Executive Pay: Obama's PATCO Moment

The President has a chance to set a new direction on executive pay and Wall Street, just as Reagan did with organized labor

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On Jan. 29, President Barack Obama called Wall Street bonuses "shameful" and "the height of irresponsibility." Could his very public attack on sky-high pay in the financial sector have ripple effects on executive compensation across the rest of the private sector?

If history is any guide, the answer is yes. A President, if he chooses the right moment to act, can have enormous impact on public attitudes. In this case, if Obama chooses to make an example of highly paid financial executives, it could make it a lot easier for shareholders and directors elsewhere to challenge multimillion-dollar pay packages. Already, bankers face a swell of public anger over the bonuses that Wall Street executives pocketed after accepting taxpayer bailout funds.

To see the best parallel to today's situation, look back to August 1981 and Ronald Reagan's actions against the air traffic controllers' union. At the time, the unemployment rate was up to 7.4%, as the economy was moving into the deepest recession since World War II. Sound familiar?

Breaking the Barriers

The controllers' union, PATCO, called a strike for more money and better working conditions. Reagan reacted by firing most of the controllers. He then hired permanent replacements for the strikers, a step that had been legal but socially taboo for 50 years.

Once the "replacement worker" barrier had been broken by Reagan, private-sector companies such as Phelps Dodge, Boise Cascade, and Continental Airlines (CAL) followed similar strategies. The result: Unions became much less willing to go on strike. The number of work stoppages fell from 270 per year in the decade before the PATCO strike, to only 60 per year in the decade after. Moreover, union pay increases slowed.

Of course, the diminution in union power had multiple causes, including globalization and a decline in U.S. manufacturing. But the attack on PATCO "had great impact," says Joseph McCartin, a Georgetown University historian who has written extensively on the PATCO strike. "Reagan made strike-breaking more patriotic and striking less patriotic."

Public Pressure Counts

Fast-forward to today. For years, the pay for top corporate executives has been climbing far faster than overall wage levels. Repeated attempts by shareholder activists and politicians to rein in exec pay have fallen short.

But new research suggests that executive pay is responsive to public pressure. According to Camelia Kuhnen, an economics professor at Northwestern University, and Alexandra Niessen of the University of Cologne, a flurry of negative articles in the press tends to push down executive compensation the next year. "Public attitudes seem to matter," says Kuhnen.

Obama, of course, has more leverage on bankers because of the public funds they have accepted (and no doubt will need more of). But the question is whether Obama will push hard on the morality of high executive pay outside the financial sector. "Every corporation has to take this very seriously," says William George, former CEO of Medtronic (MDT). Currently George chairs the board of directors' compensation committee at Exxon Mobil (XOM) and is a member of the compensation committee at Goldman Sachs (GS). "It's best for companies to step up to the Obama challenge," he says. "We have some time to act now, before we get into the spot of the government setting pay."

Impact Could Be Limited

Not everyone agrees that Obama's move to reduce compensation on Wall Street will have broader effects. "This by itself will not necessarily improve things outside the financial sector," says Lucian Bebchuk, an executive compensation expert at Harvard Law School. Bebchuk would like to see legislation to increase shareholder rights as a bulwark against excessive pay.

Still, the thought of Obama emulating the conservative icon Reagan is a fascinating one. If he chooses, this could be Obama's PATCO moment.

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