



# Who Runs Britain? Robert Peston lifts the lid on Britain's new ruling class and how they affect us.

**Speakers**     **Robert Peston**

BBC Business Editor

**Paul Myners CBE**

Chairman of the Personal Accounts Delivery Authority

Chaired by: **Matthew Taylor**

Chief Executive RSA

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## **NB**

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**Matthew Taylor:** Good evening. I'm Matthew Taylor, Chief Executive of the Society. The subject for this evening's debate is Who Runs Britain? And we're delighted to be welcoming award winning journalist and author Robert Peston to speak. Robert, as you know, is Business Editor at the BBC. We also welcome Paul Myners CBE, chair of the Personal Accounts Delivery Authority, the body tasked with implementing the UK government's plans for a new National Pensions Savings Scheme. Paul will provide, I am sure a very thoughtful and informed response to Robert's address.

Rob Peston's book "Who Runs Britain? The Super-rich and How They're Changing Our Lives" is published by Hodder and Stoughton today and will you now please join me in welcoming Robert Peston and Paul Myners.

**Robert Peston:** Well thank you so much for coming. If you'll forgive me I just wanted to start by saying that in one sense this is a very strange sort of evening for me because this was very much a joint project. A wonderful woman called Kate Jones, who was my agent and more importantly my friend was really very responsible for this book happening at all. I suspect if it hadn't been for her I wouldn't have got my act together to do it. So she's very much to blame and the awful thing is that just under a week ago she died, terribly unexpectedly, and it's sort of made this whole business of publishing and launching the book really rather odd and rather sad for me but I just wanted to start by saying thank you Kate.

Now if you'll forgive me I'll now get on to the less serious matter of my book and the book I suppose in a sense starts with this adolescent in north London growing up in a Labour supporting household sort of believing that the gap between rich and poor, the narrowing of that gap which had gone on for most of the 20<sup>th</sup> century was a given, it was a natural law that the UK would become over time a

more and more unequal society and then we had this, what you might call, a bolt from the blue, Margaret Thatcher and first, like many people I was slightly shocked by the arrival on the scene of the great woman and then equally to my surprise I discovered that some of what she did I rather approved of. That the incentives she gave to entrepreneurs and businessmen to perform by reforming the tax system, cutting taxes, privatisation, that she did, this seemed to me, when translated into economic growth and the faster economic growth that we were then experiencing, to be a thoroughly good thing. I began to think that markets were a thoroughly good thing and although I kept this residual unease about the widening gap between rich and poor which started in 1979 and became a very pronounced trend throughout the 80s and through most of the 90s, funnily enough until John Major got elected, nonetheless with the cake getting bigger I thought, 'Well, you know, this must be a good thing,' I almost signed up for the greed is good thesis and broadly speaking, however, as a what was then a City editor of a number of newspapers I would constantly say, "Hurray," when businessmen got enormous rewards, if those rewards were linked to the performance of their companies because millions of us were investors in their companies through our pension funds. So if their companies were doing well we were doing well and of course the economy was doing better and so that was me up until about 2002. Then I was City editor of the Sunday Telegraph and I began to notice something rather odd that people were, largish numbers of people were making, not just good rewards, not a million or two but tens of millions of pounds, hundreds of millions of pounds. There was this bonanza in private equity and hedge funds in particular in the City among a certain new class shall we say a financial entrepreneur and this is one of the sort of outliers, lots of people were making tens

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of millions, hundreds of millions, this chap, Jamie Simons, brilliant individual set up a company called Renaissance Capital, one of the world's great hedge funds, he managed to earn in 2006, \$1.7bn, that's equivalent to 40,000 US workers on medium earnings. So one guy's salary in a single year could employ 40,000 Americans and then another pal of mine, Philip Green, the guy who bought BHS and Marks and Spencer, single year receives a £1.2bn dividend, tax free, because his wife happens to live in Monaco and therefore they don't have to pay tax on it, that's equivalent to 54,000 British workers on average earnings. Quite a lot of money isn't it really?

So what we're seeing here is the widening gap, not just the gap widening that it had under Margaret Thatcher, but under New Labour, interesting an allegedly left of centre government, the super-rich, the people at the top are just accelerating away. So the top 0.1% of earners, and these statistics are a couple of years out of date so it's probably more than 4% now, were taking 4% of all aggregated personal income in the UK. It's a bit less than the share of the super-rich in the States but it's broadly double the average you would get in the rest of prosperous Europe. So it's a pretty powerful statistic about the increasing inequality. It's quite difficult to get a firm handle on what you might call Rich Britain but there are a number of statistics I'll throw at you very quickly; 30,000 in the UK, again these are a bit out of date so it'll be a bit more than that, a couple of years ago were earning the proverbial \$1m a year and the deputy governor of the Bank of England comparatively recently point out that only a year ago 4,200 in the City were earning more than \$1m in bonuses. So it's a good chunky number. So part of my thesis is this is a sort of neo-Victorian age. We're getting these huge fortunes being created, dynasties are being created, people are accumulating wealth on a scale that they

can't spend in their lifetime, their children couldn't spend in their lifetime, their children's, children's, children's, children's, children probably couldn't spend unless they are fantastically wastrel and stupid which of course you normally are when you're a few generations down the track but nonetheless when you're accumulating money on this scale you are genuinely, in my view, accumulating power.

So part of me says, "Good luck to them," you know if you've got the opportunity to make a fortune I'm not going to be one of those people who says you're doing the wrong thing, if you want to do it you do it but the point for me is that this shows that markets don't work efficiently. The whole point about markets, why do I love markets, it's because they are on the whole better than the equivalent socialist-controlled economy at allocating capital, distributing resources, making sure that the right bits of the economy get the money they need to grow. However, when individuals are making money on this scale that's pretty strong evidence to me that markets aren't working properly, that capital is not being allocated efficiently. In simple terms these individuals were not taking as much risk as I think they ought to have been for the kind of rewards that they were taking. So my basic thesis is, this is a significant failure of the way that markets weren't working.

Now remember this is Blair and Brown, just to go back over these equality statistics, there's a particular statistic by which people measure equality and inequality, it's called the genie coefficient and under New Labour, the genie coefficient actually for most of Britain, not all of it but it shows that Britain is becoming a more unequal place and this is the other thing which I find extraordinary and this is all to do with those people right at the top. For quite a lot of the early years of New Labour on

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this measure the 10% richest versus the 10% poorest, you know the 90/10 measure, actually the gap between rich and poor narrowed. Through most of Labour if you were very poor you got worse off and if you were very rich you got better off but if you were sort of not too poor and not too rich the gap sort of narrowed a bit but even on this measure in the last couple of years inequality has increased and that's all to do again with this extraordinary, extraordinary financial power of those right at the top.

So this chap's called Soros, you might remember him he made a few billion a few years ago when he basically sold Sterling out of the Exchange Rate Mechanism. He, I think, knows a thing or two about markets and I rather agree with him that broadly speaking the notion that markets move naturally towards equilibrium is wrong. I think most of the evidence indicates that markets tend to move towards disequilibrium. So this was my moment of crisis in about 2002/2003 I had this touching faith in markets but I'm beginning to lose it. So first of all I think to myself, 'Well who am I going to blame about this?' Well one of the things that annoys me straightaway is why aren't I getting some of this. I mean I'm saving in a pension. I've been... because I've moved around a bit, I have a pension when I was at the FT. I've got a pension at the BBC. Why aren't I getting these amazing rewards through my pension? Because it's patently clear I'm not, we're living in a period when pensions have got these enormous bloody deficits and it turns out that very few British pensions are putting money into hedge funds or private equity. The rewards are being shipped overseas or going to wealthy individuals. There are pension funds investing in these things and we'll get on to those things in a minute, unfortunately they're not ours. So I go and see this chap he's called (*inaudible*) he's a good bloke and I've known him for a while and I have a lot of time for him because he's an Arsenal

supporter. So I went to see him and he says to me, he says, "Don't worry Rob millions of teachers are benefitting from the extraordinary returns that ((Pamira?)) is making. Unfortunately, I then asked one question too many, it turns out these are not British teachers they're American teachers because American pension funds and American universities, of course, piled into hedge funds and private equity. British institutions didn't for a whole variety of reasons but it means, I'm afraid, that you and I haven't benefitted from this boom and I'm afraid I sort of slightly take the view, as you can see, that British pension funds are the Soviet Union of global capitalism. What I mean by that is that they engage in a whole series of practices, some of it's imposed by regulation, some of it is just the inertia of these things which leads to a sort of levelling down for all of us rather than a raising up. That was the first stage of my re-education.

The second stage of my re-education is I then noticed this great debt bubble. Here's this word leverage, it's very much a phrase of the moment. It's not in common usage. It's the sort of jargon that investment bankers like to use so that we can all believe that they are the high priests of the financial world. They don't want us enquiring too much about what they're actually doing but they're originally something very simple it just means debt really and there was just too much debt around the place being provided too cheaply to too many people and we've seen the manifestation of this great debt explosion. We've seen it in private equity. We've seen it in hedge funds and we've also seen it in the housing boom in this country. One of the reasons house prices have gone up so far is that there's been too much debt available too cheaply.

And so what's this all about? Well there is a sort of big underlying macro-economic trend here which is, as we

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know, vast surpluses are being generated in the great exporting nations of the world, China, India, Middle East through oil, Russia through oil, vast amounts of cash being generated, Japan still an amazingly important generator of cash and what actually happened during this period is that this cash was recycled from that part of the world to lend to all of us and in a piece earlier today I talked about investment bankers bollockese the sort of nonsense language they talk to disguise what's really going on that they thought that what they were doing in channelling this money was the equivalent of what happened with the great internet boom and that they were building this great sort of financial superhighway linking the services of the East to the West and again, this is something which has recently attracted a bit of attention, it should have attracted attention a long time ago, structured finance, broadly speaking what happened was because of this cheap debt, debt was provided in America, and this is really what's brought the party to an end, to almost anybody who wanted it. So you've heard of subprime and the great disaster of that particular sector of the US housing boom. In reality, in lots of cities there were adverts put out by mortgage companies saying, "Doesn't matter whether you've got a credit history, doesn't matter if you're straight out of prison, you can have a mortgage," and \$1.4, 1.5 trillion was lent to people who simply didn't have a hope in hell of paying the money back. These loans were then parcelled up into bonds through a complicated, or actually not terribly complicated, but by a process of getting some insurers to insure these bonds, by getting some, what are known as credit rating agencies to do some completely spurious sums, a rating, triple A credit rating was ultimately put on these bonds which was created from all this crap. When it's got a triple A rating on it, it means that it's absolutely fit for consumption by widows and orphans, unfortunately therefore a lot of widows and orphans, via

their pension funds and various banks all over the world, bought these things and we'll get onto the consequences of that in a minute. Also at the same time, and this is particularly true in 2005 and... sorry 2006 and 2007, a lot of very cheap debt made available to by companies all over the world, I mean you've heard of them, various estate agency companies, you know, vast numbers of companies bought for too high prices with too much debt in a buyer boom. Interestingly through all of this the Treasury thinks all of this is great. We've got the City which is booming so it's one of the great success stories of the UK economy and broadly speaking thinks, 'This is something we should encourage,' and they encourage it to an extraordinary extent. They actually turn up... you know I've been talking to you about the tens, the hundreds of millions of dollars that these individuals are buying, excuse me are earning, significant numbers of them pay zero tax. I mean you've probably come across the controversy over the 10% capital gains tax rate which was abolished or is about to be abolished and caused a great furore. It was sort of cloaked the abolition of that as a way of basically getting some more money out of the stars of this industry, actually, almost irrelevant to the individuals who were making the colossal sums because most of them were and are non-resident, non-domiciled, they organise their affairs so they pay next to no tax in the UK.

How did this happen? How is it that the Treasury, Gordon Brown, sophisticated individual, managed to confuse what was going on with something that was positive as it were. I think part of what went wrong I think for a period he thought that private equity, private equity in this country used to be known as venture capital but venture capital in the States is very different from private equity it is genuinely risk-taking firms with names like Kleiner Perkins and

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Sequoia. They are the genuinely... they provide the seed corn of America's economic greatness, they backed companies like Google and Yahoo and Microsoft. They take genuine risks, unlike private equity which tends to buy established businesses and then load them up with debt and make their profits essentially through a rise in asset prices and they increase their returns because of the cheapness of the debt which they have bought the companies with.

Now according to Grant Thornton, who did a bit of research on this in 2006, there are basically 54 British based billionaires paying, if you impute income to them, 0.2% tax rate. I'd love to pay a 0.2% tax rate on my income. Funnily enough when the book was published a partner who did the work rang me up and he said, "Look I'm sorry I made a mistake. I assumed that if I didn't have evidence to the contrary that some of these billionaires were paying some tax. They've since subsequently got in tax and they're not. So that figure's too high. They're actually paying less tax than that." Anyway the other sort of market failure for me and I think this is a serious point is that people who work for hedge funds and private equity, particularly hedge funds, they're brainy, they're really brainy people, these are scientists often, you know, they're fresh out of Cambridge, fresh out of Oxford, I mean you can't meet a brainier bunch of people. For me it's a market failure when they feel they've got to go and make gazillions in the City rather than finding a cure for cancer or putting people on the moon. So I think there is an economic cost and a social cost to us of what's going on.

I love the City I think the City is a great British success story but the issue for me is, is it too big, is the tail, in the sense of the economy, the City, wagging the dog of the British economy and I think there is some evidence that it does. The great news in recent years is it contributes a full third of all our economic growth but

interesting and this is some of the consequences of that. The Labour government elected in '97 saying it wanted to narrow the divide between north and south it is massively widened as a result of the relative strength of the UK. I mean I find these sorts of statistics very interesting in the south east the public sector accounts for about a third of the economy if you go north of Birmingham more or less everywhere it's well over half. In Scotland it's well over half, in the north east it's something like 70%, in Northern Ireland it's something like 70%. Arguably you've essentially got a benign socialist paradise everywhere north of Birmingham and a sort of Hong Kong south of Birmingham. It doesn't feel terribly stable to me.

Now Danny Kaye this is the guy who, now little did I think when I was growing up in 1960s north London, early 1970s north London that this was the guy who would actually help me to understand the credit crunch. You know BBC in those days was really confident about repeats, this film The Court Jester was on literally every Sunday and the point about this film is at the heart of it is poor old Danny Kaye trying to remember where the poison is and he cannot remember whether the pellet with the poison is in the vessel with the pestle or whether it is the chalice from the palace that has the brew that's true. Unfortunately then one of the goblets gets smashed and then he's on to is it in the flagon with the dragon. At the end of it he hasn't the faintest idea where the poison is. That's all you need to know about what caused the credit crunch last August because basically what happened was because of all this complex financial engineering I was talking to you about, turning all these loans to these ex-cons and these bankrupts into bonds, which were then recycled all over the world to banks and pension funds and places in Australia and Japan and Germany, suddenly there was this blinding

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realisation on August the 9<sup>th</sup> when the world's banks suddenly realised that all this stuff they just didn't know what it was worth. They saw all these people defaulting in the US, they suddenly realised these bonds weren't safe as houses and worse than that not only didn't they know what this stuff was worth, they didn't know who had it and because they didn't know who had it they didn't know where the poison was, they stopped lending because they didn't want to end to somebody who then might not be able to repay them and that's really how we got into the credit crunch and we're now into this, ghastly phrase, we're now into this process what's known as deleveraging we had leveraging, everybody borrowing, we're now into deleveraging, the banks don't want to lend to any of us any more and this what's known as the shadow banking system, I've talked about the recycling of all these loans into bonds called collateralised debt obligations, they're called collateralised loan obligations. There's the whole aspect of the way that banks finance themselves which is called through something called structured investment vehicles, you know, this bit of the banking system which none of us knew about but which contained trillions of dollars. It was trillions of dollars being recycled from the East to the West it has simply collapsed and that's one of the reasons why we're all beginning to feel a bit poor at the moment because there's less money available. It started as a liquidity crisis it's becoming what's known as a solvency crisis because when there's less money available what's been fuelling the rise in house prices, what's been fuelling the rise in the stock market that's no longer there. The fuel's no longer there. That's why house prices are coming down. That's why commercial property prices are coming down. That's why share prices are coming down. You've heard a lot about the looming US recession. You'll have noticed that interest rates have been cut very sharply over there but we're also pretty exposed over here because a lot of the

borrowing was over here. The house prices trebled here when they only doubled in the US over the past ten years. We are exposed in a very significant way to what's going on and because the City became so big. In a slowdown of course it'll affect the overall economy much more than it would had it not been the tail wagging the dog.

Now should you feel sorry for all these hedge funds and private equity people and investment bankers now that it's all going horribly wrong? Well it's up to you but they did actually trouser tens, hundreds of millions of dollars, so even if they never have to work again, why would they mind? I saw a chap called Steve Schwartzman, interviewed him the other day, he runs Blackstone, probably the world's biggest and most powerful private equity firm and he said, "Look it's all right, there's a correction going on." These people are being punished they're losing their jobs, like Stan O'Neal, the chief executive of Merrill Lynch, a bank which almost went bust in the last few months, yeah he lost his job but he took home \$160,000m as a sort of, you know, the equivalent of a gold watch and here's another funny thing about the pain that these people are suffering. Investment banks, last year, top five, their total remuneration was \$66bn that was a rise of 9% in the worst year that anybody can remember, 9% rise worst year that anybody can remember and the value of their shares since then has collapsed significantly more than \$66bn.

There's a sort of slightly Marxist phrase which has been trotted out a few times in the last few weeks by a lot of people and I think it's very apt which is that one of the failures of markets, and it is very much one of the bits of Marx that I think it's quite difficult to disagree with, is that they do have a habit of privatising profits and socialising losses.

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So how did this all happen? Well partly it happened because rightly this chap is obsessed with globalisation. He's right to be obsessed with globalisation. It's a real... it's probably the most powerful collection of economic forces at the moment and if you're going to be winning in a world where capital and labour, sorry capital and talent, capital and labour are pretty mobile, you know, you want to attract as much of the capital to the UK. You want to attract as many of the talented people to the UK. So of course there is a limit to how much you can tax. Of course he's right to be fearful of taxing too much. You don't want our most talented people to go abroad. Similarly he's right to be fearful of excessive regulation for the same reason. We want talent but if you think, as I do, that the kind of sums that these people made represents a market failure actually taxing them a bit on the margin helps to correct that market failure and just to be clear I'm not talking about a super tax I don't want to impose tax on them more than I... I'd just like them to pay what I pay that's all I care about. That just seems to me if I'm paying 40% they should pay 40%.

And to be clear I do think hedge funds, private equity play a very... in conditions where there's not a bubble I think they play a very valuable role. It is really important that there is buying and selling of companies, of assets, of shares so that you have the right price allocated and essentially investment is priced in an efficient way and goes to the right people who can use it productively. However I just don't think that's been going on recently.

So who's to blame? Well this bloke called Alan Greenspan, I do hold him to a certain extent responsible for this mess, partly because he was a great cheerleader for all these innovations over a long period of time and partly because he cut interest rates, every time the US economy got into a mess almost always there was a debt element to the mess that they got themselves into and each time rather than

allowing the banks and those people who borrowed too much to suffer he cut interest rates and this created what is often described, this is again a phrase you probably have come across recently, called moral hazard. It created a huge amount of moral hazard because it meant that if you'd borrowed too much and you'd noticed that the Federal Reserve, US Central Bank was going to bail you out it meant that the next time that there was an opportunity to borrow too much you did it because you knew that the Federal Reserve were going to bail you out again and one of the reasons the debt bubble got so big in the last cycle is because for 20 years every time the US economy got into trouble he helped out the people who'd made the mistakes and personally I think what's going on in the US at the moment, one and a quarter percentage cuts in the past couple of weeks is broadly speaking like giving a drink to a recovering alcoholic. I don't actually think it will work this time but they're doing the wrong thing again in my view.

Why have I got these chaps here? Look I think he was a bit naïve I think he put too much faith in what was going on in the City and I also think the one thing that he did that was wrong that actually, you know, private equity did that was wrong, that the banks did that was wrong, is in the good times he borrowed too much. One of the reasons, now that we're going into this downturn, that the government has less scope to cut taxes or increase public spending is because he borrowed too much over the past few years, at a time when the economy was growing strongly, in order to fund public expenditure, public expenditure's a good thing but nonetheless he should have accumulated reserves in that period so that in the bad times there'd have been more flexibility to cut taxes or increase public spending now, when we need it, so that the slowdown isn't quite as bad as it might otherwise be.

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So what now? Well as I say it's the end of that recycling, you know these people in the Middle East and the Far East have learnt their lesson. They're not going to lend, I'm afraid, to consumers any more, you know, they bought all this crap, it turns out to be crap, they're not going to lend to consumers in the US or house buyers in the US or I'm afraid homeowners in the UK any more because they're not prepared to subsidise us any more credit, will be in shorter supply for all of us. Does that mean they're not still recycling their great financial wealth to the West? No they're being actually rather shrewder. They've seen the collapse in the price of our great companies and they're buying them so what we're seeing is an enormous shift of financial and economic power from West to East. They're no longer to sort of keep us in the lifestyles to which we're accustomed but when our banks are about to go bust, thank you very much we'll have a bit of that and that will continue. I think China will buy significant British companies. There's an interesting issue about whether that's in our economic interest because there will be technology transfer. Anyway so there is this big shift going on. This just means the credit crunch is going to go on for some time and one of the things that worries me is that we don't yet know where all this poison that I've talked about, these bonds, these triple A bonds that turn out to be not quite worthless but quite close to worthless. So I think some of them will, I'm afraid have ended up in our pension funds and I think over time we will see that and we will pay a price for that. As Soros says, "I do think this is probably the most serious crash for 60 years." I'm just repeating the point that these people who helped to create this mess we shouldn't feel too sorry for them - they're on their way to a beach as we speak.

One of the lessons, better regulation obviously, more focus on basically liquidity in the system, liquidity of banks, again a bit like the government the banks should be

encouraged to build up reserves in the good times so that when the bad times come they don't have to cut lending to us when we need it.

What about tax? Here's an interesting guy. I've got a lot of time for this guy. He's actually a hedge fund supremo. He's a bloke called Jim Chanos. What he does is he spots overvalued companies and he does a very brave thing. It's quite a hard thing to sell companies that you don't own, which is what he does, when you think that they're overvalued. He basically spots emperors with no clothes on. He spotted Enron, for example, made a fortune from selling Enron at the top of the market. He spotted that all those online gaming companies were overvalued and sold them. Part of the cause of this great crisis of these insurers called Monoline Insurers, he sold them. Now interesting thing about him is that he says to me that actually he doesn't think that his industry is going to be destroyed if they pay more tax. He doesn't think people... he's based in the States, they pay, you know, actually hedge fund people in the States pay a bit less tax than we do over here, he says if taxes go up he doesn't think it'll destroy his industry. He doesn't think many of the people that matter will leave their shores which I think is salutary.

However to go back to the issue of globalisation yes I do think that nonetheless you can't deny that over time capital and talent does gravitate to low taxed economies. What does that mean? Well so in those circumstances is it worth taxing or trying to tax the super-rich at all. I think it probably is. I mean percolations in my books show that genuinely billions could be freed up for investment in, or could cut our taxes, for example, if they pay less tax we pay less tax and of course as I also point out I think it does help to create a market failure. But no government, given the problem of globalisation, given the mobility of talent

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and capital, no government can do it on its own. So what you need is you need to get over this neurosis. Governments need to get over this neurosis that they can't talk to each other about harmonising, to a degree, taxes. If the super-rich actually couldn't base themselves in any major economy. If they couldn't base themselves in the UK or the US or bits of Europe or bits of the Far East without paying at least the local tithe actually we'd all be a bit better off I think.

Why have I got him there? That is because if you think any of this stuff's interesting you can come and look at my blog and one of the great things about my blog is I put all the positive and negative comments up and quite a few people think I'm a bit like one of those things and I hope that's encouraged you also to have a look at the book.

**Matthew Taylor:** I think we always used to accuse the BBC of being closet Marxists but maybe Robert can say what closet. Okay Paul.

**Paul Myners:** 30 years ago Robert won a bronze medal in the Montreal Comedy competition for his impersonation of Margaret Thatcher. The circle is now complete with Rory Bremner doing impersonations of Robert.

This is a very good book. I think the reason why Robert suggested I come and say a few words rather than other people he cites in the book is that I'm the only person in the Marks & Spencer story who doesn't use expletives. I've known Robert for a long time. I've regularly had my Saturday mornings spoilt by Robert ringing me trying to get a story for one of his Sunday columns and we now of course know and respect him for his remarkable ability in explaining complex issues to us on our evening news programmes.

The genie is certainly out of the bottle as far as Robert describes it in terms of an increasing widening in the distribution of income and wealth in society, something which one would not have expected under

a left of centre government. The problem isn't at the lower end. In fact the Low Pay Commission, which I now chair and which was previously chaired by Adair Turner, in its annual report each year includes a graph showing how incomes have progressed at various points in the earning cycle with the bottom percentile on the left hand side, the top percentile on the right hand side and what we see is that at the very bottom there has been measurable improvement in the income of the lowest earners, the national minimum wage combined with benefit policy has had a huge impact in lifting the income of those at the bottom end of the earning spectrum and you see a gradual progression through different... as you rise up the deciles of income until you come to the top 5%, the top 1%, the top .1% where it's grown astronomically and Robert seeks to invite us to address this issue and there are significant consequences. I think we are a less safe society, we will be less peaceful with ourselves if we live in gated communities and yet those who have benefited hugely have done so without this necessarily being a direct consequence of government policy and we particularly see that now in the debate that's going on around non-domiciles.

Who runs Britain? Robert asks. Well I have some views on this and many of them are similar to Robert's but I would say that in essence I'm concerned that the City, the financial community has lost contact with its true and original purpose. Shares of companies have become tickets to trade. Pension fund trustees and investment managers do not take the responsibilities of ownership seriously, indeed they are very uncomfortable with it. One of the reasons why our major companies seem to be in the hands of a self-appointed managerial elite is because there's a vacuum of ownership. Pension fund trustees captured by actuaries have become much more

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interested in gaining the consequences of owning an asset class, equities, rather than owning businesses. Portfolios are very diversified. They have little interest in individual companies. Frequently in takeovers you find that our major investment institutions, our unit trusts, our insurance companies, our pension funds are owners of both sides of the transaction. They are both the buyer and the seller. They're hopelessly conflicted. They have no sense of real identity with the underlying business, hence the fact they also may only give lip service to some of the social obligations that come with corporate ownership. The rules of the game in terms of corporate ownership are drafted to facilitate the behaviours of investment bankers. The City code on takeovers and mergers, something which hardly anybody in the City ever criticises, they are immensely proud of something which they see as being code-based based on principles rather than detailed rules facilitates takeovers. It's almost silent on the interests of shareholders in the bidding company. It's focused solely on facilitating transactions. The City unquestioningly proposes, day after day, that mergers and takeovers make sense. A packet of cigarettes contains a health warning, takeover documents should have a health warning. It should say something to the effect that 80% of these transactions fail to deliver the value that was suggested by those who propose them. I think investment banks should be required when they issue a takeover document to put an appendix at the back of previous transactions which they also recommended as they are now doing and what actually happened with them.

We've seen the emergence of private equity as a consequence of this vacuum. Private equity is undoubtedly a bubble. Private equity has three sources of competitive advantage, they use debt, they have softer compliance and governance rules and they conceivably bring superior

operating performance. I think there's no evidence to prove, despite the work of David Walker and others, that private equity firms produce superior performance in terms of being better managed so I think we're seeing here again a phenomenon which is largely the consequence of financial leverage, of playing games with things which are too important to be played with.

The issue of wealth disparity and income disparity is in a sharp focus now because of the debate about non domiciles and it will be interesting to hear Matthew's view because Matthew was in No. 10 when much of this was happening but Brown's position before he became Chancellor of the Exchequer was very clear, that he did not favour the continuation of the favourable tax treatment of non domiciles. However when he got into the Treasury he did nothing about it until 2002, when he established an inquiry within the Treasury, so not one of his reviews, this was an internal inquiry. That internal enquiry, as far as I'm aware, has never reported. It's not possible to get any evidence under Freedom of Information of what it's done until we see a policy announcement quite recently which, in itself, was almost certainly triggered by George Osborne's announcement that the Conservative government would do something about non-domiciles. I think it's at best a policy which is not fully cooked. It has not been thought through, it is not evidence based. I have a particular plea on behalf of the Arts community, as currently drafted, any non-domicile in the UK would hastily remove any of their art from the UK for fear that it would be subject to taxation. I'm the chair of the Tate, this would be hugely damaging to our national museums and galleries if the law, as presently drafted in the consultation document issued three weeks ago by the Treasury, goes ahead as proposed we will see the removal of

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many important works of art in the UK which are either currently on loan to our museums or galleries or maybe gifted to them in the not too distant future.

I think it's a matter of public policy here around what a fair society should look like and whether we can actually look at ourselves in the mirror and say that this huge disparity of income is justifiable. I think it's perverse that we have concluded, after ten years of a left of centre government that a newly appointed police sergeant in the United Kingdom in London should have some of his income taxed at the highest rate we deem to be acceptable. A newly appointed deputy headmistress of a primary school is taxed at the highest marginal rate of taxation we judge to be acceptable in this country, 40%. That needs to be revisited but it's nigh on politically impossible it seems for any government to say we have to do something about higher levels of taxation other than index them and if we carry on in this way we're going to see an increasingly regressive form of taxation.

Finally as far as the financial community is concerned, I've talked about the weakness of equity ownership, on the issue of banking and debt I think banking is now too important to be left to bankers. Banking benefits from a public protection in a way that no other industry does. I used to think that British Aerospace had its own ministry in the form of a Ministry of Defence, the finance industry has its own ministry in the form of the Treasury and the Financial Services Authority and it's quite right and proper because banks are at the heart of the economy that money transmission and the extension of credit that they should have some form of protected status but that protected status, access to lender of last resort facilities etc. etc. is surely only justifiable to support the traditional acts of banking rather than the speculative trading of derivative instruments detached from their underlying corporate purpose. The irresponsibility of

bankers I think was captured by Chuck Prince, the now departed chief executive and chairman of Citigroup who said, even earlier in 2007 when it was quite clear there was a bubble, the music was still playing he was still dancing. This was irresponsible, particularly irresponsible when ultimately you know that if a bank fails it falls back on the public purse in some way to support the underwriting process that is required.

Robert has referred to the large losses incurred by banks, he's also referred to the fact that much of this rather distasteful paper that was created by the banking industry over recent years is now in your insurance policy, it's in your pension fund, it could even be in your unit trust. When we see estimates of the huge losses that have been incurred by banks, the billions of dollars lost by Citibank and Merrill Lynch and Morgan Stanley and others, we're only capturing that part of the asset which is in flow at the time, that part which they were left holding when the music stopped. A lot of this paper had already ended up in our pension funds and our insurance policies so I think there's a lot of woe to come yet and a lot of losses which have not yet been fully recognised or acknowledged.

The answer I think as far as banking institutions are concerned, we have to improve the quality of regulation. In particular I think the FSA has to become much more interested in the behaviour in evaluation of individuals. If, I believe, they'd been more aware of these things they might and others might have been earlier to spot the increasingly irresponsible behaviour that characterised much of what happened in the financial community over the last three or four years but I think Robert's book is an excellent exploration of these complex issues of why we've ended up with a society which is so much more unequal than anyone could have envisaged when Labour was elected to power in 1999.

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**Matthew Taylor:** Well thanks very much for that. I was just recalling as you were speaking, Paul that one of Peter Hain's many occasions when he was slapped down was when he dared to suggest the very simple and always, I have to say, seemed to me very attractive measure of creating a higher income tax rate about £100,000 and using that to raise thresholds throughout the rest of the system and actually my own experience in No. 10 was that, because I was always in favour of that idea, was that people weren't really hostile to it, it was almost inertia, There was a kind of sense that this just wasn't a subject that one would ever discuss even though actually when one discussed it in concrete terms people didn't have any particular problem with it but the idea just never emerged from the sort of places it would have had to emerge from to have been taken seriously but Peter Hain was one of the few people ever to tread on that ground and he got a good slapping when he did.

Okay so it's over to you. What we'll do is we'll take two or three questions or three or four questions at a time.

**Roland Mowthorpe:** I work at the RSA and I should probably tell you that the RSA is running a project at the moment into transparency and accountability in the financial markets. It's called Tomorrow's Investor. Robert I wanted to pick you up on one point you said that the pension funds were the Soviet Union of the UK market but wouldn't it be better if they became more socialised not less? There was a paper from the New Economics Foundation a while back which suggested that people should be able to invest their pension funds into local schools, local hospitals, and so on, this would obviously have the advantage of connecting them to their local services, it would make their pensions more secure and it would give the investment bankers less money to play around with to the benefit of us all.

**John Bailey (Journalist):** Robert neither you nor Danny Kaye mentioned much about deregulation and I wondered whether that was a factor in the malaise that you outlined so clearly. Paul did touch upon it but there wasn't much else. Deregulation yes the Big Bang I think and there's also the point, I think, that Paul also touched on about Gordon Brown's great crusade to end offshore banking havens and would that have made a difference? Would there have been any benefit had that been carried through as was suggested before the new Cons took office in '97?

**Claire Dobey:** Thinking of the title of the book does money equate to power? Who Runs Britain? Do the rich run Britain?

**Matthew Taylor:** Very good, excellent, okay simple questions there for you to deal with. Robert?

**Robert Peston:** Right in terms of pension funds I absolutely do take a view that it would be very much a positive thing if individuals took much more interest in what their pension funds were up to, recognised for example that most pension funds own a tiny slither of most British businesses and recognised that actually that confers both the rights of ownership over those business and the right to influence those businesses. Most of us in our pension funds are terribly passive. Now if and to be frank I hadn't really thought about this issue of essentially directing the resources that we allocate to our pension funds into local amenities, I mean I think if, on the margin, it forced all of us to take more of an interest in what on the whole the not very bright people who manage the money and the well-intentioned people but who on the whole just don't have the appropriate training who are the trustees, as it were, for our money, if it forced us to take more of an interest in making sure we had properly trained trustees, decent managers,

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managers were allocating the money to places where it could earn a proper return and these people were rewarded in the right way, I mean one of the things that I have to say have for a long time found profoundly shocking, one of the things that I like about hedge funds is that the hedge funds are rewarded if the value of their investments go up. Now I think there's an issue about whether they're rewarded too much but if the value of their investments go down they don't get rewarded.

Now interestingly with most of our pension funds over many years were rewarded on the basis of relative performance so if the stock market fell 10% but the value of their funds fell 9% that was a success and they got a bonus for it. Now I mean I couldn't see how my retirement was going to be funded by a fall of 9% in the value of my investment. It just seemed to me that was not an appropriate way to reward people but that was the traditional British way of rewarding the people who manage our money. So in that particular respect I happen to think hedge funds have got it right.

Now in terms of deregulation I think there was a victory sometime, it was a victory that occurred under Ronald Reagan and Margaret Thatcher of what you might call the market fundamentalists and what I mean by that is there was a victory of people who thought that the market was always right despite extraordinary evidence to the contrary. We had, particularly in the 80s and 90s these extraordinary economic cycles and every time we got into recession central banks would pump money into the system, taxes would be cut and the market would be bailed. That was perfectly obvious, to use a phrase I used recently that the markets tended towards disequilibrium rather than equilibrium and that the only way that you could keep this system on the road was for there to be massive intervention from the state and therefore the notion that even under Ronald Reagan and Margaret Thatcher

that you had this sort of non-interventionist approach is just for the birds but under the myth that markets are always right another myth arose which is that you should regulate as little possible. I think this issue of lots of regulation versus not very much regulation is not really the right way to couch it. What you want is the right regulation. Markets will always, if left alone, come up with the wrong answer and what you've got to make sure is that the regulatory structure around that actually is tackling the right things. So for me the issue is not less regulation or more regulation it is do we have the right regulation and I think the debate in this country has been for some time now that we've simply got too much and we've got to cut it. I just think that's the completely wrong was to frame the debate.

Now in terms of money and power, you know, yes I do think that money can equate to significant amounts of power and I suppose that if I'm concerned about the creation of these dynasties and this book a lot of it's about the creation of the new super-rich, it's not that many of the people who are at this moment accumulating these vast sums are obviously interfering in public policy but there are two things really, one is that I think that there is a myth and I think it is a myth that they are absolutely the sine qua non of a successful economy and therefore we dare not tax them even to the rate that the rest of us are taxed for fear that they'll go, take their incredibly valuable talents and capital elsewhere. I'm not sure that's necessarily right and that is a sort of negative power formulated by a kind of myth it seems to me but actually, and of course, and there's quite a big chapter about the funding of political parties, there is also no doubt that political parties have historically been very worried about alienating, and this is true of Labour and the Conservatives, of alienating wealthy individuals and by

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being seen to attack what those individuals think of as being their commercial interests. So again there is a negative power through the funding of political parties, however, more important for me is when an individual accumulates billions of pounds, even if he is not interested in trying to buy a political party in a sort of rather more aggressive way or setting up a think tank that will condition public opinion in the way that lots of American billionaires, for example, do, and having an influence in that way, or buying a newspaper, you know, or some other media organisation, who knows what their children or their children's children will do. There is undoubtedly a transfer of significant power going on.

**Paul Myners:** I've campaigned since the beginning of the decade to improve the quality of pension fund trusteeship. It has improved but it's still far from satisfactory, pension fund trustees, and I was a fund manager for many years, show a lack of comfort with some of the core issues involved and have often been led by the nose by the actuaries and the fund managers in a way which has not been in the interest of their members. I tend to rather agree with Robert on regulation it's a matter of having the right regulation rather than seeing it as a case of more regulation or less regulation and I would repeat the observation I made that much of this is about behaviours. After I retired I set up a reinsurance business which was based in Bermuda, which was a major reinsurance market but it was regulated by the FSA and we had to submit annual returns which ran to literally hundreds of pages, six or seven hundred pages of statistical reports. I couldn't see that the FSA could form a view on this company from those reports which they wouldn't then subordinate to the judgments that they would arrive at if they met the management and talked about the way that we were running the company and it seems to me that one of the consequences

of this move to deregulation is to make it too dependent on statistics and analysis and ratios and not enough on the ambitions and behaviours and values of the people who run the organisations.

Does money equate with power? Yes it can do. I think it clearly gives economic power. It doesn't give moral power that's the most powerful power of all and if you worship money and wealth and you can only define yourself by what you own and the things you're surrounded with and I don't think you become a powerful person. I just quickly looked in the index of the book to see whether Ashcroft, Michael Ashcroft was mentioned. He's not. There's a person who some would say has bought a political party. His dominant influence in the financing of the Conservative party for many years equates to the buying of Belize and the buying of a political party. I think that's worrying. So I think there are issues here around party political funding which we need to look at which go outside Robert's certain scope of his focus on financial markets but he does refer to this issue. I think it's dangerous that we allow political parties to become dominated by a small number of donors and on the issue of my concern about banking being too important for bankers I think one might think again whether the Glass Steigel legislation introduced in America 80 years ago, which has now been reversed, was actually fundamentally right that you separated the gambling from the banking, from money transmission and the extension of credit. We haven't done that, as a result of which we are heading towards some form of economic crisis, economic downturn, largely as a consequence of the excesses and the exuberance, the irrationality and the greed of those in the Financial Services Industry. That is a social pain which has been inflicted on us by the banking industry and it strikes me that that does raise questions about the

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appropriate regulation that we require in order to restrain the animal instincts of people that work in the financial community.

**Matthew Taylor:** Okay, sir?

**Unidentified Speaker:** Do you think that bankers' pay should be regulated and if so how would you go about it?

**Unidentified Speaker:** Paul said that banking was too important to be left to bankers do you believe that Gordon Brown made a huge mistake when he made the Bank of England independent?

**Unidentified Speaker:** Robert it would be very interesting if you could define what the super-rich is? How much money do you have to have to be super-rich as opposed to just rich and how much do you have to have to be rich but also...

**Paul Myners:** I think are people pointing at you from behind your back?

**Unidentified Speaker;** No, no, no but also are you not concerned but just at this point of your brilliant book that the government decides to tax non-doms and it's increasing the tax on capital gains tax and this is just a moment when London could lose its preeminent position if we find that all these people end up in different places?

**Unidentified Speaker:** Two questions which relate to those questions as well. First of all do you think one can actually do anything about the pre-tax inequality of distribution of income or is that a given and the only intervention is tax and secondly why would it ever make sense to increase the marginal rate of income tax at the top unless one had already returned to the Nigel Lawson equality of capital gains tax and income tax given the ease with which clever, rich people can turn income into capital gain?

**Matthew Taylor:** Thank you, brilliant, That's a good set of questions. Paul we'll start with you.

**Paul Myners:** Should the rewards of bankers be regulated? Yeah they should be regulated by the shareholders. They should be regulated by the people that own the businesses. That's what the law anticipates unfortunately the owners of businesses have shown a complete disregard hence the vacuum into which the managerial elite have positioned themselves. Very conveniently also the leaders of major business set their remuneration for each other. They all sit on each other's remuneration committee and they benchmark against the rewards of other chief executives and the remuneration committee is never going to look the executives in the eye and say, "We are a below average company which is content to employ below average people, " hence they move up the rates every year because everybody else is involved in the process and the people who are behind this giving some form of credence and support are the benefit consultants that Warren Buffet describes as Ratchet, Ratchet and Ratchet. I think a very basic principle is for companies to explain how rewards in their own company compare throughout the structure. Most companies have a pretty sensible tiered structure, I'm sure the BBC has got an incredibly simple and straightforward structure of about 185 grades, just see how those proportions, just see how they move ahead because the rewards of those at the very top of companies has grown explosively compared with others in the company. So the answer is shareholders already have that power and they should exercise it.

Secondly I think it would be one of the key questions that a regulator should ask of the independent directors of a bank is how have you ensured that the reward structure in this organisation ensures that it will be run in a safe and secure way which will not require you to have recourse to some form of emergency funding? This strikes me as being a basic

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requirement, a price to pay, a licence to operate.

Bank of England independence. Well monetary policy independence I think has been a considerable success. I think the fact that we have under a really quite outstanding governor in Mervyn King a process for setting interest rates which is independent of political interference, is a significant step forward and I don't see that the independent determination of interest rates but the MPC can in any way be at the heart of some of the issues that Robert has been talking about except if you go into the complex issue if you target conventional inflation as defined by CPI and RPI, do you allow asset bubbles to emerge and this is what Greenspan probably did and it's what Bernanke is definitely doing at the moment.

On the issue of non-doms, just for avoidance of doubt, I believe that non-domiciles have had a very, very, beneficial effect on the British economy and on British society and on British culture and I think that the proposals that have been made are over-hasty, they will not produce the income or the tax that is suggested and could be very, very damaging to British competitiveness and I want to be quite clear on that. Adair's question about what one can do to equalise pre-tax income, gosh that's a good question, you should have chaired the Low Pay Commission. I think, I'm not sure I've got an answer to that I think it's about education and opportunity to give people an opportunity.

**Unidentified Speaker:** I meant entirely at the top end I meant between 90% percentile and .02 of 1% up. I want to know what you can do at the bottom end.

**Paul Myners:** No I think the answer is primarily around taxation. Robert.

**Robert Peston:** Well just to take on ((*inaudible*)) question initially I wasn't really very scientific in terms of defining the super-rich I think we sort of know a member when you see one. I think a billion is definitely, if you've got a billion net, I

think you're a member of the super-rich. I made the mistake of just talking to a reasonably well known journalist about this and he said, "Well what have you got to have to be super-rich?" and I said, "I don't know more than £20m net?" and he said, "Oh gosh I'm not super-rich and I've got that." So you know, anyway I mean the answer is one can't be terribly scientific about it but surprisingly large, you know you find considerably more people with a lot of money than used to be the case and let's be clear I don't regard that as intrinsically a bad thing. I am very worried about this social fragmentation which Paul has referred to but my basic view and this partly takes in, I think, what Adair was getting at, I'm not remotely interested in increasing the marginal rate of tax actually, if anything, over time, one would like to see reductions both in the top rate and the basic rate, what I broadly believe is that if you belong to a club you should pay the club membership fees and most of these people derive enormous benefit from living here, whether it's the rule of law, whether it's stable democracy, even if they, as they all say, they don't use our schools and they don't use our hospitals, all their employees do and all their... and they benefit from the social network that is provided. So I just have a very simple view about this which is this is not the politics of envy this is simply, you know, if, as I say, if somebody's benefiting from the facilities in the club you pay the membership fee.

Now how do you get these people to pay the membership fee? Well actually funny enough I think there is a slight window of opportunity at the moment because actually for the first time in a long time every major Western economy has noticed that the activities of some of these people has caused their economies serious problems. US banking system in a terrible mess, the French banking system in a terrible mess. The German

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banking system in a terrible mess. The Japanese are currently sweeping it all under the carpet but it won't belong before we see the Japanese banking system in a terrible mess. All over the world the excesses of the past period are coming home to roost. This is probably the best moment that we've had in a long time to look at this whole issue of whether or not a bit of coordinated action to essentially curb some of these excesses by ensuring that these people actually don't keep quite as much as they have been making is possible, politically possible. It would require the Prime Minister to take a lead and I suspect he's terrible worried about being seen, as he always is, being characterised as in some sense as being anti-success. Well I don't think he has to characterise it in this way. I do believe that if you've got a special talent, whether you're a footballer or an artist or a banker and you're doing something genuinely creative for the benefit of all of us of course you should be properly rewarded for that but much of what these people did was not to our benefit and that's why I think we've got to have a long, hard look at the tax system. Now just how they get through the loopholes. It's the loopholes that I'm concerned about.

Now I think there were one or two other questions. On the question of the regulation of should we regulate bankers' pay? I'm not a great believer in imposing regulations if the market will address, you know, find a solution for us. I would hope that what we will now get is a market-based solution to the particular problem of bankers, individual bankers being incentivised to take terrible risks which all of us are now paying for and I suppose the reason for my optimism is because those banks, as Paul pointed out, were trying to ship all this poison out but some of it stuck on their balance sheets when the markets ground to a halt and they've suffered terrible losses and their shareholders have noticed that there are terrible losses so my

prescription, as it were, for how you deal with a remuneration system which encourages people to take excessive risks is this if you have a great year, let's say creating all these bonds out of poison and on the basis of that you generated a notional profit for your bank of x million or x ten million and on the basis of that you yourself would expect to get a bonus of a few million pounds what ought to happen is that that bonus should go into effectively an account where you can't get your hands on it for many, many years until it's clear whether or not what you've produced is poison or something that genuinely was wholesome and if you couldn't, you know, if a lot of this stuff, if a lot of these bonuses had simply, as I say, been put to one side for say five years none of these people would have received a penny because it would have been perfectly clear by now that not only had their banks been badly served but their clients had all been very badly served. So I think I would hope that the market will naturally come up with a solution of that sort and if it doesn't then there is a role for regulation.

Finally on the Bank of England I think one of the things there has been criticism of the Bank of England in terms of the way that it didn't intervene in the money markets this summer when the credit crunch was going on which is sort of one issue about whether or not a particular bit of its performance was what you might call optimal but one of the respects I think in which we should all take great comfort from the way Mervyn King has managed his institution is, unlike America, where the kneejerk reaction in a crisis of this sort is to completely slash interest rates and to, you know, essentially it's like giving a recovering alcoholic another drink, as it were, Mervyn King is being very cautious about cutting interest rates. We've had a quarter percentage point off today. He's been under enormous political pressure and

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pressure from all sides to cut more than that and they've resisted and I think that's a good thing.

**Matthew Taylor:** Robert thank you very much. Now I'm afraid we've run out of time. I'm so sorry. Tonight's event is just one of the RSA's annual programme of over 100 lectures and events. I think we can say now that the RSA is the most substantial free public lecture series in the UK. We can only do that because of the support of our fellows, many of you are fellows, so thank you for that support. If you're interested in becoming an RSA fellow visit our website.

Finally if you're looking for a place to relax and meet friends on any weekday evening you may be interested to hear the RSA Gerard bar is now open every evening until 10 p.m. So that's a great place to meet people.

Can I ask you to thank our fantastic speaker and respondent this evening Robert Peston and Paul Myners. Thank you.