You Deserve a Refund for Fat CEO Pay

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By David R. Francis
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Executive pay has become so fat it is no longer just a matter of fairness or greed. It's squeezing stockholders, perhaps even damaging the economy.

"The stakes from an economic perspective are quite substantial," says Lucian Bebchuk, a professor at Harvard Law School in Cambridge, Mass.

Here's the problem: In 2003, the top five executives at each of the 1,500 major public companies followed by Standard and Poor's earned a grand total of $350 billion. That's not peanuts, even in the scale of an $11 trillion economy. It amounts to about 10 percent of the aggregate earnings of these companies. Worse, it's double the share paid out in the 1993-95 period, when executive compensation took only 5 percent of the profits of the S&P 1500.

So corporate executives are today taking an extra 5 percent of profits for their own pockets - money that might have gone to dividends for shareholders or into investments to expand their firms. Or maybe that profit money, by boosting stock prices, could have pumped up the actual pensions or pension funds of millions of Americans.

This may be a surprise, but in a way, Uncle Sam subsidizes executive pay. The costs of fancy compensation, just like the pay of an average worker, are a company expense. It can be deducted when a firm estimates its corporate taxes. So the bigger the pay for the chief executive officer, the less corporate tax owed to Washington. In effect, every taxpayer pays indirectly for excessive corporate executive pay.

"The stakes have not yet been fully appreciated," says Mr. Bebchuk, who with Yaniv Grinstein, a finance professor at Cornell University, recently wrote a paper on the growth of executive pay.

After the corporate scandals of recent years, some experts figured CEO pay gains would moderate.

"It was an unrealistic, somewhat idealistic point of view," says Charles Peck, a compensation expert at the Conference Board, a business research and information group in New York. Many corporate boards put independent members on their compensation committees. Stock options, a major source of wealth for executives in the dotcom boom of the 1990s, must now by regulation be considered an expense on the books of companies. So fewer options are given.

Yet executive compensation has continued to soar. Last year, corporate employees got pay hikes averaging 3.5 percent, maybe a bit more with benefits. By contrast, most of the chief executives of some 3,000 companies enjoyed double-digit rate increases in their compensation, notes Mr. Peck. Of 14 industries, only the nation's top bankers received a single-digit increase.

Peck sees some rearrangement in the components of executive pay packages. For instance, CEOs may get long-term stock deals as rewards for performance, rather than options. But the link between pay and performance is much weaker than it should be, says Bebchuk.

Nonetheless, the "Lake Wobegon effect" remains in place. In a weekly spiel about this imaginary town, the host of the Prairie Home Companion radio show regularly says, "all children are above average." Corporate boards seek to hire CEOs that are above average by paying above-average pay, thereby ratcheting up compensation each year.

If companies themselves won't subdue CEO pay, Congress should, says US Rep. Martin Sabo, a Democratic prairie populist from Minnesota. Earlier this month he reintroduced a bill, the Income Equity Act, which would eliminate tax deductions for compensation that exceeds 25 times that of the company's lowest paid full-time employee.

Currently, the gap is more likely 300 to 500 times. The Sabo bill would mean that if the lowest-paid worker got $20,000, then the highest salary deduction the firm could claim would be $500,000. A company could pay its CEO more, but couldn't deduct more from its tax obligations.

A survey of Americans last year ranked "greed and materialism" as the nation's most urgent moral problem. And CEO pay is "greed's poster child," figures Sam Pizzigati, a board member of United for a Fair Economy, a Boston-based advocacy group.

But Americans have paid little attention to the CEO pay issue, perhaps because they figure that it is a company matter that they can do nothing about.

Mr. Pizzigati writes a weekly online newsletter - www.toomuchonline.org - dealing with economic equity. He charges that many top executives devote more energy to manufacturing fortunes for themselves than to manufacturing quality products. They sacrifice long-term enterprise health for short-term gains by mergers that leave veteran employees without jobs, by reducing research, and by raiding pensions.

But the Sabo bill has no chance of passage. Too many Republican and Democratic legislators depend on campaign donations from executives and their companies.