Eureka: An Opening for Economic Democracy

CEO pay is the wedge issue to get worker-directors on boards

BY MARJORIE KELLY

What the economic democracy movement needs is the PR equivalent of partial-birth abortion: an issue that the public reacts viscerally against, and that can drive a larger agenda. This intriguing observation was made by Jonathan Rowe of the Tomales Bay Institute at a recent UC-Berkeley conference on corporate reform, and its vividness made it stick in my mind. It was the perfect tactic. But what could the issue be? In the weeks that followed, as I sifted through the river of news that flows past every day, it wasn't long before an answer floated into my grasp: CEO pay. There is no issue that invokes more outrage, that cries out more for reform. And it is an issue that can drive a vital agenda: getting worker-directors on company boards.

Worker governance is a fundamental pillar of democratizing our economy: people must have voice in the institutions that control their lives. This is a truth we hold to be self-evident. It is also a genuine solution to the CEO pay problem, because independently selected worker directors may be the sole force that can bring CEOs to heel.

CEO pay is not the problem. It's the high fever, but not the illness itself. The illness is power. The solution is not to cap pay but to create structures of countervailing power.

The issue of CEO pay has thus far been unsolvable because we've defined it wrong. If pay is the problem, capping pay is the answer. But that doesn't work. In *Fortune*, Jerry Useem observed that CEO pay has been governed by the "Law of Unintended Compensation," meaning attempts to reduce it increase it. He cited three spectacular failures:

▶ In 1989 Congress capped golden parachutes with an excise tax on payments over three times salary. Companies ended up making the three-times rule the new minimum, and picked up the tab on the excise tax. CEO pay rose.

▶ In 1992, Congress tried shaming CEOs by requiring pay disclosure. CEOs used the data to argue their peers were being paid more. Pay rose again.

▶ In 1993, Congress said salaries above $1 million were not tax-deductible. Companies made $1 million the new floor on salaries, and heaped on gigantic stock-options awards. CEO pay rose massively.

Even in the wake of the Enron debacle and a collapsing stock market, CEO pay has continued rising. In 2002 when the S&P 500 dropped 22 percent, median CEO pay rose 14 percent.

Nothing stops CEO pay from rising because CEO pay is not the problem. It's the symptom, the high fever, but not the illness itself. The illness is power: concentration of corporate power in CEO hands. Unaccountable power held by the few is aristocracy. When you define the problem as aristocracy, then the solution is democracy. The solution is not to cap pay but to create structures of countervailing power—like the checks and balances of the Constitution.

The Sarbanes-Oxley Act requires public companies to have a majority of independent directors, following the common belief that board independence is the answer. But the SEC still allows director nominations to be closely controlled by management. So as James McRitchie of CorpGov.net put it, independent directors "can still be the CEO's golfing buddies." Enron, we might recall, had 12 out of 14 independent directors. It's folly to imagine such people can control CEOs, when they have no knowledge of the company, are nominated by management, are rubber-stamped in Soviet-style elections, attend only a few meetings a year, and are cut off from the life of the firm.

What we need is not independent directors but an *independent process* for selecting directors. And we need something else: directors who know what's going on inside companies. We need worker directors like Sharron Watkins, who tried to blow the whistle at Enron.

Getting workers on company boards is a high-priority goal of the AFL-CIO. "We've been asking for it for some time at the bargaining table and nationally," Ron Blackwell, director of the corporate affairs department at the AFL-CIO, told *Business Ethics*. Worker representatives had been a feature of the Sarbanes-Oxley bill, he said, but were pulled at the last minute.

If worker directors can't immediately be achieved, an interim step is for investors—including worker pension funds—to gain access to corporate proxy ballots, to nominate directors for the board. This is a chance for labor and social investors to work together on a project that is both aggressive and achievable. The AFL-CIO—as well as at least five public pension funds, including the nation's largest, CalPERS—are planning to press the SEC on this issue.

It just may fly. SEC Chairman William Donaldson has called for a thorough review of proxy rules, and new proposals on director elections are said to be forthcoming from the SEC by July 15.

An intriguing convergence of forces is at work: public outrage about CEO pay as the high-profile issue, the countervailing power of independent worker-directors as the solution, and pension funds and the AFL-CIO as the powers pushing the agenda. This private path to reform may be the most promising one we have, at a time when no progressive corporate reform agenda can make it through Washington.

As Blackwell put it: "It's a private way to democratize the corporation." Employee directors may be an idea whose time has come.

To comment to the SEC, e-mail to rule-comments@sec.gov, with File No. S7-10-03 in the subject line.