I. Introduction

"The derivatives genie is now well out of the bottle and these instruments will almost certainly multiply in variety and number until some event makes their toxicity clear… [They] are financial weapons of mass destruction, carrying dangers that, while latent, are potentially lethal" (Buffet, 2002). This is how Warren Buffet, the world's greatest stock market investor, known as the sage of Omaha expressed his concern about derivatives in his 2002 Berkshire Hathaway letter to shareholders.

These words were indeed prophetic and put the spotlight on the question of whether and how this market should be regulated. The relevant issues are quite complex and there are many diverse opinions regarding the question of regulation in general and within the context of the derivatives market in particular. *The main aim of this paper is to shed light to the question of whether political bias reflects attitudes towards derivatives regulation.* To this end, I will use articles from two highly regarded and popular newspapers and look for connections between political orientation and derivatives policy. This research might, in turn, shed light on the relative efficiency and effectiveness of various methods for derivatives regulation. Determining the best policy for derivatives regulation is beyond the scope of this paper. However, locating problems in existing policy is a much more modest goal. The secondary aim of this paper, therefore, is to locate such problems, especially if they stem from political bias.

Political bias is not always easy to identify and is not necessarily a problem if there is a satisfactory balance and recognition of its existence. In Italy, for example, where the current Prime Minister, Sylvio Berlusconi, controls most of the media, there is likely to be a strong political bias in favour of his opinions. This fact is however widely recognized and so it is not so dangerous in influencing public opinion. In countries like the USA or the UK which have a tradition of press freedom and freedom of speech the danger of political bias is potentially greater because of the belief in objectivity and balance. In these countries, journalists have a reputation for independence and factual reporting, but the selection of which facts to report is what can lead to the subtle introduction of bias. This type of subtle bias is more dangerous than the direct or blatant bias because it is not recognized for what it is.

In some cases the political bias can be national as is observed in the current reporting of the Euro crisis in Britain and the Eurozone. The vast majority of the British press seems to relish the possible demise of the Euro while their European counterparts offer a more supportive view of the Euro.

The subject of market regulation is one that has divided economists since the Keynesian challenge to the classical view during the 1930's. Since then there has been the monetarist response in the 1960's, championed by Milton Friedman, which re-asserted the virtues of the free market and sought to dismiss the effectiveness of any government interventions beyond the control of the money supply. Despite being a well-respected academic, Friedman had a political agenda and tried to use economic theory to support his views. "For decades, Milton Friedman's public image and fame were defined largely by his pronouncements on monetary policy and his creation of the doctrine known as monetarism. It's somewhat surprising to realize, then, that monetarism is now widely regarded as a failure, and that some of the things Friedman said about "money" and monetary policy—unlike what he said about consumption and inflation—appear to have been misleading, and perhaps deliberately so."(The New York Review of Books, Who was Milton Friedman, Paul Krugman 2007)

In the 1980's the free market lobby was further boosted by the adoption of supply side policies, by Reagan in the USA and Thatcher in the UK. These policies reflected the ascendancy of the Neo-Classical school of economic thought which has remained the economic orthodoxy until the recent financial crisis. This is reflected by the stance of International Institutions like the IMF which have made loans and assistance conditional on the adoption of free market policies such as privatization and structural adjustments. The core belief of the Neo – Classical school is that the market knows best and that de-regulating markets is the only way to achieve dynamic sustainable growth. . Left alone markets will clear, but if interfered with, this function will be lost.(R.Lipsey, 1989,page 626)

The justification for regulation of markets is related to the concept of market failure. Ideally the free market will ensure a Pareto efficient allocation of resources. Pareto optimality is achieved when it is impossible to make one person better off without at the same time making someone else worse off, but this requires that people behave rationally, have perfect knowledge of the market and that markets are competitive. In real life these conditions do not apply and so there is the prospect of market failure and a potential justification for government intervention in order to redress the failure. Some extreme free market supporters reject the existence of market failure outright, while others may acknowledge market failure, but consider that policies aimed at correcting them will inevitably lead to a worse outcome which simply replaces market failure with government failure. Economists use various theories and empirical studies to justify their views and many are engaged in the commendable search for knowledge. There are however, some who try to use theory and research to justify preconceived beliefs reflecting political or social bias.

Despite the fact that Warren Buffet has apparently complained that he pays less tax than his secretary, the rich and wealthy generally favour low marginal income tax rates and abolition of inheritance taxes. So as not to appear greedy they try to justify their position by claiming that high marginal tax rates on income provide a disincentive to work and effort which will have a negative effect on the supply side of the economy. Supply side economists such as Arthur Laffer are more than willing to provide theoretical support for such beliefs with the presentation of simple truisms through the "Laffer curve".

In the context of financial markets and the derivatives section in particular, it is possible to identify the problem of asymmetric information as a major source of market failure. There is a relatively large gulf in the knowledge and understanding of these markets between the potential regulators and the markets or situations that should be regulated. This provides scope for fund managers and derivatives brokers to exploit their information advantage in ways which can distort markets and secure advantageous treatment in regulatory measures. They can apply convincing arguments that certain regulations will stifle markets and restrict finance and liquidity, but these claims can only be tested if the regulations are actually applied. Until then the claims remain theoretical, but regulators might be unwilling to take the risk and be blamed for the ensuing crisis. Policy makers generally prefer to err on the side of caution than on the side of boldness.

Alan Greenspan is a good example of this conservative approach to regulation. While Chairman of the Federal Reserve he was widely respected as a cautious and prudent practitioner of monetary policy who safeguarded the US economy from inflation while at the same time promoting steady growth. Much of this growth and the optimism it generated in the economy was the result of growth and diversification in the financial sector and the regulatory framework that existed was not appropriate for the plethora of new derivative products. In hindsight, Greenspan has been criticized for not predicting the subsequent developments in the housing market and the financial markets and for failing to impose regulatory safeguards in anticipation of the changing financial market.

With respect to policy options we need to be aware of the right of centre/left of centre divide which characterizes most European and American politics. As stated above, our contention is that political affiliation or loyalty will influence the degree of support for regulation and type of regulation advocated. In pursuance of this aim we have selected articles appearing in the Wall Street Journal as representative of the right of centre viewpoint and articles appearing in the International Herald Tribune (which is also the global edition of the New York Times) as representative of the left of centre viewpoint. When the expressed views and opinions of our selected populations are evaluated and analysed an attempt will be made to assess the extent to which attitudes towards derivative control reflect political views. It is possible that the severity and significance of the crisis will transcend party political lines, but our hypothesis is that the right of centre views expressed in the Wall Street Journal (European edition) will be less in favour of derivative controls than the left of centre views expressed in the International Herald Tribune. The reasons for which we selected these specific newspapers are more deeply explained partly in the literature review and the methodology sections.

In attempting to examine and analyze the literature pertaining to the financial crisis it is first necessary to identify the groups or populations who are relevant to the debate. These include lawmakers, politicians, journalists, bankers, economists, fund managers and traders, businesspeople and the general public. Our aim is to consider informed opinions and therefore we decided to narrow down the field by considering two populations: academics and practitioners. We define academics as those who are associated with an institution of higher education and who have commented on the crisis. Practitioners are a broader group which includes those who are actively involved in the derivatives markets directly as traders or indirectly as fund managers or credit facilitators, together with bankers who are involved in various stages of financial trades and finally politicians. The analysis will not include a comparison of the opinions of the two groups as the purpose of this paper is to focus on their political bias and not their occupation.

As far as the time horizon is concerned, due to the enormous database of articles regarding the issue of derivatives regulation, and the limited time that we had, we decided to focus on the articles that have been published within the last 2 years. A more in depth explanation of how the sample for our analysis was drawn will be presented on the Methodology chapter.

For practical purposes we are limited to selecting articles and lectures in English and from the English language media and there will therefore be a bias towards American and European sources. Many commentators place the USA as the source of the problem and therefore it is natural for American viewpoints to be disproportionately represented, especially in the ranks of the academics, meaning those who have a primary affiliation to American institutions. Interestingly, it is only recently that Europe has increased its share of articles in economics journals. According to Ana Rute Cardoso, Paulo Guimaraes and Klaus Zimmerman (Trends in Economic Research: An International Perspective) in 1999 North American (mainly USA) affiliations accounted for 66% of economic research articles with only 24% by Europeans but by 2006 the European share had increased to 40% while the American share had declined to 45%.

This increased representation of European affiliated sources of articles has to some extent redressed the balance but, American views are still somewhat over represented in the literature regarding the regulation of derivative markets and the causes of the financial crisis.

Now that the aim of this dissertation has been made clear, it would be essential to explain how this dissertation is going to unfold. The next section (part II) is a literature review. In order to put things into perspective in the literature review this paper will give a brief overview of what derivatives are and of the differences between regulated and unregulated derivatives. It will then explain their uses and the problems associated with over the counter derivatives and particularly the credit default swaps including their risks and benefits. Additionally, we will explain the differences between central clearing and trading on the exchange, which are the two methods of regulation that are examined in this paper. The purpose of the above is to enable the better understanding of the topic and of course the underlying incentives behind each opinion expressed. In the same chapter, we will present some of the literature that has already examined newspapers' political bias, so as to show that the selection of the two newspapers has a meaning. We will see what has been written regarding political bias and how previous reports and analyses have the same results with our analysis.

The remainder of the paper proceeds as follows: Part III will be the Methodology chapter and will explain both: a) how we did this analysis and b) the reasons behind our decisions. It will include explanations for how the sample was collected with extreme care to being random and representative. Moreover, it includes an SPSS statistical analysis which will show whether there is a difference in the points of view expressed in the two newspapers of different political views, so as to show whether there is a connection between political bias and the attitude towards regulating the derivatives market.

Part IV will include an analysis of the statistical results presented in the methodology chapter. There, we will try to put flesh on the bones of the numbers generated through the statistical analysis by presenting examples from the newspapers articles. Furthermore in this chapter an attempt will be made to give an answer to the question of which market is more efficient, the regulated or the free market after having examined and collected information and opinions from a plethora of articles journals and scholars. Of course the main points will be drawn from the articles that were used in our analysis.

Finally, the last section Part V will draw a conclusion, which will examine the method of regulation that has emerged as the more efficient by our examination. It will sum up the findings of the statistical analysis and we will discuss whether the free market or a regulated market would be more efficient.

II. Literature Review

Derivatives:

(a) Brief Background

A brief description of derivatives is: 'Derivatives are contracts that transfer financial risk from one investor to another for compensation. For example, a call option gives one investor the right to buy an asset from another, in the future, at a pre-arranged price' (Duffie, 2009).

The derivatives contracts come under two groups which are distinguished by the way they are traded in the market:

- **Exchange traded derivatives** (ETD) are traded on exchanges. An exchange is a centralized facility, such as an electronic communications network, for matching the bids and offers of many buyers (end-users) and seller (dealer). Primarily futures and options are traded in this way. Their trade is relatively transparent.
- **Over-the-Counter** (OTC) derivatives are contracts that are privately negotiated between two parties: the buyer and the seller. The 'buyer' makes periodic payments to the 'seller, and in return receives a payoff if an underlying financial instrument defaults. Swaps, forward rate agreements and exotic options are mostly traded in this way. Their trade is of limited transparency and less frequently cleared.

Any derivatives trade, whether ETD or OTC can be cleared through a central counterparty, which assumes responsibility for the counterparty performance of both sides of a trade. Essentially all derivatives traded on exchanges are centrally cleared. [Although] Over-the Counter derivatives are centrally cleared if both parties decide to assign the trade to a central counterparty, and if the central counterparty accepts the assignment (Duffie, Lee, Lubke, 2010).

One of the main reasons some derivatives are traded over the exchanges while others are traded in Over-the-Counter markets is due to the diverse nature of derivatives contracts that makes it difficult to match buyers and sellers in an exchange-like trading environment with a system of rules.

(b) Unregulated Derivatives:

Until the 1980s, the derivative contracts could only be traded in the regulated commodities markets. The unregulated OTC derivatives market emerged with the expansion of the exclusion of "forward" contracts from futures contract regulation.

This unregulated market expanded in the 1990's, with the Commodities Futures Trading Commission ("CFTC") taking more of a *laissez faire* approach regardless of the problems that occurred to some investors like *Orange County California* (see *Timeline Table*). These unregulated derivatives were given approval in the Commodity Futures Modernization Act of 2000 (Hazen, 2009).

The OTC derivatives come in many varieties. Every derivatives contract though, can be constructed from two simple and fundamental building blocks: forwards and options (Culp and Mackay, 1994). They include: Over-the-Counter foreign currency contracts, interest rate contracts, equity linked contracts, commodity contracts, credit default swaps and other highly complex derivatives.

According to the surveys conducted by the Bank of International Settlements (BIS) (see *Table1*) the OTC derivatives market has grown dramatically:

> Total [global] notional amounts outstanding for over-the-counter (OTC) derivatives increased … in the second half of 2009, to **$615 trillion**….

This is up from more than $15 trillion 20 years ago.

GLOBAL OTC DERIVATIVES MARKET	Notional Amounts Outstanding	Gross Market Value	%
Foreign Exchange Contracts (FOREX)	49,196	2,069	9.6
Interest Rate Contracts	449,793	14,018	65.0
Equity-linked Contracts	6,591	710	3.3
Commodity Contracts	2,944	545	2.5
Credit Default Swaps (CDS)	32,693	1,801	8.3
Others	73,456	2,440	11.3
GRAND TOTAL	**614,673**	**21,583**	**100**

Table 1: **Global OTC derivatives market**

Amounts Outstanding, in billions of US dollars

Source: Bank of International Settlements (BIS), May 2010

The 'notional amount' of a derivatives contract is the market value of the asset whose risk is transferred by the derivative.

If the global notional amount outstanding for derivatives is approximately $1000 trillion, then the global OTC derivatives constitute about 61.5% of the total global notional amounts of derivatives - both ETD and OTC - outstanding. Stulz (2009) points out that "much of the difference in size between the Over-the-Counter markets and the exchange-traded markets is accounted for, by the fact that these two types of markets work very differently" (the difference is already explained in (a) above).

(c) Uses of Derivatives

Derivatives are mainly used for hedging, speculation and arbitrage.

As Culp & Mackay (1994) state derivatives provide numerous and substantial benefits to end-users. Corporations, governmental entities and financial institutions benefit from derivatives through lower funding costs and more diversifies funding sources. Derivatives, moreover, provide an efficient method for end-users to better hedge and manage their exposures to risk from price and interest rate fluctuations. Finally, they provide an effective, low-cost means for corporations and institutional investors effectively to manage their portfolios of assets and liabilities.

In other words, derivatives provide an opportunity for risk-shifting as well as investment opportunities (Hazen, 2009). According to Johnson (2001), "derivatives have always been a type of insurance. They differ from the classical model only in that, instead of assembling a 'risk pool' funded by a large number of at-risk holders, the risk is passed on to people who would not otherwise face it".

Since derivatives are characterized as a type of insurance it would be beneficial to discuss the issue of moral hazard that is always a problem with insurance instruments. Moral hazard per se, can be defined as "the risk that the presence of a contract will have an effect on the behaviour of one or more parties. In other words, people might act in their best interest, without taking into consideration the moral consequences of their actions. For instance, when covered against a specific loss, one may increase his risk taking attitude.

(d) Problems associated with OTC derivatives.

There are two main problems associated with OTC derivatives and particularly with Credit Default Swaps (CDS) which will be explained further in this paper.

(1) *Corruption*. Because transactions are negotiated privately, a trade may not be conducted at the best price and products can be sold by banks at unfair prices to the buyers. Alternatively, there is a possibility of corruption where an employee of a financial firm does conduct a transaction at a price to his advantage, in exchange for a bribe.

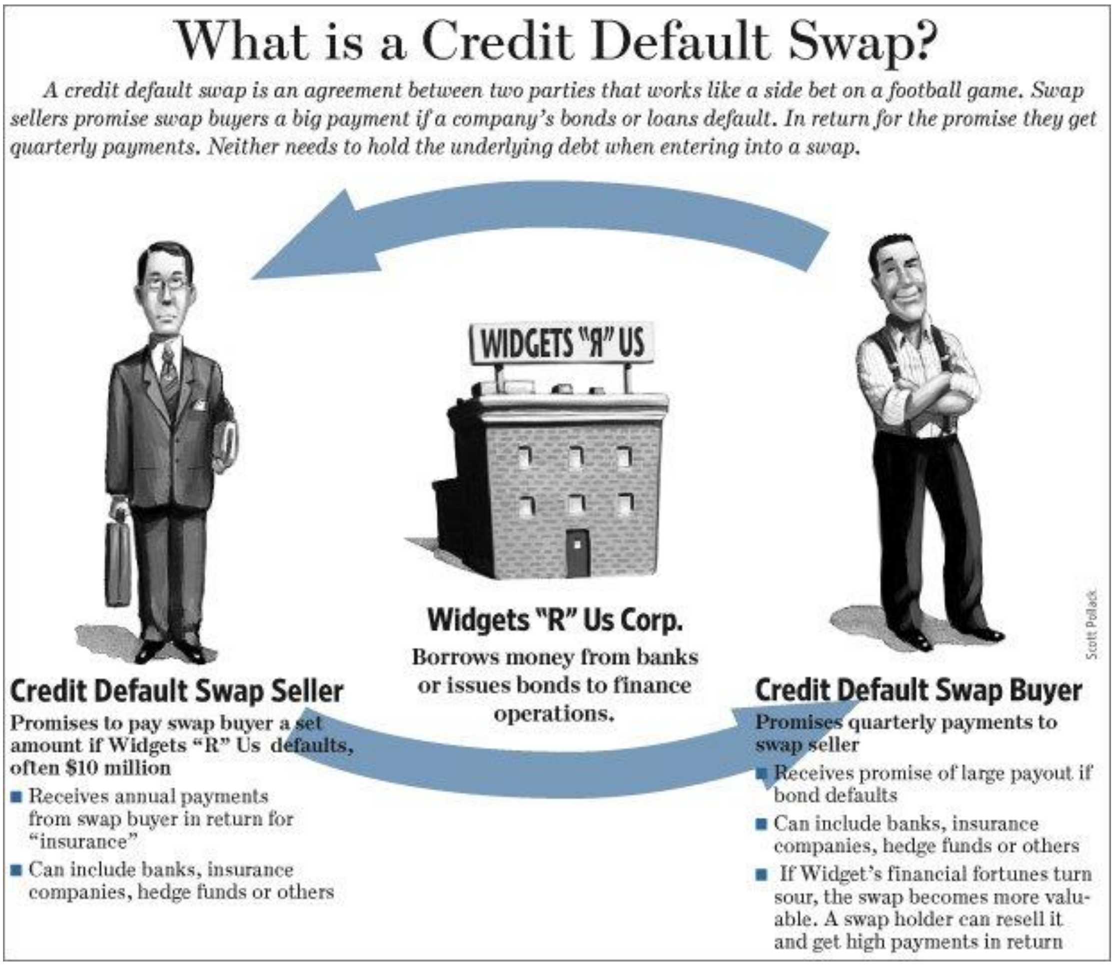
(2) *Counter-party risk*. Counterparty risk reflects the potential for the counterparty to fail to meet its payment obligation. That is, when either the buyer or the seller becomes insolvent the other is left holding a non-performing contract.

Because the OTC derivatives market is very big, with (615) trillions of dollars worth of positions worldwide, when a company holds large OTC derivatives position, it can generate *systemic risk*. That is, there can be a 'domino effect' where the failure of one company triggers off the failures of others. A good example to this is *Bear Stearns*, one of the giants of Wall Street investment banking. Bear Stearns was a very large player in the OTC market for Credit Default Swaps (CDS) and it was in distress. Its bankruptcy would have generated a disruption for all the counterparties, possibly across the entire CDS market. The US Federal Reserve Board gave J P Morgan a short-term line of credit – tens of billions of dollars - to assist the purchase of Bear Stearns by J P Morgan in order to avoid the collapse of the entire financial system. (Shah, 2008).

(e) Credit Default Swaps (CDS): Risks & Benefits

As (Engdahl, 2008) points out, the Credit Default Swap was invented a few years ago by a young Cambridge University mathematics graduate, Blythe Masters, hired by J.P. Morgan Chase Bank in New York. The then-fresh university graduate convinced her bosses at Morgan Chase to develop a revolutionary new risk product, the CDS as it soon became known.

A **Credit Default Swap** (CDS) is a type of OTC derivative. In simple terms, it is a bilateral contract in which a protection buyer agrees to pay a periodic fee in exchange for a payment by the protection seller if a bond or a loan defaults.



CDS Diagram by Scott Pollack

If a firm does not own the underlying debt, then the CDS contract is called 'naked' CDS. As Leonard (2010) puts it:

> '…what if I don't own any GM (general Motors) bonds, but I still buy insurance against the possibility of a GM default? In that case, I would be purchasing what is known in the trade as a "naked" credit default swap -- akin, say some detractors, to buying fire insurance on a house that you don't even own. I would be making a bet, plain and simple, on GM's credit-worthiness. A bet that wouldn't pay off, unless something bad happened to GM.'

The benefits associated with CDS say Skeel and Partnoy (2007) include: '...increased opportunities for hedging, increased liquidity, reduced transaction costs, and a deeper and potentially more efficient market for trading credit risk. [On the other hand], the risks associated with CDS are moral hazard and other incentive problems, limited disclosure, potential systemic risk, high transaction costs, and the mispricing of credit'.

Despite experiencing very considerable growth over the last few years, the CDS market is relatively small, (accounting for 8.3% of the global OTC market in terms of notional amounts (see *Table* 1). Nevertheless, as Eric Dinallo, the former superintendent of the New York State Insurance Department, estimated in a January 2009 interview, as much as 80% of the CDS market is traded by firms that don't own the underlying debt. (Dinallo, 2009)

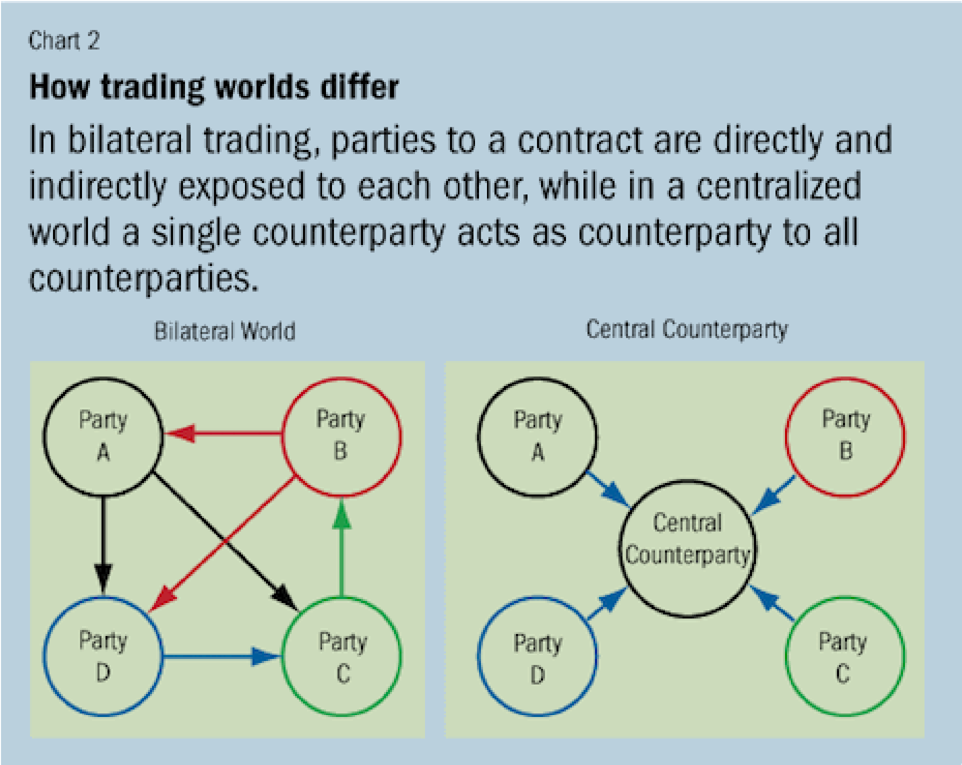
It is worthwhile noticing that, although it existed since 1990, the CDS market increased enormously starting in 2003. According to the ISDA Market Survey 1987-present, by the end of 2007, the notional outstanding amount was $62.2 trillion, falling to $30.4 trillion by the end of 2009. Buiter (2009) reasons out as follows: 'It is certainly likely that notional outstanding stock of derivatives and the trading volumes would fall to a quarter or less of their 2007 levels if derivatives could be used only to buy insurance, not to place bets'.

(f) Derivatives regulations: Brief explanations and differences

Clearing houses:

A clearing house is defined as a financial institution that provides clearing and settlement services for financial and commodities derivatives as well as securities transactions. In more detail, the role of a clearing house would be to serve as an intermediary between 2 clearing participants (ie 2 companies trading with each other). The purpose of such an intermediary would be to minimize the risk of either party failing to meet its trade settlement obligations. In order for the clearing house to be able to minimise the risk of default it must net the offsetting transactions between the parties involved in each contract. Thus clearing houses normally require collateral deposits, in other words margin payments, examine the creditworthiness of the clearing participants and in some cases even offer a guarantee fund that can be used to cover for losses that exceed the collateral deposit of a defaulting clearing participant. The following illustration, Chart 1- taken from "The Economist", april 22, 2010- shows the "order" that would preserve through a central clearing house.

Chart 1



("The Economist", April 22, 2010)

Standardization / Exchange:

Standardization of OTC derivatives trading would imply that contracts would ensure their liquidity. Standardizes contracts would demand less flexibility. A futures contract is standardizes contract, referring to a specific asset, at a specific price and quantity for a given future date. In that way the contract will be feasible to be traded on exchange and thus in a way defaulting risk would be minimised. This would imply that such a contract will no longer be merely a private agreement between two or more counterparties that does not have to follow specific strict rules, and therefore would narrow the banks' bargaining power possibly reducing their profits. In other words, it would in a manner cancel the "over the counter" nature of OTC derivatives.

Differences:

The most important differences between mandatory clearing and mandatory exchange trading are put excellently on the article below extracted from "The Economist" 's blog on the internet: (http://www.economist.com/blogs/freeexchange/2010/04/derivatives)

"A clearing requirement is a requirement that all eligible derivatives be cleared on a central clearinghouse (also known as a central counterparty, or CCP). A clearinghouse provides critical counterparty risk mitigation by mutualizing the losses from a clearing member's failure, netting clearing members' trades out every day, and requiring that parties post collateral every day. Clearinghouses also centralize trade reporting, and can provide any level of post-trade transparency to the OTC derivatives markets that your heart desires — same-day trade reporting, including prices, aggregate and counterparty-level position data, etc. Virtually all of the harmful opacity and murkiness of the current OTC derivatives markets can be ended with just a clearing requirement — that is, a clearing requirement is a prerequisite for getting rid of the harmful opacity in OTC derivatives; an exchange-trading requirement is not..."

On the other hand, the exchange traded derivatives have the obligation to use "a particular type of trade execution venue: exchanges (also known as boards of trade)" (Ibid). None of the other requirements are present. The main difference between exchange traded derivatives and clearing houses is the pricing transparency. Clearing houses provide post-trade transparency, whereas trading through the exchange guarantees pre-trade price transparency. As it will be shown later on in the analysis, that is the main reason why Wall Street seem to prefer clearing houses to the exchange. They want to be able to charge the price they desire, as pre trade price transparency would reduce their profits to an important extent as many practitioners have mentioned.

Media Bias

Since my review of the question of regulation of derivatives markets is based on randomly selected articles from the "Wall Street Journal" (WSJ) and the "International Herald Tribune" (IHT), it is necessary to consider the political stance or bias of these newspapers. Let us at this point remind that IHT is the global edition of the "New York Times" (NYT) and therefore what is found in the literature for the NYT stands for the International Herald Tribune as well. I specifically chose these two newspapers because they are both regarded as quality press and are acknowledged to be representative of the opposing left/right viewpoints in the political spectrum. The former is recognised as a conservative or right wing publication and the latter a liberal or 'left of centre' publication. This categorisation should not be controversial, as it tracks the popular conception of these two newspapers. However, for my purposes, it is necessary to have a more objective assessment of the actual degree of political bias expressed in their news articles as well as their editorials. To this end I have relied on the following publications: A Measure of Media Bias, by Tim Groseclose and Jeffrey Milyo, Nov. 2005, the Quarterly Journal of Economics, Issue 4. and Media Bias, by Sendhil Mullainathan and Andrei Shleifer, NBER Working Papers Series 9295.

In "A Measure of Media Bias" the authors use media data that does not include editorials, letters to the editor or book reviews. The main reason given is "that there is little controversy over the slant of editorial pages; e.g., few would disagree that *Wall Street Journal* editorials are conservative, while *New York Times* editorials are liberal". In other words, it is common knowledge that the WSJ tends to be conservative and the NYT tends towards the liberal, and this is reflected in the editorials. This bias that the authors identify, does not involve false statements or manipulation of facts, but is rather more subtle. It arises from the very facts that are chosen by the editors as important enough to write about and be published.

In order to measure political bias the authors developed an adjusted Americans for Democratic Action (ADA) score based on the number of times a media outlet cites certain policy groups and think tanks, compared to members of Congress. The higher the ADA score, the more liberal the bias of the media or news outlet.

Surprisingly, the measure of bias used in the study classified the WSJ as more liberal than the NYT (85.1 vs 73.7 estimated ADA score). In fact, when restricted to news content (i.e. excluding editorials) the WSJ had the highest ADA score overall. This, at the very least, shows that there is a striking difference between the news and editorial sections of the WSJ. According to the authors, this result is consistent with other studies: "the Journal's news and editorial departments are as politically polarised as North and South Korea" (Sperry 2002, in A Measure of Media Bias). Moreover, the results showed that the vast majority of journalists were liberal rather than conservative, though this does not mean that the reporting will be slanted in a liberal direction. It is more likely to reflect the views of who provides the pay cheque.

In the second study (Mullainathan & Shleifer) a different approach is taken. Here a distinction is made between ideological bias that attempts to influence the readers' opinion in a certain direction, and a spin which tries to sensationalise the story. For our purposes only the former is relevant.

Their analysis of ideological or political bias is based on the reporting of a particular incident involving a disagreement between two academics that developed into the Summers-West saga. The story was initially covered in the liberal press with the Boston Globe and the NYT supporting West. Eventually the right wing press began to investigate the issue and gave their support to Summers. In particular the WSJ questioned the validity of West's claims and together with the Economist presented counter arguments to those presented in the liberal press. When the story became politicised, through the intervention of Jesse Jackson in support of West, the right wing press was drawn into an ideological contest.

Had the dispute remained a simple news item it would have probably not been reported at all in the WSJ, but once it became political it attracted their attention.

Of course, the second study is based on a single case, which though well documented does not confirm the general situation of bias. However, it lends support to the first study, as it counts as an example of how political bias is generated in the media. Together, these two articles indicate that there is substantial political or ideological bias in news reporting and that the assumed right – left classification of the WSJ and NYT is a valid one with respect to their editorial viewpoints. Interestingly however, the news media overall appears to have a liberal bias which is even shared by the news articles in the otherwise conservative WSJ. This is likely to account for the fact that the majority of articles randomly selected from the WSJ and the NYT are in favour of financial regulation and stricter control of derivatives.

Finishing this chapter, it would be essential to state how our analysis differs from the analyses that have been previously made on the issue of political bias. Our analysis does not merely take into consideration the editorials. It takes into consideration articles, and interviews and examines what has been included, omitted or not stated and how that can affect the way in which the issue of derivatives regulation is treated. For that reason in the analysis chapter we have included some parts of the articles or of interviews to prove how political bias can be camouflaged inside the articles.

III. Methodology

As explained in the introduction the main purpose of this dissertation is to examine the extent to which political bias affects attitudes towards derivatives regulation. To investigate this bias, we looked at two newspapers with different political viewpoints. The first newspaper chosen was the International Herald Tribune and the second one was The Wall Street Journal (European edition). The first reflects viewpoints of a more left wing political bias and the latter represents a more right wing political bias. We decided to select two US newspapers addressed to a non US market. In that way, by not selecting a European newspaper, for instance Financial Times, we can be more certain that the difference found in the papers express political bias and not cultural or any other kind. For this analysis we gathered opinions expressed in the articles as well as in interviews. The reason for which we decided to undertake this analysis was to examine which method would be preferred by most practitioners, policy makers and politicians, and to examine the political influence that individuals may be under when considering the matter of regulating derivatives. Furthermore, to a broader extent, this paper and its findings could shed light to the problem of newspapers being biased and not objectively informing the people. In a way this paper clears out the ideological biases due to which participants may be hiding arguments and beliefs in order to favour their agenda.

At this point it would be essential to explain the data collection process. We used the internet sites of the two newspapers and their search engines to generate a plethora of articles. In the search engine we entered the terms: "derivatives regulation" and a list of articles appeared. However, in order to avoid being biased chronologically we selected the articles to be presented based on their relevance to the search keywords. The time horizon that we examined were the last 2 years (2010,2011). Both newspapers generated hundreds of articles and therefore we decided to examine articles from within the first 100, especially since they were ordered according to relevance. We numbered each article from the first 100 with a number from 1-100 and then we used a random number generator in the Excel ((=RANDBETWEEN(1,100))) which produced 50 numbers, ie articles, from each newspaper. The articles that matched the numbers generated were then read, analysed and our sample of opinions was gathered from them. Therefore the total sample was generated from 100 articles, 50 from the IHT and 50 from the WSJ. The list of the 100 articles can be found in appendix 1. In the IHT articles we found 43 different individuals expressing their opinions, and from the WSJ we found 42 different individuals. We followed the aforementioned process in order to guarantee randomness in our data collection process. If an individual from the sample is in favour of standardisation/exchange we put a "yes" in the relevant column. If the individual is against we put a "no". If no opinion is expressed on one of the two then we left it blank. All individuals have expressed their opinion on clearing houses but not all have expressed theirs on exchange/standardisation.

Table 1. The sample

Participants WSJ	*Exchange*	*Clearing houses*
Dimon Jamie	no	no
Nadal Steve	no	no
Barnier Michel		yes
Cunningham Rory		yes
Cliffor Smith	no	no
Judith Hardt		yes
Kastner Jason	yes	yes
Hill James		no
Barnum Jeremy		no
Huntsell Ludger	no	no
Cantwell Maria		yes
Pickel Robert		no
Mc Greevy Charlie	yes	no
Collins Susan		yes
Lincoln Blanche		yes
Mahoney James	no	no

Isaac William		no
Frank Barney		yes
Coleman William	no	no
Nelson Ben		no
Backshall Tim	no	no
Sokol David		no
Johanns Mike		no
Lo Andrew	no	yes
Raeburn Richard	no	no
Blinder Alan	yes	yes
Bair Sheila		no
Crisson Mark	no	no
Kuhn Tom	no	no
English Glenn		no
Cicione Adrea	no	yes
Shelk E. John		no
Williams Mark	no	no
Hartzog Jerry		no
Jeb Hensarling	no	no
Summers Lawrence		no
Kucinich Dennis	no	no
Seiberg Jaret		no
Stabenow Debbie		yes
Altucher James		no
Brown Scott		yes
Giancarlo	no	no

Participants IHT

Osborne George	yes	yes
Barnier Michel	yes	yes
Greithner Timmothy	yes	yes
Kristof Nicholas		yes
Morgenson Gretchen		no
Cocchetti Stephen	yes	yes
Davis Howard	yes	yes
Tarullo K. Daniel	yes	yes
Gensler Garry	yes	yes
Garret Scott		no
Maloney Carolyn		no
Giancarlo		no
Lincoln of Arkansas	yes	yes
Engle Robert	yes	yes
Mc Carthy Kevin		no
Lucas Frank		no
Richardson Matthew	yes	yes

Tumpel- Gugerell Gertude		no
Bachus Spencer		no
Cantor Eric		no
Wolin S. Neal		yes
Greenberger Michael	yes	yes
Chilton Bart		yes
Eraj Shirvani	no	no
Piplas Athanasios		no
Chavez R. Martin	no	no
Tooney Pat		no
Sestak Joe	yes	yes
Dahlkemper Kathy	yes	yes
Kilroy Jo Mary		yes
Brenner Menahem	yes	yes
Kratovil Frank Jr		yes
Pirrong Craig	yes	yes
Markey Betsy	yes	yes
Nye Glenn	yes	yes
Schauer Mark		yes
Titus Dina	yes	yes
Kelleher Dennis	no	yes
Whalen Cristopher		yes
Angelides Phil		yes
Harkin Tom	yes	
Peterson Collin		no
Royce Ed		no
Bean Melissa		no

Having collected the sample we had to perform hypothesis testing in order to examine the extent to which political views of the newspapers influenced the opinions expressed in the articles. The following hypotheses were made:

1.

(H_o): WSJ opinions support Standardisation(null)

(H_1): WSJ opinions do not support Standardisation(alternative)

2.

(Ho): WSJ opinions support Clearing Houses(null)

(H_1): WSJ opinions do not support Clearing Houses(alternative)

We have only done this analysis with hypotheses for WSJ and not done the same thing for IHT for the following reason. As it will be made clear later on in the analysis (Pearson's R value) there exists negative correlation between the opinions expressed in the two newspapers. Thus, when we say that H1 is that WSJ opinions do not support standardiazation/exchange, it is the same as saying that IHT opinions do support standardization/exchange. Consequently, if we reject the second H0 as well and we accept H1, that WSJ opinions do not support clearing houses, it is the same as saying that IHT opinions do support clearing houses. This inverse relationship between the opinions in the two newspapers will be made further clear by a regression analysis later in this chapter.

In order to examine the hypotheses, a Chi-square test is conducted. We had to perform a categorical non numerical analysis, as the opinions fell into two categories: "yes" and "no". And since this is a categorical hypothesis analysis chi-squared was chosen as the most suitable method, for examining if bias exists in the sample. The chi-squared test of independence of categorical variables is used to answer the question of whether the effects of one variable depend on the value of another variable. We specify α level at 0.05.

Hypothesis 1

Table 1

Participants * Standardisation Crosstabulation

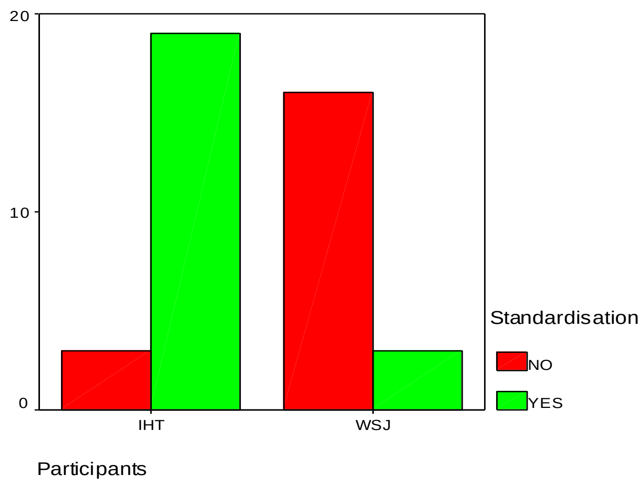
Count

		Standardisation		Total
		NO	YES	
Participants	IHT	3	19	22
	WSJ	16	3	19
Total		19	22	41

Case Processing Summary

	Cases					
	Valid		Missing		Total	
	N	Percent	N	Percent	N	Percent
Participants * Standardisation	41	47,7%	45	52,3%	86	100,0%

Diagram 1



The first part of the output simply gives information about the sample size. From table 1 it can be seen that only 3 opinions extracted from WSJ favored standardization compared to 19 from IHT. At the same time, 3 opinions expressed in the IHT were against trading on the exchange in contrast to 16 from WSJ. In total, 22 opinions favoured standardization/trading on the exchange and 19 were against.

Table 2

Chi-Square Tests

	Value	df	Asymp. Sig. (2-sided)	Exact Sig. (2-sided)	Exact Sig. (1-sided)
Pearson Chi-Square	20,421[b]	1	,000		
Continuity Correction[a]	17,681	1	,000		
Likelihood Ratio	22,519	1	,000		
Fisher's Exact Test				,000	,000
Linear-by-Linear Association	19,923	1	,000		
N of Valid Cases	41				

a. Computed only for a 2x2 table

b. 0 cells (,0%) have expected count less than 5. The minimum expected count is 8,80.

Table 3

Symmetric Measures

		Value	Asymp. Std. Error[a]	Approx. T[b]	Approx. Sig.
Interval by Interval	Pearson's R	-,706	,111	-6,221	,000[c]
Ordinal by Ordinal	Spearman Correlation	-,706	,111	-6,221	,000[c]
N of Valid Cases		41			

a. Not assuming the null hypothesis.

b. Using the asymptotic standard error assuming the null hypothesis.

c. Based on normal approximation.

As it can be seen from table 2, the value of the chi-squared statistic is 20.42. The chi-squared statistic has 1 degree of freedom (from the df column.) The last column gives the two-tailed p value associated with the chi-squared value. In this case, the p value equals .000. In table 3, there is an important warning at the bottom of the Chi-Square output. The warning tells us that 0% of the cell have expected frequencies less than 5. *Thus, none of the assumptions of chi-square has been violated and the results may be meaningful.*

Also, p-value (.0000 in this case) is less than the α value(.05) and therefore we can *reject* H_0. Thus, we conclude that opinions expressed in the WSJ do not favor standardization/exchange in relation to derivatives regulation. From table 4, we can conclude that the strength of association between the two variables (opinions in newspapers and standardization) is valid (p-value=.000) and also that there is a negative relation meaning that opinions expressed in the WSJ do not favor standardization.

Additionally, the Pearson's R value of -0.706 shows a negative relation between WSJ and IHT opinions. This is extremely important because it shows that by rejecting Ho and stating that WSJ opinions are not in favor of regulation, IHT opinions are indeed in favor of regulation. Pearson's product moment correlation coefficient shows the strength of linear dependence between two variables, in this case opinions in WSJ and opinions in IHT. The highly negative -0.706 proves the negative correlation between the opinions expressed in the newspapers and that is something that we were expecting.

Table 4

Symmetric Measures

		Value	Asymp. Std. Error[a]	Approx. T[b]	Approx. Sig.
Interval by Interval	Pearson's R	-,706	,111	-6,221	,000[c]
Ordinal by Ordinal	Spearman Correlation	-,706	,111	-6,221	,000[c]
N of Valid Cases		41			

a. Not assuming the null hypothesis.

b. Using the asymptotic standard error assuming the null hypothesis.

c. Based on normal approximation.

Hypothesis 2

As it can be seen from table 5, 27 from the opinions expressed in IHT were in favor of clearing houses, whereas only 13 opinions from the WSJ were in favor. As far as the opinions against clearing houses are concerned, we can see that 16 opinions from the IHT did not favor clearing houses, when 29 opposed to clearing houses from the WSJ.

Table 5

Participants * Clearing houses Crosstabulation

Count

		Clearing houses		Total
		NO	YES	
Participants	IHT	16	27	43
	WSJ	29	13	42
Total		45	40	85

Case Processing Summary

	Cases					
	Valid		Missing		Total	
	N	Percent	N	Percent	N	Percent
Participants * Clearing houses	85	98,8%	1	1,2%	86	100,0%

Diagram 2.

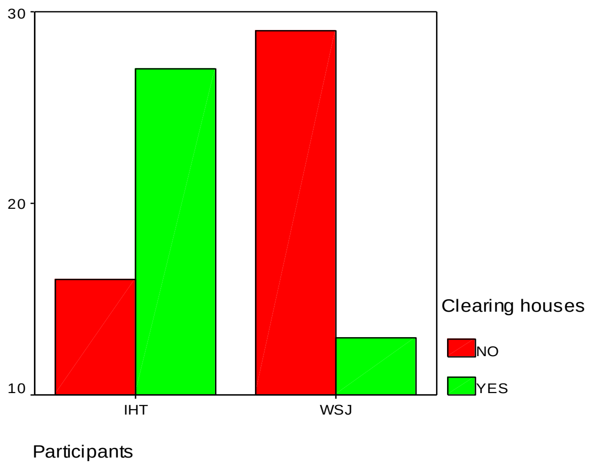


Table 6

Chi-Square Tests

	Value	df	Asymp. Sig. (2-sided)	Exact Sig. (2-sided)	Exact Sig. (1-sided)
Pearson Chi-Square	8,645[b]	1	,003		
Continuity Correction[a]	7,414	1	,006		
Likelihood Ratio	8,803	1	,003		
Fisher's Exact Test				,005	,003
Linear-by-Linear Association	8,543	1	,003		
N of Valid Cases	85				

a. Computed only for a 2x2 table

b. 0 cells (,0%) have expected count less than 5. The minimum expected count is 19,76.

From table 6, it is concluded that the value of the chi-squared statistic is 8.645. The chi-squared statistic has 1 degree of freedom (from the df column.) The last column gives the two-tailed p value associated with the chi-squared value. In this case, the p-value equals .005. In table 6, there is an important warning at the bottom of the Chi-Square output. The warning tells us that 0% of the cells have expected frequencies less than 5. *Thus, once again none of the assumptions of chi-square has been violated and the results may be meaningful.*

Additionally, p-value (.005 in this case) is less than the *α* value(.05) and we again reject H_0. So, we conclude that opinions in WSJ do not favor clearing houses in relation to derivatives regulation. From table 7, we can conclude that the strength of association between two variables(newspapers writers and clearing houses) is valid(p-value=.003) and also that there is a negative relation meaning that WSJ opinions do not favor clearing houses. At the same time it shows, due to the Pearson R's value of -.319 that opinions in IHT do favor clearing houses *showing, taking into consideration the results from the first* *hypothesis as well relating to standardization/exchange, that there is a clear relation between political bias and attitude towards derivatives regulation.*

Table 7

Symmetric Measures

		Value	Asymp. Std. Error[a]	Approx. T[b]	Approx. Sig.
Interval by Interval	Pearson's R	-,319	,103	-3,066	,003[c]
Ordinal by Ordinal	Spearman Correlation	-,319	,103	-3,066	,003[c]
N of Valid Cases		85			

a. Not assuming the null hypothesis.

b. Using the asymptotic standard error assuming the null hypothesis.

c. Based on normal approximation.

From the analysis so far it is evident that as expected, Wall Street Journal which is a newspaper of a more right wing perspective does not favour any kind of regulation, in contrast to the International Herald Tribune opinions from which favour both clearing houses and trading through the exchange. However, as will be discussed later, the preferred method are the clearing houses. Since our data is categorical and non-numerical it would be difficult to express the sample's preference in one of the two methods. Merely the fact that more opinions are in favour of clearing houses does not suffice.

In order to further assure the findings from the above chi-squared test we will also perform a regression analysis that is expected and should show an inverse relation between the opinions expressed in each newspaper. This will verify the Pearson's r value stated above and also the fact that indeed political bias does affect attitude towards regulating derivatives.

Regression Analysis

We conducted 2 regression analyses. The first one with variable X: Participants' opinions – and variable Y: Clearing Houses and the second one with variable X: Participants' opinions – and variable Y: Standardization/Exchange.

1st Regression Results

Table 8 and 9 indicate an R-square of 0.102 and a p-value 0.003, meaning that participants' views in relation to derivatives, regulation through clearing houses, can be used as an explanatory variable. Since it can be used as an explanatory variable we should examine what the outcome is. From correlation table 12 it is indicated that participants whose opinions were extracted from WSJ most possibly would not support clearing houses while those from IHT would do.

Table 8

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.319[a]	.102	.091	.4787

a. Predictors: (Constant), Participants

Table 9

ANOVA[b]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	2.154	1	2.154	9.397	.003[a]
	Residual	19.023	83	.229		
	Total	21.176	84			

a. Predictors: (Constant), Participants

b. Dependent Variable: Clearing houses

2nd Regression Results

Tables 10 and 11 indicate an R-square of 0.498 and a p-value 0.000, meaning that participants' views in relation to derivatives regulation through standardization this time can be used as an explanatory variable. At the same time correlation table 12 shows that as expected, opinions expressed in WSJ would most likely not support standardization while opinions from IHT would. The results of the regression analyses verify the findings of the chi-squared analysis and the Pearson's r value which indicated an inverse relationship due to political bias.

Table 10

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.706[a]	.498	.485	.3622

a. Predictors: (Constant), Participants

Table 11

ANOVA[b]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	5.078	1	5.078	38.700	.000[a]
	Residual	5.117	39	.131		
	Total	10.195	40			

a. Predictors: (Constant), Participants

b. Dependent Variable: Standardisation

Table 12

Correlations

		Clearing houses	Participants	Standardisation
Pearson Correlation	Clearing houses	1.000	-.319**	.803**
	Participants	-.319**	1.000	-.706**
	Standardisation	.803**	-.706**	1.000
Sig. (2-tailed)	Clearing houses	.	.003	.000
	Participants	.003	.	.000
	Standardisation	.000	.000	.
N	Clearing houses	85	85	40
	Participants	85	86	41
	Standardisation	40	41	41

**. Correlation is significant at the 0.01 level (2-tailed).

IV.Analysis:

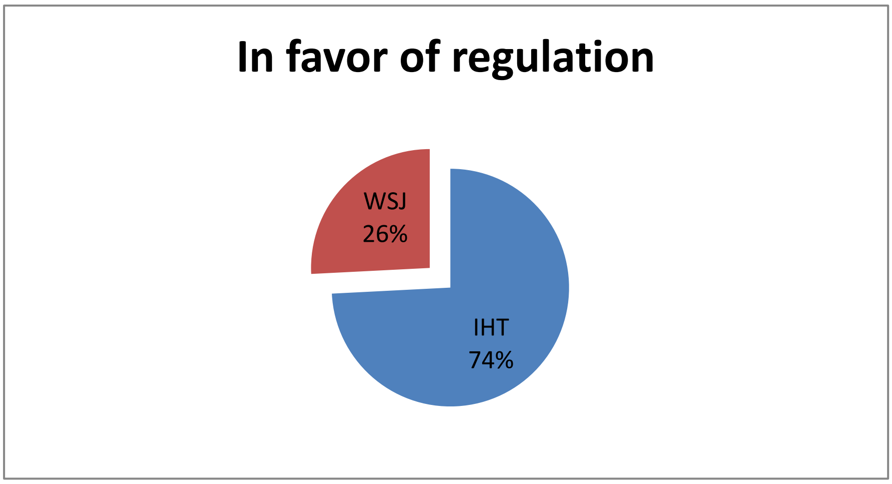
In this section we will try to put flesh on the bones of the numbers that the statistics provided. We will take some quotes from some of the most significant parts of the articles used to show how their political bias affects their attitude towards derivatives control. In that way, we can help both the government and the lawmakers to realise how many of such comments should be considered with suspicion as to how biased they are and what purposes they serve.

The debate for derivatives regulation has started mainly after the 2007 crisis. Since then a variety of measures have been suggested to deal with the problems, with some even asking for the banning of OTC derivatives. Five years later clearing houses seem to be the bet that regulatory bodies and the governments are considering to take. Therefore since our analysis has a time horizon of two years (2009-2011) it is understandable that most opinions expressed will be focused on clearing houses.

As can be seen from the statistical analysis, the political bias does indeed affect attitude towards derivatives regulation. Individuals who expressed their opinions in the more leftist newspaper International Herald Tribune were massively in favour of some form of regulation and especially clearing houses. Suffice to say that from the 43 individuals examined 27 were in favour of clearing houses and 16 against. From the 27 in favour 19 would agree to derivatives being traded on the exchange (standardisation of derivatives) to ensure some form of regulation and transparency in case clearing houses were not supported by the government and the regulatory bodies. However as it will be shown later it is made clear that clearing houses are their prime choice. On the other hand, from the 16 who were against clearing houses only 3 made a comment about trading on the exchange and of course they were against it. The reason for this is that clearing houses have been discussed much more heavily as a potential solution, as a much more radical one, and therefore it was the main topic of discussion relative to derivatives regulation.

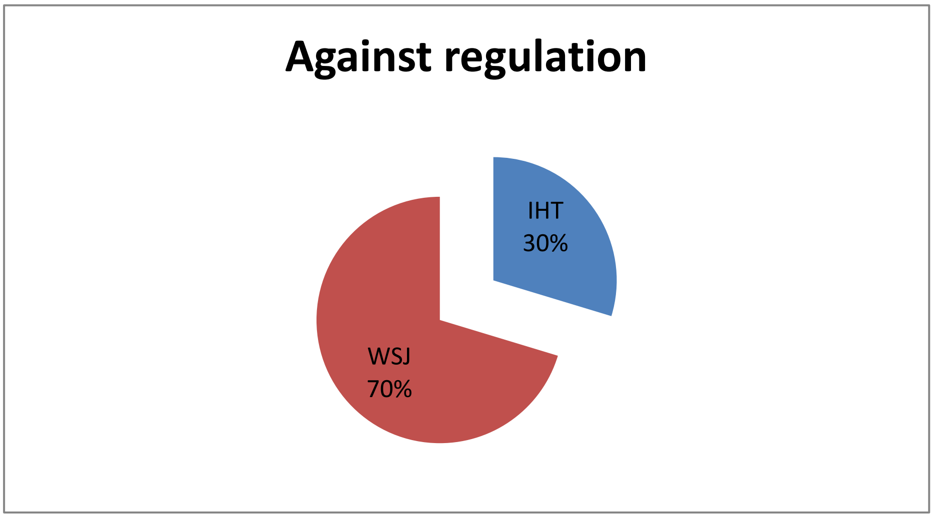
As far as the Wall Street Journal is concerned, as already stated is a newspaper of a more right wing approach. Thus, as expected, individuals whose opinions were expressed in its articles and comments were largely against regulation. Of course they all mentioned that they wanted greater transparency but that was merely for not being criticized for not wanting anything to change. Greater transparency can be achieved both by central clearing and even by standardisation but merely 13 individuals were in favour of these measures from a total of 42. At this point let's do a comparative simple analysis to examine what percentage of those who agreed and those who did not agree with derivative regulation belonged to each newspaper. In total, 62 opinions were expressed in favour of regulation, 40 favouring clearing houses and 22 favouring standardization. This shows a clear preference to central clearing. From the 62 in favour, 46 were expressed in the International Herald Tribune and only 16 were expressed in Wall Street Journal. This means that 74.1% of the pro regulation opinions were found in the International Herald Tribune leaving only 26.9% to be found in Wall Street Journal as is indicated in pie chart1.

Pie Chart1



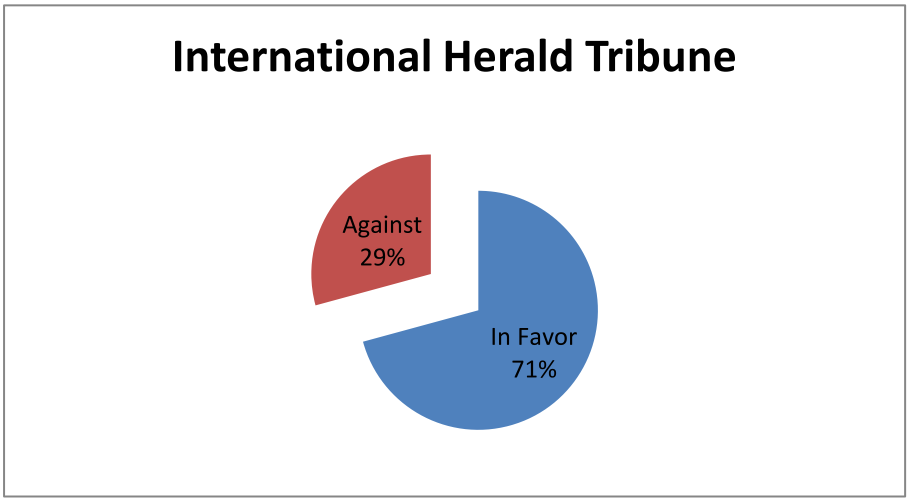
Adversely, as far as opinions against regulation are concerned, they totalled to 64. From these, 45 were against central clearing and only 19 against exchange traded derivatives. From the 64 opinions against, 45 were expressed in the Wall Street Journal and 19 in the International Herald Tribune. In other words, 70.3% of the opinions against the regulation of derivatives were extracted from Wall Street Journal and only 29,7% were found in the International Herald Tribune as shown in pie chart 2.

Pie chart 2

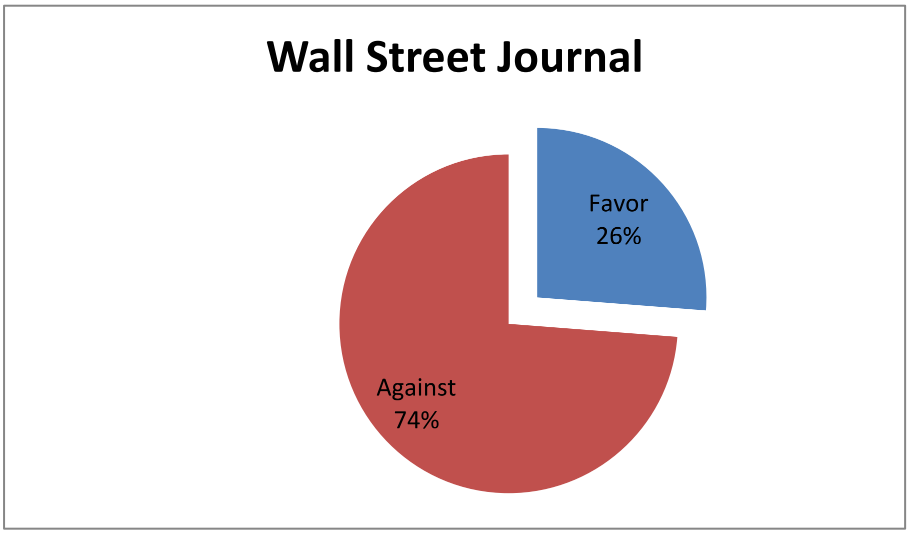


Finally, as far as IHT is concerned, the total opinions examined were 65. From those, 71% of the opinions were favourable towards regulation of derivatives, which in numbers is 46, and 29% were against, ie 19 and it can be seen in pie chart 3. With regards to Wall Street Journal, total opinions examined were 61. From these, 45 or else 74% were against any type of regulation and only 16, ie 26%, were in favour as shown in pie chart 4.

Pie chart 3



Pie chart 4



Those who favoured these measures in the Wall Street Journal did not forget to mention that they only favoured them under certain circumstances and after some adjustments had been made. One suggestion put forward was that a provision could be made for non-financial firms such as airlines, energy producers and industrial firms who reportedly use derivatives to hedge, to be exempted from derivatives regulation. The reason of course is that the purpose that such firms use derivatives is purely to cut costs and purely hedge against risks associated with sharp changes in oil prices, exchange rates etc.. Nevertheless, as Dalton 2011 notes : "The commission, however, rejects a total exemption for non-financial firms. "In particular, [a total exemption] carries the potential for (a) regulatory arbitrage for financial firms to shift their trades through the non-financial sector and (b) the possible creation and growth of systematically relevant volumes of positions in [non-financial firms] that should be of interest to regulators" (Dalton 2011). Also Leonard (2010) comments: "Attempting to distinguish, in written law, between what is acceptable hedge- legitimate risk management- and what is out of bounds speculation, would be a challenge for any regulator" (Leonard 2010). Surprisingly, Robert Pickel who is chief executive officer of the Internation Swaps and derivatives Association, New York, has actually found a positive contribution of speculators: "Having people who are in the speculation adds liquidity and depth to the market so that anybody who is a pure hedger, can tap that market and know they have a deep liquid market to turn to" (Felix Salmon, "should we be worried about stock market illiquidity?, 18/10/2011).

Another suggestion is that the problem does not lay with hedging itself, but with "naked" hedging, in simple words, hedging against a position that you don't have. Instead, some pro regulation participants in the sample have suggested the banning of naked hedging, however David Havens, managing director of Hexagon Securities has a different opinion: "what we really need to have is not a ban on naked hedging, but a mechanism- clearing house or an exchange- where market participants are forced to pony up collateral so that you have a market that doesn't spin out of control." To sum up with "naked" hedging it would be helpful to quote the words of George Soros which seem prophetical for the case of Greece and the "attack" that it allegedly witnessed by speculators: "What we must take away from this is that CDS are toxic instruments whose use ought to be strictly regulated. Only those who own the underlying asset or bond ought to be allowed to buy them" (George Soros, 2009). He then goes on by discussing: "Many argue now that CDS ought to be traded on regulated exchanges. I believe that they are 'toxic' and should only be allowed to be used by those who own bonds, not by others who want to speculate against countries or companies" (ibid). Finally, the answer to the financial institutions who wish to create this loophole with the exemption of non-financial companies comes from Representative Barney Frank (D., Mass.), chairman of the House Financial Services Committee who said: "I'm worried about the financial institutions taking the end users in effect as hostages to get out from under some of these requirements" (Damian Paletta, " Late change sparks outcry over Finance- Overhaul Bill", 01/05/2010, Wall Street Journal)

Let us at this point examine some additional issues raised by those against and in favour of regulation. Of course stating the source from which these have been extracted shows what has been proved statistically above, but is essential as it will show not merely numerically the positions that the two newspapers take, but also how the political bias is shown via their writings. Jamie Dimon, J.P. Chase CEO in his interview on the 5th of April 2011 which was printed with the title "Jamie Dimon Says regulations will stifle economic growth" in the Wall Street Journal mentions: "regulation for over the counter derivatives could prove too expensive and drive swap business overseas". He then added: "Moving OTC derivatives onto central clearing houses wouldn't eliminate risk with derivatives. It would just concentrate it" (ibid). Indeed this is a point that demands extreme care and attention. The problem in the 2007 crises was not merely the use of derivatives, but the sudden and abrupt decrease in the value of the underlying assets, ie house prices. Therefore, even if the derivatives were centrally cleared, it is highly unlikely that it would have averted house price decline. However, we are not in a position to know hypothetically how a central clearing part could react to such an event in the future. Since we are discussing the issue of unforeseen "phenomena" and black swans let us discuss another great issue which has been the centre of attention for many articles in the two newspapers. Systemic risk.

Systemic risk can be defined as the kind of risk that cannot be diversified and is inherent to the entire market, or an entire market segment. Systemic risk became mostly apparent with the current financial crisis to the extent that many economists pronounced the crisis both inexplicable and unforeseen (Stout, 2009). It raised two important issues. The one issue is whether market forces will ensure an efficient level of systemic risk if they are left to their own devices and the other is if regulated systemic risk is needed, what form should it take? In the current crisis, systemic risk has manifested itself in the moral hazard encouraged by "too big to fail" guarantees. For that reason many individuals against regulating derivatives have repeatedly raised concerns over the fact that a central clearing house could end up becoming "too big to fail", thus making no difference. An article for the Wall Street Journal back in 2009 includes Rene M.Stultz opinion expressed in his 2009 paper: "if counterparties can fail so can clearing houses. And if a clearing house clears a significant amount of OTC derivatives trades, then its failure could have a much more dramatic impact on the financial system than the failure of a derivatives dealer. From this it follows that clearing houses must be properly capitalised" (Stultz 2009). The International Herald Tribune discusses a paper by the IMF in its article of 5th April 2011 by Stephen J. Lubben titled "The problems with derivatives clearing" and comments: "The paper argues that the focus in Dodd Frank Act on central clearing of derivatives is not the best solution and that central clearing parties are apt to become "too big to fail". However, the article goes on to criticize the aforementioned paper and shed light to the points that it omits to take into consideration. To be more precise it is stated: "But what I want to focus on here is the way in which the I.M.F.'s new paper essentially ignores the costs of close-out netting, which, if you talk to some in the derivatives industry, is something to be protected with the same vigour as apple pie, mom and Old Glory." (ibid)

"In particular, the article in question worries that the move to central clearing would reduce the ability of big financial institutions to "net" their gross exposure to a given counterparty.

This is pretty typical among banking types, where netting is seen as a universal good. The costs of netting are rarely discussed."(ibid)

In addition to the above, Stultz has stated to the House Committee on Financial Services that "as long as the clearing house is well capitalised and manages its risks well, there is no material counterparty risk with clearing houses. Only this way the systemic risk can be significantly reduced" ("Stultz to the House Committee on Financial Sercvices, 2009"). However this was not mentioned in the Wall Street Journal article mentioned above that included his opinion that clearing houses could "become too big to fail".

Furthermore, as far as the IHT is concerned there are direct comments regarding the Republican Party and their attempt to misguide derivatives regulation. To be more precise, the newspaper in an article dated December 26 2010 "How to derail financial reform", quotes Representative Spencer Bachus of Alabama saying: "the regulators are there to serve the banks". Furthermore, on the same article they comment on Reupublican's Eric Cantor's statement that: "American people want and expect Republicans to cut off financing for Dodd-Frank" adding that "it would be a job killer". The comment the newspaper made, as this is extracted from an editorial was: "Could he be more wrong? Americans concern is that the financial reform is too weak. Not too strong. The Republicans intentions could not be clearer." Furthermore they went on to question how derivatives regulation could end up becoming a job killer, and actually made a sarcastic comment saying that it would end up in people not being able to afford a loan not to get one. Possibly linking the unregulated OTC derivatives market, with the subprime mortgage loan CDSs and the bailout of AIG. Additionally, in another article dated November 1, 2010 Sewell Chan mentions: "Dodd Frank financial overhaul signed into law by Obama, with almost no Republican support – perhaps because of its complexity".

Moreover, in another editorial dated 27 April 2010 and titled "Wall Street Casino" a sarcastic attack is launched towards Goldman Sachs and its derivative trading business: "*The Securities and Exchange Commission has accused Goldman of defrauding clients by selling them a complex instrument without telling them it was designed so another client could bet against it. Testifying before the Senate subcommittee on investigations, Goldman executives denied withholding information. They insisted there was nothing wrong with selling mortgage-backed products while placing bets against them.*

They called it "risk management." Most people call it stacking the deck.

We do not know whether Goldman broke the law, but we know this gambling is too dangerous. Banks like Goldman turned the financial system into a casino. Like gambling, the transactions mostly just shifted money around. Unlike gambling, they packed an enormous capacity for economic destruction — hobbling banks that made bad bets, freezing credit and economic activity. Society — not the bankers — bore the cost." The above shows the clear position that the leftish newspaper takes towards the large banks. This could be a direct result of the political bias of the leftish newspaper. Its criticism for the fact that large baks were too free to act as they pleased is what one would have expected and something that verifies the results of our analysis that political bias does affect the attitude towards derivatives regulation.

Furthermore, another article dated April 26 2010 includes yet another "attack" towards a Republican member and more precisely Nebraska Senator Ben Nelson. In that article Ben Nelson, David Sokol and Mike Johanns expressed their aversion towards derivatives regulation. However, the article went on to comment that all of the aforementioned have been accepting funding from Warren Buffet whose firm according to the article has $63 Billion derivatives portfolio according to Barclay Capital. The article actually states that Senator Nelson has received approximately $75,550 but he does not admit to it and did not wish to comment. As a last example we will use one where a Democrat is against regulation and is quoted, so as to get her response in the next paragraph. The article printed on October 3rd and titled "Wall Street goes to Sefcon II on swaps, quotes of a New York Democrat, Representative Carolyne Maloney who not only is against fierce regulation but having teamed up with a New Jersey Republican, Representative Scott Garrett stated in a room packed with 400 bankers : "I'd like very much to work with you to make sure New York City is the financial capital, not just of New York State, but of the world. If you see a regulation that is unfair, let us know and maybe we can work together." The response was immediate and came from the mouth of Mr. Giancarlo head of Sefcon who stated: "the Commodity Futures Trading Commission is proposing rules that, betray a hidden prejudice toward electronic-only" trading "ill-suited to real market conditions." The article goes on to close with a statement by mr. Giancarlo regarding the rules that Mrs. Malonyey supports: "There are those who might like to roll them back and put us back in the regulatory environment that led to the crisis three years ago. Only with reform can the public get the benefit of transparent, open and competitive markets."

From the WSJ a very interesting article dated the 20th of May 2010, "How the Financial Overhaul Vote went down" describes how the two political parties voted. Despite the fact that 39 of the 41 Republicans voted against it, in the last paragraph the article asks how it is possible to blame the Republicans since 2 members of the Democratic Party voted against the regulatory measures. The response came from Mr. Reid: "If I were writing the story, it would be pretty easy to write a story that basically 57 of 59 Democrats voted… and it would be pretty easy to write the story that 39 of the 41 Republicans voted against it. It's pretty simple math."(ibid) The above question could be received as an attempt to remove the burden from the shoulders of the Republicans and turn the attention to the two Democrats who voted against without at the same time mentioning the two Republicans who voted in favor of regulation. Not to mention that one of the Democrats who voted against, Senator M. Cantwell, did so because she thought that the new measures were not strict enough on derivatives regulation.

Switching the subject, and in an attempt to show why clearing houses are preferred to exchange traded derivatives we will quote some interesting opinions expressed in the two newspapers. Joseph Stiglitz, who has served as a Senior Vice President and Chief Economist of the World Bank from 1997 to 2000 has been a consistent supporter of regulation and has argued in favor of government intervention to correct market failures especially with regard to asymmetric knowledge. He has stated "The problem with many derivatives was that they were so complex that even if all the information about them had been disclosed, most market participants would not have been able to assess their real value. Exchange traded derivatives would have provided most of the risk managements services needed, but in a more transparent way, with more competitive pricing" (Stiglitz, 2010). Price competition however is not desired by the big investment banks. As stated in the literature review, the most important difference perhaps form the point of view of Wall Street has to do with the fact that exchanges would impose pre-trade price transparency in contrast to clearing houses which would impose post-trade transparency to almost all aspects of the deal. This is emphasized in an article of International Herald Tribune on the 19th of October 2011, with title "Derivatives": "Wall street has signaled that it can leave with a clearing house approach but it is strongly opposed to exchange trading of derivatives, which would introduce price competition and lower the profits." Therefore, since clearing houses are preferred by the majority of those who are in favor of regulation, and since the Wall Street has shown that they would prefer clearing houses to exchange traded derivatives, we can claim that the more suitable solution to be considered would be a central clearing party.

V.Conclusion

The issues associated with derivatives and their regulation are many and difficult to settle. Derivatives regulation is a topic that has been appearing often in the news lately, and results in a lot of back and forth between experts. In fact, these issues and difficulties that make derivatives so controversial are also what make them a very interesting and important topic to study. The main issue is that there is a deep divide between those experts who want derivatives to be regulated and those who do not. Of course, there are some who take more intermediary positions, i.e who think that there should be some regulation, but that the regulation itself should be severely limited. Still, there is a clear divide between those who are in favor and those who oppose the regulation of derivatives. The weight of opinion seems to support some regulation and very few are prepared to argue in favour of no regulation at all. For instance, even Alan Greenspan who has been the greater supporter of deregulation has admitted: "I was wrong about the economy. I have found a flaw. I don't know how significant o permanent it is But I have been very distressed by that fact". The traditional right wing free market view is therefore usually expressed a bit more subtly than usual in order to accommodate the apparent consensus in support of some degree of regulation. The Economist, for example which is a right of centre newspaper and generally supports the non-interventionist free market viewpoint, acknowledges the need for regulation, but points out that regulating such a complex market as the derivatives market is so difficult as to render it ineffective. (Voters versus creditors, Nov. 17th 2011).

There can be many reasons for why an expert choses a particular side of this debate. However, we wanted to test the hypothesis that an important, if not the main reason for why an expert chose a particular side, was his/her political affiliation. This hypothesis should not, in itself, be controversial. Political affiliation and economic policy often go hand in hand.

In general, advocating for regulation is usually associated with the left and advocating free market policies is usually associated with the right.

This classification is especially clear in the United States. The political spectrum there ranges from the Democrats (and possibly some environmentalists) on the left to the Libertarians on the far right. The Democrats are generally in favor of market regulation, for economic as well as social reasons. They advocate redistribution of wealth in the form of progressive taxes, state-run healthcare etc. They do not believe that the market will distribute wealth fairly, if left entirely on its own. On the other hand, the Republicans are less in favor of regulation, again for both social and economic reasons. They believe that it is not fair to redistribute wealth, while they also believe that the market will distribute wealth appropriately when left to its own devices. Still, they do believe in some regulation. They do think that there are some aspects of living in a society that need centralized regulation, for example the building of roads, schools etc. Those who do not believe in any regulation are the libertarians on the far right. They think that any intervention on the workings of the market is unjustified and will ultimately lead to problems. In addition, they believe that governments that regulate the economy or the social sphere is usually infringing on its citizens' rights. This paper finds it difficult to still believe, especially after the analysis and the opinions expressed in the articles examined, that the free market is the solution to the problems that the financial world is facing.

In Europe, the situation is less clear cut. This is because there are many more political parties that span a greater part of the political spectrum. For example, there are many parties that are much more left-wing than the Democrats. Also, various political parties differ in many dimensions. In other words, the political, economic and social divisions in opinion do not always line up, in the way they do in the US. We should mention here that this is especially true of continental Europe, whereas the UK is somewhere in between continental Europe and the US. For this reason, in this dissertation we sampled the opinions of those writing in US newspapers. However, one of the two newspapers (the IHT) is aimed at an international audience. The idea here was that the general framework would be the one present in the US, yet it would not be taken for granted, but justified in each article/editorial.

Our hypothesis was consistent with the general trend that we mentioned in the previous paragraphs. That is, we expected the experts on the left to be more in favor of derivatives regulation and those on the right to be against derivatives regulation. To this end, we randomly selected a set of articles from two different newspapers (one from the right and one from the left) and classified the authors' positions in terms of political affiliation and stance towards regulation of derivatives. As expected, there was a clear correlation between leftist orientation and favoring regulation on the one hand, while those on the right favored less regulation. A popular argument presented by the right wing lobby is that regulation, although necessary, is nevertheless not very effective because the markets are always one step ahead and are able to find loopholes to get around the regulations. For this reason they support only the most basic of regulations that can be enforced, but will have limited effects on the markets.

One worry that someone could have is that the bias in question was not a political one, but one centered in the media. We investigated this possibility by consulting two journals that have examined the question of media bias in some dtail and have developed methods of measuring media bias. Both of these journals confirmed the existence of media bias especially with respect to the newspapers that I had selected for the literary review, namely the WSJ and the IHT. Interestingly these surveys of media bias found a general left of centre bias conforming to the liberal view as expressed in the political context of the USA. The news content of virtually all media was biased towards the left of centre liberal view, including the WSJ. The editorial content however, was recognized to be the definitive test for the political viewpoint expressed.

However, there were some additional issues that emerged from this study, which are quite subtle, but also quite interesting. One was that the obvious political left of centre bias among Washington journalists, does not necessarily translate to a news article bias (Media Bias page 1225) in fact it appears that journalists tend to fit the expected tone of their newspaper rather than try to execute a political agenda. Another is that the USA media provides the whole spectrum of views so that the discerning citizen can usually find both sides of an argument relating to political issues. The implication is that political bias in the media is transparent and identifiable and therefore does not unduly influence people in any undesirable way.

It is beyond the scope of this paper to examine every aspect of political and media bias and to analyse its significance for overall policy issues. The aim here is simply to include it as a potentially important parameter in the evaluation of attitudes to financial market regulation. These attitudes will collectively influence policy makers and are at the same time influenced by policy makers and it is therefore important to be able to identify the objectivity of the attitudes. Hopefully this paper will identify some of the important issues relating to the question of regulating financial markets, and in particular the potentially toxic derivatives market. Many opinions have been recorded and general comparisons have been made, but it remains to be seen whether there is the will or the know how to effectively control these markets. There seems to be little doubt or disagreement that greater transparency is needed in order to overcome the potential market failure arising from asymmetric information. It is however very difficult to legislate or enforce transparency.

Hopefully, this paper will play its role in shedding light on the debate whether derivatives regulation is influenced by political bias. This debate, and thus this paper, is of great interest to lawmakers and the public. Lawmakers need to take into extreme consideration the reason for which each highly respected individual is in favor or against regulation. They should be in a position to block out opinions that serve political agendas and focus on solutions that come from individuals whose purpose is to ameliorate the financial world and how it operates. Additionally, the public should be informed about political bias in the opinions expressed, so that each and everyone can be able to filter out what opinions he does not consider to be objective. Finally, lawmakers could possibly benefit from the fact that through the analysis and examination of the newspaper articles, we have come to conclude that clearing houses are the most suitable solution to the derivatives regulation problem, and the most acceptable by both parties. Not to mention that the free market has failed to prove its supporters right. And that belief is also shared by the ex-President of the United States, Bill Clinton who in an interview on ABC's "This Week" program broadcasted on April 18, 2010 stated: "I think they were wrong and I think I was wrong to take their advice. Their argument was that derivatives didn't need to transparency because they were expensive and sophisticated and only a handful of people will buy them and they don't need any extra protection". In Greece there is a saying: "The stronger the enemy, the more significant the victory", and the acceptance of defeat of President Bill Clinton and Alan Greenspan, makes the victory of those in favour of regulation significant indeed.

VI. References

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VII. Appendix

The 50 articles from Wall Street Journal are:

1. http://online.wsj.com/article/SB10001424052702304798204575183472688378484.html?
2. http://blogs.wsj.com/deals/2011/04/05/jamie-dimon-says-reuglations-will-stifle-economic-growth/?
3. http://online.wsj.com/article/SB10001424052702304563104576361803281173520.html?
4. http://online.wsj.com/article/SB10001424052748703625304575115922056505044.html?
5. http://online.wsj.com/article/SB10001424052748704513104575257222839549124.html?
6. http://online.wsj.com/article/SB10001424052748703559004575257092300434822.html?
7. http://online.wsj.com/article/SB10001424052748703743504575493252555156806.html?
8. http://online.wsj.com/article/SB10001424052748703579804575441750105850046.html?
9. http://online.wsj.com/article/SB10001424052748704525704575341272318806114.html?
10. http://online.wsj.com/article/SB10001424052748704525704575341272318806114.html?KEYWORDS=derivatives+regulation#project%3Dfinreg1005%26articleTabs%3Dinteractive
11. http://blogs.wsj.com/deals/2010/01/13/live-blogging-the-financial-cirisis-inquiry-hearing/?KEYWORDS=derivatives+regulation
12. http://online.wsj.com/article/SB10001424052748704133804575197852294753766.html?KEYWORDS=derivatives+regulation
13. http://online.wsj.com/article/SB10001424052748703969204575220541275711182.html?
14. http://online.wsj.com/article/SB10001424052748703709804575202003308490606.html?
15. http://online.wsj.com/article/SB10001424052748704471204575210020265443194.html?
16. http://online.wsj.com/article/SB126023676584581197.html?

17. http://online.wsj.com/article/SB10001424052748703559004575256983028632328.html?
18. http://online.wsj.com/article/SB10001424052748704506404575592462788545960.html?KEYWORDS=derivatives+regulation
19. http://blogs.wsj.com/financial-adviser/2010/04/27/12-ways-i-would-fix-wall-street/?
20. http://online.wsj.com/article/SB10001424052748703315004575073690273589262.html?
21. http://online.wsj.com/article/SB10001424052748704285104575492182195397138.html?
22. http://online.wsj.com/article/SB10001424052748703615104575328963616067960.html?
23. http://online.wsj.com/article/SB10001424052702304563104576363730800713042.html?
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