The Global Financial Crisis: Will Hutton and Martin Wolf in conversation with Professor David Held

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Speakers: Will Hutton, Martin Wolf

Chair: Professor David Held

Professor Held

Good evening and welcome to you all and welcome to this special Ralph Miliband event on the global financial crisis and with me, of course, is Will Hutton and Martin Wolf.

It's a great honour and a privilege and I should say a great, great pleasure for me to introduce these two speakers this evening. Both have had long distinguished careers and are outstanding economic commentators and journalists. Both have been writing, it's like an old…how long have you been together, you've been writing for five decades, six decades between you.

Will Hutton is Chief Executive of the Work Foundation. Prior to this he spent 4 years as the Editor in Chief of the *Observer* and he continues to write a much respected column every week for that paper. He is also at the moment a distinguished visiting Fellow at the Centre for the Study of Global Governance which is run by Mary Kaldor and myself. Martin Wolf is Associate Editor and chief economics commentator for the *Financial Times.* He was awarded the CBE in 2000 for services to financial journalism and recently was awarded an honorary degree here for the powerful mark he has made in the public domain.

Both Will and Martin, of course, have written many bestselling books. I'm just going to mention two, Will's most recent book is *The Writing on the Wall, A Study of China* and Martin's most recent book, although another is coming, *Why Globalization Works*. You don't want to amend the title now? [Laughter]

It's my hope that this evening's event will be slightly different from the usual lecture stand-up/speak format. I want to really develop a conversation between our speakers, get them to reflect on the questions I am going to ask and explore perhaps some of the differences in views although at this moment in time it seems to me there is quite a broad shifting to the centre ground as people fear what might have happened or what still could happen to the world financial markets and to the banking system. At the end there will be time for questions from you. I have to say, unfortunately, that Martin has to leave at 7.35 at the latest but Will and I will remain until 8 o'clock to take further questions.

So let me start now with a sleuth of questions but we'll probably only get through some of them but let me just ask both our speakers the following questions and perhaps you, Martin, could respond initially. How do you compare the current state of the global financial crisis with past great economic and financial calamities? To begin to understand what has and is happening how should we compare today's events with past economic turbulence and serious economic difficulties or to put the question slightly differently how serious is this crisis compared to the ones we've previously experienced?

Martin Wolf

Okay, it's obviously the right place to start. I'd like to address that in two different ways. First, the experience of the "core" western countries themselves, particularly the US, you immediately start comparing, of course and we are all doing that, with the Great Depression and subsequent events. I think in terms, if we view it and I think this is the wide consensus view, if you view it as a financial crisis namely a breakdown in the core financial system, the banking system, related to a prior period of extraordinary credit expansion, it's certainly is more severe, there is no doubt, in that respect than anything since the war which means anything since the 1930s. If you compare it with the 1930s when a third of the banking system, more than a third of the banking system disappeared, and when it was conjoined with a massive collapse in the stock market and subsequently led to a depression in which, if I remember correctly in the US, unemployment reached 25%, world commodity prices collapsed, there was a chain of default across the whole world, unemployment levels of that kind were seen across much of Europe, so if you take the whole round of both the context of the economic consequences so far, and I stress I expect it to remain so far, you simply can't compare with what's happening now with that. We haven't even had much of a recession. So far we've had something pretty close to flat output. So it's a financial event, it clearly compares with that in certain ways, but the response of authorities, the context in which we operate with huge states, with huge states spending, the willingness of central banks to provide essentially unlimited liquidity, the sorts of bail outs we've seen, may be very different.

I think the second way of looking at this which is to my mind in many ways more interesting is to remind ourselves and this is a theme of my new book, which is called *Fixing Global Finance* is that this comes at the end of more than a hundred, more than a hundred significant banking crises often related to exchange rate crises in the world in the last 30 years and interestingly it has many similar features to these others. Many of those, of course, occurred in emerging economies, you will think of the Asian financial crisis, Latin American financial crisis, the so called Tequila Crisis in the mid-90s and so forth, but some of them occurred in developed countries most famously in Japan in the 90s and in Scandinavia in the early 90s, they all have very similar features. I am not going to make detailed comparisons now except to make two points.

In terms of the losses, the likely losses, we don't know them yet, to the financial system, which will be borne ultimately by the tax payer, in terms of that it seems overwhelmingly probable – and I've written this is many columns – that this will turn out to be "a relatively cheap crisis" and by that I mean I can't really see it going much about 5-10% of GDP in the US and Western Europe together. Now believe it or not that's relatively cheap. There have been many financial crises which have cost between 30 and 50% of GDP to recapitalise financial systems. I can give you a long list of them: Turkey, Argentina twice, Indonesia and so forth. What makes it significant, of course, and this is my very last point, therefore it's not its scale relative to the economies where it happened or its characteristics, which are very familiar unfortunately in many countries, but where it's happening. The point is this is a crisis of *the* core, it is a crisis of the most advanced financial system we have, a fairly significant or we thought was the most advanced financial system, and these are the most significant economies. So if these have a significant financial crisis, one there is no one outside to rescue them and second, inevitably, it has an effect on the whole world economy and that effect will unquestionably be a massive global slowdown which will feel to most people like a global recession. So that's my answer.

Professor Held

Will, do you go along with that?

Will Hutton
Broadly, yeah. I think that things were incredibly serious 2 weeks ago. I mean we had the week of the Wall Street Crash, 1929, the market fell, what was it, 23%. We had a week where it wasn't just Wall Street that fell by 20%, the European markets fell by 23% and the Asian markets fell by 23% and that actual simultaneous fall in world stock markets by that percentage of magnitude was not a feature of 1929. It was potentially worse, then there was a potential domino effect, an instantaneity that did not take place in '29 and there is little or no doubt that if western governments hadn't launched the kind of bail out that they did along with the guarantees into the bank market, you know, we would have had potentially a global depression whose severity would have matched that of, you know, the early 1930s, not withstanding all the stabilisers because our banking system would have been bust not just in the States, which it was very seriously bust, the European banking systems got through in better order actually than the American banking system, in the 20s and 30s, that wasn't the story.

So in that sense it was potentially worse and it's to western governments credit, you know, and actually you have to say it, I mean the combination of, first of all Hank Paulson buying, biting the bullet in the way that he did and actually reversing deeply held views as a man who believes in markets and coming up with the Paulson Plan, then it not being enough and recasting it in the light of what Brown, the Brown government came up with in Britain, Sarkozy in Europe offering great leadership with Brown of the European Union so that, you know, there we are this last time last week, we had this event last week, I mean by this time the British, French and German governments had announced versions of the Brown plan. We'd already announced in the morning what we were going to do with our banks, the Spanish government was beginning talks, the Americans were about to recast the Paulson Plan, we moved so fast and we staved off potential disaster. I agree with Martin, I mean Japan had its lost decade in the 1990s, Latin America had its lost decade in the 1980s, other parts of the world have been driven by financial crises of this magnitude or worse, what's different this has happened in the core, but it happening in the core does make it serious.

The other point I want to make before I wind up is that I think the ten trillion dollars worth of securitised assets, 60 trillion dollars worth of credit default swaps, these numbers are…the scale of financialisation and the volume of transactions in the financial markets dwarfs by very many times what was taking place even actually in the outside the core in the 80s and the 90s and certainly when you go back to the 30s and in that sense we found that the size of the financial sector in some states, I mean Iceland is a good example, Ireland is another, Luxembourg is another, even the city of London in Britain, these financial sectors and the amount of transactions and the scale of ballot sheet support that would be required if things went wrong were so beyond the particular states, was another feature of this which hasn't taken place before. This is right up there in serious financial moments in my view.

Professor Held
Can I ask you both, did you as economic commentators of the decades, I mean did you see this coming? Did either of you see this coming and if so how, and what did you see coming and if not what does that tell us about our economic knowledge and our capacity to understand trends and developments?

Will Hutton

Well some of you may have read my book *The State We're In* that I wrote in the mid 1990s where I argued that the city of London was too powerful, that the prioritisation of finance over other objectives was unbalancing the economy and it was unbalancing the priorities of British managements and I've stuck to that view throughout. Like Martin it became very obvious…when the Asian financial crisis hit you could see a pattern of ever greater financial crises. I remember writing that the next one could get into the core.

When it was obvious to both Martin and me, Martin will speak for himself, but I mean in the 12 months up to when it all began to go wrong in the summer of 2007 it was plain that priorities were too high, it was plain there was going to be a correction of the property market, it was plain it was going to cause financial difficulties. When Northern Rock got into difficulty I wrote a piece saying it must be taken in public ownership and that must be announced on the Monday morning, that's what they didn't do, and during that autumn I argued that we wouldn't get through the scale of this crisis, which was the worst I had lived through as a financial journalist, I couldn't see how it was going to get through it unless there would be further major institutions taken into leading banks. I had in mind, although I didn't name it, were Royal Bank of Scotland and HBOS.

So did I see a systemic financial crisis that would shake the entire western banking system? No, I did not and I thought we would get through. I thought it would be a much, much worse version of 1974/5 when Nat West nearly went bust, that's what I thought, I didn't think the domino effect that we've witnessed would actually take place, and if you had asked me, the way we've watched the Americans really, nearly half a trillion dollars be involved by western governments in a matter of 7 days and the recapilation of the banking systems I would have said what have you been smoking?

Martin Wolf
I think Will has been impressively honest and I am going to try to be equally honest. I think the answer is I quite clearly did not see what has happened in the last month or two. There is no doubt at all that a breakdown of this kind in the core financial system, basically a situation in which I've described in which the financial system as a system, namely a set of inter-related parts trading freely with one another, a network, disintegrated effectively completely, I did not foresee and I admit it freely, I think I'm in fairly good company in this, but I certainly didn't see the crisis we've seen in the last 6 to 8 months.

I think there are two things that I did write quite a bit about so I can point to what I thought, perhaps three things that I thought of as unsustainable trends though I didn't know how they would end. The first, which has already been mentioned, that there were a number of housing bubbles, particularly here. I started writing about that in 2003, as usual far too early, which has completely discredited me of course. The worst thing about bubbles is that identifying them far too early makes you look ridiculous particularly if you advise your sons not to buy houses as a result.

The second thing I have emphasised particularly, and indeed is a core theme of my book, as unsustainable, was what I saw as it were the solution the world had come up with, by accident really, to the problems of emerging market crises which was the shifting of the world saving surplus, which had risen to an extraordinary level in the early part of this decade, the absorption of the world saving surplus into a limited number of rich countries, particularly the US, and if you looked at the domestic counterpart of that it was clear this was all household borrowing. It was basically going to finance household borrowing and that was

associated with an explosive rise in household indebtedness both in the US and UK. This is a theme actually largely from Wynne Godley's important work, I emphasised it many times, and it seemed to me a massive point of vulnerability for the whole system because these were clearly trends that they couldn't correct that would have to be correct. I assume the external problem, mainly the dollar problem, would be more significant than the internal one but that was wrong.

The third element, which I did identify but again I got this largely from the work, very, very important work of the most prescient of the international institutions, the BIS under Bill White's intellectual leadership, was the emphasis on monetary policy, credit expansion, the disappearance of risk as a factor in determining interest rates, basically a complete collapse of risk spreads in the system, which is just another way of saying almost complete collapse of risk aversion, and we know from history, it's very clear, it's in Minsky's work, that such collapses of risk aversion are shown in markets always reverse themselves and when they reverse themselves they tend to overshoot in the other direction so I've written quite a lot of pieces saying well what would happen when that happened. That was a quite widely shared view even in the official community let alone the people who were worried and if you look at the reports, for instance, of our own central bank, the Bank of England, they constantly emphasise this theme.

So perhaps if I had been smart enough I would have put these three pieces together and said hey presto the world banking system is going to implode but what I assumed is there was going to be a correction, it would probably be quite messy, there would be some real macro-economic strain associated with it on other parts of the world that would have to absorb these surpluses but what we've seen in the last few months is to be quite honest far outside the worst things I could imagine.

Professor Held
So in some that's a yes and a no, elements of it yes but systemic quality of it, sheer systemic range of the problems probably not, which is true I suspect for…

Martin Wolf
Probably just shows actually…

Professor Held
…everyone actually.

Martin Wolf
…stupider than we would like to be.

Professor Held
No, I think that history has a way of creating unexpected outcomes which takes me on to the roots of the crisis really. I want to see if you can spend just a few moments shedding some lights on how far back in time we have to go to understand the form and dynamics of what has happened. Is it 1979, the Big Bang, deregulation, lifting of capital restrictions and so on, the growth of the financial markets and financial turnover relative to the real economy and so on, where would you begin? You can't obviously develop a full account of that this evening but where would you begin to point to?

Will Hutton

’86 <?? – 18.51> but I mean it’s an arbitrary date but I think the arrival in Big Bang and the arrival in London of American investment banks, who were able to do in London what they weren’t able to do in New York because it was prohibited by Glass Stiegel, was actually the beginnings of it. Securitisation, which was also taking place in the 1980s by Fannie Mae and Freddie Mac funny enough, began to be copied by those investment banks. Then I think the abolition of Glass Stiegel in 1998 was another key date and then really it’s been the last, I mean securitisation took off hugely post Glass Stiegel and we had 10 trillion dollars worth of securitised income streams insured by credit default and credit default swaps actually in that decade and it was that really that led to the immense leverage that the 5 big US investment banks had, you know, amazing, carrying 30/35 times the assets on their balance sheets compared to their capital and you got to a point where so much leverage was being underwritten by so little balance sheet strength that the actual structure, intellectual mistake I think of securitisation, that actually while you may secure one income stream, you can insure one income stream, you couldn’t collectively insure them all. The system couldn’t insure itself against an economic downturn and it certainly couldn’t insure itself against a very substantial loss appearing in the link in the chain. We got to that point in 2007, the trigger was the sub prime crisis but I think it could have been anything else.

So for me it’s a story that begins in the mid 1980s, it has its roots back there. I don’t know what you think, Martin?

Martin Wolf
I think the…it’s clear that financial deregulation and financial innovation, financial innovation seems always to play quite an important part in crisis of this kind, it’s a sort of classic account, in the 20s J K Galbraith, for instance, emphasised this element and one of the characteristics of financial innovation is it’s a way of concealing an exaggerating leverage, which is what Will has been talking about.

I’ll just add a few other considerations to this. First, it’s an obvious theme, for absolutely fundamental reasons, it’s a central part of financial economics but go beyond that, a financial system is very unstable, it’s inherently very unstable. It’s unstable partly because of its institutional form. Leverage of enormous proportions is an inherent part of all contemporary financial systems which is why we’ve had so many cases with these enormous losses that I’ve mentioned. I mean in essence if you have a system which is normally “levered” about 20 to 1, so there is one 5% of equity against and all the rest, 95% is debt, you really need relatively small losses and relatively small mistakes on the valuation of underlying assets, pretty easy to do, and you’ve got a bust financial system and that’s happening again and again and again and what Will said is right, people can think they’ve protected themselves against it but there isn’t enough capital in the system to protect themselves, protect them against it. The only entity that has capital enough to protect this is the government which is just another way of saying something, a point I've made many, many times, the banking system is part of the state, it can’t be anything else because essentially we’ve delegated to the banking system an incredibly valuable public monopoly, that of creating money, that’s what it does i.e. we allow them to say that their deposits are equivalent to real money and once you do that you emphasise this fragility. I won’t go into all the obvious other problems, there’s symmetric information, all the other characteristics of the financial system but that’s just, it’s going to do things like this from time to time.

Now obviously that’s made much worse if you’ve got a general view, a very strong general view in favour of deregulation, and that goes without saying, but it’s interesting in this case to

emphasise some very perverse consequences of incompetent regulation. It’s not that the banking system isn’t regulated, it was, but one of the characteristics for example, just one, is that there were quite significant capital requirements imposed against banks but in many cases they were allowed to set off, off balance sheet entities, conduit special investment vehicles, to put this sort of paper in and no capital was charged against it. Now that was in the regulatory scheme and the regulators allowed that sort of arbitrage to occur and regulatory arbitrage has been a very big feature of this.

Now let me just mention two macro factors which I think are linked. I've already mentioned…there are three background local environment conditions, very low inflation, which encouraged very easy monetary policy for a long time, which I think is essentially related to the globalisation phenomenon, the entry of China and all the rest of it, the emergence in the late 1990s and particularly 2000s of absolutely colossal savings surpluses in many countries aggregating close to 2 trillion dollars a year, which had to be absorbed somewhere, and as a result of those two phenomena together there is no doubt in retrospect a pretty significant monetary policy mistake, namely an incredibly easy monetary policy, not just the US. Basically we had an environment in which the Japanese had zero interest rates, the US had one and the ECB had two for about 3 or 4 years, it’s an incredibly lax monetary environment. So if you had that fuel to the fragility mentioned, what Will was talking about, and the very low long term interest rates, which I think are related to the saving surplus question, you basically create an environment in which borrowing seemed to be pretty well a free good and there was no regulator trying to restrict this at all and I think that’s why we ended up where we are.

Will Hutton
There’s one thing I would like to add, just to that, because I would be very surprised, and I may be wrong, but I would be very surprised if the majority of the audience can understand the difference between a bond and a securitised income flow. I think it might just be worth a minute doing this because it is really important because you’ll just get actually perhaps a deeper insight into actually just the scale of regulatory failure. I’m sorry about this but stay with me because it’s important.

If you issue a bond, if a company issues a bond two things happen, one, say it’s a bond, say the company is making lets say a billion pound profit and issues a billion pound bond, in which it pays a 5% coupon, it’s billion pound of profit is the profit out of which is going to pay the 50 million pounds of coupons, 5% of the billion is 50 million, so even if profits halve the interest payments and actually servicing the principle is more than covered by the profitability of the organisation in question, if there is a very severe downturn the bond owners are probably going to be okay and it’s secured against the assets of the company.

Now Martin mentioned this and it’s really worth highlighting it, I mean in 2000 there was almost no securitisation of…the amount of securitised assets that were traded were trivial. I mean probably, you know, you are talking about hundreds of millions, maybe billions, but not trillions and there are now 10 trillion dollars worth of securitised assets. What they are is this, I’m the company and what I do is is I say rather than pay you 50 million pounds a year out of my profits of 1 billion I am going to hypothecate one of my income streams that I as a company get. If I’m a utility, I might own a port facility and I get tariffs from the port, and that adds up to 50 million, what I am going to do is I am going to place those 50 million in a special purpose vehicle and that’s going to be the income that services the 1 billion pounds that you’re going to pay for me for that revenue stream.

You then turn to a credit rating agency, Standard and Poor's or Moody, and you say well, is this equivalent to a triple A bond and at this point any regulator should have started to say well hold on a second, in the circumstances in which profits halve, 500 million holding a bond, the bond is probably going to be okay, in those circumstances the port, the tariffs on a port, or mortgage payments, or whatever it might be, are unlikely to be hit and the 50 million will go to 45 million, to 40 million, and this bond is going to be worth much less. It's certainly not worth triple A rating that Standard and Poor's or Moody's are giving it and the idea that I could take a credit default insurance policy out on it to insure against that eventuality, to make it less risky, and then call it credit default swap so I could swap out of that policy, I could sell it you rather than hold it myself, that if you're a regulator watching from in 2000 virtually no securitisation of revenue to 2007 10 trillions dollars worth of this, to watch a credit default swap market of some low, I mean a trillion or two, mushroom to 60 trillion over a 7 year period and this was happening in Britain, in New York, I mean what were our regulators doing and it was all taking place on balance sheet and as Martin says it was an accident waiting to happen. Sorry, I just needed to explain that.

Martin Wolf
You have ignored the tranches but I am going to ignore them too.

Will Hutton
We could do the tranches [both speak]

Martin Wolf
It's not quite as simple as that.

Will Hutton
Yeah, I know.

Professor Held
I want to push on to slightly different agenda in the second half but let me just get you to spend just a couple of minutes each because this is the bit most people know about, just briefly say what have been the main features of the crisis, very, very briefly because most of us read the newspapers all the time and secondly, what have been the strengths and weaknesses of the policy response in the UK, the EU, the USA and beyond that? So let us take this together and you should assume reasonable familiarity on this because that is what we read all the time.

Martin Wolf
Okay, let me just do it sort of analytically rather than blow by blow. I think the starting point was the assumption right at the beginning, which I wrote about a lot, there was this correction and that was showing itself up in widening spreads on inter-bank borrowing and on other riskier assets, that seemed fine, that's exactly what should happen. There was a liquidity problem for some institutions and central banks started providing liquidity into the markets fairly quickly. It's well known and I think reasonable to say that because of its policies on collateral the Bank of England was the slowest on that and the ECB was the first. Interestingly, as even the ECB will admit, that was largely because when they joined all the banks together they simply added together the collateral policies of all the banks and adopted the easiest in each case. So they happened to have the easiest policy on collateral in terms of what they would take right from the beginning but liquidity was provided and in retrospect

what has become pretty obvious, and it became reasonably obvious quite soon, but the extent to which it was the case became obvious rather slowly.

It became obvious that the real thing that was driving the markets was a profound concern about the solvency of counter parties and the reason that became such a big issue is very much related to this question, is they knew they had all these "toxic assets" but the problem is nobody knew what they were worth including the people who held them or at least if they did they weren't telling anybody and the result of that is, and we knew they were spread everywhere, at least half of this, not half, 40-50% of this American stuff, leave aside the other stuff, is in Europe.

So one of the great achievements of securitisation is that it's spread bad stuff everywhere and nobody knew where so you had this real problem of worries about, worries about the solvency of counter parties. This then came much worse when significant parties just started going bust and it reached apogee when Lehman disappeared and then everybody got really nervous so we ended with the solvency crisis and that was finally recognised and that's why the capitalisation, the recapitalisation programmes, are so important. We're not through this by any means.

Now in terms of recognition I think we recognise, the Bank of England recognised the liquidity problem too late, bad for the Bank, the ECB got there first. The Fed has been incredibly aggressive and liquidity throughout. I don't think you can really criticise them. Today the Fed is emerging as probably the most important commercial bank in the United States. I think you can say they have been fairly free on that. The Bank of England did quite well on the special liquidity scheme, very neat scheme, the only one that's offering liquidity for 3 years, questions about the timing. I would say the central banks have all been sort of okay. We can have a big argument about this.

Now the governments, well the governments were unbelievably "slow" but then so was I, I'm afraid, in recognising how deep the capitalisation problem was. There were a number of relatively small institutions, relatively unimportant, even Bear Stearns relatively unimportant, which had a serious capital problem and they could be wound up, but generally the banking system was adequately capitalised and that was in retrospect, and I accept that for myself too, a serious error. The point at which governments finally realised that was a really serious error was really September and it's at that stage that the whole crisis blew up and the response of governments reached a real peak.

Now an interesting question, leaving aside their response to getting there, should governments have realised say 10 months ago that they were facing a situation in which they had to nationalise, or infuse capital, into most of the core banking system and the answer to that is maybe they should but it would have been, I think, really hard for them to recognise that at that stage because it depended on their views of the ultimate collapse in the underlying value of the assets concerned and they were, perhaps wrongly, rather more optimistic than turned out to be reasonable on that point.

I think history will say, if you compare it with the Japanese banking crisis, it took them 8 years to recapitalise, or the…even the Scandinavia banking crisis let alone the 30s, I think history will say they really screwed up in getting into this mess. I don't think there's any doubt, we will all be blamed for that, but I actually think the last year in terms of the scale of the response and speed, a year is not a long time in these sorts of crises, and the cooperation

that we've seen in the last few weeks I think is actually quite impressive and I'm sure that nobody here will agree with it but I think from the point of view of the policy response since the crisis began it could have been a hell of a sight worse.

Professor Held
Will, do you agree?

Will Hutton
I do agree with that but I am concerned. I am very concerned about the…I mean we've stabilised the situation. We've stopped there being, I mean I think there won't be a Great Depression and as Adair Turner said, he's the Chairman of the FSA, "we've kind of sorted out the basic plumbing into the international financial system", good, but here's my point. We actually need, we can't allow the system to de-leverage too quickly. We've got an awful lot of debt out there. there's 10 trillion dollars worth of securitised assets. We need to be able to hold them. We also need people to add to them if we are not going to have a very, very deep recession and my concern is that the way we've set about this and I think actually I am very concerned about the way we've done it in Britain actually, I think they've done it better in the States. The way we've done it in Britain is we've done, we've made two potential serious mistakes.

Mistake one is that we didn't bring all the banks into the recapitalisation programme and so there's an open question about how Barclays and HSBC will behave. Secondly I think the terms of it have been far too tough and we need these banks to lend. I want our banks to lend. I want them to reopen a virtually closed mortgage finance market. I don't know whether you saw the numbers today but I mean mortgages are down to…mortgage advances are running at some fraction of the level that they were running at 18 months ago and it's not inconceivable that house prices could fall by a third, 40%, 50% and that will be associated with very, very low levels of consumption growth, very long and potential further danger for some of our lending institutions. I want working capital for small and medium sized businesses. I would love to see some serious lending to our manufacturing sector. You won't get it when they're all anxious to pay off these preference shares in which they're paying 12%.

The second thing is at a global level is that the system has worked because the securitisation has been insured and the insurance system has failed actually and one of two things has to happen either some of these toxic debt, and Martin has argued this and so have I, has to be taken over by "a bad bank", which is what happened in Sweden, Securam was the name of the bad bank, or we have to do what Lloyds of London did, setting up an organisation called Equitas, which when Lloyds got into trouble with bad insurance, with bad re-insurance companies, they had to net them over a period, they net them out over 20 years, that's far too long for us. We may need to set up "a bad insurance company" in which some of the dud credit default swaps are placed and we may need governance actually to move from not just guaranteeing loans into the bank market, to actually getting into the insurance business of actually ensuring the securities. James Crosbie, former Chief Executive of HBOS, has got a scheme for ensuring issues of residential mortgage back securities as a way of reopening that market and I think that before the crisis is over we are going to have to go to the insurance business and I think it was a mistake that the recapitalisation of the banks was done on such a haphazard basis simultaneously kicking them in the teeth and wanting to lend and that's an incompatibility objective which we may rue in the month's ahead.

Professor Held

Without speaking to that at length do you agree with that?

Martin Wolf
On the recapitalisation plan I do because I wrote about that last week. I think the…I'm not completely sure, I'm genuinely not sure, whether it should have been compulsory and one of the funny things about the US is when it does things seriously it doesn't pay any attention to things like freedom of property. So Mr Paulson went to the nine banks he was dealing with and said we need volunteers to take the state's capital and you are all volunteering. We have a much more laissez faire and liberal approach to these things and it may well turn out that that was a mistake. I think it's a correctable mistake if it proves to be the case.

I am much more worried, as Will says, the government is caught in a, quite rightly, in a dilemma. It wants to get the taxpayers back and it's absolutely right to want to get the taxpayer's money back, and at the same time it wants these institutions to lend and it has decided, I think rightly, not to just nationalise them outright but that's a separate question. I think that's a balance in which they've gone too far in the direction of making sure the taxpayer gets their money back. 12% yield on this, they're certainly going to get their money back in the end, these are viable businesses as long as the economy is viable, it looks to me excessive and I do fear that that will lead to…well clearly lead to bigger spreads on their lending and it will probably lead to accelerated repayment instead of offering credit.

There are some areas of insurance I think the government will have to get into. Generalised insurance of the whole range of credit in the economy, as you'd expect, worries me somewhat, not least because I think all that mortgage lending that Will wants to do will turn out to be loss making, because I do believe that the house prices are going to go down that far.

Professor Held
You both talked about the cost, on the banks, the cost of the preference share, the 12% and so on but let, bearing that in mind, let me just ask you a question very bluntly now, which is a question that if Karl Marx were here he would look wryly at you and say, well look, excuse me, I will remind you what I wrote in the Communist manifesto that the state is but an executive committee of the bourgeoisie or to put the point differently to what extent is it true that states socialise i.e. picked up the risks and costs of reckless economic behaviour while leaving the bank and financial sectors largely unreformed so far and thereby free to repeat this behaviour in the future?

Martin Wolf
I was thinking about…my initial answer was going to be yeah, well what's new but it's more interesting than that, I think, because it actually relates to what the nature of the class structure, Mr Chair, if you are going to be Marxian about it. Marx's bourgeoisie, of course, were the owners of capital, the owners of financial capital. In this context they'll presumably be the shareholders. The shareholders of banks, they had a few good years I don't deny that, but they are getting pretty thoroughly creamed and including relative innocence like all those sovereign wealth funds that plonked money into these undervalued banks 10 months ago, or a year ago, and are now sitting on the most monstrous losses. So I think the bourgeoisie as it were, the outside shareholder, is being pretty well creamed. The people who do very well in this are the new bourgeoisie, which is the super elite employee. The people who did get the bonuses did get out before the chairs in their companies collapsed and are now sitting happily

at home with those bonuses. We're not going to have retrospective taxation, in my view rightly, so we are not going to get all that money back from them to pay for the mess.

Now, of course, there are lots of employees, vast number of employees who got these bonuses which were locked up in shares and that's that, chums, but it's clear that there are some people and I think it's particularly the super elite employee that is…and the really striking characteristic of "modern capitalism", it hasn't been pointed out much of the literature recently, is the emergence of this stupendously highly paid proletariat, if one can use this term in this context. The bigger point, however, I would like to make is the state is the arm of the political class whoever that political class may be and in our context, in our societies, it reflects the interests of a very large majority of people and one of the interests of a very large majority of people is to keep a functioning financial system so the state, as I've tried to repeat again and again, always saves financial systems unless the state itself is bust. The only financial systems that have been allowed to go down in the last 30 or 40 years have been financial systems where the state itself was bust, Argentina 2001 is a good example, very rare phenomenon.

Now in the process of saving the financial system of course it's socialising the losses that the financial system has so brilliantly created in the preceding boom, that's why it has to do it, and in so doing it rescues all the people, whoever they may be, who are engaged with those institutions and made money out of them. Some of them are the employees, many of them are people who dealt with them, many of them actually, I mean this is a lovely comment that has just been made in our paper on Saturday from one of the hedge funds that has done so well out of selling shares short, well all those transactions have been made good by, in part, the state otherwise the counter parties would have all disappeared or many of them would have disappeared and they couldn't have made their money. It is clear that it is in the nature of a financial system that ultimately losses, if they get to the point that the private equity cannot bear them, are always socialised and that is the fundamental understanding one has to have in forming any regulatory regime. The beneficiaries they vary over time, sometimes actually it's state banks that have been involved in this.

Professor Held
Will, fairness, social justice, people losing their houses, jobs and 80% of bonuses still being paid?

Will Hutton
Whoah ho, I know, I know, whoah ho, I mean I don't know whether to really kind of go for it or not it here, probably go for it [laughter]…

Professor Held
This is your moment, Will.

Will Hutton
Where does one begin? I mean the kind of money that was paid in the financial sector over the last 5 years I mean is not, is beyond the dreams of <?? – 46.04>, it's outrageous. I mean it's beyond any conception of what value is actually being added. I don't believe anybody systematically year after year is worth 10, 15, 20 million pounds a year. I don't know how you can justify that value and actually what was happening was, I mean there was one occasion, and I know a manager of a hedge fund who in one year was having a wrangle with the owners of the hedge fund, the hedge fund had made $540 million, he was paid $200

million, his basic salary was half a million dollars and he got a huge bonus, and he was complaining that the $200 million he got paid didn't conform to industry norms and he was arguing for $270. In other words in any one year half the gain went to him as the manager and half went to people who put it in the hedge fund. Now of course in Year 2 when the markets went down he'd go back to getting his basic salary having pocketed the $270 million that you might have thought the people who had given him the money to manage would like to have seen some part of in Year 1 to compensate for what was going on. They were absolute idiots.

I mean idiotic remuneration structures like that were common place. Alpha pay for kind of beta or even gamma performance and now with the world on the brink the state has had to step in and one has to then say what is the social and economic value of banking? It is indeed taking short term deposits and turning them to medium and long term loans and that's where the value added lines in banking and as Martin has said any kind of leverage, it's quite easy to make a big mistake and wipe out your capital, but we've lived in a world in which who gets those long term loans the state should be completely indifferent to and the state should actually light touch regulate the context in which that is taking place.

What we have learnt, all of us, collectively, is that…and I would actually add not just banks to the list, I mean there are very, very few firms and sectors where there isn't an independence between the public sphere and the market. I mean utilities is one obvious area and Martin has written, and I agree with him, that commercial banking in some respects should be regarded as a base utility and should never have been paid this kind of money but there are a lot of other areas, pharmaceuticals, aerospace, defence, retailing, where our supermarkets located, the politics of that, there are very few areas where actually there isn't an inter-dependence between a business model of a firm which makes for current income over time and actually the politics of it and I don't think one needs to make a kind of, to say that therefore means that actually the state is the executive committee of the bourgeoisie. The state in a democracy, in a liberal democratic society, actually does speak for a collective interest it seems to me and that collective interest is that we have a functioning banking system but the quid pro quo of that is that those that run it have absolutely no right to pay themselves the kind of money that they pay themselves and it showed phenomenal weaknesses in British corporate governance, unbelievable weakness in corporate governance, and actually now I actually think, and I have been playing this idea, I still don't know quite how it could be designed, but I think we can't retrospectively tax, obviously, but we could consider a wealth tax could we not? I mean a lot of the people are sitting on fortunes that are huge as a result of what took place in the last 5 years and have to pay for it. I mean you might get a time limited wealth tax. I am trying to think of how to devise a wealth tax that will actually do what you want it to do which is to say we have an interest in the money that you've made.

Professor Held
Let me just get in one other general question which is about the role of international financial institutions because it is very striking watching the current crisis unfold is actually the international institutions have been seemingly quite quiet, they've been passive observers of what's been going on. They haven't had or seemingly had an active role in shaping it and creating early warning systems, shaping it, producing policy initiatives and so on and those initiatives have eventually come from the states rather than the international institutional structure. What is your assessment of that? What is the role of the IMF in all of this and what

going forward do we need to think about in order to consider what these institutions might have to be like, how might have to change, going forward?

Martin Wolf
When we get into a mess like this the first thing that happens is people say why didn't the international organisations do anything about this which seems to a bit unfair because they have really next to no role. I have already mentioned that the BIS are very specialised, Banker International Settlements sitting in Basel actually has a very respectable role in warning about this and of course it was, not merely ignored actually, there were quite big efforts to suppress it and also quite scandalous.

But let's just step back a moment and ask ourselves well what role can international organisations play in a crisis of this kind? We are talking…I have a line which I frequently trot out which is that the IMF has two classes of countries over which it never has any influence whatsoever. The first class contains one member, it's the United States, it's a consistent pattern, it was designed to ensure that it would have no influence over the United States and it has no influence over the United States, one has to recognise power. The second class of countries are creditor countries and I have already indicated to you that a part in my view of the background to this, I'm not overstressing, just part of the background was these enormous global imbalances over which the IMG had no influence because it has no influence over creditor countries and that's not an accident because one of the reasons the creditor countries all became creditor countries was precisely to ensure that the IMF would never have any influence over them because that was the problem they had the last time. So that left the IMF with very little influence over important players in the run up to this.

Then you get a crisis. Well as we've recently seen, in dealing with these crises, we are talking trillions dollars but even trillions of pounds, the IMF poor thing, poor shrunken thing, has lendable resources of about, it varies with the price of the dollar, about 300 billion dollars so it's firepower is irrelevant. In any case all the IMF can offer these countries, more important, is their own currencies because these are the most valuable currencies in the world, they are the world's hard currencies and the United States doesn't need the IMF to give it dollars, it can print them, and it is and ditto with pounds and euros and all the rest of it. So the IMF is completely irrelevant in terms of giving resources to these countries. These are the ultimate sovereign borrowers of the world. Now if we get into the situation when these countries can't borrow in world markets you are sitting on a hyperinflation situation but we're not there yet. So the IMF can't do any of this.

What can the IMF do? It will do what it can do, it can advise and warn. Actually to be fair to it, particularly under Dominic Strauss-Khan, it's been rather brave as these things go in its warnings and rather sensible in its advice and the second thing the IMF can do, which is I think really very important, is to help all the emerging economies that can't print currencies that everybody else is willing to take, who are now going to be in the most terrible trouble. I'm sure you've all notices that we have a whole slew of emerging economies in very considerable difficulty, who will need a lot of funding.

The problem is, in my view and I have written this in my book, the IMF is far too small to help them effectively and a lot of countries are going to hit very, very big crises as a result and they will be the very serious victims of this situation. We need a much bigger IMF with much less conditional lending. It's a view I developed in the '97/98 crisis and even more since then when we've seen this incredible growth of self insurance by emerging economies

which have built up reserves of close to 7 trillion dollars merely in order to avoid this problem. Now the good side of that is that many big emerging economies do have a lot of reserves and should be able to sustain their growth even in this situation, that is one of the more encouraging things, but many will not and there will be, I'm not going to list them now, but there will be a long list of countries that will be very badly affected.

Now I would like to go away from the IMF, just make one final point. It is clear, regardless of what I've said, that a financial crisis in the current world is a global crisis because the banks are all global, the markets are all global. What each country does affects all the others, we've seen that most notably in the famous case of the Irish guarantees and their indirect consequences. We can't have a situation in which every government decides to deal with its own banks in its own slightly different way or even very different way, it creates incredible distortions, and indeed there are lots of other deep conceptual problems. We found that the difference in bankruptcy regimes across countries is a very big problem and that was shown very clearly in the Lehman case, I won't go into the detail, and of course we have very big problems, as we've seen in another case which I won't mention, if a country takes over a banking system and finds that most of its assets and liabilities abroad and doesn't really care much about all those foreign depositors so what are we going to do about that?

There is a very powerful case for saying that if we are going to have a global financial system we need a global structure of regulation and support. The problem is ultimately the support is fiscal and fiscal is national. This is a really fundamental core problem but the only way out of that is to defragment, disintegrate the whole global financial system, and the only way you can do that is imposing exchange controls everywhere and I don't think they're going to happen and I certainly wouldn't personally favour them. So I would say we are in a very uncomfortable half and half world in terms of having a global financial system without a global structure of dealing with it, regulating it and all the rest of it, and I think it's an incredibly important problem and even within the EU, although they did remarkably last week, quite remarkably, many, many problems remain outstanding in knowing how to handle this financial system. This is a massive wake up call but we don't have an answer.

Will Hutton
I agree with what Martin has said. I think one can specifically identify things that weren't there and need to be there. First of all, just to repeat, I am very anxious that securitisation, which is not a stupid thing to do and has been a way actually of permitting all economies to have more credit and debt than otherwise have had and that's not necessarily a stupid thing to have by the way, we need the following things. We certainly need an international clearing house for the trading of credit default swaps in which actually somebody is keeping an eye on the credit worthiness of the other side of the transaction so that you know that who buys these things and an insurance claim may be made on is actually reasonably creditworthy and actually one might go as far as the United States and have a global kind of deposit corporation in which actually for a small fee this clearing house will take a small insurance premium on each transaction and actually guarantee you that the payment will be made in the event of default.

Secondly, I think we need an international independent credit rating agency. I think the credit rating agencies have demonstrated that they simply can't be trusted to get this right and actually some of their announcements and timing of their announcements over this crisis has actually made things worse rather than better. I think this mark to mark accounting, I think the whole way accounting has been structured has made things worse not better. I think that

the capital <?? – 59.35> regime, as Martin has said, needs to be more firmly policed by global authority but we have an embryonic one, more than embryonic one, we have the Bank of International Settlements and actually we need to give it more power not less. So there are, around that piece of the story, I think things that could be done and I think will be done.

But then you have the other big thing, which Martin has said, I mean the fact that post the Asian financial crisis a lot of very poor countries built up 7 trillion dollars worth of foreign exchanges over the last decade most of which they've invested in dollar assets in New York and most of which became the liquidity, which actually investment banks were able to find, provided the buyers, the holders of that liquidity, were the buyers of these securitised assets. It's a fundamental part of the story and we have to think through how we are going to conduct foreign exchange policy because I think that if you don't want capital controls then we are going to have to find some way of insisting that countries actually freely flowed. The way the Chinese have pegged the Ramimbi over the last 5 years to acquire 2 trillion dollars worth of foreign exchange reserves causing massive distortions to their domestic banking system, let alone the consequences to the global economy, is a major source of concern to us in the west and China. We can't carry on running the global system like that.

So I do think that either a system of honest floating exchange rates or, because we are going to be half in or half out without it, we have to confront the fact that exchange controls and capital controls will come back and we'll have a fragmentation of globalisation and I think this is where, this is the big, big danger of this moment in time, the big, big danger of this moment in time. Some of you may know Italy well, I have been following I think outrageous way that the Italian right have actually blamed foreigners for, and Romanians in particular, and Romanian gypsies in particular, for their problems and Berlusconi stock is riding high, <?? – 1.01.55> to this crisis, makes it very difficult indeed for foreigners to actually buy any foreign assets in Italy, and there is a growth of ugly nationalisms around the world that if we don't manage very carefully over the next year or two or three we could actually see, actually just like in the 20s and the early 30s, reactions to this, tipping the world into rapid deceleration of trade growth, long term stagnation, vicious political movements of right and left, national communities appealing to ethnicity and blood as reason why they should bond together, pointing the finger at the Jewish or Romanian or gypsy or foreign or black of Muslim other and blaming them actually for the circumstances in which they find themselves and it really…I think that people like Martin and I, we've got big responsibility I think to help governments think through what a proper response to this is. We've got through, the patient is not going to die on the table but it is very, very wounded.

Martin Wolf
I'm about to go, I'm really sorry because it's been very interesting. I agree very strongly with Will's last remarks, I think this is the really big point. At this stage we have, I think, with luck stopped the disintegration of the financial system in total. We are going to face a very significant recession, I don't think there's any doubt. There are many policy measures that can be taken to mitigate that and it's worth discussing them but there are, and this is the crucial point we agree on, as we know from the past experience, very, very substantial dangers in this sort of situation if policy goes wrong. One of the most encouraging things of the last 2 or 3 weeks is that governments did seem to be in charge again. That I think is a part of the solution to this but there are clearly dangers. I disagree with one or two of his recommendations particularly on mark to market, I think help make it clear how serious it was, allowed us to avoid a Japanese style sitting around and doing nothing, but I think he has identified the really huge challenges we have globally ahead of us.

Let me say I have enjoyed this enormously, not the situation, but the discussion. We've all got to learn a lot from it.

Professor Held
That's my job. Before we turn the questions over to you, and Will is going to stay here for a little bit longer, let me thank both speakers for an incredibly illuminating and clear discussion. To particularly thank you now, Martin, because you're going, for your incredibly well observed and detailed commentaries, not just this evening, but in all your columns over many years and there are many of us who are loyal followers of your writings and we don't always agree of course and you and I have been in this very theatre together disagreeing about most of what you've written however there is no shrewder and better observer of this financial system than you and I want to express my great appreciation for you coming this evening.

Martin Wolf
Thank you very much.

[Applause]

Professor Held
I would like to take three or four questions to begin with so that Will has a sense of some of the issues raised by the audience.

Question
[Mary Kaldor] Well it was very nice hearing Will Hutton and Martin Wolf so much in agreement. My question, which actually I was dying to ask before Martin Wolf left, is about the link between the financial crisis and the real economy and I am not just asking about the consequences for the real economy, we're all aware of that, but the extent to which the financial crisis actually reflects a real crisis in the failure to match, if you like, the growth of productivity that's resulted from the discovery of information technologies and all of that and the pattern of demand, the fact that demand is so skewed in favour of rich people in the west, that there is such an unequal income, the fact that demand is so heavily dependent on oil and so on and so forth. I've been thinking, and I'm somebody who gets really bored with talking about securitised assets, now suddenly one's interested, but there's going to be a crisis for years because I couldn't see how this skewed real economy can continue.

Question
[Daniela Kabuji] I am afraid I am not going to speak about Italy tonight. Actually I was quite touched that Martin Wolf reminded as many other people do today, my former mentor, Hyman Minsky. Hyman Minsky, actually I think that many young people, even those who study economics do not really know what he brought and for many he discussed about the financial instability. I mean one of his books is titled *Can It Happen Again?* and of course it was the Great Depression and he was remarkably unpopular and unknown. I remember he gave a conference before he passed away more than 10 years ago, it was a big theatre like this one, there were 5 people only, you know, and somehow you can predict it because if you predict the financial crisis every day they're not particularly useful but I mean Minsky was also a student of Schumpeter and I would like to ask do you think there is anything where we can get from Schumpeter sides about the <?? – 1.08.59> of creative destruction? In other

words this financial crisis can lead to a positive destruction of the economy maybe where the financial sector becomes less important than it has been over the last 10 years.

Question
[Michael McGowan] I am a director of a UK credit union amongst other things. Mutuals, cooperatives, credit unions, building societies, friendlies, have recently been considered, until recently dinosaurs. I wondered if you could comment on how you see the role or even any opportunities for mutuals and this sector in the present situation?

Question
I want to take issue with what I have taken to be a kind of mood of self-congratulation coming from the panel a short while ago over how well the public authorities have handled this crisis and there have been many quite ordinary people who have behaved absolutely lamentably, why wasn't this sorted out a year ago? Why do we now have a recession in prospect? Why throughout the last year has no one in the political system sought to interrogate the banks? I mean heaven help us we still don't know the extent…why haven't the team of forensic accountants…why isn't it being treated with the seriousness of a terrorist attack, why haven't the banks been nationalised, why aren't these people…why aren't they doing something else?

Professor Held
A clear question and it was clear half way through.

Question
I would like to ask Will Hutton if he could elaborate on why the abolition of Glass Stiegel has had an impact. There certainly has been a number of commentators who have said that pretty much everything that happened over the last few years could have happened anyway and in fact the bail out of Merrill Lynch by the Bank of America and various others could not have happened under Glass Stiegel conditions. This has taken a lot of blame including here today.

Professor Held
That's 5 questions, we'll try and come back for a final round in a moment.

Will Hutton
Well I mean, goodness, first of all the anger. I mean, look, I can't tell you the number of times that I have paced up and down my living room asking, I mean there should be a round up, you know, there should be a Black Maria and a hundred key people and I know who 20 or 30 of them are and should be taken into police questioning and I know a couple of barristers who would love to have a crack over negligence and we could try, I mean at least the Americans do that, we do nothing here in Britain and I understand the passion with which you speak. I tell you, I mean I wrote *The State We're In* and I've known the perfidy of what's been taking place perhaps better than most and I've tried my very best to get it out there so I understand the anger.

My point is this is that actually we need these people, we need a functioning financial system, we need these people to lend to us, we need to get the credit flows going again. These markets have been virtually frozen for some months and I personally think that…and the point you make is well made except the Japanese did not move over a 10 year period and they moved far too late, the Swedes only moved when the system was collapsing. I mean we did get, I mean nobody wants to spend the half a trillion dollars that has been spent on

recapitalising banks if they can avoid it. So I share your anger, I think that, you know, the way the system has been run the last 5 years is poor to disgraceful but like the Irishman I'm not starting from there, I'm starting from here so I hope that, and I don't think either Martin or I are believers in recession and people not having work. For goodness sake I really <?? – 1.13.45> there is a lot of anger out there and I sympathise with it, strongly, passionately.

On your point about demutalisation I argued against the demutalisation of building societies in the mid-1990s and I was very…Evan Davis, <?? – 1.14.00> actually to say I told you so and I did resist saying I told you so but it was absolutely obvious and I wrote about it and I said it, it was absolutely obvious and thank god, on this one I can say I did spot it and as soon as you demutalise these organisations, and they were owned by footloose shareholders, their priorities would change to profit maximisation rather than the benefits of the people who put in deposits, who borrowed from them. It was obvious they would expand their ballot sheets too fast, obvious they would make mistakes, obvious they would get taken over, obvious that a whole swathe of great regional lending institutions that had been built up in the 19th century and were very important to the towns and cities in which they were embedded were going to be lost to either British or multinational banks. I said it, I argued it and I was regarded as a lunatic maverick.

There is scope, I noticed the Co-op are negotiating with, I think, the Britannia, the Nationwide have done very, very well, and there is scope actually for these building societies to come back. Some of them are incredibly small and why not, if you agree with this, actually open a deposit with them now. There is scope I think for the mutual and I think the lack of trust in our banking system now. People have worried for the first time in their lives whether their money is safe in the bank. Some people who made the mistake to bank with the Icelandic banks have actually had their money frozen, they can't get at it for some weeks. The lack of trust in the investment institutions in this country has now reached calamity low levels and I think the mutuals can benefit from that. That is certainly the view of the Co-op and the Britannia.

What about this point about Glass Stiegel. Look, Glass Stiegel proved to be part of…I mean the fix, you're quite right was enabled because Glass Stiegel doesn't exist but that doesn't mean it was a good idea. I must have met so many chief executives over the last 5 years who said there they were and into their room came the investment banks giving their pitch and what they wanted was they wanted to do the deal. They said if you want to buy x, y, z company here's our acquisitions team, they're going to help you do this big deal and by the way if you want short term credit our bank is going to do it for you, we want you to buy the whole package from us and there's no doubt about it the incentives in that were vast, people made stunning sums of money from bringing those deals off and winning those pickers in that way and they couldn't have done it if the institutions were separate rather than together and I have no doubt that some 21st century version of separated commercial investment banking is going to actually A) happen and B) is correct.

On this point about credit of destruction, yeah I mean I do think that. We've over relied on the financial services industry in the United Kingdom, we've undervalued manufacturing and actually the knowledge economy more generally and one of the good things about what is taking place is twofold. One I think that the banks that have got public stakes in them will actually behave differently from the way commercial banks have behaved in the past. I think they will be more supportive of distressed companies in this downturn and I think they will lend on better terms once the markets unfreeze to the kinds of sectors and companies that

would be good for them to lend to. It’s a political maturity transformation taking short term deposits and long term loans was never a neutral political and social decision. It was never ever neutral and we lived in a fictional world in which it was and now actually we understand the politics of it better as a national community and actually some of the firms that are 1,000, 2,000, 3,000 strong, all over the country who find it very difficult to get more than working capital from the banks I think will have a better deal and that is one good thing and the second good thing I think is that we will want a more balanced economy than the one we have had and actually the story that systemically markets don’t make mistakes and that only states make mistakes is I think not going to be plausible for the foreseeable future and for me who believes in a mixed economy, a Keynesian approach to economic management, that is a huge, fantastic moment. I’ve waited 30 years for it, thank god it’s happened. [Applause]

Lastly there’s the point that Mary Kaldor made about the relationship between the real economy and the financial economy, a kind of complicated point really, and the pattern of demand in the west and the way things have been pulled out of place by an overblown financial sector kind of not just the domestic economy but the international economy. What can I say but in many ways to agree. What is really hard though is to think about how you design something that would behave differently. One of the things I want to do here at the LSE with you and David and with other colleagues in the various centres of excellence in this place is I think we have a real obligation to try and think through what the international framework should be. I mean I have got a fairly good idea about to do about securitisation and banking practice but capital flows, exchange rates, debt relief, development, my god, you know, it all hooks up. We need actually to think through what a comprehensive solution would look like and we don’t have a good template. What Gordon Brown has got on the table is not adequate.

Question
[James Heath] I am consultant for the pension industry. Robert Peston has come in for some criticism in how he’s been able to effectively the RNS mouthpiece of the government. I note your comments of market to market accounting but obviously that makes everything much more volatile and I would like your opinion on the role of responsibility of journalism when we have this sort of event going on?

Question
Mr Hutton you said that you fear a fragmentation of the financial system why do you still feel as if obviously that internalisation was part of the problem which now makes us this problem and why do you still fear this fragmentation?

Question
The next of the financial summits will likely be held in the US to address the ongoing global financial crisis, my question is how do you perceive the proposed summit? What is the EU’s intend towards the summit? What is possible for that kind of summit to produce and also finally what kind of role can China play in the current financial crisis?

Will Hutton
Journalism in this crisis – it has been tricky for everybody. I have written in columns and I have commented on television and radio and occasionally facts fall into your possession which you know that if you broadcast you could create, you could make matters much, much worse. I knew, as one or two others did, how severe the crisis was in the inter-bank market and how difficult HBOS and Royal Bank of Scotland and indeed towards the end Lloyds

TSB was finding it, particularly HBOS and Royal Bank of Scotland, and there was a run on the banks in the bank market and the open question was should you name which banks that runs on or just talk about a run on the inter-bank market. Should you say in an interview we are in a situation where major…should you say we are in a situation where major institutions cannot get more, are having to get lending for longer than 24 hours from the Bank of England because they can't get it from other banks because banks won't lend to them because they so doubt their credit worthiness and by the way if you're watching let me tell you who they are so you can get your money out and they are…or should you just confine yourself to saying what I just said and it was very, very difficult. I mean steering that line was very tricky.

I think that actually the BBC's journalism was pretty good. I wish that Robert Peston, a slight word of criticism, because in the main he had an amazing network, he brought stories to the public domain very fast, he knew what he was talking about, he analysed it clearly and well, what more do you want actually and a lot of newspapers would have loved to have a Robert Peston with a Robert Peston type scoops and some of the criticism that he's got, should he have told the world as soon as he did that there was a plan for HBOS and Lloyds TSB to merge which was market sensitive…, should he have said some things in his blogs. I mean frankly I think some of this criticism coming from the financial community, given the pickle they landed us all in, was a bit rich. One of the richest things was the chief executives of the big London clearing banks accusing the government of dithering on the Tuesday before announcing the rescue package on the Wednesday when you thought I mean bloody hell, I mean you've guys have got us here, we're talking about spending 50 billion pounds, if the Treasury feel they need a few hours to shape this in a way which actually protects the tax payer that's fine by me and don't ride this tiger of dithering. I mean the action the British government is going to take is more, is faster than anyone else and more aggressive, I mean just hold your horses.

The sort of criticism that Robert Peston gets is unfair, he's done bloody well. I mean occasionally I think it is tricky, however, when one voice becomes so dominant as the only voice. On one or two things I think, for example, Robert's view that we need to get back to kind of relationship banking of 1950s style as fast as we possibly can, which has become the kind of accepted wisdom, is a tricky thing because there aren't people around sufficiently, either the BBC with the knowledge, or actually in a wider community to challenge some of his views but basically I think Robert Peston had a bloody good crisis, congratulations, we're lucky to have him is basically my view and I think some of the criticism levelled against him is unfair.

What about this question what's the EU summit for and why do I fear internalisation? Look, it is very easy, you know, in 2008, to say the last 16 years have been crap, it's all been worthless, but actually there's been a great deal of prosperity, a great deal of employment has been won, a great deal of people have led much better lives both in Britain and actually in a less developed world as a consequence of globalisation. Nobody ever got rich in any country without trade rising. It could be the silk road in the 5th century AD, it could be … wherever you find growth, wherever you find prosperity you find trade, you find countries trading one with another, it is the indispensable prop to prosperity and if we disintegrate into fragments and trading goes south and volumes of traded goods go south nobody will get rich anywhere in poor countries and rich countries alike and poor countries will feel it much worse than rich countries. So globalisation is a good, is a benefit.

What's been wrong about globalisation is its lack of imagination of its governance and indeed in some quarters the refusal to accept that it requires governance and regulation and rules that are policed. That's what's wrong and that's what I've tried to discuss tonight. That's why I am concerned about what may take place in the next 2 or 3 years and by the way when you get fragmentation you get stories about why one should fragment and I find the stories about why one should fragment even more menacing than the act of fragmentation itself because, as I said, those stories will be about the dread other, the foreigner, the people with different creeds, beliefs, colours of skins and yourselves. It will be an extremely unpleasant, noxious environment which none of us will like.

So don't go with the fashionable line that actually fragmentation and regional block is good news, it's really bad news, just like house prices halving is bad news. Believe me there is not prosperity in a world in which house prices halve and halve again. We don't want them as stupidly priced as they were in 2007 but you don't want them to collapse in value. A world in which they collapse in value is because nobody can afford to buy them for Christ's sake and that is not good news.

What should the EU bring to the party in any discussion and China? I think the EU is an incredibly imperfect multilateral organisation but it's the least bad we've got on the face of the globe and actually some of the ways the EU has approached managing the Euro, managing the bail out, managing its trade relations and financial relationships we could do well to try and reproduce them at a global scale. I think we are going to produce a college of regulators in the EU. In the financial system lets do that globally. The EU has got quite a lot to offer, I think, a Bretton Woods Two.

As for China I think that…my line on China remains the line it's always been. China is strong in the sense it's got 2 trillion dollars worth of foreign exchange reserves but in almost every other circumstance it's weak and we can't ask and we shouldn't ask 1.4 billion people whose per capita incomes are 2000 dollars a head, 800 million of whom are living in abject poverty, to kind of shoulder the burden of organising an international order to benefit the west, we really shouldn't. This has got to be driven by the west, it's got to be fairly organised, we've got to bring them into the decision making process but the burden of this lies with the rich countries not with the poor. Thank you.

[Applause]

Professor Held
It remains for me to say two things. I mean I would like to thank Will again because Will has made an outstanding contribution to economic journalism for three decades and he brought much of that together this evening and I think it was a real tour de force, Will.