

Lord Davies of Abersoch's speech to the ICC Trade Finance Conference, London, 9 November 2009

Can I start by saying that I love trade, I love trade finance. It's been part of my career, as a banker, and now that I'm in government. I want to start by saying that I think the ICC does a great job and I think that people underestimate the importance of their role, providing standards but also a voice on modern trade.

Now, according to the programme, I'm going to speak on trade, comma, finance and economic recovery. Well I will try and speak relatively quickly so we can have a good session of Q&A.

On economic recovery I think the world is just about getting back to normal. But this has been a major once-in-a-hundred-year crisis. If we look at the last 100 years and the crises that we've had: rouble crisis, dotcom crisis, Asian crisis, we have the 29 depression, but this ranks right up there as probably the deepest and, also, the most worrying. I think for the next 100 years economists will be writing books and debating the issues. But I think now that I've moved on to the other side into government I don't think anybody should underestimate the social consequences of the crisis, nor should they sweep under the carpet the very fundamental challenges that now face the financial services industry. These are very, very fundamental issues that industry has got.

Now trade. If you look at the way trade has become hugely important to most banks. What we've also got to expect that in the trade world, we've had huge imbalances in the last decade.

We've had the growth in the current account imbalances from the early 2000s. And it has been extraordinary the volume of world trade in the last decade tripled, but it has been powered by imports of cheap Asian goods by credit fuelled economies in the west.

Now there's no doubt that this led to unsustainable savings in the East dependent on excessive debt in the West. Between 2002 and 2008 China saved \$1.4 trillion, but the US borrowed \$3.9 trillion.

But what also happened is that the world economy became interdependent: two thirds of Asia's exports and commodities find final demand in the West. Most of China's official reserves are held in US securities.

As the balance of world trade shifts, the results are visible everywhere you go. I visited Jebel Ali in May, I was in China in July, last week I was in Indonesia and Malaysia, I was in India in September. I've visited about 25 countries in the ten months since I've become a government minister. There is absolutely no doubt, you know it from your own businesses. The trade corridors are changing, and they are changing in quite a fundamental way. Nobody would have expected the African trade with China to be so significant and so strategic. The middle classes in Indonesia, in China and in India are growing, and spendthrift economies are saving.

India, China, Brazil to name three are on the move. Now, if you look at the way that these economies are changing: to put it in perspective, I met the Chief Executive of China Mobile last month which has just celebrated 500 million users. They've got 500 million people subscribing to their mobiles. The scale of the Chinese industry, not just in mobile, but in many sectors, is actually going to dwarf the rest of the world. But I also met CEO of ICBC, now the largest or second largest bank in the world by market capitalisation. Two great examples of institutions that most people had never heard of a decade ago and yet at the top of the tree in their industries.

Almost 40 per cent of Indians are younger than 15. Less than 40 per cent of Indian households have a bank account and only 2 per cent of India's population has any kind of insurance cover. India will produce somewhere between 800,000 and 900,000 engineers this year. To put it into perspective, Bangalore alone will produce more engineers than the US. Now, these can be thought of as threats to the economy and us in the West, but they can also be thought of as opportunities.

What this crisis has done is made everybody realise that we are interconnected. Everywhere I go I repeat the story that some of the biggest holders of Lehmann mini bonds were actually in Hong Kong, and some of the Washington Mutual biggest holders were in Thailand. The whole financial services market and economy is global, so whatever solutions we come up with on financial services, for trade and for other things, they have to be global too. That's why we need a global trade deal. We need a Doha agreement. And as I was saying to the journalists who are in the room now before this

session, whilst it might have slipped a little bit we have got to be absolutely committed because the world needs a global trade deal. We need a deal on climate change at Copenhagen. And we need to make sure that in whatever conversations we're having, that India and China are at the top table. It was long overdue. They should have been there earlier.

Turning to finance, to be a successful chief executive - I reminisce a little bit: I used to be CEO of a bank and therefore I reminisce a little bit. I'm allowed to do that at my age – that is to stand against the market which is clamouring for growth, clamouring for earnings per share growth, clamouring for your profit before tax growth. And in a market where it is trendy to take exceptional risks, to stand against that market, takes a huge amount of courage. That's why sometimes they say a chief executive's job is quite lonely.

I remember the days, not so long ago, when if you mentioned seeking deposits, cash management, if you mentioned letters of credit, if you mentioned branches, people management, or indeed social responsibility before CSR became fashionable, you were regarded as a pre-historic monster. They are the facts. You can rewrite history, some people are now beginning to, but the reality is, it's not that long ago when people were saying that cash management and trade finance had no future. And they were certainly in those days not bonusable.

I also remember the days when the swagger of individuals involved in securitisation, credit derivatives, CDS, but also off balance sheet vehicles, used to somewhat stick in the throat.

But the crisis over the last year has seen huge changes in the industry. The nature of a bank and its place in society has been debated and will continue to be debated, I think not just for months but for years to come.

There are literally hundreds of questions now about the future of banking.

Here are just a few:

- Should the bonus culture be killed?
- What are the right levels of liquidity capital and leverage?
- How do you put enough capital against serious trading activities to make sure that the risks are managed adequately?
- How do we get banks to support SMEs? At the end of the day, Britain is an economy of SMEs, we have 4.7 million SMEs.
- How do we reduce the fees payable on M&A and other underwriting on investment banking products?
- Is the model in parts of investment banking of paying somewhere between 40-45 per cent of revenues to staff sustainable, and why should it be the model?
- What is the future of trade credit insurance? Where does it fit in with SMEs?

Now, I'm not going to go on, but there's a whole series of questions and I think we shouldn't be afraid of voicing those questions and debating them openly.

Now for those of you that are starting off your career – and I see a few of you – for those of you starting off your career in the industry the key has to be: stay close to your customer, manage risk carefully, never underestimate the importance of liquidity.

Turning to the UK. Look, we're a trading nation. We exported £368 billion of goods and services in 2007. More than 50 per cent of that is in manufacturing. We are the world's sixth-largest manufacturer. We're ahead of France who continuously say we've got no manufacturing. Funny that, when we're ahead of them. And we are the seventh-largest economy.

And it is actually interesting to reflect on what the UK has. We are a knowledge-based economy. We are very strong in high tech and we are very strong in certain industrial segments. Six of the Formula 1 teams are based in UK. Why? Because we have got the advanced engineering capability. We have 13 per cent of world turnover in aerospace and we have overtaken Denmark in having world's largest installed capacity of offshore wind power. Although we make up only 3 per cent of global pharmaceutical market we attract 10 per cent of the world's R&D in pharmaceuticals.

The UK is still the number one destination in Europe for FDI, we're second only to the US. There was an 11 per cent increase in FDI in the UK last year.

We are ranked fifth in the world by the World Bank for ease of doing business, we're up one notch from last year. As we said earlier, we've got 4.7 million SMEs. Over 120 companies register with Companies House every hour.

Entrepreneurism is for young people absolutely on the move, particularly driven by the online market.

The current competitive state of the pound gives business from all sizes a golden opportunity, for big and small companies to open new doors and to take it to the world, as we like to say in UKTI.

But I think we've got some challenges. The biggest challenge is the banks, the banks that are represented here. When the economy, as it will, in a couple of months, recovers, that is the moment when small businesses will need working capital. They need extra trade finance. And I do believe that that is one of the biggest economic challenges that we've got. As I say, we need access to finance to be there for small businesses as they come out of recession. Otherwise we will have a very serious problem.

The trade figures released this morning showed significant growth in exports – also showing fast growth in imports. But in the third quarter the trade deficit narrowed by £200 million.

So we have got to make sure that we put in place the right tools for companies to benefit from the upturn.

We've got to make sure that ECGD, the government's export credit agency, actually widens its product array and major changes to its focus. I think there is an issue around having a too narrow focus, too few customers. And we have got to rethink what ECGD's position is in the economy. We are looking at a whole range of issues in government, how we can support trade, how we can ensure access to finance. But my message to you overall is we've got a

diverse economy – that’s a fact, the financial services industry has got serious challenges, trade finance has never been more important, and we need banks – and many of you have never moved from that position – we need banks to get back to basics. The banking industry needs to be there for corporates as they recover and i think that will be in a couple of months. I think the final point is we have got to have lots of conversations about what is not working, and what is working well. Hopefully during the Q&As you will tell me what is not working, and hopefully the government can rectify it. Thank you.