LAST

Word Are Chief Executive Officers (CEOs) Overpaid?

The Multimillion-Dollar Pay of Major Corporate CEOs Has Drawn Considerable Criticism.

Top executives of U.S. corporations typically receive total annual pay (salary, bonuses, and stock options) in the millions of dollars. As shown in Table 1, each of the top five paid U.S. executives earned $90 million or more in 2008.

CEO pay in the United States is not only exceptionally high relative to the average pay of U.S. managers and workers but also high compared to the CEO pay in other industrial countries. For example, in 2005 the CEO pay at firms with about $500 million in annual sales averaged $2.2 million in the United States, compared to $1.2 million in France and Germany and less than $600,000 in South Korea and Japan.*

Is high CEO pay simply the outcome of labor supply and labor demand, as is the pay for star athletes and entertainers? Does it reflect marginal revenue productivity—that is, the contributions by CEOs to their company's output and revenue?

Observers who answer affirmatively point out that decisions made by the CEOs of large corporations affect the productivity of every employee in the organization. Good decisions enhance productivity throughout the organization and increase revenue; bad decisions reduce productivity and revenue. Only executives who have consistently made good business decisions attain the top positions in large corporations.

TABLE 1 The Five Highest-Paid U.S. CEOs, 2008

Name	Company	Total Pay, Millions
Lawrence Ellison	Oracle	$557
Ray Irani	Occidental Petroleum	223
John Hess	Hess Petroleum	155
Michael Watford	Ultra Petroleum	117
Mark Papa	EOG Resources	90

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Because the supply of these people is highly limited and their marginal revenue productivity is enormous, they command huge salaries and performance bonuses.

Also, some economists note that CEO pay in the United States may be like the prizes professional golfers and tennis players receive for winning tournaments. These high prizes are designed to promote the productivity of all those who aspire to achieve them. In corporations the top prizes go to the winners of the "contests" among managers to attain, at least eventually, the CEO positions. Thus high CEO pay does not derive solely from the CEO's direct productivity. Instead, it may exist because the high pay creates incentives that raise the productivity of scores of other corporate executives who seek to achieve the top position. In this view, high CEO pay remains grounded on high productivity.

Critics of existing CEO pay acknowledge that CEOs deserve substantially higher salaries than ordinary workers or typical managers, but they question pay packages that run into the millions of dollars. They reject the "tournament pay" idea on the grounds that corporations require cooperative team effort by managers and executives, not the type of high-stakes competition promoted by "winner-take-most" pay. They believe that corporations, although owned by their shareholders, are controlled by corporate boards and professional executives. Because many board members are present or past CEOs of other corporations, they often exaggerate CEO importance and, consequently, overpay their own CEOs. These overpayments are at the expense of the firm's stockholders.

In summary, defenders of CEO pay say that high pay is justified by the direct or indirect marginal-revenue contribution of CEOs. Like it or not, CEO pay is market-determined pay. In contrast, critics say that multimillion-dollar CEO pay bears little relationship to marginal revenue productivity and is unfair to ordinary stockholders. It is clear from our discussion that this issue remains unsettled.

**Worldwide Total Remuneration*, 2005–2006 (New York: Towers Perrin, Jan. 11, 2006, p. 20).