There are straw men everywhere, and much of the debate over the origins of the financial crisis involves whacking them as vigorously as possible and declaring victory. In Monday's Financial Times, Lucian Bebchuk and two of his colleagues from Harvard Law School's corporate governance program, Alma Cohen and Holger Spamann, go after the straw man argument that most senior Wall Streeters at firms like Lehman Brothers Holdings Inc. and Bear Stearns Cos. were "largely wiped out" when their firms collapsed. "Many -- in the media, academia and the financial sector -- have used this account to dismiss the view that pay structures caused excessive risk-taking and that reforming such structures is important."

The Harvard trio reject such a notion and offer research into pay that suggests instead that senior Wall Streeters actually cashed in a lot of shares over the years or received big cash payouts and were quite wealthy (a relative term, of course) after the deluge.

Well, a lot of strange things have been said over the past year, but I have to say that this particular straw man has more than the usual amount of straw and less than the usual supply of substance. And even if those Wall Streeters were not wiped out -- the fact is, some took serious haircuts. (See Dick Fuld and Jimmy Cayne, though the real wipeouts occurred just below the top ranks where retirement plans were mostly obliterated; Bebchuk et al. never get to that level since they only look at the senior five Bear and Lehman execs, a problem given the turnover and infighting at the top of both firms in the last year). Indeed, it would be beyond strange that these folks had never taken some scratch to buy some art, gas the Bentley or accumulate vacation homes. And even if you do accept the one-size-fits-all premise lurking here -- that because they cashed out they took enormous short-term bets -- the link between those two, wealth and risk, remains murky at best.

In fact, if you read the column carefully, they retreat from every hard premise they initially toss up, including the overstated headline "Bankers had cashed in before the music stopped." The column is festooned with qualifications: "It is true," they admit in paragraph two, "that the top executives suffered significant losses on shares they held." Or paragraph six: "Of course, the executives would have made much more had the banks not blown up." And in paragraph seven: "The fact that the executives did not sell all the shares they could prior to the meltdown does indicate that they did not anticipate collapse in the near future." And then, in paragraph eight, looms the always popular "to be sure" clause: "To be sure, executives' risk-taking might have been driven by a failure to recognize risks or excessive optimism, and thus would have taken place even in the absence of these incentives."

Ah, to be sure.

The remaining two paragraphs then lurch back to the originating thesis, and include some tut-tutting about how the Harvard trio don't really believe that last statement for a second, and that facts are facts, and that bonuses need to be redesigned. But by the time they utter the "too be
sure," they've inadvertently left the land of the straw man and stumbled into the gray light of everyday reality. The fact is, their little "study" proves nothing, except that some Wall Streeters can get very wealthy in a variety of ways. (Now that alone might be a reason to hammer down pay, but that's not what they're after.)

I don't have a study at hand, but let me offer another "theory" of what happened. That theory is bewilderingly multicausal. In some cases, particularly on trading desks, compensation did lead to reckless short-term betting. Many of these folks had no larger view and were pretty much out for themselves; others were just dumb or blind; yet others were followers not leaders; others were relatively innocent (see Alan Schwartz, who took over from Cayne at Bear a few months before the end; he had been running investment banking, which had little to do with subprime or risk). In more senior ranks, hubris, arrogance, excessive optimism borne of previous success, with perhaps some recklessness borne from the fact that they did possess plenty of money to live well if things went poorly, plus a dash of moral hazard ("they won't let us go down") and a pinch of being out-of-touch all went into the toxic stew. But each individual manifested different aspects in different quantities of these motivations, which I suspect I've oversimplified. And the different aspects of these complex psychologies may well have swung in different ways depending on time and circumstances and share price and digestion.

These firms were different: culturally, organizationally, historically. To say that the amount of money senior folks took out and stuffed into their bank accounts was somehow determinative of the crisis that unfolded is, simply put, a fantasy. And, again, what's so wonderful about this particular column, are the telltale signs that the authors themselves suspect greater complexities. Let us return to paragraph eight, when signs of doubt swim just beneath the surface: "But given the structure of executive pay, the possibility that risk-taking was influenced by these incentives should be taken seriously." Please.

Well, yes we should take pay seriously -- for any number of reasons. But we certainly can't take seriously that changing pay structures will solve all, or even most, of our problems. It does not explain the crisis alone. Indeed, it doesn't even come close. - Robert Teitelman

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