Title *The post-crisis politics of financial reform: business as usual or new global order?*

Description Poul Nyrup Rasmussen, President of European Socialist Party and former Prime Minister of Denmark talks about the politics of current efforts to regulate the financial sector.

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Contributor Thank you very much. You know, it's true that I've been working with the financial sector for a time. But honestly, as an economist from the University of Copenhagen, my thesis at the time - it's many many years ago as you could hear, the first time I was here was in 1969 as a student – so at that time, I was very heavily involved in macroeconomics and especially in Golden Rule Theory for the Welfare State. What I did at that time was to make my thesis by using Pontyragins maximum principle to optimalise the Golden Rule.

Now, my conclusion at that thesis was that with the instrument of Pontryagin, you are capable of making optimal conclusions and decisions if you know all you nee to know. And that's the problem. If we get all the information we would like to have, then we should, in practise and theory, be capable of making the right conclusions and decisions.

Now, do we have all the information about what's going on in the financial market? In a sense, yes, in another sense, no. But I think we know enough to make the right decisions and let me try to develop that thesis a bit tonight here.

First, you can easily understand with my background that my fundamental belief is that the real economy comes first. That the financial marked must be the servant of the real economy and not the master which means that, in my long life, also as active politician and student, if you like, it has always been like that. I can even recall being students at the time that it was so, that the financial market was the servant of the real economy.

At that time, I was active in politics in Denmark just before we decided to deregulate our financial markets. I recall, at that time, that our vision was, okay, let's deregulate but at the same time let's now start on a voyage for cross-border regulation, for global regulation if you like. So, in a sense, I think the progressives in Scandinavia, as a price to be paid for de-regulation on the financial market, this price was formulated very clearly, that we had to, when we deregulate nationally, we had to create some new common regulation to ensure the right behaviour and the right role of the financial market compared to the real economy.

As you know, this never really happened in real terms, not in the sense I would like it to do. We got Basel Two, but I'll come back to that. We never got, say, mandatory regulation in the sense that I think is absolutely necessary.

Now, my point of departure is also the real economy when I try tonight to make some proposals on what to do on the financial market. I'm deeply, deeply concerned with the real economy, dear students. We have, for the time being, In European Union, 22 million unemployed people, that's around 9.5% unemployment in Europe. And if I look, as an economist, on all I think we have of acceptable datas and prognosis, I think it's fair to say that we will probably have a sluggish growth in the next two, three, four years. By sluggish growth, I mean a growth that is lower than productivity and thereby implying that the unemployment will increase.

So that's why unfortunately, I fear that even taking care of the demographic challenge that we have in our countries, the unemployment will increase. Next year, my adjustment is that it will increase to 30 million unemployed, close to 11% unemployment in Europe. And that is only, quote, unquote, the registered unemployment. Behind that you have figures, especially in Eastern and Central European countries, but also in the Southern part of the continent, figures on non-registered unemployment which make us more alarmed by seeing how immense loss of human capital we're running into and how incredible loss of values in our societies we are risking.

So, the financial sector and its needed regulation has to be seen as a part of a new process of a new perspective for the European Union, as well as for the planet. We cannot deal with financial reforms without dealing with new ways of our macroeconomic economy and micro and the other way around. The financial sector and the real economy belong together in a sense I just described.

Now, the current financial crisis is certainly the worst we've had in living memory. We've had lots of bubbles – credit bubbles close to credit crunch. The latest one before this was the dot com crisis in 2000, 2001, as you recall. Before that, LTCM in 1998, a big hedge fund collapsing in US with a risk of spreading through the world.

So I'm not going through the history of bubbles and crises we have had. But this one is certainly the worst of them all due to several facts. The one is globalisation and the simple fact that never before have we seen a financial market so global as we see now. And never before have we seen so dramatic, similar, no, so dramatic coincidences of factors that led to this crisis. To understand how vast it is and how deep it is, you need to take on board the latest seven, eight years development globally.

You will recall the IMF Intervention in South East economies and the enormous strength they were obliged to take into strengthening their macroeconomics. And the consequences of that, from South East Asia, was an enormous increase in savings and this saving fled to Europe and US. So we had suddenly created, just after the dot come crisis in 2000, we had created a very very generous liquidity and credit market. And we combined it, at that time, with incredibly low interest rates.

So, in the so-called Golden Age in the financial sector, you had the combination of extremely generous credit market and historically low interest rates.

Now, here comes my first challenge and dilemma. How can we regulate, in the future, the financial market in such a way that we, hopefully some day, we are going to have a new era of low interest rates and generous credit markets without running into a new credit bubble and a new credit crisis? How can we solve this dilemma because, evidently, low interest rate and generous credit is very good for the real economy, also. So are we really crushing ourselves by saying no, in no circumstances should we come back to this era because that would feeding up to a new credit bubble.

So my first dilemma is, we must solve this contradiction between what's good for the real economy don't necessarily have to be the born of a new bubble.

This crisis revealed the extent of, you could say, the rot of the heart of modern finance. Excessive leverage, extreme risk-taking, opaque products, off-balance sheet operations that circumvented regulation and eroded capital and reserves, and deceptive lending and fraud. The result, as you know, was that 7.1 trillions of pounds worth of bank bailouts, enough to finance £1779 hand-out for every man and woman and children on the planet.

People spoke of the death of market fundamentalism, but those who held that a new Golden Age of modern social democracy, making the market servants, as I said, enter the public interest. They spoke too soon, I'm afraid, they spoke too soon. When I listen to the financial market's major actors, I hear the BAB, the BAB is Back to Business. We are on our way out of the crisis, why should we have regulation? Let's go back to business.

So, financial regulation is still beholden to vested interests so the fight for genuine reform will be tough for all those who believe that business as usual is an affront to decency and to all those who have seen their livelihoods destroyed as a result of this crisis.

I mean, just one year after the failure of Lehman Brothers, there's a varying tendency and sense that financial actions that have survived the firestorm are getting back to their previous behaviours. The gold plated bonus balls seem to have returned. So in the industry they are trying to re-write history, blaming the regulators for jealously guarding their competences and not working together.

Greenspan's first Mea Culpa in congress has now been replaced by an expedient blaming of human nature. He said just last month, quote, "The crisis will happen again but it will be different. That is the unquestionable capability of human beings" unquote. So, the conclusion, according to him, Greenspan, should be that it's human nature so the logic goes that trying to prevent a financial crisis in future is futile.

Have you read the book *Animal Instinct* which is a new one coming out from the colleagues to Joseph Stiglitz, who also got the Nobel Prize. He's developing the animal instinct as a new parameter going into explaining the behaviours but his conclusion is the opposite. Even if we have human beings animal instinct, that's why we need to regulate.

So my point is, there may be human greed in this and I can confirm that but that's not the explanation not to do anything. As for policy makers, we are seeing some signs of regulatory nationalism in Europe which could harbour the push for regulation. These factors combine to create a real risk of regulatory capture, as described by Nobel Prize winner George Stigler in his seminal work, *Theory of Economic Regulation*. We already see the signs of this. The city of London is fighting hard to avoid EU regulation. I can tell you I was just there recently and certainly I can confirm that to you. They are fighting really hard, really hard. I'm not saying they are winning but they are fighting really hard.

European policy makers have never seen a more aggressively lobbying campaign as the one launched by the hedge fund and private equity fund industry against the proposed alternative investment fund management directive. I was one of those who worked heavily to reach that point. You may recall that in the European Parliament last year, we made a report called The Rasmussen Report. I'm Rasmussen One, don't confuse me with the two others we have had in my country.

But this report was quite interesting in the sense that on the one hand there was quite a lot of compromises because for me, it was fundamental to get a broad majority behind this report about regulating hedge funds and private equity. Therefore, I used a lot of time to negotiate with the EPP, who are the Conservative biggest group in the European Parliament. A lot of time. And at the end of the day we managed to make a report which was reasonably operational.

The first point, which I think is fundamental, is in very clear text. There's an agreement between the Conservatives and the Social Democrats in the Parliament in that it should be a regulation with no exceptions. Everyone should be included. All financial players should be included in regulation. If you have someone outside then it's like water, it's just running away.

So that was number one. Number two was a common agreement that leverage have gone too far in a number of cases, that we need to regulate excessive leverage tendencies.

The third point was also as a common agreement that we need to create transparency on that market. Highly inspired by Joseph Stiglitz Nobel prize, where he documents the asymmetric information trends on our actual financial markets.

And the next one was that we combined all these claims to the industry, the ones that I've mentioned plus the capital requirement thingy. But all these claims we combined with a new offer to them based on rights and obligations you could say. We said, "Listen friends, you will have access to the whole of the European Union because we want to create a single financial market. And if we could do it, I think it would be to the preference of the real economy. A single European market: transparent, cost effective, competitive. If we could do that, you will have access to that whether you are sitting in city or in Frankfurt or wherever you are. If you fulfil these conditions.

In other words, we are giving you a passport which gives you access to the whole of the European Union so you don't have to live up to 27 different sets of regulations. We make a common set of regulations and you can have your entry pass point in each and every country you are living in but you are getting access to the whole of the European Union; 500 billion inhabitants and the biggest economy in the whole of the world, 10% bigger than United States of America.

So the idea was, you're getting access but you have to behave and you have to respect the direction of the European Union, that we are going to be the most knowledgeable economy in the world, the most competitive one based on knowledge and based on cognition – the Lisbon line as the major basis. I still think it's an excellent idea and I still think that's the way to go. But that's a long way to go ahead of us when I look at the resistance of the industry.

So, the FSA have made, or rather, taken initiative to a new assessment of this directive proposal from the European Union because you should understand that the mechanics goes like the following – just if you go to the European Union. The report I made with this broad compromise, was a so-called legislative report which is demanding a qualified majority in the Parliament. That means an absolute majority of all the number of seats. If you can get that, then there's a specific pressure on the Commission. In a legislative report, the Commission must live up to a relevant response which means that we could go to Barroso and say, "Listen, Commission President, now we have created this report and you have to transform this report to a concrete proposal."

Inside the Commission, there was a heavy, heavy debate between those who were against regulation and Barroso who, in a sense, well he wanted to be re-elected didn't he? So he listened carefully to what was this majority saying in the Parliament and we, of course, could be tempted from time to time to say to him, "Well if you want to be re-elected, Mr Barroso, you have to listen to the Parliament." That's how the play goes from time to time. But he was pressing for regulation and Mr McCreevy, the Irish commissioner who was working with this one, was opposing.

So, in a four to five month period, there was the one peak debate in the Parliament after the other between Mr Barroso and some of us, including myself, Mr McCreevy. Lots of communication and open letters back and forwards. But at the end of the day, the pressure was so high on the commission that they came out, they came up with this proposal on regulating managers of private capital poles, as we call it, the Alternative Investment Fund Managers Directive.

I just go into this picture to describe to you what this process is like because this is how you can make politics at the European level if you understand the process and which players you should make your reform with.

Okay, the Commission made a proposal; I have some criticism of that one. There is at least eight or ten loopholes in this proposal. They are too weak on transparency, it's not systematic, it's not regular so that the public authorities and supervisory bodies can get a basis for assessment on what's going on. And I must say that the threshold for the size of the funds that have to respect these regulations are simply too high. Very very high thresholds which means that you don't have to be a first degree fund manager to split your funds into three smaller ones to climb below these thresholds. And the third one is that the capital requirements, they are simply ridiculous if you go into it and see how it is.

On the deposit side I think he is close to the commission ... Barroso, he's close to what we propose. That's also one of the points which City and Frankfurt are criticising most of it. On the leverage, unfortunately here, the directive is very very weak. We need to have stronger control on avoiding excessive leverage because you all know that excessive leverage and excessive risk-taking have been one of the most dangerous keys which created this crisis.

So what I'm trying to say is that this proposal from the Commission, number one, it was an enormous `[[prosperous 0.19.34]]` step forward. On the other hand, there was loopholes and there still are. Now looking at the reaction pattern, I was astonished to see how hard it was and how uncompromised it was. Now, we have seen the report initiated from the FSA, here in London, where they asked a company to make a so-called assessment of the directive.

I'm astonished one more time. I've got the chance to look at this report and I can only say it's biased and it's non-comprehensive and if you want to make an assessment of real costs, do you start and do you only ask the usual suspects or do you ask someone else also? My point is that the only ones who were asked about the costs for this directive, that was the hedge fund industry and the private equity, they didn't ask someone in the Oxford University I tell you. They should have done but they didn't. And my second point is, if you ask the usual suspects, you should be careful on what you ask for and how you ask.

Let me give you an example. The investors side are saying, "Mr Rasmussen if you make this report regulation come true, in practise, some of the off-shore hedge funds and private equity," off-shore means outside Europe, "some of the managers in US or Japan, they will not any longer be customers to investors in Europe so that the investors in Europe, they cannot invest in the off-shore managing funds in the same way as they can today." And the argument goes like this: if they can't do that then they are losing some revenues and the cost will be immense.

When I looked into this one, I observed that the reason why they can't come out with extremist costs due to this directive in this way is that they simply in this report assume a specific behaviour from the investor side. They say, "Okay, if the investor cannot invest in two American hedge funds, which he or her would like to do, then he will invest in the second best performing manager in Europe." So the laws will be obvious between the best and the second best, right? And that goes to the products also.

I'm just saying, "How come? Do you really believe that these investors are naïve people?" These investors are professional and they, of course, would optimalise their investments under these circumstances. No one would claim that a professional investor would just go for the second best if he can't get the best in that same industry. He would, of course, say, "Where do I optimalise my investment in a much broader scale?"

And the second information to you is, I have read all this report, all these pages and I don't see one single reference, to the point that we have de facto a financial crisis. Not one. And I don't see any reference to the losses which pensions have had during this financial crisis. And I don't see any reference to the losses in the real economy due to this crisis. So I'm just asking, silently, one of the reasons why we want this regulation is to avoid that we are going to have this crisis one more time. Why doesn't that play any role in this report? And why don't they tell anything about how many hedge funds went down now, defaulted?

So what I'm saying is that this report is surprisingly biased and I think they should give it another try. I have said publicly that I would not invest one euro in this report.

So, my response is this: we should be assessing the costs to the economy of the malfunction of these funds. Compliance costs for better regulation would pale in comparison. Unfortunately, similarly in the United States of America, you see banks lobbying against the creation of a consumer protection agency and the establishment of basic rules to prevent predatory mortgage lending. Maybe I shouldn't mention that in this famous university here, but you need to know the whole picture, this is about politics also.

You know, some policy makers are particularly vulnerable to this hard industry lobbying because of the huge sums they have accepted in donations. I'm forced to say that. I ask myself why on earth the Mayor of London was so busy in Brussels in telling us how bad this regulation would be for London and for many, many other people. I couldn't understand it, after all the Mayor of London, he have a busy day, and should he really spend that much time in Brussels.

So I begin to look upon who's financing his election budget and I came to the result that 77% of the Mayor of London, Boris Johnson's election campaign, was financed by hedge funds last year. And he is now the most prominent opponent of EU financial regulation. You can draw your conclusions yourself. I'm only saying it's a hard time. And I want to add that hedge funds and private equity firms … just that I've opened my heart to you, I have financed the Conservative Party to the tune of over three million pounds in the first six months of this year. That's 55% of all the monies that they have donated since 2001.

It's not new because you see it in the US also. Even if you take the Democratic Party; the Democrats received massive donations from the industry in 2008. Commercial banks gave over 17 million dollars, hedge funds over 11 million dollars and private equity over 14 million dollars. So the politics of regulation is immense in the murky waters of campaign finance.

Nevertheless I am still optimistic that we can win this fight for a new global order of financial regulation. Financial regulation is no longer the domain of experts, it has taken centre stage in the political debate on how to safeguard the public interest. Political outrage against the financial sector will not subside as long as unemployment rises and stagnant growth threatens the growth of our welfare state. So in a sense, you can say that unfortunately this crisis in the real economy is our best ally to get regulated in the financial sector. I hope it won't be long, I hope it will be quick, but I'm just giving you this point.

Recent shocking bonus payments does not make the case weaker. So here we go. So what, in my opinion, is the new global order we need? Let's start off with a purpose on new financial regulation. I have two. The one is the principle purpose is to prevent a financial crisis happening again. The never again must be our ambition so that financial stability has to be at the centre. That's why I also support the point made by the Governor of the Bank of England that the discussion about the size of the bank being too big to fail is a moral hazard. And I agree with the point that why couldn't we separate the investment wings of the activity from the normal boring, if you like, banking activities. I think we should.

So instead of falling into the trap to discuss how big could a bank be to fail, we could say, "Well it's time to separate these activities if we want to insure ourselves better in the future."

Anyhow, I think the Governor today has a point in the journal saying that we must reduce the number of ordinary people in business, so many thousand being so dependent on only three or four big banks. That's simply not sustainable. So we must move into a more competitive environment and an environment less vulnerable.

The second point is that, as I said, the financial markets must be the servants of the real economy, not the masters. That's about long-term financing. Can I say that the only two important investment objects we have decided in the European Union, namely, one to be the most competitive `[[unintelligible 0.28.22]]` economy in the world on an inclusive basis; two, to realise our package on the climate change. These two democratic decided long-term goals for the Union, these two cost, per piece, about 1 trillion euro. And if it's long-term investments and it's 1 trillion euro, you can understand it's a huge amount of money.

And when I look upon the financial market and see do I have here natural financial actors who could go into and help us realise this goal, I see some obstacles.

Now, the principles behind the new financial regulations must therefore be: number one, covering all actors, be comprehensive, the risk of regular Tory `[[arbitrators 0.29.09]]` is too great otherwise. Number two, regulating and regulations should be equivalent to ensure a level playing field and high prudential standards amongst all financial actors, notably between banking and `[[several 0.29.27]]` banking sectors as I just implied, referring to Mervyn King's point. The third one is transparency. Transparency must be at the core of new regulations, without this regulation and supervision cannot be effected. This is the only way to see whether innovations in the financial system bear systemic risks or not.

It also follows from this one that I agree with Lord Turner's point that if the consequences of stronger claims on transparency, on level playing fields, on counter-cyclical regulation, on conflicts of interest and so on, if the consequences will be a little smaller industry in London, I would say we can live with this because as Lord Turner said, part of the activities are socially useless. And we need also here to be consequent and understanding that the dynamics of this wonderful society of United Kingdom is not all focused in London city. What counts is the interplay and what counts is the inclusiveness of all the people.

Number four is regulating the cyclicality in the system. This crisis showed, once again, the inherent pro-cyclicality of the markets and the inaccuracy of instruments like monetary policy to control them. We need a new generation of counter-cyclical measures from the national to the European and global levels; notably, capital requirements. And let me just develop this point a little further on.

I think that we need capital requirements which in good times means that they are stronger but in bad times, where we must have some understanding that you can soften your requirements if you have crisis time. So you have slow growth times. But I also think that our capital requirements should be related to the risk taking of the specific banks. In other words, the more risky you behave, the higher the claims on the capital requirement should be. And I also think that there should be a nuanced set of claims of big banks compared to smaller banks. In other words, we could and must look into how could we create this capital requirement in such a way that it's counter-cyclical, that is dampening the risk taking, that is inspiring the big banks to behave in a better way than they've done in the past.

Executive pay and remuneration should reflect long-term performances. The bonus culture should reflect, again, the real economy in a symmetric way which means that when your company doesn't behave as good, this should be seen on your bonus payments also and the other way around.

Conflict of interests have to be eradicated. That includes regulating credit rating agencies and we must, number seven, limit it ... we must limit our excessive leverage. This is not an easy thing to do. If we go into the private equity industry first, you will see that the private equity, especially leverage buy out funds, when they compose their portfolios of private companies, if you go in there, you will see that there's an inbuilt tendency in their business model to leverage these companies.

You can say the degree of leveraging a portfolio company is directly combined with the performance on the net return. How is that? It's easy because what you compare is in percentage your return compared to your own capital. And the less your own capital is, with a given return, the higher your performance are. That's why the leverage, that's why foreign capital brought into the company instead of old capital of its own, is artificially increasing your return.

So, in a highly competitive environment on private equity fund managers, you can easily understand that the more you can make debt push downs on your portfolio companies, the quicker you can change your own capital with foreign debt, the higher you can present your return. That is the major challenge in the business model for private equity as I see it.

So in my mind, there are two types of regulation you should go into. The one is trying to make some caps on how much you can try to liberate a portfolio company. What is that called? Is that 5% or 10, or what is it? I don't think so, but I would invite everybody to go into it, not least the people here in Oxford. One may use one of the well-known tools – is it an on-going concern? How much could you liberate your portfolio company to insist that you're company is alive, it's functioning? Could we develop its, sort of, standardisation? Would it be enough to take some marks, some land marks? We could say not more than this. It's a good question and we have to work further on it. But something has to be done.

Also because if you work further on the facts, you will see that last year, I saw an analysis made by, was it Bloomberg or was it Barclays? I don't remember right now but they showed that 55% of around 75 companies from the portfolio side would have defaulted due to the strengthening of the credit and the rise, the increase in the interest rate. 55% of all these default companies were coming from private equity ownership. And that's easy to understand.

And if you take the corporate bond loan markets, you will see that, in recent years, more than half of the corporate bond loan market have been rated now for B minus and if we try to track down these corporate bond loans to corporate companies, you could see that an impressively high part of these corporate loans do relate to portfolio companies which have been owned or are owned by private equity. So, upholding these principles will be a matter for very detailed regulatory proposals, you can easily see.

Now, I'd like just to present a few key elements before I close. Do I have five minutes more? Let me just go a bit into the matter. Number one is how do we get to a global governance? How do we get it global? Could I warn you about a temptation here? There are those who say, "You cannot do anything before you are getting the ideal construction at the global level. Let's wait for the base of three and let's see how much we can do on hedge funds, private equity and other private capital pools in international negotiations in the IMF or whatever it may be."

Can I say, this is a trap, as I see it? My life is too short to wait that long. So that's why I'm saying that in politics and in our aim of obtaining an regulation, I think what's in focus is the process from now until that global level. Which way are we going to choose and how are we going to do it? That's where my converging road maps comes in. I think we must understand that financial regulation has, up to now, been mostly a national affair.

International standard settles, such as the previous Financial Instability Forum now the Board, did not have any power to ensure compliance. The Basel regime was not uniformly implemented but, as the crisis showed, the national governance is totally mismatched with the extreme global interconnections of the financial market. What can we do?

I propose a two-step procedure. The first step, in the short run, is the converging road maps. We need that – the US, the European Union and Japan. You have seen the new landslide victory in Japan, which has created a new government, which is really really going into this method here. I'm very impressed. On the regulatory side, on the green side, the climate side, it's very promising from my point of view. What I see is that those three players, major players, maybe also China, develop their road maps on regulation but in a very coordinated and a very converging manner.

So that the further we go on these matters, the closer we come to each other and at some time we can make the common global regulations. I think, in a very ... in quite many years, you'll have some common regulations, first and foremost from the Basel centre and you will have some fundamentals but when it comes to the details you will have, in a couple of years at least, specifics in Europe, specifics in US and specifics in Japan.

You must recall that the way they regulate in United States, that's detailed regulation. The way we regulate, that's principle regulation and the way they do it is supervisory, observing the bad guys, taking them into gaol to be a little popular. The way we do it is to regulate the behaviour by directives and then implementations in the national legislation.

The good story is that a G20 process has already enabled this converging road map strategy to some extent. Converging road maps allow us to act quickly and effectively to prevent a return to business as usual.

Second point, about Europe. I think we are moving in the right direction about what I call financial supervision. We need to catch up, we need to make it stronger but the major design is not that bad. If you take the European Union's European Systemic Risk Board, what they propose here is that the 27 national bank governors go together with the ECB, the European Central Bank, Jean-Claude Trichet, and they, 28 people, keep a close eye on how all the national banks behave and how the monetary markets in all the 27 countries behave.

They define, they identify and they prioritise all macro financial risks. They issue warnings and give recommendations. They monitor the follow-up of risk warnings. All this is good and necessary – problem, if Lithuania don't care they don't care. So they are not having enforcing power to ensure that their advice, quote, unquote, this is actually followed up. And here we have a loophole. Compare it to the Growth and Stability Pact within the European Monetary Union. I can tell you, if you don't behave, there's a lot of instruments on the follow-up side to punish you if you don't behave, right?

So my point is that if you can do it on the Growth and Stability Pact, you can do it on this one also. The second, that's the micro potential, the European System for Financial Supervisors, that's a micro supervisory thing. It's based on four pillars. What you established at the European level is representatives from all the 27 countries, and they keep an eye on the micro side from all pillars. The one is the banks, the second is the insurance companies, the third is the institutional investors, including pension funds and the last one is some part of the real estates.

They try to move towards a single rulebook, they ensure harmonised supervisory practices so that if some of the national supervisory boards are too weak, the tell them, "Please keep an eye on this or that." They're strengthening the other side of cross border groups and they're establishing a central European database aggregating all micro information. So, again, they don't have power to follow up if they don't care. So we need, again, to put this missing link into the system, otherwise I feel it will not function.

The system's effectiveness will all depend on the agencies' powers. Regulatory nationalism still means that there is still no clear European resolution mechanism for big cross border bank's failures. Where do you go in? Where do you behave? Where do you belong, right? So, in a sense, insisting that we have our national competence and nobody should take that away from us, is the same as saying, "Hereby we have decided that they can begin to take it away from us" because the cross border banking cannot be regulated by ourselves alone without doing it together with the others.

So, the interesting thing is, dear students, that this regional level of governance is just taking shape now but it should still be stepping stones towards more enforcement and it should be very clear stepping stones towards global governance.

I think I would be attractive by proposing to you tonight a whole new body called World Financial Organisation with the same competences at the WTO, for instance. That would be a wonderful world. Well, you could have intervention mechanisms at the global level as WTO have. But I must confess that it will not be that easy, so why don't we go alongside with strengthening the IMF, getting the standards, plugging regulatory gaps, enforcing and creating sanctions connected to the IMF.

I see small signs that it's moving in that direction along with the simple fact that the G20 could agree on moving 5% voting rights from the richer world through the emerging countries. It's not much but it's a starter and I know that Dominic Strauss-Kahn, the Managing Director of IMF, he's so heavily involved in reforming this IMF institution, that I feel , in a sense, obliged on behalf of the European progressives to say, well, "Let's support this reform process and let's try to reinforce the G20 along the lines I've just described."

Last point, Basel Three. I think regulatory capture was at work since the mid-1990s in the design of capital regulation, but the funny thing was that the banks themselves influenced that regulation as they themselves influenced regulatory capital on the basis of their own quantitative risk models. So the usual suspects were asked to regulate themselves in a sense. And that meant, of course, that the Basel Two was a voluntary coping practice, which of course also meant the interpretation of Basel Two was very different from place to place.

Thus, financial stability has to be put at the heart of a new Basel Three. Counter-cyclical prudential policy is needed to control credit expansion. All systematically important financial institutions should be covered. Instruments must be strengthened and I had, to your info, just a long meeting with Joaquin Almunia, the Commissioner for Economics and the way he presented, at a meeting that we had recently in Brussels, his agenda for regulating the banks was very very promising, I must say. It was very close to what I have been describing here.

So at the end what I'm trying to say to you is that I'm still an optimist but not a naïve one and if we want to regulate in a good way, we should be very very smart, work very very hard, ensure that we are capable of communicating to ordinary people what we are doing and really really capable of making political networking.

The last point about networking is that when I look upon the continent, I feel still that in France and in Germany there is a robust understanding of regulation, I hope and I wish this would be the case also in the UK. It's the case here in Oxford, I realise, but Oxford is not the same as City as you know. I hope that the `[[argument 0.46.50]]` can make the case.

And then, at the end, just to provoke you a bit. Dear students, we need a transaction tax. We do. I was Prime Minister at the time when we had United Nations summit for Social Affairs in Copenhagen and there was one President who stood up – that was François Mitterand He stood up and he said, "Well, why don't we realise the Tobin tax?" And there was silence afterwards, nobody said anything. I tried to say, as the Chair of that UN summit, that that was a good idea but I didn't because I looked at the body language of all the others and, after all, I did want to have a good conclusion.

But what I want to say to you now as a last point, go into it. I have been working very hard with the transaction tax in Brussels. Three think tanks have been involved. We have worked with the Austrians, with the Australians, with the best minds you can have in Europe and we have now, I assure you, a well-documented proposal for transaction tax. It's backed up by the Austrian government. It will be backed up by the Greek government. It is backed up by the Australians and if you look at the Doha UN round recently this summer, they are proposing it directly. It's a part of the agenda of the G20 if you read the text, but a bit progressive, right?

By my fundamental point is that you should not fall into the loopholes the Tobin tax did by saying, "Let's separate the cross border financial transaction from the national transaction." Don't do that. It's all inclusive now. Second point, you should not exclude some products and say, "We will not go into that." It should all-inclusive also on the product side. And by the way, we have already the transaction tax. You have the stamp tax here in the UK, they have transaction tax all over the place, focused on some products on the financial market, but what I'm trying to say to you is transaction tax is not something we just pick out of the air. It's there and now we know how to do it.

If you make a financial transaction tax on all financial transactions, including those mechanic, short-selling procedures which hedge funds make. They make thousands of machine mathematical buy and sellings per day, thousands of them, and that beefs up, of course, the whole volume of transactions. If you include such transactions in your transaction tax and you just say, 'Due to the massive volume, you can make a very small transaction if we take the following: 0.05% of the volume of transaction. That's one half or one tenth of a percentage. If you do that, calculations shows us that this could, in the German economy, the biggest in Europe, finance more than half of the deficit of the actual public finances in Germany.

So, talking about burden sharing and talking on the middle road about financing in a solidaristic way the developing countries and emerging countries to come out of this financial crisis, I just say to you, there are a huge huge possibilities in this financial transaction tax.

Here we go. I talked to long. I hope you will forgive me. Thank you very much.