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Pop Goes The Compensation Bubble

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Doubts about the federal government's ability - and willingness - to reign in excessive executive compensation have persisted since Congress and the Bush administration adopted the Emergency Economic Stabilization Act in October of last year. But now, as the Treasury Department's Special Master for Compensation, Kenneth Feinberg, prepares to review pay schemes for the top executives of firms that have received TARP money, the tables have turned.

House Minority Leader John Boehner in February backed the idea of compensation limits for taxpayer-bailed out companies, saying "I think if anybody is looking to the taxpayer to help bail their company out, these kinds of executive compensation limits are appropriate." In June, however, Boehner called the idea of setting pay limits "absolute lunacy." David Boaz of the libertarian Cato Institute called Feinberg's role "the rule of one man" that subverts "the rule of law." And Gary Becker drew on the libertarian favorite F.A. Hayek to complain that Feinberg will inevitably interfere with :

> The social purpose of competition and private enterprise...to provide quick responses to constantly changing market conditions. These responses include determining and changing the salaries, bonuses, and stock options of employees and top executives. Companies get into trouble and even fail when their decisions, including decisions on the quality of employees and their compensation, are less effective than decisions of their competitors.

These criticisms are unsurprising: the image of a lone Washington bureaucrat reviewing pages of numbers to determine the pay of a hard-working, "undoubtedly" well-meaning Wall Street Capitalist is too much for any libertarian to resist.

But as Jeff Madrick wrote recently in *The Nation*, compensation in the financial services industry is not based in reality:

> [Wall Street] would add just as much to the economy through accessible and cheap financing and innovative investment vehicles at much lower levels of profits and individual compensation...Competition is supposed to wither [unearned] surpluses away. At least, that's the long-standing argument for a free market. But if this is true in other industries (and it is probably less true than is widely believed), it is clearly not so in finance. They made money not because they deserve it, but because of a special advantage they have.

In recent years, the financial services industry has become expert in what Simon Johnson calls "the politics of how you construct a multi-billion dollar opportunity so that you can get in, pull others after you, and then get out before it all collapses." Though conservatives and libertarians prefer to ignore the influence of politics when talking about the efficiency of markets, they use politics as a bludgeon whenever government "interference" is proposed.

Feinberg's compensation oversight provides an opportunity to put politics on the side of taxpayers. Feinberg will not be concerned with whether Bank of

America will lose employees to a non-TARP company that is free to set its executive pay higher. But he will be concerned with whether the public believes compensation is set too high, far from a bad thing in an era of uncertainty about why Wall Street executives are compensated so well.

As Bloomberg's Ian Katz speculates today, "Kenneth Feinberg's mandate to set pay guidelines...may set a template for Wall Street compensation." Instead of compensation limits igniting a race to the bottom, as Becker fears, Feinberg might actually rein in excessive pay across the board by creating a more reasonable compensation standard. Feinberg might actually pop the compensation bubble.

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