

### Swiss People to Vote on Caps on Executive Compensation

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On 24 November 2013, the Swiss will have to vote on whether their employment compensation regime should become more egalitarian. A popular referendum promoted by the Young Socialist Party wants to limit executive compensation to 12 times the lowest salary within the same business undertaking. While a number of issues remain unclear at this stage, it is certain that the rather flexible and internationally competitive Swiss labor market would be severely impacted if the initiative were to be adopted by the Swiss people.

*By Thomas Reutter*

#### 1) The Initiative and Its Motivation

On 24 November 2013, the Swiss people will have to decide in a popular referendum whether they would like a more egalitarian income distribution. The referendum has been prompted by a popular initiative launched by the Young Socialist Party that aims at curbing differences in work compensation (Initiative). The Initiative demands that no salary may be higher than 12 times the lowest salary paid within a certain “undertaking” or “enterprise”.

The Initiative aims at introducing a new article 110a into the Swiss Constitution that would read as follows (free translation):

*“The highest paid salary within a certain undertaking [Unternehmen] may not be higher than 12 times the lowest salary paid by the same undertaking. ‘Salary’ means the sum of all benefits (whether monetary or in kind or by services) that are being granted in connection with an employment activity.”*

The second paragraph of the proposed article allows for exceptions in particular for trainees, interns, part-time and secondment relationships.

The promoters of the Initiative argue that there is a market failure in that neither the capabilities nor the performance nor the labor market would lead to excessive salaries but only the personal relationships between the managers and the board of directors of the company by which they are employed. The promoters further argue that by adoption of the Initiative many excessive salaries would have to be curbed and “huge sums of salaries could be released and distributed differently amongst workers”. Thus, the promoters of the Initiative being members of the Young Socialists assume that companies would simply increase the lower salaries and still have the same demand for work in spite of its higher price.

### 2) The Problem of Unequal Income Distribution

Of course, the Initiative raises a number of philosophical issues of justice and fairness within society. For example, is a more equal income distribution within society a goal in itself? Or should a fair society not rather be benchmarked against how its weakest members are treated? It goes without saying that these questions cannot be dealt with let alone answered in a contribution like this.

However, it is probably worthwhile to look at income distribution in Switzerland compared to other countries from an empirical perspective. In social economic studies, the so-called Gini coefficient is used to measure income distribution in any given society. A Gini coefficient of zero means that each member of a society or country has the same income whereas a coefficient of one means that only one person makes the entire income in any given society or country. Switzerland's Gini coefficient is 0.338 before taxes and transfers (e.g. subsidies) and is 0.29 after taxes and transfers. Quite surprisingly, this is the same level as France (0.292) and means a slightly more even income distribution than Germany (0.300). Not surprisingly, the UK (0.345) and the US (0.370) have more pronounced differences in income distribution. Therefore, the peer group of Switzerland with respect to income distribution are countries considered "socialist" even as of today. Similar observations can be made when using measurements other than the Gini coefficient.

### 3) Interpretation Issues about the Initiative

As mentioned above, the text proposed by the Young Socialists to amend the Swiss constitution lacks the desired clarity in a number of respects. The most important ambiguity relates to the term **undertaking** (*Unternehmen* in German and *entreprise* in French). It appears that the sponsors of the Initiative would like the 1:12 restriction not only to apply within any specific legal entity, but also within entities of the same group. The commentary to the Initiative which states that "entire vertical structures such as holdings" are included suggests that conclusion. Although it appears that the promoters of the Initiative do not seem to be familiar with the concept of a group of companies it appears that they wanted the term **undertaking** to be interpreted in an economic rather than a legal manner as is the case, for example, in antitrust law. Assuming the 1:12 restriction should apply within groups of companies it must be further assumed that the sponsors did not intend any extraterritorial impact of this proposed Initiative and hence the restriction would be limited to that part of any group of companies that is based in Switzerland.

Companies that are not part of a group of companies but are owned by the same owner would not be affected based on a reading of the promoter's commentary. Therefore, an entrepreneur may incorporate and own a company employing highly paid managers and another company employing low paid workers without observing the 1:12

restriction. Companies in which the highest paid executives are also owners are also unlikely to have a problem if the Initiative were to be adopted. Rather than paying salaries, they could pay dividends to their manager owners. This is true for most partnership based organizations in Switzerland. If the Initiative will be adopted, we will also likely see a number of creative compensation structures that could involve international secondments or special manager shares with preferential financial rights.

#### 4) Impact and Outlook

A study by the University of St. Gallen sponsored by opponents of the Initiative has endeavored to quantify the impact of an adoption of the Initiative on the Swiss economy. The study adopted various assumptions as to the use of moneys “saved” on prohibited excessive compensation (*i.e.* exceeding the 1:12 restriction) and migration of companies and officers affected to other countries. The study also tries to quantify the impact of any tax losses. It is noteworthy that according to the study even the promoter’s best case of a re-distribution of income from higher paid workers to lower paid workers would lead to significant tax losses due to the progressive tax system. Currently, only 2% of the population pay as much as 47% of the direct income tax on the federal level. If higher salaries were curbed and channeled to lower salaries, significant tax losses would occur because higher salaries are taxed at disproportionately higher rates on the federal level and in all but two cantons.

The large Swiss corporations and financials on average have a majority of foreign nationals in their senior management, are largely owned by foreign based shareholders and do their business across the globe. It would be unrealistic to believe that these companies will remain committed to the Swiss workplace even if conditions severely deteriorate. This also relates to conditions affecting the flexibility of employment. In fact, most rankings of international competitiveness use employment and compensation flexibility as a very important criterion for investment venue selection. It goes without saying that the current competitive edge of Switzerland would be significantly impaired with the salary caps proposed by the Initiative. It can also be expected that many large corporations will relocate management positions, management companies and even their registered office outside Switzerland if the Initiative were to be adopted.

In order to become effective, any constitutional amendment such as the Initiative will have to be approved by both a majority of the Swiss people and a majority of the Swiss cantons. All major parties apart from the Socialist Party have recommended rejecting the Initiative. In recent surveys, the originally high approval rate has come down to below 50% but a rejection is still far from certain. It can only be hoped that Swiss voters are wise enough not to send a signal of deterrence to the international business community.

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