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A Comparison of the Pay of Top Executives and Other Workers

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Summary

The level of top executive compensation has been of interest to policymakers, shareholders, and employees for several different reasons over the years. Most recently, concern has centered on those corporations whose senior executives have enjoyed substantial pay packages while they have misstated their firms' financial condition and on airlines seeking federal assistance and/or concessions from employees. While the amount of executive salaries, bonuses, and long-term incentives sometimes is looked at in isolation, a comparison often is made between the pay package of the typical executive and the typical worker to demonstrate the alleged unfairness of the corporate wage structure. The focus of this report, which will be updated annually, is on the size of average executive and worker pay over the years.

Background

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

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

Most recently, interest has turned to the level of executive compensation at corporations that misstated their financial condition (e.g., Enron). The alleged actions of senior executives at these firms not only harmed shareholders in general but also employees whose pensions largely consisted of stock in their bankrupt companies. Concern also has focused on the compensation of executives at airlines that are seeking federal assistance and/or concessions from their employees in order to avoid bankruptcy (e.g., American Airlines).

Three arguments typically are made on behalf of large executive pay packages: first, their size is commensurate with the job's weighty responsibilities; second, they are necessary to prevent executives from leaving for greener pastures; and third, the comparatively small pool of qualified candidates elevates their compensation levels. It is asserted in response that compensation in the top executive labor market is not set by supply-demand conditions, but rather, is administered by corporate directors (many of whom are current or former executives) who unnecessarily limit the number of candidates they are willing to consider for senior positions.

The Pay of Top Executives and of Other Workers

The magnitude of the gap between top executive and worker pay depends, in part, on how executive compensation is measured and on the makeup of the comparison employee group. Compensation differs if it is reported as a median or average because the latter may be raised by a few large observations. The direct relationship between firm size and executive pay means that a large sample of firms, which is more likely to include smaller firms, typically produces a lower pay estimate than a small sample. Results also vary based on who is surveyed (e.g., chief executive officers or presidents), on what is counted (e.g., whether housing allowances, company cars, and club memberships are included), and on how a value is determined (e.g., the realized value of stock options in the year they are exercised or their estimated value in the year they are granted).

Table 1 presents data on the average compensation of the highest paid executives at 300-400 of the nation's largest publicly held corporations, as reported by *Business Week*; and on the average earnings of non-management employees of firms in the private nonfarm sector of the economy, as reported by the U.S. Bureau of Labor Statistics.

The second half of the 1990s was characterized by very large absolute and percentage gains in the average compensation of senior executives at these large corporations, due to growth in stock-based incentives rather than in the salary-and-bonus component of their pay packages. As the average earnings of non-managerial workers rose to a much smaller extent during the period, the compensation of these executives climbed to over 500 times the wages of most other workers.

As shown in the table, average executive compensation has declined at an accelerating rate thus far in the current decade. This pattern likely reflects the poor performance of the stock market in the past few years and the recent pay-setting actions of some corporate boards of directors. In 2002, top executive compensation fell by one-third, on average, which returned total compensation ($7.4 million) to about its 1997 level. The average compensation of the executives in *Business Week*'s sample had dropped to 282 times that of most workers in the private sector by 2002, or almost the multiple that existed in 1996.

Table 1. Average Top Executive and Worker Pay

	Executive (Exec.) pay			Ratio of worker to executive pay		Percent change (%)		
Year	Salary and bonus (S&B)	Total compensa-tion (TC)	Worker pay	S&B	TC	Exec. S&B	Exec. TC	Worker pay
2002	n.a.	$7,400,000	$26,267	—	1:282	—	-33.0	3.2
2001	n.a.	11,000,000	25,449	—	1:432	—	-16.0	3.1
2000	n.a.	13,100,000	24,685	—	1:531	—	-5.3	3.9
1999	$2,300,000	12,400,000	23,753	1:97	1:522	9.5	16.9	3.3
1998	2,100,000	10,600,000	22,994	1:91	1:461	-4.5	35.9	4.1
1997	2,200,000	7,800,000	22,094	1:100	1:353	-4.3	34.9	4.5
1996	2,300,000	5,781,300	21,144	1:109	1:273	39.1	54.3	3.1
1995	1,653,760	3,746,392	20,506	1:81	1:183	18.2	30.0	2.2
1994	1,399,698	2,880,975	20,065	1:70	1:144	9.8	-25.0	3.3
1993	1,274,893	3,841,273	19,429	1:66	1:198	15.4	0.0	2.8
1992	1,104,769	3,842,247	18,908	1:58	1:203	-1.8	55.8	2.7
1991	1,124,770	2,466,292	18,407	1:61	1:134	7.4	26.3	2.5
1990	1,214,090	1,952,806	17,958	1:68	1:109	3.5	5.2	3.3
1989	1,172,533	1,856,697	17,380	1:67	1:107	3.9	-8.3	3.8
1988	1,128,854	2,025,485	16,745	1:67	1:121	16.9	12.5	3.1
1987	965,617	1,800,000	16,250	1:59	1:111	16.4	50.0	2.5
1986	829,887	1,200,000	15,852	1:52	1:76	22.2	0.0	1.9
1985	679,000	1,200,000	15,553	1:44	1:77	4.0	9.1	2.1
1984	653,000	1,100,000	15,229	1:43	1:72	—	76.0	24.6
1980	n.a.	624,996	12,225	—	1:51	—	13.9	96.2
1970	n.a.	548,787	6,231	—	1:88	—	188.3	48.5
1960	n.a.	190,383	4,195	—	1:45	—	—	—

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

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

n.a. = not available.