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A Comparison of the Pay of Top Executives and Other Workers

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Summary

Although the reasons may have changed somewhat over time, the level of top executive compensation long has been of interest to policymakers, shareholders, and employees. Thus far in 2006, attention principally has centered on the pay of chief executives at corporations whose profits have soared and whose product prices have risen substantially (e.g., Exxon Mobil), as well as at corporations where shareholder value has declined greatly (e.g., Pfizer and AT&T). Also during the current decade, scrutiny has focused on senior executives who enjoy sizeable pay packages while misstating their companies' financial condition and thereby not only harming shareholders, but also those employees with pensions invested heavily in their bankrupt employers' stock (e.g., Enron). While the amount of executive salaries, bonuses, and long-term incentives sometimes is looked at in isolation, a comparison often is made between the pay package of senior executives and of employees in general to demonstrate the alleged unfairness of the corporate wage structure. The focus of this report, which will not be updated, is on the size of average executive and worker pay through 2004.

Background

Both worker and shareholder interests coalesced in the 1980s to bring the issue of top executive pay to the attention of policymakers. From the worker perspective, efforts at curbing labor costs to improve competitiveness were not shared by corporate heads whose large pay raises were thought by some to have contributed to the growth in wage inequality during that period. From the shareholder viewpoint, their interests and those of executives would be more closely aligned by linking raises to company performance through the use of stock-related incentives.

The stock-based, pay-for-performance share of executive compensation did indeed increase over time. However, concern arose in the 1990s about rewarding mediocre performance in a booming stock market; executives' attention becoming too focused on near-term movements in stock prices rather than on other performance measures over a longer time horizon; and diluting per-share earnings due to the increased issuance of stock options.

Some of the issues of interest during the 1980s have resurfaced during the current decade. For example, the divergence between corporate performance and executive compensation — that is, between the returns to shareholders and to executives — has again garnered public interest (e.g., Pfizer and AT&T).[1] Similarly, concern has focused on the compensation of executives at companies that have sought concessions from their employees in order to avoid bankruptcy (e.g., several airlines). More generally, questions have arisen about the relative share of corporate profits that have gone to executives and shareholders versus employees.

With the recent spike in gasoline prices, attention principally has turned to the pay of chief executives at oil corporations whose profits have soared (e.g., Exxon Mobil). The Enron trial of Ken Lay, held in the spring of 2006, also has reminded the public that some very well-paid corporate executives misstated their companies' financial condition, which not only harmed shareholders, but also employees whose pensions largely consisted of stock in their bankrupt companies.

The Pay of Top Executives and of Other Workers

Three arguments typically are made on behalf of the comparatively large pay packages awarded to senior executives:

- first, their size is commensurate with the job's weighty responsibilities;
- second, they are necessary to prevent executives from leaving for greener pastures; and
- third, the comparatively small pool of qualified candidates elevates their compensation levels.

It is asserted in response that compensation in the top executive labor market is not set by supply-demand conditions, but rather is administered by corporate directors who unnecessarily limit the number of candidates they are willing to consider for high-level positions. It also often is pointed out that many of those asked to serve on corporate boards are themselves current or former senior executives.

Regardless of the reasons for the gap between top executive and worker pay, its precise magnitude partly depends on how executive compensation is measured and on the makeup of the comparison employee group. Compensation differs if it is reported as a median or average (mean) because the latter may be raised by a few large observations.[2]

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[1] Alan Murray, "CEOs of the World, Unite? When Executive Pay Can Be Truly Excessive," *Wall Street Journal*, Apr. 26, 2006.

[2] For comparison purposes, one might want to look at the mean 2004 figures from *Business Week* shown in Table 1 ($9.6 million) and the median statistics for 2004 ($5.9 million) calculated by Mercer Resource Consulting in "CEO Compensation Survey (A Special Report); Who Makes the

(continued...)

The direct relationship between firm size and executive pay means that a large sample of firms, which is more likely to include smaller firms, typically produces a lower pay estimate than a small sample. Results also vary based on who is surveyed (e.g., chief executive officers or presidents), on what is counted (e.g., whether housing allowances, company cars, and club memberships are included), and on how a value is determined (e.g., the realized value of stock options in the year they are exercised or their estimated value in the year they are granted).

Table 1 presents data on the average compensation of the highest-paid executives at 300-400 of the nation's largest publicly held corporations, as reported by *Business Week*; and on the average annual earnings of non-management employees of firms in the private nonfarm sector of the economy, as reported by the establishment survey of the U.S. Bureau of Labor Statistics. (*Business Week* stopped reporting its long-running executive compensation series effective with the 2005 article that presented data for 2004. Accordingly, this report will not be updated.)

The second half of the 1990s was characterized by very substantial absolute and percentage gains in the average compensation of senior executives at large publicly held corporations. The growth came much more from stock-based incentives than from the salary-and-bonus component of pay packages. With the average earnings of production and non-supervisory employees rising to a much smaller extent, the compensation of these executives climbed to more than 500 times the paychecks of most other workers by 1999.

Table 1. Average Top Executive and Worker Pay

Year	Executive (Exec.) pay			Ratio of worker to executive pay		Percent change (%)		
	Salary and bonus (S&B)	Total compensa-tion (TC)	Worker pay	S&B	TC	Exec. S&B	Exec. TC	Worker pay
2004[a]	n.a.	$9,600,000	$27,485	—	1:349	—	15.7	2.2
2003	n.a.	8,300,000	26,900	—	1:308	—	12.2	2.2
2002	n.a.	$7,400,000	26,316	—	1:281	—	-32.7	2.6
2001	n.a.	11,000,000	25,646	—	1:429	—	-16.0	2.7
2000	n.a.	13,100,000	24,981	—	1:524	—	-5.6	3.9
1999	$2,300,000	12,400,000	24,049	1:96	1:516	9.5	16.9	3.2
1998	2,100,000	10,600,000	23,298	1:90	1:455	-4.5	35.9	3.9
1997	2,200,000	7,800,000	22,425	1:98	1:348	-4.3	34.9	4.5
1996	2,300,000	5,781,300	21,462	1:107	1:269	39.1	54.3	3.3

[2] (...continued)
Biggest Bucks" and "CEO Compensation Survey (A Special Report); Adding It All Up," *Wall Street Journal*, Apr. 10, 2006. Note: The executive compensation figure reported by the *Wall Street Journal* for 2005 is $6.0 million.

Year	Executive (Exec.) pay		Worker pay	Ratio of worker to executive pay		Percent change (%)		
	Salary and bonus (S&B)	Total compensa-tion (TC)		S&B	TC	Exec. S&B	Exec. TC	Worker pay
1995	1,653,760	3,746,392	20,776	1:80	1:180	18.2	30.0	2.3
1994	1,399,698	2,880,975	20,318	1:69	1:142	9.8	-25.0	3.3
1993	1,274,893	3,841,273	19,677	1:65	1:195	15.4	0.0	2.9
1992	1,104,769	3,842,247	19,127	1:58	1:201	-1.8	55.8	2.8
1991	1,124,770	2,466,292	18,619	1:60	1:132	7.4	26.3	2.5
1990	1,214,090	1,952,806	18,163	1:67	1:108	3.5	5.2	3.3
1989	1,172,533	1,856,697	17,581	1:67	1:106	3.9	-8.3	3.6
1988	1,128,854	2,025,485	16,967	1:67	1:119	16.9	12.5	3.0
1987	965,617	1,800,000	16,474	1:59	1:109	16.4	50.0	2.4
1986	829,887	1,200,000	16,095	1:52	1:75	22.2	0.0	1.6
1985	679,000	1,200,000	15,843	1:43	1:76	4.0	9.1	2.4
1984	653,000	1,100,000	15,478	1:42	1:71	—	76.0	23.6
1980	n.a.	624,996	12,520	—	1:50	—	13.9	91.4
1970	n.a.	548,787	6,542	—	1:84	—	—	—

Source: *Business Week*, various issues, and U.S. Bureau of Labor Statistics' (BLS) establishment survey data.

Note: The *Business Week* survey covers the highest paid executives at 300-400 of the nation's largest publicly held corporations. The BLS data relate to average weekly earnings of production or nonsupervisory employees on private nonfarm payrolls multiplied by 52 weeks.

a. In 2004, *Business Week* utilized a new methodology that counted the value of options in the year in which they were granted. In past years, the value of options was included in the compensation package in the year in which they were exercised. Executive compensation figures for 2003 and earlier years thus are not strictly comparable with 2004 data.

n.a. = not available.

The course of average executive compensation has been mixed thus far in the current decade. Average salary, bonus, and long-term incentives initially declined at an accelerating pace between 2000 and 2002. This short-term trend likely reflects the poor performance of the stock market at the time and the reportedly closer scrutiny given pay-setting by some corporate boards of directors. By 2002, top executive compensation had fallen to a level last seen five years earlier (less than $8 million in 1997). Since then, the pattern has reversed direction. In 2004, the average compensation of executives in *Business Week*'s sample rose to $9.6 million, or more than 300 times the wages of most workers in the private nonfarm sector. The average compensation of senior executives increased at more than seven times the rate of production and non-supervisory workers (15.7% and 2.2%, respectively) between 2003 and 2004. Part of the divergence in earnings gains probably is related to the improved performance of the stock market.

Some speculate that the double-digit rates of compensation increases consistently posted by senior executives in the mid- to late-1990s are unlikely to return because shareholders presumably would not soon forget the extravagance and wrong-doing of some top executives. Corporate directors allegedly are more closely overseeing the compensation packages awarded to senior executives, who must surpass higher performance thresholds in order to receive stock options. And options may be giving way to restricted stock grants. Less sanguine observers note, however, that those who set executive pay have been known to be quite creative. For many years now, "perks," such as access to corporate jets for personal use and contributions to home mortgages, among other things, have been a growing part of executive compensation. Indeed, top executive compensation grew by double digits between 2002 and 2004 — albeit well below the gains of the mid- to late-1990s.