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# Reader

## Can Feds Thwart Runaway Pay?

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**By Don Bauder**

The pay of American top corporate executives is obscene. About the only people who don't agree with that statement are the executives themselves. In 1980, chief executives made 42 times what the average worker made. Last year, it was 319 times, according to the Institute for Policy Studies and United for a Fair Economy. The federal government has launched several initiatives to rein in this madness. The Treasury Department wants to hold down pay at seven bailed-out banks, the Federal Reserve wants to slash gambling incentives at more than two dozen financial institutions, and Congress wants to help shareholders have some say in top executive remuneration.

But can the government handle this without creating a vast, shiftless bureaucracy? It will be difficult. And whatever or however the government tries, can it be effective? It will take a lot of luck. By using its bully pulpit and a big stick, it might get some companies to detect which way the wind is blowing and change their ways — reluctantly and modestly. But that's only a hope.

Basically, change must come from the grass roots. People must pressure companies and politicians. Those who own stock must bug boards of directors and managements to shape up, and they must tell mutual funds that hold stocks to raise hell. In particular, pension funds should ride herd on boards that let top executives rob the till. The big pension funds "should call a company and say, 'You are screwing the shareholders. We don't like your pay policies,'" says Graef (Bud) Crystal, former San Diegan, now living in Santa Rosa. He is one of the nation's top authorities on corporate compensation and a guest columnist for Bloomberg News. "If enough institutions would make that call, the stock would crater" and chief executives' stock options would go far south. The pension funds "have it in their hands to stop this but won't."

Agrees Todd Buchholz, San Diego economist/lawyer/author, "There are corporate boards that protect overpaid CEOs like the drones in a beehive protecting the queen bee. I wish that pension funds and other big shareholders were more aggressive" in fighting the plundering.

The Treasury's so-called pay czar is trumpeting his clampdown on banks that have been rescued by the federal government, such as Bank of America and Citigroup. Top executives' pay will be cut in half this year. But there are only two months left in 2009. What happens next year? "This is window dressing, political theater," says Ross Starr, economist at the University of California at San Diego. "Since the Treasury has a major ownership stake in those institutions, I suppose it can make this stick for a year or two."

Says Buchholz, "If you accept government money, you have to accept government regulation" of things such as top management pay. "I would be aghast and angry if I saw the government trying to control salaries in chemical, telephone, or other companies" that haven't been bailed out.

In July, the House of Representatives passed a measure that, among many things, gives shareholders a nonbinding advisory vote on executive compensation. A similar bill is working its way through the Senate. The concept is called “Say on Pay.” Harrumphs Crystal, “That ‘Say on Pay’ is a joke. It’s not mandatory — just advisory. It has no teeth. Maybe it will accomplish a little bit: some odd board will pay attention to shareholders.”

The Federal Reserve has imposed sweeping remuneration limits on top executives of banks. The idea is to make sure that bankers don’t have incentives to gamble with funds they have borrowed for almost nothing. “Executive compensation for financial firms and others are short-term oriented; bonuses are based on current profits, not long-term profits,” says Starr. “There is an incentive for leaders to get out before the house of cards collapses.” The Fed as a bank regulator has the discretion to make these moves.

Compensation pros like Crystal cite history. In the early 1970s, President Richard Nixon tried to impose price and wage controls, to be administered by an officious bureaucracy. “It created discontinuities and dysfunctions and fell apart” as companies figured out ways to dodge the edicts, Crystal recalls. In 1992, when the average chief executive pay was \$750,000 (then considered outrageous), President Bill Clinton tried to set up a system by which companies could not deduct pay of over \$1 million from corporate taxes. “But then they gave exceptions to small companies and decided that it only applied to the top five executives at a company” and made other exceptions. Among other dodgy techniques, a chief executive making less than \$1 million was immediately bumped up to the still-deductible \$1 million level. The measure had little effect.

But it’s different this time, says Murtaza Baxamusa, economist at the Center on Policy Initiatives. “It’s a slow process, but it’s boiling up within the community. Every single politician is listening. The topic of executive salaries has entered into mainstream talk, unlike a couple of years ago,” he says. “There is a strong role for government,” which with grassroots support will be able to do what it hasn’t been able to accomplish previously. “Corporations are getting a free ride here. Superficial makeovers are not going to fly. We have a watchful and much-better-informed public.”

Some compensation experts think the best answer is full disclosure. The Securities and Exchange Commission, which is supposed to regulate major investment markets, requires that companies spell out their top dogs’ pay in official documents. Then, industrial and labor organizations and business-oriented publications print the data with help from compensation pros like Crystal. “Sunlight is the best disinfectant,” says Crystal, but the rules are already comprehensive, and there is not much more to disclose. “We have full disclosure. Did it cause pay to drop a lot? Not much,” says Crystal, who has long been disturbed by one thing: “There is no relationship between pay and performance.”

One argument against full disclosure is the so-called ratcheting effect. Chief executives see what their counterparts are bringing home and yearn to top them. Compensation consulting firms, seeing what executives at comparable companies make, will recommend that boards give top honchos even bigger pay boosts. Crystal questions that argument: the consulting firms will find the information in other ways, he says.

Companies hire lawyers who make the disclosures in legal mumbo jumbo. “There is no such thing as full disclosure,” scoffs Baxamusa. “Nobody tells us what goes on in the backrooms of these corporations. Government needs a stick with tools and power to enforce the law.”

Crystal says the government does have one really effective tool: the Internal Revenue Service. “The IRS has the ability to deny tax deductions in individual cases,” he says. The agency can declare that

a really smelly pay package — say, \$300 million — is not deductible. “This could have a chilling effect and spread outright fear” among companies and their consultants.

Concerned that politicians will listen to an enraged public, some companies could go straight. Don’t count on it.