How long will politicians look the other way on CEO pay?

Inequity between top executives and average workers remains at jaw-dropping levels.

The Christian Science Monitor

By David R. Francis

August 25, 2008

Some 77 percent of Americans polled last year felt that corporate executives "earn too much." Most corporate boards apparently disagree. Last year, although the nation's economy was already in trouble, they gave the chief executive officers of the Standard & Poor's 500 largest companies on average a 2.6 percent pay hike to $10,544,470.

Relative to past raises, this is not a big income jump. Nonetheless, that sum is still 344 times the pay of typical American workers, says Sarah Anderson, an analyst at the Institute for Policy Studies (IPS), a liberal think tank in Washington.

On the presidential campaign trail, both Sens. Barack Obama and John McCain attack the high levels of pay for corporate bosses, but are mostly fuzzy on remedies. Several bills before Congress would attempt to tame runaway executive pay. But none have passed both houses.

How come?

Politicians are "looking out" to protect the campaign contributions they receive from corporate executives, says Ms. Anderson. And it's an election year.

For 15 years, Anderson has worked with colleagues at the IPS and others from another liberal research group, Boston-based United for a Fair Economy, to turn out an annual study of executive excess. Their work has likely fueled a rising unhappiness with today's CEO pay packages that 30 years ago averaged only 30 to 40 times the average American worker paycheck.

Anderson hopes that a new research finding in this year's report, along with a new president in the White House and a possible swing toward more Democrats in Congress, will bring about some legislative action on executive pay.

What the 2008 report finds is that five tax and accounting loopholes encourage excessive pay by allowing CEOs to avoid "their fair shares of taxes." In effect, ordinary US taxpayers are subsidizing the earnings of executives by at least $20 billion.

"Outrageous … it's a real cost to society," says Anderson. That's a big enough amount to subsidize 130,000 affordable housing units, she figures.

For that matter, it would pay for the Iraq war for about a month and a half.

One tax loophole gives preferential treatment to "carried interest" at a cost of $2.66 billion to Uncle Sam, according to the Joint Committee on Taxation.

To explain, in a publicly traded corporation, a CEO pay package typically includes salary, bonus, perks, and stock awards of various sorts. At private investment funds and hedge funds, managers get paid by taking an annual management fee, usually 2 percent of the capital they oversee, and by taking a larger chunk, usually 20 percent, of profits realized when they sell fund assets. The latter is termed "carried interest."

In good times on Wall Street, the sums can be huge. The top 50 highest-paid managers of these private investment firms made $558 million on average last year, the business trade journal Alpha reported. That's 19,000 times the average worker's pay. Yet the managers pay taxes on the "carried interest" at a capital gains rate of 15 percent, not the 35 percent for ordinary income in the highest tax bracket.

Critics see no big difference between a person managing other people's money with other professionals such as a doctor or lawyer whose earnings are taxed at ordinary income tax rates.

"It's a no-brainer," says Anderson. So when a bill closing the carried interest loophole passed the House but was blocked in the Senate by "an aggressive lobbying campaign by deep-pocketed investment fund industry movers and shakers," Anderson says, it "sent a chill down my spine."

Other loopholes include unlimited deferred compensation, offshore deferred compensation, unlimited tax deductibility of executive pay, and special accounting treatment of stock options.

Shareholders have become somewhat more aware of the cost of high executive pay. A study by Harvard University professors Lucian Bebchuk and Yaniv Grinstein found that the pay and benefits given to the top five executives in a large group of big corporations in the years 2001 to 2003 amounted to 10 percent of the total earnings of these firms. So executive pay is no longer an insubstantial matter to shareholders.

Senators Obama and McCain approve of proposals giving shareholders a "say on pay," giving them an annual, nonbinding vote on the compensation of executives. But Anderson is "a bit skeptical" that a legislated "say on pay" rule would make much difference.

Apparently some shareholders are not too keen to meddle with executive pay. Recent proxy proposals at four major Wall Street firms to require "say on pay" votes received an average of just 37 percent approval from their shareholders.

So are CEOs worth their fancy pay, as they usually argue?

A new study by economists Ulrike Malmendier at the University of California, Berkeley, and Geoffrey Tate at the UCLA Anderson School of Management, Los Angeles, cast some doubt for some "CEO superstars." After gaining fame and prestigious awards from business magazines and others for their corporate performance, they are rewarded with even more pay. But in the next three years their firms underperform by 15 to 20 percent compared with firms of non-prize-winning executives.

Ms. Malmendier suspects the CEOs are too busy writing books, sitting on other company boards, taking prestigious public service jobs, and improving their golf handicaps.