ACI Roy Bridge Memorial Lecture

The Rebalancing of the World Economy: The Rise of Asia and the Ageing of the West

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Good Evening Ladies and Gentlemen.

First, let me thank the ACI for asking me to speak to you tonight – it is a great honour to follow such a distinguished line of predecessors in giving the Roy Bridge Memorial Lecture at the ACI.

The theme of my speech tonight is a complex one: the profound geographic and demographic rebalancing of the world economy: the rise of Asia and the ageing of the West.

Inevitably this involves looking into a crystal ball which is something I am normally loathe to do.

Better men than I have done so and had the cold, hard light of posterity shine unfavourably on them. Thomas Watson, the founder of IBM, thought that there was a world market for maybe five computers. And one of the greatest physicists, Lord Kelvin opined that radio had no future, heavier-than-air flying machines were impossible, and x-rays would prove to be a hoax. And in 1900 he stated "that there is nothing new to be discovered in physics now". 1900, of course, being the year that Quantum Physics was born, with Max Planck as midwife.

profound change

All in all, like Yogi Berra, the baseball legend, I think "it's tough to make predictions, especially about the future".

So with the caveat that all my future facts and figures, while based on reputable authorities, may be wrong, let me look first at the rebalancing of the world in geographic terms.

For most of recorded history China was the world's largest economy and India was the second largest. In 1820, China and India had about half of the world's population and the world's income. But in the West, we sometimes view history from a rather myopic perspective.

In the last 200 years, we saw the relative ascendance of the West as Europe and America underwent their industrial revolutions, and as much of Asia entered a period of political instability, in part caused by dynastic change and in part by the dysfunctional impact of its encounters with the West.

That gap is now beginning to close again. Let me take China as an example.

Since China took the decision to liberalise its economy 25 years ago, its progress has been astonishing, and, of course, widely discussed.

Today, China is the world's manufacturer. There is not a manufacturer in the world that is not either manufacturing in China, sourcing in China, or thinking about it.

The variety of goods manufactured in China now ranges from the most basic through to the most sophisticated. China makes half the world's cameras, a third of the world's televisions, a quarter of the world's washing machines.

China is ever more important to Western countries. Motorola derives 20 per cent of its global revenues from China.

China's car industry, which is 50 years old, took 39 years to make its first million cars; nine years to make the second million; two years to make the third million; one year the fourth and last year made nearly two million.

And this year, the forecast is for 2.4 million cars and by 2008, four million-plus.

China is now the second-largest importer of oil and last year consumed 40 per cent of the world's cement. Those of you who have been to Shanghai, which is reputed to have been home to something like a fifth of all the world's construction cranes over the last few years, will believe that figure.

China is the most visible embodiment of the profound change affecting the global economy as manufacturing has moved East. But Asian countries are also part of that process.

And we are now seeing the beginning of a second wave of change: in services, where India has been in the vanguard.

In India, liberalisation of trade and investment regulation, an increase in FDI and a well educated and English speaking workforce have all combined to create something of a boom in areas like business process outsourcing, forecast to employ over a million people within five years, up from 171,000 in 2002.

And many other Asian countries are attracting services work previously done in developed countries.

The fact is that we are in the foothills of a revolution of services' internationalisation, which will change the face of G7 economies just as the first wave in manufacturing did.

Research by Deloittes estimates that there are 13 million jobs in financial services globally, of which two million will move location by 2008. So the new phenomenon is that services are going to be sourced in a similar way from all sorts of countries round the world.

What makes this economic, in a way it never was before? All the facets that combine to make up globalisation: deregulation and liberalisation of trade and capital markets and the revolutions in transportation and technology.

And telecommunications costs. Just one striking and relevant example: the cost of a phone call between India and the UK has fallen by 80 per cent in the last two years.

creation of jobs

It is inevitable that companies will begin to utilise the opportunities this new globalised telecoms environment presents. HSBC is doing it; so are many others. And the creation of jobs in developing countries that desperately need them can only be a good thing in the long term.

Clearly in the West, some service sectors are better insulated from change than others. Many jobs are geographically fixed. For instance, leisure and tourism are local in nature; you can't move a hotel or airport offshore – although you can move their sales ledger.

As the nature of work changes, countries that can promote flexibility in its widest sense: in labour markets; in regulation that enables the creation of new sectors and jobs; in providing their citizens with new skills; these are the countries that will prosper in this changing environment.

After all, we cannot be surprised that India which is producing something like 70,000 English speaking IT graduates a year is seeing growth in this sector when Britain produces less than 5,000 graduates a year in computer science.

In developed economies, the key factor for societies to adjust to these changes successfully, as always, will be education which allows the workforce to move to constant learning and creates the capacity to develop new skills. It is a truism that life is a constant learning process – you can no longer expect what you learnt at school or college to last a working lifetime.

Of course, we should remember that others will be moving up the value chain as well. Already we see that some higher value work is also moving from the UK: business research, financial analytics, architectural design even medical diagnostics.

Other high-value work is also portable. In a speech in January, the Prime Minister talked about a hypothetical NHS patient and said if he or she, and I quote, "needed surgery, he would be guaranteed it within six months or given the option of going anywhere in the country or abroad - NHS or private - that could provide surgery more quickly".

And if you google "medical tourism" you can see that some countries are already targeting this market. You can get weight-loss treatment in the Lebanon, a heart bypass in the Philippines, knee surgery in India and so on. Typically the surgery, the flights and two weeks in a four star hotel can be 40 per cent cheaper than just the operation in the UK.

We need also to be aware that some high-value activities in our own industry will move.

Historically the capital markets have recycled savings through London and New York. As Asia, with its high savings' rates, grows its pool of investible resources, there is no reason to suppose that they will not be recycled increasingly through domestic capital markets rather than in the West. At HSBC, we see the basic building blocks being put in place.

Asian countries have savings rates of 30 per cent-plus of GDP. Asian central banks – excluding Japan – hold US$1.2 trillion in reserves. Including Japan, the figure is around US$2 trillion.

So the opportunity is there for Asia to use its resources to do more than buy US treasuries. We have already seen Singapore build up a portfolio of direct investments. We have also seen the Chinese authorities use US$50 billion of their reserves to re-capitalise some of their banks.

But this is not a zero-sum game, even if it does create a real challenge in the G7 countries to move up the value chain and to find new markets.

In the long term, these changes will help create new consumer markets for developed countries to trade with, and economic benefits will accrue to both countries.

Indeed, research by McKinsey shows that for every dollar of labour costs moved from the US, something like $1.45-1.47 of value-added is created globally of which the US captures $1.12-1.14 and the receiving country 33 cents.

And there is no reason to believe that consumer demand in emerging markets will all be satisfied domestically any more than demand in G7 countries is.

For instance, at the beginning of last year, India had 10 million mobile phone subscribers. By the end of the year, it had 28 million and is adding 1.5 million new subscribers a month. China had 250 million subscribers last year and is forecast for over 400 million subscribers by 2007. These markets are good news for developed countries.

Of course, in many countries, the development of a mass consumer market that buys houses, cars and imported or luxury goods will begin with only a small percentage of the population. It will take a long time for most developing countries to reach G7 levels of income; even at 7 percent growth per annum it will take more than 40 years.

But the process has started. In China, we are seeing it first in the Yellow River Delta, the Yangtse Delta and the Pearl River Delta, all on the Eastern seaboard. Over time we will see growth move inland. Of course, when you are dealing with a country of 1.3 billion, if even 10 per cent are significant consumers then you have a very big market indeed.

A small example: if you look at the border between Hong Kong and mainland China, you see Hong Kongers going to Shenzhen to buy fake designer handbags and you see mainlanders going in the opposite direction to buy the real thing.

I described these changes as a rebalancing. The West will not fall back economically; rather Asia will, over time, catch up as its growth rates consistently outpace the West over the coming decades. Europe and the USA will not account for 30 per cent of global GDP each as they do today. The shares of India, China, indeed Asia as a whole, will increase.

And meanwhile, during this period, the West will also be dealing with another rebalancing: the profound demographic changes that will reshape its societies.

social implications

On the first day of the 20th century, there were three million Americans over 65; on the last day there were 33 million. And in 30 years time, there will be more than 70 million Americans over 65.

Globally, there are around 400 million people over 65. By 2050, there will be over 1.5 billion. For the first time in human history, there will be more old people than children on the planet.

This is unprecedented. For the vast part of human history, life expectancy overall was probably around 20 years. Of course there were times and places when it was higher, but usually only for a small section of the population, the ruling classes.

Advances in medicine – particularly infant mortality and the treatment of disease – and advances in agriculture and nutrition have changed the shape of human experience.

Average lifespan around the world has doubled over the last 200 years to around 65 for men and 70 for women. In Britain the figures are 75 and 80 respectively. Some of the social implications are very positive; ask any doting grandparent watching their grandchildren grow up; or, increasingly, great-grandparent and great-grandchild. My grand-daughter, born in 2002, comes from a generation of females that in developed countries has a 50/50 chance of living to see the next century.

And old age isn't what it used to be. HSBC is sponsoring a series of programmes on CNBC called "Live Long & Prosper" about the changing dynamics of ageing. One of the programmes shows a ski instructor in Italy who is 84 and still teaching.

Which was almost as impressive as her elder brother who still works as an Alpine guide at 87. He said he couldn't do the big peaks anymore, so he stuck to the 4,000 metre ones!

But all this progess does mean that the West must address the financial implications of an older and ageing population. And this is compounded by fertility rates in almost every developed country being below that necessary to replace the population. This means that, in the next few decades, the support ratio of workers-to-over 65s will become sharply lower.

This creates a particular issue for mainland Europe where a much greater proportion of the pensions of retired workers are funded by the present working population than in the UK.

This system works well enough when the support ratio sits at four or five-to-one as it typically still is in developed countries, but may well be impossible to sustain when the ratio falls to 1.8 or 1.4-to-one as it is forecast to do in Germany and Italy respectively in 2020.

In itself a reducing dependency ratio is not necessarily a huge problem. In 1900 the US ratio was around 100: 1 compared to around 4:1 today and that transition was managed successfully, largely by advances in productivity. But at some stage the equation ceases to add up. In Italy, the total population is forecast to decline 28 per cent from 56 million to 40 million by 2050. Over the same period the population will age dramatically overall.

In the West, the US will be the only developed country to enjoy any material population growth, largely as a result of immigration; immigrant populations typically having higher birth rates than host populations. Overall, one in eight Americans are now Hispanic/Latino, but one in five American children are Hispanic/Latino.

In fact, almost all the world's population increase over the next thirty years will take place in Asia, Africa and Latin America.

So there will be very different issues in developing and developed countries.

In developed countries we will see the emergence of the ageing as a powerful political constituency. The AARP – American Association for Retired People – today has 35 million members. This is an organisation so large it has its own zip code. By comparison the NRA has 2.5 million members and the NAACP 400,000.

Similarly, in the UK, Saga - the organisation for people over 50 - has a million subscribers to its magazine, far more than belong to all our political parties combined. And when Tony Blair hit 50, it was Saga Magazine that got the exclusive interview.

The age agenda is clear. The AARP's four stated priorities are: Health and Wellness; Economic Security and Work; Long-term Care and Independent Living; and Personal Enrichment.

age agenda

As you would expect, they are active lobbyists in health, in social security issues, in fact in 14 different policy areas. And this is the future for Western societies: the emergence of a strong well-organised political lobby for older people.

When you consider how many votes made the difference at the last US presidential election, the implications are profound, particularly since there is a growing likelihood of income tax-payers becoming a voting minority in some democracies. And it is not easy to imagine older populations voting themselves less health care or lower pensions.

Patterns of work will have to change as people look to fund their lengthening retirement. During history, for most people, the human experience has been to work their entire adult lives. Pensions were set at 65 because life expectancy was 45. Today many people can expect to spend decades in retirement and this is not tenable on present funding. People will have to save more and work longer by retiring later or working part-time to fund their retirement.

They will also have to take more responsibility for this funding themselves, rather than expecting government to do it. Some may do this because they do not trust governments to do it for them; some because they see that there will be too little in their pot; and some because they are rational actors in this process and know that increased expectations have to be paid for. But there seems little doubt that this will cause considerable political tension in many G7 countries.

For those of us in financial services, the implications are, of course, wide-ranging. We should be looking at providing everything from long-term savings and retirement planning to estate management and trust services to health care support and insurance.

By contrast in developing countries – the young societies – education and job creation will be the main focus although we should not ignore the plight of the hundreds of millions of women who will reach 65 in developing countries in the next few decades who face an uncertain future.

In these young societies, financial services companies will focus on providing services to new entrants to the industry. The provision of basic banking services and of consumer finance are major growth areas on a scale we have never seen before.

And, of course, as an industry we will also have to come to terms with the tremendous investment in infrastructure that urban population growth will require.

In 1975, there were five urban areas – megacities – with populations over 10 million. The UN forecasts that in 2015 there will be 21, of which 19 will be in developing countries. So there is a lot of cement to be mixed in the next few years!

In summary the world economy is being fundamentally rebalanced before our eyes - both geographically and demographically. The effects of these changes, not least in their interaction with each other, will be far-reaching and sometimes unexpected. Seeing how the world will be in 2050 from today's perspective is like imagining the television, the automobile and the atom bomb from the perspective of Victorian London.

The pessimist might conclude, for example, that the present generation of those retiring or about to retire in Europe, are in a uniquely favourable position compared with both their predecessors and their successors.

But I am an optimist. Speaking as a baby boomer, what the AARP calls the "longevity bonus" - those extra thirty years of life expectancy - strikes me as a pretty good thing for me and my grand-daughter.

And the movement of work between developed and developing countries can only be beneficial for developing countries; the challenge for the West is to adjust successfully to the new realities. But the last 25 years has shown that flexible economies are capable of fundamental change, and overall the result is for the better. Although of course we must never forget that the upheaval of transition can be painful for may communites.

In Britain for example, manufacturing accounted for 26 per cent of total employment in 1979 and less than 13 per cent today. In the last 25 years, some 3.3 million jobs were lost in manufacturing; but service sector employment rose by 6.5 million. And over the last 40 years, when the shift from manufacturing to services was taking place in Britain, real wages doubled.

This process of adjustment will continue. I see no reason to suppose that over the next 25 years the changes necessary to support the changes in job profiles, in work patterns, in pension reform and health provision won't take place.

We may not be able to see exactly how our societies will look. The one thing that is certain is that they will change. And our jobs, our companies and our economies will have to change with them.

Thank you.