Marketplace

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‘Why should the Beckhams and Rooneys of corporate finance be penalised, but not the Beckhams and Rooneys of football?’

An old wisecrack states that bankers are different from you and me: they are better paid. But are bankers also different, in the way they earn their money, from film stars, pop musicians and footballers?

Until last year, people at the top of the banking industry were in the same position as their counterparts in popular entertainment and professional sport. Their pay was not subject to official regulation of any kind. If you were a star in finance and your activities brought in revenues of millions of pounds, you could negotiate with your employers an income which reflected your productivity. In some types of banking—notably securities trading (where an individual might make millions by selling securities for higher prices than were paid for them) and corporate finance (where one senior executive with a long client list could bring in fees of several millions)—the link between income and output was clear, and might even be stated in a contract.

But in 2008 the free market in bankers’ payment practices came to an end. Various misdeeds by bank executives were revealed in the subprime crisis and an international campaign emerged to restrict their annual bonuses, which in the City of London had sometimes exceeded £10m. On 21 May, the main story on the front page of the Financial Times, which had led the campaign in the UK, carried a story on “Watchdog to focus on bank bonuses”.

According to the FT, the Financial Services Authority would in future monitor executives’ pay and reprimand organisations where inappropriate payment incentives were deemed likely to lead to excessive risk-taking. A so-called “bonus culture” was alleged to increase the danger that key institutions would run into losses and need to be bailed out by the state. As Martin Wolf, the FT’s chief economic commentator, famously remarked, the financial sector was good at “privatising gains” and “socialising losses”.

Is the regulation of pay really necessary? No one disputes that banks which take in retail deposits are in a special kind of industry, in that they promise to repay deposits at 100 pence for every pound they take in. Regulation of business practice to limit risk may be necessary, as business and finance are severely disrupted if banks cannot honour the commitment to repay at par. But throughout the 20th century, Britain’s banks consistently repaid deposits in full, without civil servants telling them how to pay their senior staff.

Of course, there are many other types of banking, notably the securities underwriting and trading of the so-called “investment banks”. Here, competition remains intense, even if it is less fierce than it was in the boom conditions of 2006 and 2007, and the principle of “survival of the fittest” determines whether a particular company can cope with challenging times. The disappearance of several of these organisations since mid-2007, and the collapse in the market capitalisations of those that remain, make a mockery of the idea that losses are socialised.

In the current financial crisis losses have fallen heavily on managements and shareholders who are very much in the private sector, while depositors everywhere continue to receive back 100 pence in the pound, 100 cents in the dollar or whatever. If an investment bank continually gives unjustified and excessive bonuses to its staff, it will go bust in just the same way as any company in any industry. Why should financial regulators meddle particularly in pay and not look at all the other relevant costs?

If the claim is that big bonuses reflected only transient profits, the flipside is that the variability of bonuses in response to changing conditions is a healthy feature of the free-market system. Economists squabble among themselves about many things, but they usually agree that wage and price flexibility ease adjustment to fluctuations in demand. On that basis, the bonus culture should be applauded rather than condemned.

The truth is that the attack on bankers’ pay has been largely motivated by envy and resentment. Film stars and Premier League footballers receive sums of money which are even more outrageous relative to average pay than what bankers earn, but no one has the guts to advocate income controls for them. The FT has so far not dared to suggest that Ofcom should curb how much is paid to TV personalities, that the Football Association should impose limits on top players’ remuneration and that the Arts Council should restrict the bonus culture for world-renowned opera singers.

Why are the Pavarottis and Domingos of bond trading somehow more reprehensible than the Pavarottis and Domingos of international opera? On what grounds should the David Beckhams and Wayne Rooneys of corporate finance be penalised relative to the David Beckhams and Wayne Rooneys of football? Despite a common misunderstanding, bank bail-outs are loans which must be repaid and are not “government expenditure” at all. The notion that the City of London receives official subsidies is preposterous. But who can overlook the fact that many TV stars benefit from licence-fee money, and that opera and sport attract an assortment of government handouts?