Google, was hired by Yahoo! after the former CEO, another outsider, left the company amid a controversy involving inaccuracies in his academic record. Mayer faced "a daunting assignment to turn around a company that in recent years has struggled with flat-lining revenue and a moribund stock price," the *Wall Street Journal* reported.[8] Sheri McCoy, who was previously a candidate for the top job at Johnson & Johnson, replaced Andrea Jung at Avon, a company *Forbes* described as "ready for a makeover."[9] Other companies that hired outsiders in 2012 included Best Buy Co. Inc., Quest Diagnostics, and Computer Sciences Corp. The top leadership position at the defense company SAIC was filled by a veteran board member.

Most companies promote insiders, many with long tenures at their organizations. According to The Conference Board report *CEO Succession: 2013 Edition*, the average tenure of internally promoted CEOs last year was 15.8 years.[10] For example, Inge Thulin had been at 3M since 1979. After a long career, he was promoted to CEO in 2012. Thulin had held positions in the company's sales and marketing, life sciences, vision care, orthopedic products, and skin health divisions. He had managed subsidiary and general company operations. He had experience with 3M in Canada, Russia, Sweden, Europe, and the Middle East, and, finally, with 3M's international operations.[11] His well-rounded internal development is more characteristic of the new style of CEO than the firm- and industry-leaping practices associated with superstar executives.

The 2012 data show that, in reality, CEOs are typically hired from inside the company. This is not really surprising, since much of the corporate knowledge that may be considered mundane—such as inside-out familiarity with the supply chain or how the widgets are made—is the type of critical experience that best determines CEO effectiveness. Such skills are learned carefully over a long tenure with a company and, therefore, are not transferable to other companies.

Empirical Support

Scholars have long recognized a distinction between firm-specific and general skills. Successful CEOs leverage not only their intrinsic talents but also, and more important, a vast accumulation of firm-specific knowledge developed over a multiyear career. Whether it is deep knowledge of an organization's personnel or the processes specific to a particular operation, this skill set is learned carefully over a long tenure with a company and cannot be easily replicated at other firms. This has important implications for the pay conundrum and for appropriate succession planning. It is very likely that a CEO's best opportunity is where he or she is currently employed. Also, for a board, more often than not, the best candidate for the CEO slot is an insider.

Empirical evidence in academic literature gives credence to the fact that executive skills are, in large part, specific to the companies where they are acquired. Data on CEO turnover and compensation are relatively easy to come by. Wharton Research Data Services (WRDS) maintains proxy-disclosed data on executives, their compensation, and other variables. For researchers, this tool gives access to information on the largest 1,500 U.S. public companies for the years 1993–2012.

Contrary to "market rate" arguments for peer benchmarking, detailed analysis reveals that CEOs rarely run multiple public companies during their careers. Even rarer are instances of CEOs "jumping" from one company to another. Except for turnaround situations, internally promoted and internally trained executives are the norm.

Several academic papers, each with independent research objectives, have analyzed the data for CEO turnovers. Since there is little ambiguity with regard to where and when a particular individual was employed, the choice of which study to reference is inconsequential. Our own analysis is consistent with the findings of these studies.

A 2012 paper by Huasheng Gao, Juan Luo, and Tilan Tang that analyzed nearly all of the WRDS data set showed results consistent with our peer benchmarking thesis. The researchers defined an executive as "job hopping" if they left one job and took another within three years. For the top executives at the 1,500 or so largest companies during the period from 1993 to 2009, the researchers identified 1,069 "hops." Most (767) were nonCEO executives moving to other nonCEO positions, while a fair amount (267) involved a nonCEO moving to become a CEO at another company. Only 27 CEOs "jumped" to become CEOs at other firms. On average, there were less than two instances of such jumps per year among all the companies studied. Another 16 CEOs became nonCEOs at another firm.[12]

A 2004 paper by C. Edward Fee and Charles J. Hadlock examined S&P 500 companies and found only six such CEO moves during a five-year period. "Jumping" to a new employer as a reason for a CEO departure represented only 2.93 percent of the 205 departures identified. The most commonly identified reason was retirement, which was the explanation given for more than 50 percent of turnovers. Mergers, ownership changes, and forced departures represented another 30 percent of the identified events.[13]

A 2011 study by Martijn Cremers and Yaniv Grinstein revealed another dynamic that is needed to understand CEO transferability and test the "market rate" justification for peer groups. Even if a company decides to hire a new

CEO from outside the company, the job is usually filled by a more junior executive and not by a sitting CEO. For instance, 374 (68 percent) of the outside CEO hires between 1993 and 2005 were nonCEOs from either public or private companies.[14] This is for a good reason. Companies typically recruit from the outside only when forced to do so because they are in need of a turnaround or lack substantial managerial depth. These are simply not attractive job opportunities for most sitting CEOs. Turnaround positions are typically of interest to a particular type of executive—either a senior executive who was passed over for the CEO job or one who specializes in restructuring and mergers and acquisitions work.

What This Means for CEO Pay

CEO compensation is not a story of competitive markets determining pay levels. Compensation committees have the ability to determine the appropriate level of CEO pay. If a CEO is really unable to move in the free fashion that is used as the basis for the concept of peer compensation benchmarking, then the earnings of other CEOs should be virtually irrelevant to the design of a specific CEO's pay package.

Supporters of the system of median benchmarking argue that it is a fair and reasonable means of arriving at a salable number. Given the uncertainty inherent in valuing a CEO's contribution and determining how much of that contribution he or she should retain as compensation, targeting pay at the peer group median may be viewed as a resolution device of sorts. However, this benign characterization misses the real problem with peer group benchmarking—the creation of a structural bias for higher and continually rising pay. Compensation critics have long argued that if all executives are paid at or above the median, the result is a never-ending escalation in pay levels—the so-called "Lake Wobegon" effect.[15] Additionally, several recent studies have demonstrated that peer groups are often manipulated to include larger peers, which results in even higher pay.[16] Variables such as CEO pay typically move up and down, and pay levels are either higher or lower in response to market conditions and other local factors. The overreliance on benchmarking has added pressures that make pay predominately responsive to external market survey data. The influence of this data can result in a bias for companies to make upward adjustments that can move pay amounts incrementally upward for all other companies as well. The compounding effect of this steady upward ratchet has been an inexorable rise in CEO pay. Internal factors would provide an important countervailing influence.

This rise in pay has come at the expense of effective incentive and motivation structures. A business organization, particularly a large public corporation, is a team-driven and communal enterprise. For better or worse, individuals working within companies compare and react to each other's pay and rewards. Therefore, the pay of individuals within the organization is highly interrelated, and the pay of even one individual must be carefully and holistically designed. A CEO's pay, which is a very public data point, cannot stand alone because it is the keystone to an effectively designed pay structure. If you are not convinced that a CEO's pay is an important driver or, conversely, an inhibitor, of corporate performance, just look at the response to any CEO who has taken the symbolic $1 paycheck. The compensation at the top is a powerful component of an effective corporate culture.

Due to the inherent flexibility of the process and the potential impact on morale, designing a truly effective pay package requires much effort and creativity. While metrics such as peer benchmarks are helpful, compensation committees must be careful not to be lulled into complacency by the sense—or appearance—of objectivity that they provide. Boards should rely on their own judgment and independent analysis of the many subjective factors important to the design of an effective pay scheme. A computer program or a consultant's data tabulations cannot replace the actual board's expertise and understanding of the company.

Board Guidance

The chief executive's pay profoundly affects the entire incentive structure of the organization and must be carefully considered. Exclusive reliance on the peer benchmarking process is insufficient. A board that neglects to take into account the many complex costs involved when determining appropriate compensation has not functioned appropriately.

As benchmarking has become universally accepted and applied, even the most independent shareholding boards use comparative metrics in setting pay. Even when applied by a model board, an exclusive reliance on peer grouping is unjustified and can lead to a steady increase in compensation. A more nuanced approach is needed.

Ultimately, the process of setting compensation should not be mechanistic. When appropriately determined, it should be based on objective factors and nuances. The key to an effective process is a group of directors who are appropriately objective and motivated to consider the money involved and reach a reasoned conclusion on the appropriate amount of pay. Shareholders elect directors for their good and objective judgment, not the mechanical and rote application of some formula. In an invigorated process, benchmarks should be viewed as one data point among many that directors must consider.

But how should the process function? Setting pay is an art, not a science. In commissioning a work of art or music, one does not attempt to supplant the artist's judgment with his or her own by dictating the precise technique or form. Likewise, we propose only general guiding principles for setting pay so as not to unduly constrain the art or judgment of the directors, who are those most informed on the matter.

We believe that, as a starting point, the board should be properly composed and given the proper incentives to ensure their ability to effectively negotiate with management about pay. Directors must be independent of management and possess a personally meaningful equity stake in the company to ensure that compensation is negotiated in earnest. An effective board-level review of executive pay must begin with this fundamental foundation. The risk of a chief executive departing because of a compensation issue is less than the "competitive" benchmarking rhetoric or the executives themselves would lead people to believe. An overreliance on peer group analysis and median targeting can lead to an unwarranted complacency. Given the flexibility involved in setting pay, directors have an obligation to exercise their discretion effectively.

Boards are currently predisposed to bias pay upward; to a large corporation, a few million dollars to meet an executive demand or peer group target seems immaterial. However, the expense far exceeds the visible payment. Since CEO pay affects the organization's cost and incentive structure, the true cost can be substantial. The bias should be toward lower pay. Executive disappointment can be managed by the board, but the damage to employee morale and motivation caused by excessive CEO compensation is far more difficult to resolve.

The board review of CEO pay should be conducted within the context of pay for the organization as a whole. Since the CEO is an employee of the corporation, his or her pay should be considered an extension of the infrastructure that governs the rest of the company's wage structure. Internal consistency or pay equity throughout the organization, up to and including the CEO, is a natural and reasonable objective. The board should not consider executive pay separately from the structures that govern compensation for other employees. It should be built upon the same foundations and precepts. Participation in bonus pools in kind with other employees may be helpful to produce this mindset. Board ratification of the CEO's contract should not be viewed singularly; it is an implicit examination and approval of the entire organization's wage and incentive structure. Current peer grouping practices assume that internal consistency must succumb to market pressure when setting CEO pay. We believe these market concerns are overblown. Boards can, and should, restore some internal consistency.

For many years, the DuPont Company was well known in compensation circles for its highly regimented internal pay equity plan for its CEO's compensation. Describing this approach, DuPont chairman and CEO Edgar S. Woolard, Jr., wrote in 2005:[17]

> We're going to look at the people who run the businesses, who make decisions on prices and new products with guidance from the CEO—the executive vice presidents—and we're going to set the limit of what a CEO in this company can be paid at 1.5 times the pay rate for the executive vice president.

This simple, intuitive approach seemed equitable to him. The company was successful at both retaining executive talent and returning shareholder value. We believe this type of balanced approach to CEO pay formulation is worth serious consideration.

How past performance should affect executive compensation is an issue that, again, calls for careful evaluation by a board. Much of an executive's prior performance has previously been rewarded through compensation in accordance with prior contractual commitments. When objectives are met, bonuses are paid. When stock price accretion is achieved, the value of an executive's equity holdings increases in turn. A board is not obligated to reward performance further by increasing the level of compensation during the next period. However, the board may feel in some cases that performance that far exceeded expectations was not adequately compensated under the previous contractual limits. In such instances, increasing compensation further is certainly acceptable. An executive who delivers results beyond expectations should be assured that exceptional efforts will be rewarded in kind. Performance should be measured and evaluated based on both internal and external considerations. For example, a board that views customer satisfaction as integral to the company's future competitive strength may take customer survey results into account. When an executive's initiative results in a marked improvement in these survey results, the board should reward the executive accordingly. Other internal performance metrics used may include revenue growth, cash flow, or various measures of return, to name a few. Bonuses and incentive payouts, as initially contracted, should reward the achievement of various objectives related to those factors. When expectations are exceeded, additional rewards may be warranted based on achievement over short and extended periods.

Used appropriately, external metrics may also be important to the evaluation of an executive's achievement with respect to continuing or improving the competitiveness of the enterprise and, therefore, may be relevant to the provision of additional compensation. Objectively constructed peer groups used for the purpose of a relative performance evaluation are necessary. If Pepsi's performance far exceeds that of Coca-Cola, Pepsi's CEO certainly may deserve relatively more generous compensation.

Conclusion

We believe that the use of external peer benchmarking in setting executive compensation has contributed significantly to the problem of high and rising pay in the United States. The pay awarded to CEOs is becoming profoundly detached from not only the pay of the average worker, but also from the companies they run. Offsetting the current reliance on external metrics with the use of internal metrics and benchmarking should help curb the persistent escalation of pay. If directors are not constrained by notions of "competitive" pay that are based on a false belief that CEO talent is transferable, then they may be able to reduce the ratcheting of pay and deliver compensation that is more acceptable to shareholders. This proposal may well result in more reasoned executive compensation schemes, more effective board oversight, and, most important, a healthier, more competitive corporation. Deemphasizing the peer group process in setting CEO pay may not be a comprehensive cure to the overcompensation problem, but the costs of doing so are minimal and provide a good starting point.

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TRANSPARENCY SAVES TAXPAYERS MONEY

Employers know how much their employees earn in salaries, wages and benefits. How else could they properly manage their business and make important business decisions?

Yet, somehow, it is controversial among some politicians and government employees when the employers paying their salaries – taxpayers – want to know how much they are making? Why would some politicians and government employees fight against the right of their bosses to know how much they make?

Right now, Canadians across the country are demanding more openness from government, and they aren't asking nicely.

Alberta's Conservative-turned-Independent MP, Brent Rathgeber started the ball rolling very modestly in Ottawa with his private member's bill to disclose government salaries above $188,000. For reasons that they have yet to explain to the public, the PMO orchestrated a gutting of the bill without any debate. Mr. Rathgeber quit the Conservative caucus later that day.

But Rathgeber continues to fight for his bill as an independent and it enjoys significant support among some Conservative backbenchers and most members of the opposition.

In Alberta, taxpayers demanded to know how much Premiers Redford's former chief of staff had been paid out in severance when he left her service. The government refused to disclose the information, even though it was legally required to under the *Freedom of Information Act*.

The Canadian Taxpayers Federation (CTF) argued that this kind of information should not have to be fought for with commissioners or in the courts, but that as the employer, taxpayers should be able to access this information without a team of lawyers. The CTF pushed for a proactively disclosed list of the salaries, wages, employer pension contributions, cash benefits and severance paid to all government employers making $100,000 or more, otherwise known as, a "sunshine list."

To the surprise of many, the government did just this. Alberta's new sunshine list rules are the most comprehensive government employee compensation disclosure in the country, and will be a model for others to follow.

This has the potential to play a hugely important roll for accountability purposes, but also for monitoring government employee costs more broadly.

Ontario has had a sunshine list since the mid-1990s, although it is limited to just salaries and wages, excluding all other compensation. It showed, for example, several Toronto Transit Commission (TTC) toll both attendees making more than $100,000, as did more than 1,400 other TTC employees.

Beyond individual examples, sunshine lists also allow taxpayers to track general trends in government employee compensation. In Ontario, the number of employees making more than $100,000 a year increased by 11 per cent in just the past year. Since 2009, the list has grown by 39 per cent.

However, it is precisely this growth in Ontario that has led some sunshine list critics to argue that that disclosure fuels a growth in spending. The argument goes that employees, now able to see what their counter-parts are making, will be jealous and demand more money.

That government employees have made out like bandits in Ontario is hard to disagree with. According to Statistics Canada, between 2008 and 2012, employees in that province have seen their weekly earnings go up by an incredible 20.8%. This, during a time when workers in the private sector were just happy to have jobs.

But is Ontario's sunshine list to blame for this? Did disclosure really fuel this explosion in government pay cheques?

The same Statistics Canada data also shows that taken together, jurisdictions *with* sunshine lists (British Columbia, Saskatchewan, Manitoba, Ontario, Nova Scotia and New Brunswick) saw an average pay cheque increase of 12.3% over these five years. Provinces with *no* sunshine list (Alberta, Quebec, Newfoundland and Labrador and Prince Edward Island), saw an average increase of 13.7%.

This means that provinces with *no* sunshine lists saw raises larger than provinces that had them.

The most likely explanation for Ontario's government bonanza isn't that they disclose salaries, but that that province has had three terms of Dalton McGuinty at the helm, who's primary base of political support was the very government employees which he treated so generously.

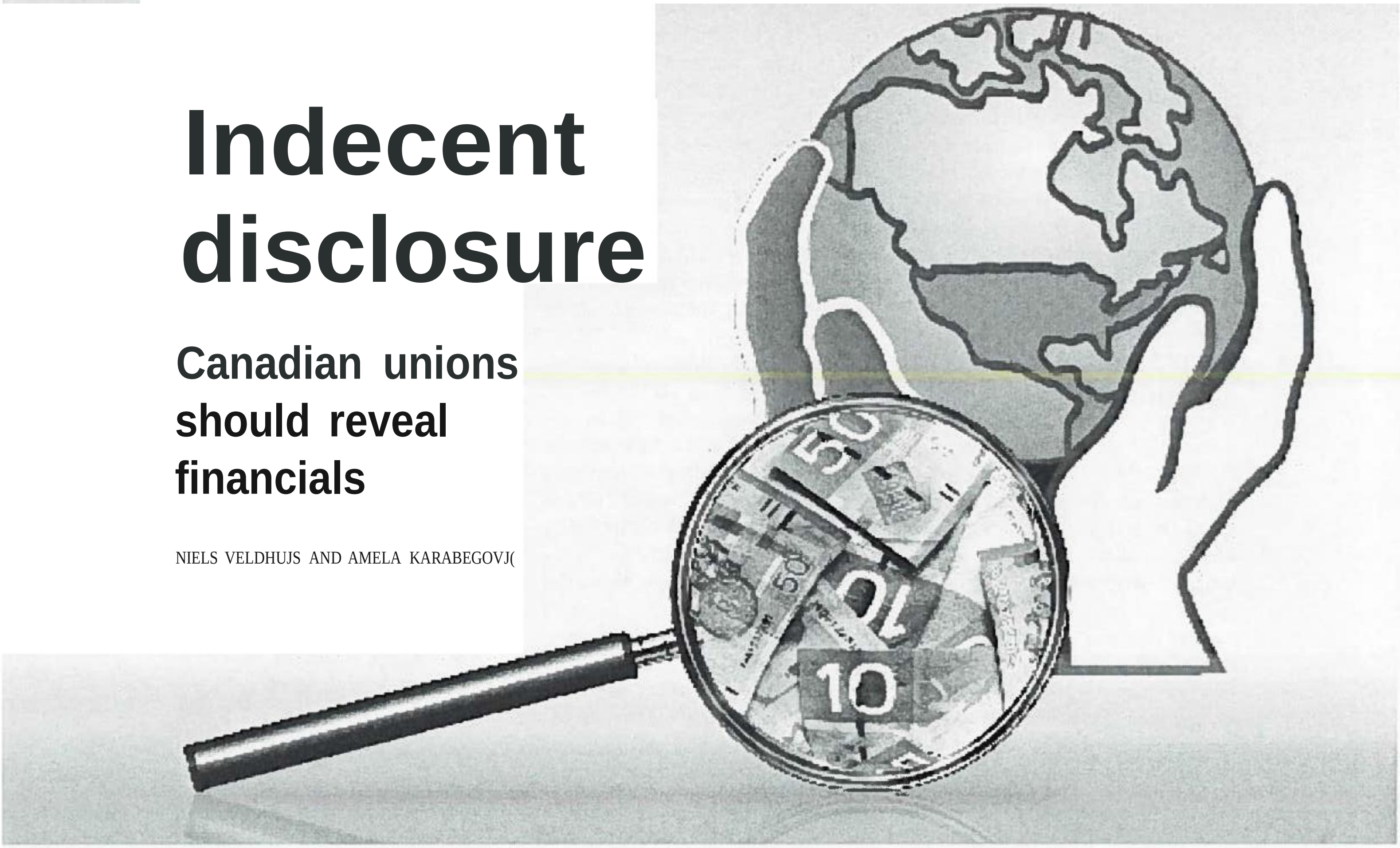
Even if disclosing government employee salaries and other benefits made no difference in the costs, taxpayers still have the moral right to know how their money is being spent on their employees. And, sometimes they need to be reminded, that we are the boss.

By Derek Fildebrandt
Posted: January 29, 2014

Indecent disclosure

Canadian unions should reveal financials

NIELS VELDHUJS AND AMELA KARABEGOVJ(



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Before Parliament was shut down, the mood in Ottawa was one of increased transparency and accountability. For instance, two private member bills making their way through the House and Senate were aimed at increasing the transparency of First Nations reserves and Canadian charities. Before this mood changes, the federal government should consider greater disclosure for another sector that severely lacks it: Canadian unions.

The current push for greater transparency

The push for greater transparency on First Nations reserves has gained traction with Canadian politicians over the past year. In the fall of2010, Kelly Block, a Conservative member of parliament tabled a private member's bill (Bill C-575: *Reserve Politicians' Pay Transparency Bill)* that would require public disclosure (on the Internet) of the salaries and reimbursement of expenses for First Nations chiefs and council members across Canada (Parliament of Canada, 2011a; Craig, 2011). The bill has passed its second reading in the House of Commons with 151 MPs voting for the bill and 128 against (Parliament of Canada, 20lla).

Similar developments have occurred in the charitable sector. Albina Guarnieri, a Liberal member of parliament drafted a bill (Bill C-470: *An Act to Amend the Income Tax Act Disclosure of Compensation- Registered Charities)* into parliament that proposes public disclosure for annual compensation of any executive or employee (at a registered charity) paid over $100,000. The House of Commons passed the bill on March s•h, 2011, and the next day it then passed its first reading in the Senate (Parliament of Canada, 20llb).

Of course, greater transparency and accountability are goals most Canadians would support. Canadian taxpayers, after all, provide billions to First Nations reserves and should therefore receive information on how their money is spent.

Registered charities, on the other hand, are exempt from taxes and can issue receipts providing their donors with tax credits for their donation. Many charities also receive direct funding from the government. In part for these reasons, registered charities are already required to provide financial information including staff compensation to Canada Revenue Agency, which publishes it for public viewing on its website (see http://www.cra-arc.gc.ca/chrts-gvngnstngs/menu-eng.html).

The benefits of transparency and accountability

Public disclosure of financial information allows interested parties to gauge the financial health and performance of organizations. In addition, transparency leads to, and is essential for, accountability. Disclosing financial information publicly allows people to determine the appropriateness and effectiveness of spending (Palacios, et al., 2006}. Empirical research has found that the benefits of greater transparency include improved governance and reduced corruption}

Indecent union disclosure

While public companies, charities- and hopefully soon, First Nations reserves-are subject to significant level of disclosure, little is required of unions in Canada in terms of releasing financial information. Currently, neither the federal government nor provincial governments require public disclosure of union financial information (Palacios, et al., 2006). This special treatment is striking given that unions receive funding from tax-deductible union dues.

In addition, workers in Canada can be legally forced to join a union as a condition of employment and have no choice but to remit union dues. Union leaders are able to use these mandatory and tax-deductible union dues to fight political battles, which their "members" and non - members may or may not support.

Union leaders in most jurisdictions (provincial and federal) would likely highlight that unions are required to make financial statements available to their members; Alberta, Prince Edward Island, and Saskatchewan do not require disclosure of financial statements to union members (Palacios, et al., 2006). However, union members must formally request financial statements, meaning the requests are not anonymous (Palacios, et al., 2006). Lack of anonymity, seriously compromises a worker's confidentiality and ability to make assessments without influence from union representatives.

This also means that the dues paying unionized workers who have not been forced to join the union, or have chosen not to join, have no right to information about how their money is being spent-even though they must pay those dues to keep their jobs. In addition, no Canadian province or the federal government prescribes or mandates a particular amount of detail in the financial statements (Palacios, et al., 2006). For instance, unions are not required to delineate expenses by type of activity. Most importantly, there is no requirement that financial statements indicate a breakdown between money spent on activities directly related to representing workers and activities unrelated to representation such as political activities.

In comparison, the United States requires significantly more disclosure from unions. To counter corruption and mismanagement, and to increase the transparency of union operations, the US government enacted new financial disclosure requirements in 2004. This legislation has required all unions

to submit detailed financial statements to the Federal Department of Labor (DOL). Large unions-those that spend over $250,000 per year-are required to provide information for 47 financial items and another 21 non-financial items organized into two financial statements and 20 supporting schedules. Less onerous requirements are imposed on smaller unions, which spend less than $250,000 (Palacios, et al., 2006}. Critically, all unions in the United States must specify the breakdown between spending on collective representation and spending not related to representation.

Another important aspect of union financial disclosure in the US is that union members and the public have equal access to all this information on the DOL website. 1hisallows anonymous access in which union representatives are less likely to influence a worker's decisions.

Providing publically disclosed information about the financial status of unions enables workers to assess more accurately the financial position, activities, and performance of their representatives. Disclosing financial information publicly allows workers and interested parties to determine the appropriateness and effectiveness of union spending. The increased transparency that comes from public disclosure is also essential for accountability and provides an incentive for union leaders to manage membership dues properly.

Despite its depth and coverage, there is room for improvement when it comes to union disclosure in the United States. For example, the available data lack simplicity, making it difficult for an average person to get a true picture of unions' finances (Palacios, et al., 2006}. Unfortunately, many additional disclosure requirements that would have made union disclosure more comprehensive were stalled and/or rescinded by the Obama Administration (Sherk, 2010; Korbe, 2011).

Specific differences in laws regarding union membership and union dues payments magnify the differences in union disclosure laws in Canada and the United States. As noted, workers can be forced to join a union as a condition of employment and are required to pay full union dues; this stands in stark contrast to the United States where workers cannot be forced to join or maintain membership in a union to retain their jobs. In addition, federal laws in the US allow workers a choice when it comes to financially supporting union activities that are not linked directly with worker representation, such as political activities.

Put another way, US workers have a choice regarding union membership and full dues payment, and have anonymous access to detailed information on union finances. Canadian workers have neither.

Conclusion

Canadian politicians should be applauded for encouraging increased transparency and accountability. Public disclosure of financial information allows interested parties to gauge the financial health and performance of organizations, and the transparency created by disclosure laws serves to improve the governance of those organizations. Given the disclosure requirements already in place for publicly traded companies, charities, and other public organizations, it is time to end the special treatment of unions. At a minimum, Canadian unions should have the same level of financial disclosure as do their counterparts in the US. As the saying goes, "a little information goes along way."

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Note

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