with (so that he comes to own) the whole planet, the whole uninhabited universe, or just a particular plot? Which plot does an act bring under ownership? . . .

Locke's proviso that there be "enough and as good left in common for others" is meant to ensure that the situation of others is not worsened. . . .

. . . I assume that any adequate theory of justice in acquisition will contain a proviso similar to [Locke's]. . . .

I believe that the free operation of a market system will not actually run afoul of the Lockean proviso. . . . If this is correct, the proviso will not . . . provide a significant opportunity for future state action.

Do CEOs Get Paid Too Much?

JEFFREY MORIARTY

America's corporate executives get paid huge sums of money. Businessweek 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. As a result, its normative dimensions have been largely ignored. Organizational theorists and economists tend to be more interested in what the determinants of CEO pay *are* than in what they *should be*. What is needed, I suggest, is a general ethical framework for thinking about justice in pay. After elaborating this framework, I will argue that CEOs get paid too much.

Three Views of Justice in Wages

To determine whether CEOs get paid too much, we first need to consider what, in general, makes a wage just. 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. 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. If, in our case, the CEO's position is not

Jeffrey Moriarity, "Do CEOs Get Paid Too Much?" *Business Ethics Quarterly*, April 2005; 15(2): 257–281.

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.[2]

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. 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. 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. It is unlikely (for reasons given below) that agreement theorists, desert theorists, and utility theorists will all come to the same conclusion about how much CEOs should be paid. I will not try to do this here. There is deep disagreement about the relative importance of these values. A full defense of one of them 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 reason to believe that the current level of CEO pay cannot be justified *simpliciter*.

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.[3]

The problem occurs mainly on the "buy" side of the equation, so we will focus our attention there. 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 to those who would appeal to the agreement view to justify the current level of CEO compensation. Since directors are 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. It is well known that shareholders do not, in 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. The group that controls the nomination process, then, controls the board's membership. 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 (Shivdasani & Yermack 1999). Although there has been a trend away from direct CEO involvement in the nominating process in recent years, most CEOs still wield considerable informal influence over it (Main, O'Reilly, and Wade 1995).

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 et al. 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 20 days of work per year (Jaffe 2003). They may also be given life and medical insurance, retirement benefits, and the use of company property such as automobiles and vacation homes. 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. There is reason to believe they have not been successful. Recent research shows a positive correlation between director and CEO pay (Boyd 1994).[4]

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. The more those CEOs make, the more the board will pay their CEO (Ezzamel and Watson 1998). The problem is that many boards have members who are CEOs of comparable firms (Main et al. 1995). 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. 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.

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. It follows that $8 million per year is not a just (average) wage. Because the independence condition is violated in a way that favors the CEO, we can be confident that the just average wage on this view is less than $8 million per year. 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 is that it has increased in years when firms have performed badly. This complaint is grounded in the desert view of justice in wages. It 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.[5]

Determining how much pay CEOs deserve involves us in two difficulties. The first is identifying the standard(s) for deservingness. Above I noted that economic contribution is often taken to be the basis of desert of wages. But a variety of others have been offered, including (i) the physical effort exerted by the worker, (ii) the amount of ability, skill, or training his job requires, (iii) its difficulty, stress, dangerousness, or unpleasantness, and (iv) its degree of responsibility or importance. Desert may be determined by one or several of these factors. The second problem is connected to the first. Once we identify the desert base(s) for wages, then we must find a way of matching desert levels to pay levels. Suppose contribution is the basis of desert, and suppose, as a direct result of key decisions by the CEO, the firm's profits increase 20 percent in a year. We might think that the CEO's desert level increases by 20 percent and therefore that he deserves a 20 percent raise. But what should his initial salary have been? Without a way of matching desert levels to pay levels, we cannot answer this question. However, from the point of view of desert, the absolute amount of the CEO's pay raise matters as much as its percentage increase.

For the purposes of this paper, both of these problems may be avoided. The first questions our ability to identify the base(s) of desert. In response, I will assume, as most parties to the debate about CEO pay do, that the basis for desert of pay is contribution. Indeed, of all the desert bases mentioned above, this is the one most likely to justify the current level of CEO pay. The second questions our ability to identify what it is exactly that people deserve. In response, I will not argue that CEOs deserve to make less than $8 million per year *absolutely*. Instead, I will argue that they deserve to make less than $8 million per year *given that* their employees make on average $27,000 per year. CEOs are not 301 times as deserving as their employees.

Under the assumption that contribution is the sole desert base for pay, the CEO deserves to be paid 301 times what the average worker is paid if and only if his contribution is 301 times as valuable as the worker's. For every $1 in revenue the worker generates, the CEO must generate $301. If the worker generates $100,000 in a year, the CEO must generate $30.1 million. 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. Instead, many people work together on the same complex projects. As a result, it is difficult or impossible to tell where one person's contribution ends and another's begins.

This is not, of course, an objection that will be advanced by those who appeal to the desert view to justify the current level of CEO pay. They need a way to measure contribution accurately. 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. The popular view, of course, is that CEOs matter enormously to their firms. 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. If we accept this view, we will conclude that CEOs' contributions are at least 301 times as valuable as their employees'.

But we should not. To be sure, some scholars endorse the popular view, but an increasing number reject it. Summarizing the current state of the debate, 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 is right, cases such as these are exceptions to the rule. Factors outside of the CEO's control normally "contribute" more to the firm's success than the CEO does.

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. These claims are not irrational. No theorist is willing to say exactly how much, compared with the average employee, the average CEO contributes. But they are unreasonable. There is mounting evidence that CEOs are not as important as they were once thought to be, and average employees are far from useless. We have ample evidence for a negative conclusion, namely, the claim that CEOs deserve to be paid 301 times as much as their employees is *unjustified*. But I think the evidence licenses a tentative positive conclusion as well, namely, that CEOs are *less* than 301 times as deserving as their employees, and so deserve *less* than 301 times as much pay. The desert view clearly does not support, and probably condemns, the current level of CEO pay.

The Utility View

Having considered the agreement and desert views of justice in wages, let us now turn to the utility view. To recall, this view says that a just wage for a CEO is one that maximizes firm wealth by attracting, retaining, and motivating a talented leader. This is perhaps the most important of the three views of justice in wages. Boards of directors frequently appeal to utility-based arguments to defend the pay packages they give to their CEOs. I will argue that these defenses fail. 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 to fill a certain job. The most important of these are effort, skill, and difficulty (including stress, dangerousness, and unpleasantness).[6] Since, other things equal, an employee will choose an easier job over a harder job, employers will have to make other things unequal, by offering higher wages for the harder job. Similarly, employers will offer higher wages for jobs that require rare and valuable skills or long periods of training, and for jobs that are comparatively difficult.[7]

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. 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 notice 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. 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 per year (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 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. 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 in our discussion of the desert view, 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. 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. 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 67 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.[8]

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. 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. To the contrary, studies show that money is not the only, or even the primary, reason people work hard (Annis and Annis 1986). 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). 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 is not just to make sure that CEOs do what investors want; it is 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. 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, 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, 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 the most sophisticated of the utility-based attempts to justify the current level of CEO pay. 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. 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). 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. In support of this, Cowherd and Levine (1992) find that pay inequality between workers and managers is negatively correlated with product quality. 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.

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 that 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? Answering this question will truly be an interdisciplinary effort. First, we must determine what the correct view of justice in wages is. That is, we must determine which of these values, in this context, 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 the CEO and the 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. Space considerations prevent a detailed discussion of how this can be accomplished. I conclude, however, with two preliminary 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. 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 investments in the firms that 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. This promotes the first objective: directors will feel more obligated to shareholders if they are themselves shareholders. It is 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. An implication of this view is that other kinds of compensation that 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.[9]

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. 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 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.
3. More precisely, CEOs would be paid *on average* less than $8 million per year. It is possible that some CEOs are not overpaid according to any of the three views of justice in wages. But even if some—or as I suspect, most—are, it follows that average CEO pay is too high.
4. This contradicts the intuitively plausible view that since most directors are rich already, the money they get paid for being a director will not influence them.
5. Most researchers believe CEO pay is not, in fact, tied closely to performance. See, for example, Jensen and Murphy 1990.
6. I do not include on this list degree of responsibility. While some people may not want to hold jobs in which they could have a significant impact on people's lives, I suspect there are equally many, if not more, who do. 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.
7. 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. But 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.
8. This is not to suggest that companies should make *no* effort to keep their CEOs. There is debate about whether CEO succession events disrupt firm performance, but most writers agree that they tend to lower the price of the firm's stock.
9. A draft of this paper was presented at Georgetown University. I wish to thank members of that audience, and also George Brenkert, Edwin Hartman, Kelly Moriarty, Jeffrey Wilder, and two anonymous *Business Ethics Quarterly* referees for helpful comments and discussion.

References

Abowd, J. M., and D. S. Kaplan. 1999. "Executive Compensation: Six Questions that Need Answering." *Journal of Economic Perspectives* 13: 145–68.

Annis, D. B., and L. F. Annis. 1986. "Merit Pay, Utilitarianism, and Desert." *Journal of Applied Philosophy* 3: 33–41.

Basinger, J. 2003. "Soaring Pay, Big Questions." *Chronicle of Higher Education* 50 (12): S9–S11.

Boyd, B. K. 1994. "Board Control and CEO Compensation." *Strategic Management Journal* 15: 335–44.

Bureau of Labor Statistics. 2004. *Occupational Outlook Handbook, 2004–05 Edition*. Washington, DC: U.S. Department of Labor.

Byrne, J. A. 2002. "How to Fix Corporate Governance." *BusinessWeek* (May 6): 68–75.

Cowherd, D. M., and D. I. Levine. 1992. "Product Quality and Pay Equity between Lower-Level Employees and Top Management: An Investigation of Distributive Justice Theory." *Administrative Science Quarterly* 37: 302–20.

Ehrenberg, R., and M. L. Bognanno. 1990. "Do Tournaments Have Incentive Effects?" *Journal of Political Economy* 98: 1307–24.

Ezzamel, M., and R. Watson. 1998. "Market Comparison Earnings and the Bidding-up of Executive Cash Compensation: Evidence from the United Kingdom." *Academy of Management Journal* 41: 221–31.

Jaffe, M. 2003. "Average CEO Pay at Big Firms Held Steady at $11.3 Million." *Mercury News* (December 30); http://www.mercurynews.com/mld/mercurynews/business/7597346.htm.

Jensen, M. C., and K. J. Murphy. 1990. "Performance Pay and Top Management Incentives." *Journal of Political Economy* 98:225–64.

Khurana, R. 2002. *Searching for a Corporate Savior: The Irrational Quest for Charismatic CEOs.* Princeton, NJ: Princeton University Press.

Lavelle, L. 2004. "Executive Pay." *BusinessWeek.* (April 19): 106–19.

Main, B. G., C. A. O'Reilly, and J. B. Wade. 1995. "The CEO, the Board of Directors and Executive Compensation: Economic and Psychological Perspectives." *Industrial and Corporate Change* 4:292–332.

Nichols, D., and C. Subramanian. 2001. Executive Compensation: Excessive or Equitable? *Journal of Business Ethics* 29:339–51.

Shivdasani, A., and D. Yermack. 1999. "CEO Involvement in the Selection of New Board Members: An Empirical Analysis." *Journal of Finance* 54:1829–53.