Closing the Gap: A Look into Capping CEO Bonuses

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Abstract

This paper seeks to persuade an audience that a federal law should be in place that would cap how much a CEO in the U.S. can receive in bonuses. This will be accomplished by taking a look at the current inequality in pay between CEO's and the average worker. Current rate of pay ratio between CEO and average worker is 1:204. It will explain why the salary of many CEO's is more than enough compensation. Most blue collar workers accumulated gross pay over the span of their careers will not match or exceed that of a CEO. It will cover some main reasons for current poverty levels. Average blue collar salary is less than or equal to cost of living, the age of retirement is rising, the amount of available good paying jobs is decreasing, child hunger crisis, and need for educated workers. Those are some reasons covered pertaining to poverty levels. Also, it will propose the economic benefits of higher blue collar wages. Increasing purchasing power of lower and middle classes will strengthen the economy. Finally, it will propose a solution of capping CEO bonuses by allowing only a percentage of their annual salary to be compensated.

Closing the Gap: A Look into Capping CEO Bonuses

It is no secret that Chief Executive Officers of large corporations are compensated very well. However, many people don't realize the magnitude of their compensations especially the bonuses. The current pay ratio between a CEO of a corporation and an average worker is a growing topic of conversation. It is a topic that is the root to many major issues in the U.S. today.

As many hard working American people struggle to make ends meet each month, there are CEO's of the company's they work for that are raking in the money. Not only do these CEO's receive a hefty yearly salary, but they also get bonuses that make their salaries look like pocket change. Recently, CEO Sam Allen of John Deere Corporation received around 25,000 shares of John Deere stock as a bonus for another record profit year. With the current value of about $90 per share, one could say Mr. Allen had quite the payday. If you do the math, his bonus for last year is valued at $2.25 million. As an employee of John Deere, this is unsettling. I find this unsettling because at the current factory workers wage, he/she would have to work 41 years at a total gross pay of $55K annually to equal Sam Allen's yearly bonus.

Currently in the United States, there are no laws pertaining to CEO bonuses and how much they can receive in compensation unless the corporation they oversee is in the stages of bankruptcy. So, the purpose of this essay will be to persuade an audience that there should be a federal law that puts a cap on how much CEO's of large corporations can receive as a bonus. This will be accomplished by taking a look at the current inequality in pay between CEO's and the average worker, why the salary of many CEO's is more than enough compensation, poverty levels, and the economic benefits of higher blue collar wages.

“The average multiple of compensation to that of rank-and-file workers is 204” (Elliot Blair Smith, 2013). Putting that fact into perspective, the current federal minimum wage is $7.25 per hour. Now let say you work in the food service industry at one of the bigger fast food chains. The CEO of the company you work for is making approximately $1480 dollars per hour based on this data.

Most blue collar workers are making less than $75K annually which sounds like a lot but not when you factor in the cost of living. Over the past couple decades the cost for everyday needs has risen dramatically. The price of a gallon of milk has gone from around a dollar to over 3 dollars. A gallon of gas 15 years ago would have run you around 89 cents, today you would be lucky to find it less than $3.50. I can remember my dad telling me about his corvette he bought when he was 18 and how it only cost him $2500. Today the price tag on a new corvette is more than what the average worker makes in a year. A home that could comfortably shelter a family of four is going to cost around $100K, not to mention the cost to insure and maintain the home. All of these costs add up quickly and producing the revenue to cover these costs is becoming harder for the blue collar worker every day.

As the expenses to live are overshadowing the workers incomes, it has become harder for them to save for retirement. This has led to an increase in the age at which a lot of workers are able to retire. Although the current age to receive full social security benefits is 62, it has been found that many workers are choosing to work beyond that age because financially they are not able to live off of the benefits they would receive. “Older workers continue to work and retirees return to work for financial reasons, socialization, and wanting to contribute/feel valued.

However, with personal savings significantly lower than in the past, the most compelling reason to work for older Americans is economic” (Lockwood, 2003). This in turn leads to a decrease in good paying jobs available. There is already a deficit of jobs in the United States and the age of the average worker increasing will only further compound the issue.

The base salary for the average CEO of a large corporation is well over two million annually. Their salary alone should be sufficient enough, but they also get many other perks including bonuses that make me ask: how much is too much? Well, as I have said before it would take the average worker 41 years of pay to equal what most CEO’s collect in one year. Believe it or not when it comes down to the taxes they pay, a lot of their income can be tax exempt. According to the National Bureau of Economic Research, legislators put a one million dollar cap on corporate deductions for CEO compensation back in 1993 to curb out of control salaries being paid to corporate executives. However, “the legislation consequently has had relatively little real impact on overall compensation" (Maistros, 2014). The legislation excluded performance based income which allowed bonuses, stock options and other long term incentive pay to be considered exempt from the cap. This means that these large corporations are using bonuses to their advantage by handing out these hefty paychecks or stock options and using them as a deduction on their taxes. This leads me to another question, who is paying the taxes to support the U.S. spending? I would have to say the middle to lower class workers are. This would make one wonder how these CEO’s think it’s ethical to accept a bonus valued at more than what the average employee will make in their career. Especially when lower and middle class families are struggling to provide food for their families.

On average, one in five children in the U.S. is starving. “More than 12 million American children live in poverty, and indeed, the United States has the worst child-poverty rate of all the industrialized countries” (Heuvel, 2003). This statistic is from 2000 and poverty levels have done nothing but climb since.

I already talked about the inflating cost of a gallon of gas, milk, and putting a roof over your head. Some other expenses to take into consideration would be the cost of natural gas and electricity. Both are resources that are highly depended on by millions of people living in the U.S. today. They are needed to heat and cool homes, provide light, heat water, cooking food, and the list goes on. These two resources are greatly needed on a daily basis and the cost to use these resources just like all others has increased because of the high demand. When you tally up all the costs that lower and middle class families are faced with, it’s no wonder poverty levels in the U.S. are as high as they are. Other countries have already taken action and are in the process of putting limits on the CEO to average worker pay ratio. “Swiss voters are taking the idea of limiting CEO pay a step further, and are considering changing their country’s constitution to limit a company from paying the top more than 12 times what its lowest-paid worker is paid” (Johnson, 2013). The Swiss are taking this situation into their own hands. “A social democratic party in Switzerland has collected the 100,000 signatures necessary to turn the fair pay measure, known as the 1:12 initiative, into a national referendum” (Beardsley, 2013).

Education is another major contributing factor to the high poverty levels in the U.S. today. As a current college student pursuing a bachelor’s degree, I can tell you first hand that college is not cheap.

“Students near the average debt of $26,600, for the 65 percent of graduates who take out student loans, put off spending or saving. That dampens growth in the local economy, but it also defers and sometimes destroys their own dreams of a career or a lifestyle” (Peale, 2013). A lot of the loans that students are taking out to attend college come with an interest rate that makes it nearly impossible to pay off. I often ask myself, is it worth it? Whether it is or not, if you dream of having a good paying job with opportunity to advance you will need a bachelor’s degree.

The rising cost of education has led to a decrease in the amount of educated workers. This is because many people lack the time, money, and abilities to attend college. Many kids graduating from high school today are choosing to enter the workforce and putting off college until they can afford it. The truth is most of them never end up going to college, whether it’s because they decide to get married and have a family or they simply can never afford it. Having an uneducated workforce can lead to a technology barrier. Technology is advancing every day, and the uneducated workers are falling deeper into poverty because of it.

With all these negative forces of life working against the lower and middle class worker, there needs to be a change to close the gap. Capping CEO bonuses can open up opportunities for higher wages and higher wages will put more money in the pockets of lower and middle class families. It’s a known fact that the more money you make, the more money you can spend. This will also have a positive effect on the economy. “This increased purchasing power across the board helps stimulate the economy and benefits small businesses, many of which were hardest hit by the recession” (Time for a Raise, 2013). More spending means more tax revenue. The amount of workers on government assistance programs could be impacted with the implementation of higher wages.

With the insight given on this topic, it is easy to see why there should be a cap on CEO bonuses. I would propose that this law limit bonuses given to CEOs to no more than 75 percent of their annual salary. With the current laws in place on tax deductions for corporate executive compensation, basing a CEO's bonus on their salary would be effective. It will keep corporations from increasing an executive's salary to allow for bigger bonuses because they would be subject to paying more taxes. It may not be as radical as Switzerland's 12:1 pay ratio across the board, but it's a big step in the right direction.

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