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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, 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 twenty 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 USD 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. Poul Volcker too has warned against this crisis in the making years ago. 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 undersupply 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) 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 be not stimulated at the expense of prudence.

About the consequences of all this crisis in the real economy, 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 favouring highly skilled labour. 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 US 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 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 for 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 US). And, arguably, there is some truth in it. But consider the increasing trouble in the property markets in the UK, Spain, and Ireland, and economic slowdown spreading all over Europe. Think also about economic nationalism and populism, which are both on the rise.

EU policy-makers, at 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 an "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 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 have 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,

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