Whats My Employee Worth The Effects of Salary Benchmarking

**Author:**Zoe B. Cullen, Shengwu Li, Ricardo Perez-Truglia

While U.S. legislation prohibits employers from sharing information about their employees’ compensation with each other, companies are still allowed to acquire and use more aggregated data provided by third parties. Most medium and large firms report using this type of data to set salaries, a practice that is known as salary benchmarking. Despite their widespread use across occupations, there is no evidence on the effects of salary benchmarking. We provide a model that explains why firms are interested in salary benchmarking and makes predictions regarding the effects of the tool. Next, we measure the actual effects of these tools using administrative data from one of the leading providers of payroll services and salary benchmarks. The evidence suggests that salary benchmarking has a significant effect on pay setting and in a manner that is consistent with the predictions of the model. Our findings have implications for the study of labor markets and for ongoing policy debates.

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