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DO CEOS GET PAID TOO MUCH?

Jeffrey Moriarty

Abstract: In 2003, CEOs of the 365 largest U.S. corporations were paid on average $8 million, 301 times as much as factory workers. This paper asks whether CEOs get paid too much. Appealing to widely recognized moral values, I distinguish three views of justice in wages: the agreement view, the desert view, and the utility view. I argue that, no matter which view is correct, CEOs get paid too much. I conclude by offering two ways CEO pay might be reduced.

America's corporate executives get paid huge sums of money. *Business Week* estimates that, in 2003, CEOs of the 365 largest U.S. corporations were paid on average $8 million, 301 times as much as factory workers (Lavelle 2004).[1] CEOs' pay packages, including salary, bonus, and restricted stock and stock option grants, increased by 340 percent from 1991 to 2001, while workers' paychecks increased by only 36 percent (Byrne 2002). What, if anything, is wrong with this?

Although it has received a great deal of attention in management and economics journals and in the popular press, the topic of executive compensation has been virtually ignored by philosophers. It should not be. Moral theorists of all stripes have a stake in the debate. Egalitarians should be concerned by the size of the disparity between CEO and worker pay. Libertarians should wonder whether owners freely agree to pay their CEOs $8 million per year.

This paper attempts to advance the philosophical discussion of executive compensation. I will focus on the pay of CEOs, but many of my arguments apply, other things equal, to the pay of other top executives. Organizational theorists and economists tend to be more interested in what the determinants of CEO pay are than in what they should be. The normative insights they have offered are at best pieces of a larger puzzle. What is needed, I suggest, is an ethical framework for thinking about justice in pay. After elaborating this framework, I will argue that CEOs get paid too much.

This conclusion will be unsurprising to many laypersons—perhaps to many philosophers as well. It seems to be a minority position among CEOs and economists (Lazear 1995; Murphy 1986; Rosen 1986), however, and for this reason it is worth defending. Moreover, agreement *that* CEOs get paid too much may conceal disagreement about *why* they do. What I have to say about the "why" question is relevant to theories of justice in wages in general.

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Three Views of Justice in Wages

To decide whether CEOs make too much money, we first need to consider what, in general, makes a wage just.[2] In this section I will sketch three views of justice in wages, each of which is based on a widely recognized moral value. I do not claim that these are the only views of justice in wages possible. But the values from which they derive are the ones most frequently appealed to in the debates about CEO pay. It is unlikely that any other view would be as attractive.

According to what I will call the "agreement view," just prices for goods are obtained through arm's-length negotiations between informed buyers and informed sellers (Crystal 1991). In our case, the good is the CEO's services, the seller is the CEO, and the buyer(s) is (are) the company's owner(s). Provided there are no imperfections (e.g., fraud, coercion) in the bargaining process, the agreement view says, the wage that comes out of it is just. Owners are free to do what they want with their money, and CEOs are free to do what they want with their services.

The "desert view" appeals to independent standards for justice in wages. It says that people deserve certain wages for performing certain jobs, whatever they might agree to accept for performing them. The wages people deserve may depend on facts about their jobs (e.g., their difficulty or degree of responsibility), people's performances in them (e.g., how much effort they expend, how much they contribute to the firm), or both. According to the desert view, the CEO should be paid $8 million per year if and only if he deserves to be paid $8 million per year.

What I will call the "utility view" conceives of wages not as rewards for past work, but as incentives for future work. The purpose of wages on this view is to maximize firm wealth by attracting, retaining, and motivating talented workers.[3] If, in our case, the CEO's position is not compensated adequately, few talented candidates will apply or remain on the job for long, and the company as a whole will suffer. On the other hand, an expensive CEO can easily earn his keep through even small increases in the price of the company's stock. According to the utility view, then, a compensation package of $8 million per year is just if and only if it maximizes firm wealth by attracting, retaining, and optimally motivating a talented CEO.[4]

Too often in discussions of executive compensation the separateness of these views is overlooked. But if we do not distinguish among them, we run the risk of talking past each other. Person P's belief that CEOs do not deserve, by any standard of deservingness, $8 million per year may lead him to the conclusion that CEOs make too much money. Person Q's belief that the pay negotiations between CEOs and owners are fair may lead him to conclusion that CEOs do not make too much money. In fact, both P and Q may agree that CEOs do not deserve $8 million per year and that the pay negotiations between CEOs and owners are fair. They may simply disagree about what is morally more important: deserts or agreements. Understanding this, of course, does not solve the debate. But it does help to clarify what it might be about.

To solve the debate about CEO pay, we must determine which view of justice in wages is correct. Neoclassical economic theory predicts that agreement-theorists, desert-theorists, and utility-theorists will all come to the same conclusion about how

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much CEOs (and other workers) should be paid (Schweickart 1996).[5] But this is unlikely to occur in the real world, for reasons given below. Even if it did, this question would still be worth pursuing. We want to know not only how much CEOs (and other workers) should be paid, but why they should be paid that much.

I will not pursue this question here. There is deep disagreement about the relative importance of agreements, deserts, and utility. A full defense of one of these values against the others is beyond the scope of this paper. Fortunately, it is not necessary to determine which view of justice in wages is correct to draw *any* conclusions about CEO pay. Below I will argue that its current level cannot be justified by the agreement view, the desert view, or the utility view. No matter which one is correct, CEOs get paid too much. It is possible, as I indicated, that new theories of justice in wages will be developed. But the theories we have sketched are based on the most common moral values, and it is not at all clear what these new theories would look like. Until it is, we have good reason to believe that the current level of CEO pay cannot be justified *simpliciter*. I will consider the views in order, beginning with the agreement view.[6]

The Agreement View

According to this view, a just price for the CEO's services is one that results from an arm's-length negotiation between an informed CEO and informed owners. I will show that these negotiations are not, in general, conducted at arm's-length. If they were, CEOs would be paid on average less than $8 million per year.

The problem occurs mainly on the "buy" side of the equation, so we will focus our attention there. Since there are potentially tens of thousands of shareholders, there are potentially tens of thousands of buyers of the CEO's services. This many people cannot effectively participate in negotiations with the CEO. Shareholders need representatives. The agreement view tells us that, to be legitimate, the representatives must meet two conditions. First, they must be independent of the CEO (the "arm's-length" condition). If they have something to gain from advancing the CEO's interests, they are likely to pay too much for his services. Second, they must be informed (the "informed buyer" condition). If they do not know what kind of talent it takes to run their firm, and how rare that talent is, they are liable either to overpay a mediocre CEO or to underpay an exceptional one.

It might be wondered whether shareholders' representatives must be selected in a particular way to be legitimate. There are, I believe, good reasons to allow shareholders to elect their own representatives. First, shareholders own the company; the CEO is being paid with their money. Second, representatives who can be voted out of office by shareholders have a stronger incentive to be responsive to their interests than representatives who cannot. But this is not a requirement of the agreement view of justice in wages. On this view, as long as shareholders' representatives are independent and informed, and the negotiations they engage in with the CEO are otherwise fair, the wage agreements they reach will be just.

Traditionally, shareholders are represented in negotiations with the CEO by a subset of the members of the company's board of directors. This may seem promising

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to those who appeal to the agreement view to justify the current level of CEO pay. Since directors are usually elected by shareholders, they might say, it is likely that the directors who negotiate with the CEO—those who form the board's "compensation committee"—are in fact independent and informed. If shareholders did not elect independent and informed directors, they would risk paying too much to an incompetent CEO, or too little to an exceptional one.

This hope is unfounded. First, there is no guarantee that shareholders would choose independent and informed representatives in a democratic election. Although parties who own large amounts of stock might be motivated to determine which of the candidates is independent and informed, many will not. Voters who do not familiarize themselves with the candidates have little chance of picking the right ones. Second, and more importantly, shareholders do not as a matter of fact elect directors in any meaningful way. When a seat on the board opens up, usually there is just one person who "runs" in the "election." Once a candidate is nominated, her election is a formality. What matters, then, is the nomination process. The group that controls it control the board's membership. But in most cases this is not the shareholders but the board itself, whose chairman in 84 percent of American firms is the firm's CEO (Nichols and Subramanian 2001; Shivdasani and Yermack 1999). Although there has been a trend away from direct CEO involvement in the nominating process in recent years (Shivdasani and Yermack 1999), most CEOs still wield considerable informal influence over it (Main, O'Reilly, and Wade 1995; O'Reilly, Main, and Crystal 1988).

This is worrisome. Whereas shareholders may elect, out of apathy or ignorance, directors who are unfamiliar with the industry and friendly with the CEO, CEOs can encourage the appointment of such directors. Do they? The fact that CEOs who are appointed *before* the appointment of their compensation committee chairs are paid more, on average, than CEOs who are appointed *after* suggests that they do (Main, O'Reilly, and Wade 1995). Examining the composition of boards of directors more carefully, we see that, in general, directors may be informed, but they are not independent.

Three factors compromise directors' independence from their CEOs. The first is gratitude. The board member's job is prestigious, lucrative, and undemanding. Directors of the 200 largest American corporations receive on average $179,000 for twenty days of work per year (Jaffe 2003; Schellhardt 1999). They may also be given life and medical insurance, retirement benefits, and the use of company property such as automobiles and vacation homes (Main, O'Reilly, and Wade 1995). In addition, there is the considerable "social capital" directors acquire in the form of connections with influential people. Thus getting an appointment to a board is like getting a large gift. This is problematic, for it is natural for gift-recipients to feel grateful to gift-givers. The larger the gift is, the more grateful, and more inclined to "return the favor," the gift-recipient will be. Since CEOs have a great deal of influence over who gets appointed to the board, the directors will feel grateful to him. To represent properly shareholders' interests, then, they will have to fight against this feeling (Crystal 1991; Nichols and Subramanian 2001).[7] There is reason to believe they have not been successful. Recent research shows a positive correlation between director and CEO pay (Boyd 1994).[8]

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Self-interest is the second factor compromising the independence of directors in pay negotiations with CEOs. To determine how much to pay their CEO, the board will usually find out how much CEOs of comparable firms are being paid (Porac, Wade, and Pollock 1999). The more those CEOs make, the more the board will pay their CEO (Ezzamel and Watson 1998; O'Reilly, Main, and Crystal 1988). The problem is that many boards have members who are CEOs of comparable firms (Kesner 1988; Main, O'Reilly, and Wade 1995; O'Reilly, Main, and Crystal 1988).[9] This is good from the point of view of having knowledgeable directors. But CEO-directors have a self-interested reason to increase the pay of the CEO with whom they are negotiating. Suppose CEO A sits on CEO B's board, and A and B run comparable firms. The more pay A agrees to give to B, the more pay A himself will later receive. For when it comes time to determine A's pay package, B's pay package will be used as one of the reference points.

The third factor is not a reason directors have to favor CEOs; it is the absence of a reason directors should have to favor shareholders. Since they are paying with their own money, shareholders have a powerful incentive not to overpay the CEO. The more they pay the CEO, the less they have for themselves. Directors, by contrast, are not paying with their own money. Although they are often given shares in the company as compensation, directors are rarely required to buy them (Daily and Dalton 2003; Hambrick and Jackson 2000). So their incentive not to overpay the CEO is less powerful. It might be wondered whether shareholders can make it more powerful by threatening to recall overly generous directors. They cannot. Shareholders in most firms lack this power. In fact, not only will directors have nothing to fear if they *do* overpay the CEO, they will have something to fear if they *do not*. Shareholders cannot recall generous directors, but CEOs can use their power to force them out.

While admitting that these influences are problematic, it might be objected that they compromise the independence of directors only if directors are "on their own" in negotiations with CEOs. But they are not. Directors are usually assisted by compensation consultants who can make accurate and bias-free assessments of a CEO's worth. On this view, provided that the board acts on the consultant's recommendation, the wage it agrees to pay the CEO will be just.

This objection fails. The reason, according to the agreement view, the pay agreements between CEOs and shareholders' representatives are unfair is that the latter group is not sufficiently independent of the former. But compensation consultants are hired to make sure boards are *informed*, not to make sure they are *independent*. Consultants can offer directors a variety of facts about CEO pay, and this will help them to avoid making obviously bad deals with the CEO. But, because of gratitude, self-interest, and lack of financial penalties, boards will still give CEOs a substantial benefit of the doubt when it comes to pay.[10]

Let me sum up. According to the agreement view, a wage of $8 million per year is just if and only if it results from an arm's-length negotiation between an informed CEO and an informed group of owners. We argued that these negotiations are not, in general, conducted at arm's-length. Because the independence condition is violated in a way that favors CEOs, we can be confident that, if they were, CEOs would be

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paid on average less than $8 million per year.[11] This is not to say that, in fair negotiations, all CEOs would be paid less than $8 million per year. A few might be paid this much or more. But in fair negotiations the pay of *most* CEOs would be less, and so *average* CEO pay would be less. Speculation about how much less, however, would be premature. A different view of justice in wages may be correct, and it may justify the current level of CEO pay. In the next section I will examine the desert view.

The Desert View

A familiar complaint about CEO pay—that it has increased in years when firms have performed badly—is grounded in the desert view of justice in wages.[12] This complaint assumes that a CEO should get the wage he deserves, that the wage a CEO deserves is determined by his contribution to the firm, and that the proper measure of contribution is firm performance. If the firm performs worse in year two than in year one, the argument goes, the CEO deserves to make less, and therefore should make less, in year two than in year one. The agreement and utility views of justice in wages cannot account, except indirectly, for this intuition.[13]

Two Problems

To determine whether CEOs deserve to make $8 million per year, we must formulate, at least in part, a theory of desert of wages. Let us begin by discussing two of the problems we will face.

The first is identifying the standard(s) for deservingness. One cannot be deserving for no reason at all; there must be some reason for, or basis of, that desert (Feinberg 1970; Feldman 1995). Economists sometimes write as if it were obvious that CEO pay, and pay generally, should be based on contribution, as measured by firm performance (Abowd and Kaplan 1999; Baker, Jensen, and Murphy 1988; Jensen and Murphy 1990). This is far from clear. Philosophers have written extensively on the nature of desert, and have offered a variety of possible desert-bases for pay, including (i) the physical effort exerted by the worker (Sadurski 1985), (ii) his contribution to the firm (Feinberg 1973; Miller 1989, 1999), (iii) the amount of ability, skill, or training his job requires (Nagel 1979), (iv) its difficulty, stress, dangerousness, risk, or unpleasantness (Dick 1975; Feinberg 1970; Sher 1987), and (v) its degree of responsibility or importance (Soltan 1987).[14] Some think a person's desert of pay is determined by only one of these factors (Miller 1989, 1999); others think it is determined by a combination of them (McLeod 1996; Young 1992).

How does the CEO's job fare? Compared to the jobs of ditch diggers and coal miners, it requires (i) relatively little physical effort. It is not unpleasant or dangerous in the way these jobs are, but it can be (iv) a considerable source of stress. Some writers suggest that CEOs are more prone to stress-related illness and burnout than average workers (Seymour 2002). According to one study (Kudo, Tachikawa, and Suzuki 1988), CEOs work on average thirteen hours per day, including time spent traveling to meetings. The CEO's job is also difficult in the sense that it requires the performance of a variety of complex tasks, such as negotiating deals, processing

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information, and meeting with subordinates and clients in leadership and ceremonial roles (Keiser 2004; Mintzberg 1990). The fact that CEOs wield significant power within already powerful organizations means that their jobs have (v) high degrees of responsibility. Decisions they make about budgets, personnel, and plant (re)location can affect thousands of people's lives. For the same reason, CEOs are in a position to make (ii) large contributions to their firms. What does it take to perform this job? Most CEOs have (iii) some formal education and many years of experience. Over 90 percent have college degrees; 50 percent hold advanced degrees. Of those who hold advanced degrees, 68 percent hold an MBA. The average CEO is fifty-three years old, and worked for his firm for thirteen years before becoming CEO (Bhargava 1993; Keiser 2004). We see, then, that the CEO's job rates highly in some categories but not in others. So, depending on how the first problem is solved, we will get different answers to the question of how much CEOs deserve to be paid.

The second problem is connected to the first. Once we identify the base(s) for desert of wages, we must find a way of matching desert levels to pay levels (Nichols and Subramanian 2001). In other words, after determining what makes a person deserving, and how deserving he is, we have to decide what he deserves. Suppose effort is the basis of desert, and suppose the CEO works 3000 hours in a year. How much does he deserve to be paid: $300,000 or $3 million? Or suppose contribution is the basis of desert, and suppose the firm's profits increase 20 percent in a year. We might think the CEO deserves a 20 percent raise. But what should his initial salary have been?[15] Without a way of matching desert levels to pay levels, we have no way of answering this question.[16]

This difficulty can be used to cast doubt on some of the traditional evidence that CEOs are overpaid. Consider again the complaint that CEO pay has risen while stock prices have fallen. Suppose the drop in a company's stock price is due directly to a decline in its CEO's performance. The fact that the CEO is contributing less now to his company than before does not mean that he is being paid too much now. It may mean that he was being paid too little before. Or consider the complaint that American CEOs make several times more than their foreign counterparts—roughly twenty-two times more than Japanese CEOs and six times more than British CEOs (Conyon and Murphy 2000; Wahlgren 2001). A skeptic may say that British and Japanese CEOs make too little, not that American CEOs make too much. Again, if we cannot map desert-creating behavior onto pay, we cannot say for sure exactly how much CEOs deserve to be paid.

To develop a complete theory of desert of wages, both of these problems must be confronted. For our purposes, however, both can be avoided. The first questions our ability to identify the base(s) of desert. In response, I will argue that CEOs get paid too much money no matter which of the proposed desert-bases is legitimate. The second questions our ability to identify what it is exactly that people deserve. In response, I will argue that, however much money CEOs deserve to make absolutely, they do not deserve to make 301 times as much as their employees. Given that their employees make on average $27,000 per year, CEOs do not deserve to make on average $8 million per year. CEOs are not 301 times as deserving as their employees.[17]

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Why CEOs Deserve Less Than They Get

Most of those who endorse the desert view of justice in wages think that the sole desert-base for wages is productive contribution. Let us begin with this view. We will consider other desert-bases below.

Under the assumption that contribution is the sole desert-base for pay, the CEO deserves to be paid 301 times what the average employee is paid if and only if his contribution to the firm is 301 times as valuable as the employee's. For every $1 in revenue the employee generates, the CEO must generate $301. To appreciate this idea, it may be helpful to think about it in another way. Suppose a manufacturing company M has 10,000 employees, 9,999 of whom engage in the (identical) assembly-line work that generates its products. And suppose in one year M generates $1 billion in revenue. For M's CEO to deserve 301 times the pay of M's average assembly-line worker, he must generate $29.2 million in revenue compared to the worker's $97,100. If we imagine, more realistically, that M employs not only assembly-line workers and a CEO but also several middle managers, the result is not too different. If each of 100 middle managers generates $500,000 in revenue, the CEO must generate $27.8 million in revenue compared to the worker's $92,200.[18] Does this happen?

Some will deny that this question can be answered. They will say that employees are not Robinson Crusoes, each at work on their own self-contained projects. Many people work together on the same projects, and as a result, it is difficult or impossible to tell where one person's contribution ends and another's begins (Anderson 1999; Goodin 1985; Scheffler 2000).

This is not, of course, an objection that will be advanced by those who appeal to this version of the desert view to justify the current level of CEO pay. They need a way of accurately measuring contribution. If the stronger form of this objection is true, however, and we cannot tell how much each employee contributes to the firm, then we cannot tell how much each deserves to be paid. So this conclusion is not unwelcome from the point of view of this paper. But it is weak. A thoroughgoing skepticism about the accuracy of contribution measurements yields the conclusion that we *cannot tell* whether CEOs deserve to make 301 times as much as their employees, not that they *do not* deserve to make this much. As far as this view is concerned, CEOs may deserve to make *more* than 301 times as much as their employees.

This kind of skepticism about the accuracy of contribution measurements is, I believe, unwarranted. Although it may be impossible to determine exactly how much each employee contributes to the firm, rough estimates are possible. This applies as much to assembly-line workers as it does to upper-level executives. Just as it is possible for managers to tell roughly how effective their employees are, it is possible for boards of directors to tell roughly how effective their CEOs are.

What do these estimates tell us? If we go by what is in the popular press, we will conclude that CEOs' contributions are at least 301 times as valuable as their employees'. The CEOs of successful corporations are glorified in news stories and biographies. Witness, for example, the flurry of books written by and about Jack Welch, the former chief executive of General Electric. Recent books refer to entrepreneurs such as Henry

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Ford and Sam Walton as "giants" and "masters" of enterprise, and describe the firms they founded as "the empires they built" (Brand 1999; Tedlow 2001). If, as these titles suggest, one person can be solely responsible for the creation of a multi-billion dollar business, it may seem to follow that CEOs—even ones of average talent—generate at least 301 times as much revenue for their firms as their employees.

This is too quick. In the first place, we must distinguish the question of justice in pay for hired CEOs from the question of justice in pay for CEOs who are also firm founders and owners.[19] Our inquiry is limited to the former question. It is possible that CEOs who are also firm founders and owners, such as Ford and Walton, make contributions to their firms that are more than 301 times as valuable as those of their employees. They may deserve extremely high pay. But this, I suggest, is because of their role as firm founders and owners. For when we look beyond the popular accounts, a different picture of (hired) CEO importance emerges.

To be sure, some scholars endorse the popular view, namely, that CEOs' performances matter greatly to their firms (Kotter 1988; Shamir, House, and Arthur 1993; Smith, Carson, and Alexander 1984; Weiner and Mahoney 1981). But an increasing number reject it (Carroll and Hannan 2000; Hannan and Freeman 1989; Lieberson and O'Connor 1972; Pfeffer and Salancik 1978).[20] Summarizing the current state of the debate, Rakesh Khurana says the "overall evidence" points to "at best a contingent and relatively minor cause-and-effect relationship between CEOs and firm performance" (2002: 23). He explains: "a variety of internal and external constraints inhibit CEOs' abilities to affect firm performance . . . [including] internal politics, previous investments in fixed assets and particular markets, organizational norms, and external forces such as competitive pressures and barriers to exit and entry" (2002: 22). It cannot be denied that CEOs' decisions at times make a difference to firm performance. These leaders may deserve bonuses for strategic thinking. But, if Khurana and others are right, these cases are exceptions to the rule. Factors outside of the CEO's control normally "contribute" more to the firm's success than the CEO does.[21]

Some will reject the research on which this result is founded. Others will point out that it is compatible with the claim that CEOs contribute 301 times as much to their firms as their employees. The "cause-and-effect relationship between CEOs and firm performance," though "minor," may still dwarf the cause-and-effect relationship between workers and firm performance, if, say, workers' contributions are much smaller than we imagine. These claims are not irrational. No theorist is willing to say exactly how much, compared to the average employee, the average CEO contributes. But they are difficult to maintain. There is mounting evidence that CEOs are not as important as they were once thought to be, and average employees are far from useless. These considerations license a *tentative* conclusion that the average CEO's contribution is less than 301 times as valuable as the average employee's contribution, and hence that, under the assumption that the sole desert-base for pay is contribution, the CEO deserves to be paid less than 301 times what the average employee is paid.

We have not argued that *no* version of the desert view can be used to justify the current disparity between CEO and worker pay. There are other desert-bases to con-

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sider. It takes only a moment to see, however, that none of these desert-bases succeeds where this one fails.

Consider first physical effort. The job of the CEO requires less physical effort than many other jobs in the firm. So a desert view according to which effort is the sole desert-base for pay will not support the claim that the CEO deserves to be paid 301 times what the average worker is paid.

Consider next skill and difficulty. The average CEO is a highly skilled individual; his job requires the performance of complex tasks and can be a source of considerable stress. But is the CEO 301 times as skilled as the average employee? Is his job 301 times as difficult and stressful? The answer to these questions is no. Some may doubt this, perhaps because they have a very low opinion of most people's jobs. Consider, then, the job of a scientist in the company's research and development department. The scientist might be paid $150,000 per year—1/53 the pay of the CEO. For the CEO to deserve to make $8 million per year while the scientist makes $150,000 per year, the CEO would have to be 53 times as skilled, perform tasks 53 times as difficult, or feel 53 times as much stress as the scientist. This is not the case. Often the scientist will be more skilled, and will perform more difficult tasks than the CEO.[22] And the jobs of CEOs are not the only stressful jobs. According to one study (Raizel 2003), 25 percent of all employees report experiencing a "great deal" of stress of work.

The final possible desert-base is degree of responsibility. Initially, this may seem attractive to the defender of the status quo, for CEOs' decisions can affect the lives of thousands of people both inside and outside the firm. But it will not work either. The decisions of lower-level workers can be equally important. Had the Exxon Valdez's captain stayed sober, millions of gallons of oil might not have been spilled into the sea. Had a few maintenance personnel in Bhopal taken countermeasures instead of running from the scene, thousands might not have died. Some of the decisions of airplane pilots, bus drivers, and engineers can have as much riding on them as the decisions of the CEOs who run their companies.

It might be replied that CEOs make a larger number of important decisions than lower-level workers. More controversially, it might be claimed that CEOs are responsible not only for their own actions but for the actions of their subordinates, so that, e.g., the CEO of the airline company is just as responsible for the plane crash as the pilot. Even if we accept these claims, in light of how important subordinates' jobs can be, it is unreasonable to conclude that CEOs' jobs are hundreds of times more so. Using degree of responsibility as the sole desert-base for pay, then, will not justify the extent to which CEOs currently out-earn their employees.[23]

We have assumed thus far that there is only one desert-base for pay. But recall that some writers think there is more than one (McLeod 1996; Young 1992). Desert of pay might be determined not, e.g., by contribution alone, but by a combination of contribution, skill, and difficulty. This possibility might be used to construct a desert-based defense of the current level of CEO pay. Suppose the CEO's contribution is nine times as large as the average worker's, that he is nine times as skilled, and that his job is nine times as difficult. It might be claimed that, if this is so, the CEO deserves

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to be paid 9 x 9 x 9 = 729 times as much as the worker. According to this argument, CEO pay is actually too low, not too high.

The claim that the CEO is nine times as deserving as the average worker in each of these respects is plausible. But the above method for determining a person's total desert-level is not. Intuitively, the right math to perform, if there is more than one desert-base for pay, is to calculate each worker's total desert-level based on all the relevant criteria—in our example, contribution + skill + difficulty—and then to compare those (total) levels. Suppose we give the employee a score of 1 + 1 + 1 = 3. If the CEO is nine times more deserving in each of these categories, he will receive a score of 9 + 9 + 9 = 27. Given these assumptions, the CEO deserves to be paid 27 ÷ 3 = 9 times what the employee is paid.

So far we have been comparing the pay of CEOs to the pay of lower-level employees within their firms. Additional evidence that CEOs do not deserve, by any standard of deservingness, to be paid $8 million per year is found by comparing their pay to the pay of professionals in other fields. The average CEO makes roughly 53 times what a medical doctor, a military general, or a federal district court judge makes (Bureau of Labor Statistics 2004). But he is not 53 times as deserving as them. These jobs require similar amounts of physical effort. They all require extensive training, are difficult to perform, and have a high degree of responsibility. And the people who perform them are in a position to make significant contributions to their organizations as well as to society as a whole. Thus we can believe either that medical doctors, military generals, and federal judges get paid far less than they deserve, or that CEOs get paid far more. The latter belief is more plausible.

I conclude—in the case of contribution, tentatively—that there is no standard of deservingness according to which CEOs deserve to make 301 times as much as their employees. If I am right, the desert view of justice in wages condemns the current disparity between CEO and employee pay. I did not argue that CEOs do not deserve to make $8 million per year *simpliciter*. Perhaps they do. But then employees deserve to make more than $27,000 per year. If employee pay cannot be drastically increased, then the desert view demands that CEO pay be drastically reduced.

The Utility View

Having seen that neither the agreement view nor the desert view can be used to justify the current level of CEO pay, in this section I will examine the utility view. The recent actions of American Airlines provide a stark example of utility-based reasoning about pay. After a $1.04 billion loss in the first quarter of 2003, the company's management requested significant concessions in pay from its employee unions. At the same time, its board gave the CEO a $1.6 million "retention bonus" (Wong 2003). They did so not to honor a clause in his contract, or to reward him for past performance. Their goal was to convince him to stay. The board believed that, without this bonus, the CEO would leave, and then the company would be even worse off. The utility view generalizes this reasoning. According to it, a just wage is one that maximizes firm wealth by attracting talented workers, retaining them in the face of competing

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offers, and motivating them to do their best. $8 million per year is a just wage on this view if and only if it accomplishes these tasks.

The utility view should not be confused with the desert view. The utility view may recommend, as a way of motivating employees, offering bonuses to those who make contributions to the firm. According to one version of the desert view, people's deserts are determined by their contributions. Since both views can recommend rewarding contribution, it may seem that they are not really different. This appearance is misleading. The reason, according to the utility view, productive employees should be rewarded is that doing so will lead to future benefits for the firm. The reason, according to the desert view, productive employees should be rewarded is that they have made contributions to the firm—and that is all. Suppose, for example, that an employee makes a significant contribution to his firm. If giving him a higher salary is not necessary to make him stay, and will not cause him (or anyone else in the firm) to make a future contribution that he (or they) otherwise would not make, then the utility view says he should not be given a higher salary. The firm has nothing to gain by doing so. The desert view, on the other hand, leaves it open that this employee should receive a higher salary, provided his contribution is significant enough.

Note also that while the utility view recommends rewarding successful CEOs, it does not recommend paying them whatever they want. The wealth created by the CEO must be weighed against the cost of his services. Suppose that A and B apply for an open CEO job. Both are talented, but A is more so. Suppose further that A demands $5 million more in pay than B. The utility view recommends hiring A over B only if A will generate at least $5 million more in revenue for the firm than B. Otherwise it recommends hiring B. The utility view does not recommend getting the most talented person. It recommends getting the person who creates the most benefit for the lowest cost—the most "bang for the buck."

This helps us to see what a utility-based justification of the current level of CEO pay must look like. It cannot claim merely that offering $8 million per year will attract, retain, and motivate a person talented enough to be the CEO. It must claim that $8 million per year is the most cost-effective wage to offer—that it maximizes firm wealth. When this is understood, many will begin to doubt that a utility-based justification of the current level of CEO pay can be provided. They are right to be skeptical. But utility-based arguments are the ones most often appealed to by boards of directors to justify the pay packages they give to their CEOs (Wade, Porac, and Pollock 1997; Zajac and Westphal 1995). Against this, I will give reason to believe that firm wealth is maximized by paying CEOs less than $8 million per year. I begin by discussing pay as a tool of attraction and retention. I then consider its role in motivation.

Attraction and Retention

Several of the desert-bases discussed above might be cited as reasons an employer has to pay more, or can pay less, to fill a certain job. The most important of these, it seems to me, are effort, skill, and difficulty (including stress, dangerousness, risk, and unpleasantness).[24] Since, other things equal, employees will choose the easier job over the harder job, employers will have to make other things unequal, by offering

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higher wages for the harder job. Similarly, employers will have to offer higher wages for jobs that require rare and valuable skills or long periods of training, and for jobs that are comparatively difficult.

The CEO's job has some of these characteristics. It does not require much physical effort, but it requires skill and training, and it is difficult and stressful.[25] The question, of course, is not *if* the CEO's job has these characteristics, but *to what degree* it has them. Is the CEO's job *so* difficult and stressful, and does it require *so* much skill and training, that offering $8 million per year is necessary to get talented people to become CEOs? Those convinced by my argument that CEOs do not deserve to be paid 301 times what their employees are paid may think not. But we are now asking a different question: not what people deserve for performing the CEO's job, but what would make them willing to perform it.

The answer, however, is similar. There is no evidence that offering $8 million per year is necessary to get talented people to become CEOs (Milkovich and Rabin 1991). Indeed, we have reason to believe that much less will do. Consider the jobs of university presidents and U.S. military generals. They are no less difficult, and require no less skill and training, than the jobs of CEOs. But the wages offered to presidents and generals are many times lower than the wages offered to CEOs. The median compensation of presidents of private research universities is $385,000 (Basinger 2003); U.S. military generals earn $143,000 per year (Bureau of Labor Statistics 2004). Despite this, there is no shortage of talented university presidents and military generals. The fact that people can be attracted to difficult, specialized, and high-skill managerial jobs that pay "only" several hundred thousand dollars per year suggests that talented people will still want to become CEOs even if they are paid less than $8 million per year.

Three objections might be advanced against this conclusion. It might be admitted that the CEO's job is about as difficult, and requires about as much skill and training, as the university president's job or the military general's job. But, it might be said, the CEO's job is in one important way more unpleasant than these jobs. Military generals get, in addition to a paycheck, the satisfaction of knowing that they are protecting their country. University presidents get, in addition to a paycheck, the satisfaction of knowing that they are helping to increase human understanding. There is no comparable benefit, according to this objection, for CEOs.

I suspect that many CEOs find their jobs immensely intrinsically rewarding, and would find this suggestion mildly insulting. But let us grant, for the sake of argument, that CEOs' jobs are less intrinsically rewarding than university presidents' and military generals' jobs. Are they *that* much less rewarding—as many as 21 times so? For the objection to succeed, they would have to be. But it is implausible to suppose that they are. While the extra unpleasantness of the CEO's job may make it necessary to offer more than $385,000 per year to attract talented candidates, it is hardly plausible to suppose that it makes it necessary to offer $8 million.

The second objection grants that talented people would still be attracted to the CEO's job even if they were offered less than $8 million per year. But, it says, when this much pay is offered, truly exceptional people become interested. Analogously, the

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people who are now university presidents are talented, but truly exceptional people would become university presidents if they were offered, instead of several hundred thousand dollars per year, several million dollars per year.

Pay does matter to people when they are choosing a profession (Bok 1993; Freeman 1971). So it is reasonable to assume that the people who become CEOs because corporations offer $8 million per year are, on average, more talented than the people who would become CEOs if corporations offered $1 million per year. But there are two reasons to think that they are not *that much* more talented, and so not worth the extra pay. First, the spectrum of managerial talent is only so wide. And $1 million per year is more than enough to attract a talented person to a difficult and important managerial job, as is demonstrated by the high talent level found among military generals and university presidents. Thus the $8-million-per-year CEO simply *cannot be* that much more talented than the $1-million-per-year CEO. Second, as we said above, firms' performances do not usually depend heavily on the contributions of their CEOs. So it is unlikely that the modest difference in talent between the $8-million-per-year-CEO and the $1-million-per-year-CEO will translate into a $7 million difference in firm performance.[26] In support of this, note that while American CEOs significantly outearn Japanese and British CEOs, American firms do not generally outperform Japanese and British firms (Abowd and Kaplan 1999).

It might be said—as a third objection—that I am missing the point. The fact is that the going rate *now* for CEOs is $8 million per year. In this market, it is necessary for any one firm to offer $8 million per year to get a talented person to become its CEO (Ezzamel and Watson 1998). This argument defies free market economic sense. It says, in effect, that the market cannot correct itself. This is pessimistic.

Our discussion has focused on attraction; we have said nothing about retention. Could it be the case that, while $8 million per year is not necessary to *attract* talented people to the CEO's job, it is necessary to *retain* them in the face of competing offers? The answer is no. In the first place, it is unlikely that there will be many competing offers. According to a study by Challenger, Gray and Christmas, Inc., of the sixty-seven CEO departures in December 2003, in only one case was "position elsewhere" given as the reason for the departure. If CEOs were paid less, this number might increase. But, even if it did, firms should not be alarmed. The difficulty of retention is a function of the difficulty of attraction. If it is not difficult to get a qualified person to take the CEO's job in the first place, it will not be difficult—or, more to the point, necessary—to retain him in the face of competing offers. The company can simply hire a new one. This is not to suggest that companies should make *no* effort to keep their CEOs. Theorists disagree about whether CEO succession events disrupt firm performance (Beatty and Zajac 1987; Brown 1982; Smith, Carson, and Alexander 1984), but most agree that they tend to lower the price of the firm's stock (Beatty and Zajac 1987; Lubatkin, Chung, Rogers, and Owers 1989). Firms need not be as concerned, however, as the current wage for CEOs implies.

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Motivation

Attraction and retention are not the only utility-based reasons for paying employees certain wages. There is also motivation. Employees who are talented *and* motivated create more wealth for their firms than employees who are only talented. There are three ways paying CEOs $8 million per year might be thought—mistakenly, I will argue—to maximize firm wealth through motivation.

First, it might motivate the CEO himself. The CEO knows that, if he does not do an excellent job, he will be fired. Since he wants to keep making $8 million per year, he will work as hard as he can. If CEOs were paid less money, they would work less hard, and firms would be worse off.

In this respect also, pay matters: it motivates people to work hard (Abowd 1990; Lawler 1991; Leonard 1990). It is thus arguable that the CEO who is paid $8 million per year will work harder than the CEO who is paid $1 million per year. But this, as we know by now, is not what needs to be shown. What needs to be shown is that the extra amount of hard work put in by the $8-million-per-year CEO is worth an extra $7 million. It is unlikely that it is. There is no guarantee that extra hard work will translate into extra revenue, and there is only so hard an executive can work. One might think that an extra $7 million per year would be worth it if one thought that CEOs would put in very little effort if they were paid only $1 million per year. But this takes a pessimistic view of CEOs' characters, as if only money—and only a lot of it—could get them to do anything. There is no empirical evidence to support this view (Bok 1993). To the contrary, studies show that money is not the only, or even the primary, reason people work hard (Annis and Annis 1986; Freeman 1971). Instead of trying to further motivate their CEOs with more money, then, firms would do better to use the extra money to increase revenue in other ways, such as advertising more.

The second motivation-based reason for paying CEOs $8 million per year is, in effect, a slightly different version of the first. It has been said that CEOs' compensation packages should be structured so that CEOs' and owners' interests are *aligned* (Jensen and Murphy 1990; Nichols and Subramanian 2001; Walters, Hardin, and Schick 1995). Owners want the stock price to go up. So CEOs should be paid in a way that makes them want the stock price to go up. This is typically achieved by paying CEOs mostly in restricted stock and stock options. Since, it is assumed, the CEO wants to make more money rather than less, this will give him an incentive to try to make the company's stock price go up. The idea not just to make sure that CEOs do what investors want, but to make sure that they do *only* what investors want. If the CEO is paid mostly in stock, he has little to gain from pursuing alternative courses of action.

Let us grant, for the sake of argument, that CEOs' interests should be aligned exclusively with investors' interests.[27] Let us also grant that offering CEOs $5 million per year in restricted stock and stock options accomplishes this (Khurana 2002). Does this prove that CEOs should be paid $5 million in stock? It does only if there is no cheaper way of achieving this goal. But there is: monitoring and dismissal. The interests of most employees are aligned with investors' interests this way. Employees are monitored. If they promote interests other than those (ultimately) of the investors,

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they are dismissed. Would anyone seriously propose, as an alternative to this practice, giving each employee several million dollars in stock options? To be sure, doing so would align their interests with investors' interests. But it is expensive and unnecessary. The same is true of paying CEOs $5 million in stock. There is no reason to give away so much of the firm's wealth when the CEO can simply be fired for poor performance. Owners could secure the same level of loyalty at a fraction of the price.

We have examined two ways that paying CEOs $8 million per year might maximize firm wealth through motivation. Both focus on the effects of high pay on the CEO. The third focuses on the effects of high pay on other employees. According to some (Bognanno 2001; Eriksson 1999; Lazear and Rosen 1981; Rosen 1986), a firm's job hierarchy can be seen as a tournament, with the CEO's job as top prize. Many of the firm's employees, they say, want this prize and will work hard to get it. The better the prize is, the harder they will work. If the CEO is paid $8 million per year, the rest of the employees will work very hard indeed. The consequent increase in productivity will be good for the firm as a whole. Ehrenberg and Bognanno (1990) find evidence for this hypothesis in the field of professional golf. They observe that golfers' scores are negatively correlated with potential earnings. The larger the tournament's purse is, and hence the more money the golfers could win, the better they play.

This is perhaps the most plausible of the utility-based attempts to justify the current level of CEO pay.[28] Still, the argument in its present form has several problems. In the first place, not every employee wants to be CEO, no matter how much the job pays. So paying the CEO $8 million per year provides an incentive to work hard to only some of the firm's employees. Second, there is evidence that this practice will have unintended negative effects. Since there is only one CEO's job, employees must compete with each other to get it.[29] The more the job pays, the more intense the competition will be. This is problematic, for competition fosters jealousy and hostility, which can hinder communication and cooperation (Annis and Annis 1986; Lawler 1981; Meyer 1975).[30] This will not matter to golfers; they play alone. But employees often work together; a decline in communication and cooperation may lead to a decline in productivity.[31] In support of this, Cowherd and Levine (1992) find that pay inequality between workers and managers is negatively correlated with product quality. They explain: "interclass pay equity affects product quality by influencing employee commitment to managerial goals, effort, and cooperation" (1992: 317). Thus, while paying CEOs $8 million per year may increase hard work, it may also increase competition. The benefit of the former may be outweighed by the cost of the latter.

Even if it is not, this does not suffice to prove that CEOs should be paid $8 million per year. My objection is familiar. That is, while paying CEOs $8 million per year might be an effective motivational tool, it is likely not a *cost*-effective one. Above we said that the $8-million-per-year CEO is likely to be only slightly more productive than the $1-million-per-year CEO. Similar reasoning suggests that $8-million-per-year CEO hopefuls are likely to be only slightly more productive than $1-million-per-year CEO hopefuls. From the point of view of utility, then, firms would do better to use the extra $7 million to increase revenue in other ways.

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Let me clarify the nature of my conclusions. I think I have amply demonstrated my negative claim: there are no good utility-based arguments in favor of the current level of CEO pay. But I put forward a positive claim as well: according to this view of justice in wages, CEOs get paid too much. In light of what we now know about attracting, retaining, and motivating managerial talent, and how important that talent is, we have reason to believe that paying CEOs $8 million per year does not maximize firm wealth. Talented people could be attracted to the CEO's job, retained in the face of competing offers, and motivated to work hard, with less than $8 million per year. This part of my argument is less secure. New research could undermine the conclusions upon which I have relied. This would be surprising, but it has not been ruled out.

Conclusion

To structure the debate about executive compensation, I distinguished three views of justice in wages: the agreement view, the desert view, and the utility view. No matter which one is right, I argued, CEO pay is too high. Owners may "agree" to pay CEOs $8 million per year, but the negotiations are not conducted at arm's-length. If they were, CEOs would be paid less. The evidence suggests also that CEOs do not deserve to make 301 times what workers make, and that paying CEOs $8 million per year does not maximize firm wealth. New evidence may emerge which challenges these conclusions. Alternatively, new theories of justice in wages may be developed. Until then, it is reasonable to believe that CEO pay is too high.

This result is important. It supports the popular suspicion that CEOs are overpaid. But our inquiry leaves an important question unanswered, namely, exactly how much should CEOs be paid? To answer it, as we said above, we must do two things. First, we must determine what the correct view of justice in wages is. It is possible that agreement-theorists, desert-theorists, and utility-theorists will all come to the same conclusion about how much CEOs should be paid. If, as is more likely, they do not, we will have to decide which value is most important. Here the writings of moral and political philosophers will be relevant. Second, we must apply the correct theory of justice in wages to the problem of CEO pay. That is, we must identify the wage that maximizes firm wealth, gives the CEO what he deserves, or would be the result of an arm's-length negotiation between an informed CEO and informed owners. Here the writings of economists and organizational theorists will be relevant. Each of these tasks will be difficult and will require a full discussion of its own.

In the meantime, what should be done? CEO pay should be kept from increasing; ideally, it should decrease. In poorly governed firms, CEOs set their own pay (Bertrand and Mullainathan 2001). Even in well governed ones, they can refuse exorbitant pay packages. Thus the most direct way of achieving this goal is to appeal to CEOs themselves. They should be pressured to accept less pay. This may not work, for various reasons. Another tactic is to enact laws which limit CEO pay. Just as minimum wage laws provide a floor for wages, we might create "maximum wage" laws to provide a ceiling for them. This approach will seem heavy-handed to some. There is, however, a middle road. This is to ensure that all firms are better governed with respect to pay.

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Determining what such firms will look like is not a matter for a priori reflection. There is a large literature which links characteristics of boards of directors to CEO pay. Drawing on it, I offer the following two suggestions.

First, CEOs should be removed from the director election process. Directors feel obligated to those who put them on the board. If this is the CEO, they will feel obligated to him, and be more inclined to overpay him. Directors should feel obligated to the people they are actually representing: the shareholders.[32] Letting shareholders elect them will help to create this feeling. It is possible that it will also make being a director a more demanding job. It may end the era in which an individual can serve on several corporate boards and still hold a full time job. This would be a good thing. Being a director is an important job: directors oversee entities whose actions can impact the welfare of thousands of people. It should feel like one.

Second, directors should be required to make meaningful financial investments in the firms which they direct. They need not all own a certain percentage of the firm's total stock. What matters is that they own an amount that is meaningful for them (Hambrick and Jackson 2000). This promotes the first objective: directors will feel more obligated to shareholders if they are themselves shareholders. It useful for another reason as well. Above we said that a problem with the pay negotiations between directors and CEOs is that directors feel as if they are not paying with their own money. Making them buy stock would help to ameliorate this problem (Boyd 1994). An implication of this view is that other kinds of compensation which seem "free" to directors should be eliminated. This includes stock options insofar as they are not counted against firm earnings. If options are given as compensation, they should be expensed.

Implementing these suggestions will, I believe, help to reduce the pay of CEOs. But it will not guarantee that they receive wages that are just. More attention needs to be paid to the fundamental question of what makes a wage just. The subject of wages has received far more attention by economists, organizational theorists, and consultants than by philosophers. This paper has provided a framework for thinking about the moral dimensions of wages. They cannot be ignored.[33]

Notes

1. For convenience, the figures for average CEO pay and average factory worker pay are rounded off in the text. The more precise figures—$8.1 million and $26,899, respectively—are used in the calculation of the ratio of CEO pay to worker pay.

2. Although CEOs are not strictly speaking wage workers, for convenience I will sometimes refer to a CEO's "pay" or "compensation package" as his "wage."

3. There are many possible conceptions of utility. As this claim implies, however, the "utility" which the utility view seeks to maximize is overall firm wealth. Stock price is a measure of firm wealth, but not the only one.

4. Some might deny that it makes sense to speak of an "agreement view" or "utility view" of *justice* in wages. We can talk about whether utility or agreements should determine the wages workers get all-things-considered. But, according to this objection, justice is *defined* in terms of

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desert; the just wage, by definition, is the wage the worker deserves. I do not want to engage in a terminological dispute. What the objection describes as a debate about the wages workers should get all-things-considered *just is* what I describe as a debate about justice in wages.

5. In a free market, employers will agree to pay workers what they deserve, as measured by their productive contributions. If they pay less, other employers will entice their workers away; if they pay more, they will incur an unrecoverable cost. In both cases firm wealth will decrease.

6. There has been no shortage of speculation about the causes of high CEO pay. Frank and Cook explain it in terms of "winner-take-all" markets and the "increasing intensity" of "competitive forces" (1995: 69). Khurana says it is the result of the "closed nature of the external CEO market" (2002: 193). Galbraith takes a broader view, attributing the growing wage inequality between workers and managers to "macroeconomic and policy forces," including "the existing structures of monopoly power" (1998: 20). Economic considerations are relevant to the question we are asking, but do not suffice as an answer to it. The question of what makes a wage just is moral, not economic.

7. Some CEOs count on this feeling. F. Ross Johnson, former CEO of RJR Nabisco, once said of the company's directors: "If I am there for them, they'll be there for me" (quoted in Nichols and Subramanian 2001: 347).

8. This contradicts the intuitively plausible view that, since most directors are rich already, what they get paid for being a director does not matter. Mangel and Singh (1993) do not find evidence of a quid pro quo pay arrangement between directors and executives, but they take CEO pay to be salary plus bonus, ignoring the fact that CEOs receive most of their compensation in the form of stock options and restricted stock (Khurana 2002). Thus Mangel and Singh's finding is consistent with the view that total CEO pay is positively correlated to director pay.

9. Hallock (1997) finds that 20 percent of firms are "any-employee interlocked," i.e., an employee from A sits on B's board and an employee from B sits on A's board.

10. Furthermore, there is reason to doubt the independence of compensation consultants' advice. In the first place, they are usually hired by the CEO, and so may feel grateful to him. Second, most compensation consultants are employed by firms which offer other consulting services. Upsetting the CEO by recommending low pay may disturb other (potential) revenue sources for their firms. These points are made by Crystal (1991). See also Ezzamel and Watson (1998).

11. Boyd (1994) finds that CEO pay is inversely proportional to board control. Two factors which, according to him, weaken board control are CEO duality (i.e., when the CEO is also chairman of the board) and high director compensation. See also Main, O'Reilly, and Wade 1995.

12. In 2002, the CEO of John Hancock Financial Services received \$21.7 million in pay, up from \$8.2 million in 2001. From 2001 to 2002, the company's stock price fell 32.4 percent and its earnings dropped 15.4 percent. Treaster (2003) says this "disparity has been drawing . . . criticism from stock analysts and executive compensation experts who say it distorts the concept that a chief executive's pay should reflect his contribution to the company's earnings and share price." Many believe CEO pay is not closely tied to firm performance (e.g., Baker, Jensen, and Murphy 1988; Jensen and Murphy 1990; Kerr and Bettis 1987), though some disagree (e.g., Hall and Liebman 1998; Haubrich 1994).

13. Some might deny that this complaint derives from the desert view of justice in wages. The complaint assumes that pay should be based on contribution, not that contribution determines desert. We need not quibble about this. The desert view posits one or more independent standards for desert of pay. One of the standards is contribution. Thus, what I have to say about (this version of) the desert view applies also to the view that pay should be based on contribution.

14. In practice, people whose jobs rank highly in certain of these categories (e.g., effort) are not highly paid. But this does not mean that they do not *deserve* to be. Our goal is not to see whether CEO pay is just according to the current standards for pay, but whether it is just according to any morally defensible standards.

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15. Some write as if this question were irrelevant. Murphy's (1986) argument that CEOs are not overpaid relies largely on studies which show a positive correlation between CEO pay and firm performance over time. He notes that "for every 10% rise in a company's stock price over [a] ten-year sample, the top executive's salary and bonus rose an average of 1.1%" (1986: 127). This fact alone does not license the conclusion Murphy draws. We must consider not just the percentage increase in CEO pay but its absolute amount. It matters, from the point of view of justice, whether the CEO's pay increases from $100,000 to $110,000 or from $1 billion to $1.1 billion.

16. Those who think the sole desert-base for pay is contribution may be able to avoid this objection. According to them, the value of an employee's pay package should equal the value of his contribution to the firm. The objection cannot be ignored for this reason, however. Contribution may not be the only legitimate desert-base for pay, or even one of the legitimate desert-bases.

17. Retributivists about criminal justice are in a similar position. Most are confident that armed robbers deserve less time in prison than murderers, but are unsure about exactly how many years in prison armed robbers and murderers each deserve. Criminal theorists call this the "anchoring problem." For a discussion of it, see von Hirsch (1993).

18. For the first example: (1 CEO * $29.2 million) + (9,999 workers * $97,100) = $1 billion. For the second: (1 CEO * 28 million) + (100 middle managers * $500,000) + (9,899 workers * $93,100) = $1 billion. I assume that all workers make the same size contribution and that all middle managers make the same size contribution.

19. I thank an anonymous *Business Ethics Quarterly* reviewer for stressing this distinction.

20. Even those who think leadership matters acknowledge its limited significance. Thomas says that "leader differences do account for performance variables within firms to a substantial degree, . . . [but] these impacts are generally insufficient to outweigh the inbuilt differences among firms that largely account for performance variation among firms" (1988: 399).

21. Bertrand and Mullainathan find that CEO pay is as sensitive to performance as it is to "luck," which they define as "changes in firm performance that are beyond the CEO's control" (2000: 204). For an explanation of how society's belief in the importance of leadership became so deeply entrenched, see Meindl, Ehrlich, and Dukerich (1985).

22. It might be objected that what matters is not the *amount* of skill the employee has, but the *value* of his skill. The CEO's skills are simply more valuable than the scientist's. The problem with this objection emerges by asking what it means by "value." On the most natural reading of this term, skill A is more valuable than another skill B if a person with A creates more benefit for the company than a person with B when both work equally hard. We have already said that the CEO's skills are not 53 times more valuable than the scientist's skills in this sense.

23. It is true that without an effective CEO, the subordinates might not have jobs. The CEO is essential to the company. But so are the subordinates. Without effective subordinates, the CEO might not have a job. My claim here is not about which jobs are essential to the company, or about how difficult it is to find people to perform certain jobs, but about which people in the organization can, through the performance of their jobs, affect the most people.

24. I do not include on this list degree of responsibility. I suspect that, while some people may not want to hold jobs in which they could have a significant impact on people's lives, there are equally many (if not more) people who want to hold such jobs. I also do not include contribution. Instead I understand "skill" expansively to include all of the talents and traits taken by firms to be positively correlated with contribution.

25. Nichols and Subramanian (2001) suggest that high CEO pay is justified, in part, because CEOs' jobs are risky. When the company performs poorly, CEOs are more likely than average workers to be fired. This ignores the fact that CEOs have less to fear from job loss than average workers. CEOs are wealthy, whereas most employees cannot afford to be out of work for long.

26. We noted above that Frank and Cook (1995) explain high pay for CEOs in terms of "winner-take-all" markets. They say that although such markets give rise to wasteful competition

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and should be discouraged, once they are established, awarding the "winners" extremely valuable prizes is economically rational. In this way, the recent increase in CEO pay "has not resulted not from any market imperfections in competitive forces, but rather from their increasing intensity" (1995: 69). In particular, because firms now hire outsiders as well as insiders, there is now more of an "open market" for CEOs, and their pay now more accurately reflects their worth. This assumes that CEOs really do, as Frank and Cook say, "contribute millions to a company's bottom line" (1995: 70). However, they provide little support for this claim, and I have given reason to believe it is false. This may mean that the CEO labor market is closed. Khurana (2002) argues for this conclusion. But in our discussion of the agreement view of justice in wages, we pointed out several other imperfections in it.

27. Stakeholder theorists, presumably, would reject this assumption. According to them, CEOs should take into account the interests of all stakeholder groups (Donaldson and Preston 1995; Freeman and Evan 1990).

28. Economists who defend the tournament theory of CEO compensation may not defend its current level. They are committed only to the weaker view that paying CEOs a high wage provides an incentive to lower-level employees to work hard.

29. CEOs are increasingly hired from outside the firm. Keiser estimates that, in the years 1960–1964, 3.3 percent of CEOs "joined their organizations within two years of becoming CEO" (2004: 63). In 1985–1989, the number was 28 percent. This complicates, but does not undermine, my argument. New CEOs have to come from *somewhere*. If a lower-level manager does not become the CEO at his present firm, he has an opportunity to become the CEO elsewhere.

30. For a discussion of competition and achievement, see Spence and Helmreich (1983).

31. See also Frank and Cook (1995). Schor describes another deleterious effect of paying CEOs very high wages: workers go into debt. Consumption is influenced by comparison, and "extremely high earners . . . [provide] a visible, and very elevated, point of comparison for those who [are not] capturing a disproportionate share of the earnings of the group" (1998: 10).

32. For a discussion CEOs' social influence over directors, see Main, O'Reilly, and Wade (1995).

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