Societal Equality Sentiment and Executive Compensation*

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Abstract

Using elections that reveal changes in countries' leniency on the left-right political spectrum, we examine whether societal sentiment regarding income inequality affects executive compensation. We find that elections that bring left-leaning (pro-equality) political leaders to power are associated with significantly lower CEO pay and this impact begins in the year of such elections, not before. We further show that a rise in pro-equality sentiment restrains powerful CEOs from extracting rents. However, such sentiment also imposes value-damaging limits on incentives of senior executives in a given firm or industry. Our results are robust to a host of alternative measures and specifications.

Keywords: Executive Compensation; Societal Equality Sentiment; Elections; Managerial Power; Efficient Contracting; Firm value

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1. Introduction

Wealth inequality has been widening and becoming an increasingly greater concern around the world (see, e.g., Piketty, 2014). Particularly, when it comes to income inequality, CEO pay is a popular target for politicians, media, and activists that advocate equality. For example, "in 2013, a Swiss referendum proposed a 12-to-1 ratio on the logic that a CEO shouldn't make more in a month than an employee in a year [...] U.K. Labour leader Jeremy Corbyn and the French socialist Jean-Luc Melenchón have both voiced support." [1] Additionally, in an interview with *Newsweek* in August 2019, the U.S. Senator Bernie Sanders said: "The American people are sick and tired of corporate CEOs who now make 278 times more than their average employees, while they give themselves huge bonuses and cut back on the healthcare benefits of their employees."

The academic literature on executive compensation, however, revolves primarily around the theories of managerial power and efficient contracting.[2] According to the managerial power theory, CEOs exert greater control over boards than do shareholders and, thereby, extract rents (e.g., Bebchuk, Fried, and Walker, 2002; Bebchuk and Fried, 2003). According to the efficient contracting theory, boards act on behalf of shareholders and offer optimal contracts to CEOs (e.g., Gabaix and Landier, 2008; Edmans and Gabaix, 2009). Both schools of thought tend to assume away from indirect influences such as the public sentiment about income inequality which in turn is likely to shape the role of the *implicit* (sociopolitical) forces such as employees, labor unions, consumer groups, politicians, think tanks, and the media (Jensen and Murphy, 1990). We aim to fill this void empirically by exploiting major shifts in country sentiment about income equality. We identify these shifts using elections that replace presumably pro-equality left-leaning country leaders with right-leaning ones and vice versa.

[1] https://inthesetimes.com/article/maximum-wage-keith-ellison-jeremy-corbyn-income-ceo-pay.
[2] See, e.g., Frydman and Jenter (2010) and Murphy (2013) for surveys of this literature.

Our choice of left-right classification to measure the societal equality sentiment is motivated by the political science literature. Specifically, we base our framework on the influential book by Bobbio (1996), which posits that the political *left* and *right* differ mainly in their approach to social inequalities, and that *left* aims, in relative terms, to rectify these inequalities while *right* tends to justify them.[3] Anecdotal evidence also supports this depiction. To give an example, WSJ states in an article prior to the 2020 presidential elections in the U.S. that: "Several prominent Democrats are pressing for redistributing wealth to low-income families in a bid to make income inequality a defining term of the 2020 presidential elections."[4]

Even though the critics of perceivably excessive CEO pay are not always from the left-wing, it can be argued that the right-wing tends to remain inattentive or passive in practice. For example, while campaigning for presidency, Donald Trump is reported to say that "high pay for CEOs is a joke and disgraceful." (*Reuters,* Sep. 2015). However, approximately two years later in June 2017, *Fortune* reports that "while President Donald Trump bashed high CEO pay on the campaign trail, since taking office, he hasn't raised the slightest concern about his fellow Republicans' crusade to repeal Obama-era executive compensation reforms." Another *Fortune* article published in August 2018 observed that "the gap between CEO and worker pay is nearing pre-financial crisis levels [...] While the U.S. stock market has soared since President Donald Trump's 2016 election, those rising tides have disproportionately boosted the salaries of CEOs—rather than their workers."

With this backdrop, we posit that when a country becomes more left-oriented reflecting greater concerns over inequality, implicit political forces are enabled to constrain CEO pay. We formalize the implications of this constraint as the *Equality Sentiment Hypothesis*. To understand the mechanisms behind this hypothesis, we build on Jensen and Murphy (1990) and argue that implicit intervention in

[3] This key distinction between left and right is widely supported. For instance, in her reflections on Bobbio (1996), Soper (1999) states that "although there are a number of problematic aspects to Bobbio's arguments on equality, few are likely to disagree with his central contention that if one is looking for a single criterion on which to distinguish left from right, then the egalitarian commitment is the one that will stand up best". See also Lukes (2005) and Rosas and Ferreira (2013).
[4] https://www.wsj.com/articles/democratic-presidential-hopefuls-amplify-income-inequality-message-11549449000.

decisions that affect within-firm pay inequality can occur both inside and outside the firm. Inside the firm, the authority over executive compensation decisions rests in principle with compensation committees, whose decisions can be influenced by the pro-equality sentiment in the country. These decisions are also open to public scrutiny as firms are often required to disclose the compensation packages of their senior executives. As a result, parties both within and outside the firm can form a political milieu against the widening pay gap between the upper and lower ends of the hierarchy in the firm. This in turn can force firms to preemptively adopt a more equal internal pay structure to avoid any societal backlash. We expect that the degree of this adoption depends largely on the underlying societal sentiment about inequality. To be specific, we predict that CEO pay is affected negatively by the left-leaning societal sentiment if the *Equality Sentiment Hypothesis* holds.

We examine the empirical validity of the *Equality Sentiment Hypothesis* by exploiting the national elections that indicate shifts in countries' stances on the left-right political spectrum. We justify using electoral competition between political parties and particularly the elections where there is a shift from right to left or the other way around based on the vast literature on democratic theory, which "expects political parties to stake out ideological and policy positions that reflect the views of the electorate and to be responsive to changes in citizen preferences" (Moral and Best, 2022, Page 1). Evidence also strongly supports the view that public opinion/sentiment matters for electoral competition (e.g., Page and Shapiro, 1983; Stimson, Mackuen, and Erikson, 1995).[5] [6]

Our country-year classifications as left-, center-, and right-leaning come from the Database of Political Institutions (DPI), which is provided by the Inter-American Development Bank; this database has been used in more than 3000 studies, making it "one of the most cited databases in comparative

[5] See, e.g., Adams (2012) for a review of this literature.

[6] It is unclear, however, whether public opinion shapes parties' competitive positioning between, e.g., leftist/redistributive policies vs. rightist/values-based issues (Tavits and Potter, 2015) or citizens are influenced by their preferred party when developing policy preferences. Moral and Best (2022) investigates this chicken or the egg dilemma in political science and show that citizen positioning tends to follow party positioning, rather than the other way around. Our analysis, however, does not rely on any particular direction that the linkage between parties and citizens goes, as long as the linkage, which is the foundation of representative democracy, is strong.

political economy and comparative political institutions."[7] In the DPI, political parties are classified as right-wing if their names contain the terms "conservative" or "Christian democratic", or they are labeled right-wing. In contrast, parties are classified as left-wing if their names reveal them to be communist, socialist, or social democratic or they are labeled left-wing by the same sources.

We define *Left* as a dummy variable that equals one if the political party of the current leader (president or prime minister) of the country is leftist.[8] To establish a causal relationship between CEO pay and *Left*, we exploit the elections when *left* takes the country leadership over from *non-left*.[9] Specifically, we create a categorical variable that we refer to as *Country Equality Sentiment Index* (*CESI*) which equals: (i) two, if, following an election, country political orientation switches from non-left (i.e., right or center) to left; (ii) one, if country political orientation switches from left to non-left; and (iii) zero otherwise.[10]

We obtain data on firm characteristics and executive pay from the Standard & Poor's Capital IQ database. Our final sample after merging these data and applying certain filters consists of 64,385 firm-year observations, with 10,942 unique firms from 23 countries over the period 2000-2017.

The evidence strongly supports our hypothesis. Consistent with the *Equality Sentiment Hypothesis*, we find that *CESI*=2 is significantly negatively associated with CEO pay, controlling for other determinants of CEO pay along with year and firm fixed effects and country time trends.[11] In economic terms, CEO pay is on average 4% (or approximately $53,847 in 2009 US dollars based on the average CEO pay in our sample) lower when political left leads the country. CEO pay is also lower by an

[7] See Beck, Clarke, Groff, and Keefer (2010) for detailed information on the DPI classifications. The database is available at: https://www.iadb.org/en/ research-and-data/dpi2017.
[8] Using alternative classifications such as the political orientation of the leading government party yields similar results.
[9] Given that their timing is generally fixed by the constitution, national elections serve as an ideal setting to study the impact of political factors on firm decisions (e.g., Julio and Yook, 2012; Bhattacharya, Hsu, Tian, and Xu, 2017).
[10] Among 64,385 firm-year observations in our final sample, elections resulted in a shift from non-left to left (left to non-left) for 3,545 (4,413) observations. Note also that there are only 11 (12) cases where an election resulted in a shift from *Center* (*Left*) to *Left* (*Center*). Thus, for brevity, we combined the cases that involved *Center* with those that involved *Right*.
[11] Country fixed effects drop out when we include firm fixed effects because no firm in our sample moves its headquarters across countries.

additional 5.6% in the year of an average election that replaces non-left with left. Last but not least, the average country where an election replaces left with non-left experiences an approximately 2.8% higher pay for their CEOs.[12]

Next, we examine how equality sentiment interrelates with the two mainstream theories of CEO compensation, i.e., managerial power and efficient contracting.[13] Under the managerial power hypothesis, left is likely to curb CEOs' ability to extract rents. Specifically, we expect a greater pressure stemming from pro-equality sentiment on the CEOs that would otherwise receive: i) more excessive pay (Core, Guay, and Larcker, 2008); or ii) a larger-than-justified CEO pay slice (*CPS*), defined as the fraction of the aggregate executive pay captured by the CEO (Bebchuk, Cremers, and Peyer, 2011). Using both measures, we find that in the election years that indicate a shift in the country toward left the degree of rent extraction by CEOs is mitigated.

We confirm our inferences concerning the interplay between pro-equality sentiment and managerial power by focusing on the firms with weak corporate governance, i.e., when CEOs are likely to have control over their pay. In particular, we find that the significant negative association between CEO pay and *CESI*=2 is more pronounced for the group of firms with CEO/Chairman duality, a low proportion of independent directors, or a low proportion of insider ownership. In addition, we decompose CEO pay into cash and equity pay and find that the negative impact of *CESI*=2 concentrates on the cash component. This finding implies that, in the absence of sociopolitical constraints on their pay, entrenched CEOs extract rents mainly in the form of cash rather than equity in order to avoid the discipline and/or fluctuations in the stock market.[14] Further decomposition of cash pay into salary and bonuses shows that country sentiment is associated with substantially lower amounts of bonuses than salary. In other words,

[12] Note that, as also stressed by Bhattacharya et al. (2017), DPI classifications are country-specific and the degree of leftism or rightism varies from country to country. However, this variation does not affect our inferences since we control for country fixed effects implicitly through firm fixed effects.

[13] Managerial power and efficient contracting theories are non-mutually exclusive. Thus, country political orientation can force deviations from both at the same time.

[14] Consistent with this interpretation, Berger, Ofek, and Yermack (1997) argue that "a characteristic of entrenched CEOs is a high level of fixed compensation, since one might expect entrenched managers to extract excessive resources from the firm.

similar to the highly criticized bonuses in the Wall Street, CEO bonuses appear to be subject to the most public scrutiny in countries where left comes to power.

Under the efficient contracting hypothesis, country-wide equality sentiment may force boards to limit certain value-enhancing practices. Any limitation that left imposes on CEO pay is expected to be particularly on the right tail of executive pay distribution and thereby weaken tournament incentives. This is exactly what we find: tournament incentives are significantly weakened both at firm and industry levels when the society appears to be more sensitive about income inequality. In our second set of tests concerning efficient contracting, we examine the overall sensitivity to firm performance and find that CEO pay is significantly less sensitive to both operating and stock performance when left assumes more power.

We acknowledge that election outcomes may reflect other factors than public sentiment about inequality that may at the same time affect CEO pay. To address this concern, we first account for the possibility that macroeconomic conditions under the leadership of a given political orientation plays a major role in the re-election of its (new) representatives (e.g., Fiorina, 1978; Kinder and Kiewiet, 1981; Lewis-Beck and Stegmaier, 2000; Aytac, 2018).[15] Specifically, we control for economic conditions using average GDP growth, unemployment rate and inflation rate in the past three years. Second, we employ survey responses related to income equality on the World Values Survey as an alternative method to measure country equality sentiment. Using these responses, we construct a survey-based equality sentiment index (*SESI*), which increases with higher preference for equal income distribution. We document that *CESI=2* has a significant positive association with *SESI*, which suggests that citizens with preference for more equality are more likely to elect a left-wing government over their non-left counterpart(s). This finding reinforces our use of country political orientation on the left-right scale as a

[15] The other determinants are typically either time-invariant country characteristics or unlikely to be captured in an international context such as "party elites' valence images with respect to dimensions of evaluation such as competence and integrity" (Adams, 2012).

basis for public equality sentiment. In addition, we show that our results prevail when we use *SESI* instead of *CESI*.[16]

Overall, our evidence implies that left-leaning societal sentiment influences CEO pay in both value-enhancing and -destroying manners. Thus, we complete our empirical analysis by exploring the net impact of these influences on firm value. When equality-driven restrictions on CEO pay prevents powerful CEOs from rent extraction, pro-equality sentiment (as measured by *CESI=2*) enhances firm value. In contrast, when the very same restrictions weaken managerial incentives, firm value is damaged.

Our paper offers several contributions to the literature. First, we contribute to the executive compensation literature by providing evidence on how country equality sentiment affects CEO pay. Joskow, Rose, and Wolfram (1996) are the first to indicate that CEO cash pay can get politically constrained. However, they provide evidence on a single regulated industry (i.e., electric utilities) in the U.S., while our evidence concerns all industries and suggests that unregulated industries are also subject to sociopolitical constraints. More importantly, we study all components of CEO pay, the implications of sociopolitical constraints for managerial power and efficient contracting theories, and the ultimate value impact of these implications. In another related study, Gupta and Wowak (2017) examine whether board members' political ideologies affect CEO pay and incentives, while we focus on the country-wide political ideology and how it affects various aspects of CEO pay. Last but not least, Mueller, Ouimet, and Simintzi (2017) suggest that any constraint on the pay gap between the top- and bottom-level jobs within firms would destroy value. Our findings on the sociopolitical constraints on tournament incentives (i.e., the pay gaps between the very top executive and the other senior executives within firms and industries) complement theirs.

[16] We prefer *CESI* as our main measure of public sentiment about inequality, given that it represents a dramatic shift in the sentiment and, unlike *SESI*, it is less likely to be confounded by the effect of other (relatively stable) country characteristics such as culture on CEO compensation decisions.

Second, we contribute to the growing body of cross-country studies on executive compensation (e.g., Fernandes, Ferreira, Matos, and Murphy, 2013; Burns, Minnick, and Starks, 2017). Correa and Lel (2016) examine the impact of a specific legislation on executive pay: the adoption of say on pay laws. They conclude that this adoption is favorable from the viewpoint of shareholders, as it leads to lower (excess) CEO pay, smaller CEO pay slice, and higher pay-performance sensitivity. We examine the impact of the nation-wide equality sentiment on CEO pay and the implicit forces of this sentiment that Jensen and Murphy (1990) refer to.

In broader terms, we contribute to the growing literature on how politics can affect corporate activities.[17] Most of this literature focuses on the impact of political uncertainty on corporations. As an exception, Bhattacharya et al. (2017) examine whether technological innovation is affected by policy, as measured by country leniency on the left-right scale, or policy uncertainty (or both) and find that, unlike policy uncertainty, country leniency does not matter for innovation outcomes whereas we find that it does affect CEO contracts.

Finally, we contribute to the political economy literature. Income inequality has been an increasingly debated topic in political and academic circles due to the dramatic rise in the share of the top earners in total income (e.g., Atkinson, Piketty, and Saez, 2011; Piketty, 2014; Alvaredo, Chancel, Piketty, Saez, and Zucman, 2017). In a country-level analysis, Scheve and Stasavage (2009) examine the impact of political orientation on income inequality for 13 countries and conclude that left-leaning countries are not more effective in reducing income inequality than the right-leaning ones. We focus on the effect of the left on corporate executives among the top earners, and find that, in left-leaning countries, the CEOs of publicly listed firms receive a significantly lower pay.

[17] See, e.g., Cohen, Coval, and Malloy (2011), Julio and Yook (2012), Gulen and Ion (2015) on capital expenditures; Bonaime, Gulen, and Ion (2018), Nguyen and Phan (2017) on mergers and acquisitions (M&As); Atanassov, Julio, and Leng (2016) and Bhattacharya et al. (2017) on innovation; Cao, Duan, and Uysal (2013) on capital structure; Colak, Durnev, and Qian (2017) on IPOs; and Tian and Ye (2018) on venture capital financing.

2. Data

2.1. Sample construction

We obtain financial statement, stock market, and executive compensation data on publicly listed companies around the world from the Standard & Poor's Capital IQ database for the period between 2000 and 2017. We require that, among the executive compensation items, salary is non-missing[18] and the CEO of the firm is identifiable.

Next, we collect information about the time-varying political orientation of the countries in our sample from the Database of Political Institutions (DPI), which is now available at the Inter-American Development Bank.[19] The DPI covers 180 countries and spans over the period between 1975 and 2017. To identify the political orientation for a given country and year, we focus on the item EXECRLC, which places country leaders (i.e., presidents and prime ministers) into three political categories: (1) *left*, (2) *center*, and (3) *right*.[20] In order to construct our main measure of equality sentiment, *Country Equality Sentiment Index* (*CESI*), we then use the election events from the DPI around which country political leniency changes. To be specific, *CESI* equals two if a national election results in a change in country political leniency from *non-left* (*right or center)* to *left*; one if it results in a change from *left* to *non-left* (*right or center)*; and zero otherwise.

We also construct an alternative measure of equality sentiment using the responses on the World Values Survey (WVS) regarding income equality. WVS consists of seven waves of surveys of many countries: wave 1 in 1981-1983; wave 2 in 1990-1992; wave 3 in 1995-1998; wave 4 in 2000-2004; wave 5 in 2005-2008; wave 6 in 2010-2014, and wave 7 in 2017-2022. In each wave, there were

[18] If salary is non-missing and any other compensation item (bonus, restricted stock awards, option grants, or long-term incentive plans) is missing, we assume the missing compensation item is equal to zero when computing the total compensation for a given executive.

[19] The database was originally provided by the World Bank.

[20] In robustness checks, we also employ the item GOV1RLC, which provides the political leniency of the representative party in the government. In the case of coalition governments, the other party or parties typically have the same leniency as the leading party. We find similar results if we extend our definition of political orientation to include the other parties in the coalition.

varying numbers of surveys across the countries in the wave. For example, there were 1000 surveys for the U.S. in wave 4. Each survey contains a variable called *Income Equality* that assumes values ranging from 1 to 10, where 1 (10) represents the strongest (weakest) preference for income equality among country residents. In other words, the lower the value of this variable for a country, the higher the preference for income equality in the country. To define a variable on a year and country basis, we take the average value of *Income Equality* across all surveys for each wave and country. Lastly, we subtract this average from 10 to convert it into a measure of pro-equality sentiment. We refer to this new variable as *Survey-based Equality Sentiment Index* (*SESI*).

To have a meaningful number of observations for each country, we exclude the countries with less than 35 observations. We also require that all dependent and control variables in our main specifications are non-missing. We conclude to a final sample of 64,385 firm-year observations with 10,942 unique firms from 23 countries. Appendix B presents the distribution of our sample by country.[21]

2.2. Summary statistics

Table 1 Panel A presents the summary statistics for our full sample – variable definitions are provided in Appendix A. Note also that all unbounded variables are winsorized at the 1st and 99th percentiles.

We use several compensation variables for our empirical analysis. *CEO Pay* denotes the total CEO compensation, i.e., the sum of salary, bonuses, restricted stock grants, stock option grants, long-term incentive plans, pension contributions, and all other compensation measured in 2009 US dollars. The average CEO pay is $1.346 million, which is comparable to the $1.09 million reported in Correa and Lel (2016). Salary and bonuses account for 71.5% of *CEO Pay*, while equity-based pay that consists of

[21] Note that the U.S. and Canada account for more than half of our sample. Thus, to ensure that our findings are generally applicable, i.e., not driven solely by these two countries, we exclude them in Table IA-1 in the internet appendix. Our main findings are generally robust to this exclusion.

restricted stock and option grants accounts for 4.2% of *CEO Pay*. To construct the *Excess CEO Pay*, we take the exponential of the difference between *Ln (CEO Pay)* and *Ln (Expected CEO Pay).*[22] CEO pay slice (*CPS*) is defined as the fraction of the aggregate executive pay captured by the CEO. The average *CPS* in our sample is 28.4%, which is comparable to the 35.7% for the sample of U.S. firms in Bebchuk, Cremers, and Peyers (2011).

To capture the tournament incentives, we use the following measures of pay gap at the firm and industry level, respectively: i) intra-firm pay gap (*Firm PG*), which is the difference between *CEO Pay* and *Median Non-CEO Pay*;[23] ii) and intra-industry pay gap (*Industry PG*), which is the difference between the total pay of the second-highest-paid CEO in the firm's two-digit SIC industry and *CEO Pay*.[24] The mean (median) of *Firm PG* is $437k ($222k), and the mean (median) of *Industry PG* is $26 ($21) million.[25] One potential problem with these pay gap measures is that variables that explain the level of CEO pay will also explain the difference in CEO pay and non-CEO pay or industry CEO pay. Thus, we use two additional tournament incentives defined as ratios: i) *Firm PG Ratio* is the difference between *CEO Pay* and *Median Non-CEO Pay* divided by CEO pay; ii) *Industry PG Ratio* is the difference between the total pay of the second highest-paid CEO in the firm's two-digit SIC industry and CEO pay, divided by the total pay of the second highest-paid CEO in the industry.

Panel B of Table 1 reports the summary statistics for our compensation variables separately for left- and non-left (right and center)-leaning countries. The last two columns present the differences in the mean and median values between *left* and *non-left*, along with the respective *t*-statistics that indicate the

[22] *Ln(Expected CEO Pay)* is the predicted value from the regression of the natural logarithm of *CEO Pay* on the natural logarithm of firm size, book-to-market ratio, stock return volatility, the natural logarithm of CEO age, and year and industry fixed effects. Note that the sum of the mean values of *Expected CEO Pay* and *Excess CEO Pay* is not equal to the mean value of *CEO Pay* due to logarithmic transformations and the smaller sample size in the expected pay regression.
[23] Following Correa and Lel (2016), we require that total pay is available for at least two executives other than the CEO when calculating *Median Non-CEO Pay*, *Firm PG*, and *CEO Pay Slice (CPS).*
[24] We follow Coles, Li, and Wang (2018) and construct *Industry PG* using the second-highest CEO pay in the firm's industry. In unreported regressions, we also find similar results when *Industry PG* is based on the highest-paid CEO in the industry.
[25] We also define *Industry PG* based on industry and firm size. The mean (median) *Industry PG* is $6.5 ($1.4) million in this case. However, our inferences are unaffected by this refinement.

statistical significance of the differences. However, the univariate tests do not account for any firm, industry, or country characteristics that vary systematically across political orientations (as can be seen in the rest of the panel) and may, at the same time, affect executive compensation. Thus, before reaching any conclusions, we perform a detailed multivariate analysis where we control for these characteristics.

3. Regression Analysis

In this section, we present our multivariate results on the relationship between societal equality sentiment and CEO compensation.

3.1. Total CEO compensation

To examine the impact of societal equality sentiment on CEO pay at country level, we begin our analysis using the following regression specification:

$$Ln(CEO\ Pay)_{i,c.t} = \alpha + \beta_1 CESI = 2_{\ c,t} + \beta_2 CESI = 1_{\ c,t} + \beta_3 Left_{c,t} + \beta_4 Election_{c,t} + \gamma X_{i(c)t-1} + \epsilon_{i,c,t} \quad (1)$$

where the dependent variable is the natural logarithm of total CEO pay for firm i, year t, and country c. Our key explanatory variable in Equation (1) is *CESI*, which identifies the countries in our sample that experienced a regime switch around national elections in terms of societal equality sentiment. Particularly, *CESI* is a categorical variable that equals two if, in a given year, there is an election and country political orientation switches from non-left (right or center) to left, one if it switches from left to non-left (right or center), and zero otherwise. *Left* is a dummy variable that equals one if a leftist country leader is in power, and zero otherwise.

We control for an extensive list of country, firm and CEO characteristics to account for other potential determinants of CEO pay, namely: return on assets, stock return, book leverage, asset tangibility, cash holdings, capital expenditures, stock return volatility, firm size, industry market-to-book ratio, CEO age, CEO graduate degree, institutional ownership, insider ownership, current GDP per

capita, current GDP growth, average GDP growth between years *t-3* to *t-1*, average inflation between years *t-3* to *t-1*, and average unemployment between years *t-3* to *t-1* relative to the year of *CEO Pay* (*t*). [26] All variables (apart from the last three) are lagged by one year relative to the dependent variable. As noted earlier, we provide the definitions of all these variables in Appendix A. We also include firm and year fixed effects and country-specific time trends in all specifications.

In Table 2, Panel A, column (1) presents the baseline relationship between CEO pay and *CESI*. Consistent with the *Equality Sentiment Hypothesis*, we find a strong negative impact on CEO pay when there is a switch in the country sentiment from *non-left* to *left* and a positive impact when there is a switch from *left* to *non-left*. The coefficient of *CESI=2* is negative and statistically significant at the 1% level and the coefficient of *CESI=1* is positive and significant at the 10% level. These effects are also economically meaningful. For example, a change in equality sentiment from *non-left* to *left* as reflected by *CESI=2* is associated with about 5.45% lower CEO pay (or $73k in 2009 USD relative to average CEO pay in our sample).[27] The coefficient of *Left* is also negative and statistically significant further reinforcing the negative impact of societal sentiment towards income inequality.

3.2. The effect of societal equality sentiment on CEO pay under the managerial power theory

In this section, we examine the implications of societal equality sentiment for CEO compensation under the managerial power theory.

3.2.1. Excess compensation and CEO pay slice

To examine whether societal equality sentiment affects CEOs' ability to extract rents, we first decompose total CEO pay into expected and excess CEO pay, following Core, Guay, and Larcker (2008).

[26] We expect changes in country leadership to be driven primarily by the economic performance of the pre-election country leaders (see, e.g., Lewis-Beck and Stegmaier, 2000; Lewis-Beck, Nadeau, and Elias, 2008), which can also significantly influence CEO pay. Thus, our specifications include the average GDP growth, unemployment, and inflation in the past three years as measures of recent economic conditions.

[27] The coefficient of *CESI*=2 in column (1) is -0.056. Thus, its impact on the dollar value of CEO pay is given by $e^{-0.056} - 1 = 5.45\%$.

Expected pay is the predicted value from the regression of total CEO pay on various determinants: firm size, book-to-market ratio, stock performance, CEO age, year and firm fixed effects.[28] All unbounded variables in this regression are in natural logarithm. We define *Ln(Excess CEO Pay)* as the difference between *Ln(CEO Pay)* and *Ln(Expected CEO Pay).* Second, we use the CEO Pay Slice (*CPS*), which is defined by Bebchuk et al. (2011) as the fraction of the aggregate executive pay captured by the CEO.

We re-estimate equation (1) with *Ln(Excess CEO Pay)* and *CPS* as the new dependent variables and present the results in columns (2) and (3) in Table 2, Panel A. Our key explanatory variable is again *CESI=2*. The control variables are the same as those in column (1) for total CEO pay. Consistent with the prediction that societal equality sentiment reduces the degree of rent extraction by CEOs, the coefficient of *CESI=2* is significantly negative regardless of how rent extraction is measured. The economic magnitude of this impact is also significant. In column (2), for example, *CPS* is on average 3.2% lower when there is a shift towards leftist societal sentiment, which corresponds to 3.15% of the average *CPS* in our full sample.[29] These results are consistent with the prediction that societal equality sentiment limits CEOs' ability to extract rents.

3.2.2. Conditional on Corporate Governance

It is plausible that our evidence on rent extraction is relevant particularly for the CEOs that have the power to extract private rents, i.e., when corporate governance is weak. Thus, we expect the negative impact of societal inequality concerns on excess CEO pay and CPS to be more pronounced for firms with weak governance. We use three indicators to identify the firms with weak governance: i) CEO/Chairman duality; ii) proportion of independent directors; iii) insider ownership. That is, a firm is classified as weakly governed if: i) its CEO is also the chairman of the board; or ii) the proportion of independent board members is below the respective country median; or iii) insider ownership is below the respective country median.

[28] See also Smith and Watts (1992), Core, Holthausen, and Larcker (1999), and Murphy (1999).
[29] The average *CEO Pay Slice* in our sample is 29%.

We re-estimate our specifications in Panel A for the subsamples of firms with weak and strong governance separately and report the results in Panel B of Table 2. The dependent variable is *Ln(Excess CEO Pay)* in columns (1)-(6) and *CPS* in columns (7)-(12). As our measure of corporate governance, we use CEO/Chairman duality in columns (1)-(2) and (7)-(8), the proportion of independent directors in columns (3)-(4) and (9)-(10) and the proportion of insider ownership in columns (5)-(6) and (11)-(12). For brevity, we only report the coefficients of the *CESI=2* variable. We also use the same set of control variables as in the previous panel. As predicted, *CESI=2* has a negative and significant coefficient mainly for firms with weak corporate governance regardless of the measure of rent extraction and corporate governance.

3.2.3. Cash-based versus equity-based compensation

Our final analysis concerning rent extraction is based on the premise that entrenched managers are characterized by high levels of fixed compensation (Berger, Ofek, and Yermack, 1997). The rationale behind this idea is that equity-based compensation exposes the manager to the discipline of the stock market, while cash-based compensation is rather deterministic. Hence, powerful CEOs are expected to receive much of their compensation in the form of cash, absent any constraints that may implicitly arise when left-leaning political leaders find wider support in their society. To test this prediction, we re-estimate Equation (1) using the natural logarithm of CEO pay in cash, *Ln(CEO Cash Pay*), and that in equity, *Ln(CEO Equity Pay*), as dependent variables.

The results are presented in Table 3. In columns (1) and (2), we find that the negative impact of the shift of a country from *non-left* towards *left* as reflected by *CESI=2* is indeed concentrated on cash pay. We do not identify any effect on CEO equity pay. In columns (3) and (4), we further decompose cash pay into salary and bonuses and find that it is mainly CEO bonuses that are limited by equality sentiment. We find that the effect of country equality sentiment on bonuses is significant at the 1% level, whereas that on salary is significant at the 10% level. In economic terms, the impact on bonuses is more than

twenty-six times higher than the one on salary, which may not be surprising as public scrutiny and media attention tend to focus on reward packages that contain large bonuses.[30]

In sum, our findings support the view that pro-equality sentiment plays a beneficial role for the firms that are vulnerable to CEO rent extraction.

3.3. The effect of societal equality sentiment on CEO pay under the efficient contracting theory

In this section, we focus on the implications of equality sentiment for CEO pay under the efficient contracting theory.

3.3.1. Tournament incentives

We first analyze the impact of equality sentiment identified based on the results of national elections on promotion-based tournament incentives within firms and industries. Similar to those used in the literature on tournament incentives,[31] we employ the following measures of tournament incentives at firm or industry level: i) *Ln (Firm PG)* is defined as the natural logarithm of the gap between total CEO pay and the median total pay among the other top executives; [32] ii) *Firm PG ratio* is defined as the gap between total CEO pay and the median total pay among the other top executives, divided by total CEO pay; iii) *Ln (Industry PG)* is defined as the natural logarithm of the gap between the second-highest paid CEO's total pay in the industry and the focal firm's total CEO pay;[33] and iv) *Industry PG ratio* is defined as the gap between the second-highest paid CEO's total pay in the industry and the focal firm's total CEO pay, divided by the former. In sum, these pay gaps measure the degree of rewards (i.e., incentives) that senior executives are offered to reach the top position in their respective firms or industries.

[30] For example, Bob Diamond was appointed as the CEO of Barclays in 2010 and the mutually-agreed bonus payment made the headlines: https://www.cnbc.com/2010/09/07/diamond-to-be-barclays-ceo-gets-hefty-bonus.html.
[31] See, e.g., Kale et al. (2009), Coles et al. (2017), and Burns et al. (2017).
[32] We require that total compensation for at least two executives other than the CEO is available for every firm-year observation, before computing the firm pay gap. Additionally, in order to keep the observations with a negative pay gap, we follow Kale et al. (2009) and monotonically transform all observations by adding a constant equal to the absolute value of the minimum gap to each observation. Our results are qualitatively similar if we drop the observations with a negative gap.
[33] Our results are robust to using the highest-paid CEO's pay.

To examine whether a shift toward the pro-equality *left* in the country affects intra-firm or intra-industry tournament incentives, we re-estimate Equation (1) using our four measures of tournament incentives as the dependent variables and present the results in Table 4.[34] Regardless of the specification, both firm and industry pay gaps are significantly negatively associated with *CESI=2*. Therefore, our results on tournament incentives indicate that the limits imposed by pro-equality sentiment on CEO pay lead to weaker tournament incentives.

3.3.2. Pay-performance sensitivity

To examine whether societal equality sentiment ultimately reduces pay-performance sensitivity (*PPS*) for CEOs, we extend Equation (1) to include the interaction of *CESI=2* with either operating performance (ROA) or stock performance (raw or industry-adjusted based on the 2-digit SIC classification) for firm i in year $t-1$.

The results where the dependent variable continues to be *Ln(CEO pay)* are presented in Table 5, Panel A. To measure performance, we use ROA in columns (1) and (2), industry-adjusted ROA in columns (3) and (4), stock returns in columns (5) and (6), and industry-adjusted stock returns in columns (7) and (8). In columns (1), (3), (5), and (7) we use firm and year fixed effects and country specific time trends as before. Given that our focus is on the interaction term between *CESI=2* and firm performance, which is a firm-year variable, we are able to include also country×year fixed effects in columns (2), (4), (6), and (8) along with firm fixed effects.[35] This allows us to account for any unobservable time-varying country factor that might affect the relationship between country equality sentiment and *PPS*.

As predicted, CEO pay is less sensitive to firm-specific performance under a shift in country sentiment towards left, regardless of the specification and performance metric employed.[36] In all

[34] Our inferences remain unaffected by using different measures of tournament incentives. Thus, to reduce clutter, we report only the findings based on *Firm PG Ratio* and *Industry PG Ratio* in the rest of our tables.
[35] Country×year fixed effects can be included because firm performance varies across firms and years.
[36] Note that, in columns (2), (4), (6), and (8) *CESI=2* and *Left* drop out due to country×year fixed effects, since they are both country-year variables.

columns, the coefficient of the interaction term *CESI=2×Firm Performance* is negative and statistically significant at 5% or lower. These findings suggest that the more left-leaning a country becomes (relative to its history) the more likely it is that the firms in the country implement contracts that do not reward their CEOs for (relatively) better performance as much as they otherwise would. In Panel B, we further decompose CEO pay into cash and equity-based pay. The dependent variable in columns (1)-(4) is *Ln(CEO Cash Pay)* and in columns (5)-(8) *Ln(CEO Equity Pay)*.[37] The coefficient of the interaction term *CESI=2×Firm Performance* continues to be significantly negative for the cash component of CEO pay while it becomes insignificant (with the exception of specification (8)) for the equity component. Consistent with our earlier inference regarding cash vs. equity compensation, this finding suggests that the cash component of CEO compensation packages attracts most attention in left-leaning societies.

Overall, our evidence suggests that pro-equality sentiment plays a major role in CEO compensation that is beneficial to firms when it restrains managerial power, and harmful when it forces firms away from efficient contracting.

3.4. Extensions and additional robustness checks

In this section we perform additional analyses and several robustness checks.

3.4.1. Survey-based measure of equality sentiment

Our measure of equality sentiment, *CESI*, is based on the elections where a shift in country political orientation towards or away from left occurs. Whether this shift is equivalent to stronger or weaker societal preference, respectively, for equal income distribution is arguable. In addition, such elections are infrequent. To address these concerns, we employ a survey-based equality sentiment index (*SESI*), which equals ten minus the average *Income Equality* for each country and wave of the World Values

[37] We find similar results using industry-adjusted performance metrics. We leave them unreported for brevity.

Survey.[38] To make it also comparable to *CESI*=2, we define a dummy variable *High SESI* that equals one if *SESI* is above its sample median.

We document in the internet appendix (Table IA-2) that *CESI=2* is significantly positively related to *High SESI*, implying that left-leaning political leaders are indeed more likely to take over the leadership in countries where the electorate has greater preference for income equality. Moreover, we re-estimate our main regressions with *SESI* as the measure of country equality sentiment and report the results in Table 6. In each column, *High SESI* is significantly negatively related to the respective compensation variable, reinforcing our earlier findings. Thus, we conclude that our inferences are unaffected by alternative approaches to measurement of public equality sentiment.

3.4.2. Pre- and post-election trends in CEO compensation

To ensure that our results do not simply capture a trend in CEO compensation that starts before regime-changing elections rather than what we aim to capture – i.e., a shift in public sentiment signified by these elections, we perform a year-by-year analysis. Specifically, we create dummy variables for the three years before and the three years after the elections where a shift from non-left to left occurs and include them in our main specifications.

We report the results in Table 7. *Year of $CESI_t$=2* is defined as a dummy variable that equals one if the current year is an election year when left takes over from non-left, and zero otherwise. *One Year Before $CESI_t$=2* is defined as a dummy variable that equals one if the current year is one year before an election when left takes over. Similarly, *Two Years Before $CESI_t$*=2 and *Three Years Before $CESI_t$=2* are dummy variables that equal one if the current year is respectively two and three years before an election when left takes over, and zero otherwise. *One Year After $CESI_t$=2*, *Two Years After $CESI_t$*=2,

[38] As described in the data section, *Income Equality* ranges from one to ten, where one (ten) represents the highest (lowest) preference for income equality. Thus, we subtract its average for each country and year from ten, in order to define *SESI* as a measure of pro-equality sentiment.

and *Three Years After* $CESI_t=2$, on the other hand, are dummy variables that equal one if the current year is respectively one, two, and three years after an election when left takes over, and zero otherwise.

We first note that firms' reaction to an apparent shift in societal sentiment towards left begins in the year of the election signifying the shift, *not before*. The largest reaction, however, typically occurs in the year after such an election. The reaction tends to remain significant in the second year (except for *Industry PG Ratio*) and mostly fades away in the third year. We conclude that the negative effect of the pro-equality sentiment on CEO compensation begins in the year of the election that left takes over, not before, and is fairly persistent within the two-year period that follows.

3.4.3. Conditional on country development and institutions

Next, we examine whether the impact of public sentiment on CEO pay depends on the level of development and the strength of institutions in the country. First, we condition the association between CEO pay and *CESI=2* on the *Corruption Perception Index* published every year by the Transparency International (TI) and report the results in the odd-numbered columns of Table 8. As defined by TI, "the index ranks 180 countries and territories by their perceived levels of public sector corruption, according to experts and business people, and uses a scale of 0 to 100 where 0 means very corrupt and 100 means very clean."[39] To ease interpretation, we create a dummy variable *High Corruption* that equals one if the country has a corruption score that is lower than the annual median score across the countries in our sample. We then interact *High Corruption* with *CESI=2*. The coefficient of *CESI=2* is generally negative and significant, meaning that our findings prevail in less-corrupt countries. The coefficient of *CESI=2*×*High Corruption*, however, is typically positive and larger in economic magnitude implying that any societal discontent with firm-level CEO pay is inconsequential in countries with high corruption.

Second, we condition the association between CEO pay and *CESI=2* on the level of development in the country, as measured by income per capita. Specifically, we create a dummy variable *Low GDP*

[39] The most recent corruption data can be found at https://www.transparency.org/en/cpi/2020/index.

Per Capita that equals one if GDP per capita for a given country is lower than the annual median GDP per capita in our sample. In the even-numbered columns of Table 8, we find that the coefficients of *CESI=2* remain negative and significant regardless of the dependent variable. However, the interaction term *Low GDP Per Capita×CESI=2* generally has a positive coefficient, implying that the negative impact of equality sentiment on CEO pay prevails primarily in countries with high income per capita.

Lastly, we examine whether our findings are sensitive to the legal standards in the country from investors' point of view. We use two measures of investor protection at country level: (i) the legal origin of the country, with French Civil Law providing the weakest protection (see, e.g., La Porta, Lopez-de-Silanes, Shleifer, and Vishny, 1998; Djankov, La Porta, Lopez-de-Silanes, and Shleifer, 2003; La Porta, Lopez-de-Silanes, and Shleifer, 2008); (ii) the Anti-Self-Dealing (ASD) Index, i.e., the improved measure of shareholder protection by Djankov, La Porta, Lopez-de-Silanes, and Shleifer (2008).[40] We report the results conditional on investor protection in the Internet Appendix (Table IA-3). In odd-numbered columns, *French Legal Origin* is a dummy variable that equals one for the countries that adopted the French Civil Law while, in even-numbered columns, *Low Anti-Self-Dealing* is a dummy variable that equals one if the country ASD score is below the sample median. We do not find any significant difference with respect to the impact of *CESI=2* on CEO pay for the countries with French legal origin or low ASD index. Thus, we infer that the association between CEO pay and CESI is independent from legal institutions.

3.4.4. Firms' reputational concerns

Our findings suggest that public equality sentiment is a significant factor in CEO pay decisions. A natural question that follows is through which channels does this sentiment influence CEO pay? There may be many visible and non-visible channels. Nonetheless, we attempt to identify reputational concerns as a possible channel. We argue that firms that have greater reputational concerns are more likely to

[40] The Anti-Self-Dealing Index is available at https://scholar.harvard.edu/shleifer/publications/law-and-economics-self-dealing.

respond to public sentiment. Specifically, we assume that firms that spend more on advertising have greater concerns over their image (see, e.g., Dimson, Karakaş, and Li, 2015). Thus, we expect these firms to be more cautious in setting their CEOs' compensation in order not to be perceived as firms that are "unfair" to their employees (relative to their CEOs). To examine whether this is the case, we generate the dummy variable *High Advertising Expense* that equals one if a given company has a higher ratio of advertising expenses to total assets than the country median and interact it with *CESI*=2. The results are reported in the Internet Appendix (Table IA-4). As expected, the coefficient of the interaction term is generally negative and statistically significant. That is, firms with greater reputational concerns tend to have lower CEO pay in the face of public concerns over income inequality. This also supports the view that it is the changing public sentiment to which certain firms are responding in their CEO pay decisions, rather than changing government policies that would apply to all firms.

3.4.5. Other robustness checks

We conduct three additional robustness checks. First, in Table IA-5, we examine whether our results are peculiar to financial and utilities industries since they are heavily regulated. Excluding these industries yield qualitatively similar results. Moreover, in Table IA-6, we define the shifts in societal equality sentiment based on the elections of the leading government party and find similar results. Lastly, in Table IA-7, we find that our results are robust to controlling for board characteristics constructed using data from the Boardex database such as board size, the proportion of independent directors, CEO-Chairman duality, and board co-option, which is defined as the number of directors appointed after the CEO assumed office divided by the board size (Coles, Daniel, and Naveen, 2014).

3.5. Societal equality sentiment, CEO pay and firm value

We complete our empirical analyses by examining whether the constraints imposed by societal equality sentiment on CEO pay ultimately affect firm value. Based on the managerial power theory, we expect that the firms with a record of managerial rent extraction benefit from the restriction of CEO

power by the pro-equality sentiment. Based on the efficient contracting theory, we expect that the same sentiment damages firms that would otherwise pay their CEOs more to create efficient (i.e., unconstrained) levels of incentives. To test these predictions, we use the following specifications that follow from Correa and Lel (2016):

$$(Industry-Adj)\ Tobin^{'}s\ Q_{ict} = \alpha + \beta_1 CESI=2_{ct} + \beta_2 CESI=2_{c,t} \times High\ Prior\ Rent\ Extraction_{i,t-1,t-3} + \beta_3 CESI=1_{c,t} + \beta_4 CESI=1_{c,t} \times High\ Prior\ Rent\ Extraction_{i,t-1,t-3} + \beta_5 Left_{c,t} + \beta_{46} Left_{ct} \times High\ Prior\ Rent\ Extraction_{i,t-1,t-3} + + \gamma X_{i(c),t-1} + \epsilon_{i,c,t} \quad (2a)$$

$$(Industry-Adj)\ Tobin^{'}s\ Q_{ict} = \alpha + \beta_1 CESI=2_{c,t} + \beta_2 CESI=2_{c,t} \times High\ Prior\ Incentives_{i,t-1,t-3} + \beta_3 CESI=1_{c,t} + \beta_4 CESI=1_{c,t} \times High\ Prior\ Incentives_{i,t-1,t-3} + \beta_3 Left_{c,t} + +\beta_4 Left_{c,t} \times High\ Prior\ Incentives_{i,t-1,t-3} + \gamma X_{i(c),t-1} + \epsilon_{i,c,t} \quad (2b)$$

The dependent variable is either raw or industry-adjusted Tobin's Q, where industry is defined based on two-digit SIC classification. In Equation (2a), *High Prior Rent Extraction* is a dummy variable that equals one if either the average excess CEO pay or the average *CPS* for firm *i* between year *t-1* and year *t-3* is greater than the respective country median over the same time period. In Equation (2b), *High Prior Incentives* is a dummy variable that equals one if either the average firm pay gap, or the average industry pay gap for firm *i* between year *t-1* and year *t-3* is greater than the respective country median over the same time period.[41]

We report the results from the estimations of Equations (2a) and (2b) in Table 9. The dependent variable in columns (1) and (2) is Tobin's q and in columns (3) and (4) the industry-adjusted Tobin's q. In columns (1) and (3), we first note that *CESI=2* carries a significantly negative coefficient suggesting

[41] Defining *High Prior Rent Extraction* based on *Excess CEO Pay* and *CPS* separately, or *High Prior Incentives* based on *Firm PG* and *Industry PG* separately yields similar results.

that for firms that are not subject to agency problems (*High Prior Rent Extraction*=0*)*, a shift in country leadership from non-left to left is negatively associated with firm value. For firms that suffer from agency problems (*High Prior Rent Extraction*=1), however, this is offset by the positive effect of the potential limitations imposed on CEO power by higher pro-equality sentiment. This evidence is consistent with the prediction that societal equality sentiment restricts rent extraction opportunities of CEOs. In columns (2) and (4), on the other hand, we find that the interaction between *CESI=2* and *High Prior Incentives* carries a negative coefficient that is statistically significant at the 1% and 5% levels, respectively, implying that political constraints on senior executives' incentives result in value destruction.

In sum, we provide suggestive evidence that the value impact of the association between pro-equality sentiment and CEO pay is positive (or at least non-negative) for the firms that are subject to the excesses of their powerful CEOs and negative for those that are constrained in rewarding their senior executives for better performance.

4. Conclusion

The classical theories of executive compensation assume away from third-party influences such as public sentiment about what is perceived to be excessive CEO pay. Proponents of the managerial power theory focus on the conflicts of interests between managers and shareholders along with the evidence implying that pay arrangements typically serve the interests of CEOs rather than shareholders. In this paper, we shift our focus to the potential conflicts of interests between managers and third parties that are bonded by sociopolitical goals. We argue that the degree to which the goal of these other parties concerning CEO pay is reached or not depends on the country stance regarding inequality, measured on the left-right political spectrum. Particularly left-oriented public sentiment is expected to implicitly restrict CEO power vis-à-vis the board that would otherwise allow the CEO to extract rents. Our findings are supportive: CEOs receive a significantly lower excess pay and a smaller slice from the aggregate executive pay in their companies in left-leaning sociopolitical environments. Moreover, when we

partition firms into two groups based on governance standards, we find that the impact of left-leaning societies on CEO pay is concentrated on the firms with weak governance – where CEOs are more likely to extract private rents. Last but not least, decomposing total compensation into its components reveals that equality sentiment refrains entrenched CEOs from receiving large cash compensation.

The efficient contracting theory, on the other hand, assumes that corporate boards act independently and the labor market functions efficiently. In this context, we examine whether country equality sentiment acts as a friction in the contractual agreements between boards and executives. We show that tournament incentives as measured by the pay differentials among senior executives at both firm and industry levels are weaker in left-leaning countries. This suggests that inequality-based societal pressure is mainly directed at the right tail of the executive pay distribution. Consequently, firms in left-leaning countries also experience weaker pay-performance sensitivity than those in right-leaning ones.

Finally, we examine how country equality sentiment affects firm value through its role in CEO pay decisions. The unconditional effect of political orientation on firm value appears insignificant. However, the benefits arising from the leftist limitations on managerial rent extraction increase firm value, while the frictions caused by the same limitations in value-enhancing practices such as tournament incentives decrease firm value.

Overall, our paper extends our practical understanding of CEO compensation beyond managerial power and efficient contracting theories. Specifically, it demonstrates empirically the importance of the underlying sociopolitical context for CEO pay policy. It also provides a simple and objective way that future studies of CEO pay can use to account for sociopolitical constraints. We believe that the natural venue to pursue next is identifying the specific channels through which the impact of public sentiment on CEO pay materializes. We hope that future research will shed light on these channels.

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Appendix A: Definitions of Variables

All compensation and financial values are in US dollars. In calculating the median non-CEO Pay, CEO pay slice, and firm pay gap, we require salary to be available for at least two executives, excluding the CEO. Our data source is Capital IQ if not specified in parenthesis.

Variable	Definition (Data Source)
Country equality sentiment:	
Left	Dummy variable that equals one if the political orientation of the country leaders (EXECRLC) is left (Inter-American Development Bank)
Center	Dummy variable that equals one if the political orientation of the country leaders (EXECRLC) is center (Inter-American Development Bank)
Right	Dummy variable that equals one if the political orientation of the country leaders (EXECRLC) is right (Inter-American Development Bank)
Country Equality Sentiment Index (CESI)	An index that equals: (i) two if a national election represents a shift from non-left to left; (ii) one if a national represents a shift from left to non-left; (iii) zero otherwise (Inter-American Development Bank)
Survey-Based Equality Sentiment Index (SESI)	Ten minus average *Income Equality* for each country across all surveys in each wave of the World Values Survey. *Income Equality* is a measure of preference for income equality in the country that ranges from 1 to 10, where 1 (10) represents the greatest preference for small (large) income differences among country residents (World Values Survey Database)
Compensation variables:	
CEO Pay	Total CEO compensation defined as the sum of salary, bonuses, restricted stock awards, option grants, long-term incentive plans, changes in pension, and all other compensation, in 2009 US dollars
Non-CEO Pay	Total compensation of a given non-CEO executive, in 2009 US dollars
Median Non-CEO Pay	Median value of total compensation of the top executives excluding the CEO, measured in 2009 US dollars
CEO Cash Pay	Cash compensation (salary, bonuses, and other cash compensation)
CEO Equity Pay	Restricted stock and stock option grants
Expected CEO Pay	Exponential of the predicted value from the regression of the natural logarithm of total CEO pay on the natural logarithm of firm size, book-to-market ratio, stock return volatility, CEO age, and year and industry fixed effects (Core, Guay, and Larcker, 2008)
Excess CEO Pay	Exponential of the difference between *Ln(CEO Pay)* and *Ln(Expected CEO Pay)*
CEO Pay Slice (CPS)	Fraction of the aggregate compensation of the executive team that is captured by the CEO
Firm PG	Difference between *CEO Pay* and *Median Non-CEO Pay*, measured in 2009 US dollars
Firm PG Ratio	*Firm PG* divided by *CEO Pay*
Industry PG	Difference between the total pay of the second highest-paid CEO in the firm's two-digit SIC industry and *CEO Pay*, in 2009 US dollars
Industry PG Ratio	*Industry PG* divided by the total pay of the second highest-paid CEO in the firm's two-digit SIC industry
Other firm variables:	
Firm size	Total assets, in 2009 US million dollars
ROA	Return on assets
Stock Return	Annual rate of return in US dollars from holding the firm's stock (including dividends)

Book Leverage	Book value of debt scaled by total assets
Asset Tangibility	Net property, plant, and equipment scaled by total assets
Cash Holdings	Short-term investment and cash scaled by total assets
Capex	Capital expenditures scaled by total assets
Stock Volatility	Yearly standard deviation of daily stock returns in US dollars
Tobin's Q	Ratio of total assets minus book value of equity plus market value of equity to total assets
Industry MB	Median value of market-to-book ratios in the firm's two-digit SIC industry, where market-to-book ratio is defined as the ratio of the market value of equity to the book value of equity
CEO Age	Age of the CEO
CEO Graduate Degree	Equals one if the CEO holds a masters or Ph.D. degree
Insider Ownership	Percentage of shares owned by the top ten insiders
Institutional Ownership	Percentage of shares owned by the top ten institutional investors
High Prior Rent Extraction	Dummy variable that equals one if prior *CEO Pay Slice (CPS)* or *Excess CEO pay* is above the respective country median, where prior *CPS* (*Excess CEO pay*) is the average *CPS* (*Excess CEO pay*) over the prior three years
High Prior Incentives	Dummy variable that equals one if prior firm or industry pay gap is above the respective country median, where prior firm (industry) pay gap is the average firm (industry) pay gap over the prior three years
Other country variables:	
GDP Per Capita	Current GDP per capita measured in 2009 US dollars (World Bank)
GDP Growth	GDP growth in the current year (World Bank)
Average GDP Growth$_{t-3, t-1}$	Average GDP growth in the past three years (World Bank)
Average Inflation$_{t-3, t-1}$	Average inflation rate in the past three years (World Bank)
Average Unemployment$_{t-3, t-1}$	Average unemployment rate in the past three years (World Bank)
High Corruption	Dummy variable that equals one if the corruption perception score of the country is below the annual median across sample countries (Transparency International)

Appendix B: Distribution of Observations by Country

Country	Number of observations	Number of unique firms
Australia	4,084	942
Austria	256	46
Belgium	234	57
Brazil	18	5
Canada	5,512	1,201
Denmark	345	62
Finland	642	117
Germany	1,749	293
Ireland	522	80
Israel	648	234
Italy	500	133
Netherlands	1,006	169
New Zealand	73	24
Norway	969	194
Philippines	41	13
Poland	281	68
Portugal	102	22
S. Africa	2,120	342
Slovenia	76	14
Spain	186	47
Sweden	1,735	361
UK	7,340	1,402
USA	35,946	5,116
Total	64,385	10,942

Table 1: Summary Statistics

This table provides summary statistics on the variables we use in our empirical analysis. Definitions of all variables are provided in Appendix A.

Panel A: This panel presents summary statistics on our measures of executive compensation and control variables used in the multivariate regressions.

Compensation variables	Obs.	Mean	Median	Std. Dev.
CEO Pay ($000)	64,385	1,346.176	613.374	2,282.470
CEO Cash Pay ($000)	64,385	808.564	556.309	808.167
CEO Salary ($000)	64,385	489.713	408.474	321.776
CEO Bonuses ($000)	64,385	185.541	0.000	425.504
CEO Equity Pay ($000)	64,385	425.667	0.000	1695.837
Excess CEO Pay ($000)	64,385	1,726.987	1,192.681	1,982.280
CEO Pay Slice	55,251	0.284	0.234	0.251
Firm PG ($000)	47,750	508.700	276.785	699.899
Firm PG Ratio	47,750	0.534	0.477	0.300
Industry PG ($000)	64,045	26,132.550	21,381.740	17,659.020
Industry PG Ratio	64,045	0.922	0.967	0.134
Explanatory variables				
CESI	64,385	0.180	0.000	0.509
SESI	52,338	4.418	4.459	0.511
Election	64,385	0.418	0.000	0.493
Left	64,385	0.497	0.000	0.500
Center	64,385	0.014	0.000	0.118
Firm Size	64,385	5,537.753	562.084	18,436.940
ROA	64,385	0.081	0.091	0.187
Stock Return	64,385	0.168	0.072	0.653
Book Leverage	64,385	0.202	0.157	0.201
Asset Tangibility	64,385	0.237	0.134	0.253
Cash Holdings	64,385	0.174	0.094	0.201
Capex Ratio	64,385	0.046	0.025	0.063
Stock Volatility	64,385	0.455	0.376	0.280
Tobin's q	64,385	1.722	1.273	1.415
Industry MB	64,385	1.698	1.634	0.597
CEO Age	64,385	3.939	3.951	0.142
CEO Graduate Degree	64,385	0.328	0.000	0.469
Institutional Ownership	64,385	0.135	0.086	0.157
Insider Ownership	64,385	0.078	0.011	0.148
GDP Per Capita	64,385	47,252.670	48,061.540	10,921.890
GDP Growth	64,385	0.019	0.022	0.017
Average GDP Growth$_{t-3,\ t-1}$	64,385	1.964	2.181	1.241
Average Inflation$_{t-3,\ t-1}$	64,385	2.216	2.178	0.976
Average Unemployment$_{t-3,\ t-1}$	64,385	7.139	6.274	3.716
High Corruption	52,677	0.266	0.000	0.442

Panel B: This panel presents summary statistics and univariate test results on all our variables for the left- vs. non-left-leaning countries, separately. Superscripts ***, ** and *denote significance at 1%, 5% and 10%, respectively.

	Left				*Non-Left*				*Left* vs. *Non-Left*	
Compensation variables	Obs.	Mean	Median	Std. Dev.	Obs.	Mean	Median	Std. Dev.	Mean	Median
CEO Pay ($000)	31,972	1,334.25	621.66	2,275.69	32,413	1,357.94	603.85	2,289.11	-23.69***	17.81
CEO Cash Pay ($000)	31,972	781.613	568.363	736.542	32,413	835.150	541.211	872.276	-53.54***	27.15***
CEO Salary ($000)	31,972	505.607	430.000	319.771	32,413	474.034	390.000	322.989	31.57	107.01
CEO Bonuses ($000)	31,972	144.438	0.000	371.531	32,413	226.088	4.651	468.194	-81.65***	-4.65***
CEO Equity Pay ($000)	31,972	467.622	0.000	1784.148	32,413	384.381	0.000	1602.257	83.24	0.00
Excess CEO Pay ($000)	31,972	1,730.52	1,180.66	2,021.92	32,413	1,723.50	1,205.34	1,942.41	7.02	-24.68
CEO Pay Slice	28,581	0.27	0.22	0.24	26,670	0.30	0.25	0.26	-0.04***	-0.03***
Firm PG ($000)	24,743	484.340	277.151	652.755	23,007	534.899	276.099	746.416	-50.56***	4.49***
Firm PG Ratio	24,743	0.531	0.473	0.299	23,007	0.538	0.483	0.302	-0.01	-0.01
Industry PG ($000)	31,813	24,236.400	19,520.540	16,981.270	32,232	28,004.050	23,336.260	18,109.980	-3,767.65***	-3,815.72***
Industry PG Ratio	31,813	0.920	0.963	0.131	32,232	0.924	0.971	0.136	-0.00***	-0.01***
Other variables										
CESI	31,972	0.14	0.00	0.35	32,413	0.22	0.000	0.63	-0.08***	0.00***
SESI	29,022	4.52	4.46	0.38	23,316	4.28	4.00	0.61	0.24***	0.46***
Election	31,972	0.44	0.00	0.50	32,413	0.40	0.00	0.49	0.04***	0.00***
Left	31,972	1.00	1.00	0.00	32,413	0.00	0.00	0.00	1.00	1.00
Center	31,972	0.00	0.00	0.00	32,413	0.03	0.00	0.17	-0.03***	0.00***
Firm Size	31,972	5,455.73	644.46	17,662.92	32,413	5,618.66	490.75	19,169.76	-162.93	153.71
ROA	31,972	0.08	0.09	0.19	32,413	0.08	0.09	0.19	0.00	0.00
Stock Return	31,972	0.15	0.06	0.66	32,413	0.19	0.08	0.64	-0.04***	-0.03***
Book Leverage	31,972	0.20	0.16	0.20	32,413	0.20	0.16	0.20	0.00	0.00
Asset Tangibility	31,972	0.24	0.13	0.25	32,413	0.24	0.13	0.25	0.00*	0.00*
Cash Holdings	31,972	0.17	0.10	0.20	32,413	0.17	0.09	0.20	0.00	0.00
Capex Ratio	31,972	0.05	0.03	0.06	32,413	0.05	0.02	0.06	0.00**	0.00**
Stock Volatility	31,972	0.48	0.40	0.29	32,413	0.43	0.36	0.27	0.05***	0.04***
Tobin's q	31,972	1.70	1.26	1.40	32,413	1.74	1.28	1.43	-0.04***	-0.02***
Industry MB	31,972	1.56	1.50	0.59	32,413	1.83	1.74	0.57	-0.27***	-0.24***
CEO Age	31,972	3.95	3.95	0.14	32,413	3.93	3.93	0.14	0.02***	0.02***
CEO Graduate Degree	31,972	0.34	0.00	0.47	32,413	0.32	0.00	0.46	0.02***	0.00***
Institutional Ownership	31,972	0.15	0.12	0.16	32,413	0.12	0.06	0.15	0.03***	0.06***
Insider Ownership	31,972	0.08	0.01	0.15	32,413	0.08	0.01	0.15	0.00	0.01
GDP Per Capita	31,972	47,766.11	49,883.12	13,214.15	32,413	46,746.22	46,437.07	8,012.58	1,019.89***	3,446.05***
GDP Growth	31,972	0.02	0.02	0.02	32,413	0.02	0.02	0.02	0.00***	0.00***

Average GDP Growth$_{t-3, t-1}$	31,972	1.65	1.88	1.18	32,413	2.27	2.51	1.23	-0.62***	-0.63***
Average Inflation$_{t-3, t-1}$	31,972	2.25	2.11	1.15	32,413	2.18	2.21	0.77	0.07***	-0.10***
Average Unemployment$_{t-3, t-1}$	31,972	8.09	7.17	4.75	32,413	6.20	5.53	1.84	1.88***	1.64***
High Corruption	25,736	0.18	0.00	0.39	26,941	0.35	0.00	0.47	-0.16***	0.00***

Table 2: Country Equality Sentiment and CEO Compensation – Rent Extraction

This table presents the results on how country equality sentiment affects total CEO pay and CEO rent extraction. In Panel A, we do not condition on the strength of firm governance while, in Panels B and C, we do. *CESI* is a categorical variable that equals two, if, following an election, country political orientation switches from non-left (i.e., right or center) to left; one, if country political orientation switches from left to non-left; and zero otherwise. Variable definitions are provided in Appendix A. All columns include year and firm fixed-effects and country-specific time trends. Heteroskedasticity-robust standard errors are clustered at the firm level. *t*-statistics are reported in parentheses. Superscripts ***, ** and * denote significance at 1%, 5% and 10%, respectively.

Panel A: Full Sample.

The dependent variable in column (1) is the natural logarithm of total CEO pay, the natural logarithm of excess CEO pay in column (2), and the CEO pay slice in column (3).

Dependent Variable:	*Ln(CEO Pay)*	*Ln(Excess CEO Pay)*	*CEO Pay Slice*
	(1)	(2)	(3)
CESI=2	-0.056***	-0.052***	-0.032***
	(-3.41)	(-3.22)	(-4.91)
CESI=1	0.028*	0.035**	0.018***
	(1.87)	(2.39)	(2.96)
Left	-0.040***	-0.042***	-0.021***
	(-3.54)	(-3.76)	(-4.88)
Election	0.006	0.005	-0.000
	(0.92)	(0.85)	(-0.14)
ROA	0.193***	0.189***	0.073***
	(5.93)	(5.70)	(5.75)
Stock Return	0.075***	0.069***	0.021***
	(14.44)	(13.48)	(9.82)
Book Leverage	-0.043	-0.053	0.008
	(-1.13)	(-1.40)	(0.52)
Asset Tangibility	-0.094*	-0.100*	-0.032
	(-1.76)	(-1.86)	(-1.57)
Cash Holdings	-0.010	-0.009	-0.000
	(-0.24)	(-0.22)	(-0.02)
Capex Ratio	0.171**	0.149*	0.082**
	(2.00)	(1.75)	(2.33)
Stock Volatility	-0.123***	-0.118***	-0.014**
	(-6.87)	(-6.69)	(-2.12)
Ln(Firm Size)	0.206***	-0.144***	-0.013***
	(19.73)	(-13.78)	(-3.01)
Industry MB	0.032**	0.039**	0.020***
	(2.01)	(2.48)	(3.32)
Ln(CEO Age)	1.220***	0.491***	0.313***
	(15.92)	(6.41)	(12.15)
CEO Graduate Degree	0.019	0.023	-0.004
	(0.92)	(1.14)	(-0.66)
Institutional Ownership	0.016	0.011	-0.020
	(0.43)	(0.29)	(-1.23)
Insider Ownership	0.014	0.012	0.048***
	(0.36)	(0.31)	(2.91)
Ln(GDP Per Capita)	0.269***	0.278***	-0.051**
	(4.34)	(4.61)	(-2.19)
GDP Growth	2.250***	2.252***	0.458***

	(5.81)	(5.85)	(3.24)
Average GDP Growth$_{t-3, t-1}$	0.005	0.007	0.003
	(0.77)	(1.04)	(1.27)
Average Inflation$_{t-3, t-1}$	-0.004	-0.002	-0.004
	(-0.55)	(-0.31)	(-1.32)
Average Unemployment$_{t-3, t-1}$	-0.006	-0.005	0.001
	(-1.24)	(-1.12)	(0.41)
Firm and Year FE	Yes	yes	yes
Country Time Trends	Yes	yes	yes
Observations	64,385	64,385	55,251
Adjusted R-squared	0.082	0.032	0.035

Panel B: Conditional on Firm Governance.

The dependent variable is the natural logarithm of excess CEO pay in columns (1)-(6) and CEO pay slice in columns (7)-(12). To classify firm governance as weak or strong, we use CEO-chairman duality in columns (1)-(4), board independence in columns (5)-(8), and insider ownership columns (9)-(12). In odd (even)-numbered columns, we use the sample of firms where governance is weak (strong): (i) CEO is (not) also the chairman of the board, (ii) fraction of the independent board members is below (above) the country median; (iii) the fraction of insider ownership is below (above) the country median.

Dependent Variable:	*Ln(Excess CEO Pay)*						*CEO Pay Slice*					
Measure of Governance:	*CEO-Chairman*		*Board Independence*		*Insider Ownership*		*CEO-Chairman*		*Board Independence*		*Insider Ownership*	
Strength of Governance:	Weak	Strong	Weak	Strong	Weak	Strong	Weak	Strong	Weak	Strong	Weak	Strong
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
CESI=2 (β_1)	-0.099***	-0.002	-0.080***	0.036	-0.074***	0.006	-0.041***	-0.015	-0.044***	0.020	-0.037***	-0.009
	(-2.69)	(-0.08)	(-3.22)	(1.11)	(-2.89)	(0.20)	(-3.00)	(-0.76)	(-4.77)	(0.79)	(-4.02)	(-0.80)
H_0: $\beta_{1,\,Weak}=\beta_{1,\,Strong}$ *[t-stat]*	[-2.28]**		[-2.83]***		[-2.16]**		[-1.87]**		[-4.36]***		[-1.96]**	
Control Variables	yes	yes	yes	yes	yes	yes	yes	yes	yes	yes	yes	yes
Firm and Year FE	yes	yes	yes	yes	yes	yes	yes	yes	yes	yes	yes	yes
Country Time Trends	yes	yes	yes	yes	yes	yes	yes	yes	yes	yes	yes	yes
Observations	18,992	21,877	21,145	19,724	22,395	18,474	18,105	18,740	18,778	18,067	20,516	16,329
Adjusted R-squared	0.030	0.044	0.040	0.037	0.045	0.020	0.058	0.044	0.047	0.065	0.077	0.020

Table 3: Country Equality Sentiment and Components of CEO Compensation

This table presents the results on how country equality sentiment affects the cash and equity components of CEO pay. The dependent variable is the natural logarithm of one plus the CEO pay in cash in column (1), the natural logarithm of one plus the CEO pay in restricted stock and stock options in column (2), the natural logarithm of one plus CEO salary in column (3), and the natural logarithm of one plus CEO bonuses in column (4). *CESI* is a categorical variable that equals two, if, following an election, country political orientation switches from non-left (i.e., right or center) to left; one, if country political orientation switches from left to non-left; and zero otherwise. Variable definitions are provided in Appendix A. All columns include year and firm fixed-effects and country-specific time trends. Heteroskedasticity-robust standard errors are clustered at the firm level. *t*-statistics are reported in parentheses. Superscripts ***, ** and * denote significance at 1%, 5% and 10%, respectively.

Dependent Variable:	*Ln(Cash Pay)*	*Ln(Equity Pay)*	*Ln(Salary)*	*Ln(Bonuses)*
	(1)	(2)	(3)	(4)
CESI=2	-0.034***	0.000	-0.033*	-0.881***
	(-6.65)	(0.05)	(1.59)	(-6.48)
CESI=1	0.025***	-0.002	0.010	0.572***
	(6.38)	(-0.78)	(0.93)	(4.86)
Left	-0.023***	0.002	0.007	-0.641***
	(-7.17)	(1.32)	(1.02)	(-7.51)
Control Variables	yes	yes	yes	yes
Firm and Year FE	yes	yes	yes	yes
Country Time trends	yes	yes	yes	yes
Observations	64,385	64,385	64,385	64,365
Adjusted R-squared	0.212	0.080	0.239	0.128

Table 4: Country Equality Sentiment and CEO Compensation – Tournament Incentives

This table presents the results on how country equality sentiment affects tournament incentives. The dependent variable is the natural logarithm of firm pay gap in column (1), the firm pay gap ratio in column (2), the natural logarithm of industry pay gap in column (3), and the industry pay gap ratio in column (4). *CESI* is a categorical variable that equals two, if, following an election, country political orientation switches from non-left (i.e., right or center) to left; one, if country political orientation switches from left to non-left; and zero otherwise. Variable definitions are provided in Appendix A. All columns include year and firm fixed-effects and country-specific time trends. Heteroskedasticity-robust standard errors are clustered at the firm level. *t*-statistics are reported in parentheses. Superscripts ***, ** and * denote significance at 1%, 5% and 10%, respectively.

Dependent Variable:	*Ln (Firm PG)*	*Firm PG Ratio*	*Ln(Industry PG)*	*Industry PG Ratio*
	(1)	(2)	(3)	(4)
CESI=2	-0.059***	-0.009*	-0.175***	-0.028***
	(-4.71)	(-1.71)	(-9.67)	(-7.75)
CESI=1	0.021**	0.010*	-0.006	0.001
	(2.31)	(1.61)	(-0.60)	(0.25)
Left	-0.034***	-0.007**	-0.030***	-0.004**
	(-4.00)	(-2.01)	(-3.95)	(-2.27)
Election	-0.007	-0.006	-0.002	-0.001
	(-1.21)	(-0.88)	(-0.29)	(-1.05)
ROA	-0.070***	-0.042*	0.036	-0.011***
	(-2.74)	(-1.99)	(1.51)	(-2.74)
Stock Return	0.010**	0.008**	0.007*	-0.007***
	(2.26)	(2.50)	(1.88)	(-8.68)
Book Leverage	0.013	0.022*	-0.021	-0.001
	(0.65)	(1.75)	(-0.78)	(-0.22)
Asset Tangibility	-0.171***	-0.045***	-0.316***	-0.018**
	(-5.32)	(-3.43)	(-7.39)	(-2.28)
Cash Holdings	-0.006	-0.039*	-0.122***	-0.011**
	(-0.19)	(-1.99)	(-4.27)	(-1.96)
Capex Ratio	0.014	-0.075**	0.316***	-0.000
	(0.28)	(-2.47)	(4.40)	(-0.04)
Stock Volatility	0.019*	0.021***	-0.100***	0.001
	(1.76)	(3.01)	(-7.69)	(0.57)
Ln(Firm Size)	0.122***	0.010***	-0.023***	-0.013***
	(27.22)	(5.94)	(-3.26)	(-8.97)
Industry MB	-0.010	-0.008	0.411***	0.018***
	(-1.08)	(-1.21)	(32.95)	(6.21)
Ln(CEO Age)	0.312***	-0.096***	-0.028	-0.109***
	(9.90)	(-6.20)	(-0.62)	(-10.10)
CEO Graduate Degree	-0.008	0.000	-0.005	-0.002
	(-1.03)	(0.07)	(-0.39)	(-0.68)
Institutional Ownership	-0.004	0.003	0.009	0.000
	(-0.23)	(0.22)	(0.31)	(0.06)
Insider Ownership	0.032	0.032**	0.020	0.007
	(1.34)	(2.02)	(0.57)	(1.51)
Ln(GDP Per Capita)$_t$	0.022	0.000	0.105**	0.011
	(0.69)	(0.01)	(2.14)	(1.14)
GDP Growth$_t$	0.976***	0.294	-0.063	-0.151***
	(3.24)	(1.12)	(-0.21)	(-2.67)
Average GDP Growth$_{t-3,\ t-1}$	-0.003	0.001	-0.016***	-0.002

	(-0.63)	(0.41)	(-3.55)	(-1.57)
Average Inflation$_{t-3,\ t-1}$	0.015**	-0.005	-0.008*	-0.000
	(2.04)	(-1.28)	(-1.67)	(-0.38)
Average Unemployment$_{t-3,\ t-1}$	-0.002	0.002	-0.010***	0.000
	(-0.71)	(1.22)	(-2.86)	(0.23)
Firm and Year FE	yes	yes	yes	yes
Country Time Trends	yes	yes	yes	yes
Observations	47,750	47,750	64,045	64,045
Adjusted R-squared	0.192	0.083	0.208	0.063

Table 5: Country Equality Sentiment and CEO Pay-Performance Sensitivity

This table presents the results on how country equality sentiment affects the sensitivity of CEO pay to firm performance. *CESI* is a categorical variable that equals two, if, following an election, country political orientation switches from non-left (i.e., right or center) to left; one, if country political orientation switches from left to non-left; and zero otherwise. Variable definitions are provided in Appendix A. All columns include the control variables used in Table 2. In odd-numbered columns, we include year and firm fixed-effects and country-specific time trends, and in even-numbered columns, firm and country-times-year fixed-effects. Heteroskedasticity-robust standard errors are clustered at the firm level. *t*-statistics are reported in parentheses. Superscripts ***, ** and * denote significance at 1%, 5% and 10%, respectively.

Panel A: Sensitivity of Total CEO Pay to Firm Performance.

The dependent variable in all columns is the total CEO pay in natural logarithm. The measure of firm performance is raw ROA in columns (1)-(2), industry-adjusted ROA in columns (3)-(4), raw stock return in columns (5)-(6), and industry-adjusted stock return in columns (7)-(8).

Dependent Variable:	*Ln(CEO Pay)*							
Firm Performance Measure:	*ROA*		*Industry-Adj ROA*		*Stock Return*		*Industry-Adj Stock Return*	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
CESI=2 × Firm Performance	-0.494***	-0.485***	-0.346***	-0.341***	-0.065**	-0.075***	-0.065**	-0.069***
	(-7.48)	(-8.02)	(-5.62)	(-6.05)	(-2.57)	(-3.11)	(-2.41)	(-2.77)
CESI=2	-0.009		-0.052***		-0.046***		-0.048***	
	(-0.52)		(-3.08)		(-2.71)		(-2.83)	
Firm Performance	0.312***	0.313***	0.307***	0.313***	0.075***	0.082***	0.077***	0.082***
	(7.71)	(8.56)	(7.53)	(8.46)	(9.74)	(10.93)	(9.23)	(10.71)
Control Variables	yes	yes	yes	yes	yes	yes	yes	yes
Firm and Year FE	yes	yes	yes	yes	yes	yes	yes	yes
Country Time Trends	yes	no	yes	no	yes	no	yes	no
Country×Year FE	no	yes	no	yes	no	yes	no	yes
Observations	64,385	64,385	64,385	64,385	64,385	64,385	64,385	64,385
Adjusted R-squared	0.076	0.076	0.075	0.075	0.078	0.078	0.078	0.078

Panel B: Sensitivity of CEO Cash and Equity Pay to Firm Performance.

The dependent variable in columns (1)-(4) is the natural logarithm of one plus the CEO pay in cash, and in columns (5)-(8) the natural logarithm of one plus the CEO pay in restricted stock and stock options. The measure of firm performance is ROA in columns (1)-(2) and (5)-(6), and stock return in columns (3)-(4) and (7)-(8).

Dependent Variable:	*Ln(Cash Pay)*				*Ln(Equity Pay)*			
Firm Performance Measure:	*ROA*		*Stock Return*		*ROA*		*Stock Return*	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
CESI=2 × Firm Performance	-0.260***	-0.243***	-0.034*	-0.048***	0.017	0.016	0.008	0.011*
	(-5.50)	(-5.62)	(-1.81)	(-2.71)	(1.36)	(1.40)	(1.36)	(1.88)
CESI=2	-0.026*		0.006		-0.001		-0.001	
	(-1.77)		(0.43)		(-0.50)		(-0.52)	
Firm Performance	0.175***	0.174***	0.037***	0.046***	0.007	0.007	0.007***	0.007***
	(5.51)	(6.05)	(5.12)	(6.61)	(1.01)	(1.15)	(3.67)	(3.61)
Control Variables	yes	yes	yes	yes	yes	yes	yes	yes
Firm and Year FE	yes	yes	yes	yes	yes	yes	yes	yes
Country Time Trends	yes	no	yes	no	yes	no	yes	no
Country×Year FE	no	yes	no	yes	no	yes	no	yes
Observations	64,385	64,385	64,385	64,385	64,385	64,385	64,385	64,385
Adjusted R-squared	0.127	0.127	0.127	0.127	0.071	0.071	0.071	0.071

Table 6: Country Equality Sentiment and CEO Compensation – Using the Survey-Based Equality Sentiment Index (*SESI*)

This table presents the results based on the preference for income equality indicated on World Value Survey by wave and country as an alternative measure of equality sentiment. The dependent variable is the natural logarithm of total CEO pay in column (1), the natural logarithm of excess CEO pay in column (2), the CEO pay slice in column (3), the natural logarithm of firm pay gap in column (4), the firm pay gap ratio in column (5), the natural logarithm of industry pay gap in column (6), and the industry pay gap ratio in column (7). *High SESI* is a dummy variable that equals one if *SESI* is above its sample median. *SESI* equals ten minus the average score on *Income Equality* for each country and year across the surveys within the corresponding wave of the World Values Survey. Variable definitions are provided in Appendix A. All columns include the control variables used in Table 2, firm and year fixed-effects, and country-specific time trends. Heteroskedasticity-robust standard errors are clustered at the firm level. *t*-statistics are reported in parentheses. Superscripts ***, ** and * denote significance at 1%, 5% and 10%, respectively.

Dependent Variable:	*Ln(CEO pay)*	*Ln(Excess CEO Pay)*	*CEO Pay Slice*	*Ln (Firm PG)*	*Firm PG Ratio*	*Ln(Industry PG)*	*Industry PG Ratio*
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
High SESI	-0.094***	-0.109***	-0.046***	-0.057***	-0.004*	-0.057***	-0.021**
	(-4.68)	(-5.51)	(-7.36)	(-4.26)	(-1.88)	(-3.40)	(-2.17)
Control Variables	yes	yes	yes	yes	yes	yes	yes
Firm and Year FE	yes	yes	yes	yes	yes	yes	yes
Country Time Trends	yes	yes	yes	yes	yes	yes	yes
Observations	52,338	52,338	47,076	40,193	40,193	52,034	52,034
Adjusted R-squared	0.090	0.039	0.053	0.102	0.062	0.206	0.062

Table 7: Country Equality Sentiment and CEO Compensation – Average Year-by-Year Response by Firms

This table presents the results on how country equality sentiment affects CEO pay over the three-year period following a regime-changing election where regime is defined based on the left-right political scale. The dependent variable is the natural logarithm of total CEO pay in column (1), the natural logarithm of excess CEO pay in column (2), the CEO pay slice in column (3), the firm pay gap ratio in column (4), and the industry pay gap ratio in column (5). *Year of* $CESI_t=2$ is a dummy variable that equals one if the current year is an election year when left takes over from non-left, and zero otherwise. *One Year Before* $CESI_t=2$, *Two Years Before* $CESI_t=2$, and *Three Years Before* $CESI_t=2$ are dummy variables that equal one if the current year is respectively one, two, and three years after an election when left takes over, and zero otherwise. *One Year After* $CESI_t=2$, *Two Years After* $CESI_t=2$, and *Three Years After* $CESI_t=2$ are dummy variables that equal one if the current year is respectively one, two, and three years before an election when left takes over, and zero otherwise. Variable definitions are provided in Appendix A. Heteroskedasticity-robust standard errors are clustered at the firm level. *t*-statistics are reported in parentheses. Superscripts ***, ** and * denote significance at 1%, 5% and 10%, respectively.

Dependent Variable:	*Ln(CEO pay)*	*Ln(Excess CEO Pay)*	*CEO Pay Slice*	*Firm PG Ratio*	*Industry PG Ratio*
	(1)	(2)	(3)	(4)	(5)
Three Years Before $CESI_t=2$	0.021	0.024	-0.001	-0.024	-0.000
	(0.98)	(1.16)	(-0.09)	(-1.01)	(-0.06)
Two Years Before $CESI_t=2$	-0.081	-0.078*	-0.047	0.038	-0.013*
	(-0.63)	(-1.85)	(-0.15)	(1.54)	(-1.75)
One Year Before $CESI_t=2$	-0.026	-0.026	-0.007	-0.030	0.003
	(-1.11)	(-1.11)	(-0.77)	(-1.30)	(0.88)
Year of $CESI_t=2$	-0.157***	-0.142***	-0.105***	-0.001	-0.029***
	(-6.20)	(-5.71)	(-9.70)	(-0.02)	(-5.16)
One Year After $CESI_t=2$	-0.209***	-0.198***	-0.112***	-0.098***	-0.013***
	(-8.01)	(-7.73)	(-10.36)	(-3.99)	(-3.12)
Two Years After $CESI_t=2$	-0.170***	-0.162***	-0.096***	-0.058**	0.017
	(-7.06)	(-6.87)	(-9.22)	(-2.39)	(1.32)
Three Years After $CESI_t=2$	0.023	0.024	-0.011	-0.070***	-0.003
	(1.18)	(1.20)	(-1.37)	(-3.19)	(-0.79)
Control Variables	yes	yes	yes	yes	yes
Firm and Year FE	yes	yes	yes	yes	yes
Country Time Trends	yes	yes	yes	yes	yes
Observations	51,164	51,164	44,228	44,228	51,164
Adjusted R-squared	0.089	0.037	0.042	0.038	0.027

Table 8: Country Equality Sentiment and CEO Compensation – Conditional on Country Development and Institutions

This table presents the results on how country equality sentiment affects executive pay conditional on the corruption perception score and income per capita of the country. The dependent variable is the natural logarithm of total CEO pay in columns (1) and (2), the natural logarithm of excess CEO pay in column (3) and (4), the CEO pay slice in column (5) and (6), the firm pay gap ratio in column (7) and (8), and the industry pay gap ratio in column (9) and (10). *High Corruption* is a dummy variable that equals one if the country's corruption perception score is below the annual median across sample countries. *Low GDP per Capita* is a dummy variable that equals one if the country's GDP per Capita is below the annual median in our sample. *CESI* is a categorical variable that equals two, if, following an election, country political orientation switches from non-left (i.e., right or center) to left; one, if country political orientation switches from left to non-left; and zero otherwise. Variable definitions are provided in Appendix A. Heteroskedasticity-robust standard errors are clustered at the firm level. *t*-statistics are reported in parentheses. Superscripts ***, ** and * denote significance at 1%, 5% and 10%, respectively.

Dependent Variable:	*Ln(CEO Pay)*		*Ln(Excess CEO Pay)*		*CEO Pay Slice*		*Firm PG Ratio*		*Industry PG Ratio*	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
CESI=2 × High Corruption	0.093***		0.099***		0.027*		-0.076		0.027***	
	(2.91)		(3.16)		(1.86)		(-1.52)		(3.12)	
High Corruption	-0.128***		-0.122***		-0.059***		-0.019		-0.008*	
	(-5.93)		(-5.77)		(-6.61)		(-0.68)		(-1.92)	
CESI=2 × Low GDP per Capita		0.070*		0.067*		0.035**		-0.008		0.023**
		(1.88)		(1.83)		(2.56)		(-0.16)		(2.36)
Low GDP per Capita		-0.048**		-0.045**		-0.016**		-0.072***		-0.002
		(-2.30)		(-2.19)		(-2.00)		(-2.96)		(-0.50)
CESI=2	-0.078***	-0.071***	-0.077***	-0.066***	-0.037***	-0.041***	-0.121***	-0.062**	-0.023***	-0.039***
	(-3.51)	(-3.88)	(-3.47)	(-3.63)	(-4.14)	(-4.90)	(-3.24)	(-2.45)	(-3.69)	(-8.39)
Control Variables	yes	yes	yes	yes	yes	yes	yes	yes	yes	yes
Firm and Year FE	yes	yes	yes	yes	yes	yes	yes	yes	yes	yes
Country Time Trends	yes	yes	yes	yes	yes	yes	yes	yes	yes	yes
Observations	52,677	64,385	52,677	64,385	45,276	55,251	45,276	55,251	52,677	64,385
Adjusted R-squared	0.084	0.083	0.034	0.032	0.039	0.036	0.071	0.083	0.026	0.023

Table 9: Country Equality Sentiment, CEO Compensation and Firm Value

This table presents the results on how country equality sentiment affects firm value. The dependent variable is Tobin's q in columns (1) and (2) and industry-adjusted Tobin's q in columns (3) and (4). *CESI* is a categorical variable that equals two, if, following an election, country political orientation switches from non-left (i.e., right or center) to left; one, if country political orientation switches from left to non-left; and zero otherwise. *High Prior Rent Extraction* is a dummy variable that equals one if prior *CEO Pay Slice (CPS)* or *Excess CEO pay* is above the respective country median, where prior *CPS* (*Excess CEO pay*) is defined as the average *CPS* (*Excess CEO pay*) for each firm over the prior three years. *High Prior Incentives* is a dummy variable that equals one if prior firm or industry pay gap is above the respective country median, where prior firm (industry) pay gap is defined as the average firm (industry) pay gap for each firm over the prior three years. Variable definitions are provided in Appendix A. All columns include year and firm fixed-effects, and country-specific time trends. Heteroskedasticity-robust standard errors are clustered at the firm level. *t*-statistics are reported in parentheses. Superscripts ***, ** and * denote significance at 1%, 5% and 10%, respectively.

Dependent Variable:	*Tobin's q*		*Industry-Adj Tobin's q*	
	(1)	(2)	(3)	(4)
CESI=2	-0.069***	0.051	-0.058**	0.050
	(-2.90)	(1.39)	(-2.47)	(1.37)
CESI=2 × High Prior Rent Extraction	0.062***		0.066***	
	(2.93)		(3.13)	
CESI=2× High Prior Incentives		-0.091***		-0.073**
		(-2.65)		(-2.15)
CESI=1	-0.017	-0.057**	-0.018	-0.055*
	(-0.88)	(-1.97)	(-0.93)	(-1.94)
CESI=1 × High Prior Rent Extraction	-0.009		-0.013	
	(-0.45)		(-0.68)	
CESI=1 × High Prior Incentives		0.040		0.033
		(1.43)		(1.20)
Left	-0.042***	-0.001	-0.042***	-0.014
	(-2.73)	(-0.05)	(-2.79)	(-0.73)
Left × High Prior Rent Extraction	0.030**		0.028**	
	(2.51)		(2.37)	
Left × High Prior Incentives		-0.024*		-0.011
		(-1.67)		(-0.82)
Election	0.009	0.009	0.007	0.007
	(1.37)	(1.37)	(1.12)	(1.11)
ROA	0.561***	0.565***	0.550***	0.554***
	(6.67)	(6.72)	(6.63)	(6.67)
Stock Return	0.351***	0.351***	0.348***	0.347***
	(40.37)	(40.37)	(40.29)	(40.27)
Book Leverage	-0.035	-0.038	-0.015	-0.017
	(-0.66)	(-0.72)	(-0.29)	(-0.34)
Asset Tangibility	-0.265***	-0.269***	-0.261***	-0.264***
	(-3.10)	(-3.15)	(-3.12)	(-3.16)
Cash Holdings	0.523***	0.522***	0.501***	0.500***

	(8.53)	(8.52)	(8.11)	(8.10)
Capex Ratio	1.424***	1.429***	1.407***	1.411***
	(10.65)	(10.70)	(10.88)	(10.92)
Stock Volatility	-0.158***	-0.159***	-0.183***	-0.184***
	(-6.42)	(-6.47)	(-7.62)	(-7.66)
Ln(Firm Size)	-0.243***	-0.244***	-0.243***	-0.243***
	(-15.16)	(-15.19)	(-15.26)	(-15.28)
Industry MB	0.199***	0.198***	-0.120***	-0.120***
	(15.27)	(15.22)	(-9.40)	(-9.44)
Ln(CEO Age)	0.056	0.066	0.060	0.068
	(0.80)	(0.94)	(0.86)	(0.98)
CEO Graduate Degree	-0.055***	-0.056***	-0.055***	-0.056***
	(-2.79)	(-2.81)	(-2.82)	(-2.84)
Institutional Ownership	0.079	0.079	0.079	0.079
	(1.59)	(1.59)	(1.59)	(1.59)
Insider Ownership	-0.186**	-0.185**	-0.201***	-0.200***
	(-2.44)	(-2.44)	(-2.64)	(-2.63)
Ln(GDP Per Capita)$_t$	0.206***	0.206***	0.194**	0.194**
	(2.61)	(2.61)	(2.49)	(2.50)
GDP Growth$_t$	0.833	0.824	0.577	0.570
	(1.64)	(1.62)	(1.17)	(1.16)
Average GDP Growth$_{t-3, t-1}$	0.032***	0.032***	0.032***	0.032***
	(4.18)	(4.19)	(4.10)	(4.11)
Average Inflation$_{t-3, t-1}$	-0.023***	-0.023***	-0.024***	-0.024***
	(-2.99)	(-2.99)	(-3.31)	(-3.31)
Average Unemployment$_{t-3, t-1}$	-0.012**	-0.012**	-0.010*	-0.010*
	(-2.06)	(-2.04)	(-1.82)	(-1.80)
Firm and Year FE	yes	yes	yes	yes
Country time trends	yes	yes	yes	yes
Observations	46,014	46,014	46,014	46,014
Adjusted R-squared	0.253	0.253	0.160	0.160