

## Seeking Clarity Amid Uncertainty: Business Leadership for a Stronger Recovery

Speech delivered by Rajat Gupta, Vice-Chairman, ICC and Senior Partner Emeritus, McKinsey & Company

ICC Regional Coordinating Group Meeting

“End of the Economic Crisis – Opportunities for International Business”

Santiago, Chile  
15-16 October 2009

Thank you very much for that thoughtful introduction. It's a pleasure to join you here today – to consider strategies for international business, as we begin to emerge from a deep and painful recession.

Signs of a fragile economic upturn may indeed be starting to appear in many countries, rebounding from the dire situation of the past year. After enduring an almost unprecedented global slump, many companies – large and small – seem ready to emerge from their recent “crisis mode,” and are again exploring new opportunities for growth.

As senior business executives position their companies to join in the hoped-for economic recovery, they increasingly recognize that corporate leadership requires more than just the basics: more than simply asserting diligent oversight of their firms' finances, and more than simply creating short-term value for their shareholders. To help promote a sustainable recovery, business leaders must embrace their role in helping shape a policy environment that promotes robust economic growth.

As the International Chamber of Commerce marks a significant milestone – celebrating our 90<sup>th</sup> anniversary – we're intensifying our advocacy efforts for a vital element of economic growth: open markets and expanded international trade. For almost a century, we've been supporting global trade as the best way to strengthen the world's economy, broaden prosperity, and lift people out of poverty. At last week's anniversary conference and dinner in New York, the U.S. Secretary of Commerce, Gary Locke, told us that the work of the ICC – supporting “the power of open markets to unlock human potential across the globe – has never been more important than it is now.” To that, I would add: The complexities faced by business leaders – as they try to navigate through an uncertain, still-fragile economy – have never been more challenging than it is now.

Amid our discussion here this week, on “the end of the economic crisis,” this is indeed a good time for business leaders to look ahead creatively – but also to reflect candidly. The global economy has now, apparently, pulled back from the brink of the economic abyss.

Yet, as the ICC's Chairman, Victor Fung, told us in New York last week: Our optimism should be accompanied by the caveat that “we may not be out of the woods yet.” After all, an improving economy is not the same thing as a strong one.

Unemployment remains painfully high, and, as a “lagging indicator” of economic trends, seems destined to rise still further in many major countries. Global trade is just beginning to rebound from its first contraction since 1982. And there's a growing awareness that it will take time to rebuild the

wealth that has been destroyed during this downturn: According to the McKinsey Global Institute, the world's total of financial assets – including equities, private and public debt, and bank deposits – fell by \$16 trillion in 2008. That is the largest, swiftest setback in economic history.

Even if we are indeed entering a period of recovery, McKinsey's economists foresee that “the new normal” will not provide the kind of gains that much of the world has enjoyed since the prosperous 1990s. We're now experiencing the end of an economic era – the last years of which were marred by excessive debt, by often-reckless management practices, and by sometimes-negligent regulatory oversight. The severity of the shock – and the reality that the global financial system came close to a breakdown – calls into question many of our recent assumptions about how the economy functions.

For those who manage companies, or who manage national economies, the recent financial Crash and its aftermath are all the more humbling . . . because, around the turn of this century, many overconfident analysts believed that economic science had conquered the business cycle. The refinement of macroeconomic technique had led to a sense of complacency about what many people were calling “the Great Moderation” – a period that seemed to offer nothing but benign inflation, a calm environment for business, ever-rising financial markets, and tolerable (if unremarkable) job growth.

It was certainly an alluring notion. Many believed that flexible and far-sighted monetary policies could “fine tune” the economy – easing any momentary downturns, while also preventing any outbreak of inflation. Many believed that perfectly efficient global capital markets could smoothly funnel some nations' excess savings and export-driven profits (like those of China) to the world's under-saving and over-consuming countries (like the United States). And, if all else failed – if a regional shock were to occur – many believed that the world's financial markets had become “decoupled”: that a downturn in, say, the advanced nations of the West would not necessarily spread to the developing nations of Asia.

History often teaches humbling lessons. By now, we've come to recognize that the past decade's complacency was, in many respects, based on hubris.

Central banks – while deft – are not all-powerful in preventing recessions. Capital markets – while efficient allocators of capital, in the short term – cannot make up for vast, long-term imbalances between spenders and savers . . . between insatiable importers and relentless exporters. And the blissful idea of “decoupling” has turned out, simply, to be an illusion.

As my McKinsey colleagues Lowell Bryan and Diana Farrell quipped, amid the most intense days of the crisis: “The future of capitalism is here – and it's not what any of us had expected.” This scenario indeed took most mainstream economic theorists, as well as most business strategists, by surprise.

A synchronized global financial plunge was regarded, only a few years ago, as almost impossible. Intricately coordinated, highly nuanced international policy interventions were seldom contemplated – and never imagined on the scale of the recent rescue operations. A few years ago, almost no one could have conceived that the world's major finance ministries would adopt a years-long, multi-trillion-dollar program of deficit spending, hoping to jump-start growth. Many observers had called, in theory, for the giant economies of the G-8 nations to eventually share authority with the more diverse G-20 . . . but it took a sudden economic crisis to force such a radical change in the global economic decision-making process.

The drama of the past year has propelled the economy and our society into truly uncharted waters. Our leaders – in both the corporate sector and the public-policy realm – have steered us ably through the most intense moments of the storm. Yet they continue to struggle for clarity about the way ahead.

The dominant economic reality of our time is, and will remain, uncertainty. Potential threats to a sustainable recovery seem to be everywhere. And clear answers are difficult to discern.

Yet shrewd business leaders recognize that, amid such uncertainty, an economic crisis may open up unexpected pathways for future creativity. Business leaders must focus – more relentlessly than ever – on the long-term challenges of creating jobs and generating incomes; of strengthening productivity; and of working toward a more open international trading system that helps the poorest nations share in the world’s prosperity.

In their scenario planning, corporate leaders must consider a wider range of possible pathways than they ever have before. One leading student of today’s marketplace – Paul Bremmer of the Eurasia Group, who focuses on geopolitical risk management – recently declared: “It is increasingly impossible to project [10 or 20 years] into the future. [Executives] need to spend an enormous time focusing on scenarios for the next 12, 18, 24 months – but they need to recognize that the breadth of potential outcomes is much greater than it used to be.” Moreover: He reminds us that “these shocks . . . are increasingly about politics – about global political risk.” This is an era, he said [in *The McKinsey Quarterly*], in which “politics trumps economics.”

That reality puts an added responsibility on the public sector, as well, as it struggles to manage uncertainty. One of the clear results of the crisis is that the authority of governments has grown. Even in countries that had long embraced the *laissez-faire* approach, public-sector agencies have newly been given the mandate to revive or restructure vast sectors of the economy. At the same time, much of the public remains, understandably, skeptical of governments’ ability to manage corporate assets – or the taxpayers’ money – wisely over the long term.

At such a moment of discontinuity, it’s vital that we review and respect the lessons of history. Even if the economic rulebook of the past decade no longer applies, now is the time to reach for the history books: There are some enduring lessons that economic history teaches us.

In shaping the response to the crisis, many of the world’s central banks have had the good fortune to be led by policymakers – including Chairman Ben Bernanke of the U.S. Federal Reserve System – who have deep historical knowledge about the response to the Great Depression. They’ve helped us to discern the right lessons from history – and to recognize the errors that policymakers made in the past, so we could avoid making them again.

Potential policy responses have figured prominently in the detailed research that McKinsey’s economists and strategists have been pursuing during the crisis. They have been modeling various scenarios for the future, and they find that policy choices will have an important impact on shaping the recovery.

The two global economic scenarios that the economists now foresee as most likely are something of a middle-ground outcome. The economy will probably not enjoy a quick rebound toward brisk growth, nor endure a “long freeze” that leads to chronic recession. Yet neither of the two likely outcomes, alas, will be very comfortable.

One critical factor is clear: More than ever before in our lifetimes, choices in public policy will shape the economy's ability to rebound from the recession. The right mix of policies could help lead to long-term renewal – while misguided policy choices could slow the economy to a slow, painful crawl. Substantial differences in outcomes – in terms of job creation, wealth creation and the sustainability of the recovery – hinge on getting the policy choices right.

The two likeliest alternatives for the economy are called the “Battered But Resilient” scenario and the “Stalled Globalization” scenario.

The relatively better outcome – “Battered But Resilient” – foresees that, after the worst of the downturn is finished, there would be a period of consolidation, at a subdued level of economic growth. That stretch of time – perhaps several years – would not feel very good for anybody. Even if the situation technically might fulfill the definition of a “recovery,” it certainly would not feel like one. Yet after the economy had worked off its excesses – once the imbalances had been allowed to clear – the global economy would gradually return to reasonable rates of growth.

Such a positive outcome relies on markets remaining open, trade returning to health, and international financial flows remaining unimpeded. “Battered But Resilient” would be unpleasant in the short run, but it would allow the global economy to appropriately correct its imbalances, and return toward sustainable growth in the long run.

By contrast, there's the relatively worse scenario of “Stalled Globalization.” In this outcome, the recession might be at its deepest point for a slightly shorter period of time than in the “Battered But Resilient” scenario – but the climb-out toward growth would be more difficult. The difference is in the choice of public policies: If protectionist policies are enacted, “Stalled Globalization” would impede the economy's return to growth.

Pursuing quick-fix, inward-looking, nationalistic policies to overcome the slump might seem tempting to lawmakers, at first, since they might help allay the fears of nervous voters. Yet inward-looking policies – and “Stalled Globalization” – would allow for only an anemic upturn. It would require many years for the global economy to get back to even barely tolerable growth rates.

In the sub-optimal scenario of “Stalled Globalization,” the economy would be hobbled by protectionist policies that seek to shield impaired industries from open competition. Well-intentioned – if short-sighted – policymakers might opt for protectionism to try to spare their national economy from prolonged pain. Which sectors were shielded, and which were sacrificed, would inevitably be a politically driven decision, not a market-based decision.

History's lessons are unanimous in providing guidance to today's policymakers toward the soundest choice for the long term. The difference between promoting a “resilient” economy and a “stalled” economy depends, in large part, on whether policymakers choose open markets, open trade and open competition – or adopt various forms of protectionism.

If there's one fact of economic history that we know for certain -- that endures even in this era of uncertainty – it's that protectionism simply does not work. That axiom of economic policy is especially true for mature, developed economies. Protectionist measures, of one sort or another, have often been tried, and they have never produced a thriving economy for the long term.

That lesson should come through clearly, as lawmakers consider the policy mistakes that aggravated the Depression era. The United States' now-discredited Smoot-Hawley tariff of 1930 did not, by itself, trigger the Great Depression – but, by provoking continuing rounds of tit-for-tat retaliation among the world's trading nations, it certainly deepened it. When President Herbert Hoover grudgingly allowed Smoot-Hawley to become law – against the advice of an almost-unanimous economics profession – countries that had once been trade partners suddenly became trade rivals. Waves of counterproductive “beggar thy neighbor” policies caused a contraction of trade, deepening the global slump. “Every man for himself” economic policies only made the global economy worse-off for everyone.

In recent months, it has been encouraging to see that many leaders recognize that the protectionist path is discredited. At the recent G-20 summits – in Washington last November, in London last April, and in Pittsburgh last month – the assembled presidents and prime ministers agreed to shun protectionism. Perhaps we should breathe a sigh of relief that the protectionist impulse – so far – has mostly been vented rhetorically, rather than in widespread new anti-trade legislation.

We must always be watchful, however, for warning signs of the protectionist temptation. Many of the G-20 leaders – after confirming, at the summit, their faith in free trade – returned home to find it necessary to fight the familiar old battles, within their own parliaments and congresses, over protectionist proposals.

Economic nationalism can take more subtle forms than familiar tariffs and quotas – the kind of overt barriers that modern-day trade laws know how to handle. The spirit of exclusion can seep into policymaking in other ways. Enacting “Buy Local” requirements within stimulus packages . . . resurrecting “domestic content” rules to try to limit imports . . . restricting the number of visas for would-be immigrants . . . even using the outbreak of the H1N1 “swine flu” virus as an excuse to foment suspicion of foreign visitors . . . have all been deployed in various countries, in recent months.

At some point, even necessary measures to forestall economic catastrophe – like the recent U.S. rescue of its endangered auto companies – could, in theory, be taken too far. Lawmakers should not let such short-term rescue operations become open-ended excuses to prop up faded national icons and discriminate against imports.

Since the advent of protectionism may make the difference between a “resilient” or a “stalled” economic future, policymakers would be wise to consider what's at stake. Overall – for most of humanity – globalization has been a major driver of economic progress. It has helped lift hundreds of millions of households out of poverty in the developing world. It has helped Western consumers get more for their money, pay lower interest rates on their loans, and (if they invested shrewdly) achieve higher returns on their investments.

Luckily, it would be difficult for protectionists to quickly unravel the globalization of goods and services – that is to say, the foundation of the system of international trade. Yet it will take energetic pro-trade advocacy merely to start reversing the contraction of trade flows. The World Trade Organization has projected that the volume of trade will fall by 9 percent this year – the most severe contraction since World War II. The International Monetary Fund foresees an 11 percent decline, worldwide, in trade in goods and services this year – and for what it terms the “advanced economies” of the West, the contraction could be 13.5 percent.

The antidote to such a contraction of trade should be further market-opening measures. That's why the ICC, at the G-20 summit in Pittsburgh, called for a renewed determination to complete the Doha Round of global trade negotiations. Although it was good to see that the communiqué from the Pittsburgh summit pledged to revive global trade and reject protectionism, the G-20 leaders stopped short of making a dramatic new commitment to Doha: They merely repeated their previous call for an "ambitious and balanced conclusion" to the trade Round. It was discouraging that the G-20 leaders did not commit themselves to an earlier target for the conclusion of the talks than the end of 2010. As Jean Rozwadowski, ICC's Secretary General, said after Pittsburgh, the success of the Doha Round "would send a shock of confidence to governments and businesses around the world, increasing the momentum towards restoring worldwide economic growth."

It has been encouraging to see, in recent months, that there have been forthright calls to shun protectionism from many quarters of the debate – from central banks, from academic economists and from many of the world's leading editorial pages. There have even been some brave political leaders who have spoken out for free trade – enduring the criticism of those who prefer to "take the easy way out."

I hope that still more leaders of the corporate community will actively engage in the debate over trade policy, speaking out clearly against the threat of protectionism. When CEOs forcefully join such a debate, policymakers tend to listen.

It's been puzzling to see the reluctance of many CEOs to engage in the debate. Perhaps, amid the deepest days of the recession, they've been "sticking to their knitting" and focusing on the day-to-day management of their companies. Perhaps – at a time when business' overall reputation has suffered, amid a backlash against Wall Street's excesses – leading CEOs have been waiting for today's waves of populist anger to dissipate.

Yet it will require bold gestures of business statesmanship to renew the momentum for expanded trade – and to help drive accords like the Doha Round toward successful completion. Boards of directors should be encouraging CEOs to engage more fully in the debate, because nothing is more central to the health of business in the long term – and to the strength of the economic recovery to come – than to make sure that policymakers get macro-level economic strategy right.

As one seasoned observer of international relations – Richard Haass, the president of the Council on Foreign Relations – recently said: It's more important than ever for business leaders to deepen their engagement in the debate on global issues. Speaking out against the protectionist threat is the most logical place for CEOs to start making the case for sound long-term policies, because it is an area in which CEOs can contribute their direct knowledge of business realities.

This is a moment when "business statesmanship" is critically needed – when leaders of the most energetic institutions in our society should re-engage in framing a coherent policy response to the current economic crisis. CEOs should be speaking out, with their Boards' full support, on how best to promote job creation . . . to ensure income growth and civic-minded investment . . . and to craft pragmatic reforms that can lead to broadly shared prosperity.

This is the moment when business statesmen should articulate how market-oriented policies benefit society as whole. Governments, nonprofit organizations and the voters at large are already debating far-reaching changes to our economic system, which will redefine the way business is conducted long

after today's crisis is over. It will be a far more enriching conversation, for everyone, if business is present at the table.

Business has always played an energizing role in resolving the dilemmas of society – the economic, political and environmental issues that shape the context in which business operates. Corporate leaders should embrace their role, in a positive spirit that acknowledges business' ability to make a valuable contribution. In fact, if business leaders fail to engage fully in the public debate, they will be doing a disservice to their companies, to their communities, and to business' ability to contribute as a positive resource for society.

We are on the brink of a brave new world – with wiser safeguards, we hope, to help moderate the extremes of boom and crash. Which economic scenario for the future will play out, remains an open question. Yet we can surely recognize the impact between a “resilient” global economy, and a “stalled” one, in helping lift the world's poor out of poverty and into the middle class.

To advance toward the widely shared prosperity that we all envision, we must all – government, business, and society at large – join a broad-minded dialogue about the shape of the economy to come.

Creating new momentum for growth will require imagination and innovation. It will require our leaders to rewrite the rules that have failed us, and to re-imagine the way that government and business – working together – serve society.

The ICC is committed to speaking out forcefully, to help shape the conditions that will lead to a resilient economy and a robust recovery. That difficult task requires nothing less than the energy of all our civic leaders and business statesmen. With your help, I feel confident that the economy can – over time – emerge from today's crisis stronger, more flexible, and better able to fulfill the hopes of those who need, and deserve, a pathway to prosperity.

Thank you very much.

# # #