Submission to Productivity Commission
Inquiry into Regulation of Director and
Executive Remuneration in Australia

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Executive pay has become a centre of public attention, with widespread concern about the levels of executive remuneration. Across Europe and the US, four fifths of people believe that business leaders in their countries are paid too much (figures range from 75 per cent in France to 77 per cent in Spain, 79 per cent in the USA and Italy, 81 per cent in Britain and 88 per cent in Germany) (Harris Interactive 2009). Similarly, 78 per cent of British adults believed directors are overpaid (Blitz 2003). I have not seen comparable random surveys for Australia, though web surveys (St James Ethics Centre 2003) and public debate (Brisbane Times 2009) suggest similar concern here and a 2004 telephone survey of 400 Australians found only 36 per cent thought bonuses and fees for executives and board members were 'fair and reasonable' (Crosby Textor 2004). This submission considers: first, the growth in executive remuneration since the 1970s; second, the causes of the growing divergence between CEO pay and pay of ordinary employees; and third, some policy implications. It focuses on the level of executive remuneration and does not consider the composition of executive remuneration, except for brief reference to the impact of composition on level.

Relative growth in executive remuneration

Since the mid 1980s executive salaries have been growing faster than average wages. However, this difference in growth rates has not always existed.

Figure 1 shows real indexes of senior executive remuneration (as estimated from Cullen Egan Dell (CED) surveys in December each year from 1971 to 1991), and of average weekly earnings (deflated by the CPI) (1992, p11). It shows that through the 1970s and the first part of the 1980s, senior executive salaries maintained a fairly stable relativity with average weekly earnings. Figure 1 also includes, for later years, a CED series on CEO pay. The series on executive remuneration and average earnings tracked each other fairly closely (other than in 1974, when wage earners gained a significant increase in real earnings, and which established a new relativity that remained fairly stable until 1985). From 1985 the series started to diverge, with major increases in real executive remuneration despite ongoing moderation in real average earnings in the context of the centralized phase of the prices and incomes Accord.

Figure 2 extends these data to 2008, by splicing CEO pay data from CED with other data. The first set, referring to average CEO cash remuneration (which includes base salary, benefits, allowances and incentive bonuses), come from Mercer Cullen Egan Dell data published by the Parliamentary Library (Kryger 1999). They cover the period from 1991 to 1998. The second set, from the John Egan Associates database, relate to median total remuneration of CEOs in the top 100 companies, and cover the period from June 1998 to June 2008. These latter data have been read from a chart in Egan (2009a). Note that median earnings can be well below average earnings (in 2005, mean earnings amongst the CEOs of the top 25 companies were 43 per cent higher than median CEO earnings (calculated from Nicholas 2006)). The AWE data are average weekly total earnings for full-time employees from 1983 onwards, and average male earnings before then.
Figure 1: Real executive remuneration and average weekly earnings, indexes, Australia, 1971-1991


Figure 2: CEO pay series and AWE, indexes, Australia, 1971-2008

Although the three CEO series relate to slightly different concepts, the picture is very clear and not dependent on how the series are spliced. As we saw in figure 1, while CEO pay maintained a stable relativity to average earnings during the 1970s and early 1980s, growth in CEO pay outstripped growth in real average earnings from the mid 1980s, but the divergence continued through the 1990s and the current decade. The divergence was not an artifact of the restraint exercised by average wage earners during the centralized Accord; it continued through subsequent periods of decentralized bargaining for wage earners as well. The growth in CEO pay, of something around 470 per cent over the period 1971-2008, was nearly nine times the 54 per cent growth in real average weekly earnings over the same period.

The increase in CEO pay is a significant factor explaining the rise in the share of national income going to top income earners over the past two decades (Atkinson & Leigh 2007). This increase in top income shares is a relatively recent phenomenon: from 1920 to the early 1980s, the share of top income earners generally declined (ibid).

**Sources of relative growth**

Several explanations have been offered for the contemporary divergence between growth rates of CEO pay and the pay of ordinary workers.

The 'global labour market' explanation is that, with globalisation, the market for senior executives has also globalised in recent decades, so that Australian firms now have to offer higher remuneration to attract or retain CEOs.

The 'risk' explanation is that executives' jobs are increasingly insecure, and their greater pay reflects the greater risk they will lose their job, and the greater losses they will face if this happens.

The 'tournament theory' explanation is that the market for CEOs is like a tournament, with high rewards for a small number of 'winners'.

The 'complex job' explanation is that the work of CEOs has become relatively more complex in recent years, requiring higher levels of skill than previously. The 'productivity' explanation, related to this, is that greater CEO skills and hence pay have been necessary to drive improvements in productivity and national prosperity.

The 'profitability' explanation is that shareholder returns and company profits have increased in recent years and the higher remuneration of CEOs simply reflects these greater profits and their contributions to them.

The 'power' explanation is that CEOs hold positions of relative power, similar or related to the power that capital has in relation to labour, and that as power has shifted from labour to capital the capacity of CEOs to extract rents (Bebchuk & Fried 2004) has increased.

The 'leapfrog' explanation is that CEOs are able to disturb relativities in CEO pay and then use their occupational power to attempt to reassert those relativities, imparting an upward bias to aggregate CEO pay unrelated to performance. For example, CEOs are able to persuade boards to attempt to pay them above the 'median' CEO salary for reasons of organizational status, and as it is mathematically impossible for most people to be paid above the median, relative CEO remuneration will rise regardless of performance. Remuneration consultants play a crucial role in the 'leapfrog' explanation.

What does evidence suggest?

First, there evidence does not conclusively support any link between rising executive pay and productivity, in support of the 'productivity' explanation. Indeed, there is good evidence
for the reverse. Shields, O'Donnell & O'Brien (2004, 2003) showed that, over the period 1999-2002, the 20 best-performing Australian companies paid their CEOs substantially less than did the 20 worst performing companies. It did not matter if corporate performance was measured by return on equity, share price change, or change in earnings per share, the same pattern held. What is more, the best performing companies increased the pay of their CEOs by only half the amount that the worst performing companies did. The researchers examined the link between CEO pay and performance in different pay bands and concluded that:

the current average pay gap between top 100 CEOs and ordinary employees is at least three times higher than that required to maximise organisational performance. (Shields, et al. 2003)

Less systematic analysis in later years also indicated highly paid CEOs underperformed lower paid CEOs (Trounson 2007) alongside numerous examples of CEO pay rising while their firm's performance deteriorated (eg Steffens 2008, West 2009, Williams 2009). Another earlier Australian study found that CEO pay was only correlated with company performance during boom periods; during soft landing and flat recovery periods there was 'no relationship between corporate performance and executive remuneration', and during recession on one measure there was a negative relationship (Matolcsy 2000). It is possible that there is a ratcheting effect, whereby bonuses boost pay during good times, but base levels are then boosted (or bonuses restructured) to offset the loss of value of bonuses or options schemes in bad times (eg Schwab 2009a)

That said, even if there were a positive (rather than negative) relationship at the micro level between company performance and executive remuneration, this would not in itself indicate that the growth in executive remuneration was due to improving performance. It would be possible for executive remuneration to reflect both micro-level performance differentials and an underlying inflation, redistributing income from elsewhere to CEO remuneration. The relationship between CEO pay and national market sector productivity over the past decade is shown in Figure 3. This compares the movements in the spliced series of real CEO pay (used in Figure 2) with movements in national market sector productivity over the period from 1978. As can be seen, growth in executive remuneration has far outstripped growth in productivity. Over the two decades from 1978, growth in real CEO pay was approximately six times growth in productivity. Once again, the divergence commenced in the mid 1980s, with CEO pay and productivity moving fairly closely together over the period to 1984, but diverging thereafter.
Figure 3: CEO pay series and GDP per hour worked in the market sector, indexes, Australia, 1978-2008

We see that the rise in CEO remuneration far exceeds the improvement in national economic performance, suggesting that there is an underlying inflationary factor in executive pay that goes well beyond any productivity effects. Even if CEOs are rewarded for their contribution to higher productivity, the rewards far exceed any contributions they have made to productivity growth.

The relationships with productivity and performance also undermine the 'profitability' and 'tournament' explanations, as these suggest the highest rewards should be associated with the highest performing companies. The 'complexity' argument also has some problems: CEOs are not the only people who make a corporation profitable. The majority of Australian workers have also faced increased work pressure (eg Morehead, et al. 1997), and a majority of employees experience overload at work, leading to poor work-life interaction (Skinner & Pocock 2008). All a corporation's workers contribute to its profitability, and if it becomes more profitable it is not immediately obvious why the senior management should be the only ones to benefit. Indeed, as mentioned, CEOs appear to be extracting gains far beyond those attributable to higher productivity. Meanwhile the argument that CEOs face higher risks that ordinary workers has also been challenged, especially in light of the 'golden parachutes' that CEOs typically have access to on conditions far superior to termination packages available to ordinary workers (Cassidy 2008, Isles 2006, Mayne 2009, Robinson 2009, West 2008).

The 'global market' explanation can be tested by considering if there is a convergence in international pay levels of executives. If the market for CEOs was internationalizing, moreso than that for other workers, then we would expect to see smaller differences in the pay of, say, American and Swedish CEOs, operating in the same labour market, than between the American and Swedish restaurant workers, operating in very different labour
markets. The data suggest otherwise. American executives remuneration grew from 42 times average production workers' wages in 1982, to 411 times in 2001 (Klinger & Cavanagh 2002). In 2000-01 CEO pay was 367 per cent higher in the USA than in Sweden, but McDonalds workers' base pay was 8 per cent lower in the USA than in Sweden (Ashenfelter & Jurajda 2001). This is not principally because the USA is a larger country than Sweden or is home to a greater number of globally significant corporations. In 2006, the 20 highest paid US CEOs received an average of three times the remuneration of the 20 highest paid European CEOs – yet the companies controlled by the US CEOs had sales 29 per cent less than those controlled by the European CEOs (Anderson, et al. 2007).

Further questioning of the 'global markets' theory comes from a 1990s survey in which only 2.5 per cent of large corporations admitted 'pay levels overseas' were a 'fairly' or 'very important' source of direction on executive salaries (Noble Lowndes Cullen Egan Dell 1992). The large differences in CEO pay levels between countries do not reflect differences in national economic performance. They appear more likely to reflect differences in corporate cultures or 'varieties of capitalism' (Hall & Soskice 2001). Swedish CEOs and boards appear to feel a greater sense of responsibility and need for restraint than do American ones.

There is evidence for the 'leapfrog' explanation in a survey of executive pay methods undertaken by Noble Lowndes Cullen Egan Dell (1992), which showed that the most important factor influencing executive pay was 'remuneration market forces' (that is, what other corporations were paying). Although the survey, commissioned by the then Department of Industrial Relations, is over a decade old, it is a crucial source of data as it provides a rare, frank insight into executive pay determination, an area that is normally shrouded in self-justification and rather secretive data. Figure 4 shows the main sources of information, advice or direction on executive pay levels in that survey.

It showed that advice and data from remuneration consultants was far more important than the views of shareholders, board members or industry associations in determining executive pay.

There is little reason to believe that the factors driving the relative size of executive pay have significantly changed since then. A very recent 'web poll' by Egan Associates, using quite different questions, indicated that the three factors 'with the most significant influence on executive pay' were 'company remuneration policies/ competitive positioning', 'market rates' and 'remuneration consultant data'. Although the results were presented graphically rather than numerically, it was clear that 'remuneration consultant data' was over twice as likely as 'shareholder views' to be rated significant, while 'shareholder views' were at least three times more likely than 'remuneration consultant data' to be rated the 'least significant influence' on executive pay (Egan 2009b).
Figure 4: How important is each of the following as a source of information, advice or direction on pay levels for senior executives, Australia, 1991.

Source: Noble Lowndes Cullen Egan Dell 1992

The NLCED survey also asked respondents about the 'comparative remuneration market' for their senior executives. Results are shown in Figure 5. They indicate that seven tenths of companies benchmarked their senior executives pay by reference to the industry in which they operated. Smaller proportions referred to occupational labour markets, firms of similar size or the Australian private sector in general.
Most relevant, however, was the question on how companies sought to pitch or 'position' their senior executives' pay. Results are shown in Figure 6. Nearly two thirds of companies had a policy of 'positioning' their executives’ pay above the median and 92 per cent claimed to set them around or above the median. Only 2 per cent aimed to position their pay below the median. Of course, it is mathematically impossible for all companies to achieve the position they are seeking. By definition, 50 per cent of firms will be paying below the median, not 2 per cent. As virtually all firms attempt to position themselves at or above the median, senior executive remuneration will increase even in an environment of zero inflation and zero productivity gains. A similar pattern was seen in the USA at that time (Crystal 1991).
Figure 6: In relation to this comparative market, where do you generally aim to position your senior executives' pay?

<table>
<thead>
<tr>
<th>Position</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Above median</td>
<td>65</td>
</tr>
<tr>
<td>Around the median</td>
<td>27</td>
</tr>
<tr>
<td>Less than median</td>
<td>2</td>
</tr>
</tbody>
</table>

Source: Noble Lowndes Cullen Egan Dell 1992

Respondents were also asked the time frame they used when estimating pay comparators for senior executives. Figure 7 indicates that some 31 per cent did not just rely on the current rates but attempted to anticipate where the median would be any time up to twelve months into the future.

Figure 7: At this policy position, what is the timing of the market?

<table>
<thead>
<tr>
<th>Timing</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Present market pay</td>
<td>54.6</td>
</tr>
<tr>
<td>Up to six months in advance of market (ie where market rates are expected to be in six months time)</td>
<td>24.5</td>
</tr>
<tr>
<td>Between 6 and 12 months in advance of market</td>
<td>7.1</td>
</tr>
<tr>
<td>Not sure or no deliberate prospective/timing</td>
<td>9.7</td>
</tr>
<tr>
<td>Not answered</td>
<td>4</td>
</tr>
</tbody>
</table>

Source: Noble Lowndes Cullen Egan Dell 1992
As a consequence of this inflationary bias in executive pay determination, a 2005 survey co-sponsored by the Australian Institute of Company Directors showed that even a majority of directors believe that CEOs are overpaid – notwithstanding the fact that, technically, it is the job of the board of directors to set CEO pay. Indeed, over two thirds of those considered that CEOs were overpaid by between 20 per cent and 50 per cent (Buffini & Pheasant 2005). A separate study found similar results. O'Neill (O'Neill 2007), undertaking in-depth, semi-structured interviews with non-executive directors of Australian public companies, found that 'when the issue of "how much is too much?" arises, almost all express a level of concern', evoking comments from directors such as that CEO pay 'needs to be capped so that it doesn't become obscene' and 'I don't think any individual is worth that much' (O'Neill 2007).

Such cynicism is not restricted to Australians. Two thirds of ethics, human resources and legal executives participating in the US corporate Conference Board's 2003 Ethics Conference said that compensation for senior executives was 'out of control' in their companies (Conference Board 2003). The problem in Australia was recognised at the top, when Paul Anderson, retiring CEO of BHP Billiton, remarked:

I think that CEO compensation is out of control, totally out of control. It’s reached a point now that there’s no way to justify the incredible compensation…there is just no value that can be created by a CEO that you can say that makes a lot of sense (Correy 2003).

Exemplifying the status element of the 'leapfrog' explanation, according to the director of the Australian Institute of Company Directors:

it's quite possible that a bank CEO would do a terrific job on quite a lot less pay, but no bank board is going to want to pay its CEO substantially less than the market norm. (Ralph Evans quoted in Buffini & Pheasant 2005).

These findings suggest that public opinion, cited at the beginning of this submission, is well founded. They reinforce how the leap frog syndrome leads to overpayment in executive pay determination.

To express it crudely, the process is something like this. Private sector executive salaries are typically set by a body like a board remuneration committee. These may include outsiders (that is, senior executives and directors from other corporations) but in Australia they are rarely fully independent of executive influence (Schwab 2009b, Shields, et al. 2003). Particularly in large corporations, this committee typically looks at the results of executive salary surveys undertaken by remuneration consultants, and takes advice from such consultants. The committee members, who identify and network with the senior executives under scrutiny, are easily persuaded that the company needs to pay above the average in order to retain such high calibre executives. Otherwise the company may under-perform and be under threat of takeover. So a large number of firms raise their salaries so that they are paying above the median (the middle of the market), and others paying below the median raise theirs to match the median. Another survey is then published. Companies see that the market rate has risen, and they have to readjust their executives’ pay so that they are paying above (or at) the market median again.

While the Australian and US survey data are from the 1990s, there is strong evidence from several recent US studies in support of the view that this process continues. In particular, Faulkender & Yang (2007) found that, when selecting comparators for determining CEO pay,
firms forego lower paid potential peers in their same industry in favor of higher paid peers outside of their industry when constructing the peer groups. This effect persisted when controlling for industry and size. Indeed comparative pay of peers was far more important in determining CEO pay than industry or size. They concluded that the selection of relatively highly paid (above median) peers to justify CEO compensation was more common where the CEO was chairman of the board, when the firm had greater market share, poorer governance and where a particular remuneration consultant was used by the firm (Faulkender & Yang 2007).

Notably, Ang, Nagle and Yang (2007) showed that CEO compensation includes a 'social circle premium', in excess of what could be justified by firm performance, and that channels of social interactions that shaped these social circle premiums included 'golfing in the same exclusive club, sharing directors who understand the local pay norm and displaying luxury mansions' (Ang, et al. 2007).

The role of remuneration consultants in the UK was recently described disparagingly by a leading fund manager:

Generally, I would say they are a thoroughly bad influence. They are seen by fund managers as having extreme conflicts of interest: they are effectively paid by the board and are only seen to be doing their jobs if remuneration rises. In theory, remuneration consultants bring a certain level of objectivity to the task, but their existence allows companies to say they have done due diligence on pay, therefore it's not their fault when benefits and performance do not match (quoted in Wachman 2009).

The House of Commons Treasury Committee, reporting earlier this month on the financial crisis, noted that

We have received a body of evidence linking remuneration consultants to the upward ratchet of pay of senior executives in the banking sector. We have also received evidence about potential conflicts of interest where the same consultancy is advising both the company management and the remuneration committee. We have received a body of evidence linking remuneration consultants to the upward ratchet of pay of senior executives in the banking sector. We have also received evidence about potential conflicts of interest where the same consultancy is advising both the company management and the remuneration committee. Both these charges are serious enough to warrant a closer and more detailed examination of the role of remuneration consultants in the remuneration process. We urge Sir David Walker [chair of a review of corporate governance in the banking industry] to examine these issues and, in particular, to consider whether remuneration consultants should be obliged to operate by a code of ethics, a proposition which we find attractive (House of Commons Treasury Committee 2009:33).

The Committee referred to evidence of

remuneration consultants of having “contributed to the general ratchet in executive remuneration because they seem to have business models which require them to earn fees which require them, therefore, to modify packages every year which, therefore, requires the packages to go up” (House of Commons Treasury Committee 2009:32).

Another witness

spoke of the ‘ratchet’ effect telling us that it was remarkable how many remuneration consultants “are given remits which refer to a benchmark of the upper quartile. If
endlessly, year after year after year, you are referred to the upper quartile, then that is an endless ratcheting and an ever-increasing gap with the rest of the workforce”.
(House of Commons Treasury Committee 2009:32).

'Leapfrogging' – which might be given the term asymmetrical pay pegging – was a significant problem for public sector pay amongst ordinary employees up until the early 1980s. Surveys would identify average 'market rates' which would lead to wage increases, followed by further rounds of surveys and wage increases. Industrial tribunals abandoned market surveys as the basis for setting public sector pay rates two decades ago. Now, in the age of enterprise bargaining, employees are told to abandon notions of 'comparative wage justice' as being old hat and dangerous. But an inflationary form of 'comparative wage justice' lives on in the market for executive remuneration. Forced disclosure of executive pay does nothing to relieve the pressure, though it probably does not worsen it much either, because it is the remuneration surveys that really set the pace.

For ordinary workers, leapfrogging is prevented by the existence of countervailing forces at the bargaining table. Management has a clear interest in resisting employee attempts to raise wages through the device of asymmetrical pay pegging. In the past, tribunals also effectively placed a break on asymmetrical pay pegging once its disultilities became apparent in an environment of generalized wage restraint.

In the case of executive remuneration, however, there is no effective countervailing force at the bargaining table. Rather than having opposing interests to executives, the board members or others who set their pay are from the same social milieu with broadly comparable interests, and often they see status or reputation costs and benefits associated with executive remuneration. In other words, the market is distorted by the absence of genuine opposition of interests that exists elsewhere in the labour market and the high degree of power possessed by CEOs, arising from the resources and information that they have access to within the corporation, their connections or networks with other CEOs and directors, the norms or attitudes that permeate the executive 'market' and their collective social identity as a class, things that all promote asymmetric pay pegging in executive pay. It is not 'arms length bargaining' (Bebchuk & Fried 2004, Yablon 2008).

The mechanism is also described in a recent study by DiPrete, Eirich & Pittinsky (2008), who modelled executive remuneration based on Standard and Poor’s ExecuComp data on executive compensation and concluded that

a small and shifting fraction of CEOs have regularly been able to ‘leapfrog’ their compensation benchmarks by moving to the right tail of the benchmark distribution and get larger than normative compensation increases, even after taking job mobility and executive performance into account. These events produce subsequent “legitimate” pay increases for others, and potentially explain an important fraction of the overall upward movement of executive compensation over the past 15 years.

Why then the breakdown of CEO/AWE relativities in the 1980s? First, 'today’s universal practice of setting CEO pay relative to peers was not common in the 1970s… the 1970s were marked by relatively little compensation consultant activity and scarce objective pay information' (Nagel 2007). Second, in part as a result of changing economic policies, the 1980s marked a shift in power between labour and capital. The share of national income going to profits relative to that going to labour increased, and continued to rise through the 1990s and 2000s (Australian Bureau of Statistics 5204.0). Income inequality – particularly between very high income earners and the rest of the population – also began to increase at this time (Atkinson & Leigh 2007). Rents that previously were shared between labour and
capital have increasingly been appropriated by capital. Although at law CEOs are employees, and their income counts towards labour's share of national product (thereby understating the shift in income from labour to capital), in substance their income, like their social context, has much more in common with that of capital than of labour. As their relative power has grown, they have increasingly captured rents through asymmetric pay pegging. The high rate of CEO remuneration in the US mentioned earlier reflects not the greater size of US companies, but the greater power in the US of capital in general, and CEOs in particular, by comparison with labour. The US has one of the lowest rates of union density in the OECD; Sweden has one of the highest (Visser 2006).

**Policy implications**

Policy proposals to curb excessive CEO and senior executive pay have largely centred around giving shareholders greater say over it. Such proposals are to be welcomed, both in relation to pay packages and to termination payments. The interests of shareholders presently feature well behind the urgings of remuneration consultants in shaping excessive executive pay. The danger is that the new ceiling on termination payments, of one year's salary before shareholders' approval must be sought, may also become a floor. Consideration should be given to a lower limit. The legal minimum for termination payments set out in the *Fair Work Act 2009* is a useful benchmark. It is unclear why CEOs, whose early termination is often brought about by poor performance in the job, should receive extraordinarily generous payouts on terms vastly superior to those available to ordinary employees dismissed for the similar reasons.

However, such policies will have only a very limited effect. This is partly because CEOs retain a strong position of power even when shareholder approval is required. Moreover, as DiPrete, et al. (2008) note, the finding of a leap frog effect:

> implies that the concept of firm-level governance of corporate compensation is inherently flawed; the linkages among firms produced by the benchmarking process guarantee that firm-level governance failure becomes a factor in the environment of other firms. In other words, rent extraction takes place even when CEOs are paid their “market wage” as established by competitive benchmarks. This argument supports the recent attention in the stratification literature to rent extraction as a manifestation of occupational power rather than an outcome of the bargaining power of individual workers.

Policies aimed at improving corporate governance will not address the core problem with senior executive pay: it is not just an issue of a misallocation of resources within an organisation, between CEOs and shareholders. It is also, and indeed more significantly, an issue of misallocation of resources within society as a whole. The very substantial relative growth in CEO remuneration has not been matched by equally substantial growth in national welfare as indicated by productivity growth. The distortion in CEO pay determination – creating an imbalance in pay setting procedures between, on the one hand, ordinary wage and salary earners and, on the other hand, CEOs – means that the former are in effect cross-subsidising the latter. In the end, the widening gap between CEOs and ordinary wage and salary earners is both a cause of, and symptomatic of, widening inequality between the wealthy and the rest.

Consideration needs to be given to the role of remuneration consultants. The recommendation of the UK House of Commons Treasury Committee for a code of conduct for the use of remuneration consultants is worthy of consideration, particularly with a view to removing discernible conflicts of interest. But short of banning their use altogether – an
option which has been proposed (eg Peston 2002) – it is difficult to see how the upward bias imparted through remuneration surveys can be avoided altogether.

The tax-transfer system is a mechanism that is conventionally used to deal with adverse distributional outcomes. One option that lends itself to consideration is an increase in the top marginal tax rate. This measure would appear warranted by the increasing inequality in personal income, particularly between very high income earners and the rest, that has been witnessed in recent years (even before allowance is made for the reductions in top marginal tax rates that have occurred over that period). Another option is to introduce wealth taxation (or estate taxation) on very high income individuals (for example, those with over $20 million in accumulated wealth, including through trusts). Australia is one of a minority of OECD countries that does not have at least one of wealth or estate/inheritance/gift taxes (Warburton & Hendy 2006).

That said, policy makers may prefer options that exclusively relate to senior executives. Another approach (not mutually exclusive with those above) would be to abolish tax deductibility against company income for senior executive remuneration packages above a certain value (indexed against growth in AWE) (eg Gittins 2009). This would act as a partial disincentive to firms to agree to excessive executive remuneration packages, and also return to the community a fraction of the losses associated with excessive growth in executive remuneration. A Bill introduced into the US Congress by Rep. Barbara Lee (the Income Equity Act, HR 1594) would deny tax deductibility for any executive pay above $500,000 or 25 times the pay of a company’s lowest-wage worker.

A more active measure would be to impose tax penalties (surcharges) for firms that exceed certain benchmarks in executive remuneration. Similarly, tax penalties could be applied to termination payouts above a certain amount. In the Netherlands a 30 per cent tax penalty is to be applied on payouts above around $850,000 (Horin 2008).

The choice of benchmarks would be highly subjective, but attention could be given to the estimate by Shields, et al. (2003) of the ‘performance-optimal range for executive remuneration of between 17 and 24 times average wage and salary earnings, beyond which the performance of a company begins to deteriorate’. It is also a range broadly consistent with the opinion of the late management academic Peter Drucker, that CEO pay should be no more than 20 times that of the rank and file worker in the company (interviewed in Schlender 2003), with the Lee Bill mentioned above, and with the recommendation of the Institute of Policy Studies that bail-outs should be only available to firms with CEO pay restricted to no more than 25 times that of the lowest paid employee (Anderson, et al. 2008). It is, however, considerably higher than Plato’s recommendation that no one should accumulate more than five times the income of the lowest paid (Morrow 1993:131).

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REFERENCES


