Executive Excess 2003

CEOs Win, Workers and Taxpayers Lose

Tenth Annual CEO Compensation Survey

HEADS, WE GIVE OURSELVES A BONUS FOR MAINTAINING PROFIT MARGINS THROUGH LAYOFFS BEFORE CHRISTMAS.

TAILS, WE JUST RAID THEIR PENSION FUND...

THE CORPORATE SEASON OF GIVING

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United for a Fair Economy is a national, independent, non-partisan organization founded in 1994 to focus public attention and action on economic inequality in the United States—and the implications of inequality on American life and labor. United for a Fair Economy provides educational resources, works with grassroots organizations and supports creative and legislative action to reduce inequality.

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Key Findings

1. CEOs were rewarded in 2002 for laying off workers in 2001.
Median CEO pay at the 50 companies with the most layoffs in 2001 rose 44 percent from 2001 to 2002, while overall CEO pay climbed only 6 percent. In addition, median CEO pay was 38 percent higher in 2002 at the top 50 Layoff Leaders than at the 365 large companies surveyed by *Business Week* magazine. The typical U.S. CEO made $3.7 million in 2002, while the typical Layoff Leader got $5.1 million.

2. As employee pension plans falter, CEOs have secured their own personal futures with higher pay.
At the 30 companies with the largest deficits in their pension plans, top executives had median pay in 2002 that was 59 percent higher than the median pay of the average large company CEO as reported in *Business Week's* annual executive compensation survey ($5.9 million versus $3.7 million). These 30 firms, with a collective pension deficit of $131 billion at the end of 2002, paid their CEOs a combined total of $352 million in 2002. Nineteen of the 30 executives saw their pay for the year rise and ten of the thirty saw their pay more than double in 2002, even as the growing pension gap threatened employee retirement security and future corporate profitability.

3. By blocking proposed stock option reforms ten years ago, Congress helped usher in an era of runaway CEO pay.
The Financial Accounting Standards Board (FASB) is making a second attempt to require companies to report stock options as expenses on their income statements. Ten years ago, FASB made the same proposal, only to be beaten back by Congressional opponents, led by Sen. Joseph Lieberman (D-CT). With the FASB proposal defeated, use of options as a "free" form of compensation continued unchecked and corporations lavished massive options grants on top executives. Between 1997 (the year the FASB proposal would have taken effect) and 2002, CEOs at 350 leading U.S. corporations listed in the *Wall Street Journal's* annual compensation survey pocketed $9 billion in options gains. Experts on all sides of the debate agree that if the 1993 FASB proposal had not been defeated, companies would have reduced their options grants. This would have meant that the yawning gap between CEO and worker pay would not have been as wide as it was during the past half-decade.

4. Blocking stock option reforms also helped U.S. corporations avoid paying their fair share of taxes.
If the FASB proposal had not been defeated, corporations would not have enjoyed the same level of tax relief from deducting the cost of options. The 350 leading firms surveyed received an estimated $3.6 billion in tax deductions based on the stock options exercises of their CEOs alone between 1997 and 2002. These tax breaks are particularly significant in light of the budget crises faced by most state governments. The amount of these options-related corporate tax deductions ($3.6 billion) is roughly equivalent to the combined 2003 budget deficits of seven of the top ten largest U.S. states (Florida, Illinois, Pennsylvania, Ohio, Michigan, New Jersey, and Georgia). It is also equivalent to the amount by which spending on Medicaid in all 50 states exceeded budgeted amounts in 2003.

5. As corporate offshore tax shelters proliferate, CEOs win and ordinary taxpayers lose.
At the 24 Fortune 500 companies with the largest number of subsidiaries in offshore tax havens, median CEO pay over the 2000-2002 period was $26.5 million, 87 percent more than the $14.2 million median three-year pay at 365 corporations surveyed by *Business Week*.

6. The CEO-Worker wage gap persists.
Despite drops in average CEO pay from 2000 to 2002, the CEO-worker pay gap of 282-to-1 is nearly seven times as large as the 1982 ratio of 42-to-1. If the average annual pay of production workers had risen at the same rate since 1990 as it has for CEOs, their 2002 annual earnings would have been $68,057 instead of $26,267. If the federal minimum wage, which stood at $3.80 an hour in 1990, had grown at the same rate as CEO pay, it would have been $14.40 in 2002 instead of $5.15.

7. There is a growing movement demanding reform, and there are many viable reform options that could be implemented:

- Require that stock options be expensed.
- End taxpayer subsidies for excessive compensation, whether in cash or stock.
- End taxpayer subsidies for gold-plated pensions.
- Protect workers by requiring more realistic pension accounting.
- Ban companies from offering executive perks not broadly available to employees.
- Improve plain-English disclosure standards of executive compensation.
- Require shareholder approval of extraordinary executive severance and retirement packages.
- Increase barriers to selling based on insider information.

Introduction

Our reports on skyrocketing CEO pay in the late 1990s were actually warning lights on the dashboard – indicators that something was seriously wrong in the economy.

Since we began tracking executive pay 10 years ago, the public image of CEOs has risen and fallen, roughly in tandem with the economy. In the early 1990s, with the economy in recession, CEOs and their lavish pay packages were a potent political issue, the object of scorn from presidential candidates and members of Congress alike. In the late 1990s, as the stock market took off, CEOs became modern-day heroes. Few really seemed to mind that CEO pay was rising much faster than worker pay, much faster even than corporate profits or the stock market.

Our CEO pay reports detailed these trends, and as well we focused on the pay premiums that flowed to CEOs who headed up corporations that laid off workers, shifted jobs overseas, or reduced their federal tax bills to less than zero. Meanwhile, the business press noted with increasing alarm the fact that CEO compensation bore no relationship to company performance. But as stock portfolios swelled in the late 1990s and new investors were enticed into equity markets, skepticism about a CEO's motives usually took a back seat to the irrational exuberance of a stock market bubble.

Some investors grumbled when a down year for the stock market in 2000 did nothing to stem the growth in CEO pay, but the view that CEOs in general were fairly paid remained prevalent until the accounting scandals of 2002 demonstrated that the late 1990s stock market boom was built on a foundation of fantasy and lies. In retrospect, given the poisonous incentives to cook the books that were set up by stock options, our annual reports on skyrocketing CEO pay in the late 1990s were actually warning lights on the dashboard – indicators that something was seriously wrong in the economy, and an example of how rising inequality and economic instability go hand-in-hand.

The accounting scandals had a profound effect on public attitudes toward CEOs and executive pay. A Harris poll taken in October 2002 found that "87 percent of all adults believe that most top company managers are paid more than they deserve, and that they become rich at the expense of ordinary workers." The poll also found that two-thirds of respondents believed that rewards in the workplace were distributed less fairly than they had been five years before.[1]

This year, we shine our CEO pay spotlight on four areas. First, in the midst of the weakest economic recovery on record in terms of jobs, we find that CEOs who announce major layoffs are well rewarded in the following year, indicating that CEOs continue to win as workers lose.

Another way CEOs win while workers lose is found in the state of the nation's private pension programs, which as a whole are seriously underfunded. While the employees of companies with inadequate pension reserves face an uncertain retirement, their bosses are earning significantly more than typical CEOs.

Stock options – the leading cause of the CEO pay explosion and a potent incentive for book-cooking – continue to provide corporations with a huge tax write-off.

Next, we turn to the problem of corporations not paying their fair share of the cost of government. Even as state and federal governments bleed red ink, the corporate tax burden has dropped to its lowest level since World War II. Stock options – the leading cause of the CEO pay explosion and a potent incentive for book-cooking — continue to provide corporations with a huge tax write-off, even though they are not required to be carried as an expense on financial statements. The lost tax revenue due to the use of stock options is substantial, and had this loophole been closed, it could have reduced the need to cut important government services or raise taxes on other taxpayers.

We also look at another leading corporate tax dodge, the offshore tax haven, and find that the 24 Fortune 500 companies with the most subsidiaries in offshore tax havens pay their CEOs 87 percent more than the typical CEO.

The report concludes with a summary of initiatives and recommendations designed to strengthen our nation's economy and democracy by reducing the extreme economic disparity between corporate executives and the rest of us.

1. Layoff Leaders: Pink Slips and Piles of Gold

CEOs who lay off workers earned significantly more than their peers in the year after the layoff announcement.

The business-cycle arbiters at the National Bureau of Economic Research recently announced that the recession that began in March 2001 ended just eight months later, in November of that year.

Tell that to the millions of unemployed Americans who have been unable to find work as companies continue to slash payrolls. Although the recession officially ended in November 2001, employers have cut 1.2 million private-sector jobs since then – bringing the total job losses in the private sector to 3.2 million since the beginning of the recession. As far as "recoveries" go, this one is the most sluggish on record.

The picture is different when viewed from the executive suites of some of America's largest corporations, particularly those firms that have announced layoffs. In our investigation of the 50 firms that announced the most layoffs in 2001, we found that CEOs who lay off workers earned significantly more than their peers in the year after the layoff announcement.

In previous years, we have examined executive compensation levels in the same year in which CEOs announced large layoffs. This year we looked at pay in the year *after* the layoff to assess whether the CEOs were in effect rewarded for cutting jobs.

The results were striking. Median CEO pay at the 50 corporations that announced the most layoffs in 2001 rose 44 percent from 2001 to 2002, more than seven times as fast as the 6 percent increase in median CEO pay at the 365 companies surveyed by *Business Week* magazine. Median 2002 CEO pay at the 2001 layoff leaders was $5.1 million, 38 percent higher than the *Business Week* median of $3.7 million.

All told, the top 50 job-cutting CEOs pulled down more than $570 million in 2002, the year after they collectively slashed over 465,000 jobs (see Table 1.1).

Chart 1.1: Median CEO Pay Increase from 2001 to 2002

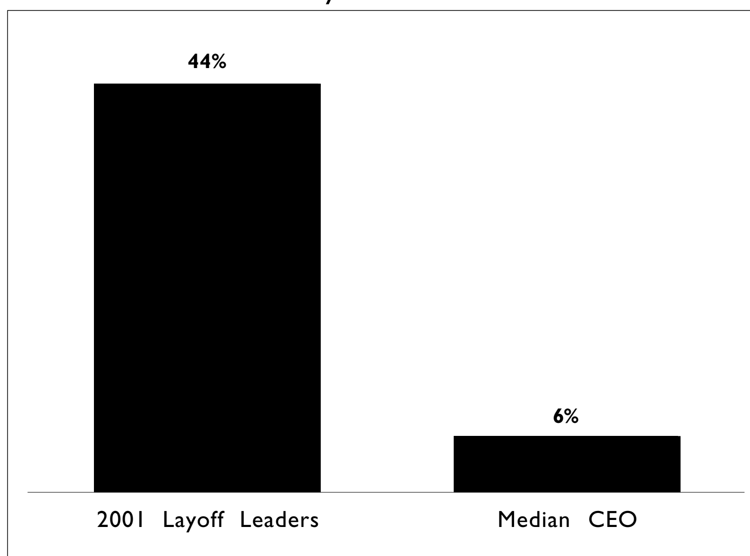


Chart 1.2: Median CEO Pay, 2002

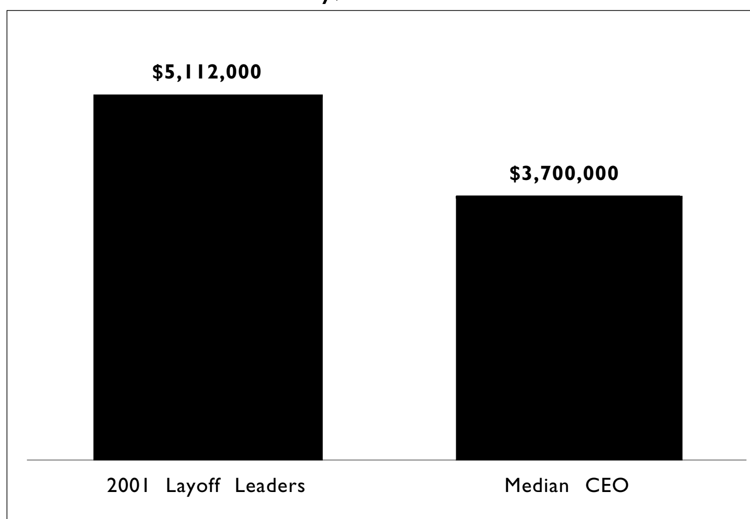


Table 1.1: CEO Pay at the 50 Companies with the Most Layoffs Announced in 2001

Company	Announced 2001 Layoffs	CEO	CEO Pay in Thousands 2001	2002	Change in Thousands	Percent Change
Hewlett-Packard	25,700	C.S. Fiorina	$1,242	$4,114	$2,872	231%
Motorola	36,224	C.B. Galvin	4,012	3,357	-655	-16%
JDS Uniphase	24,000	J. Straus	150,817	506	-150,311	-100%
Solectron	22,099	K. Nishimura	4,459	972	-3,487	-78%
Boeing	21,285	P.M. Condit	3,929	4,145	216	5%
Dana	21,250	J.M. Magliochetti	2,034	1,433	-601	-30%
Delta Air Lines	17,400	L.F. Mullin	2,179	4,688	2,509	115%
Cisco Systems	14,000	J.T Chambers	268	0	-268	-100%
VF	13,000	M.J. McDonald	3,616	2,756	-860	-24%
Continental Airlines	12,000	G. Bethune	4,185	7,628	3,443	82%
Delphi	11,638	J.T. Battenberg III	2,831	4,739	1,908	67%
Northwest Airlines	11,500	R. H. Anderson	1,568	2,763	1,195	76%
Tyco	11,300	L.D. Kozlowski	36,343	71,038	34,695	95%
Verizon Communications	10,170	I.G. Seidenberg	10,357	6,637	-3,720	-36%
Starwood Hotels & Resort	10,000	B. Sternlicht	3,185	5,122	1,937	61%
Procter & Gamble	9,735	A.G. Lafley	1,858	8,547	6,689	360%
American Express	9,500	K.I. Chenault	23,728	18,233	-5,495	-23%
Corning	8,770	J.W. Loose	4,734	10,829	6,095	129%
J.P. Morgan Chase	8,150	W.B. Harrison, Jr.	22,141	11,405	-10,736	-48%
Eastman Kodak	8,100	D.A. Carp	4,582	7,649	3,067	67%
Agilent Technologies	8,000	E.W. Barnholt	942	925	-17	-2%
Gateway	8,000	T. Waitt	1,658	16	-1,642	-99%
Sears Roebuck	7,300	A.J. Lacy	2,199	2,863	664	30%
Sara Lee	7,260	C.S. McMillan	3,454	7,962	4,508	131%
Alcoa	6,800	A.J. Belda	12,569	5,572	-6,997	-56%
SBC Communications	6,500	E.E. Whitacre, Jr.	24,932	8,451	-16,481	-66%
Textron	6,100	L.B. Campbell	7,632	4,684	-2,948	-39%
Sprint	6,000	W.T. Esrey	1,442	2,193	751	52%
Interpublic Group	5,804	J. Dooner, Jr.	3382	6,817	3,435	102%
EMC	5,700	J.M. Tucci	1,700	1,675	-25	-1%
ADC Telecom	5,500	R. R. Roscitt	2,180	5,102	2,922	134%
Merrill Lynch	5,429	D.H. Komansky	37,702	12,472	-25,230	-67%
Charles Schwab	5,400	C.R. Schwab	3,810	1,916	-1,894	-50%
J.C. Penney	5,391	A. Questrom	3,454	7,258	3,804	110%
Intel	5,000	C. Barrett	19,176	19,251	75	0%
3M	5,000	W.J. McNerney	3,754	4,801	1,047	28%
United Technologies	5,000	G. David	22,636	9,664	-12,972	-57%
Applied Materials	4,700	J. Morgan	817	854	37	5%
Citigroup	4,700	S.I. Weill	42,613	13,364	-29,249	-69%
Dow Chemical	4,500	M.D. Parker	1,090	1,550	460	42%
Aetna	4,400	J.W. Rowe	3,403	8,927	5,524	162%
AOL Time Warner	4,380	G. M. Levin	1,238	21,195	19,957	1612%
3Com Corporation	4,370	B. Claflin	3,864	1,791	-2,073	-54%
BellSouth	4,200	F.D. Ackerman	3,054	5,364	2,310	76%
Sun Microsystems	4,200	S.G. McNealy	2,327	25,885	23,558	1012%
Xerox	4,000	A. Mulcahy	3,494	5,172	1,678	48%
DuPont	4,000	C.O. Holliday, Jr.	1,085	3,285	2,200	203%
Coca-Cola	4,000	D.N. Daft	55,004	5,681	-49,323	-90%
Emerson Electric	4,000	D.N. Farr	7,940	4,262	-3,678	-46%
International Paper	3,797	J.T. Dillon	3,876	8,615	4,739	122%
Total	**465,252**			**$570,495**		
Median			**$3,555**	**$5,112**	**$1,557**	**44%**
***Business Week* Median**			**$3,491**	**$3,700**	**$209**	**6%**
Difference			**2%**	**38%**		

Source: Forbes.com Layoff Tracker, "Executive Pay," *Business Week,* April 21, 2003 and April 15, 2002, corporate proxy statements filed with the Securities and Exchange Commission. CEO Pay includes salary, bonus, "other compensation," restricted stock awards, long-term incentive payouts, and the value of stock options exercised.

The Top Layoff Leader in terms of job cuts was Carly S. Fiorina at Hewlett-Packard. Fiorina laid off 25,700 workers in 2001, and then saw her pay jump 231 percent, from $1.2 million in 2001 to $4.1 million in 2002.

Carly S. Fiorina at Hewlett-Packard laid off 25,700 workers in 2001 and then saw her pay jump 231 percent in 2002.

The Top Layoff Leader in terms of 2002 pay was Tyco's Dennis Kozlowski, who took home over $71 million in 2002 even though he was forced out in disgrace in June of that year. In 2001, Tyco had laid off 11,300 workers. Kozlowski also came out on top in terms of dollar pay increase. In 2002, his pay jumped to $71.0 million, from $36.3 million in 2001.

The Top Layoff Leader in terms of percentage pay increase was AOL Time Warner's Gerald M. Levin, who presided over 4,380 layoffs in 2001. Levin's pay increased a staggering 1,612 percent, from $1.2 million in 2001 to $21.2 million in 2002.

The spectacle of CEOs rewarding themselves while workers suffered once garnered little notice in the mainstream media. But times are changing. In July 2003, the self-styled "capitalist tools" at *Forbes* magazine posted on their website "Seven Ways to Solve the Executive Pay Mess," a set of recommendations that had come out of a conference of corporate governance experts. Item number 6 read as follows:

> "It doesn't look great to have the boss raking in a big raise when there are layoffs or pay cuts down the line. Impose a wage freeze or even a cut for the chief executive."[2]

Just such a recommendation has been made repeatedly by shareholder activists and in earlier editions of this Executive Excess report. It is heartening that corporate governance experts and business publications like *Forbes* are beginning to get the message.

Corporate executives are exploiting a faulty pension accounting system to reap massive personal rewards while making their workers' economic futures more precarious.

2. A Pension Deficit Disorder

There's a crisis in the nation's pension system. "The pension bomb is ticking – and could ultimately explode in a savings-and-loan-like crisis," warns economist Robert Samuelson.[3] The government's General Accounting Office has labeled the Pension Benefits Guaranty Corporation (PBGC), the federal agency that insures the nation's private pensions, "high risk" and in need increased of attention from Congress.[4]

Three years of stock market losses combined with a highly misleading (but perfectly legal) pension accounting system have left the nation's largest pension funds with $300 billion more in liabilities than assets, up from a $23 billion deficit in 1999, according to the PBGC.[5] Such a deficit threatens workers' future retirement security, the fiscal stability of the PBGC, and the economic growth of America's largest businesses.

Corporate sponsors of these pension plans want to lay all of the blame of the pension predicament at the door of the poorly performing stock market. In reality, corporate executives are more to blame for exploiting a faulty pension accounting system that allows them to continue to reap massive personal rewards while making their workers' economic futures more precarious. Present accounting rules give corporate managers wide latitude in setting several important variables that not only determine the long-term health of the pension plan, but also the short-term impact of pension assets on short-term corporate earnings.

Pension accounting rules adopted by Congress in 1985 allow companies to report their anticipated pension fund earnings as income. The rapid rise of the stock market during the 1990s made pension earnings a key component of many companies' profitability. For instance, in 1999, the last year the stock market was up for the year, General Electric booked $1.38 billion of pension income in their earnings. This accounted for 9 percent of the company's operating profits for the year. Other firms recorded pension gains that represented an even larger share of operating earnings:

Pensions: History and Terms

The steady rise in workers covered by pensions in the period following World War II held the promise of more secure and comfortable retirements than had been previously known. In these traditional pension plans, known as **defined benefit pension plans,** the company set aside enough money to assure the retiree a fixed monthly payment, based on final salary and years of service. The risk of the gyrations of the bond and stock markets was borne by the company, not the worker.

In 1978, Congress created **401(k) plans,** allowing workers to set aside pre-tax money for their retirement. Companies offering these plans agreed to provide a fixed percentage of each covered worker's pay. Hence, these plans are known as **defined contribution** plans. Unlike the defined benefit plan, where the company bears the financial risk of assuring the employees guaranteed monthly benefit, in a defined contribution plan the employee bears the risks and rewards associated with the market. The funds available at the time of retirement are uncertain.

Over the last 25 years, the number of workers covered by defined benefit plans has shrunk to 19 percent of the workforce, while the number of workers covered by 401(k) type defined contribution plans has grown to 26 percent of the workforce.[12] More than 50 million American workers are not covered by any private pension.

The federal **Pension Benefits Guaranty Corporation** was established to insure workers covered by defined benefit plans. The U.S. General Accounting Office recently reported that this important worker protection program is at "high risk" noting that a $9.7 billion surplus in the insurance fund in 2000 dissolved into a $3.6 billion deficit by 2002.[13]

Lucent Technologies (11 percent), Northrop Grumman (36 percent) and USX (108 percent).[6]

Pension income inflated corporate earnings reports and thus was one of the factors underlying the explosion of executive pay in the 1990s.

Though these pension gains were reported as income, they were very different from other income reported by the company. While corporate income is generally thought of as money that can be used for other things – buying new equipment, investing in research, acquiring another business – pension income affords none of these opportunities as it is money held in trust for the benefit of the company's workers. Nonetheless, pension income inflated corporate earnings reports and thus was one of the factors underlying the explosion of executive pay in the 1990s.

The level of pension income a company reports has more to do with the assumptions that are made about the long-term return of plan assets than the actual performance of the funds. Thus over the last three years, while U.S. equity markets were reporting double digit declines, the typical U.S. pension fund was assuming annual rates of return of 9 percent or more. This sharp contrast between assumptions and reality was a key contributor to today's crisis.

The pension problem has reached such a level of severity that Congress has become involved in crafting a solution. Unfortunately, the leading proposal seeks to fix the problem by legislatively pronouncing that market returns will be far greater than expected by many savvy investors. While the average S&P 500 company is still assuming a 9.2 percent long-term return on its pension assets, America's favorite investor Warren Buffett recently lowered the expected return on Berkshire Hathaway's pension plan to just 6.5 percent. This debate is far from academic: Each 0.5 percent reduction in expected returns will increase the pension costs of the S&P 500 companies by $5 billion, according to David Zion, pension accounting analyst with Credit Suisse First Boston. The nation's most conservatively run pension fund – Social Security – assumes a long-term rate of return of just 6 percent. If the Social Security trustees assumed the same high return rates as corporations, concerns about the long-term health of Social Security would significantly diminish, while concerns about private pensions would remain.

Another important cause of the current crisis is the nation's Employment Retirement Income Security Act (ERISA) law, which requires that companies only make contributions to their pension plans if the plan's assets fall below 90 percent of their expected future liabilities. Thus, with strong market returns and overly-optimistic assumptions about future financial returns, most of the S&P 500 companies enjoyed periods during the 1990s when they did not have to make any pension contributions whatsoever. For instance, General Electric, one of the few remaining overfunded pension funds, has not contributed any money to its pension fund since 1988.

Logic dictates that it makes sense to set aside funds for workers' future well-being when times are good and profits plentiful. Current pension laws provide the exact opposite incentive: make no contributions when times are good, which serves to boost reported earnings even further, until markets turn

Executives at the 30 companies with the most underfunded pension plans enjoyed median pay of $5.9 million in 2002, 59 percent more than the $3.7 million median pay of the typical large company CEO.

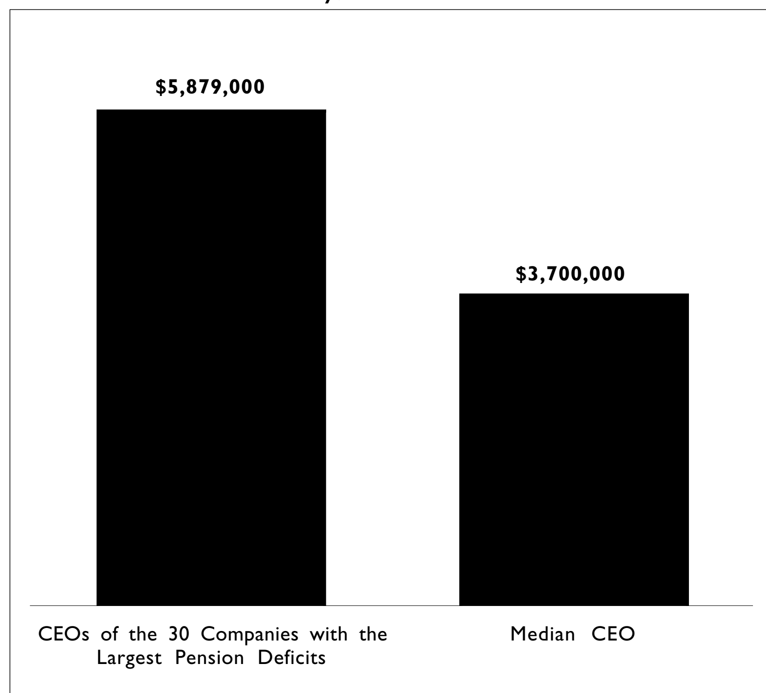
downward, profits contract and pension euphoria turns into the predictable crisis that we now face. Now with corporate earnings weak, companies need to infuse hemorrhaging pension plans with cash, creating a further drag on already faltering earnings. In 2002, U.S. corporations pumped $41 billion into pension coffers, an amount four times greater than the previous year, according to California-based Wilshire Associates.[7]

While many companies enjoyed pension funding holidays in the 1990s, a few went further and legally raided pension assets for corporate uses, and in the process contributed to transforming previously well-funded pension plans into some of America's most underfunded pensions. Lucent Technologies withdrew $800 million from its then-overfunded pension in 2001 and 2002 to pay severance benefits to 54,000 laid-off workers. DuPont withdrew more than $1 billion to pay for retiree health benefits between 1997 and 2000. IBM used $18.4 million to pay consulting fees to convert its defined benefit pension plan to a highly controversial cash balance plan. A federal judge recently found that IBM's cash balance pension plan illegally discriminates against older workers because it sharply reduces the pension benefits veteran workers expected to receive.[8]

Bailing out the Yachts

In this perfect storm of poor accounting practices, plummeting stock market returns, and tattered corporate earnings, we see corporations working hard to bail out the yachts that carry executives, while the rafts carrying workers are pounded by waves of uncertainty.

Chart 2.1: Median CEO Pay, 2002



We examined 2002 executive pay at the 30 companies with the most underfunded pension plans as identified by David Bianco of UBS Investment Research[9] and found that these executives had a median pay of $5.9 million, 59 percent more than the $3.7 million median pay of the typical large company CEO as reported in *Business Week*'s annual executive compensation survey.

These 30 firms, with their collective pension deficit of $131 billion at the end of 2002, collectively paid their CEOs $352 million in 2002. Nineteen of the thirty executives saw their pay for the year rise and ten of the thirty saw their pay more than double in 2002, even as the growing pension gap threatened employee retirement security and future corporate profitability.

Table 2.1: CEO Pay at the 30 Companies with the Largest Pension Deficits

Company	Pension Deficit in Millions	2002 CEO Pay in Thousands
General Motors	$25,440	$6,186
Ford Motor	15,611	220
Exxon Mobil	11,331	42,492
Boeing	7,137	4,145
IBM	6,435	22,701
Delta Airlines	4,907	4,688
DuPont	4,445	3,285
Lockheed Martin	4,257	25,337
Delphi	4,084	6,855
United Tech	3,900	9,664
Altria	2,993	34,799
Northrup Grumman	2,992	9,222
Raytheon	2,844	8,922
Hewlett Packard	2,660	4,114
Chevron Texaco	2,636	4,702
Pfizer	2,555	10,330
Dow	2,536	4,856
Exelon	2,459	4,749
ConocoPhillips	2,320	18,036
Goodyear	2,228	1,692
3M	2,110	4,801
Xerox	1,968	5,172
Caterpillar	1,894	2,251
Alcoa	1,829	5,572
Deere	1,816	1,719
Lucent	1,714	14,221
Tyco	1,693	71,038
Procter &Gamble	1,638	8,547
International Paper	1,527	8,614
Motorola	1,519	3,357
Total	**$131,478**	**$352,288**
Median		**5,879**
Business Week Median		**3,700**
Difference		**59%**

Sources:

Pension Deficits: David Bianco, "S&P 500 Pension Update: It's Not Over Yet!," UBS Securities LLC, June 17, 2003.

CEO pay: "Executive Pay," Business Week, April 21, 2003 and corporate proxy statements filed with the Securities and Exchange Commission. CEO Pay includes salary, bonus, "other compensation," restricted stock awards, long-term incentive payouts, and the value of stock options exercised.

Three-fourths of all large companies currently have platinum-plated supplemental pensions for their executives.

While the workers' pensions were sinking, many firms were busy rescuing their executives' pensions. This trend came to light earlier this year, when two airlines, AMR Corporation and Delta Airlines, each revealed they were secretly bankruptcy-proofing their executives' pensions while at the same time asking employees for billions of dollars of wage and benefit concessions in order to save the company. Executives of both firms encountered severe turbulence from employees after the platinum-plated retirement plans for executives were announced. Delta Airlines CEO Leo Mullin, who had orchestrated a $45 million supplemental retirement program (SRP) contribution for the benefit of

While workers' pensions were sinking, many firms were busy rescuing their executives' pensions.

33 top Delta executives, was forced to give back a portion of his 2002 pay package and to renounce some of the future pay increases called for by his contract. After it was recently revealed that three executives were leaving despite the inducement of a bankruptcy-proof pension, another round of criticism forced Delta to reduce its SRP fund by an undisclosed amount in an effort to quiet the uproar. American's CEO Donald Carty was not so lucky: in order to quell the employee mutiny, Carty was forced to abandon ship and leave the company in disgrace.

While the situations at AMR and Delta are most widely known, the use of SRPs for executives is widening. Three-fourths of all large companies currently have platinum plated SRPs for their executives according to a survey of 200 Fortune 1000 companies conducted by Clark Consulting.[10] Among the companies with underfunded pension plans offering executive SRPs are Altria Group and Motorola, which added $38 million to its SRP in 2002, while its employee pension plan was underfunded by a third.[11]

3. The High Cost of Opting against Options Expensing

By blocking options-accounting reforms ten years ago, Congress helped usher in an era of runaway CEO pay and helped American corporations avoid paying their fair share of taxes.

Unfortunately, the lessons of the past appear to have been lost on a number of key policymakers.

For the second time in a decade, the U.S. Congress is engaged in a fierce battle over the seemingly arcane issue of accounting standards related to stock options. By blocking reforms ten years ago, Congress helped usher in an era of runaway CEO pay and helped American corporations avoid paying their fair share of taxes. Unfortunately, the lessons of the past appear to have been lost on a number of key policymakers.

A Decade-Long Battle over Options Accounting

Under current rules, companies are not required to report stock option grants as expenses in their income statements, even though they can deduct the cost of options from their taxable income. The deduction is taken in the year when the options are "exercised," or cashed in. In 1993, the private sector group that writes U.S. accounting rules, the Financial Accounting Standards Board (FASB), announced plans to change that, arguing that if the estimated value of stock options was included, income statements would be "more relevant and representationally faithful."[14]

The FASB proposal set off a political firestorm. The business lobby, in particular the high-tech sector, which relies heavily on options, found strong allies in Congress. The champion of the anti-expensing cause on Capitol Hill was Sen. Joseph Lieberman (D-CT). Then-Chairman of the Securities and Exchange Commission, Arthur Levitt, who supported the FASB reform proposal, describes Lieberman as his most formidable foe in Congress.[15] Lieberman introduced a bill that would have made options exempt from the FASB proposal. Even more significant, the bill would have stripped FASB's power by requiring that the SEC ratify every FASB decision. He also initiated a "Sense of the Senate" resolution that passed almost unanimously, denouncing the accounting board for considering the proposed change in rules. According to Levitt, the resolution was enough to give an "unmistakable signal that Lieberman had the votes to stop the FASB if it pushed ahead."[16]

After about eight months of Congressional pressure, FASB backed down. According to former FASB Chairman Dennis R. Beresford, "Faced with the strong possibility that its purpose would have been eliminated by this legislation, the FASB made a strategic decision to require companies to disclose the effect of stock options in a footnote to the financial statements but not record the expense in the income statement."[17]

Stock options give employees the right to buy company stock at a set price in the future. They often have an exercise period of up to ten years. If an employee has an option to buy stock for $10 a share and exercises that option when the stock is trading at $50 a share, the employee will owe the company $10 a share and can sell the stock for a $40 profit. Continuing the example, exercising 100,000 stock options would produce a $4 million gain. Top executives get repeated megagrants of stock options producing megawealth.

Despite the appearance of momentum in favor of expensing options, the business lobby has ramped up a campaign to block reform once again.

Ten years later, the Congressional debate over stock options expensing is raging once again. This time, it is bolstered by public outrage over the wave of corporate scandals during the past several years. One of the ways that the scandal firms were able get away with distorted earnings reports was through heavy use of options as compensation. Enron, for example, handed out such massive grants that the firm took a tax deduction of $1.4 billion in 2000 alone for stock options given to top managers. Supporters of expensing include a number of heavy-hitters. In addition to Buffett, Federal Reserve Chairman Alan Greenspan, his predecessor Paul Volcker, and Nobel economist Joseph Stiglitz have lined up in support, in addition to numerous institutional investors.

Presidential Candidate Lieberman Lead Anti-Expenser

On the opposing side, Senator Lieberman is once again at the forefront. He was a staunch opponent of a bill introduced by Senators John McCain (R-AZ) and Carl Levin (D-MI) in the summer of 2002 that would have required companies that deduct the options costs from their taxes to also report them as expenses in their income statements. In August 2002, Lieberman countered with a bill of his own entitled the "Rank and File Stock Options Act" that would use tax breaks not to discourage options, but to encourage companies to distribute them more equitably. The bill also asks the SEC to recommend rules requiring executives to hold their stock options for a set period of time and to require shareholder approval for stock options plans and grants. The bill does nothing to address other concerns about stock options. In addition to the problems related to distorted earnings reports, options are also criticized for diluting the value of stock for other shareholders and giving executives a personal incentive to boost stock values by any means necessary.

Lieberman characterizes his support for options as a fight for the little guy. He argued on ABC's *This Week* in July 2002 that if companies were required to expense stock options, "the number of options granted would be reduced dramatically. And I am absolutely convinced that the people who would not get the options are the middle class workers, the middle managers, the secretaries, the folks on the line who get the options. The CEOs would continue to take care of themselves."[18]

However, Lieberman and others who use this argument are merely speculating. And without any evidence to the contrary, it is difficult to believe that companies would cut only their ordinary workers' options when the bulk of options wealth is concentrated at the top of the corporate ladder. Yes, some firms have initiated broad-based stock options plans, reflected in the fact that an estimated 7 to 10 million Americans own options. However, a study of 2000 data revealed that about 75 percent of all options are controlled by executives who are in the top five in their management hierarchy.[19] Would boards allow executives to maintain the opportunity to earn hundreds of millions of dollars in options gains, if that compensation had to be reported as an expense? It seems highly unlikely since in many cases, this would mean the difference between showing a profit or a loss.

The anti-expensing camp, which includes key members of both parties, also argue that there is no accurate way to value an option when it is granted. Investor Warren Buffett dismisses this claim by stating that options pricing is highly sophisticated, whereas "it's far more problematic to calculate the useful life of machinery, a difficulty that makes the annual depreciation charge merely a guess. No one, however, argues that this imprecision does away with a company's need to record depreciation expense."[20] Another argument against expensing is that options are crucial to the ability of small companies, particularly high-tech start-ups, to recruit employees. FASB Chair Robert Herz counters that while there may be legitimate economic and social objectives for subsidizing certain businesses in some manner, "distorting financial accounting and reporting standards and the resulting financial information is not the way to achieve those objectives."[21]

CEOs of U.S. firms have pocketed billions in options gains since 1993.

Lieberman introduced his "Rank and File" bill in the heat of the battle over the Levin-McCain bill on expensing with just one co-sponsor, Sen. Barbara Boxer (D-CA), another friend of the high-tech industry. Once it was clear that the Levin-McCain proposal would not receive sufficient support for passage, Lieberman appears to have lost interest in his bill. A year later, he has yet to gather additional co-sponsors.

Round 2

In March 2003, FASB voted to move ahead with an investigation of the stock options matter and a plan to implement new rules in 2004. Many observers assume that the rules change is a done deal, especially since the Board's Chairman, Robert Herz, told members of Congress in June that he believes stock options should be expensed.[22] Nearly 300 firms appear to feel that the writing is on the wall and have voluntarily begun to expense options. In July 2003, Microsoft went further by announcing that it would quit using stock options altogether, choosing instead to use restricted stock as employee incentives. Restricted stock awards (and all other forms of compensation besides stock options) are already required to be reported as an expense.

Despite the appearance of momentum in favor of expensing, however, the business lobby has ramped up a campaign to block FASB once again. Bipartisan bills in both the House and Senate (HR1372 and S979) would place a three-year moratorium on new rules on options accounting. Sen. Lieberman, now running for President, has acknowledged that stock options have been abused by some unethical executives, but maintains his opposition to requiring that they be reported as an expense. In March he signed a letter along with 23 other Senators opposing options expensing.

In May, high-tech leaders rewarded Lieberman with an early endorsement of his candidacy. Twelve Silicon Valley leaders, including political heavyweight and venture capitalist John Doerr, gave Lieberman their support, nine months before the first primary. Federal Election Commission reports also show that seven individuals with the last name Doerr, including John himself, had contributed the maximum to the Lieberman for President campaign.

The defeat of FASB's 1993 proposal to require options expensing allowed corporate boards to continue to lavish massive options grants on top executives with no repercussions for their income statements.

Fellow Democratic Party Presidential candidate Rep. Richard Gephardt (D-MO) has also come out against stock options expensing, announcing his position at a meeting in Silicon Valley in June 2003. President Bush is also in the anti-expenser camp. In an interview with the *Wall Street Journal* in April 2002, Bush said that he supported the status quo system of including information about the potential impact of options on earnings in a footnote in corporate annual reports.[23]

As the battle over expensing rages anew, policymakers should consider the impact of the defeat of the 1993 FASB proposal:

1. Options mega-grants went unchecked: The defeat of FASB's 1993 proposal to require options expensing allowed corporate boards to continue to lavish massive options grants on top executives with no repercussions for their income statements. We studied the 350 leading U.S. corporations listed in the *Wall Street Journal's* annual compensation survey in the years 1997 (the year the FASB proposal would have taken effect) through 2002 and found that the CEOs of those firms pocketed $9 billion in options gains in that time period.[24]

2. Options continued to bloat the CEO-worker pay gap: Experts on all sides of the debate agree that if the 1993 FASB proposal had not been defeated, companies would have reduced their options grants. A 1994 survey by the American Electronics Association supported this conclusion. Of the AEA's member firms, 87.2 percent indicated that they would have reduced the number of options granted if they were required to expense options. Some 82.3 percent would have reduced actual participation in the options program.[25]

A reduction in options grants would likely have meant that the yawning gap between CEO and worker pay would not have been as wide as it was during the past half-decade. The gap peaked at 531-to-1 in 2000, before dipping to 282-to-1 last year due to the decline in the stock market. Despite this drop, the CEO-worker pay gap in the United States remains far larger than in other industrialized countries. According to data compiled by the Towers Perrin consulting company, the U.S. gap is at least two to three times as large as in other globally competitive countries such as the United Kingdom, Australia, France, Germany, Japan, and Sweden.[26] Fat cat pay levels in the United States are mostly due to widespread use of options, which made up about 80 percent of U.S. management compensation in 2001.[27]

3. Corporations continued to receive massive options-related tax deductions: If the FASB proposal had not been defeated, corporations would not have enjoyed the same level of tax relief from deducting the cost of options. Excessive stock options earnings are a major factor in the dwindling share of government revenues comprised by corporate taxes. Corporate taxes as a share of federal taxes dropped from 12 percent in 1996 to 8.7 percent in 2001.[28]

Between 1997 and 2002 the 350 leading firms listed in the *Wall Street Journal's* annual compensation survey received an estimated $3.6 billion in tax deductions

based on the stock options exercises of their CEOs alone.[29] For some firms, the deduction claimed for options exercised by all their employees was so large that it wiped out their entire tax bill.

Between 1997 and 2002, the 350 leading firms listed in the Wall Street Journal's *annual compensation survey received an estimated $3.6 billion in tax deductions based on the stock options exercises of their CEOs alone.*

The tax deductions received by these 350 firms just from their CEOs' options earnings is particularly significant in light of the budget crises faced by most state governments. The amount of these options-related corporate tax deductions ($3.6 billion) is roughly equivalent to the combined 2003 budget deficits of seven of the top ten largest U.S. states (Florida, Illinois, Pennsylvania, Ohio, Michigan, New Jersey, and Georgia).[30] To address these shortfalls, many states are considering further austerity measures in 2004. A few examples:[31]

- In Michigan, the governor recommended 8.5 percent wage and salary cuts for state employees and a 6.75 percent cut in state aid to public universities and colleges.
- New Jersey's public colleges are facing severe cuts in state funding.
- Illinois' governor has proposed halting pay raises for non-union state employees.
- Ohio is considering allowing state agencies to furlough workers for up to 70 days.
- In Pennsylvania, support for higher education is being cut by 5 percent, while salaries are frozen for state employees.

The options-related tax deductions for the 350 CEOs is also equivalent to the amount by which spending on Medicaid in all 50 states exceeded budgeted amounts ($3.6 billion) in 2003.[32] At least 27 states have proposals to contain Medicaid costs by reducing benefits and other means.[33]

The unchecked use of options has meant excessive pay for executives, distorted information for investors, and billions in foregone revenues for governments at a time of public sector belt-tightening. And increasingly, private greed and corporate abuses aren't just hurting employees, or local communities, but all of us. If political pressure once again interferes with the business of setting accounting standards, these trends will continue.

CEOs of the 24 Fortune 500 companies with the largest number of subsidiaries in offshore tax havens made 87 percent more from 2000 to 2002 than CEOs at the 365 corporations surveyed by Business Week.

4. Offshore Tax Havens: CEOs Win, Taxpayers Lose

In addition to stock options, U.S. corporations are increasingly setting up subsidiaries in offshore tax havens to reduce their federal tax bills. This use of subsidiaries in tax haven nations such as Bermuda, the Bahamas, and the Cayman Islands is more subtle and complex than simply re-incorporating overseas, as Tyco and Global Crossing did, but if anything it is more lucrative and offers corporations a wide range of tax-sheltering options. One such scheme, in which corporations arrange phony-priced transactions with overseas subsidiaries to transfer profits to offshore tax havens, netted U.S. firms $53 billion in tax savings in 2001, according to a report released by Senator Byron Dorgan (D-ND).[34]

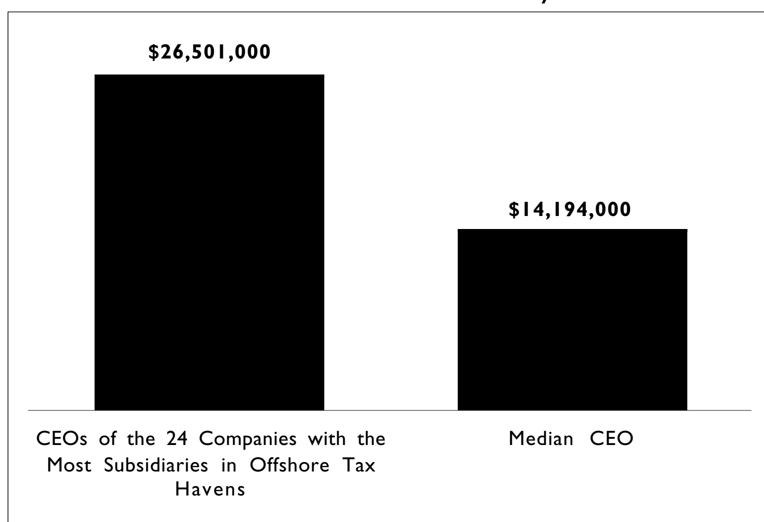
Other tax-avoiding strategies include:

- **Deferred tax payments.** Corporations can postpone taxes on income earned overseas by re-investing that income in overseas operations. This technique is particularly popular with oil and gas companies.

- **Income stripping.** A corporation's offshore subsidiary "lends" money to a U.S. unit, which then pays the loan back with interest. The interest is tax-deductible.

- **Parking intangibles overseas.** Especially popular with computer and pharmaceutical companies, this tax dodge works by transferring intellectual property such as patents and trademarks to offshore subsidiaries. The offshore unit then charges a licensing fee or royalty for use of the intellectual property, and this income escapes U.S. taxation.

Chart 4.1: Median Three-Year Total CEO Pay, 2000-2002



Cash-strapped state governments are also coping with reduced corporate income taxes as companies hide billions of dollars of income in shell companies located in low-tax states.

In April 2003, the nonpartisan organization Citizen Works compiled a list of the 24 Fortune 500 companies with the largest number of subsidiaries in offshore tax havens (see table 4.1 for a list of the 24 corporations). Among these corporations, median CEO pay over the 2000-2002 period was $26.5 million, 87 percent more than the $14.2 million median three-year pay at 365 corporations surveyed by *Business Week*.

Table 4.1: CEO Pay at the 24 Companies with the Most Subsidiaries in Offshore Tax Havens

	Number of Subsidiaries in Offshore Tax Havens	**Total 2000-02 CEO Pay in Thousands**
El Paso	244	$40,696
AES	195	16,724
Morgan Stanley	99	118,172
Citigroup	92	280,841
Aon	87	11,469
Marsh & McLennan	67	21,950
Mirant	65	11,563
Halliburton	58	38,206
Bank of America	52	27,246
Marriott International	41	5,645
BellSouth	39	13,318
Boeing	31	27,794
Williams	31	6,463
Pfizer	30	49,979
PepsiCo	29	25,756
Fluor	27	10,135
Interpublic Group	27	27,862
J.P. Morgan Chase	27	44,383
Viacom	27	52,893
Sara Lee	26	18,271
American Express	25	59,410
Lehman Brothers	23	199,902
Xerox	23	12,757
Prudential Financial	21	24,647
Median		**$26,501**
***Business Week* Median**		**$14,194**
Difference		**87%**

Sources:

Subsidiaries: Compiled by Citizen Works from corporate 10-K statements filed with the Securities and Exchange Commission. Countries considered to be tax havens include: Anguilla, Andorra, Antigua, Bahamas, Bahrain, Barbados, Belize, Bermuda, British Virgin Islands, Canary Islands, Cayman Islands, Channel Islands, Commonwealth of Dominica, Cook Island, Gibraltar, Grenada, Guernsey, Isle of Man, Jersey, Liberia, Liechtenstein, Maldives, Marshall Islands, Mauritius, Monaco, Montserrat, Nauru, Netherlands Antilles, Niue, Panama, Samoa, Seychelles, St. Christopher and Nevis, St. Lucia, St. Vincent, Tonga, Turks and Caicos, U.S. Virgin Islands, Vanuatu. See http://www.citizenworks.org/corp/tax/top25.php.

CEO pay: "Executive Pay," Business Week, April 21, 2003, April 15, 2002, and April 16, 2001 and corporate proxy statements filed with the Securities and Exchange Commission. CEO Pay includes salary, bonus, "other compensation," restricted stock awards, long-term incentive payouts, and the value of stock options exercised.

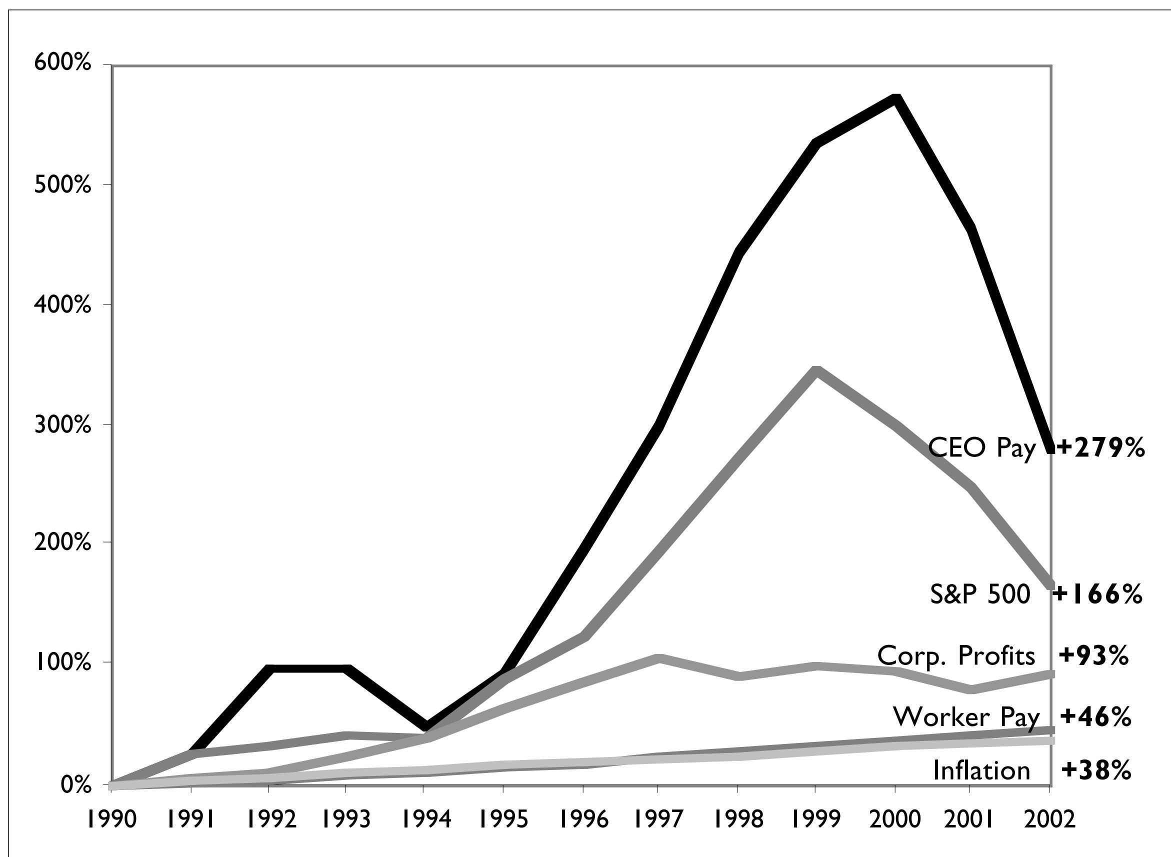
Even with drops in each of the last two years, average CEO pay since 1990 has still grown faster than other indicators of corporate health, and much faster than worker pay.

5. CEO Pay: A Decade in Review

After peaking at 531:1 in 2000, the CEO-to-Worker wage ratio has fallen back to 1997 levels, now standing at 282 times average worker pay. Even with drops in each of the last two years, average CEO pay since 1990 has still grown faster than other indicators of corporate health, and much faster than worker pay.

The decline in average CEO pay in recent years is due to the reduction in top pay packages. As *Business Week* magazine points out, however, median CEO pay — the number in the middle of the distribution — is still on the rise, up 5.9 percent in 2002 to $3.7 million.

Chart 5.1: CEO Pay, Stock Prices, Corporate Profits, Worker Pay, and Inflation, 1990-2002

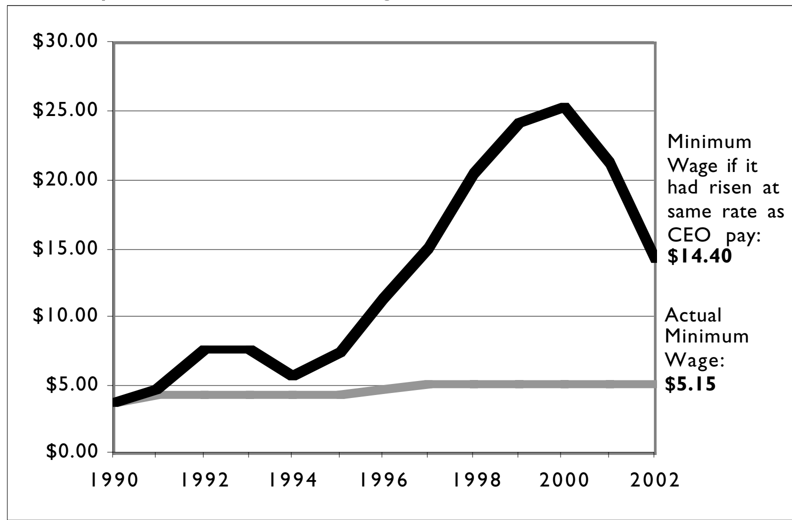


Sources: CEO Pay: *Business Week* annual executive pay surveys. **S&P 500 Index:** Standard & Poor's Corporation. Figures are year-end close. **Corporate Profits:** Bureau of Economic Analysis, National Income and Product Accounts. **Average Worker Pay:** Bureau of Labor Statistics, Average Weekly Hours of Production Workers (Series EEU00500005) and Average Hourly Earnings of Production Workers (Series EEU00500006). **Inflation:** Bureau of Labor Statistics, Consumer Price Index, All Urban Consumers.

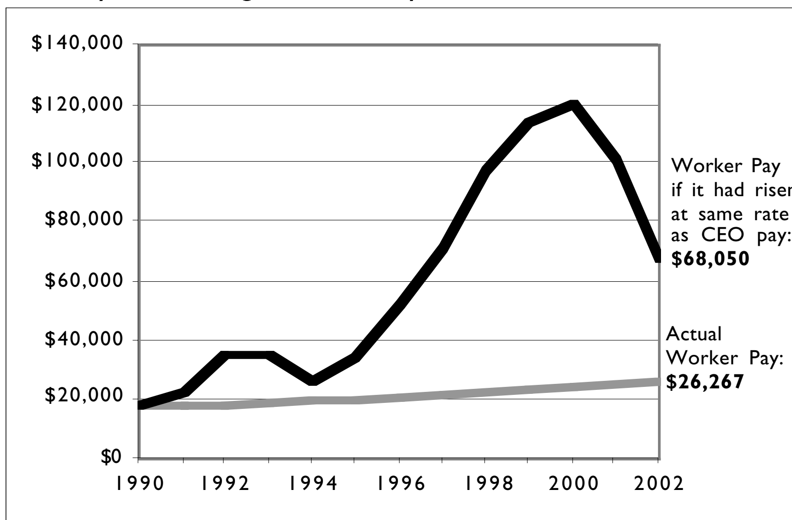
Despite declines in average CEO pay from 2000 to 2002, the CEO-worker pay gap of 282-to-1 is nearly seven times as large as the 1982 ratio of 42-to-1. If the average annual pay of production workers had risen at the same rate since 1990 as it has for CEOs, their 2002 annual earnings would have been $68,057 instead of $26,267. If the federal minimum wage, which stood at $3.80 an hour in 1990, had grown at the same rate as CEO pay, it would have been $14.40 in 2002 instead of $5.15.

The 2002 CEO-worker pay gap of 282-to-1 is nearly seven times as large as the 1982 ratio of 42-to-1.

CEO Pay and the Minimum Wage, 1990-2002



CEO Pay and Average Worker Pay, 1990-2002



Shareholders have introduced resolutions calling for expensing of options at more than 100 major U.S. companies.

6. A Growing Reform Movement Offers Solutions

1. Require that stock options be expensed.

The Financial Accounting Standards Board is currently investigating this matter and plans to issue new rules in 2004 that will almost certainly require expensing—that is, unless they succumb once again to political pressure. Many shareholders are not waiting for FASB to take action. They have introduced resolutions calling for expensing of options at more than 100 major U.S. companies. As of June, nearly half of the 40 or so resolutions that had been voted on passed, an approval rate *Business Week* describes as "almost unheard of in recent history."[35]

2. End taxpayer subsidies for excessive compensation, whether in cash or stock.

Currently there are no meaningful limits on how much corporations can deduct from their taxes based on compensation-related expenses. In 1993, Congress passed a law that attempted to cap the deductibility of executive pay to a maximum of $1 million. However, the law contained a giant loophole because it only capped "non-performance-based" salaries. In response, many corporations simply passed resolutions making all compensation above $1 million "performance-based," using their own often loose performance criteria. They also shifted much of their executive pay from base salary to stock options and bonuses supposedly linked to performance.

Rep. Martin Sabo (D-MN) has attempted to close this gaping loophole through his Income Equity Act (H.R. 2888). This bill would ban corporate tax deductions on any compensation for one individual that exceeds 25 times the pay of the lowest paid worker in the firm.

3. End taxpayer subsidies for gold-plated CEO pensions.

As workers see their own retirement benefits dwindle, there is a growing public outcry against excessive executive pensions. While majority votes in favor of shareholder resolutions are extremely rare, this year shareholders at 11 firms voted to limit severance pay. For example, at Alcoa, 65 percent of shareholders backed a resolution urging the board to allow shareholders to vote on severance deals that provide benefits exceeding 2.99 times an executive's salary plus bonus.[36] Brandon Rees, of the AFL-CIO's Executive Paywatch website, says, "We're seeing a real watershed on this issue."

Presidential candidate Senator John Edwards (D-NC) has responded to the public outrage by suggesting a way to use tax policy to curb gold-plated CEO

pensions. Edwards has proposed eliminating the tax deductibility of executive pensions that are more generous than the retirement benefits available to other employees. Edwards and Rep. John Conyers (D-MI) have also introduced legislation (S. 1343 and H.R. 2609) to keep executives from safeguarding their own pensions in special bankruptcy-proof trust funds. Under the plan, bankruptcy courts could use those assets to pay debts to employees and other creditors.

While majority votes in favor of shareholder resolutions are extremely rare, this year shareholders at 11 firms voted to limit severance pay.

4. Protect workers by requiring more realistic pension accounting.

At present, pension funds factor in current long-term interest rates in determining the expected rates of return for the pension fund. The problem with this is that interest rates generally rise during periods of economic strength, causing fund managers to assume lofty pension returns that relax the need to put money into pensions. As the economy slows, interest rates fall and the strong pension gains projected into the future disappear, leading to pension funding crises. The Economic Policy Institute proposes using a more conservative return projection for pension assets and smoothing the interest rate volatility by using a 20-year average of the 10-year Treasury yield. This would have the effect of lowering pension fund obligations during periods of economic weakness and raising them during periods of economic strength.[37]

5. Ban companies from deducting the cost of executives perks on their taxes and close loopholes that allow executives to avoid taxation on their perks.

As public and legislative attention focuses on reining in stock options and golden parachutes, executives are likely to demand more in other forms of compensation. One option is so-called "perks," which show up only in the small print of footnotes to proxy statements. Travel in corporate aircraft, luxury homes and payments for country club fees, home security systems and individual tax assistance are increasingly common rewards for those who sit atop large corporations. First they demand exorbitant pay, then they demand special security and tax help to protect their loot.

Perks are particularly galling when they serve to help executives avoid paying their share of taxes. For instance, when an executive travels in corporate aircraft for personal use, they are credited with taxable income based on the cost of a first-class commercial airline ticket, not the actual cost to the company for use of a private jet. Another executive perk gaining increasing attention is the use of deferred compensation schemes, in which a portion of the executive's pay is held by the company for payment at some later point in time. The IRS is trying to close loopholes by which these deferred payments are invested in offshore tax havens, thereby allowing the executive to avoid much of the taxes due when the deferred compensation is eventually received.

The Economic Policy Institute proposes using a more conservative return projection for pension assets and smoothing the interest rate volatility by using a 20-year average of the 10-year Treasury yield. This would have the effect of lowering pension fund obligations during periods of economic weakness and raising them during periods of economic strength.

6. Improve plain-English disclosure standards of executive compensation.

Currently, executive compensation information is provided in a variety of text, tables and footnotes in official corporate filings with the Securities and Exchange Commission. Many investors and other stakeholders would benefit from a clear summary of what corporate executives made in a given year. In order to improve the usefulness of this information, additional contextual information should also be provided: How did the pay of the company's CEO compare to firms in the company's peer group? What was the ratio between the company's highest and lowest paid employees? How many jobs did the company create during the year? How many employees were laid off? What is the ratio of the highest paid employee's compensation to company net profit?

7. Require shareholder approval of extraordinary executive severance and retirement packages.

Some of the handsomest pay packages have resulted from pay for failure — not pay for performance. For example, William Esrey, who was forced out at Sprint earlier this year due to questions surrounding the company's use of tax shelters, bailed out with more than $9 million golden parachute. In previous years, Douglas Ivester, fired as CEO of Coca-Cola, received $35 million in severance benefits, and when Mattel's Jill Barad was fired she received a cornucopia of parting gifts valued at more than $50 million. Much of this largesse stems from the fact that severance benefits are not negotiated at the time of hiring. When an executive has failed and lost the board's confidence, executives are then able to coerce huge pay packages in exchange for a peaceful departure. One solution would be to require that shareholders be given the authority to approve or reject executive severance, as well as retirement packages that provide benefits greater than those available to all employees of the firm. These votes should take place within 12 months of hiring a new executive.

8. Increase barriers to selling based on insider information

Under the Public Company Accounting Reform and Investor Protection Act of 2002, executives have to disclose stock purchases and sales within two business days of the transaction (the previous standard allowed as long as 40 days). Given the propensity for abuse, a better idea would be to return to a previous standard of public disclosure *prior* to a sitting executive selling any stock.

AFL-CIO President John Sweeney has expressed support for an even stricter approach, which would ban stock sales by executives until they have left the employ of the company. This rule change would restore the sought-after alignment of interests between shareholders and management. This alignment of interests is shredded when executives accept lush option grants and then sell the stock.

9. Put in place broader standards of board independence.

More should be done to build on the corporate accountability legislation passed by Congress in the aftermath of the corporate scandal wave. That legislation mandated that a controlling majority of directors be free from direct financial interests in the company. This definition of independence does not go far enough. CEOs from other firms make up the largest occupation group represented on corporate boards. While we do not discount the utility of having other businesspeople on boards, a company's risk is increased by having exclusively corporate perspectives on the board. Peer CEOs face numerous conflicts of interest in serving on other company boards and no place is this more apparent than in overseeing CEO pay. How many executives are going to argue for controlling pay excesses, when they know if they do someone will likely turn around and make the same argument in their own boardroom?

The AFL-CIO has proposed that shareholders be permitted to nominate their own directors in their annual proxy ballots.

Money managers know that portfolio diversity is the wise choice, as it decreases risk and improves overall performance. The same is true of diversity of thought and perspective in the corporate governance process. Directors should not only have the right to consider the impact of corporate activities on other stakeholders, but the voices of those other stakeholders should be part of the debate within the boardroom. How would the Enron situation have been different if rank and file employees served on the company's board, or if one of the company's board members was a California power customer?

The AFL-CIO has proposed that shareholders be permitted to nominate their own directors in their annual proxy ballots. (The SEC is expected to issue proposed rules on this topic in September.) Legislatures could also look to models in other countries that support board diversification. For instance, German law requires that two seats of corporate boards at firms above a certain size be reserved for employee representatives. Not surprisingly, though German companies are as large and complex as their U.S. counterparts, German CEOs, on average, make less than a fourth of what their American brethren make.[38]

10. Federalize corporate charters.

The majority of U.S. corporations are chartered by the state of Delaware, which a hundred years ago won the race to the bottom in terms of being friendly to corporate managers. Delaware law provides generous exclusions of personal liability for those who lead corporations. It is one of a small minority of states to bar directors from considering the interests of other corporate stakeholders — employees and communities — in making corporate decisions. Delaware has gone so far as to even allow companies the option of eliminating their in-person annual meetings altogether, if they instead hold cybermeetings over the internet, a move opposed by large numbers of investors who view annual meetings as the one time a year when executives must appear and be held personally accountable. Delaware's lax standards and laws have been a sieve through which questionable behavior of corporate executives has easily flowed, threatening financial markets and our economy.

Endnotes

1. Harris Interactive press release, October 18, 2002.
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24. Figures are based on executive compensation data contained in the annual survey conducted by the *Wall Street Journal* for the years 1997 through 2002. Each survey covers CEOs at leading industrial and service firms that reported compensation data to the Securities and Exchange Commission by the *Journal's* deadline in April. All have annual revenue in excess of $1 billion. The number of executives surveyed varied slightly each year, from 352 to 357, with an average of 355.
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29. The tax deductions were estimated based on a top corporate tax rate of 40 percent (35 percent federal rate plus an average of 5 percent for states). Caveats: 1) The methodology assumes that all the stock options granted to the CEOs in the sample were non-qualified stock options (NQOs) and thus provide the firm with a tax deduction, even though it is possible that some were Incentive Stock Options (ISOs). In general, no deduction is allowed for ISOs because no compensation is assessed to the employee. (A deduction for ISOs is only allowed when the employee disposes of the stock prematurely). However, experts estimate that the great bulk of options granted by companies are NQOs. For NQOs, the tax code allows a business deduction for the market price of the stock less the exercise price of the option on the date of the exercise of the option. There is no reliable method for determining the number of NQOs excluding the ISOs because firms are not required to provide this detail in their disclosures. 2) The estimate of tax deductions does not account for firms that had no tax obligation due to lack of profits.
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CEO Pay Resources

The reports listed below are available online at www.FairEconomy.org.

More Bucks for the Bang: CEO Pay at Top Defense Contractors. CEOs at the nation's largest military contractors rose 79 percent in 2002, compared to a six percent increase for typical CEOs.

Executive Excess 2002: CEOs Cook the Books, Skewer the Rest of Us. Finds that CEOs of companies under investigation for accounting irregularities earned 70 percent more from 1999 to 2001 than the average CEO at large companies.

Titans of the Enron Economy: The 10 Habits of Highly Defective Corporations, April, 2002. This prescient report showed how many of the problems dramatically revealed by the Enron scandal are woven tightly into the fabric of American business. It ranked the worst companies in 10 areas and gave Enny Awards to companies with Enronesque behavior, including General Electric, Citigroup, AOL TimeWarner, WorldCom and Halliburton. Includes 12-step program for breaking Enronesque habits.

Executive Excess 2001, August, 2001. Among the findings: Job-cutting CEOs made higher than average salaries in 2000 amid layoffs and a slumping stock market. CEOs at companies that paid zero corporate taxes got larger raises than the average CEO.

The Bigger They Come, The Harder They Fall, April, 2001. A seven-year survey of the dismal financial return to investors in companies with high CEO pay.

Executive Excess 2000, August, 2000. Updates the decade-long trends in CEO pay, charts the explosion in executive pay at dot-com companies, and highlights the huge, and growing gap in pay between private-sector CEOs and their counterparts in the federal government.

A Decade of Executive Excess: The 1990s, September, 1999. This edition focused on major trends of the decade, economic arguments against exorbitant CEO pay, the most undeserving CEOs of the decade, and a survey of what can be done.

Executive Excess 1998: CEOs Gain From Massive Downsizing, April, 1998. Focuses on layoff leaders, international banking executives, job-shifters to Mexico, and the citizens' response to runaway executive pay.

Executive Excess 1997: CEOs Gain From Massive Downsizing, May, 1997. Focuses on layoff leaders and efforts to close the wage gap.