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ARTHUR YOUNG & COMPANY

277 PARK AVENUE
NEW YORK, N. Y. 10017

May 2, 1978

The President
The White House
Washington, D. C. 20500

Dear Mr. President:

Arthur Young & Company is deeply concerned with the continuing pattern of inflation in this country. We are also concerned with forecasts that indicate that the inflationary spiral is moving up at a rate which could reach a level of 8-1/2 percent before the end of the year. As an international accounting firm, we have consistently taken the position that the level of inflation which this country has experienced in the last several years is a serious threat to the national economy and the free enterprise system. We applaud your recognition of the importance of this issue and your initiative in instituting a dialogue with business and labor. Restraint is, indeed, needed, but throughout our society, in government and labor, as well as business.

Your Special Counselor on Inflation, Robert S. Strauss, said in a speech last week that "President Carter fully recognizes that it is futile to expect the private sector to exercise self-discipline unless government is willing to toe the line." Noting that your "Administration will demand the same moderation in government spending and government wages that we ask of the private sector," Mr. Strauss said that members of Congress and the Administration have a tendency to see only one dimension of a program. Mr. Strauss added that "We must all join together in a fair effort, with no segment of our economy singled out to bear an unfair share of the burden."

As vigorously as we agree with the call for a nationwide, shared effort to combat inflation, we oppose the suggestion of a voluntary freeze on the compensation of senior executives. We oppose this freeze because, over the long term, it is counterproductive and unfair to senior executives. We believe that the compensation of executives - and indeed the compensation of all workers - should be treated in a fair, productive, and realistic manner.

For the past 15 years, Arthur Young & Company has been analyzing levels and trends of compensation for senior executives. As part of that continuing activity, we have recently concluded a study of top executive salaries in the durable goods manufacturing industry for the period 1970 to 1977. This study shows that, in spite of dollar increases, 1977 executive salaries, when adjusted for the impact of federal taxes and for the inflationary factor, are anywhere from 9 percent to 19 percent below 1970 after-tax salaries for the identical positions. Indeed, the real decline is even greater if increases in state and local taxes since 1970 are considered. As part of the same study, a review of the data in other industry categories such as non-manufacturing and financial services showed a similar pattern.

It is certainly well known that inflation has reduced apparent pay gains of other workers as well. A comparison of the impact of inflation on other groups suggests that - at least in relative percentage terms - inflation and the tax impact have hit executives harder. Government statistics show that during the same period non-supervisory production workers' take-home pay, when adjusted for inflation, has remained almost constant in terms of 1970 dollars, while executive salaries - not only those studied - have declined in real terms.

Our recent studies also show that in more than 75 percent of American industry, a significant part of executive compensation is performance-based. Indeed, many of the increases in executives' compensation that have occurred are directly attributable to incentive programs which reward high achievement. To remove such an economic incentive for corporate managers would be tantamount to weakening the hand of management in motivating performance and in keeping costs down.

Given the fact that total executive compensation is an extremely small part of national disposable income - less than 1 percent - freezing such incomes would contribute in only a minor way in the battle to control inflation. We recognize the symbolic nature of a voluntary freeze; we respectfully submit, however, that it is the wrong symbol for two reasons: 1) a voluntary freeze on executive compensation would not be meaningful to the average worker who is not likely to be impressed by any symbolic freeze on executive compensation; and 2) more importantly, by placing so much stress on a voluntary freeze on executive compensation, the government might destroy a major anti-inflationary incentive - the motivation to operate efficiently.

The economic turbulence of the 1970's has demanded a higher level of performance from corporate executives than in any other period in recent history. Top management executives have had to cope with a succession of serious problems, including environmental issues, runaway inflation, high energy costs, material shortages and a volatile foreign exchange market. Despite the buffeting, U.S. business has achieved a continuing economic recovery which is, to a large extent, a tribute to the American businessman's outstanding performance and ability to meet these challenges. In this context, as well, executive compensation has failed to keep pace with the extraordinary increase in demands on executives' time.

Thus, rather than pressing business leaders to voluntarily freeze executive compensation, we respectfully suggest that the nation's well being and your administration's goals would be better served if you were to encourage the establishment of a closer relationship between an executive's compensation and his or her contribution to the company's profitability. We would particularly recommend that you encourage discussion of the extent to which companies can voluntarily link increases in compensation to cost reduction and productivity increases.

This type of corrective and cooperative action is far-sighted, equitable, and practical. It would be a positive contribution toward lowering inflation by all sectors of the nation - government, labor, and business.

Sincerely,

ARTHUR YOUNG & COMPANY

by: Edwin S. Mruk
Edwin S. Mruk