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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. A little earlier in the current decade, it focused on the compensation of airline executives 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 senior executives and of employees in general 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 did indeed increase 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. Somewhat earlier in the current decade, concern also focused on the compensation of executives at airlines that sought federal assistance and/or concessions from their employees in order to avoid bankruptcy.

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 senior executives) who unnecessarily limit the number of candidates they are willing to consider for high level 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 establishment survey of the U.S. Bureau of Labor Statistics.

The second half of the 1990s was characterized by very substantial absolute and percentage gains in the average compensation of senior executives at large publicly held corporations. The growth came much more from stock-based incentives rather than from the salary-and-bonus component of pay packages. With the average earnings of production and non-supervisory employees rising to a much smaller extent, the compensation of these executives climbed to over 500 times the paychecks of most other workers by 1999.

The course of average executive compensation has been mixed thus far in the current decade. Average salary, bonus, and long-term incentives initially declined at an accelerating pace between 2000 and 2002. This pattern likely reflects the poor performance of the stock market at the time and the reportedly closer scrutiny given paysetting by some corporate boards of directors. By 2002, top executive compensation had fallen to a level last seen five years earlier: $7.4 million in 1997. The latest year for which data are available, 2003, finds the average compensation of executives in *Business Week*'s sample to have reversed direction — rising to $8.1 million, or 301 times the wages of most workers in the private nonfarm sector. In 2003, the average compensation of senior executives increased at more than four times the rate of production and non-supervisory workers (9.5% and 2.2%, respectively). Part of the divergence in earnings gains probably is related to the improved performance of the stock market, which made it worthwhile for executives to exercise their stock options.

Some have speculated that the double-digit rates of compensation increases consistently posted by senior executives in the mid-to-late 1990s are unlikely to return. Shareholders presumably will not soon forget the extravagance and wrong-doing of some top executives. Corporate directors allegedly are more closely overseeing the compensation packages awarded to senior executives so that they must surpass higher performance thresholds in order to receive stock options. And, options may be giving way to restricted stock grants. Less sanguine observers note, however, that those who set executive pay have been known to be quite creative. For many years now, such "perks" as access to corporate jets for personal use and contributions to home mortgages among other things, have been a growing part of executive compensation.

Table 1. Average Top Executive and Worker Pay

Year	Executive (Exec.) pay		Worker pay	Ratio of worker to executive pay		Percent change (%)		
	Salary and bonus (S&B)	Total compensa-tion (TC)		S&B	TC	Exec. S&B	Exec. TC	Worker pay
2003	n.a.	$8,100,000	$26,903	—	1:301	—	9.5	2.2
2002	n.a.	$7,400,000	26,316	—	1:281	—	-32.7	2.6
2001	n.a.	11,000,000	25,646	—	1:429	—	-16.0	2.7
2000	n.a.	13,100,000	24,981	—	1:524	—	-5.6	3.9
1999	$2,300,000	12,400,000	24,049	1:96	1:516	9.5	16.9	3.2
1998	2,100,000	10,600,000	23,298	1:90	1:455	-4.5	35.9	3.9
1997	2,200,000	7,800,000	22,425	1:98	1:348	-4.3	34.9	4.5
1996	2,300,000	5,781,300	21,462	1:107	1:269	39.1	54.3	3.3
1995	1,653,760	3,746,392	20,776	1:80	1:180	18.2	30.0	2.3
1994	1,399,698	2,880,975	20,318	1:69	1:142	9.8	-25.0	3.3
1993	1,274,893	3,841,273	19,677	1:65	1:195	15.4	0.0	2.9
1992	1,104,769	3,842,247	19,127	1:58	1:201	-1.8	55.8	2.8
1991	1,124,770	2,466,292	18,619	1:60	1:132	7.4	26.3	2.5
1990	1,214,090	1,952,806	18,163	1:67	1:108	3.5	5.2	3.3
1989	1,172,533	1,856,697	17,581	1:67	1:106	3.9	-8.3	3.6

Year	Executive (Exec.) pay		Worker pay	Ratio of worker to executive pay		Percent change (%)		
	Salary and bonus (S&B)	Total compensa-tion (TC)		S&B	TC	Exec. S&B	Exec. TC	Worker pay
1988	1,128,854	2,025,485	16,967	1:67	1:119	16.9	12.5	3.0
1987	965,617	1,800,000	16,474	1:59	1:109	16.4	50.0	2.4
1986	829,887	1,200,000	16,095	1:52	1:75	22.2	0.0	1.6
1985	679,000	1,200,000	15,843	1:43	1:76	4.0	9.1	2.4
1984	653,000	1,100,000	15,478	1:42	1:71	—	76.0	23.6
1980	n.a.	624,996	12,520	—	1:50	—	13.9	91.4
1970	n.a.	548,787	6,542	—	1:84	—	—	—

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.