

**Prof. Dr. h.c. Christa Randzio-Plath**

---

**President of the Women`s Council of Hamburg**

**Former Member of the European Parliament**

**Former President of the Economic and Monetary Affairs Committee of  
the European Parliament**

**THE FINANCIAL MARKET CRISIS: SOCIAL DEMOCRATIC ANSWERS  
SPEECH IN JAKARTA, FEBRUARY 2009**

## **CURRENT SITUATION: THE MOST SERIOUS FINANCIAL MARKET CRISIS FOR 80 YEARS**

***“Financial markets require political shaping – also across national borders in the age of globalisation. Our commitment: As much competition as possible, as much state regulation as necessary.”***

**from the Programme of Principles of the Social Democratic Party of Germany**

**We are currently in the middle of the most serious financial market crisis for 80 years and can see that capitalism cannot survive. In the USA and Great Britain, the two countries which until recently had been pursuing the creed of pure uncontrolled capitalism, a large number of banks have now been virtually nationalised and rescue packages running into twelve figures have been set up for the financial sector.**

**The root of this problem is to be seen in a systematic crisis of world-wide financial markets which was virtually inconceivable as recently as a few weeks and months ago. This financial market crisis has also been caused by financial market players who have regularly disregarded even minimum standards for creditworthiness, risk and liquidity backing in their hunt for a quick extra profit, for a 25% return. In the final analysis, this has resulted in the loss of all contact with the real economy. Anybody who did not wish to become involved as a financial market player in this respect was simply excluded. Become involved or go away, that was the alternative. Too many have decided to become involved.**

**This was also made possible by regulatory errors, which tolerated a**

lack of transparency and which permitted incorrect economic incentives. It was thus possible for dangerous risks to be shown off the balance sheet. The financial institutions were able to carry out risk business without any capital backing and were even able to pass on risks which they had taken on in the form of increasingly complex “structured financial products”, derivatives and other instruments such as “collateralised debt obligations” (CDO) or “asset-backed securities” (ABS); these were passed on in full to other investors. This resulted in a real estate bubble of unimaginable proportions in the USA; when it burst, the shockwaves spread throughout the open world finance system. The bursting of the bubble triggered off the crisis, but it was not the original cause of the crisis.

The insolvency of the fourth largest investment bank in the USA, namely Lehmann Brothers, which was more than 150 years old, dramatically exacerbated the crisis. Since that time, the financial world has changed. In consequence, the most important capital in the financial sector, namely confidence, has almost completely disappeared. When banks no longer trust each other and when potential investors no longer trust the entire sector, no money flows between the participants on the market, and no funds are available for investments any more. This is a dangerous situation. And this is the reason why the countries throughout the world have had to act and, with concerted systematic answers, have had to provide the financial markets with a firm screen under which confidence can return.

In addition, we have to ensure that such a dangerous crisis can never re-occur, that any excess is successfully limited and that a highway code is applicable for the global financial system, with no exceptions. This can happen only with a strong community of states acting in

**concert; it has to enforce such rules and engage global organisations such as the IMF to control these rules strictly.**

### **Future needs**

**The social market economy, which has been shaped to a considerable extent by social democrats, trade unions and responsible entrepreneurs, has encouraged social harmony. On the other hand, unregulated financial and capital markets which are left to their own devices endanger the social market economy. Exclusive orientation on short-term and excessive yield expectations results in recurring dangerous crises for our economy and endangers social cohesion. Financial markets are not the epitome of economies; they are designed to serve economies. They have to guarantee the proper functioning of the economy and ensure that adequate capital resources are made available; they also have to provide people with secure and profitable forms of saving and investment for retirement purposes and key private household investments. They have to serve the people.**

**We are aware that national and international financial markets are of key importance for developed economies. Stable and efficient financial markets channel limited capital to where it is needed. They provide companies and private households with capital and provide people with secure and profitable forms of saving and investment for retirement purposes. However, the international financial markets are no longer performing their duties properly. The focus on short-term returns and unilateral orientation on shareholder value prevent investments and the formation of real capital and thus growth and employment.**

**In the current crisis, it is becoming apparent in a dramatic way that**

**world-wide regulation of the financial markets was to a large extent inadequate. The weak points and risks are now becoming clearly evident: Inadequate capital, liquidity and transparency requirements, incorrect incentive systems, insufficient product understanding, inadequate risk analyses as well as the widespread blind reliance on the market's ability to regulate itself (a concept which is remote from reality). Overall, it can be stated that the financial sector has wrongly focussed on very short-term products and refinancing instead of a stabilising long-term orientation.**

**It is now becoming apparent that we need a new balance between financial markets and the state which in the long run will lead to more stability on the financial markets. With our ideas, we intend to make a contribution to a new national and international balance. Only with an efficient and new international highway code will it be possible for new confidence to be gained between the companies in the financial services industry, companies in the real economy and female and male citizens. And this is the only way in which we can achieve new stability on the financial markets and thus in our economies.**

**14 measures for more transparency and stability on the financial markets**

**We need a new balance between the financial market and the state in order to avoid losses in terms of growth and prosperity for the people, in order to identify potential sources of crisis on the financial markets at an earlier stage and also in order to achieve greater success in limiting the effects of such crises. We also need a commitment towards a culture of sustainability on financial markets. All financial products and actors have to be regulated and supervised. For developing**

**internationally agreed rules for the financial markets, the following 14 measures can contribute to stability and sustainability in the financial markets:**

**1. Higher liquidity and capital backing for the financial institutions!**

**The regulatory liquidity requirements must be expanded, greater consideration must be given to liquidity risks, liquidity cushions must be created, stress tests optimised and the regulator must be integrated to a better extent. The capital requirements must also become much more stringent. We demand minimum capital ratios. This is applicable not least for hedge fund loans, for which a minimum of 40% capital backing must be applicable in future.**

**2. Stricter accounting obligations for financial institutions!**

**Risks in future must be clearly shown on the balance sheets of the financial institutions, and it must not be permitted – as has previously been normal – for them to be spun off into special-purpose vehicles. The EU Banking Directive is not yet sufficiently precise in this particular respect. We consider that it is urgently necessary for risks to be detailed in accordance with a standard scheme. The current “fair value measurement” must be optimised in the light of the crisis.**

**3. A minimum of 20% retention for securitisations!**

**We need greater risk awareness in the entire financial system. The distinction between the decision to extend a loan and the responsibility for the related risk must be discontinued. Accordingly,**

**it must no longer be possible for financial institutions to securitize and pass on 100% of their credit risks. In our opinion, an international regulation must be created specifying that in future they will have to bear at least 20% of the risk themselves.**

#### **4. Harmful short sales must be prohibited!**

**Harmful “short sales”, in other words uncovered speculation in relation to falling share prices, have exacerbated the financial market prices. Such harmful short sales which exacerbate crises must be prohibited at the international level. Adjustment of incentive and compensation systems!**

**5. Anybody who benefits from profits must also bear losses. By means of changes to incentive and compensation systems in the financial sector on the basis of an international code of conduct, we intend to ensure that individual errors in future will involve individual sanctions.**

#### **6. Personal liability of those who are responsible!**

**The principle of “privatise profits, socialise losses” is unacceptable for us. We need international standards for stronger personal liability of players on the financial markets. Their responsibility must also be reflected in the possibility of joint and individual liability.**

#### **7. Strengthen European regulation!**

**The European regulation system must be further developed. Although initial steps have already been taken, they are by no means**

sufficient. The national and supranational co-operation of all regulatory authorities in particular will have to be anchored in the EU Banking Directive. In the next stage, the board of regulators involved in an international bank must be authorised to take binding decisions.

#### **8. Improved ratings!**

The establishment of a European Rating Agency as a counterpart to the agencies which so far have existed solely in the USA should be reviewed. The advisory activity of rating agencies must be restricted. Rating agencies must agree to apply the IOSCO code of conduct – to be further developed. A European agency – for instance the Committee of European Security Regulators – should register and control rating agencies. The significance of ratings for assessing risks should be reduced.

#### **9. Central and new role for the IMF!**

We require stronger early warning resources and better co-operation between the IMF and FSF. For this purpose, the core competences of the two institutions should be combined and enhanced. A joint annual report of the IMF and FSF could in particular enhance the effectiveness of crisis prevention.

#### **10. Strict regulation of hedge funds and private equity funds!**

Hedge funds and private equity funds must be controlled and regulated more effectively. Key aspects for us in this respect are: Obligations for disclosing asset and ownership structures, more

**stringent obligations regarding the disclosure of risks for investors, restrictions applicable to excessive debt financing and investment restrictions.**

#### **11. Demand more transparency for state funds!**

**We welcome the recent progress initiated by the IMF regarding the commitment of government funds to provide greater transparency, and we support further international, European and bilateral steps towards constructive integration of state funds in the world financial system.**

#### **12. Strengthen participation rights for employees!**

**Co-determination within a company is a key instrument for maintaining the company in the long term, and must therefore be strengthened. The sanctions for violating the information obligations of companies with regard to works councils, which have been expanded with the Risk Limitation Act, must be significantly increased.**

#### **13. Dry-out tax oases!**

**The international tax oases and offshore financial centres which are to a large extent not subject to any regulation and law must be dried out. In particular, tax evasion must be combated decisively. New methods will also be necessary in this respect. Unfortunately, tax oases and “parking spaces for illicit funds” are still to be found in Europe. Europe must therefore play a leading role in combating this problem. We demand that the EU Interest Directive be revised with this objective in mind.**

#### **14. Maintain Germany's three-pillar model – consolidate Landesbanken!**

**The three-pillar German banking system with a local structure consisting of savings banks, co-operative banks and commercial banks is a good concept. The structures of the savings banks and the co-operative banks have demonstrated their stabilising effect particularly in the current prices. This is a further reason why we reject the conversion of the savings banks into joint stock corporations and other private organisation forms. The Landesbank sector must be consolidated horizontally. And serve as regional development banks.**

#### **Reasons for the financial market crisis**

**The financial crisis was triggered off by the bursting of the US real estate bubble with a consequently sharp increase in defaults particularly of mortgages extended to borrowers with a low credit standing (subprimes). The structural weaknesses in the global financial system have subsequently been clearly revealed.**

**In recent years, the development of the financial markets in the industrialised countries has been characterised particularly by the increasing dissemination of products and techniques which enable illiquid receivables and individual risks to be converted to a form which is negotiable. This process is known as “securitisation”. The pooled and structured loans and credit risks are sold on particularly in the form of asset backed securities (ABS) or collateralised debt obligations (CDO). The purpose of separating the credit risk from the underlying**

credit is to achieve diversification for credit risks and also to achieve increased scope for additional lending. However, some of these products are extremely complex, and at the same time exacerbate the lack of transparency, because investors were no longer aware of what volume of what specific risks they held. Moreover, the process of securitisation also resulted in a significant breakdown of the link between the risks which are involved and the risk audit which normally has to be carried out by the lending institution.

The new structured financial market products with which different risks are combined in various ways gave rise to the illusion that the risks were reduced to homeopathic levels in this way and that they no longer existed. This serves as a reminder of the chimney-policy of the industrialisation process: Chimneys which were as high as possible were intended to remove the dirt as far away as possible. And indeed, the structuring process reduces the risk of an individual investment for the originator of the investment. However, as in the case of the subprime products, these proved to be an incentive to take on exorbitant risks which were not adequately priced. Moreover, the risks were channelled back onto the balance sheets of the banks (by way of credit lines extended to special-purpose vehicles sponsored by them). When the risks actually materialised, the affected financial institutions were forced to absorb the financing difficulties of the special-purpose vehicles by transferring the assets of these special-purpose vehicles – with corresponding losses – to their balance sheets. The inadequate pricing of product risks, lack of transparency and re-intermediation of the products in the final analysis meant that nobody was able to make a reliable assessment of which players on the financial markets held risk positions. Confidence in the financial market players accordingly disappeared, as did the confidence between the financial market players

**themselves. The disappearance of confidence meant that interbank trading de facto came to a standstill.**

**In view of the complex nature of the international finance system, the existing risk management systems of financial institutions, rating agencies and investors have failed to a large extent.**

**Their procedures (lacking transparency) for measuring the risks proved to be inadequate. The inadequacies of risk management were exacerbated at the financial institutions by considerable problems of capital and liquidity management. In addition, the regulatory authorities failed to devote sufficient energy to identifying the risks of special-purpose vehicles, hedge funds and private equity as well as financial products which were virtually incomprehensible. At the same time, the compensation and salary systems of many traders and investment bankers bore virtually no relation to risk and reward, and set inappropriate incentives. Whereas high bonuses and salaries were paid when business was profitable, personnel consequences for the responsible players were frequently absent in the event of losses. The accounting rules were not consistent with the requirements applicable for transparent risk presentation.**

**Crisis management: Regain confidence!**

**In order to prevent the global financial crisis from spilling over into the real economy, and to prevent savings and jobs being exposed to risk, quick action will now have to be taken in order to ensure confidence and stability. We therefore support the rescue package of Federal Minister of Finance Peer Steinbrück for stabilising the financial sector; this package has been developed in close liaison with the other member**

states of the EU and the G7 partners, and is being accompanied by similar measures in Great Britain, France, Spain and other European countries as well as the USA. In view of the general decline in the overall level of confidence, we need a comprehensive answer for the entire financial sector.

We explicitly support the efforts of the federal government to force through the direct international harmonisation of applicable accounting rules for the third quarter of 2008. This apparently technical change is of crucial importance for overcoming the current crisis: As a result of this harmonisation, certain financial instruments which currently do not have any market value in future no longer have a significant impact on the balance sheets.

It is also at least as important to set up a financial market stabilisation fund of EUR 100 billion to guarantee the refinancing and solvency of the German financial market. With the resources of this fund, the state will issue guarantees of up to EUR 400 billion for refinancing German financial institutions. The guarantees will ensure that the resources at the institutions will again be lent to other financial institutions. The fund supports the capital backing of the financial institutions. In order to strengthen the capital of companies in the financial sector, we are providing so-called “recapitalisation funds” of EUR 80 billion (EUR 70 billion plus a reserve of EUR 10 billion). This support is contingent on stringent conditions – this is an important aspect for the project group. The financial institutions must make an appropriate payment for taking advantage of liquidity and refinancing aid. And in return for recapitalisation, the state receives shares or other participation rights which are to be serviced in the long term (generally 10 years) by the financial institutions even after they have recovered. In our opinion, the

**support must be provided in conjunction with conditions relating to business policy (in particular lending to small and mid-size enterprises), the extent of management compensation or matters of dividend payments. In our opinion, it would be appropriate for the bankers who benefit from the protection screen provided by the tax payer not to receive compensation of more than EUR 500,000 p.a.; in addition, no bonuses, no severance payments and no dividends should be paid.**

**We welcome the fact that the European Commission has announced that the European aid rules will be applied in a flexible manner for the rescue packages, and invite the commission to apply aid law in this particular field – as is the case in other fields – in such a way that the political decisions which are based on a broad democratic consensus can actually be carried out in reality.**

**Crisis prevention: Highway Code for a new balance between financial markets and the state**

**Successful crisis management is one thing. However, in addition to the direct crisis management of the G7 states, the European Union, the European Central Bank and its member states, it is now necessary to improve the stability of the international financial markets so that such a crisis will not be repeated. World-wide regulation of the financial sector is necessary for this purpose. Financial markets must not be viewed as an end in themselves. They have to serve people. This was our position even before the financial market crisis – and we were severely ridiculed for this opinion. Since that time, the concept of the “locust” has been on everybody’s lips. We stated that capital returns of more than 25% as required by the financial industry are excessive – and we have been proved right. Even at the EU level, as recently as in 2007, parliament and**

**the EU Commission only just succeeded in preventing long-term financing being abolished (fixed interest loans on the financing side and the Pfandbrief on the refinancing side) and being replaced by a short-term model based on Anglo-Saxon systems. The EU Commission has now changed its attitude and has now submitted proposals for financial market regulation which point in the right direction.**

**It is plain for all to see that the markets cannot stabilise and regulate themselves. The most severe financial market crisis for 80 years has now opened a window for installing a world-wide highway code which will be applicable for the financial markets.**

**A necessary new balance between the state and markets requires more transparency and more intelligent regulations so that all participants – investors, financial institutions, regulatory bodies – are able to recognise the risks promptly and also to measure and control them appropriately. Only then will we be able to utilise the potential of the financial markets for growth, prosperity and employment. However, self regulation is not sufficient in order to restore confidence in the financial markets. It is now necessary for effective rules to be specified and enforced.**

**The leaders of the European Social democratic parties agreed to a new progressive roadmap for jobs and real value. The global financial crisis is the end of unregulated market fundamentalism. We knew that the market could not do it alone, now everyone knows. We need more than ever a social democratic regulatory regime for financial markets. We must never again permit the financial market to dominate our social market economy. Social Europe must triumph over greed and irresponsibility..**

**Preventing the financial meltdown was the first urgent step. Now we urgently take action on a second stage: to build better regulation and do all we can to avoid the financial crisis turning into a long-lasting recession. We must protect Europe's citizens from the worst effects of any recession and frame the appropriate national and European policies. Conservative free market ideology has plunged Europe into crisis. This crisis was avoidable. The financial markets' excessive and risky debt, excessive remuneration, conflicts of interest, and lack of transparency are all the result of a lack of regulation. Putting in place a sound regulatory framework is our urgent duty.**

**The PES wants markets to function better. For us, the market is our servant and not our master.**

**The PES stands for:**

- 1. Universal legislation covering all financial players with supervision across the financial markets reinforced.**
- 2. Transparency and disclosure including of debts**
- 3. Mandatory 'capital requirements' for all financial players**
- 4. Rules to prevent excessive borrowing**
- 5. Limits on executive pay and remuneration and mechanisms to ensure that earnings reflect losses as well as profits in the financial markets**
- 6. New rules to prevent conflict of interests**
- 7. Protecting workers interests such as by ensuring that employees are consulted during all takeovers including leveraged buy-outs**

**The PES will continue its work in close cooperation with the US Democrats and other progressive forces, including the trade union movement, to move in a common direction, converging over time. The PES supports a World Summit on global Governance.**

**We must take urgent actions to protect all our families against losing**

**their jobs, their homes, their savings. A roadmap for action urgently needs to be put into practice to prevent mass unemployment and encourage economic growth and an ambitious green growth strategy to jump start recovery and create jobs.**

**It is necessary to master the crisis also in the interest of the developing countries. They are affected by the energy and food crisis but also by the financial markets crisis and the crisis in the real economy in the developed world. All countries must stick to their commitments concerning the Final Declaration of the Doha Round and fulfil their obligation to engage at least 0.7% of their GNP in order to contribute to fight poverty and hunger and reach the Millennium goals by 2015.**