



How to stop the next bubble

The financial crisis has shown that markets are bubble-prone and that laissez-faire regulation doesn't work. The authorities need to get a grip if we are to avoid a mega-bubble. But we may need an even deeper crisis for that to happen

● **JONATHAN FORD (CHAIR):** I want to start by asking where we are in the crisis. Is it over? George Soros, you have said that this is the worst crisis we have been through for 60 years. Presumably you still believe that there is worse to come?

GEORGE SOROS: There is now a widespread belief that the crisis is over. I think, on the contrary, that the effect on the real economy is yet to be felt. The measures taken by the authorities will not bring recovery. There are four reasons for this. First, the fall in house prices in the US is only halfway over and in Britain it has hardly begun. Second, consumers have been slow to adjust their spending habits, but this is about to happen. Third, the financial system is severely wounded, and even though banks have been remarkably successful at raising more equity, they will cut back on lending and this will feed through to capital spending and business activity. Finally, and most important, there is a threat of inflation at the same time as a slowdown. The rise in energy and food prices will turn the slowdown into a recession.

ANATOLE KALETSKY: I agree with George that the threat of inflation is potentially the most alarming new factor in this crisis, but I would challenge the other three points. The worst is over in the real economy in the US, although not yet in Britain and Europe. US house prices do not have much further to fall,

and consumer spending will hold up. While there are, indeed, several trillion dollars of consumer spending to come out of the system, the impact may be quite comfortably spread over many years. And while the financial system has been wounded, the bank writedowns—in the US at least—have already gone beyond what is plausible in terms of likely losses. There is one shoe that has yet to drop: the continental European banks, which have not recognised the losses to the same extent.

JOHN GIEVE: We are coming through the first acute liquidity shock to the banking system, and although there are still lots of risks, we expect confidence gradually to return. But the end of that phase does not mean the end of the downturn. In Britain, where things have held up so far, what started as a very marked turndown in the commercial property market is now spreading into the housing market, and we expect a downturn in economic activity over the rest of this year. So the worst is definitely not over in that sense.

MARTIN WOLF: The whole risk adjustment process has still not worked its way through. Credit spreads in the inter-bank markets, commercial paper markets and so forth remain wide, and so banks remain reluctant to lend to one another. I am closer to George than I am to Anatole on the US housing market.

And looking at the world as a whole, the US shock is combined with two others: inflation and energy prices, particularly for Europe and emerging Asia. It is hard to imagine that this won't have a significant negative effect. The appreciation of the euro is shifting the US current account deficit to Europe. That is creating large stresses within the eurozone in terms of divergences of competitiveness between Germany and southern Europe. Meanwhile, because of inflation fears, the European Central Bank (ECB) will do nothing to help Europe in a difficult world situation. That will lead to a bigger slowdown than we now expect. China and India are suffering from weaker US demand, and will not be able to respond easily because inflation has become a big problem there too. Energy prices also act as a big tax on these economies. If you add these things together, we are heading for a significant global slowdown—if not a global recession—which will last some time.

● **FORD:** I think we should turn to the regulatory aspect. John, I want to bring you in as a representative of the “authorities,” and ask whether you are to blame for allowing this bubble to expand so far that we are now worrying about a multi-year downturn for the economy?

GIEVE: Well, the authorities always take the blame if things go wrong. There are a number of different charges. One is



about the handling of Northern Rock last August and September. We did save the Rock, but the view is that we were slow, and could have handled it better.

● **FORD:** But what about the earlier period when the bubble was blowing up?

GIEVE: Looking back to where we were this time last year, I think most people, including the Bank of England, were saying that a correction was inevitable. But at that point we didn't know how big and painful it would be. Now we can see that more of the rise in asset prices was cyclical than most people had thought. That does raise issues for monetary policy and also regulation; in particular, whether our regulatory regimes are sufficiently countercyclical—should banks be compelled to set aside more in the good times so that they can absorb losses in the bad? In the monetary context, the debate is about what weight to give to asset prices, and in the regulatory context, what you can do to flatten the top of the cycle.

WOLF: It seems pretty shameful for people who earn vast sums of money in the markets to turn around and say, "It's the fault of the regulators who didn't stop us from doing it." Nonetheless, we have to look at the authorities too. And there are two main lines. One is: it's Greenspan's fault—monetary policy was far too loose for too long, particularly after the last bubble burst, and this created the conditions for the next; and the second is that the regulatory regime was not tough enough. There is some truth in both points, but they are exaggerated. I can't believe there is any monetary policy you could imagine that would stop the house price bubbles we have seen. When house prices are going to rise, or people expect them to rise, by 10 or 12 per cent a year, an additional 1 per cent on the interest rate is not going to stop people from buying houses. Of course, we could have said that to buy a house, no one may

borrow more than three times their income and that everybody has to have a down-payment of at least 50 per cent of the property price. But I suspect that any government that tried to introduce regulations like that, or comparable regulations to stop bankers from doing deals, would have been swept from power.

MARK HANNAM: Over the last few years, central banks or regulators have had two jobs; one is to do with monetary policy, the other with financial stability. The Bank of England's new structure reflects those dual responsibilities. Until recently, it looked as if the monetary policy side had been spectacularly successful because we had a long period of strong growth and low inflation. Now, one could argue that this was made possible by globalisation—cheap labour in Asia and so on—but the central banks, the Bank of England, the ECB, the Fed took credit for it. One result is that they became overconfident about their success and took their eye off financial stability.

Monetary policy is a bit like preventative healthcare. It is all about giving people advice and steering for two years in the future, it is all about adjusting the tiller a little bit here, a little bit there, warning people about price levels and so forth. Financial stability is more like emergency care; when someone calls for an ambulance you don't sit and have a discussion about moral hazard. You get going and rescue the system. But some central bankers tried approaching the financial crisis in the same way that they deal with monetary policy—"We will meet in three weeks and look at some economic data."

Take an example: the Bank of England launched a liquidity facility this year that allows banks to shift some assets off their balance sheets by swapping them for government bonds. This could have been thought of last year. The fact that it took several months to develop this strat-

Participants from left to right:

Mark Hannam spent 12 years working in the City, for the Bank of England, Citibank and Barclays; **Jonathan Ford** (chair) is deputy editor of *Prospect*; **John Gieve** is deputy governor for financial stability of the Bank of England; **Martin Wolf** is chief economics commentator at the *Financial Times*; **Anatole Kaletsky** is an economic commentator and associate editor of the *Times*; **George Soros** is chairman of Soros Fund Management.

egy makes the central bankers and regulators look reactive. It's as if they hadn't prepared for what might happen. Does John think that is a fair criticism?

GIEVE: There was a lot of debate about whether the Bank reacted quickly enough last summer and early autumn. But we are now several months on, and all the central banks have adapted their operations to provide liquidity to the banking system. I find it quite unconvincing to think that if we had introduced the liquidity facility on slightly different terms in September we would now be looking at a very different picture. The central banks did what was needed to deal with this period of acute liquidity worries. I do not think that doing it quicker would have seen it go away.

KALETSKY: But John, I can't resist raising one issue which might have gone differently if the tactics and the footwork had been quicker, namely Northern Rock. If, back in August, the Bank of England had been prepared to advance liquidity on the same basis that you are advancing it today, in other words if the Bank had acted back in August the way the ECB did, the run on Northern Rock might not have occurred. After all, the ECB has been



The false assumption that markets tend towards equilibrium has made this crisis much bigger than it should have been

GEORGE SOROS

refinancing the entire Spanish mortgage market, which is probably at least as vulnerable to a house price correction as the Rock was, and has thereby avoided anything like Northern Rock in Spain, or indeed in Denmark or other European countries. Isn't this a fair criticism: that if you were going to end up supporting banks in the way you did in April, you might as well have done it back in August or September and avoided a lot of trouble?

GIEVE: When Northern Rock first approached us, they were looking for help for a few weeks until they could fund themselves by selling off more securitised mortgages. Their whole funding structure was based on securitisation. But the securitisation market is still closed, so it's hard to see how Northern Rock would have refinanced its balance sheet over that period.

KALETSKY: In Spain the securitisation market is also closed. The ECB has been continuously refinancing the mortgage banks there for the last nine months, and will continue to do so as long as it takes to reopen markets.

GIEVE: I don't think the sort of things that Europe did in August and September would have provided Northern Rock with anything like the funds that it needed. And there have been bank failures in the euro area. Although the amount of liquidity the ECB provided looks huge, the eurozone is a much bigger economy than ours, and there's little evidence that the Spanish have been disproportionate users of it. I am not criticising the ECB, I think they have done well, but I want to come back to the bigger picture. It is clear, ten months in to this crisis, that we are not dealing with a squall that might have blown over if central banks had offered a bit of liquidity support on slightly different terms. We are talking about something much bigger. The same markets are closed or sticky in Europe, the US and in Britain. So tactical questions are not at the heart of this.

● **FORD:** There is also the question of whether the regulatory position was suf-

ficiently prudent before the Northern Rock crisis. Was it sensible to allow Rock to acquire such a large chunk of the mortgage market with the business model that it had? Was it wise to allow banking institutions to build up hidden positions of leverage?

GIEVE: Yes. I think there are lots of questions for the regulators, and the Financial Services Authority (FSA) has been very honest in saying that it made mistakes, particularly over Northern Rock. Looking more broadly, anyone in the US would admit that the lack of regulation of the mortgage sector was a contributory factor. And what was special about the last asset boom was the growth of structured credit markets—selling off securities backed by loans and mortgages—particularly in the US. The people promoting those products did not understand how they would behave in different economic circumstances. So financial innovation was one factor that contributed to the crisis. Another was the fact that these products were spread through the international markets, which led to a more dramatic upswing. So the financial system amplified the cycle, both on the upside and now on the downside, more than anyone expected. This is why we are asking whether regulators and central banks could now be doing more to damp the cycle down.

SOROS: We are coming closer to the crux. As I explain in my new book *The New Paradigm for Financial Markets*, the regulators and the market participants were acting on a false interpretation of how financial markets operate. They worked on the assumption that markets tend towards equilibrium and deviations are random. That false perception about financial markets led to the construction of the structured products, and it made this crisis much bigger than it would have been if it was merely a US housing bubble. Some people didn't understand this. Ben Bernanke [the Fed chairman], for instance, said that it was a specific problem of the sub-prime loans, which is

wrong. Others, like Paul Volcker [a former Fed chairman], did understand it. Asset bubbles are endemic. There are self-reinforcing processes that operate where investors' initial misconceptions then reinforce a trend, and that leads to a bubble.

Regulators have to accept responsibility for preventing asset bubbles from getting out of hand. To do that, it isn't enough to regulate the money supply; you also have to regulate the availability of credit. Markets are given to extremes of euphoria and panic, and therefore you need to use margin requirements and minimal reserve requirements more actively and vary them according to market conditions. That is the main lesson.

GIEVE: If we try to use interest rates to control asset prices, we would potentially do grave damage to the rest of the economy because we would have to move interest rates by so much.

As to the regulatory sphere, yes we do need to look again at the regimes for capital and liquidity to see if we can make those more countercyclical. We have to look again at aspects of the fair value accounting regime, because I think that has probably been a factor in overstating the cycle, both on the way up and on the way down. And lastly we have to look again at incentives. That gets us into very difficult territory around bankers' pay. But we also need to look at institutional incentives. For instance, we underestimated the impact of incentives that were created by the regulatory regime itself. If you take the Basel I banking regime—international rules governing capital adequacy for banks—everyone knew that it might create an incentive for off-balance sheet finance. But we underestimated how powerful that incentive was.

● **FORD:** Is regulating bankers' pay really on the agenda?

GIEVE: Hector Sants [chief executive of the FSA] said recently that the FSA would take account of bonus structures in firms in its prudential regulation. I think that makes perfect sense. No one is recommending a pay policy for banks in the 1970s style. But we need to think more about what a good bonus structure looks like and what a bad one looks like.

And if you look at the credit rating agencies, they have hugely expanded on the back of structured credit. They have made lots of money out of these ratings and have had a strong incentive to stretch their models as far as possible to produce more ratings on a wide variety of products. So that is another example where

the incentives embedded in the system need to be addressed.

HANNAM: John, I used to run the money markets business at Barclays and these funds were big buyers of securitised products and asset-backed commercial paper. For a number of years, many of us in the industry would go to the FSA and ask them to regulate our business. Our market needed oversight not just because it was managing lots of money for clients but also because it was taking over from the inter-bank market as the way banks were funding themselves—and the only requirement to participate was for a fund to be rated by Moody's, Standard & Poor's or Fitch. We wanted FSA or central bank oversight. But we kept being told: "We're too busy, we've got other things to do, and we don't see this as an issue for us." So while the rating agencies have questions to answer, the regulatory authorities were also slow to see how the market was changing.

● **FORD:** But how can you make banks manage their capital more cautiously?

GIEVE: You could in theory impose an automatic adjustment mechanism, or you could have a more discretionary mechanism in which banks were required to keep more liquid funds or hold more capital at times when the authorities judged that asset prices were rising too fast. That would obviously involve the central bank as much as the regulators. I haven't got the perfect answer, no one has, but one lesson of this downturn is that we need new regulatory tools. There can't just be interest rates, as they affect the economy as a whole. On the money market side that Mark raises, no regulatory system can prevent people from making foolish investments. And those who placed too much faith in rating agencies and their models lost lots of money. Those people happen to include a large number of the most sophisticated investment and other banks in the world. I am not sure it is our place to tell them what to do, and whether or not they should be listening to the credit rating agencies. That said, the severity of this downturn has shown that the collective impact of some of these new structured products has affected the wider economy, and that is the reason we are looking at more countercyclical regulatory mechanisms. I would be interested in new ideas on this.

WOLF: I believe that there is indeed something very problematic about the way that we have been thinking about free financial markets and how they are

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JOHN GIEVE



regulated. George's basic point—that market deviations are natural and self-reinforcing and can, if not checked, turn into bubbles—is correct. The efficient market hypothesis—which emerged in its many variants in the 1970s—is not looking very convincing now. We have just had two of the biggest bubbles ever measured—the stock market bubble and the current credit-cum-housing bubble—in the most sophisticated economies in the world. This is not happening in Korea and you can't blame it on crony capitalism in Thailand. This is in the US and Britain, and these events simply cannot be reconciled with any version of the efficient market hypothesis. Therefore the insights of somebody like George, or like Robert Schiller, who looks at this in terms of behavioural economics, or Hyman Minsky's theories, seem to me a much better account of how financial markets actually work than the views of orthodox economists from ten or 15 years ago. The financial markets cannot be given the benefit of the doubt in quite the way that they were before. So the regulators have to start by thinking, if we let these guys do whatever they like, we might face big problems. This does not mean, of course, that we want to close down financial markets and have government-allocated capital. That is a lousy alternative, and we know financial markets do lots of things very well. We want them to exist, but we need to reduce as far as possible the consequences of extreme stupidity and extreme cupidity.

That means looking at many things from less pro-cyclical capital requirements, to incentives, to liquidity requirements, to more regulation of products sold to consumers—the mortgage lending that went on in the US was simply criminal. But we also have to understand that we are not going to completely eliminate danger. We can reduce it by various mechanisms, but we are dealing with people who are brilliant at getting around regulation—so we can regulate banks, but we end up with hedge funds and so

on. In addition, even if we had a single global regulator we would have many countries pursuing different policies, some of them at odds with one another.

GIEVE: One follow-on point. We have seen very different styles of regulation in different countries: for example in the US, you have permanent bank examiners—regulators actually sitting inside banks. But even this highly intrusive form of regulation didn't stop these financial problems.

This episode has also shown that for any individual institution, the best form of risk management may be the one that enables them to get to the exit just before the bubble bursts, having danced until the music stopped. And some of the biggest financial institutions have done well out of the last nine months—they were the ones that kept investing and trading right up until last summer, but were very responsive when things began to crumble. Of course, from a systemic point of view someone is always left at the back of the queue. And if the damage to them is sufficiently big, then that's a system problem. You can't just rely on the risk management of individual banks—however good it is. [*John Gieve leaves at this point*]

KALETSKY: I think an even more striking example is what has happened to the German banks. Some of the biggest losses from the sub-prime crisis, have been in Germany. Yet it is one of the few countries in the world that does not have a housing bubble. Its banks are very tightly regulated, and the banks most involved in credit crunch difficulties were publicly owned. By contrast, the part of the financial system that has emerged relatively unscathed through this whole thing is George's business, the hedge fund industry, which is totally unregulated. Four or five hedge funds have gone bust, but broadly speaking the hedge fund business is still going. They have suffered much smaller losses relative to their portfolios than the banks. I am not making an argument against regulation, but I am saying there is a paradox here.



I hope there is enough of a backlash against finance to impose more sensible regulation. Too little will be a disaster

MARTIN WOLF

SOROS: There may still be some bodies buried among the hedge funds. But on the broader issue, the excessive use of leverage is at the heart of the problem. People over-borrow because of the misunderstanding that you can actually calculate risks. The risk models people used fail to account for the uncertainty that is inherent in human affairs. So you must impose stricter limits on leverage. One way to control the activity of hedge funds is to put minimal reserve requirements on banks when they lend to highly leveraged hedge funds. The problem is that it has become very hard to calculate leverage because of all the clever instruments we now have. That's why the authorities gave up setting minimal reserve requirements and effectively allowed the banks themselves to decide what was prudent and what wasn't.

● **FORD:** One regulatory mechanism is for participants in the system to suffer pain when things go wrong. Have the miscreants suffered enough to act as a deterrent to further misbehaviour?

KALETSKY: Well, the shareholders of Citibank and Bear Stearns have been punished, but they were not the ones who were taking the decisions. The people who made decisions were the directors.

SOROS: Why not shoot them?

KALETSKY: Well I was going to suggest something almost as radical. The idea that for the chairman of Citigroup to be fired with a payoff of a \$100m constitutes some kind of punishment is ludicrous. And it is similarly ludicrous to argue that it is a punishment for a trader at Citigroup to be sacked having accumulated \$10m, \$20m or \$30m in bonuses over the last few years. You could make a very strong case—and it is interesting that John did touch on this—that the most effective reform might be pay packages which have significant clawback arrangements, and structures that made the directors of banks personally liable for losses that their banks suffered. The fact is that the chairmen of Citigroup and Merrill Lynch and Bear Stearns should

have been in a similar position to somebody who bankrupts a company; they should have been liable for a significant part of their wealth as well.

HANNAM: Don't forget that so far the British taxpayer hasn't lost anything, and may even be making money out of Northern Rock. Whether it will over 20 years remains to be seen, but if the Bank of England got its sums right, the country won't suffer a financial penalty even though it has lent the Rock lots of money.

KALETSKY: The state is providing them free insurance. It is a very large insurance policy essentially for free.

HANNAM: But *shareholders* in Northern Rock have lost a lot of money. Shareholders in other banks have lost money through falls in share price and rights issues. And when you highlight the senior executives walking away with multimillion pound packages, that is only because the boards of those banks wrote stupid contracts which didn't have clawback clauses. But that's not a regulatory issue. Those directors failed to represent their shareholders' interests, and shareholders are paying for poor management.

KALETSKY: But in future, why shouldn't the FSA go into the terms of management agreements with bank shareholders and say there should be a clawback?

HANNAM: Is it really fair that someone who works in the banking industry should have some liability that lasts for five or ten years in case something goes wrong, even though they might not have had a direct role in it? Wouldn't it just encourage the smarter people to leave the regulated banking industry and head for the hedge funds and private equity? This has already started to happen. If people screw up, they should be fired and shouldn't be paid bonuses, but that should apply across the board, not just in certain parts of the market. Look, the heads of Citibank, Morgan Stanley and UBS have all gone, and the governor of the Bank of England has got another five-year term. Let's be consistent about this.

WOLF: Shareholders have lost money,

but no big creditor has. Without government intervention, Bear Stearns would have gone under and creditors would have lost money, and Northern Rock ditto. Because of this implicit insurance of creditors, the cost of borrowed funds to banking institutions is reduced. That of course increases the returns on equity and probably the amount of leverage. This is the very problem that George is concerned about. This is not a trivial issue, and in light of it, you almost certainly have to ask for higher capital requirements as an offset.

Leverage is central to the system. It is not merely that there is a large debt in relationship to equity, but the debt is short term and the assets are long term. This "term transformation" is something else that the central banks insure. If you look at the whole structure of the market, the banks were all carrying long-term mortgages in these complicated products which were financed by three-month money or whatever it was. That is what Northern Rock was doing.

KALETSKY: The state is providing insurance to the system and should charge for it—perhaps with a special tax on bank profits which would, of course, go completely against free market ideas. Yet in Britain the banks, particularly the big banks, are lobbying incredibly hard against the creation of even a minimal deposit insurance scheme because they see this as an unjustified tax on profits.

HANNAM: The big banks don't like the deposit insurance scheme because it provides most protection to the smaller, more fragile banks who can then pay more aggressive interest rates on accounts and take their business away.

WOLF: Do we want more than four or five banks in this country? That is a big question that many senior bankers are talking about. Without deposit insurance we won't keep more than four or five.

● **FORD:** Do you have a view on this?

WOLF: Yes, there should be deposit insurance but it should be risk-weighted, meaning that smaller banks would pay more. That would cramp their business, but it wouldn't destroy it.

SOROS: One of the reasons banking is getting so concentrated is because everyone wants to get to the point where they are too big to fail. I don't think that is such a wonderful thing.

● **FORD:** Back to the big picture. What will happen to the financial sector in Britain and the US as a result of all this? Will it shrink? Should it? Are there areas

of business which shouldn't revive because they were fundamentally unstable and unsatisfactory?

SOROS: It should shrink. It has really got overblown. The size of the financial industry is out of proportion to the rest of the economy. It has been growing excessively over a long period, ending in this super-bubble of the last 25 years. I think this is the end of that era.

KALETSKY: I can't resist taking a contrarian view. I think this is a point of inflection, which, if you remember your school maths, can either be a turning point or, as in a cubic equation, a point where things slow down and then re-accelerate. There is at least a possibility that this will turn out to be that second point of inflection. The financial system is being tested. If this crisis continues to get worse and the real economy goes into a prolonged slump, then it will be a turning point and the financial system will undoubtedly shrink. There is, though, still a possibility that the financial system will survive the test. If it does, the appropriate analogy would be not 1929 or even 1973 but what happened in the late 1990s with Long Term Capital Management, whose collapse was followed by an even bigger bubble. I think eventually there will be a bubble that totally blows up the financial system, but we may not be there yet. I don't see many hedge fund managers driving taxis. And George, you made a lot of money in 2007.

SOROS: Yes, I did. And if we do pass through this without a hitch you will find that the private equity funds will replace the investment banks as the dominant force in the economy, because they are the ones who are now buying the assets.

WOLF: There is no doubt that there are huge opportunities for the financial sector broadly defined, because even if you believe, as I do, that it is overgrown in Britain and the US, it is undergrown in very large parts of the world. In parts of continental Europe and certainly in the emerging economies, both a larger and more efficient financial system would be large plusses. Marginal returns on capital in China are probably zero, and if they were higher than that they wouldn't have to save 55 per cent of GDP.

The second point is that the financial sector doesn't get rich out of the rest of the financial sector. It makes money by serving the wider economy, and that is linked to the scale of the sector's assets, which is in turn linked to the stock of debt in the economy. Looking at the US and

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ANATOLE KALETSKY



Britain, we must have reached at least a local limit on the scale of the indebtedness. If the debt stock grows relatively slowly, the opportunities for the sector as a whole in those countries will not grow—we have had a massive growth in leverage in the US and Britain over the last 25 years, and it is impossible to imagine the same growth in the next 25.

The regulators should start to be less reactive. Whether they do depends on how bad this crisis turns out to be, and on the strength of lobbying against proposed restrictions. These issues will be worked out in the politics of the next two years.

KALETSKY: I agree, we have reached some sort of limit in the US and Britain. But if the global financial credit system is going to grow, that could mean that the financial sectors in these economies, particularly Britain, could continue to grow because the British financial sector is in the business of lending to the rest of the world. So even if the growth of leverage within Britain is not in our national interest, the growth of leverage on a global basis, and the promotion of financial activity as an end in itself, very much is.

HANNAM: Half of the world or more is still un-banked. Many communities depend on microcredit for access to finance. The opportunity for growth of financial services is still enormous. Large financial institutions based in the west can carry on growing for a long time without having to lend any more money to over-indebted western consumers.

WOLF: You are describing Britain as a monocrop economy which can only get more specialised in its monocrop?

KALETSKY: For the next couple of years we will suffer from this. I am bearish about Britain's economy in the short term, but over 15 years maybe not.

● **FORD:** What about the politics of this in Britain, particularly if things get quite bad? Will there be a backlash against finance? Are we going to start examining the figures that finance contributes to the economy? We hear a lot about the

fact that one third of all corporation tax is paid by the financial sector, but that is only about £15bn per annum—less than half of the revenue raised by fuel taxes. Will the politicians get more interested? They seem to have been rather cowed by finance in the recent past.

WOLF: This is a huge issue. Yet the government is clearly weak and the Conservatives are very strong. This is not the obvious reaction of people who think the financial sector should be closed down. We are not going left as a country, although the Labour party may well do so. Of course, a huge recession might make a difference, but it would be blamed on the politicians. In Britain, there is no sign of a backlash against the financial sector comparable, for example, to the backlash against globalisation in the US visible in the election campaign.

HANNAM: If people in America wake up to the fact that their banks are increasingly owned by foreign governments, there could be some reaction. It would be manifested less in terms of attacks on finance and more in terms of demands for protectionism.

WOLF: We have really had only one big backlash against finance in the last 100 years, and that followed the great depression. Things have to become very serious before people connect it to finance. I hope there is enough of a backlash to impose more sensible regulation. Too little response will be a disaster, because then we may have to deal with Anatole's even bigger bubble—which could bring down the system. ■



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