Preface

When I first thought of writing this book, a few years ago, it was at a time when I was also attempting to get a foot on the property ladder in the UK. The idea to write the book and my experience in buying my first property were explicitly linked. As the well-known aphorism declares: ‘an Englishman’s home is his castle’ and having secured my first job in academia, I was looking forward to joining the throng of first-time buyers clamouring for mortgage finance, issued in ever greater volumes by the UK’s cluster of large commercial banks. The housing market was experiencing the greatest boom in its history, and many people – myself included – were in danger of being left behind. Due to ever increasing house prices, and surveying the mortgage field from a position of inexcusable ignorance, I thought initially that my fairly meagre (or generous, depending on your point of view) lecturer’s salary would get me nowhere near affording even an entry-level property in an area in which I wished to live based on a traditional ratio of income to purchase price. In more prudent days, of course, banks were willing to lend around three times salary to would-be purchasers of properties, whilst often also demanding a hefty deposit. On these terms, I would never have reached even the first rung of the property ladder.

Never fear! The Great Moderation was here! Funded by a seemingly endless supply of cheap money and consistently stable interest rates, first-time buyers like me were able to raise mortgages of many, many multiples of income – often with no deposit required – and thus experience the wealth effect that only proprietorship of a home can generate. Bankers were being rewarded handsomely for extending these loans, and bank shareholders were reaping large dividends and handsome share sale profits, as bank stocks soared in value throughout the 2000s. These trends were aided particularly by the raft of banking conglomerations and financial deregulations which characterised the pre-2008 period. Moreover, on a macroeconomic scale, it appeared that the spectre of instability which had haunted the world of finance since the mid-1960s had forever been consigned to history.

Yet, something didn’t quite add up; the joy with which I signed my first mortgage agreement was tempered by a drop of fear. Of course, the
The desire to own a home was powerful, but I was also sure, even as a non-economist, that property prices could not continue to appreciate inexorably. These doubts were fuelled further by articles by so-called doomsayers in the popular press predicting that real estate prices would eventually begin to fall, and by my chance encounter with the work of a little-heralded economist (at least, at that time), Hyman Minsky. Minsky’s work, in particular, struck a chord with the prevailing economic conditions of the mid-2000s: this was, of course, a time of supposed great financial stability, an era consistently heralded as the point when the cycles of boom-and-bust had ended. Nonetheless, despite some doubts, in 2007 I signed the mortgage papers on my first house, putting down a small deposit as a buffer against any future fall in value. Naturally, of course, I was hoping within a few years to have a nice slice of home equity.

The rest, as they say, is history.

The house I bought is now, of course, in negative equity (with no guarantee that it will ever be worth more than the outstanding mortgage). Accordingly, the experiences of 2007–2010 were chastening. For me and many others, they raised basic questions about the assumptions of mainstream economic theories and financial market modelling, which had essentially predicted that financial crashes of this variety were next-to-impossible. It has since become clear that these so-called ‘orthodox’ theories are, in fact, highly limited in explaining how financial markets operate. On a practical level, these limitations were reflected in the collapse in value of many asset markets over the half-decade following 2007 – from stocks to real estate, from commodities to sovereign bonds. Moreover, the huge rewards on offer at financial institutions – based, as they are, to a great degree on rewarding executives and senior managers through (often) short-term incentive systems – seemed to be prime culprits in creating the conditions in which these asset values could become inflated. On this basis, it is my view that there are further and serious questions to be asked of financial regulation systems and bank corporate governance regimes – which of course inform compensation packages – which proceed from a theoretical position that demonstrably fails to reflect economic reality.

Above all, this book attempts to add to the debate concerning the contribution of executive compensation at financial institutions to the greatest financial crisis of recent times. As will hopefully become clear during the book, I consider the pattern of ever more financial concentration and conglomeration, ever higher financial leverage levels, ever greater short-termism from shareholders, and ever increasing banker compensation levels to be four sides of the same financial instability
pyramid. The continued existence of this prism has been aided and
abetted by the construction of an exceedingly powerful narrative concern-
ing the supposed efficiency of markets and the virtues of individual
liberty, leading to a concerted retreat of the state, to be replaced by
private contracting. The mantra that centralised regulation is unnecessary
due to the corrective powers of market discipline, self-interest and the
profit-motive-created conditions under which the capacity of financial
institutions to generate instability increased exponentially. Many bankers
profited enormously from this intellectual failure. It is my contention in
this book that this was not an entirely unconscious enterprise.

Despite the experiences of the past few years, at the time of writing, in
the UK a new property bubble appears to be emerging, concentrated in
London but affecting the entire country. Prices are approaching 2007
levels, even though wage growth has been stagnant since the great crash.
Moreover, almost unbelievably, this latest property bubble is being
overtly supported by government, through generous taxpayer-
underwritten mortgage schemes, proffered in the main by the same
broken banks which still enjoy explicit state guarantees. I admit to having
severe misgivings concerning this trend, and fear for a future economic
path founded on ever greater levels of mortgage debt. Notwithstanding
these fears, how long it is likely to be before this boom turns to bust is
probably best answered by an economist, not a lawyer, and I have
therefore not addressed in this book the latest developments in the
mortgage markets.

Although the genesis of this book may be traced to the pre-crisis
world, it was written almost exclusively over the 18 months up to April
2014. During that time, I have had some truly enlightening experiences,
none more so than attending the 22nd Annual Hyman Minsky Confer-
ce in New York City in April 2013. I encountered scholarship and
organisation magnitudes above that which I was previously used to, and
am forever indebted to the conference participants and the Levy Eco-
nomics Institute, each of whom opened my eyes to visions of the world
of finance founded on principles of justice and common sense. I am of
the firm belief that economics and law still have much to learn from one
another, and this feeling was confirmed to me during that trip.

In researching and writing this book, I have been extremely fortunate
to have benefitted from discussions and assistance from some of the best
and brightest people I have ever encountered. First of all, I would like to
thank Andrew Johnston of the University of Sheffield who, despite his
hectic work life and his own punishing publication schedule, found time
to review my work, comment on its flaws, and explain some of the more
difficult concepts of law and economics to me. We benefit from a shared

Executive compensation in imperfect financial markets

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passion for the work of Minsky and his academic successors, and this book is much the better for Andrew’s input. I am also grateful to Trevor Pugh who, in his former life as a high-level banker, garnered more than enough knowledge and expertise to provide me with some excellent advice and thoughtful criticism when needed. If I manage in my lifetime to learn a tenth of what Trevor knows about the financial system, I shall be very happy.

Thanks, of course, also go to Emilios Avgouleas, my former PhD supervisor, (occasional) co-author, and long-time mentor. Now at Edinburgh, Emilios was extremely helpful to me during my time at Manchester, and has assisted me greatly in both my career as a lecturer, and my development as an academic. His guidance has been invaluable, and this book would not have been possible without his support (although he may not agree with everything I say in it!). Emilios – sas efharisto poli. I have also enjoyed some informative and inspiring discussions with other colleagues, both past and present, who have offered (often) kind words and support to me over the duration of the project. Special thanks in this regard go to Lorie Charlesworth, George Mair, Tony Harvey and Jamie Murray, each of whom has brought their own (unique) views of both me and the subject matter to keep my feet firmly on the ground, especially at those times when I threatened to dissolve in a haze of confusion, both legal and economic.

I would also like to thank the staff at Edward Elgar, who have been more than patient with me over the last 18 months, and have not refused a single appeal for help or the inevitable request for a short extension(!).

Finally, there are three sets of people to whom I must pay the utmost thanks. First, to my Mum and Dad, Pauline and Jim, who have constantly but gently urged me on with this task. The words of encouragement I received spurred me on a number of occasions when I wanted to throw the whole lot in the proverbial (desktop recycling) bin. Although Dad is a retired lawyer, this area of law and regulation must be as far removed from his area of practice as possible, yet his enthusiasm for my progress has been infectious, and Mum has been full of reserved yet consistent support.

Second, to my wife, Sarah, who has been as patient with this project as she has been with everything else in our lives. Sarah has been a constant source of love, attention and sacrifice during the time we have known one another, and I shall be eternally grateful for the way in which she has allowed me the time and space to complete this book. She has looked after me and encouraged me in my work, often single-handedly raising a family, running a home, and continuing with her own academic career.
Wonder Woman has nothing on Sarah. I hope one day I will be able to repay that support in kind.

Third, to my children, Neve and Marcus. You are each a daily inspiration to me, and a very welcome distraction from the rigours of work. I am thankful for every day we have together.