Executive Pay in the U.S.: CEOs Take the Money and Run

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The most fundamental and singular result of corporate policies of the past 25 years has been a massive shift in relative income from the roughly 105 million workers to the wealthiest 10 percent non-working class households in the U.S. This enormous income transfer grew in scope and magnitude annually throughout the 1980s and Reagan years, continued to expand steadily during the Clinton years, accelerated during the first term of George W. Bush, and now promises to exceed more than $1 trillion per year during the rest of Bush's second term.

Few groups within the ranks of the U.S. corporate elite have gained more from this historic income shift than the CEOs and senior managers of corporate America. In 1978, according to the Wall Street Journal, typical U.S. CEOs earned approximately 35 times the pay of the average paid worker in their company. In recent years CEO total compensation has risen to more than 500 times the average worker's pay, according to the conservative global business source, Reuters.

Defining Executive Pay

The typical worker in the U.S. receives about 90 percent of their earned income from their paycheck whether earned as an hourly wage or weekly salary. Not so for the typical CEO and senior manager. Historically only 7-10 percent of their income is earned from a salary as such. Focusing only on CEO salaries, therefore, totally misses the point and statistics quoting CEO salaries as the sole indication of executive pay levels should be especially suspect. At times the term "direct compensation" is used as an alternative measurement of executive pay. But that too underestimates such pay, as it excludes hidden indirect forms of compensation.

A slightly better term is "total compensation." It includes direct and indirect forms of executive pay. CEO total compensation may include salaries, bonuses (cash or other forms), stock options, stock grants and awards, long term incentive pay, deferred pay of various kinds, regular and supplemental management pensions, below market rate mortgage loans to managers by the company, write offs of personal loans by corporate boards, innumerable forms of perks with direct dollar value, prepaid charitable donations, lifetime use of corporate jets, company payment of CEO tax obligations (called "gross up" compensation), and so on in a long list of forms of creative and hidden pay. These and other non-salary forms of executive pay account for 90 percent or more of CEO and senior managers' total compensation.

But even "total compensation" is an inadequate indicator of executive pay. With hearings on executive pay by the U.S. Securities and Exchange Commission (SEC) to begin this spring, it is

clear that many other forms of executive compensation remain hidden by opaque corporate accounting and reporting practices, are not counted as part of “total compensation,” and are never communicated to the IRS.
During the Reagan years average CEO pay rose from just over $1 million a year to roughly $2.5 million by 1989. By 1992, at the close of the George Bush senior administration, it nearly doubled again to $4.5 milliondespite the recession of 1990-91 and falling corporate profit performance. It more than doubled again under Clinton to $11.1 million by 2000, for a 342 percent gain over two decades. Some estimates placed the pay of the average U.S. CEO as high as $14.4 million by 2001.

According to a just released study by professors Lucian Bebchuk of Harvard Law School and Yaniv Grinstein of Cornell University, based on interviews of CEOs and top managers at the 1,500 largest publicly traded corporations in the U.S., the group of 5 top managers at the corporations received collectively $122 billion in compensation between 1999-2003 compared to $68 billion for the same group during 1993-1997. On top of these 1999-2003 gains, the Harvard-Cornell study estimates another 39 percent increase in average executive compensation in 2004 for the surveyed group of the largest corporations.

But even the Harvard-Cornell figures are underestimations as they exclude the lucrative and fast-growing supplemental pensions for executives, called Supplemental Executive Retirement Plans (SERPS). Some sources estimate SERPs constitute as much as an additional one-third of total executive compensation. Were SERPS and other supplemental retirement plans included in the Harvard-Cornell study estimates, the nearly doubling of executive pay that was estimated between 1999-2003 would have been even higher.

As corporations over the past decade have been busy reducing pension benefits for workers, under-funding and even abandoning their pension plans for workers, SERPs were being added across the board by corporations in the U.S. Changes in the tax laws in 1994 provided a strong incentive for creating SERPs for senior executives as a way to shelter more of their total compensation from taxation. Less than half of senior executives had supplemental pension plans prior to 1995; today more than 90 percent have such plans. Thus billions more have been squirreled away for CEOs and senior managers of the largest public companies over the past decade.

For CEOs of the largest corporations that means at least another $60 billion in addition to the $122 billion of the Harvard-Cornell study. But that additional $60 billion still does not include the rest of the 90 percent of corporationsapart from the 1,522 surveyed by Harvard-Cornellthat have also established SERPs today for CEOs and senior managers.

One of the great scandals at Enron when it went bankrupt was that Enron executives froze workers’ pensions and did not allow them to take their money out as the company began to default, while those same executives were cashing out their pensions in a separate, supplemental

management pension plan.

Other measures of growth in executive compensation corroborate the above trends and figures for executive pay. The non-partisan research group the Corporate Library recently surveyed "median" as opposed to average CEO pay. It estimated that median CEO compensation for 2003 rose 15 percent in 2003, followed by another increase in median executive compensation of 30 percent in 2004. No doubt results for 2005 will show a continuing accelerating trend.

Trading Jobs for Executive Pay

CEOs who have been doing especially well under George W. Bush are those companies that have been involved in aggressive offshoring of jobs. Approximately eight million quality, high paying jobs have been lost due to "free" trade policies and offshoring since the 1980s and the number continues to rise rapidly. Free trade policies and offshoring reflect the radical restructuring of trade relations and foreign direct investment strategies implemented by corporate America since Ronald Reagan. More than a million jobs have been lost due to NAFTA in the last decade alone and another 2.5 million have resulted from the granting of special terms of trade with China in 2000.

For dismantling of a good part of the U.S. manufacturing base, CEOs and senior managers of U.S. corporations involved in offshoring of jobs have been generously compensated compared to their already well-paid corporate peers. For example, a Business Week survey in 2003 of CEOs at the 50 largest U.S. companies that outsource the most showed that their CEOs enjoyed an average increase in compensation of 46 percent between 2001-03, earning as a group a reported $2.2 billion while sending an estimated 200,000 jobs offshore.

CEOs and managers are now compensated at record levels, not for their contribution to the corporate bottom line anymore, but for selling off the company, for leaving quietly, or for gross performance failure. Thus Carly Fiorina, ex-CEO of Hewlett-Packard, departed last year with a package of more than $40 million. David Pottruck of Schwab left with around $50 million, and Craig Conway of Peoplesoft exited with a total package of more than $60 million. Among the biggest winners of CEO departees, however, were Phillip Purcell of the investment bank, Morgan Stanley, who left with a reported $113 million, and James Kilts of Gillette who walked out the corporate door with $165 million. Even more amazing was Steven Crawford, recent co-president of Morgan Stanley, who left after only three months of employment with $32 millionor a rate of pay of more than $10 million a month. Crawford's gain was more than matched in terms of the bizarre, though, by Daniel Carp, still CEO of Blockbuster Video Corp., who in 2004 received more than $50 million in compensation even though the company recorded a loss of $1.25 billion that year.

Comparing Pay

As previously noted, executive pay between 1980 and 2000 climbed an astounding 342 percent, outpacing the rate of inflation over the period by at least 4 to 1. In contrast, the average hourly wage for more than 100 million workers, when measured in 2003 dollars, rose from $14.86 at the start of 1980 to only $14.95 at the end of 2000. That's a 9 cents an hour gain after 20 years.

Furthermore, the average hourly wage today for 105 million workers after adjustment for inflation is exactly the same at year end 2005 as it was in 2001, according to the U.S. Department of Labor's statistics. In 2004-2005 it has fallen steadily as inflation has begun to accelerate. For the 60 million at the medium wage level or below, inflation the past two years has been rising at twice the rate of their hourly wage.

To compensate for stagnant and declining real hourly wages and earnings, U.S. workers have had to resort to alternative means to try to maintain income levels and spending. These alternatives to wage gains fall into three categories.

First, more U.S. families have been having other family members enter the workforce to supplement family incomes and/or have had to take on second part time jobs in addition to their normal job. U.S. families have increased the number of hours worked by more than 500 a year since 1980. Americans now work by far the greatest number of hours per year than workers in any of the other industrialized countriesapproximately 1,970 hours each per year out of 2,040, based on a normal 40 hour work week. The next closest is Canada where workers average about 1,800 hours. Workers in industrialized economies of Europe average fewer hours worked, 1,600-1,800 hours per year.

Second, they have had to take on record levels of consumer and installment debt, levels that have doubled from $4 trillion to more than $9 trillion since Bush II took office.

Third, workers fortunate enough to own their homes have been refinancing those homes and using the proceeds as discretionary income to pay for major purchases such as medical expenses, education, and large ticket itemsin effect living off their assets.

All three solutions to the stagnation and decline of real wages over the past quarter century, however, have their finite limits and cannot continue long term as safety valve alternatives to declining real wages, earnings, and incomes for the 105 million.

Reforming Executive Pay Abuse

Growing executive pay abuses and excesses have in recent months provoked a response from several quarters. Stockholder complaints that CEOs and executives have doubled their take from roughly 5 percent to more than 10 percent of total profits, have focused attention on the impact of accelerating levels of executive pay on shareholder dividends and stock returns. Thus, even some capitalists have now begun focusing on the issue and splits and differences about what to

do have arisen within their ranks. As a result, several bills and legislative proposals have been entered into Congress addressing executive pay.

This development has forced the Bush administration to issue a response and proposals of its own. The SEC, this past January 2006, issued preliminary draft rules for revising corporate executive pay practices and reporting. These rules were open for a 60-day period in February-March for public discussion and comment, following which the SEC would issue final rules for revising executive pay to take effect in 2007.

However, in issuing initial draft proposals the SEC made it clear that it would not impose limits on executive pay, as the objective of the SEC is only to require more accurate reporting by corporations of their pay to executives. The solution, according to the SEC, is to let the market regulate the excesses and abuses in executive pay practicesthe same market that has been allowing those abuses and excesses in the first place. As SEC chair Christopher Cox put it this past January, “Our purpose here is to help investors keep an eye on how much money is being paid to the top execs.” Apparently this means allowing them to see better the full scope and magnitude of the executive pay theft, even though there will be little they can do about it once they know the full extent of the abuse.
Executives are awarded their excessive compensation by their corporate boards. By law board members cannot be removed by shareholders. That’s how the system is set up. Furthermore, shareholders have no power to veto or approve executives’ salaries pensions, severance, personal loan subsidies, perks, and so forth. As one of the authors of the Harvard-Cornell study put it, “Shareholders have very limited power to do anything about it.”

The SEC’s tepid main proposal in its draft rules is to consolidate the reporting of executive pay for the top five managers in a corporation into a single figure in a corporate proxy statement. Currently, elements of executive pay are distributed all over the proxy statement and many are hidden in accounting rat holes in the document that never see the light of day.

Elsewhere the SEC’s draft rules merely tweak the system. For example, currently perks awarded to execs valued at less than $50,000 a year need not be reported. This limit would be reduced to $10,000. On the other hand, the SEC’s draft rules say nothing about closing some very large loopholes, such as requiring the valuation of stock options given to executives and not just reporting the number of shares of stock. Or requiring the reporting on dividends paid to executives on restricted stockwhich is currently not required at all. Or allowing corporations to deduct executive pay from their corporate taxes, which is also now permitted. Or backdating stock strike prices for stock options, which allow executives to reap huge stock windfalls.

In fact, the SEC is proposing to widen the reporting loophole for personal transactions between executives and the corporation (i.e., personal loans, gross ups, etc.). The SEC has suggested the cut off level for reporting such transactions be raised from $60,000 to $120,000, meaning that more compensation will actually be hidden rather than revealed. The Wall Street Journal

responded to the SEC's initial draft rules by declaring, "This is a case of admirable regulatory restraint." And as that business source further noted, after all "who knows what is exorbitant pay anyway."

Despite the SEC's cautious approach to reforming executive pay now running rampant, business has criticized the SEC draft by arguing that more transparent reporting is just the first step to establishing limits on executive pay, that revealing more detail about executive pay will lead to more competition for pay packages between executives and thus higher pay, and that more transparency will result in other creative ways to raise or defer executive pay. In other words, don't fix a broken system because you may break it even more.

In the middle of the political spectrum, more liberal Democratic elements in the House have called for legislation requiring shareholder approval of additional executive compensation where the sale or purchase of corporate assets are involved (e.g., mergers or acquisitions). The AFL-CIO is calling for a law that provides for shareholder approval, not just transparent reporting, of general changes in executive pay.

But like so much on the U.S. political scene today, the debate is conducted between various factions of the corporate elite. The 105 million workers in the U.S. and their direct interests in any debate of economic significance or import are left out of the picture. Thus little will likely come out of the SEC's hearings or efforts in Congress to rein in accelerating executive pay in the U.S. The coming months of debate on the subject will provide much smoke, little fire, and a lot of mirrors. Meanwhile, the real hourly pay and earnings of more than 100 million workers will continue to stagnate and decline as gas prices, medical costs, housing, and general inflation rises-forcing tens of millions to work more hours, take on extra jobs, assume an ever-rising burden of credit, and spend down the assets in their homes in order to maintain consumption levels and standards of living. Executive pay may be the ongoing obscenity; but worker pay in the U.S. is the true continuing tragedy.

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