

ster which has to be put back into the closet.” He therefore proposed that hedge funds, capital funds, and investment banks be brought under the same type of control as the regular banking system, and that reserve requirements be tightened, rather than loosened.

Isn’t this an attack on free trade? he was asked. Yes, when it’s too free, as Koehler said. It’s become so free that greed has taken over. Especially the way high debt creation has been used in speculation.

## Sovereign Governments, Unite

The Elder Statesmen’s call clearly falls short of the full program of bankruptcy reorganization and establishment of a new international monetary system that has been put forward by Lyndon and Helga LaRouche. Yet it reflects an awareness of the bankruptcy of the financial system, its horrendous social consequences, and the disconnect between the financial markets and the physical economy which is essential for the necessary moves to be taken. The mere fact that they discuss the financial world accumulating “fictitious capital, with very little improvement for humanity and the environment,” when the term “fictitious capital” has been seldom used by any economists beyond the German early 20th-Century economist Rosa Luxembourg and the LaRouches, sends a strong message to the Anglo-Dutch financial oligarchy.

It is clear that these statesmen recognize the *systemic* nature of the crisis. The next step is for them to embrace the solution-concept put forward by LaRouche: a new international agreement based on the establishment by sovereign governments of fixed currency parities; two-tier credit systems with low-interest rates for priority infrastructure projects and needed physical production; and forging new cooperative relationships to get out of the current depression. What President Franklin Roosevelt proposed as the foundation for the post-World War II world, must be implemented in order to prevent World War III.

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## Documentation

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# ‘Free Markets Cannot Ignore Social Morals’

*Here is the call, issued by 14 European elder statesmen, for a new “European Crisis Committee.”*

Danilo Türk  
President of the Republic of Slovenia  
19 May 2008

Dear President,

Financial markets can not govern us!

The current financial crisis is no accident. It was not, as

some top people in finance and politics now claim, impossible to predict. For lucid individuals the bell rang years ago. This crisis is a failure of poorly [regulated], or unregulated markets, and shows us, once more, that the financial market is not capable of self-regulation. It also reminds us of worrisome escalating income discrepancies in our societies, and raises serious questions about our ability to engage developing nations in a credible dialogue about global challenges.

Financial markets have become increasingly opaque and, identifying those who bear and evaluate the risk is frequently more than a formidable task. The size of the lightly or not-at-all regulated “shadow banking sector” has constantly increased in the last 20 years. Major banks have been involved in a game of “origination and distribution” of highly complex financial products and in pretty questionable packaging and selling of debt tied to high-risk mortgages. Inadequate incentive schemes, short-termism, and blatant conflicts of interest have enhanced speculative trading.

Dubious mortgage credits, wrongly based on the idea that never-ending housing price increases would pay for debt repayment, are only the symptom of a broader crisis in financial governance and business practices. The top three rating agencies in the world rated odd securities as relatively risk-free. One investment bank earned billions of U.S. dollars by speculating downwards on subprime securities while selling them to its clients, epitomizing the loss of business ethics!

We were warned of the dangers. Alexander Lamfalussy and the Committee of Wise Men, in a report on European securities markets (2001), underlined the trade-off between apparent higher efficiency and financial stability. [Former U.S. Federal Reserve chairman] Paul Volcker too has warned against this crisis in the making years ago. [*New York Times* financial columnist] Paul Krugman warned against the threats posed by the expanding non-regulated financial entities about a decade ago. In 2003, Warren Buffett called derivatives “financial weapons of mass destruction.” A Bank of England report on financial stability highlighted the dangerous distance between lenders and the consequences of their decisions.

The problem is a model of economic and business governance based on under-regulation, inadequate supervision and an under-supply of public goods.

This financial crisis shows all too clearly that the financial industry is incapable of self-regulation. There is a need to improve the supervision and regulatory frameworks for banks. There is a need to revise the regulatory frameworks for investment vehicles. The use of financial instruments (like CDOs [collateralized debt obligations]) has to be regulated. All financial institutions should be required, like banks, to hold minimum reserves, and the level of leverage should not be unconstrained. Last but not least, incentive schemes have to be corrected so that reckless risk-taking not be stimulated at the expense of prudence.

About the consequences of this crisis in the real econ-

omy, it seems that the world economic expertise is shy! Practically all institutions devoted to forecasts are lowering their evaluations of growth for the developed countries in 2008 and 2009. But no one says clearly if we are under the threat of an economic recession in Europe. Some symptoms, however, can be read in this sense. In the case of the European Union, the occurrence of a recession this year or next one would be dramatic!

Rising income inequality has gone in tandem with an ever-growing financial sector. It is true that technological progress has contributed significantly to rising income differentials by favoring highly skilled labor. However, misguided policies have had their major role too in this respect. Financial assets now represent 15 times the total Gross Domestic Product (GDP) of all countries. The accumulated debt of households, financial and non-financial companies, and of the American public authorities amounts to more than three times the U.S. GDP, twice the level in 1929. The financial world has accumulated a massive amount of fictitious capital, with very little improvement for humanity and the environment. This financial crisis has thrown some light on the alarming income differentials which have increased in recent decades. Ironically, for many CEOs, salaries and bonuses reached incredibly high levels, while the performances of their companies stagnated, or even went down. There is a huge ethical issue here.

Free markets cannot ignore social morals. Adam Smith, the father of *laissez faire* economics, wrote also “The Theory of Moral Sentiments,” and Max Weber connected hard work and moral values to the advance of capitalism. Decent capitalism (that respects the dignity of man, to use Amartya Sen’s words) needs effective public policy. Profit seeking is the essence of a market economy. But when everything is for sale, social cohesion melts and the system breaks down.

The current financial crisis diminishes the West’s ability to [conduct] a better dialogue with the rest of the world on global challenges, in managing the effects of globalization and global warming—just when Asia’s extraordinary economic progress poses unprecedented new challenges.

The spectacular rises in energy and food prices compound the effects of the financial turmoil and are ominous about what lies ahead. Quite tellingly, hedge funds have been involved in driving up the price of basic staples. It is the citizens of the poorest countries that will be most affected. We risk unprecedented destitution, proliferation of failed states, migration, and more armed conflicts.

Some people boast of “robust European economies,” better financial supervision and regulation (than in the U.S.). And, arguably, there is some truth in it. But consider the increasing trouble in the property markets in the U.K., Spain, and Ireland, and economic slowdown spreading all over Europe. Think also about economic nationalism and populism, which are both on the rise.

EU policymakers, at the European Union and national level, have to provide a firm response to the current financial crisis. We need pragmatism, open-mindedness, and cooperation in pursuing common goals!

Europe must take stock of these developments and identify the foreseeable consequences in the short and longer run, and come up with proposals for the international community to counter the effects and root causes of this crisis.

It is time to set up a “European Crisis Committee” gathering high-profile politicians, former heads of state and government or finance ministers, as well as renowned economists and financial experts of all continents. This committee should have the following tasks:

- To make an in-depth analysis of the financial crisis, in the wider context we have tried to outline above;
- To describe and assess the economic and social risks entailed by the financial crisis to the real economy, particularly in Europe;
- To suggest a series of measures to the Council of the European Union in order to avoid or limit these risks;
- To present to the Council of Ministers, the member states of the UN Security Council, the director-general of the IMF [International Monetary Fund], and all authorities and bodies concerned, a set of proposals to limit the effects of this crisis and prepare a World Financial Conference in order to rethink the rules of international finance and the governance of global economic issues.

In 2000, we had agreed to make the European Union the most competitive area in the world. This was reconfirmed in 2005. We must ensure that Europe’s competitiveness is supported and not undermined by financial markets. We need to act now: in the name of our citizens, for more investment, economic growth, social justice, job opportunities, and all in all, a better future for all Europeans.

Yours sincerely,

Jacques Delors  
Jacques Santer  
Romano Prodi  
Helmut Schmidt  
Otto Graf Lambsdorff  
Lionel Jospin  
Pär Nuder  
Michel Rocard  
Hans Eichel  
Göran Persson  
Daniel Daianu  
Massimo d’Alema  
Ruairi Quinn  
Poul Nyrup Rasmussen  
Eero Heinäluoma  
Paavo Lipponen  
Laurent Fabius  
Anneli Jaatteenmaki