The Good and Bad of Wage Transparency

Shocked by the Covid pandemic and its massive layoffs, but then revitalized by the sharp economic recovery and the new frontiers of work arrangements, the labor market has been undergoing over the last three years structural changes that are shaping how people are going to work. One notable phenomenon is the "Great Resignation" with a wave of employees voluntarily leaving their jobs. In 2021 alone, around 4 million people in the United States quit their jobs each month, marking the highest resignation rates in over 20 years. This trend has continued into 2022 and 2023, highlighting a fundamental shift in workforce dynamics and employee priorities.

Among such developments and its spillovers, we cannot forget to mention the just-approved EU Pay Transparency Directive commanding firms to release more transparent and detailed information about their compensation structure within contracts with both current employees and job applicants. Member states will have three years to translate the directive into national law (Exhibit 1).

EXHIBIT 1: KEY ELEMENTS EU DIRECTIVE

PAY TRANSPARENCY MEASURES	
Pay transparency for jobseekers	Employers will have to provide information about the initial pay level or its range in the job vacancy notice or before the job interview. Employers will not be allowed to ask prospective workers about their pay history.
Right to information for employees	Employees will have the right to request information from their employer on their individual pay level and on the average pay levels, broken down by sex, for categories of workers doing the same work or work of equal value.
Reporting on gender pay gap	Employers with at least 100 employees will have to publish information on the pay gap between female and male workers. In a first stage, employers with at least 250 employees will report every year and employers with between 150 and 249 employees will report every three years. As of five years after the transposition of the Directive, employers with between 100 and 149 employees will also have to report every three years.
Joint pay assessment	Where pay reporting reveals a gender pay gap of at least 5% and when the employer cannot justify the gap on basis of objective gender neutral factors, employers will have to carry out a pay assessment, in cooperation with workers' representatives.

BETTER ACCESS TO JUSTICE FOR VICTIMS OF PAY DISCRIMINATION	
Compensation for workers	Workers who have suffered gender pay discrimination can receive compensation, including full recovery of back pay and related bonuses or payments in kind.
Burden of proof on employer	Burden of proof on employer where the employer did not fulfil its transparency obligations, it will be for the employer, not the worker, to prove that there was no discrimination in relation to pay.
Sanctions will include fines	Member States should establish specific penalties for infringements of the equal pay rule, including fines.
Equality bodies and workers' representatives	Equality bodies and workers' representatives may act in legal or administrative proceedings on behalf of workers.

Such a directive marks a cornerstone achievement in labor law and retraces the latest legislation in the US too. Many labor unions, advocacy groups and political parties had been lobbied for a long time for this with the scope of empowering workers, reducing information asymmetries and therefore increasing their bargaining power. Common sense, isn't it?

However, are we really sure that wage transparency yields positive effects on the labor market?

In this article, we will review the literature over the topic, trying to find evidence that corroborates or dismantles this seemingly obvious outcome. Latest research has indeed analyzed the issue from a range of insightful perspectives.

Pay transparency should not be reduced to a mere issue of asymmetric information. The first consequence that deserves deeper investigation is the effect on productivity. This seems to depend largely on what transparency reveals. A study by Gutierrez, Obloy and Zenger (2022), involving 116 post-secondary education US Institutions with 230,788 individual-year observations, takes advantage of the progressively higher availability of wage information for US academic positions to analyze the effects on productivity of the increased pay transparency. [1]

From an aggregate standpoint, beyond any individual heterogeneity, transparency does not lead to a productivity decrease: actually, it may sometimes even contribute to an increase in it. Consistently, from an individual standpoint, transparency seems to do exactly what we would expect: inequitably overcompensated employees increase their effort, while inequitably undercompensated employees decrease their level of effort. No surprises so far, we would say.

However, the organizational level analysis seems to offer more interesting results. In this case, productivity outcomes really depend on what transparency shows of the work environment employees are embedded in. Indeed, as pay transparency makes workers conscious of the firm organizational-level characteristics, productivity tends to decrease if pay transparency reveals inequity. Instead, as long as workers perceive their working environment as fair, and as long as they are capable of seeing the link between performance and increase in pay, they will be more eager to increase their productivity. Organizational culture really matters as, intuitively, if workers perceive their employer as unfair, a transparent bonus plan might undermine their trust in the organization and their perception of their compensation's fairness.

Another study by Professor James Flynn (2022) offers a useful perspective on the effects of pay transparency on the 'type' of performance delivered by individuals. Turning to another field, the study focuses on the effects of pay disclosure on the 362 National Hockey League team players' attitudes during games (seasons 1990 and 1991). In particular, players tend to focus on performance measurement, trying to maximize those metrics. This seems pretty straightforward, doesn't it? However, it turns out that, if the payment-scheme is linked more directly to the players' aggressiveness (proxied, for instance, by their ability to score in each match), players tend to focus on aggressive behavior, lowering defense, making their team more likely to score, but also to *get* scored.

Such institutionalized behavior at a firm level is likely to increase risk taking and the vulnerability of the subject to external market shocks. Given these possible negative spillovers, companies may be wanting to consider more deeply how we want to measure performance, and possibly differentiate it depending on workers' tasks, as the wrong metric may result in decreasing teams' productivity.

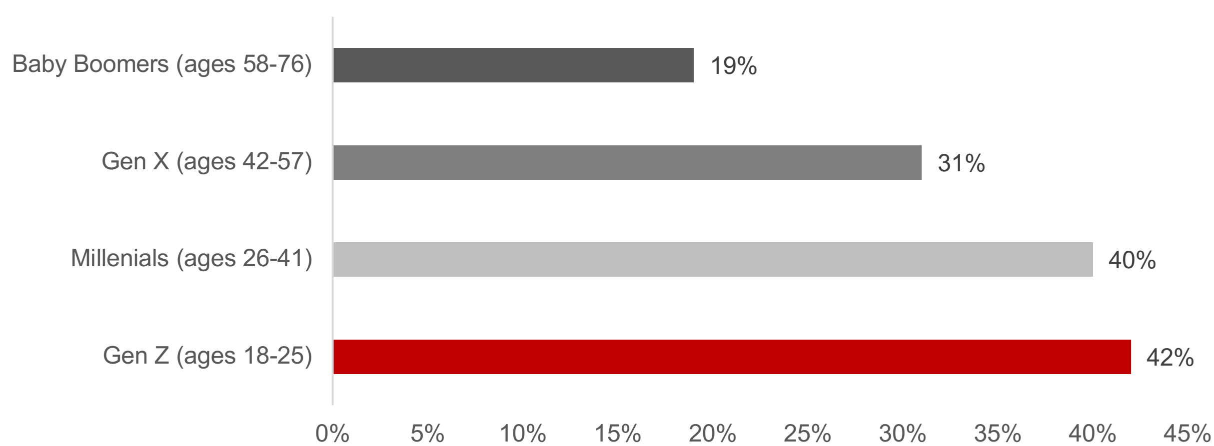
The main goal of pay transparency rules, which Professor Zoe Cullen calls *Right of Workers To Talk*, "ROWTT", is (or, at least, should be) to increase the bargaining power of workers. Her study was conducted over private firms in US states which either enacted, or didn't, ROWTT laws in 2010 and 2018, when she administered two surveys to 5,452,696 workers aged 25-54. When such features are introduced in a work environment, there are direct and indirect consequences on the work environment stemming from them, both in the short and medium term. [2]

The first and clearer effect is a short-term compression in wage differences within firms. For example, a 7% decline in average compensation for top managers in California. The compression is more consistent when a higher public aversion to high compensation is registered.

An empirical study conducted by Professor Card, conducted over 41,975 employees of 1,078 departments of the three University of California campuses, finds how ROWTT rules report little to no short- term effect on job satisfaction of employees whose pay is higher than the median; on the other hand, workers with lower-than-median pay reports higher job unsatisfaction and a greater inclination to switch jobs. According to the same studies, but in the medium term, an indirect consequence of the relative wage transparency is an increased employee turnover, whose quit rate can increase even by 75%.

Surveys conducted by Glassdoor, an online platform supporting jobseekers, show that the youth, especially Gen Z, exhibit a progressive and supportive attitude towards wage transparency while recognizing the importance of ideals such as fairness and equality. In a recent study Glassdoor shows that 58% of employees state they would consider changing jobs to work at a company with salary transparency, and that number is even higher (70%) for Gen Z employees. With the emphasis on social justice and workplace ethics being greater than any previous generation, the youth value openness, honesty, and accountability from employers, and within the professional organization (Exhibit 2).

EXHIBIT 2: WORKERS WHO SHARED SALARY INFORMATION WITH A COWORKER OR OTHER PROFESSIONAL CONTACT



Note: The total sample size was 2,449 adults, among whom 1,416 were either employed or looking for work.

Study: Sarah Foster (2022), Younger workers aren’t keeping their salaries a secret anymore — here’s why it could be a good idea, Bankrate.com.

Interestingly, Buffer, a social media management platform, from 2013 adopted a transparent salary policy to ensure fairness and eliminate inequalities. Not only they disclose their employees' salaries according to their job position, but they also provide for the formula used to calculate compensation, comprehensive of the required experience level and the cost of living associated with the job location. Therefore, there is no room for salary negotiation or special benefits. Details on salaries are available on the company's website, along with the employee's first name, role, and city of residence. In the month after the salaries were disclosed in January 2013, Buffer received almost 3,000 job applications, more than doubling the ones it received in the same period prior to the announcement.

Within workers at the same firm, in the medium term pay transparency may have unintended results also on the gender pay gap: academic research reports, for example, a reduction in the pay gap in many sectors. Notable examples are Canadian universities (30-50%, Baker et al., 2022) and Swiss firms (3.5%, Vaccaro, 2018). However, a discussion arises regarding the channel through which this gap is reduced: transparency may be in fact reducing the growth of male wages rather than increasing the growth of female ones, with serious implications on productivity and workers' mobility. Importantly, despite the positive equalizing effect of pay transparency in entry level jobs, evidence was found regarding discrimination against women both in the hiring process for higher-paid jobs and in the starting salaries that are offered (Blau and Kahn, 2016). Some of the factors driving this effect are both horizontal segregation, meaning that men and women are concentrated in specific sectors or jobs, and vertical segregation, meaning that men and women are concentrated in different job levels.

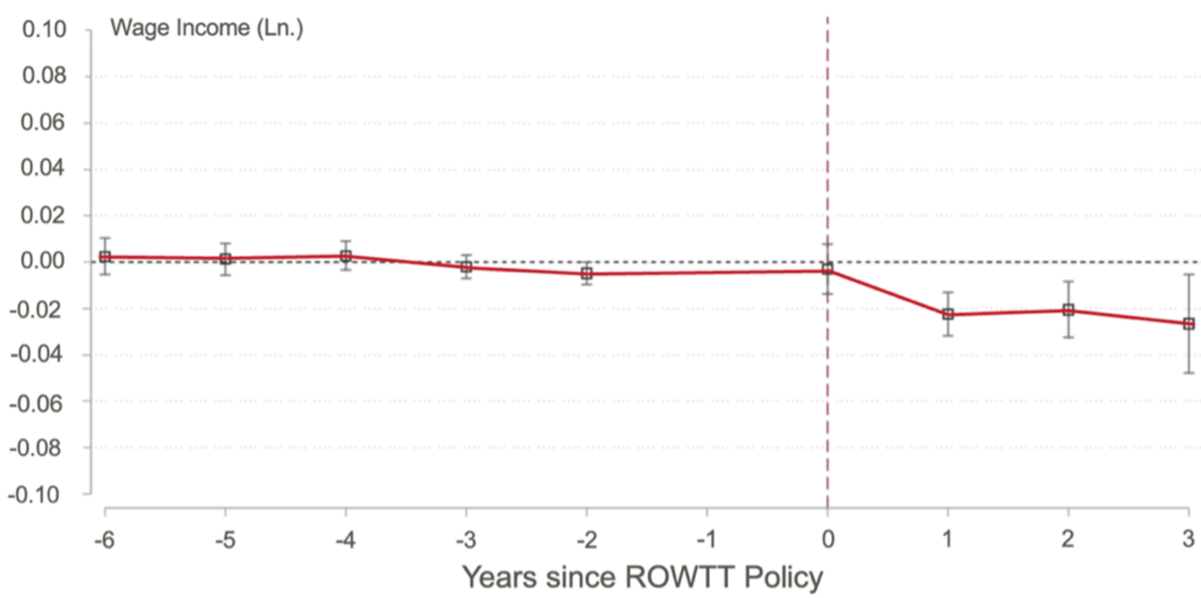
Last but not least, it seems that not only transparency makes workers change attitudes to their own task (Long and Nasiry, 2020), but also that social comparison reduces overall cooperation in the workspace (Bierman and Gely, 2004, Colella et al., 2007).

However, these results could be read as overall favorable to workers under the assumption that reduced information asymmetry on the employees' side leads workers to search for better conditions elsewhere, thus incentivizing firms to pay fair wages in order to reduce turnover and thus switching costs they have to face.

But do pay transparency laws really respond to the call for “equal pay for equal value” under the reasoning that “knowledge is power”, or is it just half of the story?

According to a study of Professors Zoe Cullen and Bobak Pakzad-Hurson, conducted in firms from the US private sector, these initiatives may instead achieve the opposite results, reducing the bargaining power of employees and negatively influencing the wage-setting curve. Pay transparency rules, in fact, provide information to workers about their value for their firms, which might generate a perverse incentive for firms to strategically manipulate such a piece of information in order to affect wage demand in their favor. Consistent with our prediction, the laws lead wages to decline by approximately 2% overall, but declines are progressively smaller in occupations with higher unionization rates (Exhibit 3). Furthermore, the bargaining power of workers is reduced due to the fact that firms are less likely to renegotiate wages as expectations of employees are anchored and hence significant salary increases become limited.

EXHIBIT 3: EFFECTS OF ROWTT LAWS ON WAGE INCOME



The event-study graph shows the evolution of wages (with y-axis displaying the natural logarithm of wage income) from a balanced composition of states (13 in total) in each of the six years leading up to the enactment of ROWTT and three years after enactment (observations were made for 17 years from 2000 and 2016). As the graph indicates, by three years after enactment, wages are 2.7% lower than the period prior to enactment.

Study: Cullen, Z.B. and Pakzad-Hurson, B. (2021), Equilibrium effects of pay transparency, National Bureau of Economic Research, No. w28903.

To conclude, wage transparency is way more complicated than a simple problem of asymmetric information. Indeed, it generates a complex system of incentives that at times produces undesirable outcomes both for the firm and for the general levels of productivity in the economy. It may lead to suboptimal behaviors and misaligned interests of the firms and employees. Nonetheless, this should not discourage policymakers to adopt policies meant to promote transparency as a tool to fight the gender pay gap and in general stimulate fair wages proportional to productivity levels. In fact, it is noticeable how it is not policies per se that generate such outcomes, but rather how the current labor market inadequately interacts with them. It may indeed be the case that, should transparency be enacted on a larger scale, in the medium to long-term firms will be able to improve their incentive mechanisms with the ultimate goal of higher productivity, and workers get the stimuli they need within a desirable framework of fair wages.

To learn more about this topic, please refer to our sources below.

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[1] We acknowledge that academia, especially in Europe, is characterized by specificities that significantly distinguish it from other labor markets. However, especially in the more dynamic, competitive, decentralized and deregulated US market, empirical conclusions inferred from this sectorial study may deliver universally valid insights about the dynamics of job search and matching and be extended, at least partially, to other sectors.

[2] The long-term consequences of wage transparency, despite being of primary relevance for the dynamics of the labour market and the outcomes of the overall economy, are still too obscure to grasp; serious issues of endogeneity further complicate the delivery of an impact analysis.