Briefing: summary of narrative

Realigning Business, Economies and Society

Overview:

- Today's economic and political upheavals reflect an ongoing misalignment between businesses and economies on one hand, and acceptable societal outcomes on the other.
- Too many people feel they are being left behind by a system unfairly stacked against them. Many people now see themselves as worse off than their parents. They believe their children's future will be worse than their own, often with good reason.
- No matter what your own political perspective, this is clearly a time of fundamental loss of confidence: in the reliability and impact of economic growth, the institutions of our interconnected world (and the trust people have in them), and the apparent ability of government, business and civil society to respond.
- How have we got here and what can we do to adjust our course? We examine the key drivers of change to contribute to discussion and debate about how to bring business, economies and society back into greater alignment.

Fast Facts:
The long growth wave, 1945 – 1989

- An economy is the engine by which human needs (and desires) can be met through opportunities. The effectiveness of the engine itself is determined by the degree to which human needs are satisfied and opportunities are realised.
- For many years, there was an intentional alignment of economic growth and social progress. The two typically went hand-in-hand.
- This alignment was underpinned by both an institutional and philosophical framework that was put in place in the aftermath of World War II to drive recovery on an international basis.
- These frameworks were leveraged to grow the economy and facilitate international trade which, in turn, drove huge progress in societal terms.

Economic growth and accompanying societal progress were underpinned by three drivers:

Globalisation:
The building out of worldwide economic institutions, facilitating the cross-border migration of people, goods, capital, and information, and ultimately driving significant increases in international trade.

Technology:
Spurred by the computer and internet, but also encompassing communications generally, biotech, and healthcare, leading ultimately to robotics and artificial intelligence.

"Financialisation":
A view of value based on financial metrics, primarily Gross Domestic Product (GDP) at a macro level and shareholder value at a corporate level.

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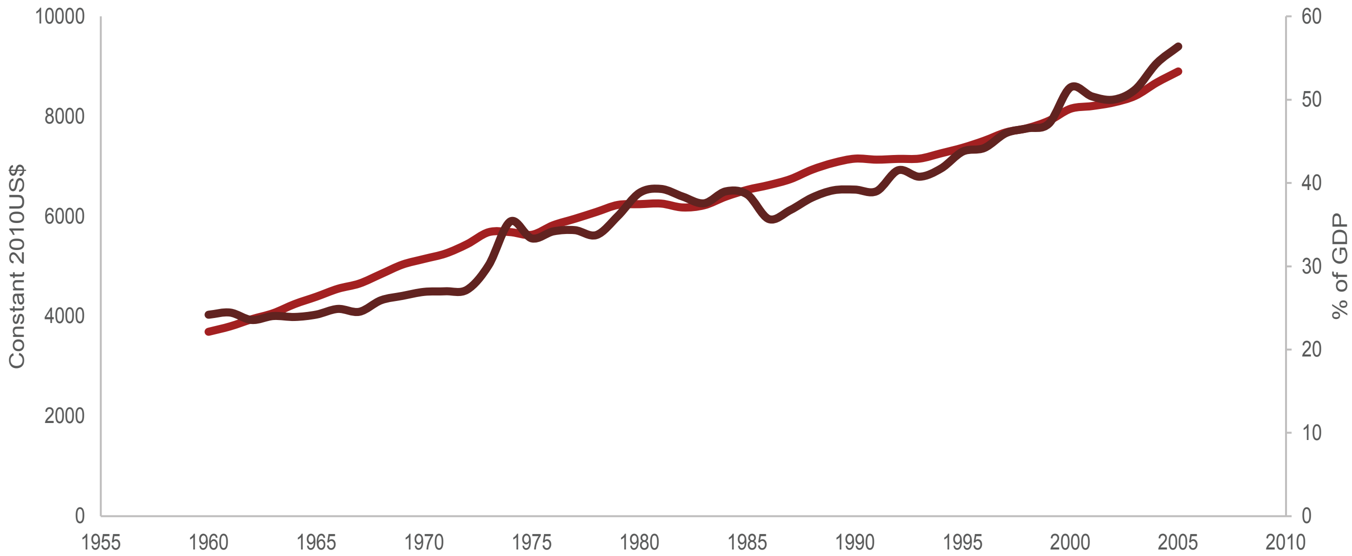
- During the post-war period, the economic “engine” – underpinned by the three drivers – supported both business and economic success, measured in financial terms, on an increasingly global scale (see exhibit 1).

Exhibit 1: Global GDP and Trade Growth



Source: World Bank[1]

Accelerated success and emerging signs of misalignment, 1989 - 2008

- At the time, it seemed reasonable to expect that this cycle represented the natural order of things and would continue indefinitely. Humanity appeared to be moving to a world without borders, in which virtually every major nation was relying upon market economies to make life better at a societal level, and now in an increasingly interconnected fashion.

- However, during the 1980s, there were a number of factors that caused the drivers of change to converge, accelerate and transform not only their essential nature but also their compound effect on a global scale.

    - The fall of the Berlin Wall in 1989 marked the start of a period in which every major country in the world adopted some form of market economy. It also had a significant psychological impact – market economies were plainly seen to have made better provision for their citizens than the major ideological competitors. Unlike the period just after the Second World War, where trade was dominated by countries with relatively equivalent wages, legal structures and technological development, a succession of trade agreements heralded the entry of countries into the international trade system that had massive populations, low wage rates, immature capital markets and nascent market-based legal processes. Large scale labour arbitrage became commonplace, facilitated by financialisation and technology.

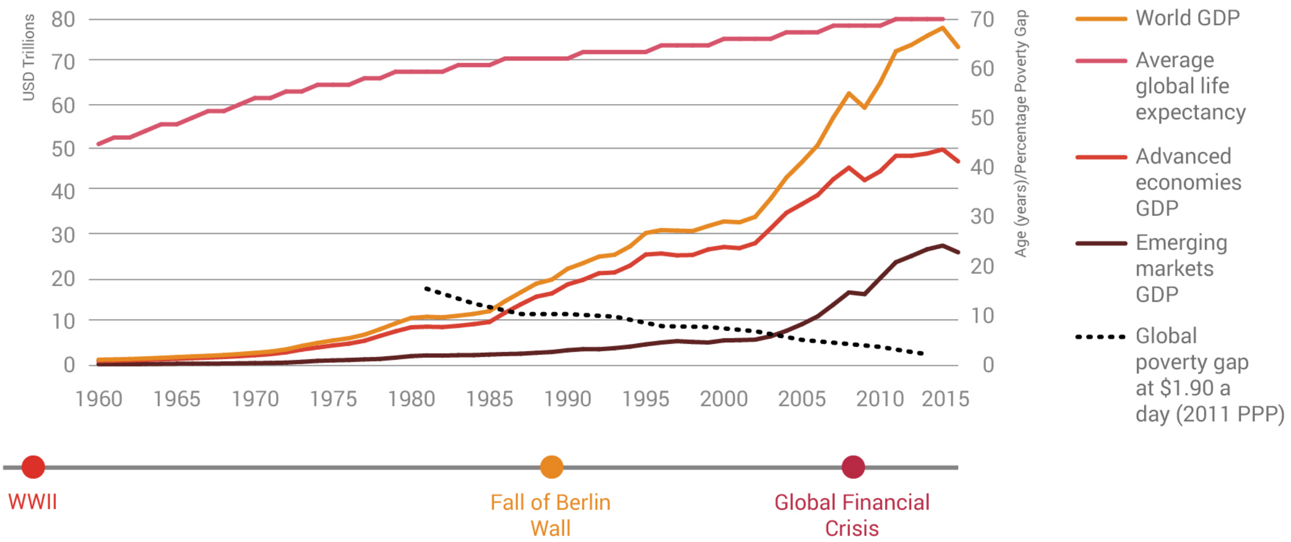
1. The World Bank, World Development Indicators (2017). Trade (% of GDP) and GDP per capita (constant 2010 US$). Retrieved from http://data.worldbank.org/indicator/NE.TRD.GNFS.ZS and http://data.worldbank.org/indicator/NY.GDP.PCAP.KD

- The emergence of the internet provided the backbone for more efficient global supply chains and ever faster transfer of information and money throughout the world. Business was able to disrupt itself and its traditional operating models at almost every level, as technology and the communications revolution facilitated truly global operating models for the first time (enabled by growing labour arbitrage that saw jobs begin to migrate *en masse* to emerging economies, and later outsourced services).

- The "Big Bang" of financial deregulation in the City of London contributed to the massive movement of capital that would significantly increase global financial capacity over the next few decades. When combined with the communications revolution, a truly global financial system began to emerge - both reinforcing and underpinned by the financial discipline of shareholder value.

- Through the 1990s, the march of prosperity hastened (see exhibit 2). Economic activity and global trade increased throughout much of the world while society continued to make great strides forward. On average, people were living longer, healthier lives and billions of people were lifted out of poverty. But it later became evident that all was not well.

Exhibit 2: Economic and Social Progress Since 1960



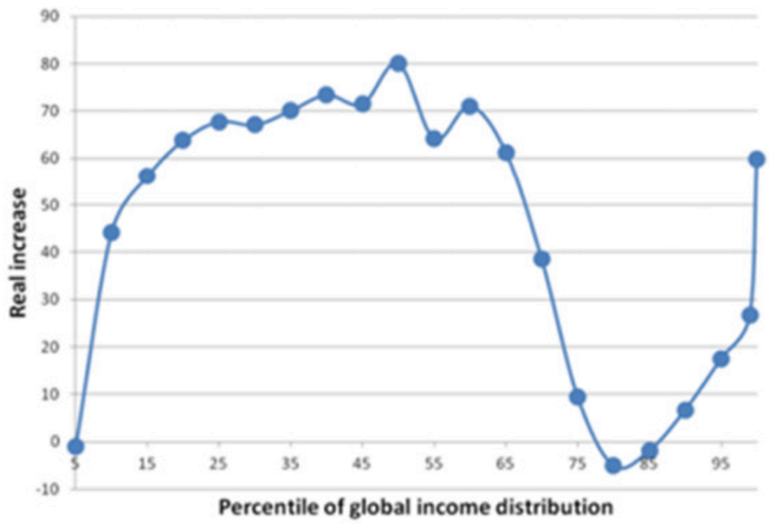
Source: World Bank[2]

2. World Bank (2017). World Development Indicators. Retrieved from: http://databank.worldbank.org/data/home.aspx. Categorisation of advanced economies taken from World Bank high income grouping, and emerging markets from World Bank middle income grouping. Poverty gap data available from 1980 only.

Global progress, local disharmony

- Research conducted by World Bank economist Branko Milanović found that (on average, globally) those in the bottom two-thirds of world income levels (other than the bottom 5%) received major gains. This includes millions of people in emerging economies. Big earners received major gains as well. But households in the 75th to 90th percentile of the global income distribution were scarcely better off economically in 2008 than they had been 20 years before[3] (see exhibit 3).

Exhibit 3: Global Changes in Real Income, 1988 - 2088



Source: Milanovic, 2011[4]

- The two primary indicators of success for the previous 60 years – GDP at the macro level and shareholder value at the micro level – were now revealed to be problematic.

    1. GDP did not reflect the negative effects of economic growth; people who dropped out of the job market, for example, were invisible to it. The GDP figures showed great global prosperity *on average*, while increasingly significant portions of the population were experiencing years of income stagnation and decline.

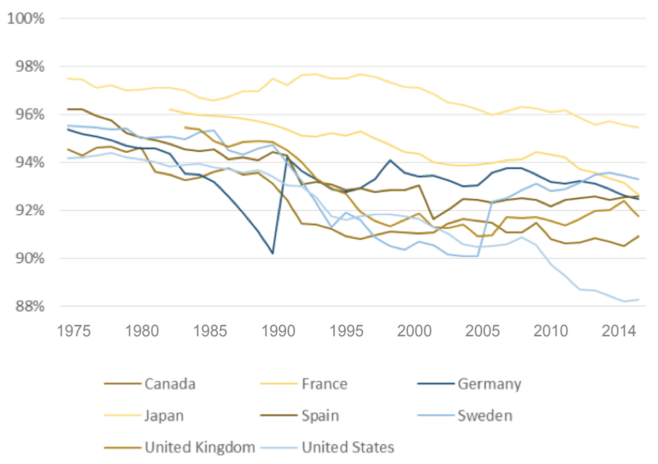
    2. The sustained use of shareholder value as the primary indicator of commercial success drove an increasing emphasis on short term results – which could be delivered more and more easily through the opportunities created by new technologies. Business decisions – shifting activities and employment on a huge scale from one part of the world to another – were entirely rational. In fact, it was the only way for global business to stay competitive as new markets opened up and customers came on-line.

- The global financial crisis in 2008 exposed the weaknesses described above but the process had been underway for some years. The crisis itself was less of a cause than an indicator, revealing the growing misalignment within the system as a whole. In a more globalised, technology-enabled world, the recession's impact was also felt at unparalleled speed.

- Many people experienced real challenges in their daily lives. For example, male labour force participation rates continue to be on a downward trend in advanced economies (Exhibit 4). This is partly due to changing demographics (retiring baby boomers and younger people spending longer in education) but globalisation and technological change are also thought to contribute. In the US, studies suggest that men with lower levels of educational attainment are the ones leaving the labour force, implying a reduced demand for lower-skilled jobs[5]. These challenges are only likely to be exacerbated by greater automation in future. In the US, for example, prime age (25 – 54 year olds) female labour force participation peaked at about 77% in 1999, but declined to 75% earlier this decade and remained stagnant (see Exhibit 5).

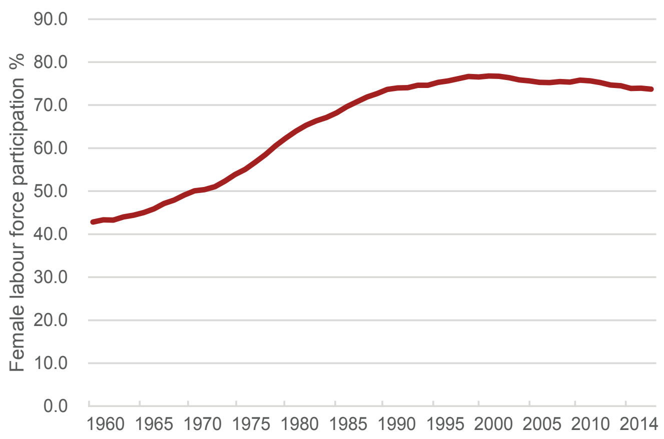
3. Milanovic. (2011). Global inequality: From class to location, from proletarians to migrants. World Bank Development Research Group.
4. Milanovic. (2011). Global inequality: From class to location, from proletarians to migrants. World Bank Development Research Group.
5. Aaronson, S., Fallick, B., Figura, A., Pingle, J., & Wascher, W. (2006). The Recent Decline in the Labor Force Participation Rate and Its Implications for Potential Labor Supply. Brookings Papers on Economic Activity.

Exhibit 4: Male Labour Force Participation Rates



Source: World Bank[6]

Exhibit 5: US Female Prime Age (25 – 54) Labour Force Participation Rate



Source: OECD[7]

- **This raises some fundamental challenges: Economic activity (measured in financial terms) does not now automatically deliver acceptable societal outcomes.**

Where do we go from here?

- It is critical not to lose sight of the progress that each of the three drivers has delivered – the data is strong and supportive. Well managed market economies have consistently delivered more successfully than alternatives, and can continue to do so.

- A globalised world is a reality – issues (and opportunities) will not respect national boundaries – technology, disease, security, migration, ideas, climate – will be relevant for all countries, to say nothing of an enormous degree of economic interaction and interdependence. This will require a high degree of cross-border engagement among broader groups of stakeholders, including businesses and governments, but also citizens more generally. Attempting to roll back to a prior state will almost certainly lead to worse societal outcomes and we have an opportunity to steer ourselves to a more positive future.

- There is an urgent need to revisit the very purpose of an economy. At its best, an economy is a dynamic and evolving framework of rules, habits, agreements, behaviours and practices which enables human – and their communities' – needs to be met, and engages people as well as technology and capital to do so.

- The three drivers have created an interdependent system that must be addressed in its entirety if we are going to alter its current course. Any change must involve the whole system in which institutions are embedded. Only then will we influence both business behaviours and outcomes to align with a re-framed system.

- Bringing about change entails balancing a set of dualities. In the recent past, we have tended to seek the answer in a choice between apparent opposites – one measure or many, globalisation or localisation, technology or people. We need to find new ways of reflecting this duality in the overall approach. For example, human needs must be met – progress must be made – on a local basis, albeit in a global context. This same duality applies to the other drivers also.

6. The World Bank, World Development Indicators (2017). Labour force participation rate, male (% of male population ages 15+). Retrieved from http://data.worldbank.org/indicator/SL.TLF.CACT.MA.ZS
7. OECD (2017). OECD Stat (database) Retrieved 5 May 2017 from: https://stats.oecd.org/Index.aspx?DataSetCode=LFS_SEXAGE_I_R#

Observations to inform a way forward

In the main elements of this story lie some observations that underpin a way forward. The path ahead is undeniably complex but there is an urgent need for multiple stakeholders – governments, businesses and others – to engage together to reframe both the manner in which our current system operates as well as its intended outcomes. The following observations have arisen from our analysis and are intended to inform discussion over the approach all stakeholders can take. They are not intended to be exhaustive or complete but a small contribution to a much broader effort to bring business, economies and society back into greater alignment.

1. **Economic growth is not universally benign.** The fundamental assumption of economic theory for the last 70 years and more has been that social progress follows economic growth. We must now recognise that this is not necessarily true. We must intentionally target acceptable societal outcomes leveraging market economies to do so.

2. **Both financial (GDP) and societal target outcomes should be explicitly framed.** This necessitates a key role for government and citizens, and must reflect the needs of local communities, cities and regions, as well as countries as a whole. And not all needs are equal. Basic human needs must be prioritised – consistent with the concept of a hierarchy of needs.

3. **We need more energy devoted to creating thriving communities.** Human needs are best identified and managed at a local level. Cities, towns, and villages are the places where social progress and economic success most naturally meet. We need to create conditions for these communities to thrive, with business as a key part of the ecosystem. Exhibit 6 presents a basic model of the ongoing development of an urban community. This will require some rethinking of both the role of the nation state and globalisation. We need to consider not only how to operate in a world of increasing global connectedness but also greater local initiative.

4. **We need to leverage the full potential of market economies operating in a globalised environment at the regional, national, metropolitan and local community levels.** A key role for the government is to create the conditions necessary for locales to address opportunities and challenges effectively and to create the institutional framework to encourage the economic engine to match human needs and opportunities.

5. **Governments and business should engage to develop policies that align the business outcomes to broader objectives** – especially in the context of global businesses operating locally, reflecting the "license to operate" and broader "purpose". The very wealthy also have a role to play in activating capacity and capital to reflect broader objectives.

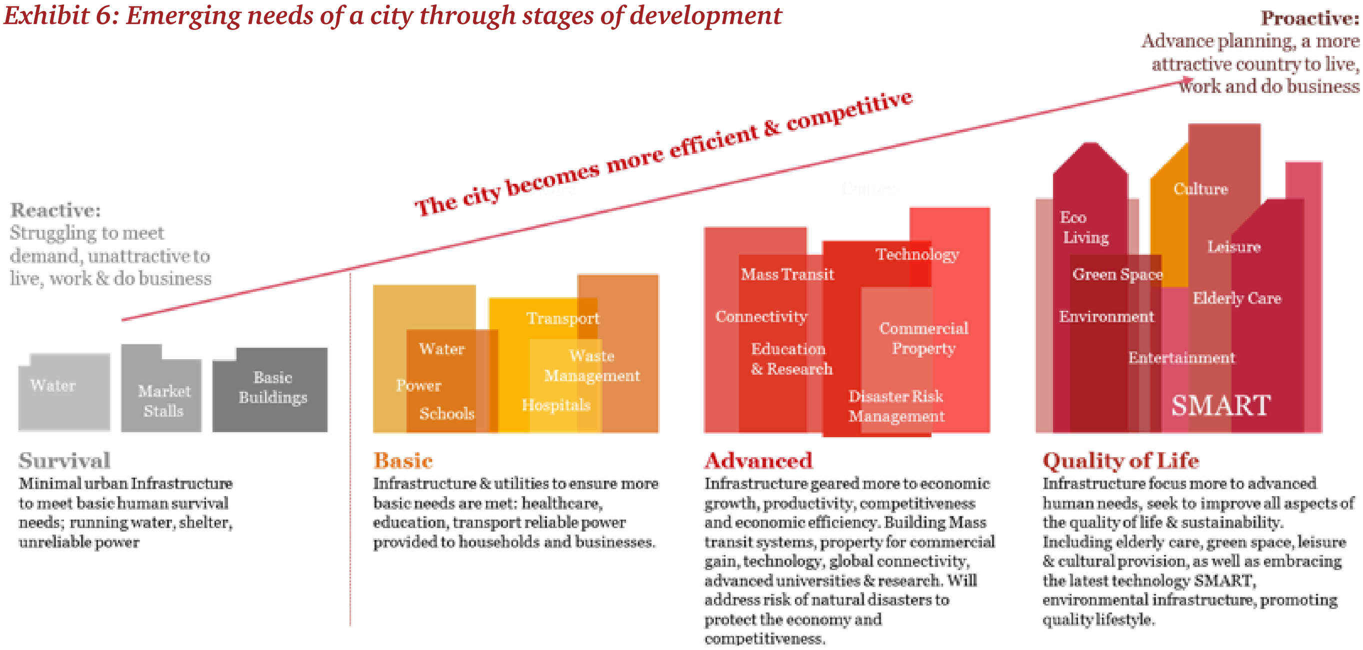
6. **Single measures of success do not accurately represent complex systems for long.** Financial performance is an essential element underpinning a market economy, but it cannot be the only measure of performance or success in a globalised economy – other broader measures reflecting target outcomes in societal terms must also be considered. We need to focus on managing the duality of GDP growth at a national level and shareholder returns at a firm level with meeting a broader set of societal and personal needs. Reporting at both a macro-economic and corporate level must reflect both financial and societal objectives.

7. **“Average” success is not enough.** It is not sufficient to target overall progress for a country or region or globally, because results can vary significantly from one community or one country to the next.

8. **Technology is indifferent to its impact on people.** There is a growing risk that technology will harm the livelihoods and wellbeing of an increasing swathe of people, whether through displacement of jobs through robotics and machine intelligence, social isolation or disruption of communities. This need not be true. Emerging technologies can help meet human needs in new ways that create new industries and unforeseen types of new jobs. This will require an evolution of global and local financial and economic systems to create the conditions to allow this to happen. In addition, technological change is most likely to be adopted effectively in those parts of the world already advantaged over the last few decades. As a result, finding ways to support the growth of the most disadvantaged areas becomes even more critical.

9. **We need to focus on education to deliver skills for the future.** This will require direct engagement between governments and business to match people’s needs with opportunities, particularly in a technology-enabled environment.

Exhibit 6: Emerging needs of a city through stages of development



Source: PwC analysis

Conclusion

- Given the pressing nature of the issues raised here, it is our hope that people will reflect on the diagnosis and observations we suggest and engage their organisations and communities to address the growing challenges.

- A healthy economy needs a healthy society, just as a healthy society needs a healthy economy. This is one of the defining lessons of the period since the end of World War Two. It has long served business and policy makers well to create the conditions for this commonality of interest. Now it is time for the system to be realigned, once again as throughout history, around greater commonality of purpose.