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Good morning Chairman Reed, and members of the Securities Subcommittee. On behalf of the American Federation of Labor and Congress of Industrial Organizations, I want to express our gratitude for being asked to contribute our views on the future of the U.S. capital markets.

Capital markets are enormously important institutions in our economy and society. Our capital markets allocate and direct the majority of the resources in our economy. Trillions of dollars of working families' retirement funds are invested through these markets, here and abroad. And finally, millions of Americans directly and indirectly are employed in these markets and the businesses and institutions that serve them.

But we are going through a period of dramatic change in the very nature of our capital markets. Ten years ago, the New York Stock Exchange could accurately be described as a place where securities were traded—a building on Wall Street in New York City, USA. Today the New York Stock Exchange is many things—a brand, a network of linked trading software, and yes, a building on Wall Street, but that building on Wall Street is becoming less and less important—comparable say to the original Disneyland to the Disney Corporation. As the New York Stock Exchange and NASDAQ each acquires controlling interests in exchanges around the world, and as market makers become increasingly globally diversified, it becomes less and less clear what we mean when we talk about the U.S. capital markets.

Increasingly, the meaning of the term U.S. capital markets means those securities and transactions where the parties choose to be governed by the U.S. system of investor protections, and consequently, to conduct their transactions in dollars. Most such transactions are today largely organized and staffed in the United States, but increasingly, with the exception of some of the more menial and less lucrative tasks, the work of structuring transactions in U.S. registered securities can occur anywhere in the world you can get a T-1 line and convince properly licensed lawyers and brokers to live.

In this environment, the truth is that powerful market institutions, whether it is NASDAQ, the New York Stock Exchange/Archipelago, or any of the large firms, whatever their national origin, don't really care that much about whether U.S. markets are "competitive." And to the extent they still do, they will care much less in five years.

And at the same time, we are seeing an acceleration of the integration of global markets. One measure of that acceleration is the wave of international mergers of exchanges. A second is the apparent rapid progress of "convergence" in accounting systems. Just a week ago the SEC issued proposed rules under which non-U.S. companies could list on

U.S. exchanges without issuing GAAP financial statements.[1] Shortly before that the SEC announced its timetable for full convergence between GAAP and IFRS, which contemplates completion of convergence in 2009.

These developments lag behind the effective integration of world markets for large cap securities, corporate and government bonds, and an enormous variety of derivative instruments related to these securities and key indexes. Through hedge fund and private equity firm borrowing, these markets are linked to commercial banks worldwide. From both a systemic risk and a market conduct perspective, capital markets are already effectively global, not national.

We then have to think of these markets in phases – currently a situation when regulation is mostly national in scope, but market activity in increasingly integrated globally, the process by which rules for global markets will be created, and finally, the characteristics of the global market regime of the future.

In this context, policymakers in the United States need to consider the following three permanent interests we have as a nation in today's capital market structure, interests that will be equally present as we move toward an increasingly integrated single global capital market:

[1] Securities and Exchange Commission, 17 CFR Parts 210, 230, 239 and 249; RIN 3235-AJ90 (Proposed Rule) (July 2, 2007)

- Ensuring that capital markets direct resources to sustained wealth generating activity in the U.S. economy;
- Providing strong investor protections to Americans who invest their savings and their hopes in the capital markets;
- Maintaining and growing capital markets activity in New York and other financial centers in the United States.

In addition, we have further interests as a nation that are the result of what are hopefully temporary conditions in our economy. For example, as a result of our low savings rate, low tax rates and trade deficit, we are dependent on foreign investment to finance our imports and our government spending. Thus we have an urgent need to attract net positive inflows of foreign capital to the United States.

The labor movement worldwide is increasingly concerned that our increasingly global capital markets are increasingly unable to provide financing with time horizons appropriate to the needs of operating businesses. John Monks, the President of the European Trade Union Confederation, has labeled this combination of increasing leverage and shrinking time horizons for business investment “financialization.” (See Appendix A). Here in the United States, the AFL-CIO has been a leading participant in an effort by the Aspen Institute that brings together investors and companies to promote a culture of long term value both in the markets and in the management of public corporations. Recently this effort led to the release of the Aspen Institute’s Principles entitled Long-term Value Creation: Guiding Principles for Corporations and Investors. (See Appendix B).

Over the last thirty years, the public capital markets have become responsible for allocating a greater and greater share of our society's resources, with a comparable diminishment in the relative role both of the public sector and of private financial intermediaries like commercial banks. This growth in the importance of the public markets has coincided with long term real wage stagnation in the United States, as well as our economy's prolonged failure to address increasingly dire economic threats, including 1) the problems associated with the combined issues of energy and the environment, 2) the crisis in health care, both in terms of coverage and cost, and 3) the crisis in retirement security. A powerful way to think about this problem is to consider that in 2006 there was $2.4 billion invested in energy technology venture capital. By way of comparison, in 2006 the video game industry generated $7.6 billion in revenue.[2]

Capital markets both reflect underlying economic conditions and shape them. While we cannot expect capital markets to be the sole provider of solutions to these profound problems, these markets need to be structured so they are pushing in the right direction. Our accounting and disclosure systems, our corporate governance systems, and our tax regime all need to be oriented toward encouraging our capital markets to produce long-

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[2] The Video Game Association, http://www.theesa.com (checked July 11, 2007).

term, sustainable value in the real global economy. In recent years, this has been the consistent theme motivating the labor movement's advocacy of improved corporate governance, accounting and auditing—our support for giving long term investors more voice in selecting corporate boards, our concerns about leveraged finance and short term oriented investment strategies pursued by hedge funds and leveraged buyout firms, and our concerns that mark to market accounting not undermine the ability of operating businesses to accurately disclose the results of their actual business to their investors.

We have heard recently, however, that the real problem facing our markets is the threat posed by the existence of other capital markets in the world with comparably deep liquidity. We disagree. In an age of increasingly integrated global capital markets, the ambition to be the sole geographic location for significant capital market activity is both unrealistic and potentially threatening to our ability to remain the leading geographic location for such activity.[3] Today in both Europe and Asia, markets of sufficient depth located in financial centers of sufficient sophistication exist to plausibly compete with U.S. markets and with each other for business. These markets have a natural advantage in competing to offer capital raising services to operating companies located in their own geographic areas. They also will attract investment capital from their own regions for similar reasons.

Currently, U.S. markets appear able to nonetheless attract business from both Europe and Asia largely because it is cheaper to raise capital here than in non-U.S. markets.

[3] Goldman Sachs, "Is Wall Street Doomed?," *Global Economics Weekly* (Feb. 14, 2007).

Investors have confidence both in our underlying legal and economic institutions and in our specific investor protections. The result is that global investors are willing to pay a higher multiple for earnings that have been certified by our regulatory structure than for similar earnings paid by companies whose securities trade only on non-U.S. markets.[4] However, there are issuers who will not list on U.S. markets regardless of what our cost of capital advantages are. Some issuers simply cannot meet our standards, others are simply unwilling to. But the vast majority of issuers globally are economically rational and will raise capital in the market where the cost of capital is lowest. Our overall market strength and positioning depends on not relaxing those standards in an attempt to win 100% market share for our capital markets. Simply put, our markets cannot be all things to all people.

As we move toward more global market rules, the earnings premium investors bestow on U.S. markets is a measure of the confidence placed in our markets' investor protections. In the wake of the strengthening of U.S. investor protections after Enron, investors globally see the robust U.S. regulatory system as a model. Key ingredients of our model include independent national regulators backed by supporting layers of SRO and state regulation, independent accounting and auditing board, a multilayered disclosure system, and ultimate access to the courts for investors seeking to enforce both their rights to information and to corporate governance decision making.

[4] Charles D. Niemeyer, "American Competitiveness in International Capital Markets," p. 2; *id*. at 3 (citing Hail, L. and Leuz, C., *International Differences in the Cost of Equity Capital: Do Legal Institutions and Securities Regulation Matter?*, 44 J. Accouting Res. 485 (June 2006)); *id* (citing Doidge, C., Karolyi, A., and Stulz, R., *Why Are Foreign Firms Listed in the U.S. Worth More?*, Journal of Financial Economics, Volume 71(2), (205-238).

In the context of the move toward global market rules, calls to weaken U.S. investor protections by firms which themselves are global market actors may have more to do with hoping to weaken emerging global standards than with any genuine concern for U.S. competitiveness.

So one fundamental policy principle that should inform our government so long as we have a clearly distinct national market from a regulatory perspective is that our interest in strong investor protections and our interest in maintaining a healthy share of the world's total capital market activity are not in conflict, but are in fact mutually supportive.

In addition to strong specific investor protections, there are other background conditions that affect the ability of a nation to sustain capital market leadership. Healthy national savings rates, a stable currency, a commitment to the rule of law and to being a responsible member of the international community are all important preconditions to being able to attract and retain both investors and those seeking capital. In each of these areas, recent trends in the United States may be cause for concern.

But there is finally another dimension to competitiveness, one that is important today and will become more important as capital markets become more global. Ultimately, any country or city's ability to be a center of capital market activity depends on their ability to be a center of human capital, information technology, and transportation infrastructure. The future of New York and our other major cities as financial centers depends on the health of their educational institutions at every level, the sophistication of their telecommunications infrastructure, and the efficiency of their transportation systems. Substandard public education, traffic gridlock, and outdated telecommunications systems are the real long term enemies of American competitiveness in the capital markets.

Ironically, one of the greatest threats to our leadership in the global capital markets may be embodied in the now often quoted statistic that in 2006, 25 individuals who managed hedge funds made three times what the 80,000 people who teach in the New York City schools earned, and yet paid a lower marginal tax rate on the bulk of their hedge fund earnings than those school teachers paid on their incomes.[5]

If we are not prepared to invest in education for the average American, or to pay the taxes necessary to fund our public infrastructure and stabilize our government's finances, we will undermine the very foundations of our capital markets, just when those foundations will become ever more important to our ability to sustain capital market activity in the United States.

Ultimately, capital markets appear on track to become increasingly global. If U.S. public policy focuses on maintaining the U.S. markets as the gold standard in investor protection, supported by continuous improvement in the key supporting structures of education, information technology, and infrastructure, we should be able to maintain our

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[5] Jenny Anderson and Julie Creswell, "Make Less Than $240 Million? You're off Top Hedge Fund List, " *NY Times*, April 24, 2007.

position as the world's leading capital market and convert that position into a position of leadership as one geographic locus for an increasingly unified global capital market that has embraced the key principles that led our national capital market to flourish in an earlier age.

Introduction by:

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The Challenge of the New Capitalism

London, 14 November 2006

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Those of you who knew Aneurin Bevan can probably guess his likely reaction to my choice of the title tonight.

Capitalism was capitalism to Nye. It was enduring and unchanging. It was the South Wales coalowners, it was the slave traders, Cecil Rhodes and other rapacious exploiters of working people in the Empire and at home. It was greed and selfishness, the drive for money dominating and twisting all other human motivations. (Bevan was often of course a lot more sophisticated then he might have been at a NUM weekend school giving the above speech. He appreciated the good things of life in full measure – even having at least a touch of what the French call 'un socialiste caviar'.)

But I don't think he would have taken easily to a concept of the new capitalism. Many things do remain the same but my thesis tonight is that capitalism has changed in very important ways and that the Left generally has few intellectual, philosophical or political answers, at least as yet. It therefore warrants the use of "new" and the formulation of a new strategy to deal with it. My purpose tonight is to encourage others also to pursue these questions.

Since the collapse of communism under its own internal contradictions, capital has the whole world, more or less, at its feet. It can go most places seeking the best returns. It is afraid of nothing – there is no competing system which threatens its expropriation. This struck home to me vividly when Bill Clinton visited Vietnam towards the end of his Presidency. You won the war, observed Clinton wryly, but, now, to survive, you are observing the rules of world capitalism. He could have added “Our rules, American rules”.

There is still protectionism in many parts of the world. I was interested last week to see that even in the open economy of Sweden, the Wallenberg family and its foundations, which act as a holding company for several of the big Swedish multinational companies, are being accused of protecting Scania, the truck manufacturer against a German takeover. Not everyone is allowing the new capitalism a clear run but the pressures are on.

You can see it in rising levels of inequality. If you work in the global economy, especially in its financial sectors, rather than manufacturing, chances are you are doing well. Exceptionally well, if you are at executive level.

On the other hand, the new workshop of the world is China and it is being followed by other developing countries with inexhaustible supplies of cheap labour – and access to capital. The impact on some sectors of the UK economy like textiles and footwear has been devastating.

Most of all, you can see it in the operation of financial markets. Since the 1980s, changes in regulation and technological developments have led to huge changes in the way financial markets work, in the role of banks, and in the rise of new investment forms.

The City view is that this trend is almost wholly beneficial, moving financial markets closer to ‘perfect competition’ and optimal outcomes. At most there is concern about two issues: illegal activity (fraud etc) and possible systemic risk. But, recent developments point to a whole series of concerns, including accounting scandals: the cases of WorldCom, Enron and others have shown that market mechanisms combined with existing auditing rules and regulation are inadequate to protect investors, workers and pensioners against the risk of fraud. This is new rootless capitalism without any geographical responsibilities, as shown for example, by HSBC hinting, threatening, that it might relocate its headquarters outside the UK.

Stock options are also a concern. One increasingly popular method to align shareholder and managerial interests has been for the former to grant the latter stock options. This has created huge incentives for managers to pump up stock prices. This encourages short-term thinking on the part of managers. Costly, long-term investment projects (including R+D) are likely to come under increasing pressure to produce fast results or be abandoned.

Pressure from pension funds is also a recent phenomenum. The general pensions crisis, plus the increasingly market-driven pension system in a number of countries (with competition to generate higher returns) is increasing the ‘activism’ of pension fund managers.

They are increasingly investing in riskier assets (notably hedge funds). They are increasing the demand for returns made from investments in productive companies, depriving the latter of resources, and are restructuring their portfolios more frequently, reducing firms’ certainty with regard to future funding. (On average, investment funds hold stakes in German companies for less than 2 years). Many of us with pensions are also shareholders and we should worry that pensions are getting shakier as this new capitalism, which is supposed to act for us, grows in strength.

Private equity funds are also a big concern: Their most damaging strategy (asset stripping) is to buy up companies whose share price has, for whatever reason, fallen below the value of its assets. The latter are sold off at a profit. Fund managers grow rich while (good) jobs are lost and established companies (with consensual industrial relations systems) are destroyed.

In other cases firms are bought up and then ‘restructured’, before being sold off at a profit. The wider economic impact of such practices depends, of course, on the nature of the restructuring carried out. The German bathroom equipment producer Grohe is an example of a successful company systematically run down by successive takeovers. There are many British examples.

What is certainly the case is that private equity fund involvement is almost always highly leveraged. In other words the buy-out is debt financed: the purchased firm becomes responsible for servicing these debts. Woe betide the highly leveraged Manchester United if it ceases to be able to attract full houses at Old Trafford.

The consequent drive for higher returns inevitably exerts downward pressure on wages and conditions. Even where jobs are not lost, private equity owners are perceived to be less interested in the longer-run and in more technical issues of the particular branch of production, and <u>much</u> readier to challenge existing norms, procedures and structures, especially those relating to workers, unions, and works councils. That in turn threatens workers' commitment to the company for which they work, their willingness to invest in firm-specific skills etc. Not much scope for partnership working there.

Costly defensive strategies are also of concern. The potential damage from hedge funds is not limited to actual takeovers; the pressure to avoid hostile takeovers forces incumbent management to take actions that bolster the firm's share price in the short run (including postponing selling assets investment and, making workers redundant) with damaging effects on the longer-term performance of the company. It cannot be easy running a firm doing difficult things when you are up for sale every day and every night of every year.

Banking finance is changing. In many European countries banks with close links to 'their' industrial companies have traditionally been the main channel of external finance. In addition, in some, publicly owned (and various forms of cooperative) banks were important. This model was characteristic, in particular, of Germany, Austria and other successful economies into the 1980s (at that time it was widely held in the English-speaking countries to be a superior system to our Anglo-Saxon model).

However, more recently, these countries have moved towards a greater role for stock markets (equity finance) on Anglo-Saxon lines, reflecting, not least, the perceived, recent superior performance of these economies. This breakdown of close bank-company relations has caused major problems, especially in Germany where small and medium enterprise in particular have faced a credit crunch. The existence of public banks – criticised by the orthodoxy for alleged inefficient capital allocation – also enabled broader regional development aims to be pursued and inter-company linkages to be taken into account in lending decisions. In addition such lending is much less procyclical and, last not least, government guarantees effectively reduced the cost of capital. Yet the pressure is on to wipe out public-sector banking in Europe.

I plead guilty to being one of those who underestimated the impact of the changes. Some of you will remember that when I became General Secretary of the TUC in 1993, I put promoting workplace partnership at the centre of the TUC's programme for the future. I did not fully appreciate what was happening on the other side of the table. Indeed until my daughter's boyfriend got a job with a hedge fund, I did not appreciate fully what a hedge fund did. After his explanation, my first question to him was "Joe, is it legal?"

The concept of partnership with capital was not one Bevan would have warmed to – and plenty of other trade unionists feel the same way. To them, partnership is class collaboration, sleeping with the enemy. To others, if partnership was just at workplace level and not in the strategic commanding heights of the economy, it was an unequal partnership. "Like one man and his dog" sniffed one critic.

But my motivation was rooted in experience of the successful post war reconstruction process in many European countries, underpinned by partnership between unions and employers. Sometimes it led to effective incomes policies with more cohesive, solidaristic unions and wider collective bargaining agendas than the UK. Often it had produced more successful, higher productivity companies in sectors where our companies were failing.

I was also struck on my many visits to British workplaces by how much shop stewards and workers wanted their companies to be successful; and not just because the penalties of failure were evident in the high levels of bankruptcy and unemployment which characterised the 1980s and early 1990s. They wanted to be proud of what they did, of the successes they had achieved. Few just recited a list of problems and grievances. Alienation was uncommon.

So partnership deals, based on mutual respect, with high productivity swapped for commitments to train workers and maintain employment, or at least avoid compulsory redundancy, were our cause.

It was not original: earlier advocates had included Bill Jordan, John Edmonds, and, I suppose, Eric Hammond, although his no strike clauses did much to discredit the term partnership.

As many of you know, the TUC set up the Partnership Institute, the Labour Government followed with the Partnership Fund and various others like the IPA continue to spread the word.

But my question now is - partnership with who? And what has been happening on the management side?

Some partnership companies have thrived. Tesco and Barclays Bank have prospered and attribute some of that to their improved industrial relations arising from partnership deals.

Others have disappeared, tragically Rover whose “New Deal” was an early pioneer of partnership agreements. Many others have been absorbed into multi-national companies with worldwide reach and global brands, often with no UK ownership involved.

One thing is for sure – the changes in company structure have been rapid and profound and the challenge for unions is often identifying who the partners are, - or if like Bevan you don’t like the word “partners”, who should we be negotiating with? Have we any allies and pressure points? What is the union future under the new capitalism?

These are key questions to address tonight.

Take a glance at the UK economy. Some have used the term “Wimbledonisation” – that is, we provide a good location but the top prizes are won by foreigners. That is not wholly accurate in relation to every part of the economy but when you look at foreign ownership of investment banks and many other major financial and professional services companies; at the utilities, at the carplants and at the airports; at the current sales of Corus Scottish Power possibly AMEC and John Laing; at the current hawking round of our biggest manufacturer, British Aerospace, to American buyers, a picture emerges, outside pharmaceuticals and petroleum, of foreign companies owing much of the commanding heights of the British economy – not to mention Manchester United and Chelsea, the current commanding heights of the Premier League. There is, we have learned, a price for everything.

I often muse - where are the nationalist parties on this ‘clear out’ sale of British assets? Where are the Conservatives and UKIP when we need them? They have a lot to say when there is the merest hint of a little more shared sovereignty at European level. But on the unfettered sale of our key national assets, they are dumb. Or, possibly, they have friends earning handsome fees arranging the sales. (Not quite Bevan’s famous “vermin” speech describing the Tories at Belle Vue, Manchester but a little Bevanite touch that).

Apart from selling our commanding heights, we have the onward march of shareholder value and its importance in setting executive remuneration. Time was when executives’ rewards bore some relation to those of other employees and they were in the same pension fund. These links have gone, and, among other things, it is contributing to the weakening of many pension funds for employees.

Executive pay rose 28% last year. Incomes Data Services recently reported that never in its 15 years of monitoring executive pay have so many earned so much. Until recently I had not realised how much time and energy some boards spent on setting their own remuneration and incentives. Of course, they are negotiating with themselves and when you are in that position, you find it easy to give yourselves the benefit of every doubt. Comparability may have less relevance to most workers than it used to, now we are in a low inflation era. But it is still a potent principle in the boardroom. “Make sure we stay in the upper quartile” is the campaign slogan but they have no need to put it on a banner and take to the streets.

They seem oblivious to how this makes them appear to the rest of their work forces. More and more they resemble the Bourbons – and they should be aware of what eventually happened to the Bourbons. This shameless attitude contrasts incidentally with what is happening in Germany where Siemens have cancelled a 30 % executive pay increase after a debacle with the sale of their mobile phones business. It would not have happened here – the debacle possibly, the cancelled pay increase, certainly not.

Optimists hope that all this will be contained by better informed, more active shareholders. After all, today’s shareholders are largely pension funds and life insurance companies and mutuals, seeking to get as high a return as possible for members, for us, and millions like us. They hope that our values will put pressure on the tycoons and boardroom titans to behave responsibly and improve governance.

I have to hope that they are right, and I recognise the sincerity of some people in this field, but I cannot help but notice that some investors who are proud to work to a corporate social responsibility agenda can also be the toughest seekers of high returns. Thus the world's largest pension fund is switching more and more over to hedge fund investment. The Californian Public Employees Retirement Scheme recently won approval to invest up to 25% of its portfolio in hedge funds. Railpen, the UK rail fund, has invested £ 600m and Sainbury's has trebled its exposure to hedge funds.

Of course, as Janet Bush said recently in the New Statesman, hedge funds are not new, just notorious. They have been around since the late 1970s. But their scale is accelerating and the funds they manage are equal to the GDP of the eighth largest economy in the world – Brasil – and have grown 5x since 1998.

Yet how many of us have much understanding of what a hedge fund is? Here is a definition from "Google"

"The term hedge fund has come to mean a relatively unregulated investment fund, often a partnership rather than a corporation in form, and characterized by unconventional investment strategies (ie., strategies other than investing long only in bonds, equities or money markets).

“Hedge funds use alternative strategies such as selling short, arbitrage, trading options or derivatives, using leverage, investing in seemingly undervalued securities, trading commodity and FX contracts, and attempting to take advantage of the spread between current market price and the ultimate purchase price in situations such as mergers. When strategies become extremely complex hedge funds may acquire potential and unanticipated risk of catastrophic losses.”

Other relevant facts – they are attracting many of the nation’s best young science brains on the promise of fabulous rewards. They are often based in tax havens. Most of the world’s most prominent banks run such funds in conjunction with more orthodox activities. And they are looking for quick returns – around 15% pa. National regulators do not know what to do and are fearful if they do anything, the funds will emigrate entirely. The German Vice Chancellor, Franz Müntefering called them “locusts”. He was right.

It should be the European Commission which takes this on if nation states are too timid to do so. But the EU internal market commissioner, Charlie McCreevy recently ruled out new rules, saying hedge funds played a crucial role and put the “fear of God” into company boards – for the benefit of all – he claimed. It is the Americans, burned by huge financial scandals who look at least a little more likely to act. What is evident is that no-one in the UK is facing or dare face the challenge – and something like 70% of Europe’s hedge funds are London-based, except of course for tax purposes; 80% of the world's hedge funds operate from the Cayman Islands as regards tax.

I have concentrated on hedge funds and their bewildering array of variations to indicate how powerful the financial services sector has become. But if hedge funds are the Provisional Wing of the sector, then there's plenty of more mainstream players contributing to the situation of debt financed, casino capitalism, with public companies, unless very strong, being chips on the gambling tables.

For trade unions we know that this capitalism, when it penetrates sectors such as food and beverages, hotels and catering, accelerates layoffs, casualisation and outsourcing. It "adds volatility to a destructive mix which is profoundly destabilising for workers and their unions." The International Union of Food and Hotel Workers has direct experience of this, as member confederations come to the international union for aid in helping to turn back particular company offensives.

Often these offensives are promoted by the investing shareholders, as they seek huge rates of return. Unions seeking to bargain over changes in conditions or negotiate the impact of restructuring, or challenges to closures, run up against the new financial power brokers. These people are not so interested in arguments about improvements in production or services , increased productive capacity, new product lines, long term viability of markets or consumer needs. They want their quick returns.

Some may say, it was ever thus in business but let’s look at a few examples from the food and beverage sectors:

- Heineken in 2006 announced half year results which earned profits 56% higher than the previous period and simultaneously announced the cutting of 1,000 jobs in the following year.
- The brewers, Inbev announced a 15,3% increase in earnings and plans to cut 360 jobs at the same time; having already shut my favourite Boddingtons brewery at Strangeways, Manchester.
- Nestlé announced a 21 increase in net profits while promoting job insecurity, losses and outsourcing, casualisation, production transfers and closures.
- Gate Gourmet is perhaps the best known case in the UK. It was in the news for weeks as the doughty Asian women working for the catering company supplying British Airways fought for their jobs. Gate Gourmet had been bought by the private equity firm, Texas Pacific – now chasing AMEC by the way. The new company planned a period of “organic growth” which began, in the words of the IUF “a meticulously planned assault on trade unions, beginning at Heathrow”. The company stealthily hired hundreds of contract workers before mounting an attack on the existing workforce and their working conditions. You saw the scenes on TV no

doubt, with hundreds of older women in Saris standing on a roundabout, on strike for their jobs, and being told by an American manager they were sacked.

Often the problem we face here is that the fund managers who control these companies, in effect, do not see themselves as employers. In few systems are they defined as employers and have none of the legal obligations that employers have. In the case of Gate Gourmet, that company denies that the management decisions it took have anything to do with Texas Pacific, although it does acknowledge its fiduciary duty to the investor company. I almost said "parent company". In days gone by, I could have used that as an accurate, legal definition, but the new investment funds are not 'parents'. They want to run their children's lives but they are not parents…nor employers.

So we are seeing therefore is a yet further disintegration of the social nexus between worker and employer. This relationship, dating back to the industrial revolution and beyond, has produced layer upon layer of employment law and, importantly a culture containing broad social rights and obligations. The new capitalism wants none of it. It wants to be foot loose and fancy free, without obligation. In the old days, when trade unions – especially those in North America – realised that corporate campaigning could be more effective than striking, we had some noticeable successes. But what if the ultimate owner is a hedge fund?

Can you go and lobby the AGM, as we did with our corporate campaigns? Can you organise with other disgruntled groups of share-holders as we did then? Not so easy.

The European Central Bank is worried about all this even if Mr McCreevy is not. The US authorities are worried too. But the fear to act is widespread and deep rooted. No longer does the Ford Motor Company treat its banks and investors with a degree of disdain, demanding their services on Ford's terms. The new titans are not the old ones. For Ford then, read Goldman Sachs now. It is the capital markets who call the shots.

So <u>must</u> we all get used to a new language of leveraged finance, second lien loans, mezzanine finance, syndicated loans, global share insurance, credit default swaps, collateralised debt obligations and so on?

I think we must. All this is too important to be left to the practitioners who have a vested interest in obscuring what they do from the rest of us. At the very least, we must understand and debate much more fully what they do – that they are speculating as much as legitimately hedging risk and that these practices are dangerous to economic stability, traditional industry and jobs. I would like to see the City pages of the press more challenging and less respectful on these matters.

So what else can we do? The answers are not easy. If you believe like me that the recent relative success of the UK economy has been based on rising house prices, mostly fuelled by earnings from the financial services sector and perhaps, more recently, the increase of the public sector, you can understand that the Government worries about clumsy intervention with negative or unintended consequences.

But, we should stop according financial services a specially privileged place in the UK economy. It was the only industry specifically mentioned in the Treasury's five tests for possible euro entry yet UK overseas earnings from the City are still only one tenth of those from exporting goods. With all the pressures, the old capitalism is not dead. It needs help and respect, not laissez faire neglect. It needs to stand up for itself, speak with a louder voice and not be in awe of financial markets. The CBI need to become a lot clearer that they must stick up for industry not just – as they do on autopilot - against trade union lobbying and any hint of regulation. They need to compete against the overmightly financial sector.

Second, we should examine – and I am currently pressing the EU to do this and will continue to do so at the forthcoming macro economic dialogue– how capital markets fund research and development and innovation - if indeed they do. I believe that the next big idea after the IT revolution will be environmental technology. So, more tellingly, does General Electric of America and they are directing their R+D towards this area. Will the city slickers earn at least some of their fat bonuses by backing inherently risky ventures on tough issues like climate change and renewable energy. Some hopes I fear. Short term thinking is the enemy of innovation and R+D.

Can we therefore revisit the idea of a National Investment Bank providing capital for productive purposes in key areas of scientific and technological challenge? This now would need to be set in the context of the single market in Europe but we must find a way of supporting serious R+D and innovation. We cannot not rely on the market, especially with the way it is evolving.

Next, we should expose – and prosecute, fiercely, corporate wrong doing. This is not victimless crime. The perpetrators are robbing us all and should not receive an easy time. The Americans are showing the way again, rightly ignoring the CBI's unctuous concern for those Britons caught up with the Enron scandal.

Next, politics should not be intimidated by what is going on. The present disenchantment with politics reflects a feeling that it has no answers to the big issues. The Labour Government on some issues – for example child poverty, Africa, the NHS - is trying hard to make a big difference. On other issues, especially on achieving a high level of employment, it has succeeded; who honestly thought 10 years ago that we would get anywhere near full employment ever again? We are not proud of the quality of some of the jobs but the achievement is real. It would have been appreciated by Nye Bevan even if he would have been bemused by the Government Ministers and ex Ministers criticising so loudly and confusingly the outcomes of the record spending on his beloved NHS. You don't need an Opposition and the Daily Mail if your own side accentuates the negatives.

Yet I am critical of the Government for swerving away from confronting the rise of this new, overmighty capitalism. Their worry was, and is, overmighty unions. The reality is overmighty financial capitalists. Yet there were some signs of early promise, never realised. In 1996, Tony Blair made a speech in Singapore calling for stakeholding, not shareholder value, to guide us into the future. He was following Will Hutton's praise for the Rhineland model of Germany and France in his best selling book – "The State We Are In" which had called for entrepreneurial accountability to unions, communities, the environment as well as shareholders. I was elated and wrote immediately an article for the Times hailing this Damascus-like conversion.

My elation was brief. Before Mr. Blair's plane had touch down back at Heathrow, the speech's meaning

had been hastily redefined. It was made clear that there was no intention to re-empower unions, Labour was the friend of business and capital, not a promoter of stakeholding at all. The term stakeholding was never heard to pass the lips of the Prime Minister, nor the Chancellor, again.
But yet, but yet…

The latest companies Bill codifies the principle of what it calls “enlightened shareholder value”. That requires a director to promote company success in the interests of the long-term, company employees, suppliers and customers, the community and the environment, and to maintain a reputation for high standards. I do not yet know what we can make of this but it is a welcome step in the stakeholding direction.

Finally, what should be the trade union response? We may not have always liked it but we knew where we were with the Ford Motor Company. Goldman Sachs by contrast is a foreign land and hedge funds are in a different universe. We won’t achieve anything by cuddling up to them but there is wide scope for campaigning on the corporate reputations of at least the mainstream financial institutions. We should do this, and mobilise our own shareholder power. After all, workers are still around 50% of the trustees of some of our largest pension funds.

We should also throw our weight behind the new International TUC formed 2 weeks ago of socialist, christian and former communist unions. It is burying old tribal conflicts in our own ranks to lead the fight against the dark side of globalisation and to campaign for taxation on the speculators such as the Tobin tax. We must support it to become a champion of good business practices, of decent relations with decent employers while ruthlessly fighting the speculators. I will be taking on the additional job of general secretary to a Pan European Region of the ITUC operating from Connemara to Vladivostock.

We must also use to the full the European dimension. A region of the world with 450 million people characterised by decent welfare states, public spending averaging around 40% of GDP, excellent public services in the main, the world's strongest unions, spreading democracy and union rights through Eastern Europe - this Social Europe seems to me to be a great source of union strength. It can take on the casino capitalists and to promote respect and rewards for those who accomplish real things in improving our society. We must encourage it to develop European rules for the games of the new capitalism, and to contribute towards drawing up global rules. It is no longer good enough – if it ever was for the Labour Government to fight off European initiatives to bring some greater co-ordination and order to financial markets.

Nye Bevan was not a dreamer about a common European future. He regarded the Common Market as a vehicle for capitalism. Indeed it could have been so and some are still trying to make it so. But so far trade union and socialist action – and to be fair Christian Democracy too - has made it something quite different. And Bevan was of course an internationalist who today would have recognised that the new global capitalism requires a global response. He would have recognised that in this as in other fields like world poverty and global warming, Britishness may be important but it will not be enough.

We have to fight the battle all the time. Every generation needs mobilising to preserve what we have and to promote progress based on the values of social solidarity. Following Vice Chancellor Müntefering reference to insects, I believe that the future must be based on the industrious bee, not the rampaging locust, on strong trade unions balancing capital, - yes, wherever possible, forming partnerships - and on active Government – at international, European Union, national and regional levels. We cannot rely just on active shareholders.

So tonight, chairman, I have taken you on a tour of trade union views of the new capitalism. As ever, the problems are clearer than the answers. But the memory of Aneurin Bevan demands that we undertake restlessly and urgently a search for these answers. Our future – the world's future - is too important to place in the hands of the new capitalists.

Thank you

LONG-TERM VALUE CREATION:

GUIDING PRINCIPLES FOR CORPORATIONS AND INVESTORS

BUSINESS & SOCIETY PROGRAM

The Aspen Institute's Corporate Values Strategy Group (CVSG) is dedicated to re-asserting long-term orientation in business decision-making and investing. Members of the CVSG share concern about excessive short-term pressures in today's capital markets that result from intense focus on quarterly earnings and incentive structures that encourage corporations and investors to pursue short-term gain with inadequate regard to long-term effects. Short-termism constrains the ability of business to do what it does best – create valuable goods and services, invest in innovation, take risks, and develop human capital. CVSG members believe that favoring a long-term perspective will result in better business outcomes and a greater business contribution to the public good.

The Aspen Principles offer guidelines for long-term value creation for both operating companies and institutional investors. The Principles were created in dialogue with CVSG members who—as leaders in both investment and business—sought to identify common ground from many sources, including the Business Roundtable, Council of Institutional Investors, CalPERS, CED, TIAA-CREF and others. To fully understand the spirit and nature of the Principles, it should be noted that:

1. The Principles are not intended to address every issue of contemporary corporate governance, but instead are designed to drive quickly to action in areas that *all parties* agree are critically important. CVSG members share a deep concern about the quality of corporate governance and favor effective communication between and among executives, boards, auditors, and investors. CVSG members will continue to engage in independent activities related to corporate governance issues not addressed here.
2. In drafting these Principles, members of the CVSG sought consensus and agreed that an overly-prescriptive approach would slow progress. The Principles are thus offered as guidelines, and are not detailed at a tactical level. Investors and companies, especially boards of directors, have the opportunity to innovate and adapt them to meet individual and evolving circumstances.

The Aspen Principles address three equally important factors in sustainable long-term value creation: metrics, communications, and compensation.[1]

1. Define Metrics of Long-Term Value Creation

Companies and investors oriented for the long-term use forward-looking incentives and measures of performance that are linked to a robust and credible business strategy. Long-term oriented firms are 'built to last,' and expect to create value over five years and beyond, although individual metrics may have shorter time horizons. The goal of such metrics is to maximize future value (even at the expense of lower near-term earnings) and to provide the investment community and other key stakeholders the information they need to make better decisions about long-term value.

In pursuit of long-term value creation, companies and investors should...

1.1 Understand the firm-specific issues that drive long-term value creation.

1.2 Recognize that firms have multiple constituencies and many types of investors, and seek to balance these interests for long-term success.

1.3 Use industry best practices to develop forward-looking strategic metrics of corporate health, with a focus on:

- enhancing and sustaining the value of corporate assets,
- recruiting, motivating, and retaining high-performing employees,
- developing innovative products,
- managing relationships with customers, regulators, employees, suppliers, and other constituents, and
- maintaining the highest standards of ethics and legal compliance.

1.4 De-emphasize short-term financial metrics such as quarterly EPS and emphasize specific forward-looking metrics that the board of directors determines are appropriate to the long-term, strategic goals of the firm and that are consistent with the core principles of long-term sustainable growth, and long-term value creation for investors.

2. Focus Corporate-Investor Communication Around Long-Term Metrics

Long-term oriented companies and investors are vigilant about aligning communications with long-term performance metrics. They find appropriate ways to support an amplified voice for long-term investors and make explicit efforts to communicate with long-term investors.[2]

In pursuit of long-term value creation, companies and investors should...

2.1 Communicate on a frequent and regular basis about business strategy, the outlook for sustainable growth and performance against metrics of long-term success.

2.2 Avoid both the provision of, and response to, estimates of quarterly earnings and other overly short-term financial targets.

2.3 Neither support nor collaborate with consensus earnings programs that encourage an overly short-term outlook.

3. Align Company and Investor Compensation Policies with Long-Term Metrics

Compensation at long-term oriented firms is based on long-term performance, is principled, and is understandable. *Operating companies* align senior executives' compensation and incentives with business strategy and long-term metrics. *Institutional investors* assure that performance measures and compensation policies for their executives and investment managers emphasize long-term value creation.

In pursuit of long-term value creation, companies and investors should implement compensation policies and plans, including all performance-based elements of compensation such as annual bonuses, long-term incentives, and retirement plans, in accordance with the following principles…

3.1 *How are Compensation Plans Determined and Approved?*
Executive compensation is properly overseen by a compensation committee of the board of directors. The board recognizes that…

a) The compensation committee is comprised solely of independent directors with relevant expertise and experience, and is supported by independent, conflict-free compensation consultants and negotiators.

b) The compensation committee calculates and fully understands total payout levels under various scenarios.

c) Boards and long-term oriented investors should communicate on significant corporate governance and executive compensation policies and procedures.

d) Careful strategic planning, including planning for executive succession, helps the board retain a strong negotiating position in structuring long-term compensation. The succession planning process is disclosed to investors.

3.2 *What are Executives Compensated For?*
Corporate and investor executives and portfolio managers are compensated largely for the results of actions and decisions within their control, and compensated based on metrics of long-term value creation [see Principle #1].

3.3 *What is the Appropriate Structure of Compensation?*
Compensation that supports long-term value creation…

a) Promotes the long-term, sustainable growth of the firm rather than exclusively short-term tax or accounting advantages to either the firm or employee.

b) Requires a meaningful proportion of executive compensation to be in an equity-based form.

c) Requires that senior executives hold a significant portion of their equity-based compensation for a period beyond their tenure.[3]

d) Prohibits executives from taking advantage of hedging techniques that offset the risk of stock options or other long-term oriented compensation.[4]

e) Provides for appropriate "clawbacks" in the event of a restatement of relevant metrics.

f) Requires equity awards to be made at preset times each year to avoid the appearance of market timing.

g) Ensures that all retirement benefits and deferred compensation conform to the general goals of the compensation plan.

3.4 *How Much Are Corporate and Investor Executives Compensated?*
Corporations and society both benefit when the public has a high degree of trust in the fairness and integrity of business. To maintain that trust, the board of directors…

a) Ensures that the total value of compensation, including severance payments, is fair, rational and effective given the pay scales within the organization, as well as the firm's size, strategic position, and industry.

b) Remains sensitive to the practical reality that compensation packages can create reputation risk and reduce trust among key constituencies and the investing public.

3.5 *How is Compensation Disclosed?*[5]
Public disclosure, fully in compliance with SEC rules, includes, in clear language…

a) Individual and aggregate dollar amount of all compensation afforded to senior executives, under various scenarios of executive tenure and firm performance.

b) The compensation philosophy of the board and the specific performance targets that promote the creation of sustainable value in the long-term.

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1. As this document is a reflection of existing sources, the greatest level of detail is offered on executive compensation. See the Appendix for a full list of organizations and sources of these principles.
2. In accordance with the SEC's Regulation Fair Disclosure
3. However, there may be circumstances in which boards should allow the sale or transfer of an executive's equity to accomplish purposes that do not alter the long-term incentive nature of the compensation.
4. In situations where senior executives are permitted to make personal equity trades that relate to their compensation, such trades should be fully disclosed ahead of time.
5. The new Compensation Discussion and Analysis requirements address disclosure requirements of the SEC.

Appendix

Sources of the Aspen Principles

1. Business Roundtable Institute for Corporate Ethics and CFA Centre, *Breaking the Short Term Cycle*
2. Business Roundtable, *Principles of Executive Compensation*
3. CalPERS, *Corporate Governance Core Principles and Guidelines*
4. Committee for Economic Development, *Built to Last: Focusing Corporations on Long-term Performance*
5. Council of Institutional Investors, *Corporate Governance Policies*
6. Financial Economists Roundtable, *Statement on Executive Compensation*
7. The Conference Board, *Report of the Commission on Public Trust and Private Enterprise*
8. TIAA-CREF, *Executive Compensation Policy*

Other Resources

9. Buffett, *2005 Letter to the Shareholders of Berkshire Hathaway, Inc*
10. Caux Roundtable, *Principles for Business*
11. Davis / McKinsey Quarterly, *How to Escape the Short-Term Trap*
12. EBR Consortium, *Enhanced Business Reporting Framework*
13. Gordon, *If There's a Problem, What's the Remedy?*
14. Hodak, *Letting Go of Norm*
15. Jensen, Murphy and Wruck, *Executive Remuneration*
16. Kaplan and Norton, *Alignment*
17. Koller, Hsieh & Rajan / McKinsey Quarterly, *The Misguided Practice of Earnings Guidance*
18. Monks, *Corporate Governance in the Twenty-First Century*
19. Rappaport, *Ten Ways to Create Shareholder Value*
20. The Aspen Institute, *Corporate Values Strategy Group working groups*
21. The Conference Board, *Revisiting Stock Market Short-Termism*
22. United Nations, *Principles for Responsible Investment*
23. Wachtell, Lipton, Rosen & Katz, *Compensation Committee Guide and Best Practices*
24. Weil, Gotshal & Manges, *Seven Things Shareholders Want Directors to Understand in 2007*

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