Congress Pecks Away at CEO Pay

Legislation would give shareholders a formal say in executives' compensation packages.

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Maybe, at last, corporate executive pay is being tamed.

Three years ago, Business Week magazine headlined a story on executive pay, "The Gravy Train May Be Drying Up."

It didn't happen. Last year, chief executive officers at 350 large American corporations enjoyed an 8.9 percent average boost in direct compensation (salary, bonus, benefits, and long-term incentives), finds Mercer Human Resources Consulting, in New York. Median compensation for the CEOs was $8.2 million. Half got more, half got less.

But Congressman Barney Frank, the Democratic chairman of the House Committee on Financial Services, suspects that a bill passed by the House April 20 "will retard that rate of growth substantially." Over time, he said in a phone interview, the gap between the pay of the top boss and that of average workers could narrow.

For most working Americans, at least those who didn't get a promotion or take a better job, their inflation-adjusted pay has been falling or flat for many years.

By 2005, the CEO-worker pay gap had grown to 411 to 1, compared to 107 to 1 in 1990 and 42 to 1 in 1980, according to United for a Fair Economy (UFE), a liberal advocacy group in Boston. A CEO makes more pay on Jan. 1 than most employees get for a full year of work.

"All the economic benefits of the last two decades are going into the pockets of the people at the top," complains Michael Lapham, director of UFE's Responsible Wealth project.

Gradually, Americans have become more aware of what critics term "obscene" or "greedy" executive pay packages. Frequent scandals involving executives cooking corporate books and backdating stock options to their financial benefit have further damaged their reputation. And now the politics have changed.

Addressing business leaders on Wall Street in February, President Bush said, "The salaries and bonuses of CEOs should be based on their success at improving their companies and bringing value to their shareholders."

There's no correlation between CEO pay levels and corporate performance, charges Mr. Frank, a Newton, Mass., representative.

Frank's bill passed by a 269 to 134 majority, with the support of 40 Republicans. It requires that shareholders (the owners of public corporations) be allowed to vote every year in an advisory capacity on compensation packages.

If, in the future, the compensation committees of boards that set CEO pay levels tend to ignore the objections of many shareholders to high executive pay packages, "then we will do something more," Frank warns.

Frank's "say on pay" bill was quickly introduced in the Senate by Sen. Barack Obama of Illinois, a candidate for the Democratic presidential nomination. The move suggests that the high level of income inequality in the United States could be a "major" issue in the 2008 election, says Patrick McGurn, special counsel of Institutional Shareholder Services (ISS), experts on corporate governance.

Democrats hold a 51-to-49 majority in the Senate, so prospects of passage for the bill are good. But it could face a presidential veto. Mr. Bush told his Wall Street listeners that the government shouldn't interfere in corporate governance.

Executive pay is no longer a simple matter of envy. It has "macroeconomic" consequences, according to a study by Lucian Bebchuk of Harvard Law School and Yaniv Grinstein of Cornell University. They found that the aggregate compensation paid to the top five executives in US public companies had reached 10 percent of profits, roughly $350 billion, in 2003 – twice the 5 percent level of 1993. "This issue is not merely symbolic but rather of practical significance," Professor Bebchuk testified to Frank's committee.

To Frank, the pay levels undermine shareholder value and market confidence. So his bill should "further the workings of the capitalist system," in his view.

The Securities and Exchange Commission, which regulates the financial statements of corporations, has made it easier to assess all elements of executive compensation. Starting this year, it is requiring fuller disclosure in annual corporate proxies given to shareholders. The proxies now include, in one table, payments for pensions, deferred compensation, limousine service, etc.

Charles Peck, a compensation specialist with the Conference Board, a New York business research group, sees this as "a serious and sincere effort to make executive compensation more visible to shareholders and other readers of proxies." He describes the combination of the "say on pay" bill and the SEC disclosure provisions as "progress" in restraining CEO pay growth. But Mr. Peck doubts that either will significantly reduce the magnitude of CEO compensation. "No dramatic change," he says.

Nonetheless, a new study by ISS finds that a "say on pay" law introduced in Britain in 2003 is having a real impact on executive compensation in the island nation.

"Some British activists think it may mark the moment when British capitalism decided to stop converging with its American counterpart," the study notes. Several European countries and Australia have followed Britain's lead.