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Is Pay Transparency Good?

Countries around the world are designing pay transparency policies with the intention of combating pay discrimination. The consequences of these policies have been wide-ranging, proving at times to impact productivity, employment, wages and well-being in unanticipated ways. In this paper, we examine the evidence to-date and ask, on the whole, is pay transparency a good thing? We conclude that our evidence allows us to design transparency policies to the benefit of most. However, the most popular policies - publicizing the salary gender gaps of private firms, fully disclosing internal salaries, protecting co-workers who share pay information – force trade-offs between lower wages and more equal wages, and create both winners and losers.

I. Introduction

Most pro-transparency initiatives are based on the notion that transparency gives workers more bargaining power: workers can use salary data to negotiate fairer and better pay. The logic follows like this, suppose you're a long-tenured worker in a firm and you don't know anyone's salary but your own. One day, you happen to learn that your three colleagues all make 20% more than you do. You're all doing the same work. This is valuable information: it signals how much value your employer gets from the work carried out in your role. Armed with this knowledge, you confront your boss and ask to be paid as much as your peers. She readily agrees to the raise. Why? This information has given you a new advantage. Without knowing your colleagues' salaries, you might have underestimated your worth to your boss; if you had asked for one, your boss might have easily have denied your request. Now, however, you and your boss have common knowledge of the value your providing; you're confident she can secure the raise, and your boss may fear embarrassment, resentment or even a lawsuit. So, at first glance, it seems that transparency not only increases your pay, but also promotes equity. After all, now all the people doing the same job receive the same wage.

The case of Lilly Ledbetter is commonly cited as an example of this. Ms. Ledbetter received a covert message from a male colleague sharing his salary with her and alerting her to differences in the pay checks they had received year over year, despite doing the same work. She eventually used this information to press legal charges against her employer for unfair compensation, and the case became the basis for the 2009 Lilly Ledbetter Fair Pay Act, which removed the statute of limitation for pay discrimination law suits (Phillips, 2009).

Since a little transparency helped successfully renegotiate salaries, you might think that more transparency would help more employees do the same. That's the reasoning behind many transparency mandates.

But that story overlooks important issues: first, the very act of learning that you have been earning less than your peers can have psychological consequences. Rather than feel empowered, you may feel disappointed, discouraged, or disgruntled. Akerlof and Yellen (1990) conjectured workers who learned they were underpaid would feel lower morale and reduce their effort at work. Luttmer (2005) proposed this information could be a significant set-back for overall well-being, since happiness hinged on how one's income compared to others. Even if you discover you're the highest earner among all your peers, you may suffer from fear of being resented by others, or feel uncomfortable the circulation of a number that could be construed as your value to society or employer (Cullen and Perez-Truglia, 2018a; Edwards, 2005; Trachtman, 1999). Indeed, demands for privacy appear to rival demands for information about others' salaries (Cullen and Perez-Truglia, 2018a).

A second facet overlooked is what you may learn more broadly about your career options from the availability of pay information. Suppose you learn about the pay of a co-worker who is more advanced in their career than you are, has more skills and experience on the job. Perhaps the pay information is indicative of how your extra effort will eventually be rewarded, and you feel motivated to work harder. You may even learn about the salary of your boss whose role you have a shot at getting promoted into, and the desirability of that role may depend on that new information about pay. In sum, you may actually make effort and career choices differently on account of that pay information (Cullen and Perez-Truglia, 2018b; Dewatripont et al., 1999; Gibbons and Murphy, 1992; Gibbons and Waldman, 1999a,b; Harris and Holmstrom, 1982; Holmstrom, 1999; Lazear and Rosen, 1981; Rosen, 1986). To boot, the sheer visibility of that pay information may itself hold the employer accountable for rewarding your hard work and paying you a comparable amount to your boss when you earn that promotion (Mas, 2016).

Finally, the original narrative about pay transparency neglects how the employer responds to broad increases in transparency, when employees have new visibility into pay setting choices. How will the employer make decisions about wages and hiring when they anticipate this information will become widely known? The answer is that they likely set more equal wages, but lower wages overall. To develop intuition for this, imagine a scenario with maximum salary transparency. You not only know the wages of your peers, but you also recognize that your wage will be visible to coworkers. Suppose you demand higher pay than your peers'. The employer can credibly reject this demand, saying, "If I give you a higher salary, I'll have to give everyone else a raise too, and I just can't afford that." Under pay secrecy, you might have been skeptical of such a claim and bargained more aggressively, but due to transparency, you grasp the (true and costly) ramifications of asking for more than the current maximum wage earned by others. Therefore, full transparency leads similar workers to get the same wage. You cannot negotiate this wage upward, and the firm gets the power to set the wage. To maximize its profit, the firm acts like a monopsonist and sets a relatively low wage. Thus transparency increases the de facto bargaining power of the employer, becoming the enforcement mechanism for a low wage (Cullen and Pakzad-Hurson, 2021). These forces are particularly visible in settings where workers have high individual bargaining power to begin with, such as in highly educated, non-unionized labor markets.

Each facet of pay transparency— the interpersonal comparisons, the infringement of privacy, the learning about potential earnings, and the spillover between co-worker negotiations— affects effort, wages, inequality and well-being differently. Aspects of the policy design, and the environment in which the policy is enacted, can lead one set of forces to subsume the others. For example, a policy that reveals the percentage wage gap between levels of the organization is likely to promote learning about earnings potential and minimally affect peer-to-peer comparisons and privacy concerns. In most contexts we would expect this to have a positive, motivating effect across the board. However, there are exceptions. Enacting the same policy in an environment that is highly non-meritocratic, where a pay gap between levels in the organization underscores undeserved gains rather than earnings potential, could undermine the positive effect altogether and lower morale.

In the following sections, we delve into the details of four key mechanisms behind transparency's effects and discuss the factors that allow us to predict which mechanisms will dominate. We show how these distinct mechanisms create winners and losers in most instances of pay transparency. Pay transparency policies create a tension between forces that tend to equalize pay, and forces that place downward pressure on wage levels through both bargaining and morale effects. We conclude by putting forth policy designs that minimize detrimental consequences and which give us confidence that, yes, particular forms of pay transparency are good for society.