How to Limit Executive-Pay Scandals

Executive Pleonexia

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Last year, the president of the United States--the CEO of the country--was paid $400,000, with a $50,000 allowance for expenses and up to $100,000 for travel. The amounts are fixed by statute and do not vary with the success or failure of his administration. With responsibilities hardly comparable to the president's, the CEO of Citigroup made nearly $26,000,000 in 2006 (counting all benefits). He may have done better in his job than the luckless president did in his, but surely not 47 times better. Further, if the average annual wage of non-executive employees of Citigroup was, say, $50,000, the CEO made 520 times their salary. There are dozens of such astonishing cases. As a member of Congress recently said, "The average CEO makes more money before lunch than the average worker earns all year."

The cumulative effect of this pleonexia--the revived word for abnormal greed--is "hardly pocket change," as Lucian Arye Bebchuk and Jesse M. Fried wrote in the *Journal of Corporation Law* two years ago. They show that, from 1993 to 2003, the total amount paid to the top five executives of public corporations amounted to $351 *billion*; and that, from 2000 to 2003, the ratio of their aggregate compensation to corporate net income increased to nearly 10 percent. That kind of money could have been put to uses far more beneficial to the shareholders and society: dividends, more research yielding helpful products, improved salaries and health insurance for non-executive employees, better corporate efficiency (permitting lower prices), and so on. It is not merely the shareholders of these corporations (whether they approve or not) that are affected.

The legal fix for this problem, however, is most unsatisfactory--a vacuum of rules. When salaries of senior executives are approved in advance by "disinterested" directors, judges simply defer to their decisions; the question of corporate waste is ignored. Even the American Law Institute has accepted that obeisant position. But the executives (especially the CEO) and the board may be too chummy, too mutually dependent, to expect their negotiations to yield results fair to the corporation. (Baseball stars, at least, negotiate their generous salaries at arm's length.) For judges, the problem of applying a metric to measure fair salaries may be insoluble.

That we recoil viscerally from such greed is a signal that a moral issue is at stake. Recall that the prophet Jeremiah denounced "covetousness," and Isaiah spoke of the "greedy dogs which can never have enough." A CEO who makes hundreds of times the amount paid to regular employees diminishes the humanity of ordinary men: No man's "worth" can be said to so greatly exceed another's. To be sure, special rewards for special contributions to the firm are justifiable. But a rule of reason must be brought into play.

Most solutions to the problem seem ineffective or utopian. It would help to improve the way compensation arrangements are disclosed and to require that shareholders approve executive

compensation--as legislation currently pending in Congress stipulates--but those are measures that are unlikely to curb excess. A better method is for shareholders to amend corporate by-laws to prohibit benefits that exceed, say, some multiple of the median worker's salary. And an amendment to the securities acts to set maximum pay for executives of public companies--perhaps a multiple of the pay of the president of the United States--is conceivable but extremely unlikely, since it would provoke fears (probably exaggerated) of executive flight. (A new IRS rule that taxes over-the-top pay might seem ideal, but it's a draconian measure that wouldn't necessarily compel companies to use funds more wisely.) What we need is a nonpartisan commission along the lines of the Iraq Study Group to consider the question and recommend solutions.