Should Executive Compensation Be Regulated?
An investigation of the economics involved in the societal discussion of this topic.

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Abstract

The debate surrounding the regulation of executive compensation is prevalent throughout American society and is discussed in various areas such as the economics discipline, government, think tanks, special interest groups, the media, the private sector and pop culture. Individuals and groups within these areas use various forms of economics to analyze executive compensation and formulate an opinion as to whether or not compensation should be regulated. A neoclassical economic view leads to the conclusion that compensation is set at appropriate levels by the market without government intervention, while a social democratic or moral critical viewpoint will perceive executive compensation as outrageously high and often results in a call for regulation of these pay practices.

Introduction

The regulation of executive compensation is one of the most controversial topics addressed in society today. Executive pay has been rising over the last several decades, and with the advent of the Internet boom in the 1990's it has reached higher levels than ever before. During the decade spanning 1999 and 2000, CEO compensation increased an average of 1300%[2] and in 2004 the average pay received by CEOs of major companies was $9.84 million[3]. This has become a concern for individuals in nearly all areas of society, from economics and government to special interest groups and the media. These sectors each address the issue from a unique point of view and target

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[2] Information taken from Joel Shuman's article "What's Wrong with the Current System? Compensation without Long-Term Value Creation."

[3] Value retrieved from the AFL-CIO Executive Paywatch website.

various audiences in their discourse. Ultimately, they all have an effect, to some degree, on the opinion of the general public toward the regulation of executive compensation.

There are three dominant forms of economic thinking that may be found in the literature published by these sectors of society: neoclassical, social democratic and moral-critical. Neoclassical economics is based on the idea that humans act rationally when making decisions in the economy, and that they always attempt to maximize their net happiness and avoid unnecessary pain. Neoclassical economists believe that the free market is efficient, absent externalities and various agglomeration and scale economies, and they are concerned with finding and illuminating market imperfections. They are generally opposed to government intervention in the economy other than for the reasons stated above, or for redistributionist purposes, and advocate total market freedom. The social democratic style of economics maintains that justice must be considered when making distribution. Social democratic economists often make political statements and, by targeting both politicians and voters, promote government intervention that will increase the fairness of the economy by redistributing wealth to the poor through instruments such as taxes and welfare. Moral critical economics originated in humanistic literature, but elements of it may now be found in nearly all aspects of society. Its adherents promote the ideals of fairness and social empathy above all else. Moral critical economists attempt to change the attitudes of others by illuminating negative aspects of the economy and appealing to the public's innate sense of fairness to make changes.

These styles are predominantly featured in the attitudes towards executive compensation that are reflected in the publications of various sectors of society, including the economics discipline, government, think tanks, the media, special interest groups, the private sector, and pop culture. By examining the ideas put forth by each of these sectors regarding the regulation of executive pay, it is possible to gain a balanced view of the debate, the key players and issues. It is also important to identify the audience each group is attempting to reach and the group's reasons for promoting their policy towards executive compensation.

Economics

The economics discipline has discussed the issue of executive compensation for many years, but it is only recently, as executive pay has rapidly increased, that the amount of literature and controversy surrounding this topic has compounded as well. Economic literature is primarily concerned with determining the appropriate level of executive pay given the executives' input into the market. There are, however, some economists who believe that the most efficient market conditions will be achieved through government regulation of executive compensation. Although the economic literature is predominantly neoclassical in its discussion of this topic, there is also an intriguing social democratic component where economists attempt to determine, through the use of economic modeling, what a 'just' amount of compensation is.

The economics profession has attempted to evaluate the method by which executive compensation is determined and ultimately reach a conclusion as to whether or not this process is economically efficient and appropriate. To analyze the various executive compensation methods, economists use statistical analysis and regression models in an attempt to find a relationship between executive performances and the amount and type of executive compensation. Economists have determined that not only is there a strong statistical link between firm performance and executive compensation

(Abowd and Kaplan, 1999:149) but that executive wages are also related to the executive's potential marginal product and factors such as the risk inherent in their job with regard to the stability of the industry or the business environment.

This is a typical neoclassical method of analysis as economists attempt to evaluate the efficiency with which executive salaries are set, through the use of mathematical formulas and economic modeling. The economists involved in this discussion are convinced that the market will yield an efficient salary for executives as long as compensation packages are constructed properly. Executive compensation is composed of four general areas: a base salary, an annual bonus, benefits that may include a pension, and other various long-term incentive plans. (Abowd and Kaplan, 1999:146) It is important that the compensation packages correspond with the executives' performance in order to provide incentives for them to work harder. Abowd and Kaplan tell us "economic theory certainly predicts that executives will work harder when given larger incentives to do so," and that incentive programs such as bonuses and merit payments for upper level employees help increase executive performance. These neoclassical economists also believe that the market is not perfect in its allocation of executive compensation because the packages focus much more on salary, the level of which is set based on a variety of subjective factors, rather than performance driven incentives.

Additionally, the neoclassical economic literature surrounding this topic primarily focuses on attempting to model and evaluate the relationships that exist between executive compensation and other factors, such as the level of managerial discretion (Finkelstein and Boyd, 1998:184) and its relationship with compensation in firms with either high or low performance. (185) This literature does not focus on proposing solutions such as government regulation, but rather on the utility of the executives and the subsequent appropriateness of their compensation. Ultimately these economists find that "the links between CEO wealth and performance have increased dramatically over time." (Abowd and Kaplan, 1999:155) They emphasize that they feel the market is indeed determining the appropriate wages for these executives.

The social democratic voice is also heard throughout the economic literature, and hints of it may be found in works that are primarily neoclassical. Recently there has been a call by the public for government to implement legislation restricting executive pay, and economists have been attempting to discern whether or not this would help increase the effectiveness of executive performance and more efficiently allocate executive salaries. These economists evaluate executive compensation using the same statistical and analytical methods as the neo-classical economists, but they also address the question of whether the compensation is "fair" (Abowd and Kaplan, 1999:160) or "excessive." (Rose and Wolfram, 2000:197) They are concerned with the relationship between executive compensation and wages received by other employees of a firm. Although neoclassical studies have shown that "CEOs have their compensation cut when layoffs are announced," the decrease in the executive's compensation is not significant enough to deter further layoffs. (Abowd and Kaplan, 1999:160) Traditional economic thinking would suggest that CEOs should not be deterred from taking some steps aimed at increasing profits, but encouraged to take others. This emphasizes the fundamental difference in neoclassical and social democratic economic thinking; the idea of efficiency versus fairness.

Many economists have acknowledged that there are serious problems with the method by which executive compensation is determined. CEO compensation for example is determined, in principle, by the stockholders or owners who, in reality, delegate the responsibility to the board of directors. The board of directors then gives the responsibility to a compensation committee but retains the right to ultimately approve the committee's recommendation. Because all decisions must eventually be approved by the board of directors it would follow that any interaction they have with the executive will influence their compensation decision for that executive in addition to considering his/her work effort and productivity. (Cyert, 1997) Some economists, inspired by this subjectivity, now advocate compensation packages that place more weight on performance-based incentives rather than a large base salary. One way to encourage this change is through some sort of government tax that might be promoted by a social-democratic economist, such as the Omnibus Budget Reconciliation Act of 1993 that "eliminated corporate tax deductibility for compensation in excess of $1 million for the CEO and each of the next four highest paid executives within a firm." (Rose and Wolfram, 2000:197) Economists have been investigating the effectiveness of this tax in reducing "excessive" compensation and although they use neo-classical methods, the fact that they have classified some executive compensation as excessive shows that they have a slightly social-democratic tinge to their style of economics. They have found that, while this "million-dollar cap" has tended to keep executive pay under or around the million-dollar mark, total compensation actually increased after the tax was passed due to a corresponding increase in performance based incentives. (201)

At this point, economists are not prepared to make a judgment regarding the regulation of executive compensation. They show, however, that compensation generally corresponds to both the firm's performance (Abowd and Kaplan, 1999:149) and stock price. (155) By emphasizing performance based incentives rather than base salary, economists have shown that firms can achieve higher caliber performances from their executives and better align executive interests with those of the company. (Abowd and Kaplan, 1999:159) These economists have used neoclassical methods to analyze executive compensation as a practice, and a few have adopted a social-democratic viewpoint to inspect its equity and fairness. By researching and writing in these styles, these economists have presented a clear view of the situation and brought to light many aspects of executive compensation that are very successful and many practices that need to be reformed.

Government

As executive compensation has been brought to the forefront of the American public's attention, it has become a major political issue as well. As early as 1991, politicians have been discussing the implications of escalating executive salaries and compensation packages and debating the appropriate action to take. This was an important concern during the 1992 presidential campaigns and has prompted a string of legislation proposals that address various compensation issues and have met with various degrees of success. Some politicians have adopted a social-democratic economic view and believe that executive compensation is too high overall and that it should be restricted by the government, while others have adopted a neoclassical economic view and believe that the market appropriately sets executive compensation. The majority of politicians, however, has embraced a mixture of the two styles and believes that government regulation is necessary to ensure that compensation is effectively tied to performance.

The discussion surrounding increasing levels of executive compensation has been growing ever since the early 1990's. Politicians who were outraged by the growing discrepancy between the highest and lowest paid workers brought this issue to the forefront. Martin Olav Sabo, a Democratic congressman from Minnesota, was responsible for contriving the first legislation addressing this problem. He proposed the Income Equity Act in 1991, an act that would restrict tax deductions for executive compensation that exceeded twenty five times the compensation received by the company's lowest-paid worker. (Murphy, 1994:2) The legislation was not passed, but Sabo has modified and reintroduced the act several more times, most recently in 2003, and has met with little success. Congressman Sabo's goal in introducing the Income Equity Act is to "combat the troubling growth of economic inequality in America…by encouraging corporate responsibility." (Sabo, 2001:1) Politicians such as Congressman Sabo are in the minority and are generally not economists, but their beliefs are consistent with the social-democratic style of economic thought. They desire to achieve fairness through redistribution rather than to evaluate the accuracy of executive compensation as the market has set it.

Many other politicians and people involved in government approach the executive compensation discussion from a purely neoclassical viewpoint. One example is Thomas Donohue, President and CEO of the U. S. Chamber of Commerce. He believes that CEO pay is fundamentally a reflection of the marketplace and that because of the difficulty and risk associated with executive positions, well-qualified executives have a very high market value. (Donohue, 2004:1) Politicians like Donohue claim that the free market is efficient and that government regulation of executive compensation will ultimately prevent the most talented individuals from accepting positions in which they are not paid what they are worth, which will in turn harm companies and the overall economy. (Donohue, 2004:3) Although there are politicians and individuals in other government positions who believe wholly in the power of the free market to set executive pay, there are many others who think that some government regulation is needed to ensure that the market is correctly determining compensation.

The majority of individuals in the government speaking out about executive compensation draw ideas from each of these arguments and styles. They assert that although the free market is able to accurately determine the efficient compensation for upper-level executives, some government regulation may be needed to ensure that compensation is positively related to executive performance. President Bush, for example, gave a speech regarding corporate responsibility in July 2002 and stated that although it is fine when "an executive whose compensation is tied to his company's performance makes more money when his company does well," (3) he also supported a pension reform proposal that would treat corporate executives and workers the same during "black out" periods, stating that "what's fair for the workers is fair for the bosses." (4) He also challenged CEOs to be upfront and honest about their earnings and to explain why they deserve the compensation packages that they are receiving. (5) This exhibits both a belief that executives who increase the value of their companies should receive high compensation, but also that a social-democratic sense of 'fairness' and ethics must be taken into consideration as well, and that this fairness may be achieved through government regulation.

Other government officials, such as Senators Carl Levin and John McCain are also promote the regulation of executive pay. They introduced the "Ending the Double Standard in Stock Option Accounting Act" which would reform stock option accounting by requiring that companies must show shareholders and the government the same set of books. By increasing the transparency of compensation practices, the politicians believe efficiency will subsequently increase as well. This legislation was not passed, but has been supported by various other organizations and influential figures, such as Alan Greenspan. (Klinger and Hartman, 2002:10) Greenspan criticized high levels of executive compensation in a testimony given on the state of monetary policy in 1999, saying that he "find[s] a lot of what is being paid to individual CEOs not directed to the value that they are producing for their shareholders, who are paying the bill." (Perry and Zenner, 2000:1) Greenspan later gave a speech at the 2002 Financial Markets Conference of the Federal Reserve Bank of Atlanta on Stock Options and Related Matters, describing the distortion in reported earnings that may result from a failure to expense stock option grants. (Greenspan, 2002:2) These individuals have exhibited both a neoclassical belief that the free market can determine appropriate compensation and a social-democratic opinion that regulation may be necessary to help achieve this efficient outcome.

The regulation of executive compensation is a complicated issue that is not easily resolved among government employees and politicians. While some feel that compensation is excessive and should be regulated, others claim that the free market sets an efficient price for talented executives. Still others believe that there should be a balance of free market and regulation in an attempt to relate compensation to executive performance. This issue will continue as a topic of discussion as long as different interest groups, such as think tanks and special interest groups, support different politicians.

Think Tanks

Think tanks are distinctly American institutions[4] that are created by individuals or endowments to conduct research on current issues and problems. The few think tanks that have addressed the topic of executive compensation have reached definitive conclusions on whether or not they believe it should be regulated. These think tanks fall into two distinctive categories and may be identified with specific styles of economic thought. The most prevalent view is a form of moral-critical outrage at the excessive compensation these individuals receive and a desire to promote government regulation of this excess. The opposing view that is less widely held is a neoclassical analysis of executive compensation.

The most vocal think tank that approaches the issue of executive compensation from a moral critical point of view is the Institute for Policy Studies, which conducts an annual study in conjunction with the special interest group, United for a Fair Economy, to analyze the growing wage gap between CEOs and workers and to suggest actions that should be taken to minimize this gap. By promoting fairness and social empathy, this publication illuminates the imperfections of the market that allow executives to be paid, on average, over 300 times more than the average worker's annual salary. (Anderson, 2004:1) Some of the complaints against CEOs listed in the publication include the fact

[4] From "The Fifth Estate: Institutions for Extending Public Policy Debate in Emerging Democracies – Lessons from the American Experience" by Craufurd D. Goodwin

that executives make increasingly higher salaries, even when their companies are performing poorly or the CEOs are acting illegally. The report also claims that the current approach to executive compensation encourages risk-taking that is excessive and unnecessary and makes it relatively simple to use accounting techniques that blur the truth and help to increase CEO pay. (Klinger, 2002:3)

In keeping with the moral critical style, the Institute promotes government regulation of executive compensation that will encourage fairness and social empathy towards the average worker. The report supports several pieces of legislation that have recently been introduced and could eventually help curb executive compensation. For example, it praises the Income Equity Act, which was described in the previous section as a limit on the tax deductibility of a CEOs salary greater than twenty five times that of the lowest paid worker at his company.[5] (Anderson, 2004:26) Clearly, the Institute is striving to achieve fairness for average workers through the regulation of executive compensation. Other regulations that are supported by the Institute and mentioned in "Executive Excess" are the elimination of tax deductibility of executive perks that are not offered to other employees and the requirement that stock options be expensed (Anderson, 2004:26) These are two of the most controversial aspects of executive compensation, especially the expensing of stock options, which means that companies would either be required to include all stock options on the accounting statements shown to shareholders or encouraged to do so by not allowing corporations who do not expense options from taking tax deductions when these options are exercised. (Klinger, 2002:17)

A less vocal, contradictory view is held by think tanks that approach the issue from a more neoclassical standpoint. As one might expect, the National Bureau of

[5] See page 7 for more on the Income Equity Act.

Economic Research is one of these institutions. There have been several studies conducted of executive compensation by the NBER and the issue is consistently evaluated in terms of the neoclassical principle of efficiency and the free market. One of these studies mentioned earlier in the discussion of economic literature found a strong statistical link between firm performance and executive compensation (Abowd and Kaplan, 1999:149), as well as a connection between stock price and executive wealth.[6] (155) The researchers believe that firms should ensure that pay is linked to performance by formulating pay packages that are composed of several performance-based elements such as stock options and bonuses in addition to salary. (162) These studies by the NBER address the issue of fairness that is so prevalent among the moral-critical literature and refute some of the primary evidence given as an example of executive-worker inequality, claiming that executive compensation does not, in fact, go up when layoffs are announced as is claimed by the other group. While the National Bureau of Economic Research does not usually take official stands on its research, several other think tanks adopt a neoclassical stance on this issue and believe that the free market efficiently sets levels of executive compensation and that it is best left unregulated.

Although there are very few think tanks that are concerned with the regulation of executive compensation, the ones that have addressed the issue are either moral critical or neoclassical in their analysis. The moral critical faction, which includes the Institute for Policy Studies, is very vocal about their outrage over the levels of compensation and believe that it should be regulated to achieve some measure of fairness among a company's employees, whether upper level executives or manual laborers. The neoclassical group often uses data from the National Bureau of Economic Research, and

[6] See pages 3-6 for discussion of the Abowd and Kaplan study.

approaches the effort from a purely academic standpoint, using economic theory to evaluate the compensation of executives and determine whether or not it is efficient. This group does not support government regulation of executive compensation, but instead claims that the free market appropriately sets compensation.

The Media

The media is one of the primary sources for information on important issues facing the American public. Although claiming to be impartial and unbiased, it is often accused of reporting news that is prejudiced and frequently chosen for its entertainment value rather than its importance and applicability to the public. News outlets such as newspapers and electronic media like television and radio are often the only sources from which the general public derive its information on current events, and must therefore be considered some of the premier contributors to the discussion surrounding any policy question. The media approaches the topic of executive compensation from a moral critical point of view and attacks compensation levels as being excessive and unfair to shareholders and average workers, both of which are portrayed as representatives of the American public. Although this approach is similar to that of various other sectors, the media extends this critical analysis to tie excessive executive compensation to other more prominent issues that the public is interested in, such as the accounting scandals that have recently come to light. But despite the moral critical nature of the analysis, reporters often use neo-classical ideas to promote their ideas of equality and fairness.

The media's discussion of executive compensation takes for granted the fact that CEO pay is too high and focuses instead on addressing the question of who is hurt by this excessiveness and what should be done about it. The outrage at the levels of compensation and the desire to promote fairness among class levels are both moral critical in nature. By claiming that executive compensation is both excessive and unfair and emphasizing the increasing gap in CEO and worker wages, the media is promoting an image of executives who take advantage of their companies and employees, and is then contrasting this greedy and immoral image with the perceived innocence of the well-intentioned public. The large discrepancy in the wages of executives and lower level workers is one of the main arguments used by the media to convince the public that executive compensation is too high and that something must be done to change it. The media also attacks what it perceives as greedy tactics by executives such as deferred compensation, and then converts these actions into consequences for the public. For example, in an editorial from the *New York Times*, the author states that because executives demand these deferred-compensation plans, recent Congressional restrictions that have been placed on the pension plans of ordinary workers have prompted many businesses to eliminate pensions for their workers and to provide only their executives with this deferred-compensation. The editorial then goes on to point out that this "exacerbates the growing economic gap between executives and the rank and file." (NYT 10/18/96) By making the problem personal for these individuals by relating the actions of executives to their lives and the lives of their fellow Americans, the media is trying to capture the interest of the public and to initiate a call for social reform.

It is interesting to note that the reform called for by the media is not a call for government regulation of executive compensation, but instead for a higher level of integrity among the business community. Although the arguments against the current levels of executive compensation are moral-critical in nature, the media's solution incorporates many of the ideas of neoclassical economics. While none of the articles explicitly mention efficiency or the free market, the majority advocates an increased level of correlation between the performance of an executive and the amount of compensation that the executive subsequently receives. Inherent in the idea of pay for performance is the concept of efficiency and the economic theory that in a truly free market, executives who are paid for their performance will have their value set at an efficient level. Many of the articles written about the debate suggest that executive pay packages be restructured in order to achieve this pay for performance compensation and to realign the interests of executives with those of the investors. (Leonhardt, 2002:2) This restructuring should not result from government regulation, however, but should be instituted by the board of directors in charge of the companies or from the CEOs themselves who realize the inherent unfairness of their excessive pay packages.

The media, unlike most other sectors that have addressed the issue of executive compensation, has associated excessive compensation with other issues that the public is concerned with. Many of the articles blame the greed of executives, which has led to massive compensation packages, for the immoral behavior that has been occurring among executives of successful companies in recent years. These accounting scandals, such as the ones at WorldCom and Tyco, have occurred when executives misrepresented accounting information and took advantage of this misinformation to sell portions of their company stock and make large amounts of money before the stock prices began to reflect the accurate information and fall. The media and subsequently the public have been outraged over this scandal and public confidence in executives and America's large corporations has dramatically decreased. (Dunaief, 2002:2) The media clearly ties the greed of executives and their large compensation packages to the immoral accounting practices and scandals that have recently been brought to light. This seems like a bit of a stretch and may be attributed to the idea that, although the media's job is to report the news, it must also cater to the interests of the public in order to maintain and increase their readership. In this case, the public is demanding to know who or what is responsible for the immoral actions of executives in these scandals, and although there is no simple answer, the media has provided one in the form of executive greed and excessive compensation.

The media has been very involved in the conversation surrounding the regulation of executive compensation and although the majority of articles and reports adopt a moral critical point of view and are morally outraged at the excessive levels of compensation packages, they tend to take a neoclassical approach toward solving the problem and promote pay for performance compensation rather than government regulation. Because of its need to maintain public approval and satisfy its customers, the media also has blamed excessive executive compensation for the immoral behavior of top executives at several corporations in an attempt to provide the public with someone to blame. This emphasizes both the influence the media has of the public's perception of an issue, and of its conflicting interests to both report the news objectively while maintaining the interest of its customers, the public.

Special Interest Groups

Special interest groups are organizations whose foundations are based on a commitment to a particular policy outcome or to represent the interests of a certain group of individuals. There are many special interest groups that address the issue of executive compensation and although they generally don't add a lot of new information to the discussion surrounding its regulation, they do provide an interesting voice that is very accessible to the public. The discussions of these groups regarding executive compensation are similar to those found in the media and many think tanks, in that they adopt a moral critical viewpoint for their analysis and then provide a neoclassical solution to the problems that they identify. By working in conjunction with think tanks and competing with the media for the public's attention through independent publications, special interest groups strive to provide the public with an admittedly biased view of the issue and to persuade them of the validity of their arguments.

The special interest groups that are interested in executive compensation are primarily labor groups concerned with achieving social and economic justice in the United States and promoting corporate responsibility. The group that is most vocal regarding executive compensation is United for a Fair Economy, an organization whose purpose is to increase awareness of the allegedly devastating effects of concentrated wealth and power and to encourage social movements that promote greater economic equality among upper level executives and average workers. Other interested groups include the American Federation of Labor and Congress of Industrial Organizations, the Council on International and Public Affairs, and others. All of these groups have websites through which they try to reach the public and many also publish newsletters and journals. The most prominent is the publication *Executive Excess* that, as mentioned earlier, is the result of the joint efforts of United for a Fair Economy and the Institute for Policy Studies, a think tank that strives to create a more responsible society. An annual publication which is often cited in writings by other special interest groups, *Executive*

Excess examines the illegal actions of CEOs and the growing CEO-worker wage gap, and then provides recommendations for actions they believe should be taken to decrease this gap and the excessive salaries being paid to upper-level executives.

These special interest groups use a moral critical approach to evaluate executive compensation and employ strong language that appeals to the public's sense of fairness to promote their ideals of economic equality and justice. By describing executive pay as "excessive" and "exorbitant" and the worker wage gap as a "chasm," these organizations emphasize the inherent inequality that they perceive in the economy and its disastrous implications for the welfare of average workers. They examine the effects of excessive executive compensation on the average worker and ultimately conclude that high levels of CEO compensation not only increase the worker wage gap, which is demoralizing to lower-level workers, but that their questionable accounting practices with regard to stock options often take money away from shareholders and retirement savings away from hard-working families. (AFL-CIO, 2005:1) It should be expected that special interest groups would use a moral critical argument to support their ideas; because their purpose is to promote particular outcomes it is not surprising that the support for their beliefs stems from strong moral opposition to a particular aspect of society. What are surprising are the neoclassical solutions that these groups present in response to the issue of excessive executive compensation.

All special interest groups have a specific goal that they are trying to reach and most involved in the debate regarding executive compensation desire some type of government regulation to be enacted. It is surprising, however, that they use the neoclassical idea of linking executive pay to performance in many of their articles. The neoclassical theory of the efficiency of free markets is then used to promote government legislation of executive compensation based on the idea that regulation is needed to ensure pay is actually tied to company performance. Recommendations such as the requirement that stock options be expensed and an end to tax payer subsidies for excessive compensation comprise the groups' attempt to ensure that executive compensation is at a fair and efficient level, which they all agree would be considerably lower than it is currently. (Klinger, 2002:17)

Although the special interest groups that have studied executive compensation are very positioned in their analysis of the topic, they do exhibit a strong understanding of the complexities of the issue. Not only do they provide a moral critical examination of compensation practices and the harm that is brought to individuals by the high levels of remuneration received by executives, but they also provide concrete solutions that they believe will solve the problem and better correlate executive pay and company performance. While these groups are admittedly biased and focused on achieving a specific policy outcome, they are also an important voice in the debate surrounding regulation of executive compensation and when analyzed in conjunction with think tanks and the media, provide an interesting and fairly well rounded analysis of the situation.

The Private Sector

The regulation of executive compensation is of special interest to the private sector, the segment of society that would be most directly affected by this proposed regulation. This sector consists of those individuals involved with business rather than government or academe and includes the executives whose compensation is often deemed excessive by other areas of society. Although some within the private sector believe that executive pay should be regulated by the government in order to achieve a social-democratic ideal of greater equality and fairness and others adopt a moral-critical stance and are outraged at the perceived excessive nature of executive compensation, the majority ascribe to the mercantilist style of economic thought and use neo-classical arguments to assert that appropriate compensation levels are determined by the free market provided that pay is accurately tied to performance. These individuals claim that government regulation is not necessary, but rather the boards of directors of companies are responsible for insuring that the compensation awarded to executives reflects their true market value. The differing opinions are reflected well in a poll conducted by Paracon in August 2003 that gave executives the opportunity to discuss the issue of compensation regulation, as well as through op-eds written by CEOs and statements made by executives to the media.

The poll conducted by Paracon was in response to an announcement by William Donaldson, the Chairman of the Securities and Exchange Commission, who declared his intention to target excessive executive compensation in order to restore the confidence of investors. The poll asked if investor confidence would be increased if executive pay were regulated, and the results were somewhat surprising. Almost thirty percent of the individuals polled, most of whom hold senior positions within their companies, believed that compensation regulation would increase investor confidence.[7] The respondents were also given an opportunity to comment on their vote and respond to the comments of others, and it is this conversation that is truly intriguing. Of those who believed that investor confidence would be increased by the regulation of executive compensation,

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[7] This Paracon Poll was initiated on Monday August 4, 2003 and 1,164 individuals were asked, "Do you think investor confidence will be increased if executive pay is regulated?" 69% responded no and 31% responded yes.

many exhibited a very social-democratic mindset that many upper-level executives were paid too much, especially in comparison with the lower-level employees at their companies. Several of these respondents commented on this perceived pay disparity and the need to ensure that executive pay is fair. They stated that executives do not work alone but that their salaries often falsely imply that they are disproportionately vital to the success or failure of their company. There were many respondents who believed that controlling executive compensation would be "a good step toward closing the class division between executive and non executive employees." (Paracon, 2003:11) Others also emphasized that executives are merely employees of corporations and should be treated accordingly.

Dane A Miller, CEO of the medical-device firm Biomet Inc., is an example of a CEO with social democratic views of executive compensation who does not believe government regulation is the appropriate method by which to control excessive compensation packages. Dr. Miller tells the *Wall Street Journal* "everyone should have a little problem making an obscene amount of money on the backs of shareholders" and then emphasizes that he thinks it is wrong for management to receive much higher wage increases than lower-level workers. This reflects a social democratic desire to elevate the average worker and to put all laborers on more equal footing. Dr. Miller does not, however, advocate government interference in executive compensation. He believes that it is the responsibility of the company boards to "see to it that their senior management, specifically the CEO, is not compensated in a fashion that would appear obscene to anybody." (Lublin 2005) Dr. Miller puts an interesting twist on the discussion regarding executive compensation regulation among the private sector, and is a prime example of a

CEO who adopts a social democratic viewpoint, but does not advocate regulation of compensation by the government.

The second argument that featured predominantly in the conversation of those who voted in the Paracon poll that the regulation of executive compensation would increase investor confidence was a moral-critical indignation at the preposterous levels of compensation. These individuals did not address the discrepancy between executive and lower-level employees, but were instead appalled over the massive amounts of compensation being awarded to many executives. (Paracon, 2003:3) Many respondents claimed that executive pay is excessive and out of control, and that although executives should receive some extra compensation for the work that they do, the government should regulate exorbitant pay. (Paracon, 2003:6) Many of these respondents believed that government intervention would not only increase investor confidence; it would ultimately reduce executive compensation to a more appropriate level. Upon considering the group of senior-level managers that participated in this poll, it is amazing that even a small number would adopt either this moral-critical attitude, or one of social-democratic fairness and redistribution of wages. (Paracon, 2003:1) It is likely accounted for by the fact that some companies that employ these individuals are very small and it is highly unlikely that they are receiving large compensation packages. This might prompt them to speak out against those who do, either out of jealousy or righteous indignation.

The majority of respondents to the poll were against government regulation and proponents of the ability of the free market to determine shareholder value and the value of executives. (Paracon, 2003:9) These voters, almost all of who are senior-level executives, employ self-interested, mercantilist thinking and use neo-classical arguments to promote their own self-interests. Many of these respondents said that in order for the market to appropriately determine the true value of executives, pay must ultimately be tied to performance. (3) They also asserted that it is the role of compensation committees and boards of directors to determine appropriate compensation and to accept accountability for properly designed executive compensation plans that are in the best interest of the corporation. (12) These respondents who were against the regulation of executive pay also used neo-classical arguments to describe the problems that would be associated with regulated compensation, such as the talent that would be lost from firms because of their inability to attract the best workers to top positions by offering them large compensation packages that they deserved. (10) They also asserted that in addition to negatively affecting these high performers and making mediocrity the new executive norm, regulation would also make compensation politically rather than performance driven, and therefore decrease the efficiency of the market. (16) Ultimately, those polled renounced government regulation of compensation and called for a voluntary shift in the method by which boards and committees allocate compensation, ensuring that it is performance-based and long-term so that pay is effectively tied to overall executive performance. This discussion is more in keeping with the arguments that would be expected from a group of individuals who are considering the government's decision to regulate their pay. Because many of the respondents likely receive large salaries and other valuable perks, they would naturally denounce government regulation that would limit their compensation packages.

This neoclassical idea that the CEO salaries should reflect their performance is also reflected in the statements made by many executives in various interviews and public statements. For example, Scott Cleland, CEO of the Precursor Group in Washington, DC, tells The Conference Board in their publication regarding executive compensation that "CEO base salary should be what the market bears" and then emphasizes the importance of using restricted stock and bonus plans tied to strategic objectives to correlate pay with performance. (Budman, 2005) In the same Conference Board publication, Jim Mitchell, the former CEO of IDS Life and executive VP of marketing and products for American Express, makes a similar argument for performance based executive compensation and suggests that it should be based on both "true economic value creation over time" and customer satisfaction with the executive. (Budman, 2005)

Although the majority of executives in the private sector have rejected government regulation as a method of increasing investor confidence there are a few who support regulation as a means to boost confidence. In the Paracon poll, those who spoke against the regulation used self-interested, mercantilist arguments cloaked in neo-classical terminology to further their own interests and maintained that the current method of compensation determination by boards is most effective, and reject any form of government intervention. Contrastingly, the social democratic and moral critically minded executives who support government regulation as a means to increase investor confidence believe that compensation is excessively high and something must be done about it. While some called for a redistribution of wealth to lower-level employees, others were morally outraged at the levels of compensation and believed that government regulation is the only way to ensure that a more appropriate level of compensation is achieved. Rather than merely thinking of themselves, these individuals are taking the public good into consideration and abandoning their own self-interests. These widely varying opinions among what might appear to be a homogenous group of individuals might also be attributed to the discrepancies in the sizes and types of companies that they work for. Those who had received more economic education might also have had fewer qualms about advocating unrestricted executive compensation. In this case, each executive is ultimately promoting their own individual self-interest, even when it appears that they are merely proponents of the social good.

Pop Culture

Pop culture is the one segment of society that is geared unashamedly toward the general public and vies for their attention and approval while simultaneously possessing the power to significantly influence the public's opinion on practically any topic. The various components of culture include movies, literature, the arts, and other areas, which both shape and reflect the customary beliefs, social forms, and material traits of a social group[8]. Throughout the twentieth century, CEOs have been portrayed as evil in many aspects of culture, but nowhere more so than in the movies and on television, beginning with silent films and continuing in current productions as well. The list of movies and television shows featuring executives of large companies as villains is incredibly long, and many CEOs feel that this is an unfair portrayal that has escalated with the recent accounting scandals at companies such as Enron. These executives have now begun turning to the one cultural work that portrays CEOs as moral and noble rather than unprincipled thieves: Ayn Rand's novel *Atlas Shrugged*. Examination of the cultural views presented throughout movies and literature brings to light one of the major causes of public distrust of executives and emphasizes the role that culture must have played in

[8] Definition of "culture" taken from the Merriam-Webster Online Dictionary.

the vilification of these individuals. Although the sheer volume of movies and television programs with an anti-CEO message seems overwhelming, it must also be noted that the solitary positive work, *Atlas Shrugged,* has generated an unforeseen following and support for its attempts to counteract the ideal so commonly portrayed in the movies and on TV. (Jones, 2002)

The first film to portray executives as evil was the silent film *Metropolis,* which was made in 1927 and foretold a future in which "rich magnates live in splendor off the backs of those toiling in the dark underground." (Jones, 2004) Since this initial example of dastardly CEOs in the movies there have been countless others, some of the most notable being *Citizen Kane*, in which a newspaper tycoon engages in a series of tyrannical actions, and *Wall Street*, which describes a young stock broker taken under the wing of a ruthless and greedy corporate raider who encourages him to trade illegal outside information. *Wall Street* is the epitome of a film that portrays executives as villains and emphasizes the immoral nature of the business world. The movie's antagonist, Gordon Gekko, is a wealthy and powerful executive who will stoop to exceedingly immoral levels to accumulate even more wealth and power. The most infamous quote in the movie, spoken by Gekko, is that "greed is good," further cementing the public's idea of executives as callous and driven by greed rather than regard for the welfare of their companies or the public. Robert Thompson, director of the Center for the Study of Popular Television at Syracuse University, attributes this unfavorable portrayal of CEOs to the public's desire to see these individuals, who are daily rewarded with wealth, power and respect in many other aspects of life, "brought down to size." (Jones, 2004) But the villainous portrayals resulting from this public envy of executive lifestyles merely serve to perpetuate the feelings of resentment and jealousy experienced by the public towards CEOs.

It is interesting that despite the large number of negative portrayals of executives in movies and on television that solutions are rarely proposed to fix the problem. Although executives are generally depicted as villains and therefore are destined to be defeated at the end of the film or program, there is rarely a push for government regulation of compensation. The comedy *Arrested Development* depicts a CEO being sent to jail for illegal accounting practices, one of the only situations in which government intervention is expected, but the regulation of executive salaries is never touched upon. Instead, the protagonist takes the higher ground and usually achieves a moral victory over the evil executive. This reflects the public's moral objection to what they perceive as excessive pay received by CEOs and emphasizes the moral critical nature of film and television's discussion of the issue. Rather than suggest solutions to the problem they merely attack the level of compensation on the grounds that it is excessive and unfair, and what they lack in constructive ideas is made up for in outrage and indignation.

In the mass of movies and television shows attacking executives, there is one piece of literature that encourages executives by reminding them that "self-interest is not only the right thing to do from an economic standpoint but it is moral, as well." (Jones 2002) Ayn Rand's novel *Atlas Shrugged* depicts a world in which executives are the creators of all value and who choose to go on strike when their minds and hard work are taken advantage of by the government and lower-level workers. While movies attack CEO compensation on the basis of moral indignation, Rand uses neoclassical devices to support her libertarian ideals of a free market with little or no government intervention. *Atlas Shrugged* is not a book that will be read by the majority of the public and will never likely have a great effect on public opinion regarding CEO compensation. But it provides a motivation for the work of the many executives who have read it and influences the way that they view their jobs and subsequently their positions in society. A survey conducted for the Library of Congress in 1991 shows that *Atlas Shrugged* is second only to the Bible in terms of books that have made a difference in people's lives. In this way, although movies and television may reach a much wider audience, the impact they have upon the lives of the public is likely to be much more vague than the intense impact this book has had on the lives of executives who have read and been inspired by it.

In *Atlas Shrugged,* Rand is vehemently opposed to the regulation of executive compensation, subscribing instead to the neoclassical idea that the free market will efficiently set the value of an executive's labor given the value that they create for their company. Government regulation is only acceptable when protecting property rights, American freedom and other behavior that might harm an individual's right to pursue their own self-interests. Therefore the prosecution of executives behaving illegally (like those at Enron) is entirely permissible, but government attempts to legislate morality are considered the most heinous of crimes. (Jones, 2002)

The negative portrayal of executives on television and in many movies, such as *Wall Street*, has helped to vilify CEOs and encourage public opinion that they are immoral and excessively compensated. This moral critical image has permeated our culture and CEOs have become stereotypical villains, an image that they feel is undeserved. The novel *Atlas Shrugged*, however, presents an entirely opposite portrayal of executives in which they are both moral and the creators of wealth rather than thieves of it. It has inspired executives and uses neoclassical rationale to justify the work that they are so highly criticized for performing. Ultimately, I think that these aspects of pop culture merely confuse the debate surrounding the regulation of executive compensation and are a byproduct of this discussion rather than an active participant. However, they are very important influences on public opinion and that is an important factor that must be taken into consideration when evaluating the role that they play.

Conclusion

Upon observing the interaction among the economic styles used in this argument, the notable clash between the neoclassical ideas and the moral critical/social democratic ideologies becomes apparent. The neoclassical economists are unable to comprehend why the public is so outraged at the levels of CEO pay. They believe that if the CEOs create large amounts of value for their companies, they should be compensated for it. They might also think that CEO pay is the result of competitive pressure and that allowing the market to determine compensation assures that the prospective CEO goes to the use where he is most valued. The moral critical and social democratic voices, however, don't care about efficiency or how much value is created; they only see dollar amounts that appear excessive when compared with average compensation. But even if they have little or no regard for the neoclassical viewpoint, they do embrace some of its ideas and terminology to make their points regarding fairness.

The economic discipline, as well as its literature, is primarily concerned with determining the appropriate level of executive pay given the executives' input into the market. While this literature presents a largely neoclassical viewpoint of the topic, a social democratic element is often present as well. This element is often reflected by economists' attempts to utilize economic modeling to determine an appropriately "fair" level of compensation for executives. Although the majority of economists believe that government should not be involved in the determination of executive pay, there exists a minority of economists, both neoclassical and social democratic, who claim that government regulation of executive pay will result in efficient market conditions.

Within the government sector, the majority of individuals have embraced a mixture of the neoclassical and social democratic styles. These politicians believe that government regulation is necessary to ensure that executive compensation is linked to performance. Outside of this group, there are politicians at either extreme; some have adopted a social-democratic economic view and believe that executive pay is too high and that the government should restrict it, while others have adopted a neoclassical view and believe that the market appropriately sets executive compensation.

Think Tanks' discussion of the regulation of executive compensation contains little of the compromise found in the government's viewpoint. Moral-critical outrage at the excessive nature of executive pay is the most common view, and leads to a desire to promote government regulation. The opposing, less dominant, view is a neoclassical analysis of executive compensation that opposes regulation by the government.

The media attacks executive compensation levels on a moral critical basis and portrays them as excessive and unfair to the American public. The media often ties excessive compensation to other prominent issues to gain the public's interest, and often use neo-classical ideas to promote their moral critical ideas of equality and fairness.

Special interest groups adopt a moral critical viewpoint for their analysis of executive compensation and then provide a neoclassical solution to the problems that they identify. These groups strive to provide the public with an admittedly biased view of the issue and to persuade them of the validity of their arguments. Although they bring little new information to the debate, they are very successful at reaching the public and providing persuasive arguments for the regulation of compensation.

The majority of individuals in the private sector use neo-classical arguments to promote their mercantilist ideas that appropriate compensation levels are determined by the free market provided that pay is accurately tied to performance, and that government regulation is not necessary. These individuals are looking after their own interests, and far outweigh the smaller social democratic and moral critical groups which believe executive pay should be regulated in order to achieve equality and fairness.

And, finally, pop culture has a long history of portraying CEOs as evil villains and promoting regulation of their activities and, ultimately, compensation. Very few neoclassical works balance this social democratic imagery, but one primary example is Ayn Rand's novel *Atlas Shrugged*. This book portrays executives as heroes and denounces government intervention in the economy, thereby inspiring executives and countering the strong social democratic movement within pop culture to promote government regulation of executive compensation.

It is important to notice the interaction of these various areas of the economy in the discussion surrounding the regulation of executive compensation. One example is the relationship that exists between special interest groups, think tanks and the media. Both think tanks and special interest groups conduct research and investigate policy questions, but the special interest groups are more openly directed at achieving a particular result whereas the think tanks maintain an air of impartiality. These organizations then provide the media, and therefore the public, with much of their information. Special interest groups are often competing with the media for readership of their publications, but when their work is read together, special interest groups are often the ones that give the public its ultimate opinion regarding various issues. Because they are so passionate and vocal about issues they care about, special interest groups can be much more persuasive than the media, which is ideally an impartial voice. The complex relationship among these three types of organizations involved in the policy debate may be confusing or biased at times, but ultimately serves to provide the public with a fairly accurate view of the complexities of the issue. This is true for the other sectors as well; they combine to create an interesting and thorough discussion of the regulation of executive compensation.

Another significant realization when examining the debate surrounding the regulation of executive compensation is that everyone in each of these societal segments has an agenda, even if they are attempting to disguise it and to appear impartial. Regardless of this bias, however, each voice is vital to the debate because they each affect public opinion in some manner and it is ultimately the public who determine, through the election of government officials, whether or not executive compensation should be regulated. I think that the topic is well discussed by these sectors and that the various groups draw out all aspects of the issue. One important voice that we don't hear enough from is the executives themselves. The Paracon Poll was one of the only pieces in which executives were able to give their opinions without having them skewed by the media or politicians. This is an important current debate that must ultimately be decided by the government. If executive compensation is eventually regulated, it will lead to harsher tax codes and stricter regulation of pay practices. Otherwise, government must take deliberate steps to emphasize that they will not regulate executive pay and, although the executive pay levels will likely continue to disturb many organizations and individuals, it will eventually lose its prominence in the public arena.

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