

## The ethics of bankers' bonuses

Bankers are in the news once again – thanks this time to the eye-watering sums we hear will be finding their way to the top team at Barclays. Before we allow the heat of the debate to crowd out the light, it would do us all good to pinpoint what exactly we find objectionable here and what we would like to see done differently.

The first objection is that *no one should be paid millions*. This argument is intuitively powerful, especially when we set the rewards of the best paid bankers against the modest level of the UK's median salary. To pay people in the millions - let alone the tens of millions - seems to say that their efforts count for more than the combined efforts of large numbers of their fellow citizens. But if we follow the argument through, it commits us to imposing a cap on incomes, *either* through the state restricting how much employers can pay their employees *or* through income taxes that are confiscatory at the upper end.

The idea of capping incomes was once the stuff of political debate in this country. But those days are long gone. A cap would affect not just the best paid bankers but high rollers from Simon Cowell to James Dyson and there is no obvious political appetite to put the squeeze on such people nor to risk turning them into tax exiles.

The second objection takes this on board. It says *maybe some people should be paid millions, but the bankers should not*. This argument, in turn, feeds off two quite different ideas. One is that there is nothing about banking to make us think it generates star performers: grey suits should get grey money. The other idea is the now familiar one that the banks are only in business thanks to the taxpayer. Any commercial success the bankers enjoy rests upon a mountain of public support that must be discounted from calculations about their *true* worth and performance.

The grey suits argument may come from the idea that big rewards should only go to people who stand out from the crowd - such as entrepreneurs and entertainers - rather than those who lie hidden within vast corporations. Being visible, the talents of entrepreneurs and entertainers are recognisably superior to our own. The fact they bring cheer to our daily lives helps their cause as well. Moreover, most people are hard pressed to describe what top bankers do all day, what stuff they need to be made of to do it well, and what the downside is of living their lifestyle. All of which may have led many to fancy that there can't really be too much to this banking game after all.

Like most people, I have a lot of sympathy with the bailout argument – but I don't think we should simply lump together all the banks and convict them of equal recklessness. Not all banks acted with the folly of RBS.

The third objection says *it is wrong that bankers should receive millions in bonuses*. Of course, this can easily become just another way of expressing the first two objections, such that its true target is the

millions rather than the fact they are paid in bonuses. Allowing for this, why has the issue of bankers' bonuses remained so contentious?

One answer is that the debate about bonuses is often conducted at cross-purposes. People assume they are appealing to a common idea of what a bonus *is* when really they are trading in different ideas.

A bonus is something people are paid over and above their base salary. Precisely because they have this over-and-above quality, it is easy to see bonuses as inherently wasteful and unnecessary. Lots of people are willing to give of their best at work without the prospect of a bonus: why shouldn't bankers and their like do the same? But bonuses shouldn't be about giving employees something-for-nothing. They should be about exchanging something-for-something.

The idea that how much people are paid should be a function of how well they do their job is nothing new. Indeed, paying people a base salary could be seen as an imperfect rendering of this principle: it seems to reward people for what they do *regardless* of how well they do it. In its purest form, the payment-by-performance principle would do away with base salaries altogether. In their place would come a system whereby employees racked up plus-points for a good day's work and minus-points for a bad day's work: their pay at the end of the week/month/year would be wholly function of the balance between pluses and minuses.

Of course, there are any number of objections to a system of this kind. It would likely make for an atmosphere of instability – not to say blind panic and cut throat competition – at the workplace. It would put the managed even more at the mercy of those who manage them. And it would be ill-suited to the many areas of our economy where there are multiple, and contestable, criteria for assessing what constitutes a good or bad day's work in the first place. There is a very wide range of activities, in the public sector and elsewhere, that simply do not lend themselves to being truncated into something resembling a sales target that was met or missed.

None of these objections, however, undermines the idea that base salaries are a crude interpretation of the payment-by-performance principle. If we believe in that principle – and most of us do – we must be open-minded about allowing space in our reward schemes for something-that-isn't-a-base-salary. If you don't like the b-word, you can call that something a commission or a performance-related payment. But if you're not of a squeamish disposition, you can just call that something what it is – a *bonus*.

All of which tells us that the idea of bonuses – understood as something-for-something payments – is not as alien to our ordinary thinking about how people should be rewarded in the workplace as many suppose. Moreover, it makes perfect sense to speak of people being *entitled* to their bonuses. If my employer promises me £1000 on top of my base salary for meeting a particular target, then clearly I am entitled to that £1000 if I fulfil my side of the bargain. An employer that did not pay me my £1000 would be guilty of cheating me out of what I am owed.

So, it is too lazy to say that bankers aren't entitled to their bonuses, just because they are bonuses. If they have honoured their side of the bargain, why should they not be paid for it? Here a second argument kicks in. True, it says, bankers may indeed be entitled to their bonuses. But that's not the same as saying they *deserve* them. The issue of desert goes wider than whether each side has kept their part of the bargain between them. A bonus scheme might be absurdly generous: it might give

people riches out of all proportion to the contribution they made to the fortunes of their employer. In order to be deserved, a bonus must be proportionate or fitting.

From here, the argument extends still further. My pay could be proportionate in one sense but disproportionate in another. It could be proportionate in the sense that it truly reflected the contribution I made to the success of my organisation: having brought in £10million worth of business, it's only fitting that my cut of that should be £1million. But my pay could be disproportionate when set against the pay of other people in other areas of the economy. Earning £1 million might make sense (indeed, even be commonplace) within my immediate occupational world but try justifying that kind of reward to a care assistant or primary school teacher and see where it gets you.

Do most of us have enough information about how the bonuses of bankers are calculated to decide whether they are proportionate, in the first sense at least? That is unclear: their gargantuan scale may simply reflect the gargantuan scale of the banking sector itself. Do most of us have a clear picture in our minds about whether it would improve the functioning of the banking sector if the balance between base salary and bonuses were to be radically different from what it is at the moment? Unclear, again. Clearly, bonus schemes that create perverse incentives should be done away with. But that's a point about perverse incentives, not one about bonuses themselves. Getting rid of bonuses altogether might just create its own perverse incentives. Moreover, it's not obvious how it would address the central criticism made of bankers at the height of their financial folly – that the pay of too many of their number was not a true reflection of their performance on the job and of the risks they were taking with their (and our) money.

For now, the cry against bankers' bonuses has a catch-all quality: their bonuses are taken as emblematic of continuing excess and ingratitude. But if we are serious about making a success of the banking sector then we shall have to make our peace with the idea of something-for-something payments and realise that, whether you have the courage to describe them as bonuses or not, they can be a vital tool in linking pay and performance.