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Perhaps we can begin by asking, what happens when financial literacy is not in place? When it is not in place, we think – loan sharks. Throughout a period in my life I would have thought about loan sharks in that way as well. But I've just been to a series of meetings – I returned yesterday from a G20 meeting, from Tunis where African Finance and Planning Ministers met on Wednesday and got to Tunis from Sao Paolo where the G20 finance ministers met last week, and got to Sao Paolo from Johannesburg, so we've been getting around different parts of the world focusing on one issue. And that issue is the present financial crisis.

The reason we have to talk about it in the way that we do is because it no longer is something confined to financial markets narrowly defined. It's a question of what happens when financial literacy is not in place, but it's less about the consumers in this instance than it is about the policy makers and regulators. The issue of financial literacy clearly can only work if there is a symmetry of interest and action. Much of the discussion in this conference will be about consumers, but I think that if we don't also pause to examine in detail the other side of the equation where finance ministers and central bank governors in the spirit of regulators sit and have to take decisions, where you have legislators who have to view and enable the work of regulators through appropriate legislation – if that is not in place then regardless of how much effort and energy and cost goes into supporting consumer behaviour, the system comes apart as it now has been shown to do.

There’s a story that I read and think is cute, but I keep losing the detail. It’s about the butterfly in India and the hurricane in America. True or not it’s a nice story to tell given what has happened over the past year, expect that in this case the butterfly and hurricane are both in the same country – and its not in India. But the storms, when they happen, spread across the world and clearly they impact on India like they impact on South Africa. This issue has been in play for some time. None of us should pretend that we understood just how devastating it would be. Some may recall that on budget day this year, I started with the budget speech in a weather studio, telling the story of the storm. The story of the storm has been there for some time and you actually have to take it back to what was a very important date – the 9th of August 2007 – when it was clear that there was something radically wrong. On that day, there was a coordinated response by the European central bank and the US Fed who together had to pump $90 billion of liquidity into the markets that day. It was in many ways the beginning of what we are seeing now. One of the reasons that this liquidity had to be pumped was because suddenly there were people queuing up to withdraw money from institutions in different parts of the world because ordinary people came to feel that their money wasn’t safe in banks. Now if you are running a savings institute and people prefer the mattress to the bank then you have failed miserably. But clearly that’s what happened beyond that date and what happened when you saw those queues of people in the UK trying to withdraw money from Northern Rock, which resulted in the nationalisation of Northern Rock in February this year. But it was less about Northern Rock than about a series of things that had been happening in that country where the butterfly moved its wings and the storms first struck in the United States.

Amongst the issues that happened there was that regulation failed. It failed and supervision then couldn't do what supervision had to do. And so in this period we've lived through over the past 30 to 40 years when everything was leveraged, when the world moved through the Berlin Wall coming down and we entered a unipolar world and nothing mattered but greed, the wheels came off supervision and regulation because tomorrow would always be happier and greedier than today. What failed in this context was that people who were elected or appointed to supervise markets failed to understand fundamentally how markets work. In many respects it's no different from what happens when very poor people find themselves in the debt trap. Frequently because people don't understand where money comes from or how money works – how interest may be calculated or what the impacts on their own lives might be.

The other date which would be important in history is the 23rd of October this year, because that is the day which former Fed Chair Allan Greenspan gave testimony to Congress and admitted that he failed to understand what the impact of this large unregulated part of the market is. Between that date and today and beyond I think there is something that we clearly need to understand about certain changes that will impact on the operations of market and also on consumer behaviour. It's worth trying to get a sense of some of these trends.

But go back to that period of leverage. On the one hand for consumers there was loads and loads of very cheap money available, partly because of large global imbalances which is a macro economic problem which was raised but not acted on, and partly because profit could be maximised in a way that actually spoke to the most profound form of regulatory failure – risk was taken off the balance sheet. More room was created on the balance sheet for greater and greater risk and greater and greater leverage. If you look at the risks taken off the balance sheet there was everything – mortgage lending, mortgage originators tended not to bother, they were completely unregulated and unsupervised, they could lend to anybody, and to maximise returns they obviously opted to lend to people who had no ability to pay. What the mortgage originators knew was that they could transfer that risk to other institutions and they transferred it to banks. The banks bought this and between originators and banks with ratings agencies who treated this frequently, these collateralised debt obligations, treated it as AAA credit and the banks bought it and the banks knew that included in what they were buying was actually pretty toxic stuff. Then they would dice and slice and take insurance on this bad risk so that somewhere down the line it would be someone else's problem. This dicing and slicing came in the form of the derivative – in fact an insurance product called the Collateralised Debt Swap – it was designed as a very clever idea by a group of young bankers at the end of 1994, placed on markets in 1995, and by the year 2000 there was $100 billion of this stuff available. Try and calculate the growth from zero to a hundred billion in five years and get the slope of that. By the end of 2007 there was $62 trillion of CDS written up – insurance product; a lot of it over the counter, unregulated, unsupervised, it was going to be somebody else's problem to pick up.

Now these bad loans are being called and the insurances are being called. One of the companies that was involved in very significant write ups of CDS is a company whose initials appear on the jerseys of a soccer club– it's an American Insurance Group. They wrote up just under $450 billion of this stuff and now there's a call, but they are incapable of meeting those obligations. They are primarily not an insurer of bad debt, they are primarily an insurer against all manner of other risk. What this results in is the authorities in the US have to take a view about AIG as AIG can you imagine families losing homes in California right now due to fires who have probably insured with a company like AIG, they took the correct decision to protect against calamity, not being able to make a call because AIG had veered off what they are best able to do into these derivative products and therefore cannot meet the obligations that ordinary working families and others had provided for. Or you can look at hurricane Gustav and the families that lost everything there and were probably also insured. If you allow insurance companies to go off the wall because of regulatory failures then its people who may actually have taken correct decisions to provide against risk who would suffer. These things are important because understanding how markets work and understanding the place of regulation in markets is so fundamentally important in times like this. The symmetry of information, of control, of education about how markets are supposed to work, becomes exceedingly important. As these issues unfold the bad risk which was picked up by those two big mortgage guarantors in the US, Freddie Mac and Fanny Mae which between them had $5.1 trillion worth of mortgages on their books – if they go belly up you could imagine what the impact would be on the lives of ordinary people because understanding sub-prime which has been about lending to people without income, without jobs, without assets is one kind of risk. What has happened is that as part of the housing market was hit, families that have jobs and incomes and should be able to meet their mortgage, find themselves in an environment where there's an asset mismatch – where prices are coming down and there's no connection between mortgages they are trying to redeem and what the value of the asset might be worth. Trapped in that $5.1 billion of Fannie Mae and Freddie Mac are many millions of families who find themselves in that situation. Whilst financial markets are about discrimination and part of education is to minimise the discrimination, part of regulation is to ensure that the discrimination is not unfair. Financial markets can't work without discrimination but what happens when they fail is that they fail also to discriminate between good and bad.

And what you've seen in those markets is something not confined to either housing or to the United States because some Chinese banks were sitting with some parts of these assets and some insurance companies originally from South Africa picked up some of that and the risk has been spread across the world. And so, the solution to the problem needs to be found from across the world.

In the first instance what fuels all of the financial sector is inter-bank lending. When the Reserve Bank sets the Repo, it's the repurchase rate but it also has a big impact on the inter-bank rate, because banks keep each other alive in this way. But for banks to keep each other alive, the one has to know what the other bank's assets are worth. If your collateral is worth nothing or if your collateral is as bad as mine then I'm not going to be lending to you. Which is what caused the inter-bank lending to seize up – when this happens it doesn't just seize up between banks, it seizes up in all of our lives because we've come to take so much for granted about what happens in the financial sector. Basically what happens is that the financial sector provides a link between the present and the future. If money isn't there, then banks can't lend, and the link between the present and the future is cut. The same thing obviously also applies to investors who need to borrow against future revenue to have investment capital to create the employment that then creates the future revenue streams for other people. So when the financial sector seizes up, everything seizes up.

Rich countries between them have put about $4 trillion into play to support the financial sector, not because of the financial sector but because of the link between the financial sector and the rest. The link with the rest is of course what we have to try and deal with because in our failure to deal with that the impact would be too profound. It's as serious as going into depression.

It's a very simple formula. It's a matter of going back to that country where the butterfly first moved its wings. Cleary credit is not available, the average savings rate in the US has been negative for a few years, families are indebted probably to the tune of 112 per cent of next years' income. When you have that kind of situation people can't afford to extend that link between the present and the future. If what you do in Detroit is manufacture cars and people can't get the credit to buy those cars, people can't afford to buy those cars, what are you doing making those cars? If you can't build those cars, what about the car component manufacturers – the people in Port Elizabeth who make catalytic converters for cars? And if you aren't using catalytic converters, why are you mining platinum?

You can look at this thing from different perspectives because indeed if you were lucky to be a BEE partner in mining you're going to find yourself under water. These links are important to understand because if markets seize up, the impact is felt very far downstream. And so we return to that which we know - which is financial literacy for Ministers and Members of Parliament, and public servants, and business people, all of them. If we understood that a bit better, then we probably wouldn't be sitting with what the world is living through now. In many respects our financial sector in South Africa is working much better than most. It's boring. I mean, there isn't a word in Zulu, or Afrikaans, that translates to Collateralised Debt Swaps – I've checked. So, we haven't gone there. If you look at mortgage originators, there aren't many that aren't part of banks. If you look at the attempted securitisation of these mortgages there aren't too many products around in this market.

When I was in the States earlier this year there was a small report that there were 42 originators of student loans that couldn't proceed in this market so the idea of no student loans available in the United States presented the authorities with a problem where the Secretary for Education had to provide money from the Treasury to keep student loans alive. If you pause and consider all of the ramifications and then you understand why a financial system that sometimes is boring and sometimes is difficult and sometimes doesn't make available copious amounts of cheap credit is actually the best advice in the circumstances. This doesn't suggest that the battle for access should end. But it does say that we must be informed by rationality and the experience of what is happening around us in the world. But also we must be informed by the fact that these issues are not going to disappear if the G20 in the course of the next few months finds some way to keep this global economy afloat. These issues are going to be in every economy as a feature probably for the next five years. Saving becomes more important. But savings on its own without sound regulations doesn't work – you can look at Germany which has a fairly high savings ratio and well-capitalised banks. If one single bank goes offshore for tax purposes, and it happens to be the biggest mortgage lender, finds itself in trouble there and then has to turn to German taxpayers and say, “we are in trouble”. Regulation and oversight are fundamentally important. Look at China – the Chinese people together save 54 per cent of GDP. But that’s because they’re scared of their own future; that’s because there’s no retirement provisioning, no health care provisioning and people fear aging. So, it must be savings for a purpose, the financial sector for a purpose, linkages for a purpose, it must bring together so much of what we understand about the world and the way it is supposed to work, so that the interrelationship between the financial sector and the productive side of the economy is something we should never take for granted, and something we should never allow the decoupling of.

This was of course much of the thesis of Keynes – about preventing the financial sector from operating for its own sake and one of the better known Keynesians who won the Nobel Prize in 1981, James Tobin said “I confess to an uneasy Physiocratic suspicion...that we are throwing more and more of our resources...into financial activities remote from the production of goods and services, into activities that generate high private rewards disproportionate to their social productivity. I suspect that the immense power of the computer is being harnessed to this ‘paper economy,’ not to do the same transactions more economically but to balloon the quantity and variety of financial exchanges. For this reason perhaps, high technology has so far yielded disappointing results in economy-wide productivity. I fear that, as Keynes saw even in his day, the advantages of the liquidity and negotiability of financial instruments come at the cost of facilitating nth-degree speculation which is short-sighted and inefficient....I suspect that Keynes was right to suggest that we should provide greater deterrents to transient holdings of financial instruments and larger rewards for long-term investors”.

The same issues – strip it down and I think that we should all agree that regulation must exist in order to provide protection to the consumer and user or depositor. Regulation must also provide, as it does in this country, to improve the quality of intermediation as the FAIS does. Regulation must provide, as the National Credit Regulatory Act does, for some intervention in limiting this appetite for an endless amount of credit in the lives of people. And regulation must hold those who are licensed to intermediate banks and non-banking financial services to account for their actions. Regulation should also provide for the need for all pools of capital to be supervised so that you can't transfer these entities into off-balance sheet things. Northern Rock for instance was transferring their off balance sheet risk to an entity located on the isle of Guernsey and the fruits of that investment were nominally destined for children suffering from Down's Syndrome. Not a dime ever reached those children.

Greed knows no conscience. Regulation is about that but I think that none of it works unless it is matched by the symmetry of an informed populace that takes informed decisions about their own lives, who are able to then discern the best decisions to take to link the present and future – because that's what financial services are ultimately about.

Thank you very much.