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Two Goals for Executive Compensation Reform

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I. INTRODUCTION

The compensation of chief executive officers ("CEOs") and other top business executives has soared in recent years. The rise is huge in both absolute and relative terms. For the CEO of a large company, pay went from about one hundred forty times the pay of an average worker in 1991 to about five hundred times the pay only twelve years later.[1] There has been much debate among scholars and in the political realm as to why the increase has happened, whether it is a negative occurrence, and what, if anything, we might do to address the matter.

Some do not believe that the increase in compensation is a problem. My concern here, though, is mainly with those who do believe that there is a serious problem. Within that group, there are at least two very different types of concerns that lead to two very dissimilar goals for proposals to reform executive compensation. One concern focuses on executive compensation as a problem that both reflects and exacerbates poor corporate governance.[2] The other concern focuses on executive compensation as a source of increasing economic, political, and social inequality.[3] The purpose of this essay is to briefly compare and contrast these two different concerns and to evaluate some arguments that claim that corporate governance, but not equality, should be important when considering whether and how to reform executive compensation. I suggest that corporate law scholars do not have a good basis for completely ignoring inequality as a major social concern. I believe that reducing inequality is an important social goal and advocate using policies that attempt to reduce inequality to help guide our regulation of executive compensation.

Most corporate law scholars hold concerns about corporate governance as a higher priority than general inequality. Lucian Bebchuk, a professor of law at Harvard Law School, and Jesse Fried, a professor of law at the University of California, Berkeley, make this quite clear in their book *Pay Without Performance*, the leading statement in contemporary legal scholarship for the position that executive compensation is in need of serious reform:

> To begin, there is the "moral," "fairness-based"—and, some might say, "populist"—opposition to large amounts of pay. In this view, putting aside practical consequences, paying executives hundreds of times what other employees get is inherently unfair and unacceptable.
>
> Our own criticism does not come from this perspective. Our approach is completely pragmatic and consequentialist, focusing on shareholder value and the performance of corporations (and, in turn, the economy as a whole). We would accept compensation at current or even

1. LUCIAN BEBCHUK & JESSE FRIED, PAY WITHOUT PERFORMANCE: THE UNFULFILLED PROMISE OF EXECUTIVE COMPENSATION 1 (2004).

2. *See infra* Part II.

3. *See infra* Part III.

higher levels as long as such compensation, through its incentive effects, actually serves shareholders.[4]

Thus, for Bebchuk and Fried, the sheer size of executive compensation is not necessarily a problem. The problem arises when that compensation is designed in ways that grants substantial amounts of shareholder money to executives without giving them appropriate incentives to increase shareholder value. In their view, it is quite possible that a properly designed system would give executives even higher average compensation for the greater risk that might flow from a system that more effectively serves shareholders' financial interests.

In contrast, it seems that the political attention that executive compensation is receiving recently is driven in part by a concern over growing economic and social inequality in the United States. In the last several decades, inequality in income and wealth in this country has increased dramatically.[5] Rich CEOs have become poster boys for this problem.[6] This trend may be a part of the motivation underlying proposed legislation in Congress to require an advisory shareholder vote on executive compensation.[7]

In Part II, I briefly consider some ways in which these two concerns regarding corporation governance and inequality overlap, but note that ultimately they may differ significantly in many circumstances. The next two parts then consider two arguments in favor of the scholars' position of focusing only on the corporate governance concern while ignoring the effects of compensation on general inequality. Part III presents the leading argument among law and economics scholars for concentrating only on economic efficiency when applying legal rules. This argument states that we should set most laws at their efficient level, then achieve the redistribution of income and wealth that we desire through tax and transfer policies. I argue that this strategy does not take into account political constraints that may block that implementation of policy. Aiming to reduce executive compensation may be a more politically feasible way of reducing inequality and is worth pursuing for that reason.

Part IV presents a different argument for focusing only on the corporate governance concern. According to this argument, executive compensation only accounts for a very small part of the growth in general inequality. Even if it is appropriate to use legal rules to try to reduce inequality, using executive compensation rules for that purpose is ineffective because executive compensation is just too small a part of the problem. I am more agnostic about this argument, but I

4. BEBCHUK & FRIED, *supra* note 1, at 8.

5. *See* David H. Autor et al., *Trends in U.S. Wage Inequality: Re-assessing the Revisionists* 1 (Nat'l Bureau of Econ. Research, Working Paper No. 11627, 2005); Thomas Piketty & Emmanuel Saez, *Income Inequality in the United States, 1913-1998*, 118 Q. J. ECON. 1 (2003).

6. *See* Autor, *supra* note 5; *see also* Piketty & Saez, *supra* note 5.

7. *See* The Shareholder Vote on Executive Compensation Act, H.R. 1257, 110th Cong. (2007), *available at* http://financialservices.house.gov/ExecutiveCompensation.html.

am inclined to believe that this reasoning should not block positing reduced inequality as a goal of executive compensation regulation. There is certainly some evidence in support of this argument against targeting inequality through executive compensation, but I also consider some counter evidence and argue that we need more thorough and varied empirical inquiries into what role executive compensation has played in the growth of inequality in the United States. Overall, reforming executive compensation seems likely to be a moderately important part of a broader strategy of reducing inequality in the United States. Thus, I conclude that neither of the two positions analyzed in this article should dissuade us from pursuing reduced inequality as one of the guiding goals of executive compensation regulation.

II. OVERLAPS AND DIFFERENCES IN THE TWO APPROACHES

There is certainly some overlap between the two different concerns about executive compensation. The sheer size of executive compensation and its extremely rapid growth are red flags for those who advocate for corporate governance.[8] The size suggests strong motivation for executives to try to bend compensation in their favor, and it is hard to believe that the huge growth in compensation levels has been accompanied by an equal growth in the effectiveness of top executives. It is certainly possible that changes focused on improving corporate governance will lead to lower average compensation for top executives. To the extent that is true, those concerned with increased inequality can applaud such changes. However, it is also possible that changes motivated by corporate governance concerns could lead to increased compensation. In that case, the two basic concerns will diverge.

There is also a more subtle reason why corporate governance mavens may want to consider growing inequality as a problem. Increased inequality may matter to various corporate constituencies, particularly to employees. Resentment over executive compensation may sap worker motivation, leading to poorer performance, and ultimately lowering profits.[9] However, it is unclear how far that effect goes in tying together divergent concerns over inequality and corporate governance. First, there is currently little systematic evidence that resentment of high CEO pay significantly affects employee performance. Moreover, even if there is such a negative effect, it could be outweighed by possible positive effects on profitability of high but well-designed executive pay.

Another line of reasoning can connect governance and inequality concerns in a different way. Many people who are concerned about increased inequality may not object to inequality per se, but rather only to inequality that is improper.

8. *See generally* BEBCHUK & FRIED, *supra* note 1.

9. For an example of employee resentment of CEO compensation, see James Parks, *CEO Compensation: A Year's Pay for a Day's Work*, Aug. 29, 2007, http://blog.aflcio.org/2007/08/29/ceo-compensation-a-years-pay-for-a-days-work.

One reason to care about equality is a concern for fairness: People should be paid what they deserve for their efforts and no more. Certainly, a part of the concern over rising executive pay is the sense that CEOs have not really earned this increase.[10] If one could show convincingly, however, that CEOs have indeed dramatically increased the value created by their companies, then the increase in inequality might be seen as justified.[11]

On the other hand, the link between governance and inequality concerns is also limited. A concern with just desserts is not the only reason that many people care about growing economic, political, and social inequality. General moral sense about what top officers deserve to earn may not completely overlap with what compensation package gives those officers incentives to increase shareholder value. Moreover, even if one believes that CEOs have earned their higher pay, one might find the resulting increased inequality disturbing for other reasons.

Therefore, it is a tough empirical question to determine how much the concerns about governance and inequality converge and how much they diverge. Advocates of each position may find that they can unite on many matters supporting or opposing specific measures. However, it is also probable that the two concerns will point in different directions regarding some proposals. Thus, it is useful to try to sort out whether we should be guided by corporate governance concerns, inequality concerns, or both in addressing potential executive compensation reforms. The next two parts consider two different arguments for why we should not care about the effect of executive pay on general inequality as we weigh potential reforms of executive compensation.

III. ARE TAXES AND TRANSFERS THE BEST MEANS TO ADDRESS INEQUALITY?

The first argument against reducing inequality as a goal in executive compensation reform is a general one and applies to all areas of legal regulation. Law and economics scholars generally concern themselves only with economic efficiency when they evaluate legal rules.[12] A variety of justifications for this approach are available, but the leading one states that we should address inequality only through tax and transfer policy.[13] I argue that this reasoning is wrong, both in general and as applied to executive compensation regulation.

10. *See* Nanette Byrnes & Jane Sasseen, *Board of Hard Knocks*, BUSINESSWEEK, Jan. 22, 2007, at 37; *SEC Shoves Executive Pay into the Spotlight*, BUSINESSWEEK, Aug. 22, 2006, *available at* http://www.businessweek.com/investor/content/aug2006/pi20060822_357187.htm?chan=search. *But see* Charles M. Yablon, *Essay: Bonus Questions – Executive Compensation in the Era of Pay for Performance*, 75 NOTRE DAME L. REV. 271, 273 (1999) (positing that executives did not deserve high rates of compensation in 1990, but that CEOs obtained extremely good results for their shareholders in the late 1990s, making their multi-million dollar bonuses seem justifiable).

11. *See* Guillermina Jasso & Eva M. Meyersson Milgrom, *Distributive Justice and CEO Compensation*, (2006), http://www.meyersson.com/Jasso&Meyersson-CEO-DJ-2006-08-31.pdf.

12. *See* ROBERT COOTER & THOMAS ULEN, LAW & ECONOMICS 4 (3d ed. 2000).

13. *Id.* at 111–12 .

The classic version of this argument is the Second Fundamental Theorem of Welfare Economics. According to the theorem, any desired Pareto efficient outcome can be achieved through first redistributing income through lump sum taxes and transfers, and then allowing production and exchange to reach a competitive equilibrium.[14] The fundamental theorem applies only in a "first-best" world where the economy has no imperfections that prevent an efficient competitive equilibrium from emerging.[15] That is not the real world, so the fundamental theorem is of limited use for practical policymaking.

However, Harvard Law School professors, Louis Kaplow and Steven Shavell, have replicated a variant of the theorem within a "second-best" framework. Given certain assumptions, they show that it is more efficient to achieve desired distribution effects solely through tax and transfer policies, even where those policies introduce distortions, rather than setting other legal rules at inefficient levels in order to achieve some desired redistribution.[16] The basic idea is that using non-tax policies to redistribute income introduces additional distortions that can be avoided if we use only tax policy to redistribute.[17] If this argument is correct, then a specific application of it is that we should not use corporate law or securities law to attempt to redistribute income away from corporate officers. Rather, we should set whatever rules best maximize the efficiency of corporate governance, and if those rules lead to undesirable income distribution, then address it through the tax system.

Chris Sanchirico, a professor at the University of Pennsylvania Law School, has already given good reason to suspect that the assumptions underlying Kaplow and Shavell's argument are not generally accurate, and that their result does not hold under more general assumptions.[18] Here, though, I shall consider a different

14. HAL R. VARIAN, MICROECONOMIC ANALYSIS 220–21 (1st ed. 1978). Pareto efficiency is a concept in economics to determine the efficiency of actions in the market. "Pareto efficiency means that no one can be made better off without someone becoming worse off." *Intelligent Design*, ECONOMIST, Oct. 18, 2007, *available at* http://www.economist.com/finance/displaystory.cfm?story_id=9988840; *see also Marvelous Markets; The Perfect Firm; So What?*, ECONOMIST, Oct. 11, 1986, at 84 ("A fully competitive market system is, as economists are fond of saying, 'optimal.' Vilfredo Pareto defined the idea early this century. He showed that, on certain assumptions, a free-market economy will allocate resources in such an efficient way that it is then impossible to make somebody better off without making somebody worse off.").

15. *See generally* VARIAN, *supra* note 14, at 153–55.

16. *See* Louis Kaplow & Steven Shavell, *Should Legal Rules Favor the Poor? Clarifying the Role of Legal Rules and the Income Tax in Redistributing Income*, 29 J. LEGAL STUD. 821 (2000); Louis Kaplow & Steven Shavell, *Why the Legal System Is Less Efficient than the Income Tax in Redistributing Income*, 23 J. LEGAL STUD. 667 (1994); Steven Shavell, *A Note on Efficiency vs. Distributional Equity in Legal Rulemaking: Should Distributional Equity Matter Given Optimal Taxation?*, 71. AM. ECON. REV. 414 (1981).

17. *See* sources cited *supra* note 16.

18. Chris William Sanchirico, *Deconstructing the New Efficiency Rationale*, 86 CORNELL L. REV. 1003 (2001); Chris William Sanchirico, *Taxes Versus Legal Rules as Instruments for Equity: A More Equitable View*, 29 J. LEGAL STUD. 797 (2000) (arguing that a general second-best world redistribution is most efficiently achieved with a mix of policy and rules).

critique of the Kaplow and Shavell position, one which I have developed briefly in several articles.[19] There are political limits to how much redistribution we can accomplish through tax policy.[20] Further redistribution through other legal rules may be more politically possible. This may be because the non-tax rules are set by different policymakers who are more willing to consider redistribution or because popular sentiment is more inclined to accept fairness arguments in the non-tax rules.

We may be at such a moment in the case of executive compensation. Much popular attention and disapproval is now focused on increasingly high executive pay.[21] People think something should be done about it, and politicians feel some pressure to respond or may see political gain to be had by doing so. Deflecting this pressure to more general tax reform would probably dilute it to a point where it no longer had much political impact. Redistribution is always politically difficult—the rich are generally able to defend their interests well. Thus, if popular sentiment makes some redistribution politically possible, we (those of us, that is, who believe that some redistribution is currently desirable) should not pass up the chance because we think that other measures would do a better job of redistributing, especially if those other measures are not currently politically feasible. The best can be the enemy of the good.

This political feasibility point can be pushed a step further. Some legal rules affect the distribution of political power.[22] As such, they affect the political feasibility of future policies, including the possibility of income redistribution. In setting such rules, we should take their political impact into account. The rules of corporate governance may be an important instance of such rules.[23] The officers and directors of large corporations have much political power at their control.[24] They can and do use that power to advance a variety of interests, including their corporations' interests, their class interests, and their own personal interests. Any serious attempt to take income away from the very rich is not particularly likely to succeed in a system where politicians are heavily indebted to large corporate givers, and those large corporate givers are in turn run by people who do not like

19. *See* Brett H. McDonnell, *The Economists' New Arguments*, 88 MINN. L. REV. 86, 111 (2003); Brett H. McDonnell & Daniel A. Farber, *Are Efficient Antitrust Rules Always Optimal?*, 48 ANTITRUST BULL. 807, 825 (2003); *see also* Thomas F. Cotter, *Legal Pragmatism and the Law and Economics Movement*, 84 GEO. L. J. 2071 (1996).

20. *See* Giacomo Corneo & Hans Peter Grüner, *Social Limits to Redistribution*, 90 AM. ECON. REV. 1491, 1493 (2000) ("In the model more inequality, as measured by the difference between the wealth of the rich and that of the poor, tends to *lower* the extent of redistribution desired by the middle class.").

21. *See, e.g.*, Joe Nocera, *What if C.E.O. Pay is Fair?*, N.Y. TIMES, Oct. 13, 2007, at C1.

22. *See* Corneo & Grüner, *supra* note 20, at 1491–93.

23. *See* Brett H. McDonnell, *Employee Primacy, Or Economics Meets Civic Republicanism at Work*, STAN. J.L. BUS. & FIN. (forthcoming 2008), *available at* http://ssrn.com/abstract=878790 (discussing the disparity between perceived influence of shareholders in corporations and their actual influence).

24. *Id.* at 22.

attempts at large-scale redistribution.[25] Thus, corporate governance rules, which limit the ability of officers and directors to use corporate resources in ways that do not directly benefit the corporation, would be potentially quite politically important. Of course, for that very reason they are also hard to enact.

Thus, I am not inclined to accept the Kaplow and Shavell tax and transfer argument on redistributive policies as a reason for ignoring distributive concerns in setting the rules governing executive compensation. If there is a political opportunity to enact a new rule of corporate governance that would reduce the growing inequality that results from higher executive pay and/or that would limit the ability of corporate managers to use their positions to lobby for rules of the game that benefit them, it would be worth doing so, even if in theory we could achieve the same degree of redistribution more cheaply through higher taxes on the rich. For the moment, measures to limit executive pay may be politically possible; higher taxes on the rich seem less likely.

IV. DOES EXECUTIVE COMPENSATION HAVE LITTLE EFFECT ON GENERAL INEQUALITY?

The second argument against using executive compensation regulation to reduce general income inequality is much more specific to the topic of executive compensation than the Kaplow and Shavell argument. This argument is that the large increase in executive compensation at public corporations has been only a small part of the general increase in income inequality over the last few decades. Even if we were to completely stop, or even reverse, the growth in the pay of executives at public corporations, income inequality overall would be changed very little. This argument garners more empirical support than the one I considered in the previous part, but it is not currently completely persuasive. It may be that executive compensation is still a fairly important factor in explaining the general increase in economic inequality. Thus, regulating executive compensation should play a moderately important role in reducing that inequality.

A recent working paper by Steven Kaplan and Joshua Rauh, professors at the University of Chicago Graduate School of Business, lays out the facts for this second argument against reducing inequality as a goal in regulating executive compensation quite forcefully.[26] They gather evidence from a variety of resources to try to construct some of the composition of the top 1 percent, 0.5 percent, 0.1 percent, 0.001 percent, and 0.001 percent income brackets.[27] Their core finding is that top executives of non-financial public corporations comprise no more than 5 or 6 percent of *any* of the top brackets, and that while the percentage of such

25. *See generally id.*

26. Steven N. Kaplan & Joshua Rauh, *Wall Street and Main Street: What Contributes to the Rise in the Highest Incomes?* (Ctr. for Research in Sec. Prices, Working Paper No. 615, 2007), *available at* http://ssrn.com/abstract=931280.

27. *Id.* at 2–4.

executives in some of these brackets rose modestly between 1994 and 2004, the increases were not dramatic, and by some measures, the percentages did not increase at all.[28] Kaplan and Rauh argue that the managers of hedge funds, venture capital funds, and private equity funds, investment bankers, and lawyers have played at least an equally important part in the growth of inequality.[29] They posit that this group collectively earns much more and composes a significantly larger part of the top income brackets than the top executives of nonfinancial public corporations.[30]

The Kaplan and Rauh figures suggest rather strongly that public corporation executives are, at most, a relatively modest part of the explosion of income inequality at the top of the pyramid. As the evidence currently stands, however, I do not think that they have yet proved that such executives are an insignificant part of the equation, or that political action aimed at their pay makes no sense. There are still enough gaps in their reasoning that it could well turn out that executive pay makes sense as one part, albeit a modest one, in a broader strategy aimed at reducing inequality.

One gap is that although Kaplan and Rauh consider all of the groups mentioned above (as well as athletes and celebrities), all of these categories combined compose no more than about a quarter of even the highest income brackets according to their figures. It is a little puzzling to consider who else composes the remaining three quarters of the wealthiest people in America. Kaplan and Rauh say their estimates are rather conservative, but doubt that these groups could explain more than 40 percent of the top categories.[31] They point to executives of privately-held companies, trial lawyers who are not part of the top two hundred law firms, and independently wealthy individuals as important parts of the missing rich.[32] I find it hard to believe that those groups could explain a big part of the missing 60 to 75 percent, nor is there any other obvious missing large group. This discrepancy calls into some question how accurately they have characterized the composition of the top brackets.

Kaplan and Rauh point out that deferred compensation, such as pension benefits, are not included in the income measure for public corporation executives that they use.[33] Also missing are items such as in-kind perks. These items are a fairly important part of executive compensation.[34] Although these items may also be missing from the measures they use for other groups, such unreported items are

28. *Id.* § II.

29. *Id.* at 1, 4.

30. *Id.* § III.

31. *Id.* at 37.

32. *Id.*

33. *Id.* at 8.

34. *See* BEBCHUK & FRIED, *supra* note 1, at 87–117.

probably a much larger part of the compensation of public corporation executives than they are for the compensation of the others. As Bebchuk and Fried argue, the agency problems within public corporations give rise to strong incentives to compensate executives in ways that are relatively hidden from public view.[35]

Additionally, the measure of executive compensation that Kaplan and Rauh use does not include income that executives earn from investments they have made outside investments in their own company. The primary measure that Kaplan and Rauh use considers only compensation received from one's company and asks how many executives fall within the extreme high-income tax brackets based on that compensation alone.[36] It is important to note that tax brackets are based on income received from *all* sources. Insofar as executives are able to make large investments only because of previous income they have earned from their jobs, such income should be included. One measure Kaplan and Rauh present helps address this question—they recalculate the share of executives in top income brackets excluding investment income from the calculation for all earners. This calculation comes closer to comparing apples with apples—it compares the income that executives receive from their companies with the income all high-earners receive, excluding income from investment for all groups (both executives and non-executives). Under this calculation, the share of public corporation executives in the top brackets rises notably, hitting almost 12 percent of the top bracket under one measure.[37]

Another reason to give special attention to the executives of large corporations is their special political power.[38] Their power does not come simply, or even mainly, from their personal income. Rather, they harness great power from their ability to direct the use of the vast resources of the companies that they run. These resources are a major source of the funding for political lobbying. Insofar as one cares about economic inequality at least in part because of the effect it has on political inequality, then public corporation executives should certainly be a source of special concern.

Despite these caveats, it does seem quite plausible that investment bankers, the managers of hedge funds and private equity funds, and corporate lawyers are at least as large a part of the problem of rising inequality as are the top officers of public corporations. I would think that those who care about limiting inequality would want to turn their attention to these groups as well. Indeed, they seem to be doing so, at least in the case of hedge funds.[39] I do not think, however, that the cases of public corporation managers and of hedge fund and private equity

35. *Id.* at 67–68.

36. *See* Kaplan & Rauh, *supra* note 26, at 10–11.

37. *Id.* at table 1d.

38. *See supra* notes 23–25 and accompanying text.

39. *See* Victor Fleischer, *Taxing Blackstone* (Ill. Law & Econ. Research Paper Series, Working Paper No. 07-036, 2007), *available at* http://ssrn.com/abstract=1012472.

managers are as drastically different as Kaplan and Rauh make them out to be. Private equity managers, like public corporation managers, are responsible for deciding what to do with large sums of other people's money. Thus, some of the special political concerns just mentioned for public company managers also apply to private equity managers.

Moreover, the agency concerns that apply to public company managers are also present for private equity and private corporation managers to some extent. The literature on this subject, for the most part, seems to assume the opposite—namely, that public corporation managers face a uniquely severe agency problem.[40] It is true that the separation of control and ownership that comes with large numbers of dispersed shareholders does present an especially hard monitoring problem. Nevertheless, variants of the problem still occur with private funds and companies. A controlling shareholder or partner may take advantage of minority equity holders. Indeed, that is why courts have traditionally been more likely to find fiduciary duty violations in private company executive compensation cases than public company cases.[41] Investors in hedge funds may be rich themselves, but they still may be foolishly leaving money with inadequately monitored managers.

Finally, suppose that after further inquiry we decide that the pay of public company executives does indeed only account for around 5 to 10 percent of the extreme concentration of wealth at the high end of the income bracket. Does that mean we should ignore it and instead go after the more important causes of inequality? Not necessarily; 5 to 10 percent is not chicken feed. If we tackle five different areas that each contribute 5 to 10 percent to the overall problem and make real headway with each, we will be well on our way to getting some control over the growth in inequality in our society. I doubt there will be one magic bullet that explains the vast portion of the increase in inequality. If public company executive pay is one modestly important cause among many, then addressing it makes sense as part of a larger program of reducing inequality. That is particularly true if this is one of the causes for which there is the most political support for taking action, and even more so if some actions here might tilt the balance of political power so that further action in other areas becomes possible in the future.

Thus, the empirical role of executive compensation in increased inequality remains unclear and worth further study.[42] In the meantime, though, it does seem likely that executive compensation will have a modest but notable role to

40. *See* Margaret M. Blair, *Reforming Corporate Governance: What History Can Teach Us*, 1 BERKELEY BUS. L.J. 1, 39 (2004). *See generally* Donald C. Langevoort, *Agency Law Inside the Corporation: Problems of Candor and Knowledge*, 71 U. CIN. L. REV. 1187 (2003).

41. JESSE H. CHOPER ET AL., CASES AND MATERIALS ON CORPORATIONS 149 (6th ed. 2004).

42. *See* Ian Dew-Becker & Robert J. Gordon, *Where Did the Productivity Go? Inflation Dynamics and the Distribution of Income*, 2 BROOKINGS PAPERS ON ECON. ACTIVITY 67 (2005) (discussing a study that found that executive compensation played a large role in recent increases in inequality). However,

play in explaining the increase in inequality, and also a modest but notable role to play in feasible political strategies to reduce that inequality.

V. CONCLUSION

There are at least two quite different goals underlying the current focus on high executive compensation: concern about poor corporate governance and concern about growing inequality. Although advocates who are motivated by differing concerns may still be able to agree on many measures for regulating executive compensation, sometimes they are likely to disagree. Thus, it is helpful to think about whether both concerns provide potentially valid reasons for regulation.

In this essay, I have attempted to make one small step in thinking about that question. Most corporate law scholars seem to care only about corporate governance, not inequality. This position seems to put them at odds with most politicians on the issue of executive pay. My inquiry has been whether the scholars are justified in ignoring the effect of corporate pay on inequality. In addressing that question, I have considered two different arguments in favor of ignoring the inequality concern. Neither of these arguments are frequently articulated in the corporate law literature. Indeed, the lack of concern with general inequality is not itself often explicitly articulated; however, it appears to underlie most scholarship in the area. Thus, even if one believed that neither of the arguments that I have considered here was correct, one could still choose to ignore the inequality concern for some other reason. I do think, however, that these two arguments are among the very best available to defend the prevailing scholarly implicit consensus. Hence, I hope to have removed some intellectual roadblocks to using the reduction of inequality as a goal in regulating executive compensation.

Of the two arguments, I think the first—the broader, more theoretical argument—is the weaker. The Kaplow and Shavell argument for using tax policy alone to correct for excessive inequality is built on shaky assumptions and ignores much political reality. There is not much reason to accept it as a general proposition, and in the particular case of executive compensation, it is not very persuasive. The second argument, though, should be of much greater concern for those tempted to use executive pay regulation to address economic inequality. We still need better evidence as to how much of a role executive pay has played in growing inequality, but the answer seems to be that its role is fairly modest at most. Those who really want to tackle growing inequality will have to advance many other policy reforms as well. Still, regulating executive pay is likely to be a sensible and decently important part of an overall package of reforms.

Of course, in this brief essay, I have done nothing to show why we should care about inequality as a problem in the first place. I have not even produced

Kaplan and Rauh raise several methodological objections to the Dew-Becker and Gordon article. *See* Kaplan & Rauh, *supra* note 26, at 6.

evidence to show that inequality has grown significantly in the last few decades; I have simply assumed this disputed point, although there is plenty of evidence for it.[43] Even assuming inequality exists and that we should want to reduce it, I have not showed that the benefits of doing so exceed the costs of any particular reform proposal. Nor have I laid out what different policy proposals might follow for executive compensation were we to take reducing inequality seriously as an important goal in this area. Others have addressed those points elsewhere. My limited task here has been to consider whether either of the two arguments presented in this essay can justify ignoring inequality as a concern in regulating executive compensation. My provisional answer is no. If corporate law scholars want to continue ignoring reduced inequality as a goal, they should devote more effort to defending that choice. Better still, they should accept reducing inequality as a legitimate and important goal in our efforts to regulate executive compensation.

43. *See generally* Autor, *supra* note 5; Piketty & Saez, *supra* note 5.

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