Afterwords

Do the Top 1% Deserve Their Pay Packages?—And Why?

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It is difficult not to be sympathetic with the view of the various and varied Occupy movements and with their single common theme that the wealthiest 1% of Americans, and, indeed, the world—as this is not only the single largest mass American movement since protesters effectively forced Lyndon B. Johnson not to seek reelection for the U.S. presidency, but also a movement without national borders—have it all, at least financially speaking, whereas the rest of us have increasingly less.

Libertarians often offer abstract arguments to the effect that massive inequality is a necessary part of free enterprise, that an unequal distribution of talents must necessarily result in an unequal distribution of rewards, and that, in the long run, this very inequality benefits the least well-off. Such arguments might well do in less gut-wrenching times, but in times that "try men's soul's,"[1] to use Thomas Paine's phrase, and where short-run survival is often at issue and *the* issue, these arguments will not only fall on deaf ears, but actually do the conservative-libertarian movement serious and long-lasting damage—as the Tea Party seems to understand in its attempts, at times, to make common cause with the Occupiers. Therefore, and also because these abstract arguments are quite well known, we will steer completely clear of them here, instead concentrating on three arguments that if less tried-and-true are also far more appropriate to the times.

We begin by asking a counterfactual question. What if all Chairmen and CEOs of for-profit corporations were paid no more than $200,000—and by this I mean *in toto*: salary, bonuses, stock options, deferred compensation, retirement contributions, and all other perquisites combined? In short, they would receive absolutely no astronomical pay packages whatsoever. What then? I submit that no sane person would ever agree to take on those jobs. This is not because such jobs require a so-called 24/7 commitment, for the truth is that many minimum-wage workers or near-minimum-wage workers

[1] Thomas Paine, *The American Crisis*, in *The Life and Major Writings of Thomas Paine*, ed. Philip S. Foner (New York: Carol Publishing Group, 1993), chap. I, p. 50.

Reason Papers 35, no. 1 (July 2013): 187-192.

work just as many hours, perhaps more, often at more than one grueling job, than your typical top 1%-er.

There are two rather obvious reasons why, without those astronomical pay packages, people would have to be drafted into the top leadership positions of for-profit corporations. Both, believe it or not, relate to precisely the concerns that motivate the motley Occupy movements. The first requirement of a Chairman or CEO is to do right by his stockholders. This can only be done by meeting the competition head-on. What does this, in turn, require? It all too often requires gut-wrenching business decisions which have nothing *whatsoever* to do with the records of service that employees of the firm have compiled. It means, instead, that if a division is unprofitable and does not appear likely to regain profitability, because the good or service it provides has fallen out of vogue, sometimes merely because of the whims of consumers ("pet rocks" of yesteryear come to mind), then notwithstanding the excellence of perhaps every single employee in the division, it will have to be shuttered, sometimes within one day. It also means that if a division is merely *becoming* unprofitable, although its goods and services are much in demand, because another company produces the same good or service much more inexpensively in parts of the world where business regulations are virtually unknown, competition will force the company's top leaders, once again, either to close the division or, in the alternative, ship it to parts of the world where the results for almost all of its American—or European, for that matter—employees of many years' standing are just the same—namely, the unemployment line.

I aver that no sane Chairman or CEO enjoys making these gut-wrenching business decisions, which have nothing at all to with justice or just deserts, but rather with the product or service being offered or with a merger or acquisition which, however efficient, must necessarily result in layoffs so as to avoid duplication and *be* more efficient. Those astronomical pay packages—the lavish parties, the mansions, the yachts, the private jets, and the like—are there as a salve, a balm, intended to distract their recipients from the suffering they are causing so that they can do what they must do for the company's remote owners—the stockholders—without themselves falling apart.

But there is also another and equally important reason for those astronomical pay packages that should also resonate with those supportive of the restive Occupy movements. While considerable scrutiny of the business practices of publicly traded corporations is not only reasonable but mandatory, given the ubiquitous urge of those entrusted with the capital of (very) remote owners to defraud those very owners (a problem known as "the agency problem" in brief, and "the agent-principal problem" in full), the similar scrutiny applied to the personal lives of corporate titans is utterly unwarranted and yet just as pervasive. This sort of intrusiveness by the press, the paparazzi, and increasingly the public-at-large via the Internet would simply not be tolerated for anything like the $200,000 total annual pay package posited at the start of this piece. Again, something is needed to distract the corporate titans from the unwanted, unwarranted, and intrusive attention they are wont to attract. This is the second purpose they are, and need to be, allowed their lavish parties, mansions, yachts, and private jets.

Take all of this away, and no one will wish to serve at company helms—and large corporations will die. Does this matter to the modern economy? Indeed, it does. Here's why. It *is* true that most new jobs originate from small businesses, most enterprises altogether are small, and that these drive the economy—but it is always the hope of the owners to go big, and perhaps even to go public with an initial public offering (IPO). Furthermore, even small enterprises rely heavily on larger suppliers and large communications, computer, and transportation networks. Finally, the chain and franchise are critical parts of the American economic landscape, the former because it is generally less expensive for consumers, the latter because although one cannot take one's franchise outlets public, one *can* become quite well off, as one franchise owner explained to me, by competing with himself rather than others and owning multiple franchise outlets in the same general area. Thus, the large, publicly traded corporation in all of its varieties is a critical feature of the economy. Take them all away and we'll be back to a subsistence economy in which only family farms, very small outfits which rely on only small-scale local production, and small craftsmen and artisans can survive—as in medieval times. Even the run-of-the-mill small business in today's economy must have the communications, computer, and transportation networks that have largely evolved privately; the same goes for power sources, but these are not usually private. At any rate, reversion to the subsistence economy of medieval times is not a very attractive prospect, to say the least. It may *seem* "romantic," but neither Americans nor Europeans are too happy when communication, power, and computer lines go down and transportation becomes almost impossible, as has happened in many of the natural disasters that beset various parts of the more-industrialized world during the early twenty-first century.

Finally, it is essential to revisit a third reason for those pay packages only adumbrated thus far: the agency problem. The agency problem exists everywhere—from the small shop where, on occasion, the manager acts contrary to the wishes, and sometimes the interests, of the principal, the owner, to large, publicly traded firms, where the top executives all too often sell out their stockholders for their own interests. As stockholders are very remote from the scene, owners *in absentia*, structuring the pay package of top executives appropriately is key. The trouble, of course, is that, in the words of John Marshall, "human nature, black as it is"[2] (or, at least, can be), nothing will truly work. Pay top executives a straight salary, and there is simply no incentive to keep stock prices high. Pay them with stock options and there is plenty of incentive to artificially, that is, by *artifice*, inflate stock prices. Pay

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[2] John Marshall, "The Virginia Ratifying Convention," in *The Debate on the Constitution, Part Two* (New York: Library of America, 1993), p. 740.

them with bonuses and there are both this last incentive and no incentive in bad times to make gut-wrenching decisions. Pay bonuses in bad times, too, though, and the disadvantages of a straight salary reappear. As there is no real solution to the agency problem, that is, to the defects of human nature this side of the Redemption, nothing truly works and large firms must simply settle for some combination of the above forms of incentive, and others besides, to compensate their top executives. Even so, many of them end up doing time in penal institutions, some for serious crimes they really did do and for which they simply must be held accountable. When temptations are ubiquitous and are coupled with the not inconsiderable threat of long terms in the federal penitentiary system, one has yet a third reason for those astronomical pay packages.

Thus far, we discussed only corporate moguls, giving at first two, and ultimately three, reasons for their outsized pay packages: the need for gut-wrenching business decisions which have nothing whatsoever to do with any conception of just deserts, the continual intrusion on their personal lives which has nothing to do with how ably they perform their fiduciary duties, and "the agency problem."

Do these arguments apply to others in the top one percent—some there with extraordinary levels of compensation and some without? We will now examine celebrities, CEOs or Executive Directors of not-for-profit organizations, and high elected or appointed political figures. However, we will consider not only these three arguments, but also one contrary one.

First, let us examine celebrities. While they don't face the need to lay off many people at a pin drop and there is no agency problem, they face not continual but continuous intrusion on their personal lives. It is common to say that celebrities feel "entitled" and thus often act badly—"train wrecks," in the common parlance. Maybe sometimes, but, on the whole, I don't buy into this myth. Rather, just as relationships (normally, but by no means always, illicit) do not flourish properly underground, they also cannot flourish under that strange combination of microscope and telescope to which celebrity relationships are routinely subjected. In other words, the media, both "professional" and lay in the Internet age, are in large part responsible for *creating* "train wrecks" by their obsessional focus on the few performers and athletes who make it big. I put the word "professional" in scare quotation marks, because pandering is anything but constructive and professional; it is destructive and unprofessional. Celebrities, then, we would argue deserve their outsized pay packages not merely because of their outsized talents, but also both as compensation for the scrutiny and for the nearly inevitable toll it takes on their personal lives.

Second, let us examine heads of not-for-profit organizations. In an interesting article, Karen Selick argues, "There's no such thing as a nonprofit organization."[3] She points out that "every single employee of a nonprofit

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[3] Karen Selick, "There's No Such Thing as a Nonprofit Organization," *Ideas on Liberty* (June 2003), pp. 35-37.

institution is actually a 'profit center' in himself."[4] The evidence she adduces for her argument that nonprofit enterprises are, in reality, run for the benefit of their employees—the rhetoric to the contrary notwithstanding—is impressive. In a table taken from the January 2002 issue of the *Fraser Forum*, there is a comparison of the wages of employees in thirteen job classifications in Canada's hospital sector (unionized, but nonprofit) and hotel sector (unionized, but for-profit). The wages of the hospital workers ranged from 9% to 39% higher, with a median premium of 17%. As Selick is quick to point out, not one of the hospital job classifications required *any* specific medical knowledge. All of them were rather ordinary blue-collar and white-collar jobs. In view of this evidence—carefully indicated in the distinction between the vernacular term "nonprofit" and the correct, legal term "not-for-profit," the latter indicating *purpose* with the former merely indicating putative *function*—and the near-total absence of scrutiny of the personal lives of those who run these enterprises (with the exception of politicians who double-dip), the sole remaining argument is "the agency problem." While there is certainly an agency problem for tax-exempt institutions which receive tax-deductible contributions, there are ways for donors to ensure that their funding is used wisely, as I have discussed at length elsewhere.[5] In any event, and again with the exception of politicians who double-dip, whatever agency problem remains hardly ever results in substantial prison sentences, probably because the amounts of money at issue are relatively small. Thus, they do *not* deserve the high pay packages that they typically do not get.

Finally, let us examine political officials. While high elected and appointed political officials face extraordinarily harsh scrutiny and there is most certainly an agency problem when they act contrary to the wishes, and often the interests, of those they represent, and while a good number of elected politicians and a small number of appointed officials end up indicted, tried, convicted, and sentenced for good cause, none of this persuades me that their pay packages ought to be raised. On the contrary, they ought to be reduced at the federal level to the average that can be obtained from a study of comparable offices of the several states, so that as with the states, many of these jobs become effectively part-time. Not all conservatives with an oftentimes libertarian bent agree. Listen to one eminent dissenter, who says, "Because a well-ordered polity is a prerequisite for . . . excellence, the political vocation is good and the estate of government is grand,"[6] and "[the United States] should express renewed appreciation for the ennobling

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[4] Ibid., p. 35.

[5] Joseph S. Fulda, "In Defense of Charity and Philanthropy," *Business and Society Review* 104, no. 2 (Summer 1999), pp. 179-189; see esp. p. 188, nn. 14 and 15.

[6] George F. Will, *Statecraft As Soulcraft* (New York: Simon and Schuster, 1983), p. 27.

functions of government."[7] The writer, the lone commentator who normally remains above the rough-and-tumble of the political fray and concentrates largely on ideas, is George F. Will, who intends in his work at issue to make an extensive case for "a reassertion of the grandeur of politics."[8]

I would imagine that Will might find the absolutely incredible perquisites of the United States Congress justified, at least were that body to act with the deliberate care for which he makes an extensive argument. To which this author responds, simply, "But it won't."

Another two points can also be made. First, although neither elected nor appointed officials have outsized pay packages while serving in office, the so-called "revolving door" by which former officials become lobbyists or "of counsel" to prestigious law firms or collect big on the lecture circuit after serving in office, compensates them more than adequately for the scrutiny, intrusiveness, and risk of prosecution they face—as they see it. There is certainly a grave shortage of statesmen, but no shortage of aspirants for political office. This last point leads me to the second point I wish to add, namely, that the revolving-door situation is unhealthy for the body politic. The best way to ensure *de facto* term limits, since *de jure* term limits are about as unlikely as can be, is to keep those salaries *very* low and the jobs *part-time*.

As it is, the United States Senate, to take one example, has been called a "rich man's club"; increasing salaries will only increase the already formidable advantages of incumbency. Of course, it is not wealth *per se* that is objectionable. What makes the matter problematic is that the free-enterprise system is *not particularly good for already wealthy individuals*; rather, it is best for those who *aspire* to become wealthy, the small entrepreneurs who, as previously noted, drive the economy. This explains, in part, why so many billionaires oppose measures that they once might well have supported, but which now threaten their standing.

[7] Ibid., p. 24.

[8] Ibid., p. 26.