

The American European Community Association

The Changing Balance of the World Economy: The Asian Challenge to the G7 Economies

Speech by Stephen K Green

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Good Afternoon Ladies and Gentlemen.

Thank you to The American European Community Association for asking me to speak to you today. My subject is first, the changing balance of the world's economy and second, possible G7 responses.

First the rise of China and India in economic terms. We speak about rise, but that, perhaps, is based on our short-term historical perspective.

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

For instance, we all remember Columbus as a great navigator. He sailed in three ships, the largest the Santa Maria, a sixty-footer.

We forget that, 80 years before, Admiral Zheng was sailing throughout the South Pacific, the Indian Ocean, the Persian Gulf and Africa visiting dozens of countries proclaiming the magnificence of the Chinese empire, and forging trading relations. On his voyages Zheng commanded 300-plus ships with perhaps 30,000 men; his flagship was 440 feet long.

In the last 200 years, we have seen the relative ascendance of the West as Europe and America underwent their industrial revolutions, and as 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. 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.

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.

These shifts have translated into profound change in Western economies as manufacturing has moved East.

We are now seeing the beginning of a second wave of change: in services, much talked about of late.

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 work previously done in developed countries. There is some resistance to it; there is some debate about the quality of service in, for instance, call centres. We have even seen some work put back onshore, by companies like Dell and Lehman Brothers.

But 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.

Deloitte Research 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 has before? All the facets that combine to make up globalisation: deregulation and liberalisation of trade and capital markets. The revolutions in transportation and technology.

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

It is inevitable that companies will begin to exploit the opportunities this new globalised telecoms environment presents.

historical
perspective

In HSBC's case, I now have over 7,000 colleagues in service centres in India, China and Malaysia, and a new centre commissioned in Sri Lanka, providing a whole range of services - payments processing, credit approvals, call centres, and so on - to customers in the UK, the US, Hong Kong, Australia and elsewhere.

This facet of globalisation is causing some disquiet in developed economies. And indeed, it is fair to say that it is arguably their biggest socio-economic challenge over the next generation.

But experience suggests that flexible economies will be able to adjust.

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

The question is: can it continue to adjust?

The key factor for society, as always, will be education which allows the workforce to move to higher value jobs. But we should also be aware that some higher value work is also moving: business research, financial analytics, even medical diagnostics.

In the longer term, we need to be aware that some activities that we consider today to be high value will also 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.

Clearly some 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.

But the real need is for flexibility.

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 benefit most.

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.

Nevertheless some disquiet remains. When HSBC announced the creation of 4,000 jobs in our global service centres to service customers from, among other countries, the UK, the press response was intense. And understandably so.

Because if you look at the issue locally, it is true that the effects can be traumatic. You are all aware of how the shift in manufacturing produced distressing consequences for many communities.

And I acknowledge that no matter how sensitively we handle this, it cannot be painless. But we do this because we absolutely believe that by not managing this process, we would be abrogating our responsibilities to our customers and shareholders. And, in the long term we would be putting many more jobs at risk. If you hide from this issue or pretend it's not there, the reckoning comes later as you become less and less competitive.

But I should also say that we are proud to be creating good-quality jobs in countries that desperately need them. There can be no doubt that the disparity in income between developed and developing countries is untenable. So not surprisingly the perspective is different in developing economies.

We create great jobs in state-of-the-art facilities. This helps boost the local economy in any number of ways: infrastructure improvements, training of the workforce, the introduction of global best practices, and the creation of new jobs in the local service and supply sectors.

And remember that global resourcing of jobs is not a one-way street. HSBC develops its IT for our operations in 79 countries and territories in Canada, Hong Kong, India and the UK, because that is where we can do it most efficiently. The endgame will not be that everything moves to India and China. But Europe and America will no longer be the centre of economic gravity.

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.

So this is not a zero-sum game. But it does create a real challenge to move up the value chain and to find new markets.

socio-economic challenge

The growing wealth of a growing number of people in these countries creates consumer demand. There is no reason to believe that demand will all be satisfied domestically any more than demand in G7 countries is.

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 per cent 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.

As consumer markets grow in China, in India and other developing countries, developed countries have every opportunity to build enduring trade partnerships to the benefit of all.

That is the challenge for all of us. You can't stick with the status quo, because there is no status quo now. We are in a state of transition. The economic balance of the world is changing irrevocably. This means changes in the composition of work performed in developed countries and the flexibility to make those changes.

There is a constant need for flexibility in its widest sense – in education, in labour markets, in regulation, in management thinking – to ensure competitive excellence. The G7 countries have no divine right to the relative affluence they currently enjoy.

For developing countries these changes mean new jobs and the growth of new consumer markets. Overall, these changes, disruptive in parts though they will be, will be good for East and West alike. The challenge is for individuals, companies and countries to ride the second wave of work internationalisation to harness the full benefits.