CEO pay in US continues its relentless climb in 2005

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Few things expose the real character of American society and politics more clearly than the extraordinary and ever-increasing level of inequality, the accumulation of vast, almost incomprehensible, sums of wealth in the hands of a relatively small group of people. The United States is a country in which the entire corporate and political structure is dominated by one overarching drive: the personal enrichment of a narrow oligarchy.

A glimpse of this state of affairs can be found in several recent surveys of compensation for chief executive officers at major US corporations. These CEOs are a subset of the wealthiest layer of the American population, and they perform a critical function—they ensure that the corporations they manage are operated in the interests of the major investors that compose the American ruling elite. For this service they are handsomely rewarded.

The reports only measure CEO compensation, neglecting other sources of wealth accumulation such as individual investment portfolios. Nevertheless, the figures reveal that a truly staggering level of social resources is being channeled into the pockets of these individuals.

USA Today published its annual report on CEO pay April 10, based on data collected by eComp Data Services. The analysis included a chart of the compensation doled out to chief executives at 240 of the country's largest companies, where total compensation included direct salary, bonuses, incentives, gains from exercised stock options, and the value of newly issued stock options. Not all top companies are included in the survey. The *Wall Street Journal* and the *New York Times* published separate analyses of the figures.

The newspaper found that six of these CEOs took home over $100 million in 2005. At the top of the list was Richard Fairbank, the chairman and CEO of Capital One Financial, which recently announced plans for an acquisition of North Fork Bancorporation, part of a general consolidation in the banking sector. Fairbank exercised stock options that brought him nearly $250 million, giving him a total compensation of $280 million. "His personal haul," *USA Today* noted, "exceeded the annual profits of more than 550 *Fortune* 1000 companies, including Goodyear Tire & Rubber, Reebok and Pier 1."

Capital One's acquisition of North Fork created a stir of controversy last month when it was revealed that the head of North Fork, John Kanas, will get a $135 million payout if the deal goes through, including $44 million to reimburse Kanas for personal income taxes. All told, top executives at North Fork will receive in the neighborhood of $350 million as a result of being bought up by Capital One.

The other executives at large companies breaking the $100 million mark were KB Home's Bruch Karatz ($164 million), Cendant's Harry Silverman ($133 million), Lehman Brothers' R.S. Fuld Jr. ($119 million), Genentech's Arthur Levinson ($109 million) and Occidental Petroleum's Ray Irani ($106 million).

KB Home is a home building company and Cendant is a real estate services company. Both companies have benefited from the housing market bubble. Lehman Brothers is an investment bank, whose earnings like many of the top investment banks have been up as a consequence of intensified merger activity, including the Capital One deal and the rapid consolidation of the telecommunications sector—a process that has resulted in the wiping out of thousands of jobs. Irani's earnings at Occidental reflect the extraordinarily high compensation handed out to executives at oil and energy companies.

Nine more chief executives among the companies surveyed received over $50 million last year, while 131 received over $10 million. All told, the 240 executives included in the *USA Today* summary of large companies took home a total of over $4.5 billion dollars.

The paper noted that "median 2005 pay among chief executives running most of the nation's 100 largest companies soared 25 percent to $17.9 million, dwarfing the 3.1 percent average gain by typical American workers."

A few of the top earners were not included among the largest companies. These included the CEO of Analog Devices, Jerald Fishman, "who cashed out $144.7 million from his deferred compensation plan and made another $4.3 million in salary, bonus and options gains," the newspaper reported. Perhaps the executive with the highest income was Google's head of global sales, Omid Korestani, who exercised stock options giving him a massive $288 million.

In general, stock options have become an increasingly lucrative means by which executives have enriched themselves. A stock option allows the recipient to buy a stock at some preset price at a future date of his choosing (after a set period has elapsed). If the actual value of the stock at the time is above the preset price, the stock can be bought at the lower price and sold at the higher to yield a quick profit. The aim of this form of compensation is quite simple: it creates a personal incentive for executives to boost the short-term value of their company's stock.

A previous study from the *Wall Street Journal*, published March 15, found that executives at the 150 biggest companies in Silicon Valley (California's technology center) took home $1.55 billion by exercising stock options in 2004, up 50 percent from 2003 and 177 percent from 2002. The 2005 figure is even higher, and represents a recovery after a sharp drop in stock option compensation following the stock market collapse in 2001.

In its study using slightly different figures, the *New York Times* found that mean CEO pay at 200 large companies increased 27 percent in 2005, to $11.3 million. The *Times* noted that CEO pay at big companies is more than 170 times average worker pay. In fact, this is a major underestimation. Based on Bureau of Labor Statistics data indicating an average salary of about $28,000 for a production worker, these CEOs earn on the order of 400 times the pay of ordinary Americans.

While pay for CEOs is rising by double-digit percentage points every year, wages for average workers are falling behind inflation, meaning that real wages are declining. The argument is often advanced that companies cannot afford to pay high wages or benefits to workers—who can be replaced with workers in lower wage countries—even as tens of millions of dollars are routinely doled out to top executives, whose skills are supposedly irreplaceable. Treasury Secretary John Snow recently explicitly defended the pay of CEOs on the basis that their salaries were the product of efficient market forces of supply and demand. "In an aggregate sense," he said in an interview with the *Wall Street Journal* published March 20, "it reflects the marginal productivity of CEOs."

What is really involved, however, is not differential compensation based on the value added to the company, but rather a massive transfer of wealth from the bulk of the population into the hands of the ruling elite. To keep investors happy, executives oversee job cuts and cost reductions, and if they are successful, stock prices soar and the executives themselves reap the rewards.

The extraordinary rise in CEO pay is part of a long-term trend in which management of major US companies has been increasingly subordinated to the immediate financial interests of Wall Street and the major investors. When profit rates in the United States began to decline in the 1970s, an attempt was made to counteract this tendency with CEOs tasked with pushing through job, wage and benefit costs in order to boost earnings. The trend continues today with individuals such as Delphi's CEO Robert Miller, who was hired explicitly to implement massive cuts in labor costs to the detriment of tens of thousands of workers.

Of course, the link between stock price and CEO pay is not always exact, with some executives receiving large bonuses while their company's stock flounders. The *Wall Street Journal* reported on March 18 that many companies backdate their stock option grants, so that the preset price for purchasing stock is lower than it would be otherwise, artificially increasing the payoff to executives. At the top of American corporations, there is a whole network of intersecting interests, in which members of company boards, who often are associated with other companies, and outside compensation consultants reward executives in exchange for particular benefits.

The focus on stock values and short-term earnings has created a situation in which the actions of executives often undermine the companies they oversee. A recent article, ("Value Destruction and Financial Reporting Decisions" http://papers.ssrn.com/sol3/papers.cfm?abstract_id=871215) academics John Graham, Campbell Harvey and Shiva Rajgopal interviewed chief financial officers at major American companies and found that "the majority of firms are willing to sacrifice long-run economic value in order to deliver short-run earnings. Companies do this in response to intense pressure from the market to meet expectations, and to avoid the severe negative market reaction to not delivering."

Tying executive pay to stock values has also created an incentive to manipulate accounting books to obscure financial difficulties. Companies like Enron, WorldCom, Tyco and others that have collapsed into bankruptcy after accounting scandals in recent years are hardly unique. The executives at these companies made millions, and so long as the company stock price was soaring, the political and media establishment lauded them. Several now find themselves on the docket, but only after a lot of very wealthy people lost a lot of money.

The controlling interest of this very small layer of the population is the principal driving force behind government policies, both domestic and foreign. A recent analysis by the *New York Times* found that the Bush administration's tax cuts on investment income will hand back an average of $500,000—more than most people will earn in 10 years—to individuals with incomes of $10 million or more.

An insight into the criminality and arrogance with which the US government carries out wars, assaults democratic rights and rips up the social gains of workers can only be gained through an understanding of the motivations and interests of America's superrich.