"Perverting Civilization" or Pursuing Dreams?

Economic Arguments About Executive Compensation Practices in the United States, 1890 to 1940

Katherine M. Savarese

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Plato told Aristotle no one should make more than five times the pay of the lowest member of society. J.P. Morgan said 20 times. Jesus advocated a negative differential - that's why they killed him.

-Graef Crystal, former executive pay consultant, 1998[1]

I. Introduction & Background

It is almost impossible to read a news or business publication today without encountering a heated discussion of executive compensation practices, ranging from indignant criticism to staunch defense. Strong opinions are unsurprising given that, in 2007, CEOs in the S&P 500 averaged $10.5 million each, 344 times the pay of the typical American worker.[2] Most recently, the debates have centered on the actions of Kenneth Feinberg, an attorney appointed "Special Master of Compensation" by the Treasury Department to oversee executive salaries and bonuses at companies receiving funds from the Troubled Asset Relief Program (TARP).[3] His attempts to moderate and even cut compensation of CEOs have provoked intense, and conflicting, reactions from the public and the business community. This recent outcry begs the question: how did it all begin? When and why did executives first start receiving such lavish salaries and bonuses, and what were the economic arguments about these practices?

Although diverging opinions about appropriate pay levels are not new, the present environment of transparency and disclosure of executive compensation is. Before 1934, there was no public reporting of salaries and bonuses for corporate executives in the United States, and for years after, numerous companies used strategic methods to shroud the exact numbers.[4] Only

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[1] Sam Pizzigati, "Quotes," *Inequality.org,* http://www.demos.org/inequality/quotes.cfm. Graef Crystal is an author and former executive pay consultant who later became critical of executive compensation practices.

[2] These figures come from a report by the Institute for Policy Studies and United for a Fair Economy, available online at http://www.ips-dc.org/reports/executive_excess_2008_how_average_taxpayers_subsidize_runaway_pay. Sarah Anderson and others, *Executive Excess 2008: How Average Taxpayers Subsidize Runaway Pay, 15th Annual CEO Compensation Survey* (Washington, DC: 2008), 1.

[3] Stephen Gandel, "Wall Street, Meet Ken Feinberg, the Pay Czar," *Time Magazine*, November 2, 2009, http://www.time.com/time/business/article/0,8599,1933078,00.html?iid=sphere-inline-sidebar.

[4] These methods included awarding bonuses in the form of stock options. For a more thorough discussion of such practices, see George Thomas Washington, *Corporate Executives' Compensation: Legal and Business Aspects of*

in the second half of the 20th century did accurate reporting become the norm, and only in the past two decades has this information been made easily available to the public in the form of online databases.

Given the lack of organized data before, the existing scholarly literature primarily focuses on the post-1970s era. I believe, however, that it is possible to trace the precursors of today's compensation packages back to the late 19th and early 20th centuries. In her 1948 *Guide to Business History*, Henrietta Larson wrote under the Executive Salaries heading, "This subject has been studied inadequately. The few studies which have been made do not go farther back than the late 1920's."[5] This paper aims to shed light on the developments leading to a U.S. Senate Resolution on 29 May 1933[6] directing the Federal Trade Commission to study executive compensation—culminating in the *Report of the Federal Trade Commission on Compensation of Officers and Directors of Certain Corporations* in 1934—and to examine the ideas of executives, the government, lawmakers, and the general population about the practice of awarding large salaries and bonuses to executives.[7]

Limiting the scope of my examination to the period between 1890 and 1940, I will focus on the practices of three of the largest corporations of the early 20th century—United States Steel, Bethlehem Steel, and General Motors—and the public perception of some of the leading figures and executives of the time, including J.P. Morgan, Charles Schwab, and Elbert Gary. Through these case studies I will explore the economic thought in the business world that gave rise to the corporate executive's progression to the upper echelons of income and society, and the

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Salary and Bonus Plans, Stock Options, Pensions, Indemnity Agreement, and Related Matters (New York: The Ronald Press Company, 1942), chapters 3 and 6.

5 Henrietta M. Larson, *Guide to Business History: Materials for the Study of American Business History and Suggestions for their Use*, vol. 12, *Harvard Studies in Business History* (Cambridge: Harvard University Press, 1948), 984.

6 Senate Resolution 75, 73rd Congress, 1st Session, (1933-34), 77 Cong. Rec. 4474, 4475 (1933).

7 Information about Senate Resolution from Washington, *Corporate Executives' Compensation,* 228.

public perception of such practices, ultimately culminating in government action to regulate executive compensation for the first time in the United States.

II. Combinations in the 1900s and the Rise of Businessmen as Celebrities

In 1895, a national news outlet pronounced, "It is given to few men to attain the position in the financial world that is now held by J. Pierpont Morgan."[8] Although never a corporate executive himself, J.P. Morgan played a significant role in creating both the companies that yielded powerful executives and the environment of profligate wealth that produced their salaries. Featured regularly in newspapers across the country, from the *Bangor Daily Whig and Courier* to the *New Orleans Daily Picayune* to the *Denver Daily News*, Morgan could not so much as buy a new dog without the press reporting and commenting on the matter.[9] "The influence Mr. Morgan exerts, his ability to command the ablest executive and managing capacity and the tributes he pays to genius by calling it whenever he sees it so that it may be brought into association with his own interests," were highly regarded and envied by the nation.[10] It was largely this faith in his judgment that gave him the license to combine companies within the same industry, most famously steel, to create some of the largest corporations the United States had ever seen. Popular belief in his abilities was transferred to the men he chose to run his enterprises, who also entered the spotlight as 'celebrity CEOs.'

While business savvy engendered respect, tremendous wealth inspired in the public the most awe and fascination. Throughout the 1890s and 1900s, newspapers and magazines published a great quantity of articles reporting on the most trivial details of rich men's lives—for

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[8] "J. Pierpont Morgan – He Is a Power in American Financial Affairs," *The Milwaukee Journal*, July 10, 1895, pg. 8.
[9] Editorial, "An Eastern paper tells us that J. Pierpont Morgan is a great lover of dogs," *Salt Lake Semi-Weekly Tribune,* August 29, 1899, pg. 4.
[10] "J.P. Morgan's Influence," *Boston Daily Advertiser*, September 28, 1899, pg. 4.

example, "Fads of Rich Bachelors - How a New York Millionaire Spends His Money: Ancient Suits of Fine Armor"[11]—and advertisements claiming to have the secrets to getting rich—even medicinal formulas 'guaranteed' to help one make money.[12] One piece, reprinted in several newspapers in different U.S. cities, observed, "Money is always a fascinating subject. The poorer a reader is, as a rule, the more greedily does he devour the stories of how immense fortunes were made; with keener zest does he hear of the eccentricities of the newly rich."[13] Not all coverage was favorable, but even criticism revealed intrigue. When discussing the "launching of J. Pierpont Morgan's new yacht in New York Harbor," one paper calculated that "fourteen of the guests represented a total amount of wealth in excess of $300,000,000," and accused them of "perverting civilization."[14] As a point of comparison, that would equal $7.899 billion, or $564.2 million per person, in 2009 dollars.[15]

In December 1900, Morgan began organizing the companies that would become United States Steel—including Andrew Carnegie's entire steel business, sold to Morgan for $492,006,160[16]—and in the spring of 1901 the corporation began work.[17] According to Baker, "Never before had there been such a huge business deal . . . It is difficult to convey any adequate idea of the magnitude of the Steel Corporation."[18] Seemingly overnight, America's first "billion-dollar corporation" was born.[19] Despite only retaining a position on the Board of Directors,

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[11] "Fads of Rich Bachelors," *The Milwaukee Journal*, May 14, 1892, pg. 12.
[12] "Getting Rich," *The Penny Press*, October 3, 1896, pg. 6.
[13] J. H. Beadle, "The Eccentric Rich," *The North American*, July 6, 1892, pg. 2.
[14] "Money and Property," *Semi-Weekly Tribune*, December 23, 1898, pg. 4.
[15] This and subsequent inflation calculations computed by Wolfram *Mathematica*, www.wolframalpha.com.
[16] Arundel Cotter, *The Authentic History of the United States Steel Corporation* (New York: Moody Magazine and Book Company, 1916), 9.
[17] Ray Stannard Baker, "What The U.S. Steel Corporation Really Is, And How It Works," *McClure's Magazine*, November 1901. The other companies that were combined to make U.S. Steel were: The Carnegie Steel Company, the Federal Steel Company, the American Steel and Wire Company, the North American Sheet Steel Company, the American Tin Plate Company, the American Steel Hoop Company, and the Lake Superior Consolidated Iron Mines (Rockefeller interests).
[18] Baker, "What The U.S. Steel Corporation Really Is, And How It Works."
[19] Arundel Cotter, *U.S. Steel: A Corporation With a Soul* (Garden City, NY: Doubleday, Page & Company, 1921), 6.

Morgan's firm made a considerable profit on the transaction, estimated between $750,000 and over two million dollars—or between $19.27 and $51.38 million in 2009 dollars.[20] Having initially made Charles M. Schwab president of U.S. Steel, Morgan replaced him in 1903 with Elbert H. Gary after Schwab left to take over Bethlehem Steel.

III. Elbert H. Gary and the United States Steel Corporation

Although not the first president of United States Steel, Elbert H. Gary was the most famous and influential. In his testimony in one of several unsuccessful Federal anti-trust suits brought against the corporation, Robert Bacon explained that Gary "has done more for the U.S. Steel Corporation in its development and the benefits it has brought all hands than any one man since its formation."[21] While his fame stemmed partly from his association with the greatest industrial enterprise in the world, "Both the competitors of the U.S. Steel Corporation and its employees spoke, not of the corporation but of its head,"[22] for it was Gary's novel business practices that distinguished him in the corporate sphere. "At the beginning of the century, and indeed much later, the average corporation executive either refused information to the public and to stockholders or gave it sparingly and grudgingly,"[23] but such was not the case with "The Judge," as Gary was fondly called by those who knew him. Speaking to a writer for *Harper's Weekly* in 1908, Gary illuminated his dreams and goals for the business world:

> Any man who says he is not influenced by selfish motives in his dealings is, of course, a hypocrite. We all know better; but there is a host of men who can appreciate a policy of honesty, and every sane man sees that such a policy must be scrupulously followed. And this idea should extend until it prevails in all dealings and in the management of all corporations. It is in the air!

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[20] Sources disagree on the amount he made, some asserting the number was as high as $12 million. I have cited the lower estimate from "What The U.S. Steel Corporation Really Is, And How It Works" as it seems less exaggerated and is based on an examination of the company's books, although it is not beyond doubt that the number was many millions more.
[21] Quoted in Cotter, *Authentic History,* 80-81.
[22] Arundel Cotter, *The Gary I Knew* (Boston: The Stratford Company, 1928), 36.
[23] Cotter, *The Gary I Knew*, 118.

> The tendency of business henceforth will be to respect the public, and the man who antagonizes that policy will be ground out sooner or later.[24]

Arundel Cotter, a prominent financial journalist and frequent contributor to *Barron's,* averred, "The story of United States Steel is the tale of how Gary made his dream come true."[25] Over years of covering U.S. Steel for *Barron's,* and after writing two books on his company, *The Authentic History of the United States Steel Corporation* in 1916, and *United States Steel: A Corporation With A Soul* in 1921, Cotter eventually became quite close to Gary, and even "respectfully dedicated" the *Authentic History* to him.[26] Their relationship did not unduly influence his observations about Gary or U.S. Steel, however, and Cotter maintained enough critical distance to accept his work as a reliable source of information, while his special connection allowed him unparalleled access and insight into the running of the corporation.

Born on 8 October 1846 and raised in a middle class family in Illinois, Gary initially strove to be a lawyer and succeeded in establishing a prosperous legal practice in Chicago. According to Cotter, "The year 1898 was probably the most important in Gary's life. It was at this time that he first met J. Pierpont Morgan, the elder."[27] Borrowing money from Morgan, Gary established the Federal Steel Company in 1898 and gave up his legal practice to become its president in New York City. The *Milwaukee Journal* reported on his move and change of career, noting "The salary of Mr. Gary is said to have been fixed at $60,000 a year—or $10,000 a year more than the president of the United States makes."[28] His legal knowledge and business acumen soon attracted the attention of magnates of the steel industry, and in 1901 Morgan invited Gary to join his U.S. Steel enterprise as chairman of the Executive Committee, offering a substantial

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[24] Elbert Gary, quoted in John Kimberly Mumford, "This Land of Opportunity: 'The Watchword of the Hour – Honest Business and Fair Play,'" *Harper's Weekly,* June 13, 1908, 20.
[25] Cotter, *Authentic History*, frontispiece.
[26] Ibid.
[27] Cotter, *The Gary I Knew,* 105.
[28] "A Man Whose Salary is $60,000 A Year," *The Milwaukee Journal*, October 17, 1898, col E.

salary increase. Though annual reports of the time did not include salary data, in his 1916 book on U.S. Steel Cotter stated, "the salaries of the president and of the chairman of the Executive Committee were placed at $100,000 each" in 1901.[29] George Thomas Washington, a lawyer who wrote on executive compensation practices, corroborates this number in a footnote, mentioning that, "After the foundation of the United States Steel Corporation in 1901, Judge Gary was reputed to be receiving a salary of $100,000 and a bonus of nearly $400,000."[30]

As president of U.S. Steel, Gary "elevated the tone of business ethics,"[31] and "adopted policies of publicity, of fair dealing with competitors, with labor and with the public that eventually overcame to a great extent the public hatred of corporations. He convinced the man in the street that big business could be conducted openly, honestly and profitably at the same time."[32] Nevertheless, he was a formidable force. In the early years of U.S. Steel, when a competing member of the board fell ill, "Gary seized the opportunity to consolidate his position. He was made chairman of the board of directors, with the special title of 'chief executive officer,' and was vested with all the powers of the board and of the finance committee when those bodies were not in session."[33] While possessing many admirable qualities, he "was not lacking in personal vanity; he had great faith in his own ability and judgment, and realized as well as anyone else how important an asset he was to the United States Steel Corporation,"[34] giving him license to increase his salary from $100,000 to an estimated "$300,000 to $400,000"

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[29] Cotter, *Authentic History*, 28. In 2009 dollars, his salary would be $1.58 million.
[30] 2 *Editorial Research Reports*, No. 10 (1935) 237, quoted in Washington, *Corporate Executives' Compensation*, 226. In 2009 dollars, his salary would be equal to $2.569 million, with a bonus of $10.28 million, calculated by Wolfram *Mathematica,* not a far cry from today's CEO salaries.
[31] Cotter, *The Gary I Knew*, 21.
[32] Cotter, *The Gary I Knew,* 116.
[33] Cotter, *The Gary I Knew*, 112. This is also one of the first recorded uses of the phrase "chief executive officer" that I have found thus far.
[34] Cotter, *The Gary I Knew*, 68.

by 1916, according to Cotter, who insisted that rumors of his salary exceeding $1 million were false.[35] Illustrating the extent of Gary's fame and esteem, Cotter recounted:

> He became not only a national but an international figure. When he traveled it was almost in state, and he was entertained by kings and potentates. His acquaintance included almost everyone in the world who was worth knowing. His judgment was respected and his opinions carried weight everywhere . . . He became the leading figure in the business world by virtue of his position as head of the largest of all corporations and by his own statesmanlike business ability.[36]

One of Gary's many contributions to U.S. Steel was the Stock Subscription and Profit Sharing Plan implemented in 1902, modeled on Andrew Carnegie's method of "appealing to the loyalty of his men through self-interest."[37] While a novel development for the industry, in a company of the unprecedented size of U.S. Steel, the necessity of an incentive plan to cohesively unite all the workers in various plants across the country was obvious. The plan was designed to accomplish three main objectives:

1. To interest employees in the Steel Corporation as a whole and not merely in the operations of the subsidiary for which they worked
2. To give them an incentive to do everything possible to reduce expenses and correspondingly increase profits
3. To offer them an inducement to stay with the corporation and identify themselves with it[38]

It accomplished these goals by entitling all employees of the company to buy stock at below-market prices, and rewarded those who remained with the company five years for more with "a bonus of $5 a year on each share of preferred and $3.50 a year on each share of common stock held."[39] Notably, the plan distinguished between "the men who occupy official and semi-official positions and who are engaged in directing and managing the affairs of the corporation and of its several subsidiary companies" and laborers, inviting only the former to participate in the profit

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[35] Cotter, *The Gary I Knew*, 56. Cotter does not give the sources of his salary estimates, and they do not include bonuses, so it is possible that Gary's total earnings could have been closer to $1 million, or $19.9 million in 2009 dollars.
[36] Cotter, *The Gary I Knew,* 125-126.
[37] Cotter, *The Authentic History of U.S. Steel*, 37.
[38] Ibid., 38.
[39] Ibid., 39.

sharing portion of the plan, which distributed additional corporation profits to these executives.[40] Despite this division, employees were ostensibly happy with the plan and the company's financial success is a testament to its effectiveness.[41] Gary served as chairman of the board until his unexpected death on 15 August 1927 at the age of 82.

IV. Charles M. Schwab and the Bethlehem Steel Corporation

With the exception of his two-year turn as the president of U.S. Steel, "Bethlehem [Steel] has been the *magnum opus* of Schwab's life."[42] Like Gary, Schwab came from a middle class background and worked his way up the ranks of the steel industry, beginning as a stake driver and ending up president of one of the largest steel companies in the United States. Unlike Gary, he was not motivated by benign concern for workers or fairness, and "repeatedly remarked that he [was] not in the business to make steel, but to make money for himself and the other stockholders of Bethlehem Steel. The manufacture of steel [was] merely the means to this end."[43] Initially insecure about his standing in the industry, when Schwab "took charge at Bethlehem he was determined to demonstrate that he had the ability to make a great steel company out of rather unpromising material—and he has done it."[44] Writing extensively on Bethlehem Steel as well as U.S. Steel, Cotter explained that "the enormous success of the

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[40] Cotter, *The Authentic History of U.S. Steel,* 39-41. The idea of profit sharing to increase productivity and provide incentives for hard work originated in the late 19th century, but was not widely adopted, especially in the United States, until the 1920s, making Gary an innovator in respect to early implementation. Profit sharing eventually came to be known as the "Bonus System," from which the modern concept of the bonus derives. In the 1920s, several leading economic historians published investigations of profit sharing, and by 1929 most large corporations had adopted some form of the system.

[41] It is a testament to Gary's iron will that there were only ever two strikes, one around 1901 and one in 1919, and no successful union organization, at U.S. Steel throughout his reign, despite his refusal to eliminate Sunday work until 1910 or adopt the 8-hour work day until 1923. He was not a cruel dictator however, and spent considerable sums on improving the health and safety of workers and the quality of company towns.

[42] Arundel Cotter, *The Story of Bethlehem Steel* (New York: Moody Magazine and Book Company, 1916), 40.

[43] Ibid., 20.

[44] Ibid., 41.

Bethlehem Steel Corporation has been undoubtedly due in great part to the bonus system."[45] Based on this theory "that practically every man, given an equal opportunity, would reach as great success as another, that there were no men of extraordinary ability,"[46] Schwab's plan, according to Cotter,

> Differs from most other so-called profit-sharing plans in that every individual coming within its scope gets directly the fruit of his own efforts and gets it quickly. For . . . the average man cannot become enthusiastic for a reward for applied endeavor a year or more ahead, nor will he give the best that is in him if his return is on a pro rata basis with the entire organization.[47]

This bonus system applied to each worker in the organization, "with the exception of the executive officers, whose work covers the entire company and who must therefore be paid on the general results."[48] According to Cotter,

> Wonderful tales have been told of the enormous bonuses paid to officials of the company under the plan. They are probably exaggerated, but in 1914, during which year Bethlehem Steel earned about 32.5% increase on its common stock E.G. Grace, now president of the corporation, drew down a bonus of over $200,000, so that it is not at all improbable that his bonus in 1915, when some 112.5% was earned, was near the $1,000,000 with which he has been credited.[49]

In an interview in 1918, Schwab declared "The use of the bonus system has been the only successful way to secure individual co-operation to the extent we have found desirable."[50] More adventuresome than Gary, Schwab frequently appeared in the papers and gossip magazines for his outlandish exploits, such as breaking the bank at Monte Carlo, but his escapades also brought higher scrutiny, leading to negative press. In 1921, the *New York Times* published an article entitled "$260,000 Expenses Paid for Schwab," disclosing accusations that Schwab had charged $260,000 in personal expenses to the Shipping Board and Bethlehem Shipbuilding Corporation,

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[45] Ibid., 18.
[46] Ibid., 53.
[47] Ibid., 18-19.
[48] Ibid.
[49] Cotter, *The Story of Bethlehem Steel,* 22.
[50] "Bethlehem Bonus System – Stockholders Give Sanction to Long-Existing Payment Plan," *New York Times*, April 3, 1918.

listing $100,000 as a construction cost.[51] Whether or not these and other allegations were true does not diminish Schwab's status in the business world, formally acknowledged when he won the Bessemer Medal, "the highest honor which can come to a steel man," in May 1928.[52]

Schwab also distinguished himself by his method of choosing and promoting his closest advisors, directors and assistants. When he took over Bethlehem in 1903, Schwab decided

> to select for the carrying on of the enterprise only men already with the company; to bring in no new men. He believed that there were quite a number of young men at Bethlehem who, under his leadership, could take charge of the company's operations and make the proposition a paying one––and events proved him right.[53]

"He selected 15 of these men, the original 'Boys of Bethlehem' . . . and told them that, if they stuck to Bethlehem Steel, gave to it all of their ability and energy, he would make them all millionaires." Admitting he is "not sure that every one of the chosen few is now the owner of millions," Cotter asserted that "several, at least, are, and the rest are well on the way to becoming so."[54]

Younger than Gary, Schwab lived through the depression and experienced public criticism of his bonus plan, resulting in legal proceedings by minority stockholders in 1931. Responding swiftly to the attacks, Schwab "assumed full responsibility for the Bethlehem executives' bonus system in the face of widespread criticism and litigation," and modified the system to placate shareholders who proceeded to drop the suit. According to *New York Times* coverage of the story, "It has been estimated that the reductions in executives' bonuses would aggregate $1,200,000."[55]

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[51] "$260,000 Expenses Paid for Schwab," *New York Times*, January 21, 1921.
[52] Arundel Cotter, "'Covering' Schwab: Difficulties of a Reporter Who Accompanied the Steel Master to London," *Barron's,* May 28, 1928, 11.
[53] Cotter, *The Story of Bethlehem Steel,* 55.
[54] Cotter, *The Story of Bethlehem Steel,* 55-56.
[55] "Bethlehem Bonuses Are Cut by New Plan, Salaries Increased," *New York Times*, July 3, 1931.

V. Public Perceptions: Scholarly Journal and Newspaper Coverage

As mentioned in the introduction, official records of salaries and bonuses did not exist prior to 1934. While F. W. Taussig and W. S. Barker published the first study dealing with executive compensation, *American Corporations and their Executives: A Statistical Inquiry,* in 1925, it was limited in scope and relied on self-reporting, as evidenced by its finding that out of 400 manufacturing companies, only one paid a salary of $100,000; furthermore, it did not account for the executives of the largest corporations which are the focus of this study.[56] The few existing examinations of this topic suggest that salaries did not escalate until the 1920s, but there are details that indicate an earlier date. One of the four authors who studied executive compensation cited in Larson's *Guide to Business History*, George Thomas Washington provides an interesting perspective in his 1942 book, *Corporate Executives' Compensation: Legal and Business Aspects of Salary and Bonus Plans,* an account of his experiences as a lawyer assisting in "litigation involving the validity and effect" of bonus plans, and preparing "compensation contracts for corporate officials."[57] In his overview of the history of executive compensation, Washington distinguished between salaried workers and "the great leaders of industry," concluding that until the 1920s, "the corporate executive simply had no place in the upper income levels."[58] Although the government and the public may not have realized the magnitude of executive salaries earlier, I do not believe that compensation suddenly surged in the 1920s, but rather that the trajectories of men like Gary and Schwab are indicative of a much earlier increase among large industry corporations.

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[56] F. W. Taussig and W. S. Barker, "American Corporations and Their Executives: A Statistical Inquiry," *The Quarterly Journal of Economics* 40, no. 1 (Nov. 1925): 1. Contemporary evidence suggests that salaries of $100,000 or above were much more common for executives than this survey indicated.
[57] Washington, *Corporate Executives' Compensation,* iii.
[58] Washington, *Corporate Executives' Compensation,* 226.

When discussing salary size, it is important to differentiate between three types of rich men in the early 20th century: bankers, such as Morgan, who made a lot of money in business deals but were not themselves salaried executives, businessmen who inherited fortunes, such as William Henry Vanderbilt, and those who worked their way up the corporate ladder from the bottom, such as Elbert Gary and Charles Schwab. This paper concerns the perception of the third type of man, who first rose to great prominence with the ascension of huge corporations in the 1900s.

In the late 19th and early 20th centuries, many public news and opinion outlets began coverage of the presidents and executives of those companies as both society figures and arbiters of the business world. Entire newspaper articles were devoted to the salaries of even relatively obscure individuals simply because they earned a lot of money. Until the 1920s, this coverage remained largely frivolous and designed for entertainment purposes. A good indication of the sentiments of these pieces, *Harper's Weekly* ran a recurring feature entitled "This Busy World," a briefing on the activities of political, business and society figures, which often included tales of Charles Schwab, "a pretty big man in a very small world."[59] In contrast to the privacy of their business dealings, the off-duty activities of rich and famous businessmen were open to public scrutiny, whether they liked it or not. Schwab gambling on vacation in Monte Carlo sparked a flurry of news coverage, and the musing: "Probably he forgot how small the earth has grown, and thought himself at liberty to profit by any form of relaxation that seemed harmless and inviting. But he knows better now."[60]

Despite the wide gap between the salaries of corporate executives and the average worker, media coverage did not seem to focus on injustice, but rather expressed awe at those

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[59] "This Busy World," *Harper's Weekly*, January 25, 1902, 122.
[60] Ibid.

who had achieved success. A 1911 report on U.S. Steel for shareholders and investors by Dow, Jones & Co. estimated that the average yearly wage per U.S. Steel employee in 1903 was $720.[61] Assuming Gary's salary to be $100,000 in 1903, it was 138.8 times the yearly earnings of his average employee, yet such comparisons were uncommon or nonexistent in the national media at the time. Even prominent 'muckraking' publications like *McClure's* and *The American Magazine* did little to criticize executives' actions. In December 1906, Peter S. Grosscup published an article entitled "Who Shall Own America?" examining the "corporation problem" whereby the "property of this country is owned by the many and controlled by the few."[62] As of June 1906, however, he recanted and, instead of "exploiting evils," called attention to "the seeds of reform already being sown by a few well-managed corporations" in another article entitled "The Rebirth of the Corporation,"[63] which discouraged government intervention and instead advocated public ownership of stock and scrutiny of corporations.

The extent of the public's knowledge of executive salaries before the 1920s is unclear, but there were several definitive reports of high earnings as early as 1901, as well as Cotter's books published in 1916. According to Washington, "the highest salary found prior to 1900 was one of $75,000 paid to the president of a life insurance company in the '90s," a sum referred to as "enormous" in a court case at the time.[64] An article in the *Milwaukee Journal* from 13 June 1898 possibly alludes to this same instance with the headline "Largest Salary Earned in New York – Paid to Henry B. Hyde, President of a New York Insurance Company."[65] Most notably, on 23 March 1901 *Harper's Weekly* reported:

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[61] Dow, Jones & Co., *A Decade In United States Steel* (New York: The Wall Street Journal, 1911), 3. The report does not indicate if this average wage includes those of executives, but given its proximity to estimates of the average national wage (around $700), I am assuming it only reflects workers' salaries.
[62] Quoted in Peter S. Grosscup, "The Rebirth of the Corporation," *The American Magazine*, June 1906.
[63] Ibid.
[64] Washington, *Corporate Executives' Compensation*, 226.
[65] "Largest Salary Earned in New York," *Milwaukee Journal*, June 13, 1898, pg. 4.

> It seems to be true that Mr. Schwab, of the Billion Dollar Steel Combination, is to be paid a salary of a million dollars a year. It is a large salary. Probably it is the biggest salary ever paid to a commoner. Kings have had more, but kings are different. There seems to be no doubt that Mr. Schwab's services will be worth the money paid for them . . . It is perfectly easy to believe that the United States Steel Corporation will need some one to do a million dollars' worth of thinking for it every year, and when the case is put that way Mr. Schwab's salary doesn't seem too big.[66]

Other than a note of sarcasm, the piece did not contain any direct criticism of Schwab, or of Morgan for setting his salary. It is unclear, given the tone of the article, whether $1 million was meant to be an accurate report or a droll exaggeration, but likely it was in earnest. Apart from the coverage in *Harper's*, there was virtually no reporting on the salaries of the officers of the United States Steel Corporation around the time of its founding, indicating either a lack of public interest or an acceptance that such salaries were rightfully earned by executives. Predating the railroad salary revelations by over a decade, *Harper's* also reported on William H. Newman, the incoming president of the New York Central Railroad:

> There is a new great man: a really and truly great man, of whose greatness evidence no less conclusive is offered than that he gets a salary of $50,000 a year. That is meager pay compared with Mr. Schwab's, but compared with any one else's salary it is impressive. Only able men are worth so much.[67]

Again with an edge of sarcasm Martin casts doubt upon the wisdom that a man's greatness is mirrored in his salary, but does not openly criticize the sum, instead giving an account of Newman's rise through the ranks of the railroad industry beginning as a freight agent and eventually becoming president of a line.

Harper's delivered a subtler hint as to the value of executive salaries in a summary of a series of papers from the *North American Review* entitled "Industrial and Railroad Consolidation." Explaining, "The articles set forth, more clearly and in smaller compass than they can be found elsewhere, the arguments as to the advantage to the community of great combinations of effort," the editors summarized the primary benefit of combination as being

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[66] E.S. Martin, "This Busy World," *Harper's Weekly,* March 23, 1901, 319.
[67] E.S. Martin, "This Busy World," *Harper's Weekly,* June 22, 1901, 636.

"The enormous saving in the salaries of high-priced men—presidents, vice-presidents, and office staff generally. When the work that has heretofore been done by a dozen or twenty separate corporations is put under one head, eleven or nineteen presidents and office staffs are saved."[68] If executive officers had not been making considerable salaries as of 1901, significant money saved would not have been a justification for consolidation.

I have not had the chance to examine the personal records of officials describing their thoughts behind executive compensation—if such records exist—but it is possible to infer their theories and motivations from their actions. Implementation of profit sharing plans indicates a belief in the motivational and retentive power of monetary bonuses to promote devotion to and exertion on behalf of the corporation. Executive salaries and bonuses served as profit sharing on a much larger scale. As corporate officials transitioned from the old titans of industry to professional executives, salaries increased to lure talented leaders, motivate men to work their way up the pay ladder, and maintain company loyalty.[69] Lack of knowledge about executive compensation practices is unsurprising given that "few companies revealed their salary schedules to the public, or even to their own stockholders. Business tradition forbade discussion of such matters."[70] According to Washington,

> the large payments of the 1920's were given little or no publicity. The writer knows of one huge corporation which in 1929 quietly paid its president total compensation of nearly a million dollars. The possibility that this fact might become public was considered so dangerous to the welfare of the company that even the directors themselves, with the exception of the controlling group, were not permitted to know the exact amount. This was not an isolated case. Payments even larger were made by other companies with the same policy of silence.[71]

Based on the limited information available, it is possible that most people had such high regard for prominent executives that they did not think to question their personal gains.

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[68] Editorial, "Industrial and Railroad Consolidation," *Harper's Weekly,* May 4, 1901, 450.
[69] Washington, *Corporate Executives' Compensation*, 226-227.
[70] Washington, *Corporate Executives' Compensation*, 226.
[71] Washington, *Corporate Executives' Compensation*, 227-228. Washington references court cases as sources for his information which I was not able to examine in the scope of this paper.

The commencement of hostilities in Europe changed everything, however, as the government sought to control vital industries during wartime. According to a 2009 article on executive compensation in the 20th century by Carola Frydman, an economist at MIT University, "Revelations regarding executive pay first occurred during World War I, when railroad corporations became managed by the federal government and the exorbitant salaries of railroad officers were exposed."[72] The winter of 1921 brought the *New York Times* headlines "N.Y. Reserve Bank Salaries Attacked,"[73] and "Denies $100,000 Salary."[74] On 23 December 1922, a *Wall Street Journal* article entitled "Commerce Commission Goes Into Executives' Salaries," reported that the Senate Committee on Interstate Commerce had compiled data on "increases or decreases in the salaries of railroad officers amounting to $5,000 or more per annum during the war period" to investigate "the cause of the increase of some $1,400,000,000 in railroad operating expenses in 1920 as compared with 1919."[75] Explaining that

> A comprehensive list of railroad salaries for the year 1917, collected by McAdoo's railroad wage commission, was made public for the first time in 1918 by being placed in the Congressional Record; but the new list, beginning with 1914, shows the trend of railroad salaries during the period of the war and the general inflation that accompanied it.[76]

The article went on to note,

> Of the ninety chief executive officers shown in the list (chairmen, presidents, receivers, etc.) as indicated by the compensation for six months of 1921, only one received an annual salary of $100,000; seven . . . received $75,000 or over; six . . . received $60,000 to $75,000; nine received $50,000 to $60,000; five received $40,000 to $50,000; 16 received $30,000 to $40,000; 19 received $20,000 to 30,000; seven received from $15,000 to $20,000; eight received from $10,000 to $15,000 and 12 received $10,000 or less.[77]

Ultimately, the author made no judgments about the executives or their salaries, instead simply listing them for each company in detail. Such passive appraisals of compensation disappeared

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[72] Carola Frydman, "Learning from the Past: Trends in Executive Compensation over the 20th Century," *CESifo Economic Studies* 55, no. 3-4 (2009): 466.
[73] John Skelton Williams, "N.Y. Reserve Bank Salaries Attacked," *New York Times,* October 21, 1921.
[74] "Denies $100,000 Salary," *New York Times*, December 25, 1921. In this article, the president of the Pennsylvania Railroad system defended the pay of officials, but I could not access the full text in the New York Times Archive.
[75] "Commerce Commission goes into Executives' Salaries," *The Wall Street Journal*, December 23, 1922, pg. 12.
[76] Ibid.
[77] Ibid.

along with national prosperity in October 1929 as the Great Depression set in and the "high rewards of the boom years gradually came to light."[78]

In addition to findings from "investigations by equity receivers and bankruptcy trustees after the collapse of several large companies," litigation initiated by stockholders against corporations brought compensation practices to the forefront of the national consciousness.[79] In "Lowering High Salaries," a *New York Times* correspondent remarked that, "Only recently, in connection with the salaries, bonuses and stock gifts which went to the management of the American Tobacco Company, has there been evidence of the difficulty of justifying huge incomes in depressed times . . . Yet in the compromise of a stockholder's suit its officers have consented to earnings more in keeping with the general condition of the American people."[80] In a series of pieces published between 1932 and 1934, *The New York Times* both publicized and castigated executive compensation schemes in articles calling for the lowering of high salaries, reorganization of corporate structure, government inquiry into compensation practices, and even taxes on excessive pay.[81] While the public may have been in the dark about, or at least content to turn a blind eye towards, executive compensation before the Great Depression, the sharp contrast between the excesses of corporate officers and the hardships suffered by most Americans spurred outrage, ultimately leading to government investigation and intervention.

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[78] Washington, *Corporate Executives' Compensation*, 228.
[79] Washington, *Corporate Executives' Compensation*, 228.
[80] "Lowering High Salaries," *New York Times*, July 15, 1933.
[81] See "State Needs to Revise Methods," *New York Times,* June 5, 1932; "Inquiry into High Salaries Pressed by the Government," *New York Times*, October 29, 1933; "Gore Proposes Tax on Excessive Pay," *New York Times*, March 1, 1934; "Big Salaries Bring Demand for Curbs," *New York Times,* March 5, 1934; and "High Salaries in Hard Times," *New York Times*, March 11, 1934.

VI. Government Crackdown: The Federal Trade Commission Reports of 1934

In response to public and presidential pressure, on 26 February 1934, Garland S. Ferguson, Jr., the Chairman of the Federal Trade Commission, issued the "Report of the Federal Trade Commission on Compensation of Officers and Directors of Certain Corporations" with a note at the top of the first page reading "CAUTION: To be held in confidence until presented to the Senate, which will probably be on Monday, February 26, 1934."[82] Confidentiality was necessary given the sensitive and volatile nature of public opinion on the subject, as demonstrated by the backlash against corporations that the Commission's findings eventually generated. The report, "initiated by the Commission following a resolution of the United States Senate, proposed by Senator Costigan and agreed to May 29, 1933, calling for information regarding the salaries and other compensation of executive officers and directors of specified classes of corporations,"[83] was not easy to compile. Though the Federal Trade Commission was authorized by the United States Senate, and the Supreme Court via the commerce clause, to investigate corporations and individuals engaged in interstate commerce, executives at the companies targeted were less than willing to cooperate. After years of operating without government oversight, powerful executives were not ready to concede so quickly to what they perceived to be a new presidential administration flexing its muscles. Consequently, the report was not entirely complete.

Although 877 schedules were returned, "shortly after the returns began to come in it became obvious that many companies had not included indirect compensation, that is, amounts paid by subsidiary or affiliated companies."[84] Several companies made incomplete returns; some

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[82] Garland S. Ferguson, Jr., "Report of the Federal Trade Commission on Compensation of Officers and Directors of Certain Corporations," Federal Trade Commission, Washington DC: February 26, 1934, 1.
[83] Ibid.
[84] Ibid., 5.

alleged that they did not engage in interstate commerce and were thus exempt from the inquiry; and others refused or neglected to report entirely. Despite these limitations, the report was groundbreaking in the public attention it focused on long held company secrets. For the first time in U.S. history, the average citizen experienced a clear picture of the internal operations of some of the largest corporations in the world that, in many ways, had strong indirect influences on the lives of most people in the country. Furthermore, the findings of the Commerce Commission provided data that allowed scholars to finally study executive compensation through an academic lens. Most notably, John Calhoun Baker published a great many articles on the subject between 1936 and 1939, and the book *Executive Salaries and Bonus Plans* in 1938, ultimately making it the focus of his career and earning him esteem in the field of economic history.[85]

Page 13 of the report discussed four companies that "replied to the request for information with a general denial of the Commission's powers," including the General Motors Corporation which

> by its General Counsel questioned the authority of this Commission to make this inquiry. A letter from the Chairman of the Commission similar in tenor to that addressed to General Aviation Corporation . . . was sent on January 17, 1934, but no reply or report was received from the General Motors Corporation.[86]

In its Annual Report for the year ended December 31, 1934, under the heading Executive Compensation, General Motors stated

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[85] See John Calhoun Baker and William L. Crum, "Compensation of Corporation Executives—The 1928-1932 Record," *Harvard Business Review,* Spring 1935; John C. Baker, "Incentive Compensation Plans for Executives," *Harvard Business Review*, Fall 1936; Baker, "Executive Compensation Compared with Earnings," *Harvard Business Review,* Winter 1936; Baker, "Operating Expenses and Executive Compensation Policies of Investment Companies: 1929-1935," *Harvard Business Review*, Spring 1937; Baker, "The Compensation of Executive Officers of Steel Corporations," *Harvard Business Review,* Summer 1937; Baker, "Executive Compensation Payments by Large and Small Industrial Companies," *Harvard Business Review*, Summer 1939; Baker, "How Should Executives Be Paid?" *Harvard Business Review,* Fall 1939; and Baker, "Payments to Senior Corporation Executives," *The Quarterly Journal of Economics* 59, no. 2 (1945): 170-184.

[86] Ferguson, "Report of the FTC," 13-14.

> As a Corporation policy, it is believed that the remuneration of the Corporation's administrative staff, is a personal relationship between each individual involved and the Corporation itself. It is held to be highly undesirable and contrary to the interests of the stockholders to approach the question from any other standpoint.[87]

In the minds of the public, General Motors' hesitation to reveal its compensation reports indicated sinister machinations. Attempting to put such suspicions to rest, Lammot du Pont, a director and former chairman of the General Motors board addressed the annual stockholders meeting of 1938 and "explained that, in meeting their obligation to secure the best brains possible to manage the property, the directors of General Motors had to establish executive salaries in competition with other employers of executive talent as well as in competition with what high class executives could earn in business with themselves,"[88] echoing the words, 70 years later, of many CEOs in the United States today in response to renewed government examination of executive compensation.

VII. Conclusions: History Repeating Itself

In researching this topic I have been continually struck by the amazing, if somewhat eerie, similarities of the sentiments expressed by reporters and CEOs in the early 20th century and what is being said by those same groups today. On November 23, 2009, the *New York Times* ran an article with the headline "Executives Kept Wealth as Firms Failed, Study Says,"[89] that sounded as though it could have been lifted out of the same edition 80 years earlier. Reporting that "top executives of Bear Stearns and Lehman Brothers collected hundreds of millions of dollars before their firms collapsed," the article indicates that some companies have not changed

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[87] General Motors, "Twenty-Sixth Annual Report of General Motors Corporation," December 31, 1934.

[88] "Lammot du Pont Defends Scale of Salaries Of General Motors Executives; Is But Half Average of 20 Other Firms on Basis of Net," *Wall Street Journal,* April 27, 1938.

[89] Louise Story, "Executives Kept Wealth as Firms Failed, Study Says," *New York Times*, November 23, 2009, section B3.

their practices sine 1929.[90] Although executive compensation practices of the latter half of the 20th century have been studied extensively, the history of these ideas requires further inquiry. In a presentation on "U.S. Earnings and Wealth Inequality Over the 20th Century," given recently at Harvard College, Emmanuel Saez described the U-shaped curve of income inequality in the U.S., beginning with extremely high levels in 1928, dropping throughout much of the 20th century, and in recent years increasing again to approach 1920s levels.[91] Further research would be required to determine what, if any, relationship exists between income inequality and executive compensation practices, or between the peak of executive compensation levels in the 1920s and the market collapse during the Great Depression, but it might be a worthwhile subject to consider particularly given the current economic climate.

[90] Ibid.
[91] Emmanuel Saez, "U.S. Earnings and Wealth Inequality Over the 20th Century," Harvard Center for History and Economics Seminar and Workshop: Economic Inequality in the Long Run, 18 November 2009.

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