Executive Pay

- Should the Dutch government use tax measures as an effective way to regulate compensation?

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Preface

A lot of different opinions exist concerning the issue of executive pay. This research is an in-depth analysis of the effectiveness of tax measures by looking at both the effects of possible tax measures and the desirability of the stakeholders. This research paper is written as an assignment for the research block Global Business: Firm Strategies for the master Global Business & Stakeholder Management at the Rotterdam School of Management.

We would like to thank Ton Mertens, a specialist in employment taxes (partner at Loyens & Loeff and a lecturer at the University of Amsterdam), for giving us more information and a better insight on this topic and the Dutch situation specifically. Furthermore, we would like to thank Prof. Dr. L.C.P.M. Meijs for being our supervisor. His advice and feedback proved to be very helpful during the process of writing this research paper. He really helped us thinking critically about this research.

Finally, we would like to thank the BSM Department at Erasmus University Rotterdam for giving us the theoretical background, which came in hand during the research process.

We would also like to take this opportunity to show our gratitude for the collaboration of this team. Given that we did not know each others style of researching beforehand, it worked out very well, without disappointments. Writing the feasibility study and group contract beforehand proved to be very helpful, since we got a better understanding of the topic and each other.

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Executive Summary

Increased public and political debates have prevailed about the growth and increased level of executive pay packages in both the private and the (semi-)governmental sector. In the market sector, executive pay is often comprised of a fixed base salary and pension plans, and variable components like annual or long-term bonus plans, stock options, and performance shares (Murphy, 1999). This report has investigated the effectiveness of three income taxation possibilities in the market sector in The Netherlands, namely introducing more progressive tax tariffs in general, increasing tax rates for certain parts of the executive pay package, and limiting corporation taxes deductibility for certain parts of the executive pay package above a certain amount.

It is recognized that the effectiveness of a tax measure is based on two aspects: whether the measure is efficient, thus whether the increased taxation has the consequence of decreasing executives’ income; and whether the measure is ethical, thus whether the tax measures and its effects are desired by the different stakeholders.

All these tax measures do not eventually lead to the result of a structural decrease of income inequality in The Netherlands. First of all, executives have relatively strong bargaining power in the current context of a prosperous market with low unemployment rates. As a result, executives are able to demand from their companies that they compensate the loss of income they have to bear due to the increased income taxes and therefore the goal of increased income equality has not been reached (Mertens, 2007). In the most extreme case, when companies are not willing to compensate increased income taxes, taxation may lead to talented executives moving and working to other countries, the so-called ‘brain drain’ (Van der Kwast, 2006; Van Uffelen, 2007). Since these tax measures do not lead to decreased income levels for executives and increased income equality, they cannot be considered efficient.

In addition, the results of increased corporation costs or a brain drain of talented executives to other countries are developments that are not aspired by all stakeholders. As a result, it is argued that taxation measures are not effective in increasing income equality and decreasing extremely high executive salary levels. It is proposed that other measures that might be efficient and that are supported by all stakeholders entail increasing transparency of corporate governance practices.

A final issue concerns the ownership of executive pay. Although all stakeholders feel entitled to judge executives’ compensation levels, it is also suggested that executive pay primarily is an issue of the market sector, and thus the owners of the company, the shareholders.
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Introduction

In 2006, Donald Shepard, the executive of AEGON, received €6,351,000 in salary, bonuses and pension. He received almost 48% more than the previous year (Volkskrant, 2007).

Is a million Euro enough for a CEO or should it be more like a billion Euro, or do they earn too much? Executives can earn a lot of money. They do not just receive a salary, but their position usually comes with attractive short and long term incentives. For example Murphy (1999:6) defines executive pay as base salary, annual bonus (tied to accounting performance), stock options, long term incentive plans. The amount executives earn is something of which many people dream, but will never receive. The last years it has become a hot issue in many developed countries, particularly the amount CEOs receive and if the compensation levels should be regulated. The media often comes with topics concerning this issue covering the opinion of political parties, labor unions and of the public itself. It is therefore an issue which involves a lot of stakeholders.

Wouter Bos, the Minister of Finance in The Netherlands, is looking into possibilities to deal with the extremely high salaries of executives and the benefits they receive. Not everybody is happy about this and many discussions are about to what extent the state should interfere with this issue. Should the state impose regulations or should it be more of a corporate governance issue, in which firms create a code of conduct. What would happen if the state imposes an increase on taxation?

Figure 2 - Triple-E triangle, issue executive pay
This paper researches the effectiveness of state regulation by imposing an increase in taxation on executive pay packages. It will provide the reader with a better understanding of the issue at hand and supplies the reader with the background knowledge to form their own opinion and gives them an insight about the effectiveness of possible tax measures. A focus will lie on the Triple-E triangle (Van Tulder & Van der Zwart, 2006: 153), by looking at the effects of tax measures (efficiency) and the desirability of the stakeholders (ethics) to impose a higher income tax. This paper is an in-depth analysis of the situation in The Netherlands and aims at the market sector.

The paper will start in the next chapter with the first step of the reflective cycle (Van Tulder, 2007: 27), the problem and problem definition, explaining what is meant by executive pay, which components it entails, the principles and the trend of the last years. The next chapter comprises the diagnosis phase. It explains the causes for the increased compensation levels, the way it is regulated in The Netherlands and which stakeholders are involved. The third chapter is the Design/Outcome phase of the reflective cycle and clarifies the research approach and research questions for this report. In the implementation chapter, the actual research is conducted. It explains the effects of imposing tax measures and the desirability of the stakeholders involved. The final chapter, where the evaluation phase is carried out, will, according to the results in the previous chapter, answer the research questions by explaining if imposing tax measures in The Netherlands is effective or not. The last part will also explain the limitations of this research and recommendations for further research.
1. Problem definition - background executive pay

This section will explore the different dimensions of the issue of executive pay in the market sector. While executive compensation can be analyzed and evaluated in both the market sector and the (semi-)government sector, a focus will be put on commercial companies. In this section, the different trends in the field of executive compensation will be analyzed, namely its strong increase and the debates that followed this. This section will also identify the theoretical roots of the issue of executive compensation. However, first attention shall be given to the definition of executive pay and of its several components.

1.1 Meanings of executive pay

Different authors have found different definitions for the concept of executive pay. Murphy (1999:6) defines executive pay as base salary, annual bonus (tied to accounting performance), stock options, long term incentive plans. According to Bebchuk & Grinstein, executive pay comprises “the sum of the executive’s salary, bonuses, long-term incentive plans, the grant-date value of restricted stock awards, and the (grant-date) Black-Scholes value of granted options” (2005: 284). The business magazine Forbes also describes executive pay in similar terms: “We define total compensation as salary and bonus; ‘other’ compensation includes vested restricted stock grants and ‘stock gains’, the value realized from exercising stock options during the just concluded fiscal year” (Forbes staff, 2004).

These definitions of executive pay are closely related to each other. Normally, executive pay consists of two parts: a fixed salary component and a variable salary component. This last component generally entails bonuses and stock options, from which an executive will benefit when a certain target is reached. These provisions can be considered salary incentives that align the interests of top management (the ‘agents’) with the interests of the shareholders (the ‘principals’).

In all stated definitions pension plans are not included. However, in some studies pension plans are added to this definition, since its value can be an important component of executive compensation (Bebchuk & Grinstein, 2005: 284). Due to this reason, pension plans will be included in the definition of executive pay in this research. Executive pay will be treated here as an executive’s salary, pension plans, and annual and long term incentives (including bonuses, stock options and incentives).
1.2 Components of executive pay

Executive pay consists of different components, namely a base salary, and annual and long term incentives, like bonus plans, stock options, and other forms of compensation. The base salary is a fixed compensation component, while the incentives are normally variable from nature and based on some performance indicators (see figure 1.1). The components will be treated more in detail now.

Figure 1.1 - Components of Executive pay

Base salary
The base salary comprises a fixed amount of money that the executive receives. Normally the level of this compensation component is established through benchmark practices, in which the executive gets relatively the same level of compensation as other executives working in the same industry of the same size. In addition, this base salary of CEOs of stock listed companies is generally not dependent upon the age, experience, or education of the CEO (Murphy, 1999: 9-10).

The base salary is fixed and therefore guarantees a certain level of income for the CEO. This income is favored over variable income, since executives are commonly risk-averse. Another important role of the base salary is that it is used to establish variable pay components, which is often a multitude of the fixed component (Murphy, 1999: 9-10).

Bonus plans
Annual bonus plans are offered to executives when a certain level of performance is realized in a year. There are several forms of bonus plans apparent at different companies; still all these plans contain the following three aspects: performance measures, performance standards, and a pay-performance relation. Generally, an executive does not receive a bonus until a certain performance standard is
reached, for which he will receive a minimum bonus. Bonus plans generally also have a cap, which is the maximum amount of bonus than an executive can obtain in a certain year. The range between the minimum bonus and the cap level is called the incentive zone, in which an executive’s bonus will increase for every improvement in performance (Murphy, 1999: 10-11).

The performance standards can be divided into different categories. The most occurring are standards that are based on the companies’ budget plans, standards that compare results to that of the previous year, discretionary standards that are set subjectively by the board of directors, and standards that are based on the relative performance compared to peer groups in the market. These performance standards are evaluated by several performance measures that determine whether the standards are reached. Most companies use two or more measures, which can be financial or non-financial. Financial measures are often based on accounting profits, which could be either revenues, net income or economic value added. Other financial measures are based on profits on each share or on growth rates. Non-financial measures can for example include customer satisfaction or specific operational objectives (Murphy, 1999: 11-12).

Although a bonus plan can give strong incentives to CEOs to increase company performance, a few problems are recognized in this context. First, the focus on performance measure of accounting profits might not increase performance on the long run, since generally these measures are short-term and backward looking from nature. In addition, these measures can be manipulated. Second, performance levels are generally determined by the board, even when they are based on budgets or other standards, and therefore problems can occur when the CEO or other executives can influence the board in setting the standards. Finally, the incentive motive will only work when the executive is able to reach the performance standards. Executives are likely to hold earnings for the next year with the objective to receive a bonus then when they are unable to reach the performance standard in a year, or when they already reached the cap level of the incentive range (Murphy, 1999, 14-15).

Stock options

Stock options are agreements that the holder of the option is entitled to purchase a share of stock at an exercise price for a period that is determined beforehand. Generally stock options are not exercisable at the date at which they are issued but at a later point in time, for example after 10 years. Several ways to design stock options exist. In some cases, exercise prices can be indexed to industry prices, while in other cases the options are only activated when a performance level is obtained (Murphy, 1999: 16). In The Netherlands, the Corporate Governance Committee has advised that stock options should only be obtained by executives when a performance level is reached, and that the exercise price should not be lower than the stock-listed price of the share of stock when the option is granted. The options should also not be exercised within three years of being granted, and the conditions regarding
the granting of options should remain unchanged (Corporate Governance Committee, 2003: 10-11). These guiding principles have the objective of linking executives’ pay to performance, and hereby minimizing the manipulation of the compensation setting in favor of the executives.

Stock options are often used since it is argued that they align the interests of the management with the interests of the shareholders. When the share price increases, both the shareholders and the executives gain. Still it is essential to realize that stock options do not provide the same degree of incentives as stock ownership. Executives might be inclined not to pay any dividends to shareholders, since this increases the share price. This can however be minimized when executives are offered dividend protection for their stock options, which can entail that previous dividends are paid to the executives when they exercise their options. CEOs might also be inclined to take more risks, since this might increase the share price. Finally, when the exercise price of the option falls under the share price, the option price might be valued again in the favor of the executive. This can occur in order to align the interests of the executive to the shareholders again (17-18), although this should be prevented according to the Corporate Governance Code of The Netherlands (2003: 11).

Stock options have often been considered a favorable way to direct and reward executives since it was possible to deduct the compensation expense from the corporation taxes in The Netherlands that the stock-listed company paid (Murphy, 1999: 20). However, this is not possible anymore in The Netherlands, and thus stock options have lost their tax advantages for the stock-listed companies.\(^1\)

**Performance shares and other forms of compensation**

Performance shares are bonuses that are rewarded to executives when they reach a certain level of performance. Sometimes they fall under the annual bonus plans or the long-term incentive plans but in some cases they are not included. Performance shares are increasingly used instead of option plans, and the size and value can be high when performance is reached. To illustrate, 88% of the companies that were listed on the AEX in 2005 rewarded its executives with performance shares (Hewitt Associates, 2006).

Finally, other forms of compensation that executives can receive are restricted stock, long-term incentive plans, and retirement plans. Restricted stock entails that the executives receives shares that the executives typically lose when he leaves the company. Long-term incentive plans often have the same structure as annual bonus plans but often run for five years. Finally, the last form of compensation is an executive’s retirement plan, which can account to a large part of the compensation

\(^1\) In some cases companies still possible to deduct stock options expenses from the corporation tax they have to pay but this only occurs when the options fall under the Stock Appreciation Right (SAR), which is a special construction that gives the executives only the right to the value increase of the share he holds the SAR of (Mertens, 2007).
of an executive but which is often difficult to determine on the basis of publicly available information (Murphy, 1999: 23-24).

1.3 Principles of executive compensation
The principle-agency theory has been essential at forming the basis of executive compensation. Under the principle-agency theory, executive pay is constructed in such a way that the interests of the executive (the agent) align with the interests of the shareholders (the principles). This is important since it is assumed that the executive is a rational actor who is focused on his own self-interests. A major problem for the shareholders is that they delegate the work of managing their company to the CEO, but they have incomplete information to judge whether the CEO acts in their best interests. As a consequence shareholders reward CEOs on the basis of stock prices, not since this reaps the greatest benefits for them, but because this provides information on which actions the CEO took. This is called the informativeness principle (Driessen, 2004: 3-4; Murphy, 1999: 26-27).

The principle-agency theory thus has the implication that variable pay that is based on stock prices is vital in either aligning the interests of the CEO with the interests of the company, or at least in exercising control over the actions of the CEO. In this scheme, the compensation of the executives will be set by the Board of Directors according to the wishes of the shareholders, and it will be constructed in a way that will enable shareholders to obtain information whether the executive has taken actions that lead to benefits (increased stock price) for them. A contracting theory is provided by Bertrand and Mullainathan, who question the view that shareholders set CEO pay. They argue that CEOs themselves might take control over the process of setting the compensation. CEOs might have greatest power in a company that is weakly governed, which they approach as the situation in which the CEO has greater bargaining power and when monitoring capability is low. They argue that good governance is essential for shareholders to have effective control over the pay process and actions of CEOs, since otherwise skimming can occur (Bertrand & Mullainathan, 2000: 203-208).

1.4 The growth of executive pay
The growth of executive pay can be identified at three distinctive levels, namely the macro-, meso- and micro level. This is treated in this paragraph.

At the macro level
From the 1990s until now there has been a huge increase in executive compensation globally. In the USA, the average compensation of the top-five executives increased with 125% between 1993 and 2003 (Bebchuk & Grinstein, 2005: 285) (see figure 1.2). A similar development can be seen in The
Netherlands, where executives of the AEX Fund earned 51% more in only two years time (between 2002 and 2004) (RTLZ, 2006). Moreover, Donald Shepard, CEO of Aegon, received a total compensation of EUR 6.351 million in 2006, which is 47.9% more than he received in 2004 (see figure 1.3) (Volkskrant, 2007). As a consequence, a Dutch newspaper even called this development a “salarisrace” (‘salary race’) (Rengers & Alphen, 2007).

Figure 1.2 - Increase in Compensation of CEOs in the US (Bebchuk & Grinstein, 2005: 286)

Still, there are significant differences between the USA and other countries, including The Netherlands. Compensation levels in the USA generally are higher than in other countries (Murphy, 1999: 7, 79). However, Murphy also suggested in 1999 that the composition and levels of executive compensation are converging, which he links to the increasingly global market of capable executives (1999: 8). The degree to which this has happened however can be debated, given that the highest compensation that a CEO has received in the world is 1,700 million dollar (James Simons from Renaissance Technologies in the USA) in 2006 (Volkskrant, 2007) This is a very large contrast to the relatively ‘low’ amount of 11.644.556 euros that Jan Bennink of Numico received, which made him the highest-paid executive in 2006 in The Netherlands (Vereniging van Effectenbezitters, 2007).

At the meso- and micro level

It is clear that CEO compensation has increased in The Netherlands, but that the levels of compensation are still lower than in the USA. Even in The Netherlands there are still differences in the growth of executive compensation among different companies. CEOs working in companies that were listed on the AEX enjoyed the highest income increase, namely 52% on average. This is a clear contrast to the compensation growth of CEOs working for companies listed on the AMX or Small Cap, whose income increased only with 15% or even decreased with almost 1% (Hewitt Associates, 2006).
The growth of the different components of executive pay in The Netherlands shall be evaluated now. Executive compensation can be divided in fixed and variable components. The fixed component of CEO compensation, the base salary, increased 12% between 2002 and 2004. The largest increases in CEO pay occurred in companies where a new CEO was attracted. In these companies, the average increase in CEO compensation was 24%, while in companies where no new CEO was installed the base salary only increased by 8.5%. Possible reasons for this difference include that higher salaries are necessary to attract new talent when the company is in financial trouble or to offer competitive compensation in a certain industry, or that new CEOs were capable of profitable negotiations (Swagerman & Terpstra, 2007: 50). Jeroen van der Veer received the highest amount of fixed compensation in 2006 in The Netherlands, which amounts to 1.625.000 euros. However, this is only an increase of 6.6%, making the increase relatively incremental (Vereniging van Effectenbezitters, 2007).

The average variable pay of executives increased 13% from 2003 to 2004, and 67% of the Dutch CEOs of stock-listed companies received higher variable compensation in 2004 compared to 2003. Variable compensation could be considered an important component of total pay, since average variable compensation was as high as 79% of the base salary in 2004 (Swagerman & Terpstra, 2007: 51). This is in contrast with the guidelines of the first draft of the Corporate Governance Code that stated that variable pay should not exceed 50% of the base salary (Vereniging van Effectenbezitters, 2007). However, executive compensation specialists from Hewitt Associates and the University of Groningen also argue that a substantial variable compensation component is advisable when it is verified that this will strongly align the interests of the CEO with the interests of the shareholders (Hewitt Associates, 2006).

The variable pay component consists of several elements. One part of variable pay is annual bonus plans. In 2004, bonus plan payouts comprised 47% of the base salary of CEOs, which is an increase compared to 40% in 2003 and 34% in 2002. In total, 12% of the Dutch CEOs of stock-listed companies did not receive the bonus in 2004, which is a decrease compared to the 23% of CEOs that did not receive the bonus in 2002. This result is plausible since most companies had better financial results in the bull market of 2004, in which shareholders’ return also increased (Swagerman & Terpstra, 2007: 51). In 2006, Donald Shepard of Aegon received the highest bonus payout in The Netherlands, namely 4.059 million euros, which amounts to 56% of his total compensation (Vereniging van Effectenbezitters, 2007).

Another part of the variable compensation consists of stock options. The value of stock options and performance shares that were granted to CEOs have increased with 70.8% between 2002 and 2004, in which the average option package amounted to 93% of the base salary value (Swagerman & Terpstra,
In 2006, Jan Bennink of Numico received the highest payoff from stock options and performance shares: almost four million euros from options and more than five million euros from performance shares (Vereniging van Effectenbezitters, 2007).

Finally, pension plans are also an important part of executive compensation. The average value of pension plans was 26% of the base salary in 2004, which is a slight decrease from the level of 2002 (Swagerman & Terpstra, 2007: 50).

In summary, executive compensation in The Netherlands has increased in almost all pay components during the last couple of years. Variable pay has augmented to the highest degree, and for several CEOs variable pay including stock options and performance shares are beginning to account for larger portions of total compensation compared to fixed compensation and pension plans.

1.5 Increased debates about the level of executive compensation

An increase in societal debates and up stir about growing executive pay can be identified. Debates have prevailed about the increased executive compensation for CEOs working in the market sector. While executive compensation in commercial companies should typically be considered an issue of the market sector (Van Tulder & Van der Zwart, 2006: 173), other actors, like the media, political parties, and the public, have also engaged in the discussion. Most often they have emphasized the huge increase in pay levels and they have labeled them as unacceptable (NRC.nl, 2007; Van Uffelen, 2007). In several cases, the labor unions and the employees have also spoken out since they strongly objected the rise in executive compensations, especially when companies are facing difficult times and several employees are laid off (AKVAKABO FNV, 2005; Trouw, 2007).

In this situation, an expectational gap is present between the different stakeholders. Three types of expectational gaps can be identified: factual gaps, conformance gaps, and ideals gaps (Van Tulder & Van der Zwart, 2006: 158). An ideals gap can be found when analyzing the issue of executive compensation. Different norms and values apply among stakeholders on the topic of the height of executive pay. Labor unions, the public, political parties, and the media often consider high executive pay unethical, while the shareholders generally accept these levels. However, in the case of TNT, the shareholders (VEB) recently did not agree with the high salary level that was proposed for CEO Bakker at the annual meeting of shareholders. As a result, it was decided upon a lower salary level for the CEO (RTLZ, 2007).

Still, it should be kept in mind that the case of TNT is an exception. The shareholders generally do not view the level of CEO compensation as a problem, as long as the executive does his job right. The
height of executive compensation is important but their main concern is to attract good executives since there is only a limited supply of suitable candidates available. As a consequence, they are willing to offer a high compensation to them, regardless to what other stakeholder say about this.
2. Diagnosis of the issue

This section will start off by explaining the causes for the increased compensation levels of executives. It will then continue by explaining the regulations imposed in The Netherlands and finally a short overview is given which stakeholders are involved in the issue of executive pay.

2.1 Causes for the increased compensation levels

There are several causes that explain the increased pay that executives, working in the market sector, have received. According to the research of Nagtegaal and Swagerman in which they studied 71 annual reports of companies in The Netherlands from 2002-2004, the total reward of the executives has risen due to an increase in the base salary (12% for the companies investigated in The Netherlands), the main cause for this was the replacement of executives in which the new CEO received a higher base salary. Another cause according to their research was an increase of the yearly bonuses due to an improvement of company results and an increase in the value of long term incentive packages caused by the introduction of performance based shares (Hewitt Associates, 2006).

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<td>• Increased base salary</td>
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<td>○ Improvement of company results</td>
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<td>• Increased long term incentive packages</td>
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<td>○ Introduction of performance based shares</td>
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Table 2.1 – Causes increased executive pay

It is important to realize that executive pay not only consists of a base salary but has a stock option component as well. This stock option component is included since it increasingly aligns the interest of the executive with the interest of the shareholders (principle-agency theory). In The Netherlands it is required by law to include information about the compensation package of the executives in the annual report. In other European countries like Belgium, Germany, Denmark and Spain the information is stated as total board pay only (due to privacy reasons) (Ferrarini & Moloney, 2005: 313). However, the true economic value of the stock options was often underestimated, since the costs were not directly visible (Bebchuk & Grinstein, 2005: 300).

In addition, there are now increased outside employment opportunities for executives. This can take place in different sectors and levels. At the micro level, there is increased executive mobility between
individual firms, since it is not common anymore to have a career in only one company. At the meso level, directors at (semi-)governmental organizations have the option to work for the commercial sector as well. Finally, at the macro level, mobility of executives also occurs between countries and regions. This development is accelerated by the high demand for skilled executives and the relatively scarce pool of them. Thus, there is high unfulfilled demand for executives and companies are more frequently willing to offer competitive pay to attract and to keep a talented director (Bebchuk & Grinstein, 2005).

A last important aspect concerns the procedure how the compensation package of the CEOs is established. Normally, the Board of Directors decides upon the level of compensation (Code Tabaksblat, 2003: 20), however it is not unlikely that the CEO can influence this process. Often the company has difficulties to attract talented people especially when it is in financial trouble. As a result, the bargaining position of the CEO increases. The shareholders are still able to object to the salary level of the executive of the company during the shareholder meetings or in the most extreme case by firing the Board of Directors, which cannot be considered a sustainable solution. In practice, this therefore rarely happens. Large foreign investors generally do not raise any protest or critical questions against the compensation packages of the executives. Dutch shareholders do in some cases, like the last two shareholder meetings of ABN AMRO. However, the compensation package of the executives at ABN AMRO was still approved by 88.4% of the shareholders, and equally above 90% of the shareholders at Philips, TNT, and Unilever also approved these plans (Rengers & van Alphen, 2007). Thus, the shareholders generally approve the compensation package or have limited power to change the procedures, and consequently executive pay increased during the last couple of years.

The increase in executive compensation packages has lead to a discussion among the stakeholders. The causes for this debate are, according to the research of Cornelisse et. al. (2005), missing credible solutions for the initiation of reward packages for CEOs, undefined character of reward packages, the high absolute and relative level of the actual reward, and finally missing transparency.

The debate on the amount of executive pay and benefit package does not only occur in The Netherlands, but in many other developing countries in the world. At the moment there is for example also a debate happening in the Unites States in which they discuss the shareholders voting rights concerning this issue (CNBC, 2007).

2.2 Regulation in The Netherlands concerning executive pay

In The Netherlands a remuneration committee is responsible for the compensation policy in which the income and benefit packages of the executives are discussed. This needs to be according to the Dutch
corporate governance code (‘code-Tabaksblat’), which was introduced in 2004. The Dutch corporate governance code is intended as a guideline for improving corporate governance practices. Even though it is a guideline, it is regulated by law that companies need to follow these guidelines or otherwise explicitly state why they are not following the guidelines as stated in the report. This needs to be approved by the shareholders.

The code states several guidelines for the remuneration of executives. For example the remuneration should be such that the proper executives can be recruited and maintained, it needs to be transparent and be available to the public, and the amount received when the contract is terminated may not exceed a one year salary pay, unless there is a good reason for doing so.

Following the code is already a step in the direction to make the amount executives receive more transparent. However, the code does not include all options which have been argued by the stakeholders to control the excessive salaries and benefit packages of executives. For example it has been argued by several parties in society, among others the labor unions, that state government could impose a higher income tax, to reduce the salaries.

The way income taxation is arranged in The Netherlands is that the salary is taxed. In addition, employees also have to pay taxes on the profit they make with stock options that they receive as a part of their compensation. As can be seen in table 2.2 in appendix one, there are different taxation levels and each level has a different percentage for how much tax needs to be paid. Currently, income above €52,229 a year is taxed at a 52% tax rate, which is the most progressive tax rate in The Netherlands. It would influence the amount people earn tremendously, if governments increase the percentage of how much tax needs to be paid above a certain amount earned. This however is not in favor by other stakeholders as they are afraid that executives may find other ways to obtain money.

Special rules concerning income taxes apply to expats that are working in The Netherlands. In order not to discourage foreign talent to work for Dutch companies by the 52% income tax tariff for high incomes (compared to for example income taxes of around 40% in the UK and the USA), a 30% rule applies to expats in which they do not have to pay income taxes on 30% of their total salary. This rule only applies to expats who have studied or worked at least 15 years outside The Netherlands and have gained their expertise abroad, which the companies for which they work were unable to find in The Netherlands. While several foreign executives gain from this attractive regulation, it also applies to footballers working in The Netherlands. It ensures that for really talented executives and football players, The Netherlands is still a country with an attractive tax regime to live and work (Mertens, 2007).
2.3 Stakeholders

The level of executive pay is a highly debated issue and the stakeholders have different opinions about what and if anything needs to be done about the amount CEOs receive. Below the main stakeholders are listed with a short explanation why they are directly involved and what their position is towards this issue.

- **CEOs:** CEOs are directly involved in this issue since the possible changes made will affect them. They prefer high compensation and are often at the company for a short period of time and their performance is frequently measured for only this period. For this reason they have an incentive to favor short term success over long term profits, since in this way they can maximize their pay off through share options.

- **Board of Directors:** The Board of Directors wants to find and keep skillful CEOs to run their company and they want to satisfy their shareholders. They run limited risk to loose their own positions and they often grant advantageous compensation plans in order to attract talented executives (of which some may belong to their old boys’ network).

- **Shareholders:** Shareholders want to have an increased share price in the long run. Therefore they want a CEO who can accomplish this at the lowest cost possible. As long as the CEO lives up their expectations the high salary and benefits of the CEO are usually accepted. However the shareholders play an important role in approving the CEO compensation package.

- **Government / political parties:** Some stakeholder believe that the government should interfere with the compensation level of CEOs, the opinion about to what extent the state should interfere in this issue is divided among the political parties in The Netherlands. A majority in the second chamber wants to regulate the skyscraping salaries of executives, but the opinions on how to accomplish this are divided. For example the CDA wants to limit the golden goodbye to a maximum of one year salary (nrc.nl, 2007). Paul Tang of the PvdA believes that the bonuses concerning take-overs should be regulated by law and not by the companies themselves (nrc.nl, 2007).

- **Labor Unions / employees:** Labor unions advocate salary increase for employees of different companies and industries. Usually Labor unions have the opinion that the compensation of executives is unfair. Especially in difficult times when the CEO is the only one who benefits a salary increase. Whenever the company is facing financial successful times the employees would like to be compensated for their efforts as well.
3. Research design

Now that the concrete issue of executive compensation and its causes are elaborately defined, the design of the actual research is presented here. The research questions will be given, the focus of the research will be explained and clarified is which level of analysis will be treated. An assessment of the used methodology will be given too.

3.1 Focus of research

An analysis of the issue of executive pay is made in the problem definition and diagnosis phase. This has shown that executive compensation levels have increased strongly from the 1990s on, in a global as well as a Dutch context. In society, debates have emerged too whether it is acceptable or ethical for an executive to receive extremely high compensation levels. In addition, public and political discussions have focused on the desirability and possibility of regulating the compensation levels that executives can receive in for example the market sector. The question in this discussion is how far governments should go to intervene in the increase of compensation levels. Should governments only give a moral appeal to boards of directors to be more modest (Doorduyn, 2007) or should a government be more active by, for example, imposing a salary cap or increase taxation on high compensation levels (Van Uffelen, 2007). The effectiveness of this last regulation possibility is researched now in the actual research.

Dutch Prime-Minister Balkenende declared in 2005 that he wanted to consider fiscal measures in order to discourage self-enrichment (nu.nl, 2005) and Dutch Minister of Finance Bos stated in 2007 that a plan to increase taxation on excessive bonuses was ‘an interesting thought’ (Douwes, 2007). This research explores if an increase of taxation is really an effective measure for governments to control the compensation levels of executive pay packages. This can be broken down into two research objectives. Investigated is if an increase of taxation is efficient and really affects compensation levels. Furthermore, researched is whether this regulation possibility is actually desirable, based on the different opinions of the mentioned stakeholders in the diagnosis phase.

Chosen is to focus on the market sector in the Dutch context. This means that the (semi-) governmental sector is not taken into account. Van Tulder & Van der Zwart (2006) characterize the market sector by its objective to make profits and by its non-governmental nature. The phrase ‘Dutch context’ means that the opinions and points of view of the Dutch stakeholders and Dutch government are explored in this research. The chosen focus on the Dutch market sector will be further elaborated in the next paragraph, ‘Level of analysis.’
3.2 Level of analysis

The actual research can be conducted on three distinct levels, namely the micro-, meso- and macro level. The micro level focuses in this case on the effectiveness of an increase in taxation on executive compensation levels in individual companies. The meso level concentrates on the effects and desirability of an increase in taxation in a specific sector. This could be either the market-, state-, civil society sector or one of the hybrid sectors. The macro level contains a broader perspective on this matter and gives an overview of the effects and desirability on a state- or country level. The policy and practices on this matter in one country or region is assessed.

It should be clear now that this research paper will mainly focus on the macro- and meso level in The Netherlands. Because this research tries to explore the effectiveness of a state regulation possibility, it is essential to analyze this issue at the macro level. It is explored whether an increase of taxation can be used effectively by the Dutch government to control compensation levels in the market sector in The Netherlands. There will also be a focus on the meso level, because only the effects of the increase of taxation on the executive pay packages in the market sector are taken into account in this research.

3.3 Methodology

This research is mainly conducted on a qualitative basis; no quantitative methods are used to conduct this research. Desk research, by combining both primary and secondary resources, is the main technique by which this research is conducted. Primary resources comprise sources like newspaper articles, websites, codes, reports, interviews and surveys. Surveys were not carried out in this research due to time constrains, however one interview was carried out with Ton Mertens, a specialist on employment taxes to gain more insight in the Dutch tax situation. Secondary sources comprise the available scientific literature on this subject.

The first paragraph of this chapter already explained that two objectives are researched to explore the effectiveness of a tax increase on executive pay packages. The first objective is to research if an increase in taxation actually has an effect on compensation levels in the Dutch market sector. Scientific literature is mainly used here to explore what the effects could be. The second objective explores if an increase of taxation is actually desirable, based on the opinions of the different Dutch stakeholders. Primary resources are mainly used to assess these opinions. For example, newspaper articles can be used to gain insight in the opinions and points of view of the different stakeholders. Websites of institutes like labor unions and political parties are available too and these sources are used additionally. When the two objectives are combined, an answer is formulated whether an increase of taxation is actually an effective measure.
These research objectives can be put in the ‘Triple E-triangle’, developed by Van Tulder & Van der Zwart (2006: 153). The first objective can be put under the ‘efficiency’ header because it assesses whether an increase of taxation actually does what it is supposed to do, namely controlling compensation levels. Thus the efficiency of the state regulation possibility is examined here. The second objective can be seen from an ‘ethics’ point of view because here is assessed whether an increase of taxation answers the desires of the different stakeholders in society. These two objectives combined may give an answer to the effectiveness of an increase in taxation. If this measure is efficient and if it is desirable, then this measure can be seen as an effective measure.

3.4 Research questions

Now that the research focus and the research design are explained in the above paragraphs, this chapter can be concluded with the formulation of the research questions. The main research question can be formulated as follows:

- What is the effectiveness of regulation through an increase in taxation on executive pay packages?

In addition, this research question can be divided in the following sub-questions, which shall be treated in this paper:

- What are the effects of an increase in taxation on executive pay packages?
- Is an increase of taxation desirable based on the different opinions of stakeholders?

It can be seen that the two sub questions cover the two research objectives mentioned in the first paragraph of this chapter. Above that, the first sub question covers the ‘efficiency’ part of the triangle, while the second question covers the ‘ethics’ part of the triangle. The use of this triangle is explained in the methodology paragraph. The answers to these two questions can be combined together to give an answer to the main research question which covers the ‘effectiveness’ part of the triangle.
4. Implementation

The research depicted in the preceding chapter, is carried out in this chapter. This chapter can be divided in two research objectives, which were presented in chapter three. The first part of this chapter describes which effects might occur when tax measures are imposed. The second part explores the desirability of this measure by describing the opinions of different stakeholders.

4.1 Different possibilities to use tax measures

An overview of the different taxation possibilities to control compensation levels is mentioned below.

<table>
<thead>
<tr>
<th>Overview of possibilities</th>
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</thead>
<tbody>
<tr>
<td>1. Raise top tariff of income tax, make tax system more progressive</td>
</tr>
<tr>
<td>2. Increase tax rates for certain parts of the executive pay package</td>
</tr>
<tr>
<td>3. Limit deduction possibilities for certain parts of the pay package above a certain amount</td>
</tr>
</tbody>
</table>

Table 4.1 - Overview taxation measures

Dijkman (2007) states that Wouter Bos, Dutch Minister of Finance, was not in favor of just raising the top tariff of the income tax, but did not want to exclude other fiscal measures beforehand in order to do something about high compensation levels. But he did not specify what these measures could be like. Thus it can be concluded that there are different ways by which governments can use taxes in order to influence compensation levels.

One possibility is raising the top tariff of the income tax. In The Netherlands, the top tariff of the income tax is 52%. This rate needs to be applied to high incomes, but the 52% rate is also applicable if stock options are exercised (Belastingdienst, 2006). Shorter & Labonte (2007) state in their CRS Report for the American Congress, that the tax system indeed can be made more progressive as a possibility to reduce income inequality. Related to this, governments can adjust marginal tax rates of high incomes (Goolsbee, 2000a).

Tax rates can also be increased for certain parts of the executive pay package. For example the Dutch Christian Democratic party, CDA, proposed a plan to increase taxation of excessive bonuses. Bos reacted by stating that this was “an interesting thought” (Douwes, 2007).

Another possibility to use taxation as a measure to affect pay levels, might be interesting for the Dutch government. This possibility comes from the US. In 1993, the US tax code, the Internal Revenue Code Section 162(M), was extended with a feature that “disallowed a corporate deduction of any executive pay above $1 million that is not ‘performance based’” (Hall & Liebman, 2000: 5). This piece of
legislation was imposed because it would “reduce ‘excessive’ CEO pay by raising its cost to the corporation” (Rose & Wolfram, 2000: 197). This specific “Million Dollar Rule” cannot be imposed in The Netherlands, because both countries have different tax systems. Deduction possibilities are already put under constrains over time, by the Dutch government. For example, stock options are not deductible anymore. On the other hand, cash bonuses are still deductible (Mertens, 2007).

The Dutch government might use the same kind of measure by limiting the corporate deductibility possibilities of, for example, cash bonuses above a certain amount. Thus the effects of limiting deductibility of certain parts of the executive pay packages, like the non-performance based parts, are assessed too.

### 4.2 Effects on compensation levels and compensation composition

The effects of the tax measures considered above, on compensation levels and the structure of the pay package are explored in this paragraph. Bartlett (1993) argues that a progressive tax system in general is not an effective method to reduce income inequality (or to decrease compensation levels): “Higher rates simply cause the rich to shift their income from taxable forms to non-taxable forms or to forms that are taxed at a lower rate.” Bartlett states that a change in progressive tax systems in general causes a shift in the compensation structure of executives. Above that, Bartlett (1993) states that “the history of tax-rate increases shows that they seldom produce much revenue.” Thus Bartlett does not see tax rate increases as an effective measure.

Mertens (2007) also argues that compensation levels of executives would not automatically decrease when higher tax rates are imposed. This would only happen when the gross income of the executive would remain at the same level, but most of the time gross income levels are increased by the company to compensate the loss of income. Currently unemployment levels are relatively low (approximately 5%) in The Netherlands (CBS, 2007) and there is a high demand of skilled executives, as a result CEOs have relatively strong bargaining power. Executives do not want to pay for the higher taxes, and because of this bargaining power, these labor costs are carried over to the company. The company is willing to pay these costs because they want to attract skilled executives. The costs for the company will increase, although this effect is relatively minor for the company. Based on Mertens, an increase of taxation will not have the intended effect, but leads to the opposite. On the other hand, when CEOs have weak bargaining power, for example in a market that is characterized with severe unemployment, then effect of tax increases would the be stronger. In that context companies are less willing to compensate for the loss of income.

Pizzigati (2005: 63) shows that during the last decades, tax progressivity vanished in the US. “The nation’s 400 richest tax payers now pay just 17.5 percent of their total incomes in federal tax. Sixty
years ago (...) the richest Americans paid 78 percent of their total incomes in federal tax.” Wealth in the United States has now been concentrating for over a generation, and the tax code, during these years of rate cutting, no longer could brake this concentration. Pizzigati (2005) further states that progressive tax rates did impact the concentration of wealth in the United States enormously, but any new steep rates would likely not be sustained over the long haul. Thus progressive tax rates only have a temporary effect.

The Netherlands has seen the same trend of rate-cutting the last decades. For example, the top tariff of the income tax declined from 72% to 52% (Van der Kwast, 2006). This may have lead in The Netherlands to a larger concentration of wealth too. Pizzigati shows, based on history, that tax progressivity, although Bartlett argues the effectiveness of it, had a temporary impact on the wealth (read: compensation) of rich people.

Goolsbee (2000a) researched how the total taxable income of executives reacted on marginal taxation increases. This research shows that an increase of marginal taxation did not lead to permanent shifts in taxable compensation levels. The parts of the executive pay package which are taxable, showed virtually no reaction to the marginal tax increases on the long run.

There was only a short-term drop in taxable income in the years surrounding a tax change. This response came almost entirely from a large increase in the exercise of stock options by the highest-income executives. This reaction can be seen mainly as a shift in the timing of compensation and not as a permanent shift in the form of compensation. This reaction might occur in The Netherlands too, because companies have to pay a 52% tax rate when exercising a stock option. If this rate is raised, executives might exercise these stock options before the rate is actually increased.

Goolsbee (2000a) further concludes that executives without stock options, executives with relatively lower incomes and more conventional forms of taxable compensation such as salary and bonus, show little responsiveness to tax changes. Goolsbee (2000a) shows that there is some evidence that non-taxable forms of income slightly increased. This underlines the statement of Bartlett that higher tax rates cause a shift to non-taxable income.

Murphy (1999) states that the popularity of these stock options reflects for large parts their favorable tax and accounting treatment. Stock options offer an attractive way to defer taxable income, and are mainly invisible from corporate accounting statements. Murphy (1999: 20) states that “stock options represent a relatively unique form of deferred compensation in which the recipient has substantial discretion in determining when to realize taxable income.” Thus, as Goolsbee (2000a) already stated earlier, exercising stock options can be timed in such a way that taxation is minimized. Goolsbee
(2000b) states that the presence of options gives executives more flexibility in changing the timing of their reported income and appears to make them much more sensitive to the short-run timing of tax changes. This is the case in The Netherlands too. Although stock options are taxed at the highest 52% rate, since 2005 the income gained from stock options is only taxable when these options are exercised (Belastingdienst, 2006). Executives in The Netherlands can time the exercising of stock options in such a way, that taxation is favorable to them. In that sense, stock options have a tax advantage over other forms of pay, in The Netherlands too. Stock options do not have a real tax advantage in The Netherlands, because stock options and share plans are not deductible anymore (Mertens, 2007). Thus the advantage of stock options comes mainly from the possibility to decide when a taxable income will be realized. The problem definition of this research paper already stated that the growth of executive pay comes from a major part from the increased use of stock options. The increased use of stock options is accelerated by the tax advantages stated by Murphy.

Hall & Liebman (2000) argue the conclusions of Goolsbee (2000a) and Murphy (1999). Their research examined to which extent tax policy has influenced the composition of executive pay. They show that there is little evidence that tax changes played a major role in the dramatic explosion of stock option based pay. Options currently just have a slight tax advantage relative to cash in the US. Hall & Liebman could not find evidence that there were major shifts in the timing of option exercises as a response to tax rate changes. Furthermore, the regulation that limits a corporate deduction of any executive pay above $1 million that is not ‘performance based’, did not lead to a decrease of the total executive compensation level but causes a shift from salary to ‘performance based compensation.’

This raises the question what the actual effects are of this "Million Dollar Rule.” Shorter & Labonte (2007: 30) state that “despite the deduction limit, overall executive compensation continued to rise rapidly, and the limit may have contributed to the rapid growth of executive stock options.” Thus this government regulation encourages behavior that evades the regulation’s original intent.

Perry and Zenner (2001) underline this. They conclude that firms have reduced salaries in response to this regulatory measure and that salary growth rates have declined in the years after imposing this measure. Although, the researchers found that the regulation did not lead to reduction of the growth of total CEO compensation. The structure of CEO compensation was altered by reducing salaries but increasing pay for performance sensitivity by using stock options. These conclusions underline the conclusions of Hall & Liebman. Rose & Wolfram (2000) come to the same conclusions. The deduction limit restrained salary increases, but lead to more performance based components of executive pay packages, so the total executive compensation level did not decrease.
Based on this, Shorter & Labonte (2007) argue that if the purpose of the deduction limit is to control overall executive pay levels, then the limit would be more effective if it was expanded to cover all forms of pay and not only the ‘non-performance based pay’, because that leads to a shift from salary to stock options. Thus this could be a good suggestion for the Dutch government too.

Many costs can be deducted from corporate taxes in The Netherlands, including personnel costs (Ondernemerstips.nl, 2006). The SP, the Dutch socialist party, has argued that the company often supports high executive compensation levels since it is able to deduct these costs from the profit on which it has to pay corporation taxes. Therefore, they argue that a limit should be introduced to the amount of personnel costs that are deductible from corporation taxes (SP, 2007a). Shorter & Labonte (2007) further state that given the importance of stocks and stock options in executive pay, policymakers could consider reducing the tax preference currently given to income generated by stock options.

4.3 Other effects

Changes of tax rates may lead to other effects too. The first effect relates to the mentioned effects in the previous paragraph. Imposing tax measures might lead to CEOs or companies being creative in trying to evade these measures. In the prior chapter it was already stated that when CEOs have more bargaining power, they can ask the companies for compensation for the loss of income because of higher tax rates. Bartlett (1993), and Goolsbee (2000a) in a minor way, already concluded that an increase of tax rates might lead to an increase of non-taxable forms of pay. This increase might weigh up the decrease of the levels of taxable parts of the pay package. CEOs can time when exercising stock options, in favor of tax rates. When a tax rate is raised, CEOs quickly exercise the stock options at the old, lower rate to gain advantage. The ‘Million Dollar rule’ also caused a shift from salary to performance based stock options in the US, to weigh up the decline of salary. Imposing this kind of measure might lead to the same effect in The Netherlands. Bartlett (1993) states that the rich “often evade higher rates by making increased use of deductions and other legal tax shelters.” Another example of this effect can be found in the paper of Polsky & Hellwig (2005). Tax advisors devised a strategy that would shelter the gains, attracted from stock options, from federal income tax. Eventually, these advisors came up with a shelter that they believed would defer tax on these gains for as long as an executive desired. In the end, this shelter actually had an opposite effect of accelerating income, but this example shows that CEOs keep trying to avoid certain tax rules. In The Netherlands, a well-known example of a tax deduction or -shelter includes the practice of mortgage interest deduction, which is a widely used legal technique in which mortgage interest expenses can be deducted from the amount of income a person needs to pay taxes over. Especially for people with houses with a high mortgage, this deduction can lead to large tax savings (Van der Kwast, 2006). In
The Netherlands, the possibilities to be creative or to use tax shelters have vanished nowadays, because most opportunities have already been restrained by the Dutch government (Mertens, 2007).

Imposing higher tax rates might also affect the competitive position of a country. This is one of the reasons why Wouter Bos is not in favor of imposing a higher top tariff (Van Zanten, 2007, Kooistra, 2007). Van Uffelen (2007) also states that an increase of tax rates might lead to companies being driven out of The Netherlands. This can also be seen from an historical point of view. The last decades income tax rates lowered in The Netherlands from 72% to 52% and corporation tax rates lowered from 48% to 25.5%. This was done because the competitive position of The Netherlands was at stake, since skilled and wealthy people migrated to countries with a more attractive tax regime (Van der Kwast, 2006). Still Mertens (2007) considers that this effect is relatively minor nowadays. He argues that there is no real scientific research done on this matter and that only a very small group of executives will react on an increase of taxation by leaving the country. A lot of high-paid executives have family ties with the company and so they do not leave the company easily. In addition, not all executives have the desire or the contacts necessary to work in other countries. On the other end, Mertens argues that at a certain taxation rate, everybody would leave the country. Only it is unknown at which level that would happen (2007).

Bartlett (1993) disputes that higher taxes on the rich would benefit the economic position of the poor and the middle class because of redistribution. “On the contrary, there is strong evidence that higher taxes on the rich would eventually lead to higher taxes on the middle class.” Tax rates originally imposed on the rich often apply to those with middle incomes in just a few years, because of inflation and real growth of the economy. Bartlett (1993) states that the main effect of raising tax rates of high incomes is to make higher taxes on the poor and the middle class more “palatable”.

A final effect is presented by Shorter & Labonte (2007: 34). They state that an increase of the progressivity of the tax code “cannot target executives specifically without also affecting other high income individuals.” Thus this measure is too broad or general. Wouter Bos also says in Van Zanten (2007) that “the top tariff works too general and also affects people without excessive incomes.”

To summarize these paragraphs, a table is constructed with an overview of all the effects that might occur (see table 4.2).
Table 4.2 – Overview effects taxation measures

<table>
<thead>
<tr>
<th>Effects on compensation levels and compensation structure</th>
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</thead>
<tbody>
<tr>
<td>Progressive tax rates only have a temporary effect</td>
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<tr>
<td>A change in progressive tax systems in general causes a</td>
</tr>
<tr>
<td>shift in the compensation structure of executives,</td>
</tr>
<tr>
<td>depending on contextual factors that affect the</td>
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<tr>
<td>bargaining position of the executive in the company</td>
</tr>
<tr>
<td>Increase of marginal taxation did not lead to permanent</td>
</tr>
<tr>
<td>shifts in taxable compensation level, only a shift in</td>
</tr>
<tr>
<td>the timing of compensation</td>
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<tr>
<td>Executives in The Netherlands can time the exercising</td>
</tr>
<tr>
<td>of stock options in such a way, that taxation is</td>
</tr>
<tr>
<td>favorable to them</td>
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<tr>
<td>A measure like the “Million Dollar Rule” did not lead</td>
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<tr>
<td>to reduction of the growth of total CEO compensation,</td>
</tr>
<tr>
<td>only a shift in the composition of the pay package</td>
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<table>
<thead>
<tr>
<th>Other effects</th>
</tr>
</thead>
<tbody>
<tr>
<td>CEOs trying to evade taxation measures, e.g. a shift</td>
</tr>
<tr>
<td>from taxable- to non-taxable forms of pay</td>
</tr>
<tr>
<td>Affecting competitive position of The Netherlands</td>
</tr>
<tr>
<td>Higher taxes on the rich would eventually lead to higher</td>
</tr>
<tr>
<td>taxes on the poor- and middle class</td>
</tr>
<tr>
<td>The measure to increase progressivity of the tax code</td>
</tr>
<tr>
<td>is too broad or general. It cannot target executive</td>
</tr>
<tr>
<td>specifically, without affecting other individuals</td>
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</table>

4.4 Effects of regulation in general

The previous paragraphs show that imposing tax measures may not lead to a restrain of compensation levels on the long run. Some effects occur that are not intended by imposing tax measures. Thus imposing tax rules does not seem to be an efficient way to control compensation levels. It might be useful to assess if state regulation in general might have a ‘positive’ effect on compensation levels. Joskow, Rose & Wolfram (1994) found evidence that CEO compensation levels change with the regulatory environment in which the company operates. Political pressures place constrains on executive compensation. CEOs of highly regulated companies earn a lower compensation level than CEOs in less regulated industries. For example, CEOs of firms operating in more ‘pro-consumer’ regulatory environments earn lower compensation than ‘pro-shareholder’ regulatory environments. Joskow, Rose and Shepard (1993) conclude that economic regulation is “an effective mechanism through which public concerns about executive pay can be translated into political and regulatory action, and ultimately in reduced CEO pay.”

Imposing tax measures does not seem to be efficient for state governments, but when governments already have a strong regulatory- or political influence on certain industries, certain measures to affect compensation levels can be used effectively.
4.5 Why might governments still apply tax measures?

Based on the prior paragraphs, it can be said that tax measures have a doubtful effect on executive compensation levels. But why might government go on with using tax measures in order to try to control compensation levels? Shorter & Labonte (2007) state that for example imposing a more progressive tax system is widely considered to be the least costly way to redistribute income, in terms of lost economic efficiency. Thus tax measures are for governments a relatively simple way to try to control compensation levels.

Another reason might be found in the article of Van Uffelen (2007) and Mertens (2007) states this too. An advantage for governments is that imposing increasing tax rates leads to more revenues for governments. Thus increasing tax rates might not lead to declining compensation levels, but may be used by governments because it has positive effects for the government itself.

Now that the effects of state regulation by tax measures are explored, the desirability of an increase of taxation is assessed by combining the opinions of the different stakeholders.

4.6 Stakeholders

A tax increase will clearly affect many different stakeholders, from the CEOs who will need to pay higher taxes, to the government who has to impose the regulations and need to adhere to the economical consequences of the country. This part will explain per stakeholder what the opinion of the different stakeholders is and if it is desirable to impose a tax measures in The Netherlands.

CEO

Executives who receive a high compensation package also drive up the salaries of other employees (Westfa, 2006). Managers who receive a decent compensation use their influence to also reward other employees, because they want it to seem justifiable that they earn that much. However there are some managers who complain about the high compensation packages which are granted today. For example Kees van Lede (former commissioner of Akzo Nobel), Jan Timmer (former Phillips manager) and Karel Vuursteen (former Heineken executive) talked in the television show ‘Netwerk’ about the ridiculous high amounts of compensation packages and that the executives loyalty is only measured by money. They think that the relationship between performance and reward is lost (De Boer, 2007). Although they expressed their opinions on the television show, they did not do anything about their own excessive salaries.

Many CEOs do not touch the subject of executive pay, since they rely on the remuneration packages they receive and that they are perceived to be based on what is normal for the market. The CEOs can
however exercise some power. If they are skilled and have a strong bargaining position, they can demand a lot from their employers, since many companies want to attract them and the compensation packages are then an attractive offer. The skimming view is based on this view, namely that executives have considerable power in setting their own compensation package (Bertrand & Mullainathan, 2000: 203-208).

If a higher income tax will be imposed by the states, it is most likely that CEOs will try to avoid this by changing the compensation structure. Subsequently the imposed tax rules will have no effect on the total compensation levels. The CEOs become creative, however the possibilities to evade taxes have decreased (see paragraph 4.3).

**Board of Directors**

The board of directors monitors the policy of the managers to look after the continuity of the company and the interests of the parties involved (shareholders and employees). They want to attract the top managers to work for their company and they are willing to offer them interesting compensation packages in order not to loose them to competitors. If an increase of income tax will be imposed they will probably find new ways of attracting executives by offering them more income that compensate for the new unfavorable tax rules (Dijkman, 2007). For the board of directors it is not desirable that the state interferes, however it is not bad that they have to more strictly follow the code-Tabaksblat and involve the shareholders.

**Shareholders**

Shareholders possess shares which means that they own part of the company and therefore have a right to speak up during the general meeting (Vragen over beleggen, 2007). They have the right to appoint or fire the members of the executive board. Shareholders need to give their approval to changes made in the remuneration at the annual meeting (code-Tabaksblat, 2004). According to the monitoring commission of the Corporate Governance Code, the shareholders are more involved and the companies adhere by supplying them with more information besides the information given at the general meeting. However there are some draw-backs since the shareholders are not always known to the company, companies are careful with the information they supply to the shareholders, and sometimes withhold important information (Monitoring Commissie, 2006). Shareholders have gained more power in the last year. For example two hedge funds demanded the dismissal of the commissioners of Stork this year (Willems, 2007). The Nuon top-manager Ludo van Halderen gave back his bonus for his performance in 2004 (197.000 Euro), after the shareholder meeting, in which the shareholders ‘pressured’ the manager to make a substantial gesture (De Visser, 2005). However the question remains to what extent their power reaches. Usually it is more of an advisory role as explained in the code-Tabaksblat.
The Netherlands has a law which states that companies cannot give away shares without voting rights. However they have come with a solution by creating a foundation who is able to sell the shares, which results in people not having a voting right (Vragen over beleggen. 2007). This shows that companies have ways to find loops in the law. However the companies need to make sure that they keep their stakeholders satisfied as well and therefore need to be careful with what they do and how they do this. In that sense shareholders have the power to influence the companies’ decisions.

If the state does increase the income tax, it will affect the shareholders to such an extent that they will have to approve or disapprove of new remuneration deals for executives. This will have a different impact for different shareholders. Foreign shareholders act differently compared to their Dutch counterparts. Dutch shareholders tend to protest more against the high amount executives earn, however foreign shareholders are more likely to agree with the compensation packages for executives (Rengers & van Alphen, 2007).

**Labor Unions**

There are a few labor unions represented in The Netherlands, the FNV is one of them. FNV is a labor union which comprises 16 independent unions; one of them is the ABVAKABO. The ABVAKABO pleads for introducing a law of a maximum income next to a minimum income (ABVAKABO FNV, 2005). Edith Snoey, president of ABVAKABO, said that it is necessary to introduce such a law, since the different parties involved keep on pushing the responsibility to one another (Jongerius, 2005). Agnes Jongerius said in her speech that “the self enrichment of the top directors and the growing income differences are unjustifiable” (Jongerius, 2005). The FNV wants that people with high incomes take on a heavier load. The FNV finds that the fiscal options of the extreme remuneration need to be more extensively explored by the chamber. For example Gortzak suggests that more research needs to be done to explore the possibilities of increasing the income tax of executives with a salary of more than 300.000 Euro (FNV, 2007). The FNV also finds that the remuneration norms in the code-Tabaksblat need to be adjusted. They think that for example the variable part of the reward of managers needs to be maximized to a maximum of half of the total remuneration (FNV, 2007).

Agnes Jongerius would be very disappointed when Wouter Bos, Dutch Minister of Finance, would leave this issue up to the employers and employees, because she then expects nothing to happen. However René Paas of CNV, another labor party, agrees with Bos that the tax measures will not work. He thinks that the most effective way to pressure this issue is by the opinion of the public (Parool, 2007). The CNV recommends the social-economic council to talk with the employers about the excessive salaries. However, if they cannot come to an agreement, then the state should interfere (Trouw, 2007).
Employees

For employees it is important that the salary levels are fair. For example, if you work hard and deliver good work, you get a bonus. However in some cases the executives get an increase in their salary even when the business is not doing well and the employees see a decrease in their salary. The employees want to see some reward as well in the company. For them it is not desirable if the state increases the income taxes, but it is desirable that the company which they work for, creates corporate governance in which they reward their employees when the business is doing well, instead of giving the executive a high bonus. Also in case of merges and acquisitions managers can earn a lot of money. For example Bennink received the tremendous amount of 80 million Euro, only because Numico was acquired by Danone, which caused the stock price to rise (Van Uffelen, 2007). Imagine that instead of giving Bennink this much they would have spread the amount among the employees. They would have probably been a lot more positive about the merger. It is therefore desirable for the employees that the companies create a code of conduct according to the rules in the code-Tabaksblat, however it is not desirable for them that the state increases the income tax. Especially because some research has shown that in some cases the increase of tax rates for high income levels can lead to an increase of taxes of the middle class and poor people (Bartlett, 1993). This is explained in paragraph 4.3.

Political parties

The political parties in The Netherlands have different point of views concerning the issue executive pay. Appendix 2 further elaborates the point of view and states a short explanation of the main political parties, who are represented in the Second Chamber in The Netherlands. A short description of the main political parties is presented in table 1, stated below.

<table>
<thead>
<tr>
<th>Political parties</th>
<th>Opinion (as stated on the website of the political parties)</th>
</tr>
</thead>
<tbody>
<tr>
<td>CDA</td>
<td>Primary responsibility of companies. When this does not lead to decreasing compensation levels, then the state should interfere.</td>
</tr>
<tr>
<td>ChristenUnie</td>
<td>Increased transparency and advocacy for shareholders to reduce excessive wage levels.</td>
</tr>
<tr>
<td>GroenLinks</td>
<td>Focus on transparency. The Board of Directors should moderate income levels in the first place, but the state should intervene in case of no results.</td>
</tr>
<tr>
<td>PvdA</td>
<td>A dialogue between employers and employees is essential in order to reach an agreement, state intervention in case of failure.</td>
</tr>
<tr>
<td>SP</td>
<td>State should impose tax measures to regulate high income levels of executives.</td>
</tr>
<tr>
<td>VVD</td>
<td>Government is not entitled to influence the high incomes in private sector. Salary levels are the responsibility of the executives and the Board of Directors.</td>
</tr>
</tbody>
</table>

Table 4.3 - Opinions political parties about executive pay in private sector

As can be seen in table 4.3 there are different opinions concerning how to deal with the high levels of income of executives and if the state should interfere. Most parties agree that it is not their primary responsibility, but that it should be regulated by the companies themselves. However, there are some
parties who want the state to do something about it. For example the SP has the opinion that the state should impose tax measures to regulate the high income of executives (Parool, 2007). According to Wouter Bos, Minister of Finance, imposing higher salaries will only lead to higher gross salaries, since the executives want to earn the same net salary as before (Parool, 2007). However the social-democrats (PvdA) believe that fiscal measures, prohibition conditions or extra supervision are purposeful (De Witt, 2007). According to Donner, Minister of Social Issues and Employment, if the state has to interfere with income levels, it will be the end of the collaborate labor agreement. He thinks it is the responsibility of the organizations (CNV, 2007).

For the political parties it is desirable to come to a mutual agreement concerning the regulations of executive pay. They are more on one line concerning the (semi-) governmental sector than for the private sector. Many debates will follow what the best option is for the private sector, since the different parties have a different perspective concerning this issue. The chamber finds that the venture council should get access to the general meeting of the shareholders to talk about the salary policy and to get a chance to create an opinion about this matter (CNV, 2007).

For the political parties it is desirable that according to the code-Tabaksblat the companies regulate their own corporate governance in such a way that the state does not have to interfere. This would be the ideal situation, however it is most unlikely to occur overnight. Many other countries are dealing with this issue as well and the state needs to be aware of the economic consequences. The Netherlands has much higher tax tariffs for the high incomes than other European countries (Taxation and Customs Union, 2007 and De Witt, 2007). Looking at the economic consequences it would not be desirable to impose higher income taxes, however to minimize the difference in income levels and create a country in which the people with a higher salary pay more it would be desirable to impose regulations by the state.
5. Evaluation - conclusions

The previous sections have focused on the effects of different taxation possibilities of the Dutch government to regulate executive compensation and on the different stakeholders’ views on this option. These two aspects can be considered the efficiency and the ethics objectives of the Triple E-triangle (Van Tulder & Van der Zwart, 2006: 153). These two aspects are the elements that determine whether a measure is effective. This is treated in the research question that states the following: ‘What is the effectiveness of regulation through an increase in taxation on executive pay packages?’ This question will be answered in this section, but first it will be considered whether tax increases are an efficient and desirable way to regulate executive compensation.

5.1 Efficiency

The efficiency element of the research question assesses whether an increase in taxation actually controls compensation levels, thus that it serves the purpose for which it is designed. The following sub-question reflects this function: ‘What are the effects of an increase in taxation on executive pay packages?’ This question will be treated in this section.

Three different taxation possibilities were identified to regulate executive compensation. These include introducing a higher top tariff of income tax, increasing taxation for only a part of the executive compensation, like bonuses, or limiting deductibility of the executive compensation expenses from corporation taxes. Introducing a higher top tariff of income tax, clearly affects the wealth of executives, since they have to give a larger proportion of their income to the government. However, it is recognized that not executives, but the companies that they work for may bear increased costs, since due to the currently tight employment market executives have increased bargaining power to demand this from the companies they work for. Therefore, this tax measure is not likely to have the result of decreasing income inequalities in The Netherlands as long as the bargaining position of executives decrease to such a degree that their companies are able to decline executives’ demands to compensate for increased taxes. This situation could for example occur when the market is characterized by severe unemployment. In this context, increased taxation rates affect the income of the executives (Mertens, 2007). Thus, in this context only the net effect of increased taxation would be that executives will lose income.

The second taxation possibility entails taxing certain parts of an executive’s pay, like excessive bonuses. While in the USA this has led to the increased use of stock options as a compensation component, this is less likely in The Netherlands, where stock options generally fall under the income
tax that an executive has to pay. The effect of increasingly taxing bonuses may then lead to reduced
association between performance and pay and this clearly is against the objectives of the shareholders.
Increasing taxation of only one part of the pay package has the effect that the loss of income is
compensated with an increasing use of other forms of pay. Therefore this measure is not only likely to
increase the income tax that executives have to pay, but also to decrease the incentives the executive
have to create shareholder wealth.

The taxation and accounting advantages of stock options have decreased over time, for example since
an executive now has to pay tax on the profit that is earned on a stock options received from the
company. In addition, stock options costs are not deductible of corporation taxes anymore, in contrast
to a few years back. However, the executive is still able to choose when he exercises the stock option,
and thus when he realizes a tax payment. Still, this can only be considered an incremental advantage
since the time to exercise an option is clearly also dependent upon the market situation.

A final tax measure entails limiting the total amount of all forms of executive compensation that a
corporation can deduct from its corporation taxes, which in another form was implemented in the USA
under the name of the `Million Dollar Rule´ (Shorter & Labonte, 2007). This Million Dollar Rule
limited the corporate deduction of the non-performance part of the executive pay package above $1
million. This measure was not effective. It only changed the structure of the pay package; it did not
lead to lower compensation levels. A possibility could be that companies are only able to deduct a
total of 1 million euros of the total costs of each executive from their corporation taxes, which makes
it more costly for companies to give high rewards to its executives. However, it is unclear whether the
total compensation level of the executives would decrease, or whether the company has to incur
increased costs which will be added to the prices of its products or services.

Other effects of increased taxation include that executives gradually try to find more ways to evade tax
expenses, for example by the use of deductions or tax shelters. Still, it is recognized that although tax
shelters and deductions have been employed frequently in the past by wealthy individuals and
executives to pay reduced amounts of taxes, tightened regulation have ensured that a lot of deductions
and shelters have disappeared (Mertens, 2007; Van der Kwast, 2006) and thus that there are not many
opportunities to evade tax payments anymore.

Another possible effect of increased taxation takes place at the macro level. It is suggested that the
economic strategic position of the country might be at stake, when income taxes are increased and
when occurs in the context that this effects executives. This appears since the executive has the option
to leave and work in another country with lower income taxes, when the executive loses more income
due to increased tax payments. This so-called `brain drain´ can be a very serious consequence since the
most talented people emigrate. Still, it could be argued that only a very small group has the contacts, the ambition, and the desire to move to another country and work there and that only with a very large increase in income taxation this could be considered a serious threat (Mertens, 2007). A final effect of increased income taxation is that the increased tax revenues might lead to redistribution of incomes in a country, although there are contrasting results on this issue.

In the end, increased taxation does not appear to be an efficient way to regulate compensation levels. First of all, it is unlikely whether the executives will be the persons that will be most affected by an increase in income taxes, or whether it will be the companies that they work for that have to bear the costs. It is not likely that tax measures have a structural effect on total compensation levels, because the loss of income is compensated. Contextual factors like the employment figures are clearly important in this discussion since they influence the bargaining position of the executive in setting their salary levels in the company. Secondly, it is possible that talented executives may leave The Netherlands when income taxes are increased to, although this obviously also depends upon the level of the increase as well. This undoubtedly is not a solution either.

5.2 Ethics

The ethics element of the research question assesses whether an increase in taxation answers the desires of the different stakeholders in society. The following sub-question reflects this function: ‘Is an increase in taxation desirable based on the different opinions of the stakeholders?’ This question will be treated here.

Different stakeholders were identified in the issue of executive compensation: the CEO, the Board of Directors, the shareholders, the labor unions, the employees, and the political parties. These parties are involved at the micro-, meso-, or macro level at which executive compensation can be analyzed, or at a combination of levels.

At the micro level, the issue of executive pay concerns the CEO, the Board of Directors, the shareholders, the labor union, and the employees working in that company. The CEO, the Board of Directors and the shareholders generally are not in favor of increased income taxation that will affect the executive’s compensation, since the CEO usually wants to maximize his own income and the Board of Directors and shareholders want to attract talented executives. The CEO might be able to bargain that the company will pay for the extra costs and since the shareholders and Board of Directors want to keep its talented CEO they will grant this easily. The labor union and employees of the company support any form of increased income taxation, since they consider it ethical that there is a limit to the amount executives can earn and they also support redistribution of income. Still, they
might be frustrated when an increase in income taxation will be accompanied by an increase in gross salary levels for the executives as well.

At the meso level, the political parties have different points of view about the increased income taxation. Left-wing parties like GroenLinks and SP strongly support a higher top tariff in income taxes. In contrast, other parties like the VVD, CDA, D66 and ChristenUnie do not want to increase the top tariff but are considering other fiscal measures. The PvdA generally support a higher top tariff in income taxes, although it is concerned about the competitive position of The Netherlands. Clearly, if the political parties that support an increased tariff for income taxes will not support a possible increase of executives’ gross salary levels at the same time by their companies as well, since their tax measure will have no effect on the income levels of executives (but will raise tax incomes for the government though).

At the macro level, the competitive position of The Netherlands might be at stake when very high income tax rates will be introduced. This is especially the concern of the PvdA, and right-wing political parties. CEOs might be inclined to live and work in countries where they have to pay lower income taxes. While higher income taxes causes no real effects for executives when their companies are willing to bear the costs by increasing their gross salary levels, it can be a problem when companies are not willing to bear this costs, for example in a market context with severe unemployment or with other factors that decrease the bargaining position of the executive in the firm. This might cause executives to live and work in other countries, which might cause problems for the company and in the longer run for the business climate and competitive position in The Netherlands. Higher salaries might then be a possibility, but this might even cause more public and political debate. The other possibility is to offer some other form of incentive to executives. If this is not successful in attracting or keeping CEOs, executives might move to other countries with a more appealing tax regime. This can lead to a shortage of CEOs in The Netherlands, and more bargaining power of CEOs. In addition, this may lead to a decreased competitive position of The Netherlands in relation to other countries, which affects the whole Dutch economy. It is debatable whether a tax measure will lead to this situation, but the possibility exists. History has shown that a top income tax tariff of 72% led to the migration of wealthy Dutch individuals to Belgium, which had a more favorable tax regime, and in an increasingly globalized world emigration becomes a much smaller step to take. Clearly, no stakeholder involved in this discussion would aspire such a development.

5.3 Effectiveness
The research question stated the following: `What is the effectiveness of regulation through an increase in taxation on executive pay packages?’ It is recognized that the effectiveness of a measure is
dependent upon two pillars: its efficiency and its ethics. The previous sections have shown that increased income tax tariffs generally do not lead to decreased levels of executive pay. In the worst case scenario, increased taxation does not serve its purpose and even leads to additional negative effects like executives’ migration and a weakened competitive position of The Netherlands. In this discussion it is important to take the contextual factors that influence the outcomes of tax measures into consideration. In a market that is characterized with unemployment, it is logical that executives have a more powerful bargaining position and they can demand their companies to pay increased levels of salary to compensate for the increased income taxes. As a result, the goal of the tax measures will not be reached, since the measures only affect the companies and only the structure of executive pay is changed, not the total amount of compensation. Therefore the efficiency of this measure can be questioned.

The other pillar on which an effective measure is rooted concerns ethics. For the different stakeholders, the desirability of a taxation increase depends on its effect on the executives’ compensation levels. In the best scenario executives do pay more taxes, and for stakeholders that want to restrain executive compensation the measure thus serves its purpose. However, the worsened economic position of a company or a country due to executives’ migration can also be the consequence of increased taxation. This clearly is not the development that any stakeholder involved aspires. The situation in which the companies compensate the increased income taxes that an executive will pay is obviously also not approved by the stakeholders. Therefore, it is also questionable whether increased taxation and its effects are truly desired by all stakeholders. As a result, tax measures cannot be considered an effective measure, since in most cases it does not restrain executive compensation levels and it does not lead to the desired results for stakeholders.

Besides tax measures, other possibilities exists to regulate executive compensation or to at least increase shareholder’s control over the issue. This is often linked to increased transparency and extended participation of other parties in the decision-making processes, as is described in the Corporate Governance Code of the Dutch Government. Although it should be kept in mind that this code only consists of guidelines that each company has to comply to or otherwise explain its motivation in case of non-compliance, it still is a tool and method that every stakeholder is positive about. Shareholders and the Board of Directors clearly gain from the increased transparency and control they receive. For other actors like political parties, employees, and labor unions, these guidelines are also positive although they do not consider them sufficient on itself. Still, since the guidelines have widespread support, it might offer room for negotiation and debates between the different actors involved in the discussion. Perhaps multi-stakeholder dialogues can be a good suggestion that can build on the Corporate Governance Code and can start to focus on similar interests.
and ideals. In this way, new initiatives may evolve and the stakeholders might get an increased understanding of each others’ position and motives.

A final point concerns the ownership of the issue of executive pay. It is argued that this issue is located in the market sector (Van Tulder & Van der Zwart, 2006), and consequently that this issue is ‘owned’ by the shareholders, the owners of the company, and to a lesser degree by the Board of Directors, the CEO, and the employees. In the public and political debate this is often neglected, and it is argued that the state also has a role to play in setting limits to executive compensation. In addition, the public and media also have an opinion on the issue and thus almost feel that they are entitled to judge. It is important to realize that it is debatable who owns the issue of executive pay. It differs between people with a different political ideology and many different actors might feel entitled to this issue, while factually the shareholders remain the party that owns the company, hires the executives and finally pays them.

5.4 Letter of recommendation

The conducted research presented in this paper, has several limitations. These limitations are presented here. From there, some recommendations can be made for further research.

Limitations

Only the Dutch context is taken into account in this research. The effects of tax measures and their desirability are explored for The Netherlands, but it is not investigated if the conclusions can be generalized to other countries. Besides that, only the market sector of The Netherlands is analyzed. The issue of executive pay also plays a role in the (semi-) governmental sector, but this sector was not investigated.

In the implementation phase of this paper, the effects of tax measures are mainly assessed by using US literature. No scientific literature was found on the Dutch situation. An interview with a tax specialist was held to gain more insight in the Dutch situation about taxation, and additionally it is also tried to apply the information of the US literature to the situation in The Netherlands. Furthermore, this research is conducted on a qualitative basis, thus this might give a more ‘subjective’ view on this issue.

The effects and desirability of only one regulation possibility, an increase in taxation, is explored. There are other measures which the Dutch government might impose, but these are not analyzed. The effects and desirability of self-regulation by companies are not assessed either, but this possibility could be an important alternative for state regulation.
The stated limitations lead to recommendations for further research.

Recommendations
Because only the Dutch context is taken into account, further research needs to be done for other countries in order to see whether the situation in The Netherlands is country specific or a general view on the matter, which accounts for other countries too. But this research might be valid for governments of other countries which face a major societal debate or protest too. This may count for the surrounding countries of The Netherlands, but every country has another tax system therefore it is hard to compare. It might also be interesting to analyze income taxation in The Netherlands with income taxation in other European countries in a comparative approach, especially since many debates have prevailed about harmonizing European regulation.

Because this research was done on the basis of qualitative research, quantitative research can be conducted to extend this research, in order to give a more factual basis for the arguments. Examples include specifically measuring the effects of the tax decrease in the 1990s in The Netherlands on the levels of executive compensation, or measuring the effects of tax increase in other countries on executive compensation levels. Although this can be considered an ambiguous approach, in which the contextual factors have to be taken into account, it can still provide some insights for the current debates about executive compensation.

Besides the market sector, further research has to be conducted for the (semi-)governmental sector in The Netherlands. A lot of primary sources were found on this sector, but scientific literature was harder to find. When more research is done, the two sectors can be compared to see if there are structural differences in the possibilities to control compensation levels and whether regulation (including taxation) changes in one sector affect the compensation levels in the other sector.

The possibility to use tax measures is singled out in this research, but it is useful to give a complete view on the matter by analyzing all the regulation possibilities. This could be either the effectiveness of other state regulation possibilities, but the effectiveness of self-regulation is another possibility. To give an example on the Dutch situation, the effectiveness of the compliance of the Code Tabaksblat can be researched. When research is done on this matter, the two possibilities, either state- or self-regulation, can be compared in order to see which possibility might be more effective.
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Information about Ton Mertens:
Ton Mertens is a specialist in employment taxes. He is a partner at Loyens & Loeff, a service law firm with integrated corporate law and tax practices. He is also a lecturer at the University of Amsterdam, where he teaches on wage taxes

Other sources


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Appendix 1

Table 2.2 – Tariff income tax

<table>
<thead>
<tr>
<th>Level</th>
<th>Taxable income from labor and home</th>
<th>Income taxation tariffs</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>until € 17,046</td>
<td>34.15%</td>
<td>16.25%</td>
</tr>
<tr>
<td>2</td>
<td>from € 17,047 to € 30,631</td>
<td>41.45%</td>
<td>23.55%</td>
</tr>
<tr>
<td>3</td>
<td>from € 30,632 to € 52,228</td>
<td>42%</td>
<td>42%</td>
</tr>
<tr>
<td>4</td>
<td>€ 52,229 and higher</td>
<td>52%</td>
<td>52%</td>
</tr>
</tbody>
</table>

Source: http://www.belastingdienst.nl
Appendix 2

Description of the main political parties and their point of view concerning the issue of executive pay.

CDA: stands for ‘Christen Democratisch Appèl,’ it is a Christian democratic party for citizens, from all different backgrounds. They stand for public justice, spread responsibility, solidarity and a growth of welfare for the present and future generations (CDA, 2007). The opinion of the CDA is that they think it is unacceptable when managers receive extraordinary high salaries, especially if the salaries of the ‘normal’ employees need to be leveled. The managers need to act socially responsible, however if they do not carry out their responsibility, the CDA feels it will need to act upon this by imposing state rules and regulations. The CDA supports the code-Tabaksblat and if the organizations will not follow these guidelines by their own initiative, the CDA will take the initiative to propose regulations concerning this issue (CDA, 2007). According to Donner, Minister of Social Issues and Employment, if the state has to interfere with income levels, it will be the end of the collaborate labor agreement. He thinks it is the responsibility of the organizations (CNV, 2007).

PvdA: stands for ‘Partij van de Arbeid,’ it is a social-democratic party. They would like to bring society closer together without the differences of social classes. This also means that they would like to reduce the cap between the rich and poor. They want to maximize the top-income package in the public as well as the semi-public sector (PvdA, 2007). In April 2007 Wouter Bos, Minister of Finance, said he did not want to take any financial measures to reduce the high salaries of executives, however his party in the Second Chamber wants to push the employers and employees to get to an agreement concerning the high salaries and if this is not reached that the state imposes rules and regulations by law (Parool, 2007 and De Witt, 2007). According to Bos imposing higher salaries will only lead to higher gross salaries, since the executives want to earn the same net salary as before (Parool, 2007). However the social-democrats believe that fiscal measures, prohibition conditions or extra supervision are purposeful (De Witt, 2007).

SP: stands for ‘Socialistische Partij,’ it is a socialistic party. Their goal is to reach a society in which human dignity, equality and solidarity are a central issue (SP, 2007b). The opinion of the SP concerning the extraordinary high salaries is that there should be a maximum salary in the public and semi-public sector. Nobody who works for a public cause should earn more than the prime-minister (‘minister-president’). Within companies the difference between salaries need to be dealt with by putting all employees under the collective labor agreement (‘CAO; collectieve arbeidsovereenkomst’), in which the highest and lowest salaries are dependent on one another. The collective labor agreement will be generally binding. The venture council (‘ondernemingsraad’) will get a voting right concerning the top salaries within the company.
Concerning the public sector the SP wants the managers of governmental and semi-governmental organizations to earn not more than the salary of the prime-minister. Often it is the case that managers today receive much more (for example the top of energy company Nuon receive almost € 850.000), the SP thinks that they should not earn more than their boss, which is the prime-minister. The SP finds the propositions of the salary raise of 30% for politicians unheard of (SP, 2007b). They are of the opinion that the state should impose taxes to regulate the high income of executives (Parool, 2007).

VVD: stands for ‘Volkspartij Voor Vrijheid en Democratie,’ it is a liberal party. The VVD wants to be there for society, a political debate is therefore essential. Everybody within the party can contribute to the debate and the outcome of the discussions is what the VVD stands for (VVD, 2007). The VVD strives for more transparency concerning the amount earned by managers in the (semi-) public sector. They therefore agreed with the law WOPT (‘Wet openbaarmaking uit publieke middelen gefinancierde topinkomens’; law on publication of top incomes financed from public resources). They however find it acceptable that managers in the public sector may earn more than the prime-minister, if the manager delivers a top performance. They find it important that there should be a focus on quality as well. However they are against this norm in the semi-public sector (VVD, 2007).

GroenLinks: is a progressive socialistic green party. GroenLinks argues that the difference between what ordinary employees earn and what their managers earn is out of proportion. They find that directors have to moderate themselves. In the public sector they do not want any civil servant to earn more than the prime-minister. The law Harrewijn, which was an initiative of GroenLinks, has become effective earlier this year. It is a law which states that for the large companies and organizations the amounts managers receive in salary need to be made public. They expect that the directors are discouraged to excessively let their salaries increase. In the (semi-) public sector they find that the salary of the prime-minister should account for the maximum. They find that the cabinet should regulate this by law (GroenLinks, 2007).

ChristenUnie is a Christian party. They strive to create a society which more and more functions to Gods will. To reach this goal they want to be represented in every political level. They base their political conceptions on the word of God and strive for a society in which people look after one another (ChristenUnie, 2007). The ChristenUnie thinks that if companies do not adhere to the code-Tabaksblat, they will have to introduce a dividend discount to encourage shareholders to speak up and exert their influence to reduce the excessive wages in companies. They are in favor of maximizing the wages in the (semi-) public sector, the norm would have to be the income of the prime-minister (ChristenUnie, 2007).