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## "DEVELOPMENT IN A CHANGING WORLD"

### Introduction

I first visited Malaysia when I was 19 years old and I was working as a DiscJockey on a troopship. Little did I think I would be standing before this audience today.

It is such a pleasure to visit your wonderful country again - to be in a beautiful country with a current account surplus, and with superb infrastructure. It is fifty years since I first visited Malaysia, so I have witnessed for myself your amazing transformation. Naturally, I'm delighted to have this opportunity to address you today.

Looking at the distinguished list of previous speakers in the Khazanah Global Lectures, I asked myself what insight can someone whose whole career has been spent in international business, mainly in banking, offer this audience? So I want to talk about some of the lessons I draw from my experience living and working in many countries during almost five decades, when business has been at the forefront of a significant transformation of the world we live in.

The years since I started my career have seen enormous changes. So enormous, that they're impossible to get into perspective from this close up. It will 2 be years, decades, before we can make anything like a full assessment of the transformations in the economy, in business, in geopolitics which have taken place since I arrived to work in Asia in 1964 at the age of 22.

All this change tends to go by the shorthand name of globalisation - but my theme today is that we need to get underneath the usual cliches about globalisation. We need to think a bit harder about how to manage the political and economic upheavals it has brought about, especially now the financial crisis and recession have put the spotlight on some of the challenges.

Of course here in Malaysia you've experienced tremendous changes of your own. Obviously the drop in world trade in the past year has hurt the economy, but a recovery seems to be under way. And looking over the longer period, the standard of living in this country has almost trebled in just 20 years - a remarkable achievement. The growth in the Malaysian economy and rise in real incomes demonstrates the opportunities globalization has offered countries which are able to take advantage of them.

There are other examples too. I could point to the astounding growth record of China and India, and other Asian countries. Never before have so many people seen their

Incomes rise above poverty level in such a short period as in China since 1980. Or for that matter I could pick out countries in other regions, such as Ireland and Spain, which were also poor places a generation ago.

Despite the upheavals of the past year or two, the economic record of recent times is remarkable. Not only has there been impressive growth in many developing or emerging economies, there has also been a much stronger productivity performance in the developed economies. The information and communication technologies lies behind this. In fact, the impact of these technologies has been truly remarkable.

I've had a chance relatively recently to learn much more about one of these, namely mobile phones. Ubiquitous and personal access to communications has been a boost to productivity in countries which already had a fixed telephone infrastructure. So for example, mobile devices have played a large part in the revolution in logistics, which in turn has helped businesses reduce the level of inventories they have to keep, cutting costs and reducing the degree of volatility in the economy.

The effect of mobile has been all the more dramatic in countries which previously lacked widespread access to fixed line communications. For the past five years Vodafone has sponsored a programme of research into the social and economic impacts of mobile in developing countries. The evidence on the improvements in livelihoods and social connections due to access to communications is clear. The research shows an increase of 10% in mobile access, increases the rate of growth by 0.5%. The success of mobile in these countries has a strong global dimension too. Without the agreement of global standards and the operation of manufacturers and operators across national borders, smaller countries would never have been able to benefit from strong competition and reduced costs.

But I don't intend to talk about the benefits of globalization or multinational business, which I hope speak for themselves. Instead, I want to set out the main challenges. These have become all the more apparent in the past year because of the strains imposed by the financial crisis. The crisis itself is not the main issue, however.

The fundamental challenge is managing an ever-more interconnected global society and economy, when both technology and demography are transforming the existing map of power, and when key resources including energy are being used unsustainably, and when knowledge is the key investment priority.

So fundamental is this challenge, or rather set of challenges, that we have to look back to the late 18th and early 19th century to find parallels for the scale of transformation under way. And, just as then, we need a tremendous advance in human understanding in order to respond effectively - an Enlightenment for the 21st century.

## **Global Governance**

The first hurdle is the challenge of what tends to be called 'governance' and means how the global economy and society should be run.

Only people without much experience of business could ever believe in the abstract idea of a market free from any government involvement. The reality is that government decisions, from taxes and regulations, to how well contracts are enforced in the courts, shape private enterprise. Markets work well, and business can thrive, where governments work well.

This is why there is such a strong correlation between the countries whose governments are effective and those with a good growth record.

At the level of the nation state, it's hard enough to get the framework of governance right. Sadly we read in the media every day about countries where the quality of government is abysmal, where the rule of law does not operate, where the infrastructure is inadequate, where basic services are absent and corruption is rife.

When we turn to global markets, the inadequacies of global governance are all too clear as well.

In one way this isn't surprising. The economic historian Niall Ferguson has pointed out that in 1913 more than four fifths of the people in the world lived in 14 empires. In 1946 there were only 74 sovereign states. Whereas now there are 193 sovereign states of which only 37 have more than 30 million inhabitants.

We live in a world of many states, most of them very small, but also a greater number of important states than a century ago. Negotiation of global rules in these circumstances is extraordinarily difficult.

This was painfully obvious in the reaction to the financial crisis from the summer of 2008 onwards. Decisions, which had to be taken urgently, were taken at the national level even though the financial institutions involved - and even more the transactions which were unwinding - were international.

It quickly became clear that the G7 was not the right forum for the co-ordination of economic policies, and the G20 has now rightly taken its place. Whether this group will be effective remains to be seen, however - there will be too many people in the room in these meetings for decisions to be taken, so the G20 might prove a staging post on the way to a G4 of the EU, US, China and India - or perhaps some other permutation.

Anyway, for many global markets the G groupings are not the right kind of forum for decision-making anyway. Often the tasks are quite specialised. In banking we have the BIS. For trade there is the WTO. There are international organisations for intellectual property, telecoms standards, fisheries agreements, and a thousand and one other areas. Sometimes these are very effective in shaping the development of a vibrant new market - as the example of the impact of the global QSM standard in mobile shows.

In other areas the international machinery does not work all that well. The WTO for instance ought to have created a level playing field in trade based on the same rules

for all, but in practice even the smallest country can veto agreement. Too many of member governments have therefore negotiated regional and bilateral trade deals, which is understandable but has undermined open global markets. Jagdish Bhagwati of Columbia University has described this as a 'noodle bowl' of complex rules and arrangements, and the metaphor seems very apt.

This is an issue of great importance to Malaysia, which the WTO has again ranked as one of the world's leading trading nations. The liberalisation of services trade under way now is a recognition of the role trade in manufactured goods has played in the transformation of this economy. The openness of the world economy as a whole, and the contribution of trade to economic growth, give Malaysia an enormous stake in ensuring that the system functions effectively and is as fair and open as we can make it.

Nobody worried too much about the ineffectiveness of the WTO or the drawn out Doha trade negotiations when the economy, and trade, were booming. Unfortunately the drawbacks are clearer now that trade has shrunk so dramatically. There are signs of protectionism and rising levels of tariffs. The growth in trade has been the engine of the international economy since the end of the second world war.

My instinct is that we don't face anything like a repeat of the 1930s, when international trade spiralled downwards so quickly, causing the Great Depression. The creation of supply chains which cross the continents has gone so far, and to such a level of specialisation, in the past 20 years that I still believe it won't ultimately be reversed. Even so, it would be reassuring if the machinery for governing world trade worked better.

As for the machinery for regulating and governing the financial markets, its inadequacies have been all too clear during the market crisis and its aftermath. National governments had to take the lead in immediate responses to the crisis; and even though the impetus for change is now abating as financial markets slowly normalise, we are not much closer to building a stronger international framework.

On a positive note, the leading role taken by Malaysia internationally in Islamic Finance is very encouraging.

### **Let Us Consider the Changing Balance of Power**

More effective machinery for global governance will depend in large part on a consensus about where economic power lies in the modern world. We're in a period when more or less everybody can see where things will end up but there is little real agreement about the journey or the timeframe. The Economist magazine said in the 1850s that the United States was becoming the world's dominant economic power, but it took the rulers of Britain much longer - almost a century in some cases - to acknowledge the reality.

There are tectonic shifts in geopolitics under way at present. Many leaders in the EU, like their earlier counterparts in the days of the British Empire, seem not to understand

the inexorable shift in economic power to Asia. Many leaders in the US do, I think, understand but see it mainly as a threat to the long American dominance.

An Asian audience will understand the value of learning from experience in other countries, from what others do well and also from the mistakes they have made. I fear this is not nearly so well understood in Europe or the US. The political and media worlds there tend to be inward looking. There is a shocking degree of ignorance there about what is happening in China and India, and a reluctance to believe that these countries have anything to teach westerners.

There is something a little odd about this, After all, Americans can look at the achievements of Silicon Valley and see that people from India and China have played an enormous role there in building the US software industry. Why is it so hard to make the leap of imagination required to understand the strengths of the same sector in India and China?

I know from my own experience too that in many areas Asia is ahead of America and Europe. If there isn't a greater willingness elsewhere to learn from Asian experiences and achievements, and to accept the arrival of Asian countries as economic powers, the geopolitical scene could become uncomfortably fractious.

This is a large subject which goes beyond my scope here today. But of course, the arrangements for international governance of the global economy are relevant to the wider political questions. Is it too much to hope that we might be able to navigate these geopolitical waters better in the 21st century than in the previous two?

### **Let Me Turn to the Role of Business**

Part of the answer to the challenge of governance will fall to business. Large corporations are important institutions, and we've seen the high tide of the idea that their activities are a private matter, of interest only to shareholders. Even before the financial crisis, most leaders in business accepted the principle of corporate responsibility. And certainly now that taxpayers in so many countries have had to rescue the banking system, it would be hard to deny that business decisions can have major implications for the economy as a whole.

However, there is in many countries a wide gulf between business and government. For good reasons, many business executives are sceptical about political interference, which can be populist and counter-productive, and is rarely well-informed about the context for business activities.

Having said that, business leaders should acknowledge that there is a clear and valid public interest in how private enterprise operates. One example is the role of business activities and decisions in leading to unsustainable extremes in the distribution of wealth. We should be open about the corrosive effect of undeserved bonuses in the financial markets, for instance.

While there is a role for incentivizing effort and rewarding success, greed and undeserved rewards have tarnished the reputation of some financial institutions. In countries where less than 10% of the people pay the majority of the taxes, Inequality is likely to be a problem.

Another example is the role companies have played in financing old age pensions. There are in the UK quite a few companies which amount to large pension deficits with small ongoing businesses attached. Other companies which are not in the same position are retreating from offering any fixed pension provision to their employees. Given that the average business has a shorter existence than the average working life, It is clear that the traditional pattern of providing pensions has to change, but that does not mean business has no role in helping people finance their retirement.

More generally, the structure and governance of corporations will need to change. It's revealing that the language and metaphors we use to describe the world of business are typically military -the very word 'company' is one example, and we still speak of the 'officers' of a corporation, and the 'competitive struggle' and so on.

This language reflects the historical origins of modern corporations in quasimilitary imperialist companies in the 19th century. But it also reflects the fact that most companies - certainly most large ones - continue to be organised on a hierarchical, command and control model.

This is wholly Inappropriate, though, for a world where communications are so easy and cheap, and where the main resource any company has is the completely mobile one of its people. Hierarchies are efficient in a world of expensive communications, in the same way that hub and spoke transport systems are efficient. Networked, horizontal organisations are efficient in a world of cheap and accessible communications.

More important Is the need companies have to use the brainpower of everybody in the organization, in order to improve productivity and compete effectively.

Let me give just one example from my personal experience about how fruitful it can be to harness talent as widely as possible. In the late 1990s at HSBC we faced a fundamental decision about internet strategy: should our internet activities be operated in a standalone business or should they be plumbed into the heart of the bank? We asked a group of people in their mid-20s from around the bank's global operations to make the decision. They chose the latter route, and it was the right one.

It's probably easiest to see the importance of contributions from any corner of the business in some areas of strategy, and the use of new technology is obviously one of those. Many companies find it hard, though, to cede the central control implied by a genuine commitment to enabling all employees to contribute fully to the business. But the active engagement of employees is the most effective way to ensure that the business also acknowledges and fulfils its wider responsibilities.

## Education

The effective business and government of today needs employees of the right calibre. At the heart of the transformed global society and economy of the future will be education. The education systems we have now were shaped in response to the challenges of an earlier epoch of transformation. At the turn of the 19th into the 20th century, electrification and mass production created the need for a large and literate workforce, able to operate machines and deliver output to precise standards. Universal primary and then secondary education spread steadily in order to deliver the workforce for the mass production, manufacturing era.

For the information age, the needs are different. The economy needs knowledge workers, able to understand and respond to the flows of Information at their fingertips, with enough autonomy and flexibility to make decisions for themselves in order to serve customers effectively. The majority work in services, but in manufacturing as well the demand for highly educated and adaptable employees is growing.

The development of more workers with these skills - autonomy, adaptability, creativity - will also be part of the adjustment to the increase in income inequality. The evidence seems strong that an under-supply of skills of this kind have contributed significantly to much faster growth in incomes for highly skilled professional workers than for the majority.

Just as the spread of literacy helped address the intolerable inequality in the leading economies in the Victorian era, so the spread of higher skills will do so now. At present, too many people are leaving school inadequately educated and equipped to make the most of the opportunities available.

The needs are clear, but education systems are responding only slowly, Schools remain for the most part educational mass assembly lines and are not producing enough of the kind of knowledge workers needed by businesses. Finding the right people is a massive - probably the massive - challenge in many businesses.

But it would be wrong to think the purpose of education is to serve the economy. Its fundamental purpose is to equip people to realize their fullest potential in the circumstances in which they find themselves. The spirit guiding education should still be that of John Dewey, although he wrote for an earlier time. He saw education as being fundamental to effective democracy and a healthy society. He campaigned against the highly authoritarian and regimented schooling of his own time, arguing that it could not teach understanding.

Although today's education systems are much more progressive than those of a century ago, the moral is still valid. Education needs to enable greater individualism and creativity. We need young people who can think, not young people who can repeat what they have been told.

## Demographic Transition

This brings me to a final challenge I want to discuss in this lecture. That is the demographic challenge. Rich countries will find that they have fewer and fewer young people, and poor countries on the whole have young and growing populations whose aspirations are very far from being met.

It has always amazed me that governments do not pay more attention to the effect of changes in population on their societies and economies. The demographic changes under way now are profound. And yet how many Ministries of Demography can you count?

On the one hand the global population is continuing to grow. It has reached about 7 billion, and the UN projections are for the total to climb to 9 billion by mid century. The number of people consuming food, energy and other resources will have risen by 50% in 50 years. Although this is a slight slowdown in the 20th century pace of increase, and although the increase is concentrated in poorer countries with lower levels of consumption, it still represents an enormous demand on the capacity of the planet to cope.

On the other hand there are many economies where earlier slowdowns in the rate of population growth mean their populations are ageing and in some cases on the verge of declining in absolute numbers. The explanation for the so-called demographic transition of declining birth rates lies in the combination of rising incomes and girls' education. So for the most part, it is the rich countries experiencing this pattern - although China also faces the same outlook due to the one child policy.

In 1964 the average number of births per woman in China was 7.8. But by 2006 it had fallen to 1.8, about the same as the UK and France, and below replacement rate. In big cities such as Shanghai it is even lower. By 2050 there will be getting on for half a billion people over 60 in China, and these older folks will make up a quarter of the population. Policy there has brought about the same pattern of demographic transition that occurred in the OECD economies through income growth. Some countries including Japan and Italy will see population declines by 2040.

The consequences of this pattern of demographic change are likely to be profound - although any predictions should be accompanied by the cautionary note that a baby boom in one place or a spurt of economic growth elsewhere can change the pattern.

In those countries whose population is ageing and possibly declining, the challenge lies in the ratio of pensioners to workers. Pension systems in their current state will not be sustainable, but reforming them - by raising retirement ages or requiring people to save much more for their own retirement - will be extremely contentious politically. Ageing electorates are unlikely to vote willingly for reform but might then find younger taxpayers rebelling against the healthcare and pension burden.

What's more, we have no experience in the world's economic history of the impact of population decline. Economic success has so far always gone hand in hand with a



growing population. It is an open question whether we will find ways to keep the economy and incomes per capita growing when one of the key resources is shrinking in quantity, although in theory higher productivity can compensate.

So far one of the responses to these pressures has been greatly increased international migration. Although the flows as a proportion of total population have been smaller in this era of globalisation than they were a century ago, the absolute number of people moving for economic reasons has been large. This has brought tremendous benefits - no major business could conceive of not having a workforce of varied nationalities and talents. A successful knowledge economy needs the people who possess that knowledge, and not even the biggest country can develop everything it needs by itself.

Yet there are tensions as well in the much greater contact between people of different cultures and expectations.

At the same time, the growth of population in poorer countries, those elsewhere in Asia, and in Africa and Latin America, will bring its own growth challenges. These countries will need to achieve what has come to be called a growth miracle, a take-off in the economy which generates jobs and allows living standards to rise. 'Miracles' is the right term - the standard of living can be transformed within a generation, as the experience of so many South East Asian economies and China has shown.

Growth like this is needed to reduce poverty. The extremes of global poverty have always been morally unacceptable, I believe they have also become untenable.

Mass communications, especially the rapid spread of access to satellite television since the mid-1990s and the same explosion in access to mobile communications and mobile internet now, mean even the poorest person on earth is aware now of how the affluent lead their lives. They see the adverts and soap operas, and of course it changes their own aspirations.

The full social impacts of modern communications are not at all well understood but I'm convinced that this kind of awareness spells dramatic change. It is unthinkable, either in moral or practical terms, that people in poorer but growing countries should not be able to enjoy the benefits the well-off enjoy - the housing and energy consumption, the consumer electronics, the cars and flights - with obvious consequences for the demand for energy and other resources. This of course is the background to the global climate discussions in Copenhagen.

We must all hope that, although the detailed negotiations will certainly be difficult, there is indeed a shared understanding that it is in the interests of all nations and all people to find ways to satisfy the future demand for energy in a sustainable way.

## **Conclusions**

Let me try to draw these threads together. Capitalism has defeated Communism in the battle to improve people's lives. But now capitalism and free markets have to show that they can benefit the vast majority of people, not just the elite and not even just the middle class. Inequality between countries and also within many countries has reached unacceptable levels.

In order to raise the standard of living for so many people, we will need to emphasize renewable resources, and recycle much more of what we use. It is possible that 15 or so western countries have already consumed half of the world's natural resources. We are going to need to find the resources and better ways to use them to support the global population of seven billion and rising.

Key to this will be education. Not only is investment in people key to solving this challenge of sustainable growth, education is also what will enable people to lead fulfilling lives. The nature of education needs to change radically, however, to reflect the changed nature of our global society. Which nations do well in the economy of the future is essentially down to how well they address the challenge of reshaping their education systems.

There is the additional challenge of responding to the changes in demographics. Most social systems currently depend on the traditional population pyramid, with a large population of young people supporting a smaller group of old people. In many countries this is changing, and changing rapidly and dramatically, which will bring political tensions.

This will be just one of the challenges faced by governments and policymakers. The framework of governance at every level - inside corporations, in national government and also at the international level of governing trade and finance - has not caught up with the new realities.

There is no doubt that these are enormous and demanding challenges. It will certainly not be an easy task for the individuals leading any of these Institutions or governments. However, the future we face if we do not try to respond to these profound trends shaping our world will be far more difficult and challenging. The time to start creating a better future is now.

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