TITLE: **The great big pay disparity**

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At the peak of the global financial crisis the Prime Minister was full of bravado as he stood up for workers and their families in denouncing the “outrageous” size of executive pay packets. Less than a year later his government was talking down strong action and expectations.

Now in the shadow of Christmas, the Productivity Commission has given the government the cover it needs to squib the issue.

The Commission’s final report reveals little inclination to seriously address excessive executive remuneration. While its recommendations aimed at reassuring shareholders have been watered down, there is a distinct lack of recommendations aimed at addressing the equity issue which the report so starkly highlights.

Between 1993 and 2008 the average pay of CEOs in Australia’s top 100 public companies skyrocketed from just over half a million dollars to $3.2 million. During the same period the average weekly wage approximately doubled to an incomparable $62,218.

The market has not served to keep a check on this increasing gap.

This pay disparity between executives and workers is not, however, a universal phenomenon. Greater pay parity is evident in Europe than in Australia while greater disparity is present in the UK and the US.

Increasing pay disparity has been attributed to a shift from salaries to performance incentives. This shift has also been cited as a contributing factor in the global financial crisis with greater risk taking used to improve performance outcomes. In Australia this shift was advanced by an influx of US executives in the mid 1990s.

The role of bonuses and share options in the US grew in response to the Clinton administration’s attempt to limit executive pay.

However, the limit on executive pay failed to include performance-based pay and incentives, a critical shortcoming. The limiting of salary levels alone resulted in counterproductive increases in share-based payments. Australia does not want to make the same mistake.

Yet, the US experience does not rule out an acceptability cap on what is a reasonable rate of pay as argued by the Productivity Commission.

Determining a reasonable pay rate for executives, while still permitting a company and its shareholders to pay above this rate if they wished, is a constructive approach to executive pay. Payments above this reasonable rate would not be considered a payroll expense and would therefore not be considered a legitimate company expense and therefore tax deductible.

Using an acceptability limit would mean shareholders, rather than tax payers, would be the ones paying for the gift of “status money”. This is likely to lead to far more scrutiny of payments and in turn to more reasonable levels of executive pay.

The Productivity Commission’s dismissal of this approach is based on the experience of the US. However, with the benefit of this experience a variable rate of reasonable pay, taking into account the size and responsibility of an executive’s role, along with reforms to capital gains taxation would eliminate the shortfalls manifest in the US experience.

Australia’s capital gains system provides a tax advantage and incentive for executives to opt for payment in the form of shares. While there is a risk in accepting a variable entity as payment the 50 per cent tax discount offsets this risk and increases its attractiveness.

Removing the concession on capital gains tax would address many of the issues surrounding excessive executive pay.

The concessional tax rate on capital gains is a far greater incentive to share-based payments than a variable rate of reasonable pay would be. Yet, the Productivity Commission left this concern unaddressed.

Another simple but effective option is to increase the top marginal income tax rate.

During the GFC the Prime Minister succinctly articulated what was at the heart of public disquiet over executive pay:

The key thing with executive pay is this - first of all, people around the world are fed up and angry with these outrageous packages paid to financial company executives who have contributed so much to what has gone wrong in the global economy. And who pays the price? Working people and their jobs.

Having now been given the lacklustre Productivity Commission report it is up to the government to stand by its earlier convictions and address this outrage. Otherwise it will be another case of all talk, no action.