Item 3 of the agenda:

The financial crisis: The consequences on the real economy

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Item 7:

THE GLOBAL FINANCIAL CRISIS

UNI's Agenda for Change

- **UNI Global Union Response**
  Eight questions for discussion

- **The US Financial Crisis**
  and the End of Free Market Fundamentalism

UNI Global Union Response
Eight questions, for discussion

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Eight questions, for discussion

1. ***What is happening?***
2. ***Why is it happening?***
3. ***How are governments trying to manage the short-term crisis?***
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5. ***Is this a turning point?***
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7. ***What about the real economy?***
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1. What is happening?

"The financial markets have not done what they are supposed to do, which is to manage risk and allocate capital" – Joseph Stiglitz, economist

Although this is not the first financial crisis in recent times (Asia 1997-8, Russia 1997-8, Argentina 2001) it is quite exceptional in its global spread and in its seriousness. The banking systems in large parts of the developed world have, effectively, seized up.

Venerable names in banking and finance, some of them massive institutions, have gone already or have had to be bailed out.

Banks are refusing to lend to one another – removing the money flow which, like engine oil, normally lubricates the economy – and are reluctant to lend to business and individual customers. This is reinforcing the pressures driving major economies into recession.

The crisis is certainly not yet over. But, as a reminder, the last few months have seen some unprecedented events.

Signs of the storm ahead:

- July 2007: Bear Stearns (US) securitised mortgages hedge fund collapses
- Sep 2007: massive outflow of deposits at Northern Rock bank (UK)
- Feb 2008: forced nationalisation of Northern Rock
- March 2008: Bear Stearns collapses, sold to JP Morgan
- July 2008: forced sale of another UK mortgage bank to Santander

The storm breaks (early-mid Sep)

- forced nationalisation of US Mortgage institutions Freddie Mac and Fannie Mae
- Lehman Brothers investment bank (US and global) bankrupt
- emergency sale of Merrill Lynch to Bank of America
- US government injects $85bn to save AIG insurer (US)
- forced take-over arranged for 4th largest UK bank HBoS.
- announcement of $700bn Paulson Plan for banks' 'toxic' assets

The storm rages (late Sep – present)

- Fortis (BEL, NL) requires emergency bailout, nationalised in NL
- Dexia (BEL, FR) in distress
- Washington Mutual becomes largest US bank failure
- Wachovia Bank (US) fails
- Crisis of Hypo Real Estate Bank (DE)
- Banking crisis in Iceland
- Ireland, Greece, Denmark lead measures to protect deposits
- UK govt part-nationalises major banks
- Major stock market collapse, Japan; bankruptcy of Yamato insurer
- Joint European action to recapitalise banks
- G7 Finance Ministers talks, Int Monetary & Financial Ctte meeting

2. Why is it happening?

"The irony of the post-Cold War period is that the fall of communism was followed by the rise of another utopian ideology. In the United States and Britain, and to a lesser extent other Western countries, a type of market fundamentalism became the guiding philosophy". John Gray, economist, London School of Economics, October 1st 2008

UNI Global Union has, on many occasions, pointed out that the excesses of a turbo-charged finance sector, increasingly detached from the real economy, were unsustainable. UNI has

identified for example the enormous damage that private equity companies and hedge funds have been wreaking.

But although it can be hard to resist saying 'we told you so', this is not the time to retreat to a self-satisfied smugness.

On one level, the current financial crisis can be traced back to the provision of unaffordable mortgages loans in the US. These outstanding debts were then bundled together and sold on as an investment product (a process known as *securitisation*). These rapidly became just another investment vehicle, completely detached from the original mortgages. We know now that these assets are 'toxic', but nobody knows which financial institutions have been left holding them.

If it hadn't been US sub-prime mortgages it would have been something else, however. Recent years have seen the development of ever more sophisticated financial products. These collectively are described as derivatives (investments made at one, or more, removes from the equities or loans on which they are ultimately based). AIG was brought down, for example, by its excessive investment in derivatives called credit default swaps (CDS). These are investment products where you bet on whether or not other investments turn rotten.

In a similar way short-selling, a technique where you can benefit from share price falls without needing to invest in the shares themselves, was a contributory factor to the collapse in bank share values.

At another level, therefore, the crisis can be attributed to a lack of adequate regulation. The fast-burgeoning derivatives markets, and the hedge funds which exploited them, were grossly under-regulated. Financial products were so complex that nobody, it seems, fully understood them.

Prudent debt-to-capital ratios, a core principle of traditional banking, were not required for investment banks. These typically borrowed up to thirty times their capital. Rating agencies, supposedly independent, were permitted to accept payment from investment banks whose products were being rated.

As long as the money merry-go-round kept turning, no-one wanted to intervene.

The current financial crisis can also be seen as a consequence of the obscene greed of those who benefited personally from enormous salaries and bonuses. As the ETUC has said, "this crisis was caused by greed and recklessness," to which can be added a disastrous short-termism. The rewards taken by those in the finance sector were quite unrelated to value added in the real economy.

Blaming individuals is inadequate, however. Greed has been at the heart of the financial system itself, especially since the 1980s when the fundamentalist neoliberal ideology has become dominant. As we know, this lauds the alleged all-encompassing power of market forces and proclaims the view that government intervention and regulation, public ownership and state intervention are market-distorting (= 'bad'). Deregulation, market 'liberalisation' and privatisation, and laisser-faire government inaction are conversely 'good'.

The present crisis reveals the fallacy of this dangerously simplistic ideology. Banks and finance companies are not dealing in consumer products, but at core in the simple principle of social trust. Money, an essential part of the fabric of every society, operates effectively only because we

collectively will it to do so. A well-functioning financial system is a necessary public good, as basic as, say, a reliable supply of drinking water.

3. How are governments trying to manage the short-term crisis?

"Unfortunately we have an idea of market fundamentalism, which is now the dominant ideology, holding that markets are self-correcting; and this is false because it's generally the intervention of the authorities that saves the markets when they get into trouble." – George Soros (fund manager and author)

'Market forces' have proved themselves completely unable to resolve the financial crisis. It has been left to governments and regulators to try to repair the damage.

They have urgently tried a number of different tactics.

These include:

- facilitating take-overs of banks in difficulties
- reassurance: trying to reassure the markets/public by extending bank deposit protection schemes
- injecting liquidity: trying to combat the drying-up of market liquidity (for example, the virtual disappearance of inter-bank lending)
- capital injections into banks: improving a bank's overall strength, by improving its capital base.
- taking banks into public ownership: up to now (UK, Iceland, US), undertaken to prevent complete bank failure
- bailout of 'troubled assets' (as with the US Paulson plan). Purchase with public money of 'toxic' assets (hopefully to be resold later).
- creation of 'bad banks'. Corralling likely bad debts in one 'bad bank', hopefully leaving others detoxified

4. How should we respond to these stratagems?

"The emergency action to support financial institutions that are too big to be allowed to go bankrupt is necessary. However it is unacceptable that governments nationalise the losses of financial capital and privatise the profits" – TUAC Secretariat statement, September 19th 2008

Bringing stability is a necessary first step. However:

- Big isn't necessarily better: Arrangements to enable big banks (eg BNP-Paribas, Santander, Lloyds TSB) to gobble up ailing smaller banks (Fortis, Bradford & Bingley, HBOS) may resolve immediate problems for regulators. However there is a significant down-side, both in relation to competition policy (public choice) and job losses.

- Large banks are not immune from problems, and are even harder to regulate at national level. (Many of Europe's large banks have assets greater than their home state's GDP; UBS's assets are four times the Swiss economy, for example.)

- Government intervention – and public money - should come with enforceable conditions. A condition of the government's guarantee of all deposits in Denmark, for example, is that participating banks do not pay dividends to ordinary shareholders, buy back shares or launch new executive options schemes.

- Involve the workers. UNI Finance has called for each of the fifty-one EWCs in the finance sector to hold emergency meetings to discuss the impact of the crisis.

- The aim should be to save the banking system, not bankers. The cost of bailout plans must be shared equitably.

- It isn't just banks which are facing hard times. Individuals are also suffering from the financial crisis. Home-owners face repossession of their homes, as house values drop. Unemployment is increasing. Government measures must be holistic, helping these individuals too.

5. Is this a turning point?

"The world financial crisis must be a turning point and cause a complete change in the way the financial world works" – ETUC, London Declaration

"Rest assured: the [free market] ideology will come roaring back when the bailouts are done" – Naomi Klein, Canadian author

We are in the middle of a crisis, which (logic and history tell us) will eventually pass. We can't predict what will happen between now and then, though. And what happens afterwards is still to be played for.

Things won't automatically change for the better. Naomi Klein's cynical stance (above) is a sobering reminder of the ability of financial capitalism to benefit even from major crises. We can note, for example, the following, taken from recent news reports:

- Analysts are continuing to predict where the financial pickings can be made from the current turmoil.
- Leaders of failed businesses are walking off with huge pay-offs (Stan O'Neal, who led Merrill Lynch to disaster, kept more than $160m).
- AIG, a week after it was rescued by the US taxpayer, spent $370,000 on a management event at a California spa.

There will certainly be reforms instituted. However, these will not necessarily challenge the essential ideology which led the financial sector into the current crisis. Calls restricted to, for example, greater transparency, greater disclosure and better risk management can be absorbed without fundamental change.

Nevertheless, Naomi Klein's pessimistic assessment is not necessarily inevitable. This is a moment of real opportunity. The dominant ideology of market fundamentalism has taken a serious knock. We urgently need to counter-attack.

6. What are our demands?

"Our system must be rebalanced towards financial institutions providing capital for productive investments in sustainable development and towards greater equality" – John Monks, General Secretary ETUC (Financial Times, October 3rd 2008)

We are not starting from scratch. The thirteen demands for regulating financial markets, issued by UNI Finance in May 2008 (included as an annex to this report), remain relevant and should be promoted as widely as possible. As UNI Finance says, the aim is "a fundamental overhaul of the financial industry based on effective regulation, long-term investment and sustainable growth".

UNI Finance has also called for a banking system which remains diverse, not one consolidated into ever-bigger superbanks: "UNI Finance is in favour of a financial system that comprises small, medium and large companies; that comprises not only private institutions geared towards maximising profits but also public and cooperative ones. Such a pluralistic structure provides extra stability".

There is an urgent need to defend post office banks and other public banks, particularly those under immediate threat of privatisation. The network of mutual and cooperative financial institutions, established to meet their members' needs rather than pay shareholder dividends, has been under ideological attack in recent years but demonstrates that another model is possible.

In the future, the financial industry should be made to contribute its fair share to the public purse. Both the Economic Policy Institute (US) and the French NGO Attac have renewed calls to explore the opportunities for an international tax on financial transactions. As the EPI says, this would help to offset the costs emerging from the bailout. This proposal needs to be urgently examined further.

As UNI Finance demands, tax havens should be eliminated.

There is widespread public revulsion at the excessive salaries and bonuses earned by those at the top of the tree in the finance sector. We should seek mechanisms to ensure that these manifestations of executive greed never return.

Bank nationalisation and equity investment by governments in banking institutions is being presented as a short-term stop-gap measure, to be reversed as soon as possible. We should argue by contrast that the public nature of the banking role makes this appropriate for the long-term, as an integral part of the work of reconstructing a new, less crisis-prone financial system. Sell-offs of public holdings in banks should be opposed.

The separation between the real economy and the giddy excesses of the financial world must be eliminated.
Much investment money is workers' capital, built up in pension funds and life assurance funds. There should be safeguards to prevent these funds being placed in speculative or high-risk investments.

Workers in the finance sector need to be given a key role in the reconstruction work ahead. UNI has the central role to play here internationally.

7. What about the real economy?

"Action in the financial markets is essential, but it is not sufficient. We also need to… limit the damage to the real economy" – Dominique Strauss-Kahn, Chairman, IMF

Governments' current responsibility is not only to rescue banks in distress but also to ensure capital is readily available for the real economy. The financial crisis comes at a time when the world's economies have in any case been suffering from downturn. The danger now is a full-scale recession.

The OECD (October 10) predicts a 'strong slowdown' across the OECD area, together with a slowdown in India and downturns (reduction in growth rate) in China and Russia. Unemployment is climbing; it was already 7.5% in the Euro area and 6.1% in the US in August, with the trend clearly upwards.

- Action is needed now to stimulate the real economy. New measures to ensure that capital is available for business development are needed.

- Governments should bring forward public infrastructure programmes; public investment here is as necessary as it is in banking stabilisation.

- The emphasis should be on sustainable growth, what one writer has called a new 'environmental Keynesianism'. As TUAC pointed out in September, there is great scope to create new 'green jobs': a worldwide transition to energy-efficient buildings would create millions of jobs, for example.

- Banks' push for profit has left their customers extremely poorly served. There is opportunity to rebuild a financial sector which takes customer service seriously, and creates the jobs necessary for this to be achieved.

- Public disgust with the excessive greed of senior banking executives can be harnessed to reinforce calls for decent work with decent pay and conditions for all.

- Developing countries are facing particular difficulties. They face reduced demand for their exports, and reduced access to trade credit. As the International Monetary & financial Committee has acknowledged, many developing countries are already suffering the effects of higher food and fuel prices. The necessary action from the World Bank and IMF must be without the neoliberal strings which accompanied previous funding regimes.

- Developed countries must not be allowed to respond to the crisis by cutting aid or reneging on commitments under the Millennium Development Goals.

8. What are the opportunities?

As our financial system lies on the brink of collapse, it is time to build a new one, based on fairness instead of naked greed… There is a once-in-50-years opportunity to create new institutions" – Will Hutton (UK writer, chief executive of The Work Foundation)

"What comes out of this turmoil is very open to question. I think that you will have to somehow reconstruct the global financial architecture" – George Soros (fund manager and author)

We have to use this opportunity to defeat the Ideological hegemony of market fundamentalism. We have to re-assert the value of public services, provided for public good not private profit.

There is an opportunity to roll back the tide of recent years, which has seen moves to privatise – among much else - public utilities, education and health care provision. UNI can take a particular lead in relation to postal services, as well as electricity provision.

There are already calls for the post-war global structures of finance, put in place at the 1944 Bretton Woods conference, to be reviewed (A recent Financial Times opinion piece had the headline 'We need a new Global Monetary Authority', for example). UNI Global Union and the international union movement generally, must work hard to be centrally involved in these debates.

It is easy sometimes to think that it is enough to get the rhetoric right, or to be content with a well-drafted list of demands. UNI, and unions generally, need to lift their sights, to be prepared to take on a visionary role in the months ahead. If we really do have a once in a lifetime chance to build a new financial system, as Will Hutton (above) suggests, we must ensure that this chance is seized.

Allies will be needed. One possibility would be to work for an international summit or world forum, perhaps under UN leadership, during 2009.

UNI has a particular role to play as the global organising body for workers in the finance sector. There are considerable opportunities here for effective action. UNI Finance has already called on European Works Councils to meet to discuss the crisis. There may be possibilities under the auspices of UNI Finance for calling a high-profile joint meeting of worker representatives from major banking and insurance companies worldwide, so that workers in the industry can themselves get their voices heard. This is a time for creative ideas of all kinds.

We have so much to criticise the way in which banks and investment institutions have behaved in recent years. But we should perhaps also acknowledge that, in amongst the grossly excessive money-making and the creation of ever more fantastical financial products, there has been energy and a high level of human ingenuity demonstrated. We need to turn that energy and ingenuity to more productive goals, where everyone can share the benefits.

Appendix: UNI-Europa Finance demands on regulation of financial markets
Issued 16 May 2008

UNI-Europa Finance therefore calls for the following steps to be taken for more effective regulation of financial markets:

1. Increase transparency

The balance sheet must show all the risks taken by a financial services company. This includes contingent liabilities. Moreover it should no longer be possible to do business via other businesses, for example via conduits, if they do not appear on the balance sheet.

It is important that all players on the financial market are subject to the same duties and controls. Hedge funds, sovereign wealth funds and private equity companies must be subject to the same rules on transparency as banks and insurance companies.

2. The financial sector must be subject to statutory regulation

Whilst every small regional bank or insurance company in Europe is subject to strict supervision, it does not apply, for example, to hedge funds, sovereign wealth funds or pension funds. This must change. A single regulatory system is needed for all players in the financial markets.
Financial transactions between European companies and companies with off-shore financial centres that are not subject to controls comparable to those in Europe must be made illegal.

3. Supervision of the financial sector

The supervisory authorities in different countries must enhance their international cooperation. At the same time they must not neglect their national responsibilities, as in the case of Société Générale. Within the European Union we must ensure that all companies are supervised according to the same criteria, wherever they are based. International supervision standards must be regularly updated to keep up with new requirements and with the innovativeness of the industry.

4. Rules on capital adequacy

All loans and credit liabilities must be backed by corresponding equity. The basis for this is the Solvency 2 and Basel 2 rules. These rules must be reviewed. High risks must be supported by higher capital adequacy ratios.

5. Pension funds and life assurance

Pension funds and life assurance companies have become a major part of people's pension provision. The acts of regulation on financial investment for these companies must prohibit high risk investments, for example in hedge funds or private equity funds.

6. Tax breaks for private equity

The tax concessions given to the private equity and hedge funds industry in many countries must stop. For example, in Germany private equity managers have a partial exemption on their income tax. This tax promotion of private equity, justified by alleged shortage of capital, is counter-productive. Private equity should be subject to the same tax regulation as other players in the financial industry.

7. Pay systems for executives

Incentive programs and remuneration policies for executives and investment bankers must be revised. Remuneration must be kept at reasonable levels, and must be properly linked to the revenues and results of the companies. Today consumers and ordinary workers suffer the consequences of bad management and excessive wages for high paid staff. Risk must never be disregarded just because remuneration levels remain the same regardless if you succeed or not.

8. Leveraged buyouts

Loans made to companies that are to be taken over for the purpose of funding the purchase price must be prohibited. Using this method, some hedge funds have in recent years driven flourishing companies to ruin and in so doing earned high profits for themselves.

9. Rating agencies

There must be an end to the current world oligopoly of rating agencies. Rating agencies should not work on the development of financial products and subsequently issue a creditworthiness rating for the same products. Such conflict of interest is damaging.
We need independent rating agencies that do not (cannot) carry out rating on the basis of economic interest. Within Europe at least one public rating agency should be established.

10. Tax havens

Tax havens must be put out of business. This requires international agreement and national tax laws that ensure that business done with tax havens is taxed according to national regulations if a certain minimum level of tax is not paid abroad.

11. Company takeovers - outsourcing – offshoring

Before companies or important divisions of companies can be bought or sold, the employees affected or their representatives must be informed and the consequences of the planned decisions discussed with the employees' representatives. If consultations do not take place, then it must be stated in law, for example via an EU-Directive, that the company takeover cannot go ahead.

12. Consumer protection

Financial services are an indispensable intermediary for the functioning of society. The essential basis for this is a fundamental trust of customers in financial institutions. Therefore, a high level of consumer protection at national and international level is necessary. Statutory regulation must guarantee that any financial institution provides its customers with qualified and proper advice based on their interests.

13. Employees at the core

Finance sector employees are those that make the industry function. Regulators and companies must ensure that working conditions and pay incentives promote rather than hinder regulatory objectives and excellent customer service. Essential elements are training and lifelong learning schemes that provide employees with the necessary skills.

The US Financial Crisis and the End of Free Market Fundamentalism

Circular No. UNI U068/GS
Nyon, 25 September 2008

To members of the UNI World Executive Board

The US Financial Crisis and the End of Free Market Fundamentalism

Dear Colleagues,

This week U.S. President George W. Bush is asking the American Congress to authorize the US Treasury to borrow and spend up to $US 700,000,000,000 to bail out the US finance sector. This is on top of the hundreds of billions he has already borrowed to rescue Bear Stearns, to nationalize Fannie Mae, Freddie Mac and AIG, and to fund the operating deficit of America's federal government. He is going to ask U.S. taxpayers to take on the burden of paying the interest on this new debt and to eventually pay it back. And he is going to ask the world to run the risk of unleashing global inflation to end a crisis his government helped create. It is simply breathtaking.

The Bush plan may or may not end the global financial crisis, but the extraordinary events of the past two weeks should mark the end of free market fundamentalism. The dangerous fragility of global finance first exposed by the Asian financial crisis of the late 1990s and repeatedly demonstrated over the years in a series of panics in Mexico, Argentina, Turkey and other nations now threatens to throw the world economy into the worst crisis since the Great Depression. World leaders have repeatedly failed to adopt needed reforms in the global financial system following each of these financial panics, clinging to a misguided faith in financial deregulation. They must not fail to act this time.

In the short term, the challenge will be to avert a total catastrophe. But soon thereafter the world's governments will have to abandon the casino capitalism of the market fundamentalists and build a new economic model that puts workers and sustainable development before the interests of financiers and speculators. Reform must be comprehensive and it must be global. There needs to be enforceable standards of financial transparency and adequate capital reserves to control reckless risk-taking. A Tobin tax on financial transactions to control excessive speculation is also long overdue. UNI and its affiliates must be ready to fight for these reforms.

Time to retire "market fundamentalism'

Former World Bank economist Joseph Stiglitz, who is now a top adviser to US Presidential candidate Barack Obama, captured the historical moment when he remarked: "the fall of Wall Street is for market fundamentalism what the fall of the Berlin Wall was for communism -- it tells the world that this way of economic organization turns out not to be sustainable. This moment is a marker that the claims of financial market liberalization were bogus."

Two weeks ago, in order to avoid a global financial panic, the U.S. government took over Fannie Mae and Freddie Mac, two giant mortgage finance companies that have underwritten housing loans in the USA worth more than $5 trillion. The panic occurred anyway due to the plummeting value of mortgage-backed securities (MBS) initially worth hundreds of billions of dollars. These securities, held by financial institutions all over the world, are at the heart of the global financial crisis that began more than a year ago with the collapse of housing prices in the United States and the United Kingdom. In a dizzying series of events last week, one major US investment bank (Lehman Brothers) declared bankruptcy, another (Merrill Lynch) staved off collapse by merging with a commercial bank (Bank of America), and the U.S. central bank took control of one of the world's largest insurance companies, AIG, with a massive $US85 billion secured loan. In the UK, Lloyds TSB took over HBOS, one of the largest of its kind. This follows a government bail-out of Northern Rock.

In response to these stunning developments, stock prices plummeted on Wall Street and around the world and credit markets froze up as banks stopped lending to each other. That in turn threatened the safety of $3.5 trillion invested in money market funds where tens of millions of Americans hold their household savings. Facing a 21st-century style "run on the bank" as more than $200 billion was withdrawn from money market funds in less than 48 hours, the Bush administration checked its neo-liberal ideology at the door and intervened massively. The U.S. Treasury announced plans to guarantee money market funds for a year and proposed legislation to spend up to $700 billion to buy overvalued mortgage-backed securities in an effort to end the panic. Central banks around the world chipped in by injecting hundreds of billions into the world's banking system. Credit and equity markets remain unstable and we are far from out of the woods.

The crisis now gripping the world economy was no accident. It was the direct result of the radical free market fundamentalism pursued by governments for more than a generation. Aided and abetted by financial deregulation, most recently in 2004 when the US Securities and Exchange Commission loosened rules on market capitalization for U.S. investment banks (increasing their permissible leverage ration from 10-1 to 30-1), and a willingness by regulators to allow reckless sub-prime lending to grossly over-inflate housing prices, America's banks and other financial institutions turned Wall Street into a casino dominated by hedge funds and financial hucksters. These institutions sold complex and risky securities to unsuspecting investors all over the world. As the value of these securities evaporate and Wall Street firms teeter on the edge of bankruptcy, millions of American workers face the loss of their homes, their pensions and their life savings. And since financial markets are global, contagion risks expose workers everywhere to the same dangers.

What's next?

This week in Washington negotiations over legislation to authorize the Bush plan to bail out the finance sector will take place. These negotiations present the first opportunity to cast aside the failed economic policies of the past 30 years. Hard questions need to be asked about the Bush plan. Does it make sense? Will it reward the very culprits who caused the crisis? Will it even end the crisis? Assuming satisfactory answers are forthcoming, it is essential that the Bush administration not be given a blank cheque. A bailout should have lots of strings attached. It must restore sensible financial regulation and offer real economic relief for America's workers and their families. It must reign in excessive executive pay on Wall Street. And it must give taxpayers an equity stake in the firms that are being rescued.

An even more important opportunity to turn the page on the age of free market fundamentalism will come in five weeks time when America chooses a new President. The choice on November 4 is clear. Barack Obama represents change. More than a year ago, he called for a complete overhaul of America's system of financial regulation. John McCain represents more of the same. He has advocated financial deregulation for more than 25 years in Washington and last week argued that "the fundamentals of the American economy are strong." UNI's affiliates in America are pulling out all the stops to make Sen. Obama the next President of the United States. UNI's affiliates around the world stand in solidarity with them and hope that they will succeed.

Sincerely,

Philip J. Jennings
General Secretary