[Macroeconomic Implications of Executive Pay Caps]

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Francesco Caselli

Centre for Economic Policy Research, Centre for Macroeconomics, London School of Economics and Political Science

I study the introduction of statutory caps on executive pay ratios (pay caps) in a span-of-control economy with heterogenous managerial talent. Managers hire fewer workers than they would in the absence of pay caps, and the marginal product of labor is not equalized among firms. The ability of the marginal manager declines. Inequality between managers and workers, and among managers, declines, but inequality among workers increases.

Quantitatively, overall inequality decreases substantially, especially via a reduction in top income shares, but the GDP losses are also significant. In addition, the redistribution favours the “middle" deciles between 50 and 90, rather than the bottom 50% of the income distribution. Future work will build on this “first pass" to analyze the effect of pay caps in economies distorted by monopsony power, non-pecuniary benefits of control, and managerial rent extraction.