

**Speech given by Sharon Bowles MEP at  
HSBC Conference on Regulation with Growth  
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Thank you very much for inviting me to speak and I wish that I could have stayed for the whole conference. Alas there are as ever triologue duties, but it's nice to get out at least for a couple of hours!

This conference is on regulation and growth and Stephen has just laid out some thoughts on emerging economies, the Silk Road and its implications for Europe.

I would like to say a few things in a way that I think is interconnected.

First on regulation. I have noted many times that what started as a financial crisis metamorphosises with time. Economists tell us it is normal for a financial crisis to have follow-on phases of economic and sovereign crises.

We now have two more crises - growth - which I suppose is part of the economic crisis, and a regulatory crisis, at least insofar as uncertainty is concerned. Now you all know that I am not always in agreement with everything that banks say and want, but having run my own business for 25 years before being elected I do buy the "uncertainty" line. It is not just banks that want to know what to expect, so do businesses in the certainty of their credit lines and bank relationships.

It would be wrong, however, to say it is all to do with regulation, some of it is the time we are in, but I do believe that regulators and legislators should endeavour to minimise uncertainty.

I guess we all thought that when Basle came up with its proposals, there was a reasonable understanding of where everything was going. Alas that has not really been the case because, for example, the views on liquidity have been changing: in some ways for the better in that at least the total or even majority reliance on sovereign debt is not seen as smart anymore. On the other hand the new tool is not yet fully understood and may have unintended consequences including increasing complexity.

On CRD4 we have also had the merry dance over implementation dates, and the various European Institutions' preoccupation with putting

pressure on the legislative process by never admitting things take a little longer than the Commission planned is far from helpful. Indeed I would like a rule that says the implementation date must always be set so that the co-legislators have as much time to do their work as the Commission took.

There is also a conflict between long and short term.

Governments struggling with high debts want growth as soon as possible, so do banks, but getting it without repeating the sins of the past looks difficult. Too much of past growth we now know was false, often consisting of bringing forward expectations of tomorrow's growth into current asset prices. So we ate tomorrow's growth before we got there, the pantry is empty, or worse the growth we ate does not exist and there is resulting debt and impaired assets. We must resist return to such cash flow time travel that only serves the purpose of a short term boost to GDP, which has too much dominated our mindset and resulted in us selling inflated assets to each other. That is not sustainable growth and has driven a huge inequality between generations.

Also failure to face up to the sins of the past is prolonging the sovereign and banking crisis in the Eurozone, which of course the markets know, and adds to the uncertainty crisis.

Rightly there is a focus on long term investment and also longer term perspectives within management.

And as with so many questions about how to get to somewhere, the Irish answer of 'I wouldn't start from here' is applicable.

The recent report of Professor Kay gives some indications of where - often with the best of intentions - we have gone astray in the past. Too frequent reporting, all in the interests of transparency, encourages short term horizons in the thinking of executives.

And reconfirmation of directors at AGMs which is good for accountability has the downside we know from democracy. Politicians seek to please in order to get re-elected, what makes anyone think company directors are made of sterner material.

There are also conflicts. Fragmentation of the investor base is seen as a disadvantage to long term investment and understanding of a particular company, yet at the same time when I am looking at prudential

requirements I am interested in diversity of portfolios. I prefer that to synthetic hedging, I also want understanding of what is going on to take pride of place.

This is not a new idea, in some regulations - Solvency II is a good example, diversity was recognised in many ways. I had a much harder job trying to implant recognition for specialisation. These should not be mutually exclusive within a piece of regulation, provided you know what is going on.

In the Parliament we have been trying to pursue relationship lending within the framework of CRD 4, but we are coming up against the supervisory attitude of 'how is that to be defined and checked'. My answer is by demonstrating knowledge, it can't be done by tick box, and looking forward perhaps we should call it knowledge lending.

When it comes to liquidity, I mentioned unintended consequences. A lot more concentration on liquidity presses towards trading and the easily tradeable rather than locked-in longer investment. Easy trading, particularly when it comes to debt instruments, also means more complexity and in fact more consumption of costs within in the financial system. Such costs may boost bank turnover and GDP, but it is the area where one can ask is it actually doing anything useful - or worse restraining the useful.

Bonds are rendered more liquid by the derivatives that surround them, thus rendering a simple investment more complex. Long bond purchases will be hedged with a futures contract to look after the short side, and indeed they will receive a regulatory reward for hedging. Meanwhile those buying shorter dated bonds will hedge the long side with a futures contract and get their regulatory reward too. In the middle of these futures transactions - which will be netted off from one another - are the banks, obviously charging for their services.

Similar regulatory encouragement to complexity applies in other asset classes and then in the end the trade ends up in the derivatives and not the underlying financial instrument itself.

Of course we can not just abandon the procedures that we are used to, but I do see a link between progressive reduction of complexity and finding the right place to face the future.

Looking to the long term future we see that readjustments will be needed as the emerging world changes, catches up and possibly overtakes us unless we find that place.

The problem I see is that the Western economy can no longer sustain the 10% financing cost of the financial system, on top of which we have both high asset and high labour costs. Asset prices and labour costs may level over the longer term, but financing costs can not forever be kept overly low on the one hand through unrealistic interest rates and central bank intervention, and on the other coupled with unreasonably high servicing costs from the complexity of financing, and indeed regulation.

This means that we need to simplify the investment chain with fewer intermediaries, fewer derivatives and maybe even fewer asset classes. Crowd financing will be part of the future, it should be embraced not dismissed as fragmentation. I believe such investors are likely to want more direct access to parts of the business they are interested in and can understand and it may also provide a route to better distribution of wealth.

I think it is in our interests to take on board a simplification agenda because it will help to address fundamentals within our own economies that need rebalancing for our own good and for our future trading. Long term we can not expect to earn our keep by exporting our financial complexity and for many countries neither can we sell raw products and our labour costs, through housing costs, are too high to sell manufactured goods. The edge we have in high tech and luxury goods is something that will erode.

The future will not stay as it is now. Countries like the BRICs which were booming have had a setback. Some of the mistakes of the West are being copied in China.

If we look collectively what is the competition? South America, China, Asia, Australia all have raw material resources. Peru and Bolivia look as if they will contribute cheap manufacturing labour, South East Asia has technical skills. So they can all swap and match among themselves, do they need us long term? By 2050 the EU will only be 4% of the world population.

We have both to fight our way in and look to what we are doing at home.

On fighting our way in we know that trade is important and I will put in a plug here for the Parliament which is still fighting to lower trade finance costs.

Indeed earlier this year when a delegation from the committee was in Hong Kong, and repeatedly I was having to explain what Europe was up to, not a small task which my colleagues and the EU ambassador ended up dubbing Sharon's EU road show, the effort that the Parliament was making on trade finance was the single issue that gathered most attention. We in Europe have the opportunity to set the trend here against the fearfulness that took hold in Basle. We firmly take the view that in the current climate lack of data on defaults, because there are not enough of them, is no reason to delay more favourable treatment. Better to boost trade now, help growth and help relationships. I'm having a harder time than is justified on this and some positive help from the Council or Commission side would be appreciated.

Looking to the home front, already we do see some repatriation of manufacturing where consumer demand and trends will not wait six months for shipping. New technology may also help. Who says that 2050 will still be dominated by large scale production? Alongside the shipping issue and energy costs, technology may well diversify into more bespoke and localised production with innovations like three dimensional printing. Formula 1 cars are all made by computerised epoxy printing and etching techniques, where will that lead in the longer term. I am not saying we will all have Star Trek replicators - because I have always wondered about conservation of matter in that - but far more portable high tech manufacturing is a real possibility. Ideas and relationships are key.

This brings me back to the point I made about simpler, more direct and more localised investment. However this is not in a nostalgic times past manner, but by embracing technology within both industry and the financial industry. Generation Y (under 35s) want information now and go looking on the web. Generation Z will extend that further.

So there is much to play for. We should lead not follow.