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## Editors' Note

**The growth in executive compensation** over the last 30 years has been a particularly visible illustration of the larger takeoff in earnings inequality. During the early stages of that takeoff, these dramatic changes were happening under the radar; indeed, the public was not just unconcerned by the changes but was largely unaware of them. But that's obviously no longer the case. We are in the midst of a historic moment in which public debates about the legitimacy of executive compensation have taken on a new urgency. The main purpose of this issue is to ask how such debates might be deepened by considering the leading scholarly work on offer.

The basic facts of the takeoff are not in dispute. As of 2007, the CEOs of the largest U.S. firms earned about 344 times more than the average worker, a ratio that's nearly eight times larger than what prevailed some 30 years ago. During the deregulative period (i.e., 1980s–2000s), a common view among academics and other commentators was that high CEO pay was not particularly troubling, that it was just a matter of a well-functioning market offering up rewards commensurate with the CEO's ever more consequential decisions. The economic crisis suddenly made such views appear quaint and naive. As the crisis played out, it became a matter of some controversy that seemingly disastrous CEO decisions were still amply rewarded, and the pendulum has swung back to the view that compensation decisions have been "captured" by the firm's management and thus were corruptly made. However fashionable that critical view now is, it no more bears a free pass than the equally pat formulation that presumes that, whatever CEO pay may be, it perforce reflects the work of competitive market forces. We have therefore asked some of the most prominent scholars of executive pay to identify the ways in which pay does and does not reflect the true marginal product of executives. We have also asked them, insofar as pay is out of line with that true marginal product, what role should public policy play in correcting things?

It doesn't take a careful reading of the resulting essays to appreciate that smart and empirically savvy scholars can legitimately disagree on the matter. In our lead piece, Lucian Bebchuk and Jesse Fried describe how directors have strong economic incentives to cater to the interests of executives rather than shareholders, which has resulted in not just excessive pay but also decision making that isn't fully attentive to creating shareholder value. If that's the diagnosis, the appropriate remedy is institutional reform that forces directors to take shareholders into account. In the second essay, Alex Edmans and Xavier Gabaix contend that the main problem isn't that board members have been co-opted, but that managers have incentives to maximize the value of their stock options by pumping up stock prices in the short term. This diagnosis underlies their clever institutional reforms intended, in part, to incentivize managers to take the long-term view. In the concluding essay, Robert Frank rejects all such corporate reform; rather, he argues that current pay levels indeed reflect, on average, the value that executives create. Although he would leave existing pay-setting institutions intact, he nonetheless regards pay levels as socially destructive and suggests that tax policy be deployed to curb runaway growth.

The executive pay controversy hinges fundamentally on whether pay exceeds the value that executives add. And so it should be. In the United States, the commitment to a market economy resides deep in our cultural DNA, and as such, most people are well prepared to accept high compensation—insofar as it's rightly earned. The simple but crucial question taken on in this issue of *Pathways* is whether this conventional American formula for justifying high pay is indeed on the mark.

—David Grusky & Christopher Wimer, Senior Editors