

Executive Excess 2005

Defense Contractors Get More Bucks for the Bang

12th Annual CEO Compensation Survey



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Key Findings

1. Ratio of CEO pay to average production worker pay leapt up to 431 to 1 in 2004:

The ratio of CEO pay to average worker pay increased from 301-to-1 in 2003 to 431-to-1 in 2004. By contrast, in 1990, the average large company CEO made just 107 times the pay of the average production worker.

2. CEOs at the biggest defense contractors are personally profiting from the war in Iraq:

- **Military contractor CEOs received 200 percent raise since 9/11**

At the 34 publicly traded US corporations among the 2004 top 100 defense contractors with 10 percent or more of their revenues from defense contracts, average CEO pay increased 200 percent from 2001 to 2004. By contrast, the average pay for large company CEOs as a whole rose only 7 percent during this period.

- **Defense CEOs almost doubled pay gap with generals and privates**

Since September 11, the ratio between median pay for defense CEOs and pay for military generals has increased to 23-to-1, up from 12-to-1 just three years earlier. The pay ratio between defense CEOs and army privates soared to 160-to-1, up from just 89-to-1 in 2001. Generals with 20 years experience earned \$168,509 and privates earned \$24,278 in 2004, including housing allowances and extra combat pay.

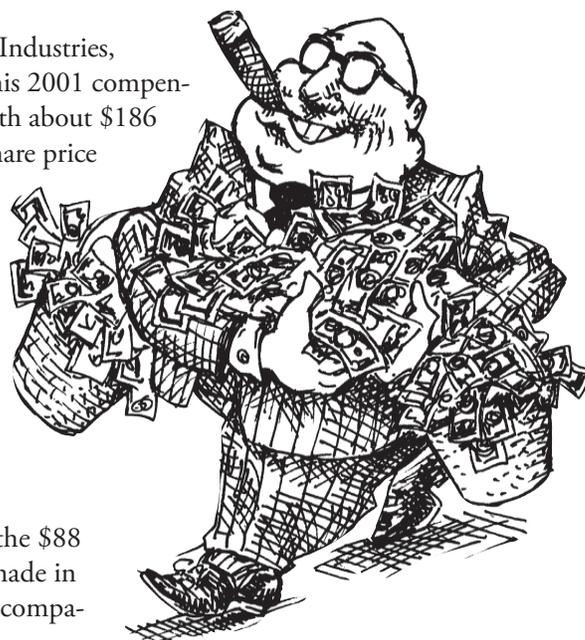
- **Body armor profiteer got 13,349 percent raise since 9/11**

David H. Brooks, CEO of bulletproof vest maker DHB Industries, earned \$70 million in 2004, 13,349 percent more than his 2001 compensation of \$525,000. Brooks also sold company stock worth about \$186 million last year, spooking investors who drove DHB's share price from more than \$22 to as low as \$6.50.

In May 2005, the US Marines recalled more than 5,000 DHB armored vests after questions were raised about their effectiveness. By that time, Brooks had pocketed over \$250 million in war windfalls.

- **Top 2004 defense compensation awarded after Pentagon terminated flagship project**

It would take an Air Force airman 3,634 years to make the \$88 million that United Technologies CEO George David made in 2004. David's big payoff came in the same year that his compa-



ny faced the humiliating cancellation of its Comanche helicopter program. The US Army requested it be scrapped after investing \$6.9 billion and 21 years of effort into the helicopter (including 10 years with David at the helm).

- **Halliburton: \$11.4 million in pay for \$1.4 billion in dubious billing**

Halliburton CEO David Lesar received a 171 percent pay raise between 2003 and 2004, the period when government auditors were tallying up \$1.4 billion in ‘questioned’ or ‘unsupported’ charges by the company for work in Iraq.

Meanwhile the firm allegedly fed only leftover scraps to Turkish and Filipino support workers at a military camp in Iraq.

3. Trends since 1990 show continued high pay for bad behavior and other executive excess:

- **CEO pay on the rise**

In 2004, average total compensation for CEOs of 367 leading US corporations was \$11.8 million, up 45 percent from \$8.1 million in 2003 and \$2.0 million in 1990.

To put the 431-to-1 CEO-worker pay gap in perspective, consider that average production workers would today be making \$110,126, if their pay had risen as fast as CEO pay since 1990. Instead, the average production worker made \$27,460 in 2004.

If the minimum wage had risen as fast as CEO pay since 1990, the lowest paid workers in our country would be earning \$23.03 an hour today, not \$5.15 an hour.

- **Pension underfunding fattened executives’ wallets**

The funding shortfall in the nation’s large private pension plans reached a record \$353 billion at the end of last year, up 27 percent over the previous year. The CEOs of those firms with the most underfunded pensions, on average, received \$20.4 million in 2004 compensation, 72 percent more than the average large company CEO.

Inducted into the CEO Hall of Shame in the Pension Tension category is Exxon Mobil’s Lee Raymond.

- **Tax dodgers paid CEOs more**

Of the 46 large companies that paid no federal income tax in 2003, ten reported more than \$1 billion each in 2003 pre-tax income to their shareholders. Collectively these companies earned \$30 billion in profits

in 2003. The \$12.6 million average CEO pay of these rogue tax-avoider firms in 2003 was 55 percent more than the \$8.1 million received by the average CEO that year. In 2004, these ten firms paid their CEOs \$12.5 million, on average, 6 percent more than the 2004 average CEO pay.

Inducted into the CEO Hall of Shame in the Tax Dodger category is Pfizer's Hank McKinnell.

- **Eighteen book cookers among 100 highest paid CEOs over 10 years**

Of the ten highest paid CEOs each year over the ten years from 1995 through 2004, eighteen of the 100 slots were filled by CEOs whose companies were either later found to have committed fraud or to have been forced to make material restatements of earnings to correct previous overstatements of profits.

Inducted into the CEO Hall of Shame in the Book Cooker category is Tyco International's Dennis Kozlowski, the book cooker with the highest pay—more than half a billion dollars.

- **Stocks of highest paid CEOs' companies performed dismally**

If you had invested in the stock of the company led by the year's single highest paid CEO since 1990, you actually would have lost money. You would have done nearly six times better by investing in the S&P 500 index. A \$10,000 investment in the Greedy CEO portfolio in 1991 would have decreased in value to \$8,079 by the end of 2004, while a similar investment in the S&P 500 would have increased to \$48,350.

Inducted into the CEO Hall of Shame in the Stock Tanker category is Computer Associates' Charles Wang.

- **A billion dollars to one man**

Over the last 15 years, the cumulative pay of the ten highest paid CEOs in each year together totals more than \$11.7 billion.

Of the 150 possible slots for the highest paid executives over this period, not a single one was filled by a woman, and only one non-white male appeared on the list, Charles Wang, founder and former CEO of Computer Associates.

Inducted into the CEO Hall of Shame in the Gross Pay category is Citigroup's Sandy Weill, whose \$1.1 billion in cumulative executive compensation since 1990 topped all others.

The ratio of CEO pay to average worker pay increased to 431-to-1 in 2004.

I. Introduction

For a dozen years, the Institute for Policy Studies and United for a Fair Economy have collaborated to track the problem of excessive executive compensation. Most of the major business publications also issue annual CEO pay surveys, and many of them have been increasingly critical of executives they considered overpaid. But the fixation of most of the corporate world and the business press has been on whether CEO pay reflects performance—defined narrowly by stock value. Our critique has been broader.

We have looked not only at how CEOs have performed for shareholders, but also at how they have treated their workers and society in general. Public reaction to our reports has convinced us that a wide swathe of Americans agree that executive pay should reflect these broader values and that extreme inequality undermines our democracy.

This year, as the war rages on in Iraq, we decided to devote a special section to executive compensation among top defense contractors. The war has illuminated deep inequalities in our society at many levels. There are the gaps between the many young men and women who join the military for financial reasons and those who can afford not to. There are divisions between the soldiers on the ground and their more highly paid counterparts employed by private contractors. And, as we document in this report, there is a growing chasm between those on the battle lines and the men in the executive suites who are making millions off the defense-spending boom.

As the death toll mounts among Americans and Iraqis, it seems particularly unjust to see executives profiting personally from the horrors of war. Excessive executive pay can also hurt morale and performance for those lower on the ladder—in this case, the men and women in combat.



Excessive pay is a problem not only in the defense industry. The ratio of CEO pay to average worker pay increased to 431-to-1 in 2004, up from 301-to-1 in 2003 and 107-to-1 in 1990.

This year's report also reviews and updates some of the most harmful pay trends of the past decade and a half, such as excessive compensation for the CEOs who are hurting workers by underfunding employee pensions or those who are straining our public services by not paying their fair share of taxes. For each trend, we have selected inductees in a CEO Hall of Shame who best symbolize these harmful pay policies.

What can be done about these disturbing trends? *Executive Excess 2005* concludes with a summary of recommendations designed to strengthen our nation's economy and democracy by reducing the extreme economic disparity between corporate executives and the rest of us.

II. More Bucks for the Bang: War Profiteers at the Greed Bazaar

As the casualty count in Iraq continues to rise, top executives of defense contractors are cashing in on the war and the post-9/11 boom in overall defense spending. National defense expenditures rose from \$329 billion in 2001 to \$406 billion in 2004, with about half of that amount spent each year on private contractors.¹

IPS and UFE researchers examined executive pay levels at the 34 publicly traded US corporations that were among the top 100 defense contractors in 2004 and had 10 percent or more of their total revenues from defense contracts² and found a trend towards individual war profiteering by CEOs.

A. Defense CEO versus Military Pay

Defense spending boom has boosted military contractor CEO pay by 200 percent since 9/11

CEO pay among large US companies as a whole increased from 2001 to 2004 by only about 7 percent on average.³ By contrast, the defense contractor CEOs' average compensation increased 200 percent during this period. CEO pay levels dropped at only 7 of the 34 companies studied.

Median pay for defense CEOs of these firms was \$3.9 million in 2004. Because several had off-the-charts pay packages, average compensation for the group was much higher, at \$11.6 million. George David, of helicopter maker United Technologies, came in No. 1 among defense contractors, with total 2004 compensation of \$88.3 million, followed by David H. Brooks, CEO of bulletproof vest producer DHB Industries, with \$70.6 million (see profile on page 10).

Figure 1: Military-Related Pay, 2004

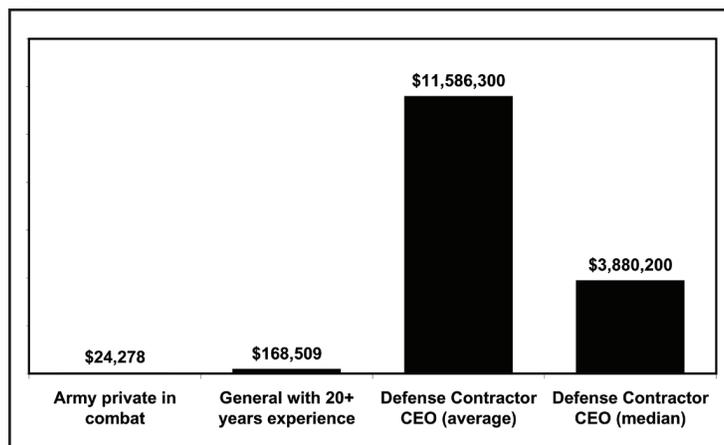
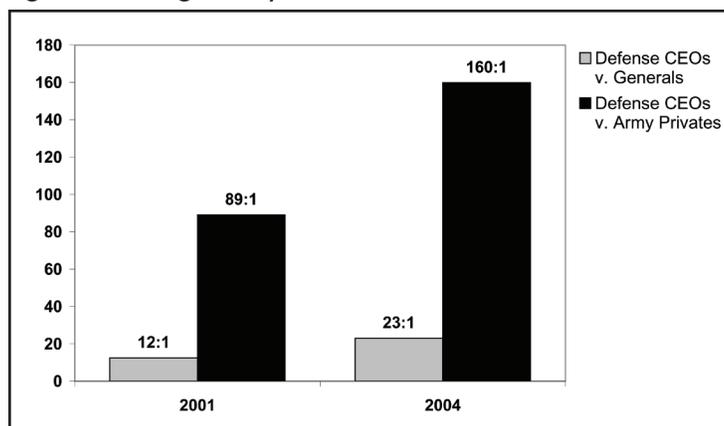


Figure 2: Change in Pay Ratios, 2001-2004



Sources: Department of Defense, Defense Finance and Accounting Service, 2001 and 2004 Military Pay Rates for E-2 (second-lowest rank enlisted personnel) and O-10 (General—figure for those with 20 years experience). Includes: base pay, housing allowance, and imminent danger/hostile fire pay. Some military personnel qualify for additional assistance, such as allowances for family separation (\$250 per month in 2004).

Defense contractor CEO pay raises outstrip those for military personnel

Since September 11, 2001, the ratio between median pay for defense contractor CEOs and pay for military generals with 20 years of experience has increased from 12-to-1 to 23-to-1.

The pay ratio between defense CEOs and low-ranking enlisted personnel, such as an army private (E-2 grade), has jumped from 89-to-1 to 160-to-1. Including housing allowances and extra combat pay, military generals made \$168,509 in 2004, up from \$148,223 in 2001. Army privates in combat made \$24,278, up from \$20,758.

CEO pay levels shatter government benchmark

The defense contractor CEOs' compensation levels are also far out of line with the maximum benchmark compensation allowable under government contracts, set at \$432,851 for FY 2004.⁴ Congress first imposed a ceiling on compensation for defense contractors in 1995, in reaction to public concern over mass layoffs in the defense industry. The benchmark is based on the median compensation for all senior executives of US corporations with \$50 million or more in annual sales. It applies to wages, salary, bonuses and deferred compensation, as recorded in the firm's financial statements. This attempt at government control over pay for public contractors has had little impact. It applies only to compensation costs charged under the contract and does not limit the compensation that an executive may otherwise receive. Thus, for example, if a company's stock value shoots up because the 'War on Terrorism' has created a rosy outlook for the defense industry, a CEO may rake in tens of millions in options gains that are unaffected by the government benchmark.

B. What's Wrong with a Little War Profiteering?

Private/public sector gap leads to brain drain

Defenders of sky-high CEO pay often argue that such compensation levels are justified because corporate leaders bear tremendous responsibilities and must oversee complicated business activities. However, this defense doesn't hold up well when their pay is compared to that of military generals. Although the military leaders are responsible for the lives of thousands of personnel and command highly complex operations, they receive only a tiny fraction of typical defense contractor pay. This disparity encourages brain drain from public service into the private sector due to pay incentives to leave government jobs.

And in fact, there is a virtual revolving door between the Pentagon and many of these contractors. Two of the most prominent examples include men who were both chairmen of the Joint Chiefs of Staff: Gen. John M. Shalikashvili, who sits on the boards of Boeing and L-3 Communications, and Gen. H. Hugh Shelton, a consultant to Northrop Grumman and Anteon International. Larry Welch, an ex-Air Force General who served on the Joint Chiefs of Staff, is among a number of former military big shots on the CACI board, while a former US Army four-star general is president of DHB Industries.

Lower down the hierarchy, pay gaps between military personnel and private contractors are also enormous. Private American security contractors working in Iraq earn \$120,000 to \$300,000 per year (5 to 12 times as much as an army private).⁵ Resentment seems inevitable. Indeed, lawyers for employees of Zapata Engineering who were detained after a shooting incident in Iraq in June 2005 claim that US marines beat the civilian workers and taunted them about their high salaries.⁶

Brookings Institution scholar Peter Singer also notes that the brain drain that results from these gaps comes at a high price to the military. "Unlike a pilot who retires to go work for an airline, soldiers within the private military industry stay within the same sphere and, indeed, their firms often directly contract back with the military. The military not only prematurely loses the human capital investment it originally made in training soldiers, but then sees these exact skills billed back, at higher rates."⁷

Fat paychecks for CEOs don't make us safer

Some might argue that the men in our survey of defense contractor CEOs (and they are all men) play an extraordinarily important role in our economy by making products and services necessary for our national security. However, as detailed in the case studies in the next section, CEOs included in the study run firms that have been found to have committed fraud, sucked up billions of taxpayer dollars in boondoggle projects, played a shady role in the interrogation

Private American security contractors working in Iraq earn 5 to 12 times as much as an army private.

Questions have been raised by members of Congress about whether political ties are a bigger factor than anything else when companies like Halliburton receive no-bid contracts.

of Iraqi prisoners, and supplied the military with security gear of questionable quality. By virtually any measure, it would be hard to argue that these types of activities have contributed to a safer America.

Defense contractors bear less risk

Still others may argue that such high pay for CEOs is an appropriate reward for the high risks they take as the top players in our cutthroat economy. But many defense contractors enjoy protections from competition that are hardly consistent with a free market. According to the Center for Public Integrity (CPI), about a third of contract dollars to top defense contractors in recent years have been awarded on a cost-plus basis, meaning that the government must cover any cost overruns and pay an additional, percentage-based fee.⁸ Former Halliburton employees told Congressional staff that the company's motto was: "Don't worry about price. It's cost-plus."⁹

Moreover, CPI found that only 40 percent of Pentagon contracts between 1998 and 2003 were conducted under what the Defense Department terms "full and open competition." The government claims that noncompetitive contracting procedures are necessary in cases where there is only one company that can do the job or when it is necessary for reasons of national security or urgency. But many questions have been raised by members of Congress and others about whether political ties are a bigger factor than anything else when companies like Vice President Dick Cheney's former firm, Halliburton, receive no-bid contracts.¹⁰ And even if noncompetitive contracting is necessary, it means that the leaders of these companies enjoy a privileged blanket of security.

When compared to the pay of those who are bearing the greatest risk of war—the military personnel on the front lines—defense CEO pay levels are even more disturbing. Studies have shown that extreme gaps in pay at corporations contribute to low morale among employees.¹¹ The inequities in military-related pay likely contribute to similar problems in the armed forces, an important issue at a time of record low enlistment rates.

Guns versus butter

War profiteering should be of particular concern at a time when the military spending boom, combined with tax cuts for the wealthy, is putting a severe strain on social programs. Under the Bush administration's proposed budget for fiscal year 2006, funding for defense and international discretionary programs would be increased by \$199 billion above current levels over the next five years. By contrast, domestic discretionary funding will be cut by \$212 billion during this period, meaning sharp reductions in spending for education, veterans' health care, environmental protection, housing, and many other programs.¹² State governments will have to cope with a reduction in federal grants of \$71 billion over the next five years. This will mean tough choices between raising taxes or cutting programs such as special education, child care, and rental assistance.¹³

Especially at a time when so many Americans are being asked to tighten their belts, it is hard to argue that defense contracts which subsidize sky-high CEO pay are a good use of taxpayer dollars.

It is important to note that even within the defense budget itself, there has been a shift away from human resources to high-tech weaponry. The research and development component of defense spending has increased fastest since 9-11, to a higher level than at the peak of the Cold War arms race. This in spite of the fact that security experts argue that counter-terrorism operations depend largely on well-trained and maintained troops.¹⁴

Just not right

Some of our most respected American leaders have decried the act of war profiteering. President Franklin Delano Roosevelt, commander-in-chief during WWII, expressed his sentiment when he said: “I don’t want to see a single war millionaire created in the United States as a result of this world disaster.”¹⁵ Harry Truman first made a name for himself as a Senator by traveling around the country going from one defense industry factory to another to investigate charges of war profiteering. He subsequently led a Special Committee to Investigate the National Defense Program formed in 1941 that saved an estimated \$15 billion in military costs.¹⁶ When he became President, Truman continued his crusade against profiteering. He emphasized the need to “share fairly the necessary burdens imposed by the defense effort. We can do this best by holding the cost of living stable, by preventing profiteering by anyone, and by paying for our military needs through higher taxes.”¹⁷

In September 2004, a bi-partisan coalition of Senators led by Dick Durbin (D-IL) and Larry Craig (R-ID) introduced a resolution calling for the creation of a modern-day Truman Committee to improve oversight of wartime contracting.¹⁸ Thus far, however, this initiative has not received widespread support.

“I don’t want to see a single war millionaire created in the United States as a result of this world disaster.”

—Franklin Delano Roosevelt

C. A Closer Look at Seven War Profiteers

DHB Industries

David H. Brooks, CEO of the company he named after his initials, DHB Industries, has seen his bulletproof vest business boom since September 11, 2001. Due to procurement snafus, there was a shortage of such vests for nearly the entire first year of the war and producers like DHB scrambled to fill orders. In 2004, Brooks was even too busy to take much vacation time. DHB's proxy notes that he received \$87,500 in compensation for "foregone vacation." That kind of perk might be hard to stomach for the 50,000 or so military personnel who have looked forward to earned breaks, only to receive stop-loss orders extending their periods of duty in Iraq.¹⁹ But even harder to swallow is the fact that Brooks billed the company for this compensation in a year during which he made more than \$70 million in direct compensation, most of it in options gains. That represented a 13,349 percent jump over his 2001 compensation of \$525,000, putting him at the top of the defense contractors list in terms of pay increase.

But the \$70 million that Brooks earned in salary, bonus and exercising stock options was still only a small portion of his personal profits from DHB last year. Between November 14 and December 29, Brooks sold company stock worth about \$186 million. DHB stock had skyrocketed in value since September 11, from less than \$1 per share in the late 1990s to a high of \$22.53 in December 2004. Brooks' massive sell-off caused jitters on Wall Street, driving the value of the stock as low as \$6.50 per share. It hovered around \$7 in August. To improve his image, Brooks placed a retired general on his board, but that did little to appease shareholders who were particularly outraged because the company had denied reports that Brooks had filed to sell substantial amounts of stock.²⁰

Some might argue that Brooks is worth every penny if he is providing a product that is saving lives in Iraq. But the US Marines are concerned that DHB's bulletproof vests may not be so bulletproof. In May of this year, the Marine Corps recalled 5,277 DHB Interceptor armored vests after questions were raised about the vests' ability to stop 9-mm pistol rounds.²¹ By that time, of course, Brooks had pocketed \$250 million-plus in war windfalls.

Halliburton

CEO David Lesar took home \$11.4 million in 2004, up from \$4.2 million in 2003. It seems the ones who really deserved a pay raise are the government auditors who have cranked out one negative report after another about Halliburton's activities in Iraq. The company jumped to the No. 1 slot among Iraq contractors when its Kellogg Brown and Root subsidiary received a no-bid contract in March 2003 for up to \$7 billion for oilfield services.²² In response to public outrage, the Pentagon later cancelled that contract but allowed Halliburton to obtain others. Today, Halliburton alone holds 52 percent of Defense Department contracts for work in Iraq. Among the charges cited by auditors:

-
- More than \$1 billion in “questioned” costs and an additional \$442 million in “unsupported” charges—a total of more than \$1.4 billion.²³
 - Halliburton employees caught taking \$6 million in bribes.²⁴
 - Losing or not accurately accounting for \$18.6 million in government property.²⁵
 - Failure to fulfill promises to clean up dirty kitchens where food for troops is prepared.²⁶

It is hard to comprehend how performance like that would warrant a generous pay raise for Halliburton’s CEO. Workers at the bottom of Halliburton’s hierarchy have not enjoyed the same largesse. In testimony before the Senate Democratic Policy Committee, a former KBR food production manager reported that the company charged the government for serving food to its Turkish and Filipino support workers at Camp Anaconda in Iraq but actually gave them only garbage bags of leftover scraps from the troops’ meals.²⁷ And of course Lesar’s gains contrast most sharply with the ultimate loss suffered by the 63 Halliburton employees who have been killed in Iraq.²⁸

United Technologies

With total compensation of \$88 million, United Technologies CEO George David was the highest-paid defense industry executive in 2004. It would take an entry-level Air Force airman 3,634 years to make that much. David’s big payoff came in the same year that his company faced the humiliating cancellation of its Comanche helicopter program. The US Army requested that the program be scrapped after investing \$6.9 billion and 21 years of effort into the helicopter (including 10 years with David at the helm). United Technologies subsidiary Sikorsky Aircraft and Boeing were the main contractors for the Comanche. The Army decided that it wasn’t worth the cost after the per-unit cost of the helicopter more than quadrupled over the course of the project. The Comanche enjoys the distinction of being one of only two weapons programs that have been canceled by the Bush administration.²⁹

Northrop Grumman

The firm’s 2004 CEO pay was 8 percent lower than in 2001, but at \$6.7 million, CEO Ronald Sugar did pretty well for a guy whose company is known for bungling the job of training the Iraqi National Army. Sugar became CEO on April 1, 2003, shortly after the US invasion. In June 2003, the company’s Vinnell subsidiary subcontracted with Science Applications International to train nine 900-troop battalions for the Iraqi army. One year later, Major General Paul Eaton complained that “We’ve had almost one year of no progress.”³⁰ In the most humiliating debacle, more than half of Vinnell’s first battalion deserted. No one doubts that the working environment in Iraq is challenging, to say the

least, but the US Army clearly viewed Vinnell's performance as too poor to be sustained. It denied the firm an option in its contract to expand its services to all 27 battalions of the Iraqi army, and instead the Army has taken greater responsibility for the training.

CACI

Compared to 2001, CACI CEO J.P. (Jack) London's pay jumped 170 percent to \$3 million in 2004, a year in which he spent a considerable amount of time dealing with the scandal over his employees' involvement in alleged prisoner abuse at Abu Ghraib. The number of CACI interrogators at the prison, now notorious worldwide for acts of torture, is disputed. The military says 27; CACI says 10. At any rate, one of them, Stephen Stephanowicz, figured prominently in Major General Antonio Taguba's internal investigation of abuses at the prison, which was leaked to the press in May 2004. The Army report accused him of encouraging military police to terrorize inmates and "clearly knew his instructions equated to physical abuse."³¹ A subsequent report by a panel of generals is less damning, but cites testimony of witnesses who accused Stephanowicz of ordering soldiers to use dogs to threaten prisoners and shaving the hair and beard of a detainee and forcing him to wear women's underwear. The report also cites abuses by two additional CACI employees and referred all of those cases to the Justice Department for possible prosecution. Despite demands by human rights groups that CACI be barred from further contracts in Iraq, the Army in August 2004 awarded the firm a new contract for interrogation services in Iraq worth up to \$23 million. CEO London has consistently dismissed the allegations against his employees as just "some misbehavior."³²

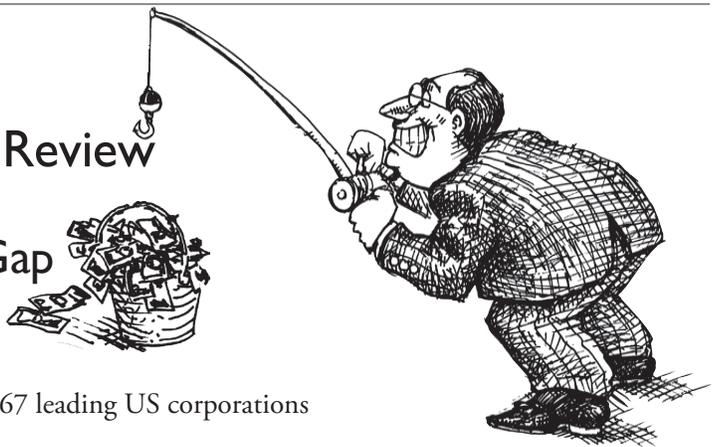
Boeing and Lockheed Martin

CEOs of the country's No. 1 and 2 defense contractors were not among the top earners last year. However, there is no need to pity CEO Vance Coffman of top contractor Lockheed Martin. He may have made a relatively paltry \$6.7 million in annual compensation during the eight months that he served as CEO last year, but when Coffman retired in August 2004, he hauled away a retirement package that no doubt made up for it—\$63 million in two lump-sum payments, in addition to a regular pension of about \$87,000 per year.³³

At Boeing, CEO Harry Stonecipher made a relatively modest \$4 million pay package, but the guy only lasted a little more than a year in the job before being ousted for hanky panky with a female executive. That drama came on top of the scandal of 2003, when longtime CEO Philip Condit was forced to resign in the wake of revelations that the company had arranged to hire a top Air Force procurement official while that official was setting up a lucrative contract for the company. But the company appears to be back in excessive pay mode after awarding a signing bonus of stock options worth \$25.3 million to new CEO W. James McNerney in July.

III. CEO Pay Trends: A Decade and a Half in Review

A. CEO versus Worker Pay Gap Looms Wider

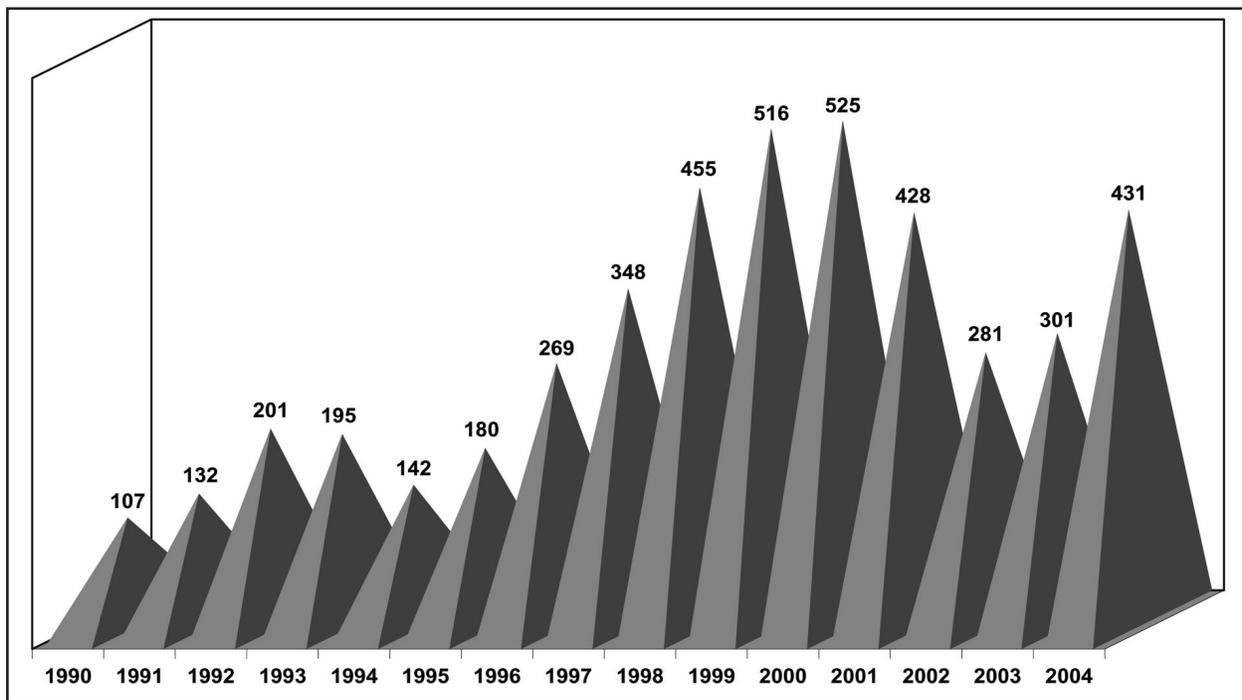


In 2004, average total compensation for CEOs of 367 leading US corporations was \$11.8 million, up from \$8.1 million in 2003.

The ratio of CEO pay to average production worker pay increased from 301-to-1 in 2003 to 431-to-1 in 2004. While this is still smaller than the 2000 peak of 525-to-1, it is more than 10 times as large as the 1982 ratio of 42-to-1. Moreover, the gap has widened sharply in the past two years, as executives have moved to cash in stock options.

Total executive compensation is defined throughout this report as salary, bonuses, restricted stock awarded, payouts on other long-term incentives, and the value of options exercised in a given year; we do not include the estimated value of stock options awarded. In the past, *Business Week* used this same methodology for calculating total compensation. This year, the magazine changed its meth-

Figure 3: Average Executive to Average Production Worker Pay Ratio, 1990-2004



Source: Total executive compensation: Business Week annual compensation survey, various issues, 1991-2005. Includes: salary, bonus, restricted stock, payouts on other long-term incentives, and the value of options exercised. Note: 2004 total compensation figure calculated by the authors based on data in Business Week survey. Average worker pay: BLS, Employment, Hours, and Earnings from the Current Employment Statistics Survey, Table B-2.

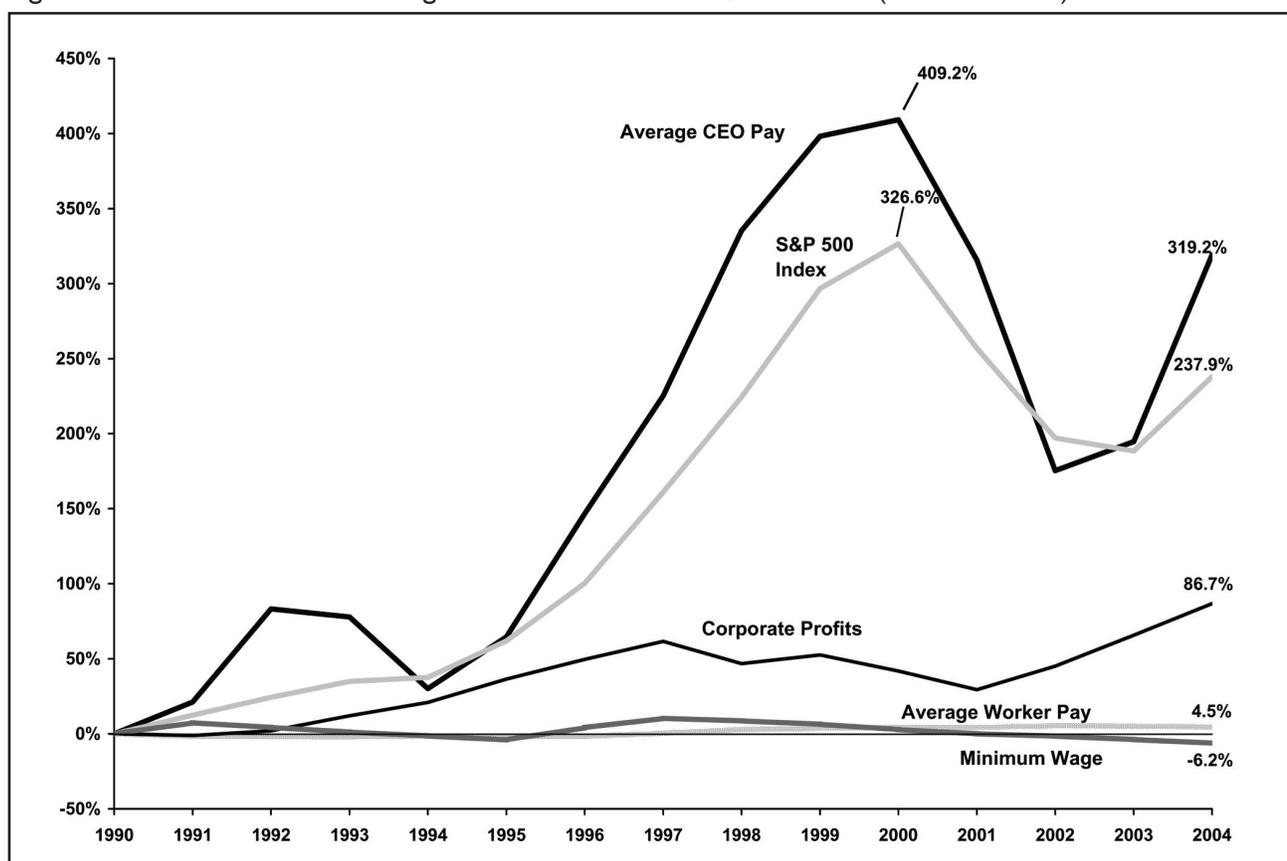
odology to replace the value of options exercised with an estimated value of options grants. Since we have based our analyses on the *Business Week* sample in the past, for consistency we decided to continue to use their sample of companies and calculated the average compensation figure ourselves, using the methodology that the magazine used until 2005. A more detailed discussion of executive compensation is provided in Appendix A of this report.

CEO pay outstrips other economic indicators

Average executive compensation has been on the rise for two years. In contrast, corporate profits have been growing at a much slower rate, and the value of average worker pay and the federal minimum wage have stayed relatively constant or decreased over the past decade and a half.

Cumulatively, the average executive's compensation has increased by more than 300 percent, after adjusting for inflation, while the average production worker

Figure 4: Cumulative Percent Change in Economic Indicators, 1990-2004 (in 2004 dollars)



Source: Total executive compensation: Business Week annual compensation survey, various issues, 1991-2005. Includes: salary, bonus, restricted stock, payouts on other long-term incentives, and the value of options exercised. Note: 2004 total compensation figure calculated by the authors based on data in Business Week survey; S&P 500 Index: Economic Report of the President, 2005 Table B-96; 1997, 2000 Table B-93; average of daily closing index; Corporate Profits: BEA, NIPA, Table 6.16, with inventory valuation and capital consumption adjustments; Average worker pay: BLS, Employment, Hours, and Earnings from the Current Employment Statistics Survey, Table B-2; Minimum wage: Lowest mandated federal minimum wage, nominal; US Dept. of Labor, Employment Standards Administration, Wage and Hour Division; Adjustment for inflation: BLS, Average Annual CPI-U, all urban consumers, all items.

has scraped along with less than 5 percent in pay raises over 15 years. Minimum wage workers have fared even worse. Their pay has dropped by over 6 percent in real terms since 1990.

To put the CEO-worker pay gap in perspective, we calculated how much average production worker pay would be worth today if it had grown at the same rate as CEO pay. In 2004, the average worker would have made \$110,136, compared to the actual average of \$27,460. Similarly, if the federal minimum wage had grown at the same rate as CEO pay, it would have been \$23.03 in 2004, instead of \$5.15.

Figure 5: Value of CEO Pay and Average Production Worker Pay, 1990-2004 (in 2004 dollars)

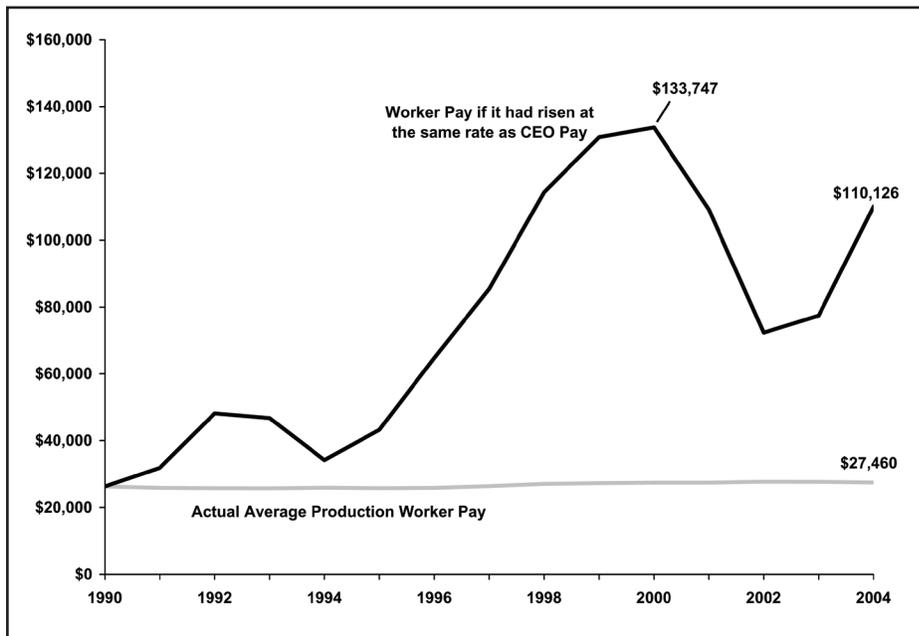
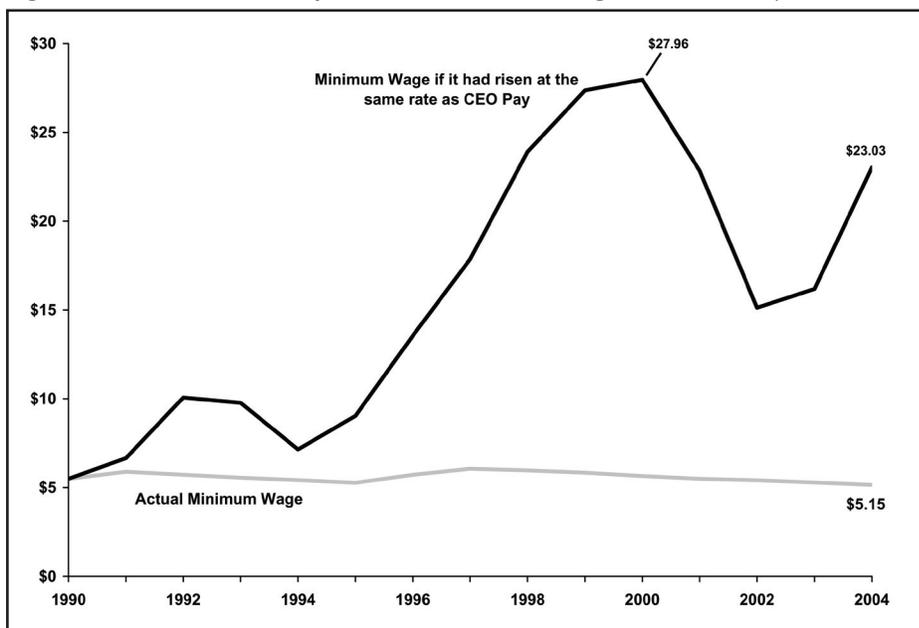


Figure 6: Value of CEO Pay and the Minimum Wage, 1990-2004 (in 2004 dollars)



B. Peeks at the Trough: Updates on Five of the Most Harmful Pay Trends

I. Pension Underfunders

The S&P 500 companies that most underfund their pensions also pay their CEOs 72 percent more than other large companies.

The trend from more secure defined benefit plans to defined contribution plans like 401(k)s, in which employees bear all of the investment risk, continues. The number of defined benefit plans contracted by half over the last decade. Today just 41 million Americans are covered by defined benefit plans.³⁴ Of these defined benefit plans, 25 percent have been converted to cash balance plans, adopted by companies to save money, but which often have the effect of negatively impacting the expected benefits of veteran employees.³⁵

Like the growing gap between the pay of average workers and corporate executives, the gulf in retirement benefits also deepens. While retirement benefits offered to average employees have grown more anemic and at risk, retirement benefits enjoyed by corporate executives continue to broaden and strengthen. While some executive perks such as country club memberships and use of company aircraft are being reined in, more companies are adding supplemental retirement benefits, which offer lucrative retirement plans above and beyond those available to average employees, to their stable of executive perks. Supplemental Executive Retirement Plans (SERPs) were created to get around the limitations on size of pension payouts in the nation's pension laws.

Pension tension fattens executives' wallets

In 2003, we looked at the pay of CEOs of the 30 companies with the largest funding gaps in their pension accounts and found that on average firms putting their employees' retirement security at risk paid their executives 59 percent more than the average large company CEOs.³⁶

Two years later, the nation's pension crisis has deepened. The funding shortfall in the nation's large private pension plans reached a record \$353 billion at the end of last year, up 27 percent over the previous year, according to the federal Pension Benefit Guarantee Corporation. If all pensions were included, the agency estimates the gap would be even wider, \$450 billion.³⁷

Similar to our findings two years ago, this year's survey of the S&P 500 companies with the largest underfunded pensions found that the CEOs of these firms, on average, received \$20.4 million in 2004 compensation, 72 percent more than the average large company CEO.

**Crude Coverage CEO Hall of Shame Award:
Exxon Mobil's Lee Raymond**

Some of the companies with underfunded pensions are facing tough industry conditions that have placed their long-term viability in jeopardy. For many others, there is no excuse, as severe underfunding of pensions has coincided with record profits and lavish executive compensation.

This year's CEO Hall of Shame inductee for Underfunded Pensions is Exxon Mobil Corporation's Lee Raymond. Exxon Mobil's \$12 billion pension shortfall is exceeded in size only by Ford. But unlike the struggling automaker, Exxon Mobil continues to report record sales and earnings. Forbes magazine estimates that at the current rate of its 2004 pension contributions, it will take Exxon Mobil 24 years to close its pension funding gap—more than twice as long as the other big S&P 500 companies with the largest underfunded pensions.³⁸

You'd never know Exxon Mobil was so far behind in funding its obligations to employees by looking at its executive pay. CEO Lee Raymond, a perennial figure among lists of highest paid executives, took home \$81.7 million in 2004, the third highest amount among the firms with the greatest pension funding shortfalls. The present value of Raymond's accumulated pension benefits exceeded \$81 million, according to the company's 2005 proxy statement.



2. Tax Dodgers

The 2004 average pay of the CEOs of the ten biggest firms paying no federal taxes in 2003 was 6 percent higher than the \$11.8 million received by average large company CEOs. We first examined the connection between corporate tax avoidance and executive pay in 2001, finding that large profitable companies that avoided paying federal corporate income taxes paid their executives 12 percent more, on average, than other large company CEOs.

With the tax departments of large corporations having morphed from boring back office cost centers into sexy engines of profit growth, taxes paid by large corporations are at their lowest level in generations, and are among the lowest in the industrialized world. Corporate tax cuts in 2002 and 2003, the rise in paper offshore subsidiaries, perverse stock option accounting and the evisceration of the corporate alternative minimum tax have saved large corporations tens of billions of dollars a year. Forty-six of the nation's 275 largest companies paid no federal income tax in 2003, according to a study by Citizens for Tax Justice.³⁹

Where are all these tax savings going? Some of them are finding their way into the pockets of CEOs.

Of these 46 tax-avoiding companies, ten reported more than \$1 billion each in pre-tax profits to their shareholders in 2003. Collectively these companies earned \$30 billion in profits and paid their CEOs \$126 million in 2003. If these ten firms had paid taxes at the 35 percent statutory tax rate, they would have contributed more than \$11.7 billion to the federal treasury, instead of extracting \$3.3 billion in refunds—a \$14 billion swing from just ten companies.

In 2004, these ten tax-avoiders paid their CEOs \$12.5 million, on average, 6 percent more than the average CEO took home that year.



**Taxpayer Dysfunction CEO Hall of Shame Award:
Pfizer's Hank McKinnell**

This year's CEO Pay CEO Hall of Shame inductee for Taxpayer Dysfunction is Viagra-maker Pfizer's Hank McKinnell. In 2003, Pfizer reported \$6 billion in profits and yet received a \$168 million refund from the federal government.⁴⁰ CEO Hank McKinnell's pay for the year topped \$28 million, 338 percent more than the average large company CEO.

Pfizer's inability to get excited about paying taxes stands in contrast to some of its industry competitors. Over the three-year period ending 2003, Pfizer had an effective federal income tax rate of 8.2 percent. Over the same period, similar-sized competitor Merck paid 32.5 percent of its income in taxes.⁴¹

3. Book Cookers

The trend toward earnings-inflating aggressive accounting and, in some cases, outright cooking of the books has been one of the drivers of excessive CEO pay. The prevalence of book cookers on *Business Week's* highest paid CEO list has made it difficult in some years to distinguish them from the police "Wanted" posters that hang in post offices.

While the Enron scandal is commonly viewed as the beginning of the corporate accounting debacle, its roots actually go back to the mid 1990s, with Greentree Financial and Consec being the first poster children for pay for shady accounting. In both 1995 and 1996, Greentree Financial CEO Lawrence Coss topped the list of highest paid CEOs, taking home \$168 million in the two years combined. In 1997, Greentree took a \$308 million charge to earnings related to "special purpose entities"—the same sort of off-balance sheet assets that later led to Enron's unraveling.⁴² The news weakened Greentree's once high-flying stock and eventually forced the company to sell out to Consec.

We examined the ten highest paid CEOs over the ten years from 1995 through 2004, and found that among the 100 slots filled by the lavishly paid, eighteen of them were filled by CEOs whose companies were either later found to have

committed fraud or to have been forced to make material restatements of earnings to correct previous overstatements of profits.

The prevalence of book cookers on the list of ten highest paid executives peaked in the year 2000, when half of the executives were later found to be presenting faulty accounting statements. Our 2002 study of the pay of the 23 companies under investigation for book cooking between 1999 and 2001 found that over those three years, the average pay of a book cooking CEO was \$62.2 million, 70 percent higher than the pay of the average large company CEO.⁴³

The trend has dissipated in the years following Enron's demise, with just one book cooker appearing on the 2002 and 2003 highest paid CEO lists and none appearing in 2004.

**The Vertical Pinstripes CEO Hall of Shame Award:
Tyco International's Dennis Kozlowski**

Best known for \$6,000 shower curtains and a two million dollar birthday party underwritten with corporate assets, Dennis Kozlowski was the book-cooking CEO that took home the greatest amount of pay over the last fifteen years. Between 1990 and 2003, when he left the company, Kozlowski pocketed more than half a billion dollars in pay and perks.

Convicted of misappropriating \$600 million of corporate assets, Kozlowski is presently awaiting sentencing of up to 30 years for his crime.

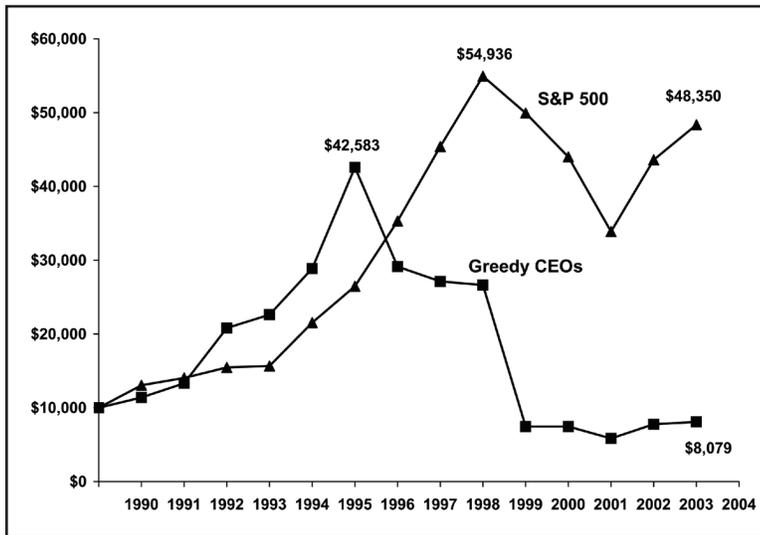


4. Stock Tankers

If big pay follows big performance then investing in the stock of the highest paid CEOs should be a surefire path to prosperity. Unfortunately quite the opposite is true. If you had invested in the stock of each of the single highest paid CEOs since 1990, you actually would have lost money. In fact, you would have done nearly six times better by investing in the S&P 500 index.

We constructed an artificial portfolio to consider the performance of the firms headed by the top-paid CEOs with that of the unmanaged S&P 500 index. We assumed two portfolios each with an initial value of \$10,000. The Greedy CEO portfolio was invested each January 1st in the stock of the previous year's highest paid CEO as reported annually in *Business Week's* executive compensation scorecard. At the end of the year, that stock was sold and the stock of the highest paid CEO for the year then ending was purchased. For instance, the portfolio began on January 1, 1991, by purchasing \$10,000 worth of stock in LIN Broadcasting, headed by 1990 excessive pay champ, Donald Perls. By December 31, 1991, the portfolio had risen in value to \$11,390 when it was sold and the stock of H.J. Heinz, headed by Anthony O'Reilly, the top-paid CEO in 1991, was purchased.

Figure 7: Greedy CEO Portfolio versus S&P 500 Portfolio, 1990-2004



The second portfolio was invested in the S&P 500 and left unchanged throughout the period. Dividends were reinvested in both portfolios.

Between 1991 and the end of 2004, the Greedy CEO portfolio shrunk to \$8,079, while the S&P 500 portfolio rose in value to \$48,350, almost six times more than our other portfolio. While the highest paid CEOs' performance topped the S&P 500 in seven of the 14 years, the Greedy CEOs more often turned in truly dismal performances. The S&P 500 outpaced the Greedy CEO portfolio by 15 percent or more in five of the years, while the highest paid CEOs bettered the S&P 500 by 15 percent in just two years.

Figure 8: Greedy CEO Portfolio versus S&P 500 Portfolio, 1991-2004

Year	Company	CEO	Company Stock Performance	S&P 500 Performance	Greedy CEO Portfolio	S&P 500 Portfolio
Starting Investment:					\$10,000	\$10,000
1990	LIN Broad	Donald Pels	13.9%	30.5%	\$11,390	\$13,050
1991	HJ Heinz	Anthony O'Reilly	16.9%	7.6%	\$13,315	\$14,042
1992	Hospital Corp	Thomas Frist	56.2%	10.1%	\$20,798	\$15,460
1993	Disney	Michael Eisner	8.7%	1.3%	\$22,607	\$15,661
1994	Morton	Charles Locke	27.7%	37.5%	\$28,870	\$21,534
1995	Greentree Financial	Lawrence Coss	47.5%	22.9%	\$42,583	\$26,465
1996	Greentree Financial	Lawrence Coss	-31.6%	33.4%	\$29,126	\$35,304
1997	Travelers	Sandy Weill	-6.9%	28.6%	\$27,117	\$45,402
1998	Disney	Michael Eisner	-1.8%	21.0%	\$26,629	\$54,936
1999	Computer Associates	Charles Wang	-72.0%	-9.1%	\$7,456	\$49,937
2000	Citigroup	John Reed	0.0%	-11.9%	\$7,456	\$43,994
2001	Oracle	Lawrence Ellison	-21.8%	-23.0%	\$5,831	\$33,876
2002	MBNA	Alfred Lerner	33.1%	28.7%	\$7,761	\$43,598
2003	Colgate Palmolive	Reuben Mark	4.1%	10.9%	\$8,079	\$48,350

**Stock Tanker CEO Hall of Shame Award:
Computer Associates' Charles Wang**

Charles Wang has the dubious distinction of delivering the worst stock performance in the year following his rise to the top of the highest paid CEO list. In 1999, Wang took home \$655 million, his share of a \$1.1 billion stock bonus shared among the company's three top officers. Months after the award was paid the company announced a business slowdown and questions about the company's accounting practices emerged and the stock price collapsed, losing 72 percent of its value in the year following Wang's windfall.

In the years that followed, Computer Associates admitted to accounting lapses including a "35 day month," keeping the books open past month end in order to book additional sales. The company restated its 2001 and 2002 earnings, reversing \$2.2 billion in improperly booked revenue. Wang retired from Computer Associates in 2002. Subsequently, three of his colleagues pled guilty to charges of accounting fraud. Wang was not charged in the financial wrong-doing, though he was CEO at the time they occurred.



5. Gross Pay

Over the last fifteen years, the cumulative pay of the ten highest paid CEOs in each year together totals more than \$11.7 billion.

Of the 150 possible slots for the highest paid executives over this period, not a single one was filled by a woman, and only one non-white male appeared on the list, Charles Wang, founder and former CEO of Computer Associates. Wang filled two of the slots, including boasting the second highest pay of a CEO in any single year, when he took home \$655 million in 1999. (Oracle's Lawrence Ellison holds the single year pay record, a whopping \$706 million in 2001.)

In 1990, the combined pay for the ten highest paid executives was \$365 million. The pay for the top ten peaked at \$1.6 billion in 2001, before falling back to \$481 million last year. In 2000, only executives clearing more than \$100 million made it onto the list, the only year that happened.

There were a number of contenders for the title of highest paid CEO over the last fifteen years. Wang and Ellison both received more than \$800 million in pay over the period. Runner-up for the highest paid CEO was Disney's Michael Eisner who fell just short of extracting \$1 billion from Disney shareholders, taking home \$980 million. Eisner appeared on the highest paid CEO list three times in fifteen years, leading it twice in 1993 and 1998. In 1993, Eisner was the first American CEO to top \$200 million in annual compensation, a record that stood until 1997. Eisner reclaimed the title the following year, 1998, when he crushed the existing pay record with a \$575 million pay package, an amount that was more than half the company's total operating profit for the year. Eisner's

1998 pay bonanza has been exceeded only twice since. So tepid has been Disney's recent performance that in 2004, in an unprecedented move, 43 percent of Disney's shareholders voted against returning Eisner to Disney's board. Eisner was stripped of his Chairman title and set on a path to stepping down from the throne of the Magical Pay Kingdom.



**Live Richly CEO Hall of Shame Award:
Citigroup's Sanford Weill**

This award—named in honor of Citigroup's marketing slogan—goes to Citigroup's CEO Sandy Weill, the only CEO to receive more than \$1 billion in pay and perks over the last fifteen years. During his tenure at Citigroup and its two successor companies, Primerica and Travelers, Weill appeared on the top ten highest paid CEO list nine times in fifteen years and led the list twice in 1997 and 2000.

Boat loads of stock options fueled the explosion of CEO compensation at the top of the pay charts, but Sandy Weill enjoyed a special benefit that propelled his meteoric pay. Weill received reload options: when he exercised a stock option, he was not only paid for the value of the option, but given a new replacement option to boot.

The largesse of stock options was rooted in sleight of hand accounting that allowed options to be granted without counting them as expenses on the company's income statements. Repeated calls for reform, from the investment community, the Financial Accounting Standards Board, and activists such as ourselves, were repelled for many years by the powerful force of CEOs and their corporations. Finally this past June, the Securities and Exchange Commission set in place rules requiring the expensing of stock options going forward. We are already seeing the result in smaller option grants.

IV. Reducing the CEO Pay Gap

A. Congressional Action

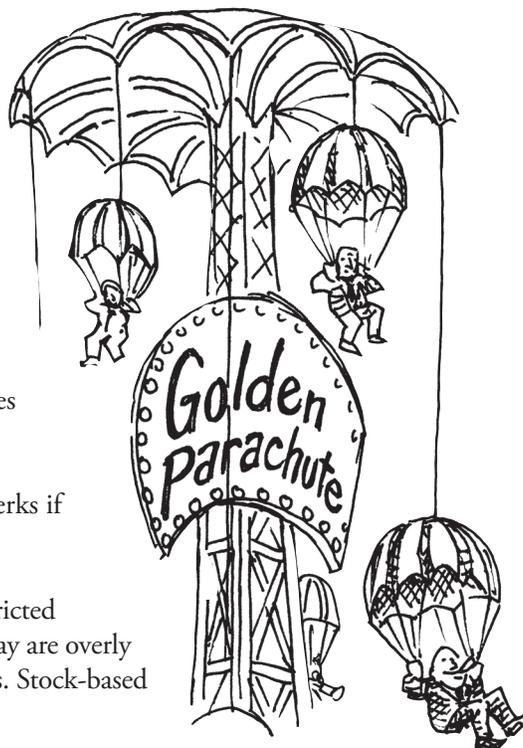
Changes in tax and government procurement policy

Excessive CEO pay continues to be encouraged by US tax law. Tax law allows reasonable business expenses as tax deductions, but while we know how many martinis are reasonable in the eyes of the IRS, no such standard has been introduced when it comes to reasonable business expenses associated with executive compensation. A 1986 attempt to cap executive pay deductions at \$1 million, unless amounts above this were based on performance standards approved by shareholders, has proved wholly ineffective as most companies ask shareholders to approve vague boilerplate language that thwarts the intent of the law.

In the aftermath of the September 11 national tragedy, Congress set an important precedent for ensuring that executives would not profit personally from the country's troubles. In a law that authorized a \$15 billion bailout for airlines hurt by the terrorist attack, the lawmakers required that companies receiving the funds ban raises and limit severance pay for executives whose pay in the year 2000 exceeded \$300,000. The principle behind this law should be applied more broadly. During wartime, pay levels should be frozen for executives of companies receiving defense contracts (or other war-related contracts, such as for Iraq reconstruction). In addition, the loopholes in the existing so-called "benchmark" for executives of all public contractors should be closed.

Additional solutions might include:

- Adopting the Income Equity Act (HR 3260)—Reintroduced on July 12, 2005, the Income Equity Act sponsored by Rep. Martin Olav Sabo (D-MN), would define "reasonable business expense" for executive pay as that which was no greater than 25 times the pay of the lowest full-time worker in the firm. Corporations would still be free to pay highly-compensated employees whatever they wished, but taxpayers would no longer subsidize amounts greater than 25 times the lowest paid worker.
- Limit deductibility of executive pay and perks if corporate pension funds are underfunded.
- Limit deductibility of stock-based pay (restricted stock and stock options) if these forms of pay are overly concentrated in the hands of few employees. Stock-based



pay has created an enormous amount of wealth for corporate executives and has been a prime contributor to the growing divide between executives and other employees. The underlying rationale for stock-based pay is to align the interest of corporate leaders with shareholders. Public policy should encourage both broad-based wealth creation and the alignment of all employees' interests with the goals and mission of the enterprise.

- Limit deductibility of executive pay if corporations fail to make proscribed minimal levels of federal corporate income tax payments. If corporate business models do not allow them to sustain sufficient levels of profitability without taxpayer subsidies, taxpayers should not be providing additional subsidies for highly compensated executives.

B. Securities and Exchange Commission Action

Foster competitive corporate board elections

- Allow shareholders greater access to nominate alternative director slates to the Board. The SEC made such a proposal in 2003 and it garnered the greatest number of public comments of any proposal in Commission history. More than 90 percent of comments supported this important reform and yet the SEC has failed to act, blocked by influential business groups, including the Business Roundtable, the powerful network of CEOs, which threatened suit if the regulation proceeded. Corporate boards are self-nominating and overwhelmingly made up of current and retired CEOs, who have a vested interest in not challenging compensation systems that they themselves benefit from.

Increase shareholder participation in governance of executive compensation.

- Shareholder proposals on executive compensation continued to be one of the most popular topics at 2005 annual meetings, with more than 100 proposals introduced. Union pension funds have taken the lead in submitting shareholder proposals on a range of executive compensation issues, including requiring shareholders to approve supplemental retirement plans for executives; requiring performance hurdles to be met before restricted stock vests; and requiring shareholder approval of severance payments in excess of two times the executive's annual salary. The SEC has long held that shareholders have broad purview over matters of executive pay and could mandate that shareholders directly approve corporate pay practices that are prone to excess and abuse. British shareholders must annually approve executive pay, a tradition that has contributed to greater restraint in executive pay than the United States has experienced.

C. Voluntary Corporate Actions: The Executive Pay Hall of Fame

While the most common justifications of executive pay practices over the last fifteen years have been based on the “great man” theory of individual achievement, a few compensation practices we’ve found are based on different values that reflect business as a shared enterprise.

Here are a couple signs of hope:

The I Didn’t Do It Alone Award:

Brad Anderson, CEO of Best Buy, shocked the business community after his 2003 announcement that he was giving his 200,000 stock options to outstanding non-executive employees. Foregoing the grant worth \$7.5 million sent the message that Anderson’s \$3.2 million salary and bonus were enough and the contributions of others were critical to the company’s success. Anderson was inspired in his action by his fellow Minnesotan and former Fastenal CEO Bob Kierlan, who regularly distributed his personal stock to his associates. Perhaps Anderson’s spirit will spread to another Minnesotan, William McGuire, CEO of United Healthcare, a poster boy for most excessive compensation in 2004. United Healthcare’s Compensation Committee raided the steroid cabinet down at the clinic and provided McGuire with a bulky \$125 million pay package.

The Horatio Ratio Award:

Too often gluttonous CEO pay is backed by the belief that single employees create enormous value. Standing in contrast to this “CEO picking the company up by its bootstraps” mentality are folks like Whole Foods Markets’ John Mackey, whose pay is limited to no more than fourteen times the pay of the average employee at the leading health food retailer. Mackey says of his pay philosophy: “We have a philosophy of shared fate, that we’re in this together.”

The Shared Sacrifice Award:

The annals of American business history are full of stories of firms with policies to avoid layoffs, where all workers took temporary pay cuts in order to preserve jobs and corporate executives took the largest pay cuts. We know of no large publicly traded companies that retain this antiquated ethic. This is an award we’d like to be able to give; a start might be freezing executive pay during periods of downsizing.

Appendix A: Understanding CEO Compensation



Publications like *Business Week*, *Fortune*, *Forbes* and the *Wall Street Journal* each use a different definition of executive compensation, and these definitions have changed over time, making it difficult to compare one year's compensation to another. The discrepancies that result can be enormous—in the millions of dollars—so it's important to understand what different definitions of CEO pay represent.

Our Executive Excess reports have always used the definition of CEO compensation that *Business Week* used in its “Executive Compensation Scoreboards” until 2004. That definition includes: salary, bonuses, restricted stock awards, payouts on other long-term incentives, and the value of options exercised in a given year; it does not include, however, the estimated value of stock options awarded. In the April 2005 issue on CEO pay, *Business Week* changed to a new definition that leaves out the value of options exercised but includes the estimated value of stock options awarded.

Throughout this year's Executive Excess report we've chosen to recreate the old *Business Week* definition of CEO pay—and not to use this year's new definition—so that we can make valid comparisons between years. Besides the advantage of comparing over time, there's another reason that we prefer the definition that includes options exercised and not options granted: it fits the common-sense definition of pay understood by most laypeople of “how much money you got this year.”

Proxy term definitions

Data on CEO pay comes from the proxy statements that companies are required to file with the Securities and Exchange Commission (SEC). These annual statements report on the status of the company and solicit votes from shareholders on issues to be decided at the companies' upcoming shareholder meetings. Each company's proxy statement includes detailed information on top executives' compensation, including:⁴⁴

Salary: The payment received just for showing up to work. Typically a small portion of a CEO's total pay package, the salary very rarely declines during down years.

Bonus: An annually determined cash payment reflecting general achievement of objectives. Although bonuses sometimes decline during years of poor performance, they are often significantly higher than the salary.

Other Annual Compensation: This catchall category reflects the perks and other benefits provided to the CEO on an annual basis. (This is different than the proxy category “All Other Compensation,” which represents perks not provided

on an annual basis). It includes company payments to various financial plans and personal benefits like country club memberships.

Restricted Stock Awards: Unlike options, which represent the right to purchase stock in the future, stock grants are made up of actual shares of stock. Usually, these awards are subject to some restrictions, which prevent the stock from being sold or transferred for a certain period of time, or until certain earnings thresholds have been met. Stock awards are valued based on the market price of the stock on the grant date.

Long Term Incentive Plan (LTIP) Payouts: In response to shareholder criticisms that CEOs' pay was too short-term oriented, Long-Term Incentives were created. The plans offer financial rewards (of cash or stock) for performance over a longer time period, commonly three to five years.

Stock Options: Stock options represent the right to purchase a certain number of shares of company stock at a set price (the strike price) after waiting a set interval of years. Only if stock prices go up do stock options become valuable.

Present Value of Stock Option Grants: Companies must calculate the theoretical worth (in current dollars) of options granted in the fiscal year covered by the proxy, based on one of two formulas mandated by the SEC.

Value Realized from Stock Options Exercised: This represents the actual money a CEO has gained through the stock options he or she has exercised in the fiscal year. It is calculated by finding the difference between the market price of the shares the CEO purchases when he or she exercises the option and the strike price.

Effects of different calculation methods

The most significant difference between definitions comes in the reporting of stock options; some sources include the present value of stock options granted during the fiscal year in a CEO's pay, while others include the value realized from the options the CEO exercised during that year. CEOs choose when to exercise their options based on fluctuations in the companies' stock price (the higher the price, the greater their gain), so the value of exercised options varies tremendously from year to year. Using the value of options granted to calculate CEO pay instead results in a smoother trend, since options are granted on a less erratic basis.

Average executive compensation for fiscal year 2004, as calculated with the old *Business Week* definition used throughout this report, is \$11,832,561. Using *Business Week's* new definition of CEO pay, this average drops to \$9,072,000, changing the ratio of CEO pay to average production worker pay from 431:1 using the old definition to 330:1 using the new definition. Median pay is affected much less dramatically by the change in definition, from \$6,855,000 according to the old definition to \$6,629,000 using the new one.

Which companies are included in CEO pay reports?

There is even more variation and less clarity when it comes to how the various reports choose which companies to include. The 367 companies that *Business Week* has included in this year's report are drawn from the 500 largest by market value; the *Wall Street Journal* includes "350 major US corporations;" *Forbes* uses the "500 biggest companies as measured by a composite ranking of sales, profits, assets and market value;" the AFL-CIO includes all of the S&P Super 1500 companies; and *Fortune* uses the Fortune 500 companies. The companies included are further limited by the availability of proxy data for the current year: publications include only those companies that file their proxy statements by the reports' publication dates.

Defining Total Executive Compensation

Using Exercised Options

Business Week (2004 and earlier): salary, bonus, other annual compensation, restricted stock awards, LTIP payouts, and value realized from options exercised.⁴⁵

Forbes: salary, bonus, other annual compensation, all other compensation, restricted stock awards, LTIP payouts, and value realized from options exercised.⁴⁶

The Wall Street Journal: salary, bonus, restricted stock awards, LTIP payouts, and value realized from options exercised.⁴⁷

Using Granted Options

Business Week (2005): salary, bonus, other annual compensation, restricted stock awards, LTIP payouts, and the present value of options granted in the fiscal year (calculated using the Black-Scholes formula and standardized inputs determined by Standard & Poor's ExecuComp).⁴⁸

AFL-CIO's "Executive Paywatch": salary, bonus, other annual compensation, restricted stock awards, LTIP payouts, and the present value of options granted in the fiscal year (as reported in the proxy).⁴⁹

Fortune: salary, bonus, other annual compensation, restricted stock awards, LTIP payouts, and the present value of options granted in the fiscal year (calculated by Equilar using the Black-Scholes formula as of grant date).⁵⁰

Appendix B: Data Tables

Top 2004 Publicly Traded Defense Contractors with 10% or More Revenues in Defense

To measure CEO pay in the defense industry, we examined 34 publicly traded US corporations that were among the top 100 defense contractors in 2004, and for which defense contracts made up more than 10 percent of their total revenues. These contracts do not include those administered by the US Agency for International Development for Iraq reconstruction. Total direct compensation covers salary, bonuses, gains from options exercises, other long-term incentive payouts and the value of restricted shares at the time of the grant.

Company	CEO	Executive Compensation			Value of Defense Contracts in 2004 (\$ millions)	Defense as % of 2004 Revenue	Key Product/Service
		2001 (\$ thousands)	2004 (\$ thousands)	% change 2001-2004			
Alliant Techsystems (1)	Daniel Murphy 2004, Paul David Miller 2001	2,902.0	1,713.5	-41	1,021.4	36.5	Ammunition
Anteon International	Joseph M. Kampf	655.9	6,200.1	845	700.7	55.3	IT services, including systems integration
Armor Holding (2)	Warrem B. Kanders	0.0	8,200.1	n/a	579.3	59.1	Protective equipment for military personnel and vehicles
Boeing (3)	Harry Stonecipher 2004, Phillip M. Condit 2001	3,929.0	3,994.8	2	18,476.6	34.9	F-15 fighter, C-17 air transport, Apache Helicopter, JDAM "smart" bombs
CACI International	J. P. (Jack) London	1,094.2	2,951.6	170	530.8	46.3	Information technology, prisoner interrogation
Computer Sciences	Van Honeycutt	2,146.0	19,782.6	822	2,390.8	17.0	Information technology, Iraqi police training
Cubic Defense System	Walter J. Zable	752.2	1,405.3	87	267.7	37.1	Combat training systems and communications electronics
DHB Industries	David H Brooks	525.0	70,605.0	13,349	232.2	68.3	Flak jackets and other bullet-resistant vests and body armor
DRS Technologies	Marks S. Newman	1,060.0	2,694.7	154	305.8	30.5	Electronic systems for surveillance, weapons targeting, flight recorders, thermal imaging, air combat training, and video recording
Engineered Support Systems	Michael F. Shanahan	17,094.5	39,730.0	132	693.8	78.5	Electronics, support equipment, and technical and logistics services
General Dynamics (4)	Nicholas D. Chabraja	5,719.0	31,528.4	451	10,375.1	53.1	Abrams MI tank, Trident submarine
GTSI	M Dendy Young	382.4	1,159.4	203	335.1	31.1	Computers, software, and networking products
Halliburton	David L. Lesar	6,682.0	11,421.6	71	7,996.8	39.1	Oil field services, construction (including Camp X-ray in Guantanamo Bay), maintenance
Harris	Howard L. Lance 2004, Phillip W. Farmer 2001	1,824.0	2,681.4	47	605.8	24.1	Microwave, satellite, radio, digital and wireless communications equipment and systems
Humana	Michael B. McCallister	1,530.0	1,970.5	29	2,372.1	18.1	Health care
ITT Industries	Steven R. Loranger 2004, Louis J. Giuliano 2001	2,992.0	11,846.1	296	1,539.7	22.8	Combat radios, night-vision devices, airborne electronic-warfare systems
L-3 Communications (5)	Frank C. Lanza	1,511.0	2,025.0	34	2,495.3	36.2	Satellite, avionics, missile defense, marine communications
Lockheed Martin (6)	Vance D. Coffman	16,556.0	6,733.3	-59	20,817.6	58.2	F-16, F/A-22 jet fighters, C-130J air transport, Hellfire, Javelin missiles

Company	CEO	Executive Compensation			Value of Defense Contracts in 2004 (\$ millions)	Defense as % of 2004 Revenue	Key Product/Service
		2001 (\$ thousands)	2004 (\$ thousands)	% change 2001–2004			
Northrop Grumman	Ronald D. Sugar 2004, Kent Kresa 2001	7,352.0	6,739.9	-8	11,894.1	39.8	B-2 stealth bomber, amphibious assault ships, training Iraqi army
Oshkosh Truck	Robert G. Bohn	896.0	3,765.5	320	1,024.4	45.3	Heavy-payload tactical trucks
Perini	Ronald N. Tutor	250.0	14,380.6	5,652	444.6	24.1	Construction, including Iraq's electrical infrastructure
Raytheon	William H. Swanson 2004, Daniel P. Burnham 2001	2,588.0	5,343.7	106	8,472.8	41.9	Patriot and Tomahawk missiles, "Bunker Buster" bomb
Rockwell Collins	Clayton M. Jones	783.0	2,687.9	243	588.4	20.1	Aviation electronics and communications equipment
Science Applications Int'l	Kenneth Dahlberg 2004, J. Robert Beyster 2001	1,873.0	2,800.0	49	2,450.8	31.6	Telecommunications, training Iraqi police
Shaw Group	James M. Bernhard Jr	2,941.7	2,876.2	-2	499.4	16.2	Power generation engineering and construction
Sierra Health Services	Anthony M. Marlon	3,257.1	15,989.3	391	427.8	27.2	Health care
Stewart and Stevenson Services	Max L. Lukens 2004, Michael L. Grimes 2001	637.7	750.0	18	375.8	32.5	Medium tactical vehicles, including cargo trucks and troop carriers
Tetra Tech	Geoffrey M. Hertel	1,532.1	315.0	-79	261.8	18.2	Management consulting and technical services
Textron (7)	L.B. Campbell	7,632.0	14,855.5	95	1,760.2	17.1	V-22 Osprey
Titan	Gene W. Ray	7,354.0	1,016.6	-86	933.5	45.6	Computer and communication systems, network security, systems engineering
United Industrial	Frederick Strader 2004, Richard R. Erkeneff 2001	580.9	765.5	32	331.0	86.0	automatic test equipment for avionics, electronic warfare test and training systems and aircraft maintenance
United Technologies (8)	George David	22,636.0	88,321.6	290	5,521.5	14.7	Black Hawk, Sea Hawk, Comanche helicopters
URS	Martin M. Koffel	4,534.0	6,442.9	42	803.8	23.8	Defense systems engineering and technical assistance and operations and maintenance services.
VSE (9)	Thomas Dacus 2004, Donald Ervine 2001	279.0	240.0	-14	231.7	107.3	Engineering, testing and logistics services
	Average	3,896.5	11,586.3	716.4	3,169.4	39.3	
	Median	1,848.5	3,880.2	86.8	752.3	35.5	

Sources: contracts: Department of Defense Directorate for Information Operations and Reports, table 3—DoD Top 100 Companies and Category of procurement—fiscal year 2004; revenues: Fortune, April 18, 2005; compensation: company proxies. Total direct compensation covers salary, bonuses, gains from options exercises, other long-term incentive payouts and the value of restricted shares at the time of the grant.

1. Includes value of contracts to subsidiary Alliant Lake City Small Caliber.
2. Parent company of American Body Armor and Equipment. Although the CEO did not receive compensation other than options grants in 2001, the firm paid \$937,260 in 2001 to a corporation controlled by the CEO.
3. Includes 50% of the value of contracts to Boeing Sikorsky Comanche Team, Bell Boeing Joint Program, and Team Apache Systems.
4. Includes value of contracts to GM GDLS Defense Group.
5. Includes value of contracts to subsidiary Army Fleet Support.
6. Includes 50% of value of contract to Team Apache Systems.
7. Includes 50% of the value of contracts to Bell Boeing Joint Program.
8. Includes 50% of the value of contracts to Boeing Sikorsky Comanche Team.
9. Value of defense contract exceeds revenues due to a backlog of funded contracts not yet completed.

The S&P 500's Biggest Underfunded Pensions

Company	CEO	Executive Compensation 2004 (\$ thousands)	2004 Dollars In Arrears (\$ billions)	Years To Break Even at 2004 Rate of Funding
Exxon Mobil	L. Raymond	82,310	12	24
Delta Air Lines	G. Grinstein	291	5	11
Lockheed Martin	C. Coffman	7,364	5	10
Raytheon	W. Swanson	5,559	4	9
General Motors	R. Wagoner	4,738	8	8
Dow Chemical	W. Stavropoulos	18,363	3	7
Procter & Gamble	A. Lafley	15,131	2	6
Pfizer	H. McKinnell	16,352	3	6
Exelon	J. Rowe	10,274	3	6
Ford Motor	W. Ford, Jr.	17,512	12	5
Electronic Data Systems	M. Jordan	2,217	2	5
DuPont	C. Holliday	3,518	4	5
IBM	S. Palmisano	11,424	7	4
Hewlett-Packard	C. Fiorina	3,764	2	4
Conoco Phillips	J. Mulva	92,436	2	4
United Technologies	G. David	88,632	3	3
Altria Group	L. Camilleri	11,901	2	2
Boeing	H. Stonecipher	4,158	4	1
Goodyear	R Keegan	4,226	3	N/A
Alcoa	A. Belda	7,515	2	N/A
	Average	20,384	4	7
	Median	8,895	3	6

Tax Avoiders						
Company	CEO	2003 Executive Compensation (\$ thousands)	2004 Executive Compensation (\$ thousands)	2003 Pre-tax Profit (\$ millions)	2003 Federal Taxes (\$ millions)	2003 Effective Tax Rate
Boeing	P. Conduit/H. Stonecipher	3,698	4,158	1,069	-1700	-159.0%
Public Service Enterprise Group	E. J. Ferland	2,452	2,783	1,369	-208	-15.2%
FPL Group	L. Hay	6,436	6,096	1,282	-181	-14.1%
AT&T	D. Dorman	10,819	9,780	2,723	-343	-12.6%
SBC Communication	E. Whitacre	18,691	14,170	8,941	-476	-5.3%
Disney	M. Eisner	7,255	8,307	1,764	-59	-3.4%
Time Warner	R. Parsons	11,614	14,176	4,224	-140	-3.3%
Pfizer	H. McKinnell	9,678	16,352	6,088	-168	-2.8%
Lehman Brothers	R. Fuld	52,954	35,241	1,825	-39	-2.1%
Burlington Northern	M. Rose	3,183	13,803	1,226	-18	-1.5%
	Average	12,678	12,487	3,051	-333	-21.9%
	Median	8,467	11,792	1,795	-175	-4.4%
Note: Pfizer's stock options granted listed two assumptions 5% or 10% stock growth, we used the more conservative 5% assumption.						

Endnotes

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Past reports on CEO pay from United for a Fair Economy and/or the Institute for Policy Studies

The reports listed below are available online at www.FairEconomy.org.

Executive Excess 2004: Campaign Contributions, Outsourcing, Unexpensed Stock Options and Rising CEO Pay. CEOs at the companies outsourcing the most workers were paid more than typical CEOs. The report also looks at the link between high CEO pay and campaign contributions.

Executive Excess 2003: CEOs Win, Workers and Taxpayers Lose. CEOs at companies with the largest layoffs, most underfunded pensions and biggest tax breaks were rewarded with bigger paychecks.

More Bucks for the Bang: CEO Pay at Top Defense Contractors. CEOs at the nation's largest military contractors rose 79 percent in 2002, compared to a six percent increase for typical CEOs.

Executive Excess 2002: CEOs Cook the Books, Skewer the Rest of Us. CEOs of companies under investigation for accounting irregularities earned 70 percent more from 1999 to 2001 than the average CEO at large companies.

Titans of the Enron Economy: The 10 Habits of Highly Defective Corporations, April 2002. This prescient report showed how many of the problems dramatically revealed by the Enron scandal are woven tightly into the fabric of American business. It ranked the worst companies in 10 areas and gave Enny Awards to companies with Enronesque behavior, including General Electric, Citigroup, AOL TimeWarner, WorldCom and Halliburton. Includes 12-step program for breaking Enronesque habits.