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Executive pay in America

Paying the piper

Will Barack Obama’s reform of executive pay work?

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CREATING political theatre by cracking down on executive pay may prove to be the easy part for Barack Obama. Coming up with a sensible and effective way to compensate senior managers at companies bailed out by the American taxpayer will be far trickier—and the new president's first effort, unveiled on Wednesady February 4th, is unlikely to be his last.

Capping the non-equity-based remuneration of executives in companies receiving “exceptional assistance” at $500,000 a year and banning “golden parachutes” for failed executives is likely to strike most Americans as fair, or even generous, given that Mr Obama himself earns a mere $400,000 and the rules will apply only to new bail-outs. Indeed, after the outrageous payment of billions of dollars in bonuses by Wall Street firms that had survived only because many more billions had been injected into them by the government, the executives should probably be grateful for getting off so lightly. Moreover, executives will be allowed grants of restricted stock (which they cannot sell until the taxpayer is repaid), so they may yet end up making a fortune.

Last time a president tried to curb fat-cat salaries was in 1993, when Bill Clinton signed a law restricting the tax deductibility of executive pay to $1m. This merely prompted a burst of creativity. Perks were devised that got around the cap, and there was a boom in paying executives with shares and options that, thanks to the bull stockmarket of the 1990s, made everybody far wealthier than they would have been using the old pay formulae.

Mr Obama has the dubious advantage of trying to cap pay amid a severe economic downturn, rising unemployment and structural changes in finance that will reduce pay anyway. A recent study of Wall Street pay, carried out by Thomas Philippon and Ariell Reshef for the National Bureau of Economic Research, found several periods during 1909-2006 when remuneration plunged, and argued that now could be another such period.

Nonetheless, even in these tough times, talented bankers are likely to find opportunities elsewhere that promise far more than $500,000. And even those that do not leave may simply choose to work less hard, says Alan Johnson, a pay consultant. As a result the new rules may weaken the management of rescued banks—just as low pay arguably weakened regulation and helped cause the financial crisis.

Will Mr Obama's message to bosses that they have “got responsibilities not to live high on the hog” lead to restraint in executive pay more broadly? Ira Kay of Watson Wyatt, a pay consultant, thinks it might, because rising pay on Wall Street in recent years led to higher pay elsewhere—a trend that may now operate in reverse.

In the long run, the more significant change may be Mr Obama's decision to give American shareholders a vote on executive compensation, through a “say on pay” resolution. A vote is certainly more sensible than a crude government limit—especially if it is extended to all public companies, not just those bailed out by Uncle Sam. A similar reform is reckoned to have made at least some difference in Britain, and not before time.