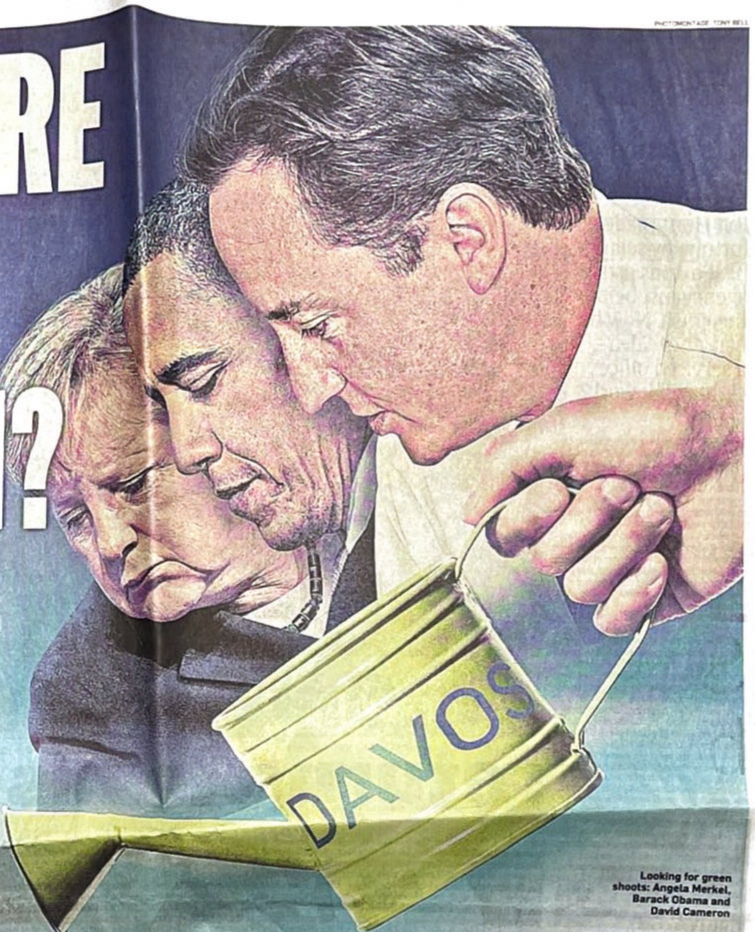
PHOTOMONTAGE TONY BELL

SO, WHERE IS THE GROWTH?



Looking for green shoots: Angela Merkel, Barack Obama and David Cameron

At Davos, western business leaders were crying into their beer while the Africans and Asians partied. Unless the West can revive its moribund economies soon, it will be left behind, reports Dominic O'Connell

Heads bowed, a gloomy group of European businessmen and bankers trooped into the funicular carriage.

They had just listened to Angela Merkel, the German chancellor, deliver the opening address to the World Economic Forum, and now they were going to drown their sorrows at a dinner party hosted by Barclays at the imposing Schatzalp hotel overlooking the ski resort.

"Awful, wasn't it," grunted one chief executive. A klaxon sounded, the doors began to close — and a group of African delegates burst in, chattering and laughing. "Isn't it fantastic!" a Nigerian state oil official burst out as the car ascended through the snow, the lights glittering below.

Last week's annual jamboree of the rich, powerful and famous was a two-speed event. Those from developing economies — like the Africans enlivening the funereal trip to the Barclays bash — were excited by the prospect of new ideas, new markets and new prosperity.

Those from the West were bowed down, not just by the weight of the eurozone crisis, but by the growing sense that their countries had lost their mojo and were losing out to the excited newcomers in the race to be top dog. All week the hunt was on for that elusive tonic that might put them back on track — growth.

In Britain, it's in short supply. In the last quarter of 2011, the economy shrank 0.2%. Another negative return in the first three months of this year would put us back into recession.

That sorry fate almost certainly awaits the eurozone, and if a Greek default in March leads to a messy break-up of the single currency, our current travails could seem insignificant.

At Davos, business leaders and economists estimated that a shattering of the euro could cost the British economy 5%-10% of GDP — and that may prove optimistic. America is faring better. It grew 2.8% at the end of last year, although 1.9% of that was down to companies rebuilding their inventories after deliberately depleting them over previous months.

A return to growth would fix a number of problems — rising unemployment, mounting state debts, and the near-impossibility of paying for state pensions and care of the elderly.

"The problem in the West is about debt to GDP ratios," said Tidjane Thiam, chief executive of Prudential, the giant insurer with operations in America, Britain and Asia. "We tend to forget the second part of the equation. Increase GDP, and you improve the ratio."

"We have a crisis of balance of payments, of competitiveness and of labour costs," said Sir Martin Sorrell, chief executive of WPP, the global marketing agency. "The question is, are politicians prepared to do the necessary things to fix all those areas? I, for one, am betting the farm on the emerging markets. What I have heard here [at Davos] hasn't changed my view."

By the end of the week, the search for growth had become a mantra. At midnight on Friday, at the Standard Chartered party in the Belvedere hotel, as drunken delegates swayed embarrassingly to the music, in a corner of the room Ed Miliband, the Labour leader, repeatedly questioned Gerard Lyons, the bank's global economist. "So where," asked Miliband, "is the growth coming from?"

IT WASN'T always like this. In the 1950s and 60s, the OECD countries had a great run thanks to the steady demolition of trade barriers. In the 1970s and 80s a new surge in capital flows across borders buoyed growth in the West. One chief executive of a Chinese company described the recent transition: "One way of looking at it is to say western labour — workers — had a monopoly of access to western capital. That all changed when China opened up."

Now the emerging markets are catching up, and fast. Stephen King, HSBC's chief economist, points out that 10 years ago, not one of the top 20 container ports in the world was in China. It now has five of the top 10.

A bigger change could be just around the corner. King thinks the West's woes mean emerging markets can happily go off and play among themselves. He says a new "southern Silk Road" will emerge, where the main channels of global trade do not touch the West at all.

"These trade routes have been slower to emerge because, until recently, barriers between the emerging countries have been quite thick — language, tariffs, lack of infrastructure. That is changing fast."

Instead of investing its massive surpluses in American treasuries, King said, the Chinese government will increasingly put it into physical infrastructure in Africa and other new trade partners.

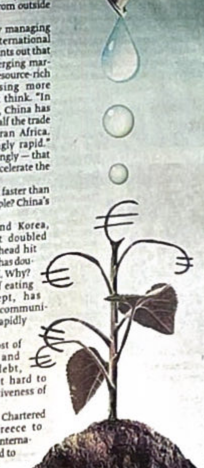
"If China's demand for oil continues to grow at its present pace, it will be using the world's current total annual production by 2035. It has to secure that supply."

There is evidence to support King's views in the recent growth in global GDP. In 2001, world output was about $32 trillion (£20 trillion). When Lehman Brothers went under, it was $60 trillion. Last year it was $70 trillion. Nearly all the growth has come from outside the West.

Min Zhu, deputy managing director of the International Monetary Fund, points out that China's rise in emerging markets, particularly resource-rich ones, is progressing more quickly than most think. "In the past five years, China has moved up to take half the trade flows of sub-Saharan Africa. That is astonishingly rapid." Zhu notes — worryingly — that social media will accelerate the rate of change.

"Ideas move a lot faster than goods." Zhu's example? China's appetite for meat.

"In America and Korea, demand for meat doubled when income per head hit $15,000. In China, it has doubled at $5,000 a head. Why? Because the idea of eating meat, the concept, has changed and been communicated much more rapidly this time round."



Thanks to the cost of welfare systems and high levels of debt, Europe will find it hard to match the competitiveness of emerging markets.

Lyons at Standard Chartered thinks that for Greece to become competitive internationally it would need to devalue by 40%. "For Spain it's 25%, and France 15%. And after that, they would still have to run hard to stay competitive."

There may be more to the West's woes than just debt and generous welfare. Joseph Schoendorf, a founder of Accel Partners — one of the most successful Silicon Valley venture capital firms — said tech companies in America cannot find the skilled people they need.

"Across the companies we have invested in, there were, last week, 1,577 vacancies for engineers or other skilled jobs. These are six-figure salaries. And we can't fill them. We have tried for green cards [work permits for foreign staff] and been told 'no'. For every engineer who isn't hired, that's another five or six support staff who don't get hired," he said.

"Industrial countries have a window of about only 10 years to invest in growth and technology, not fritter it away on government spending," said Raghuram Rajan, professor at the University of Chicago's Booth business school. Even red-blooded capitalists agree. "We've got three to four years to improve our capitalism in the West," said David Rubenstein, one of the founders of Carlyle, the American private equity firm. "If we don't, we'll lose the game against state-sponsored capitalism in Asia."

SHORT of a drastic — and politically suicidal — re-engineering of the welfare state, the West's best hope of finding growth lies in the dynamism of its private sector. As research for The Sunday Times showed a fortnight ago, the FTSE 100 companies are sitting on a cash pile of about £137 billion — enough to pay for defence and education for a year. In America, the figure is reckoned to be $2 trillion, much of it stashed offshore, the profits of foreign subsidiaries that big US corporations don't want exposed to domestic tax.

> **WE HAVE AUSTERITY, SO THE PUBLIC SECTOR IS GOING TO SHRINK REGARDLESS**

"This is not 2008," said Sir John Peace, chairman of three FTSE 100 firms — Standard Chartered, Burberry and Experian. "Then the banks had big problems, and so did big companies. The companies have sorted themselves out and the banks have been recapitalised. There are levers governments in the West can pull — tax, incentives for investment, enterprise zones. And companies need to play their part. Last year the FTSE 100 made collective profits of £73 billion. So tell me why they can't afford to employ another 1,000 apprentices between them."

Bob Diamond, chief executive at Barclays, thinks the solution is "not that complicated".

"We have austerity, so the size of the public sector is going to shrink regardless," he said. "The private sector is where growth will come from, and it will take up a greater proportion of the economy. We are not going to get there by giving banks a hard time. We need pro-business policies, and in America we need a change in tax policy to encourage corporations to bring their foreign cash onshore and put it to work."

The anti-business rhetoric from coalition ministers is a sore point for Britain's business leaders. Several FTSE 100 chairmen and chief executives are debating whether to write a joint letter to David Cameron on the subject, and it is likely to be put on the agenda for a meeting of his business advisory panel in February.

What particularly riles the big banks is the vilification of Stephen Hester, chief executive of Royal Bank of Scotland, over his bonus. After weeks of public debate — with interventions from David Cameron, Nick Clegg, George Osborne, Vince Cable and Ed Miliband — the bank's board last week gave Hester shares worth £963,000, which will vest in three years. There was no direct endorsement of the decision by ministers. Osborne told British business leaders at Davos it was a decision for RBS directors.

The chairman of a rival bank was privately vitriolic in his condemnation. "Cameron and Osborne should be sticking up for someone who is doing a difficult job for the taxpayer. I wish Hester would stick two fingers up to them, and sue them for the money. He could then tell the court all the undertakings he was given by ministers when he agreed to take the job.

"And if he goes, how much would they have to pay the next person? It will either be someone decent, who will want £10m upfront because they won't trust the government, or they'll get the chief executive of an NHS trust, pay them £100,000, and it will be a multi-billion-pound disaster."

While western businessmen fretted in Davos about what they regard as own goals by politicians, there was some comfort in the obstacles that will impede emerging market growth. One of the biggest of these is currency — Min Zhu of the IMF said it would take a long time to set up the structure for China's renminbi to become freely convertible.

Eventually, however, the West will need to make some difficult choices. "Macro economic policy has run its course," said HSBC's King.

"The Keynesians talk about more stimulus, but we've had the stimulus. We are going to have to work harder, longer, for fewer benefits. Apart from that, we are into what I call the theological option — praying for a recovery."

Cameron stands up for capitalism

Outside the Great British Tea Party in Schneider's Cafe — an event to lure the Davos billionaires to invest in the UK — a protester, bizarrely dressed in a death mask, a cape made of dollar bills and a giant American bank note around his neck, handed out leaflets.

They urged an end to greed and consumerism, asking delegates to turn their backs on capitalism.

He had other things on his mind too. Squinting upwards in the alpine sun, he hoped the powers that be at the World Economic Forum wouldn't take against his solitary vigil.

"They have snipers on the roofs here, don't they," he said.

A shot never rang out. The protester, however, had been canny in his choice of target.

The British, and in particular David Cameron, were among the most vigorous defenders of free markets and capitalism at the conference, in contrast to some of the agonising at official sessions inside the conference centre.

After his keynote speech on Thursday, Cameron was asked directly about the future of capitalism by Jitesh Gadhia, a senior managing director at the British arm of Blackstone Group, the American investment firm. Are we not, said Gadhia, on an inevitable path towards state-directed business?

"No," said Cameron. "We need to make a defence of our system against state capitalism. Our respect for the rule of law and freedom of businesses is one of the things that make us so attractive to international investors. You can judge this by how often the courts rule against the government, and in Britain's case, that's all the time. We have to stand up and shout about those values."

Many others at Davos, however, highlighted capitalism's failings, in particular, an unequal distribution of wealth and an unsustainable drain on the planet's resources.

"Like it or not, capitalism is based on consumerism," said Sharan Burrow, general secretary of the International Trade Union Confederation. "We need a fairer distribution of wealth and a return to collective bargaining."

"I don't see young people running to join unions," retorted Ben Verwaayen, chief executive of Alcatel-Lucent, the communications giant.

One big fear of business leaders is not a collapse in the values of capitalism, but its curtailment through a return to protectionism.

"You can see signs that some political leaders are beginning to circle the wagons," said one FTSE 100 chairman.

"There have been little hints in what Angela Merkel said during the week, and in Barack Obama's state of the nation address. That is what really frightens me."

According to some academics at Davos, the debate could be irrelevant. They argue that humanity's — and capitalism's — march is well on its way to badly damaging the environment.

Johan Rockstrom, executive director of the Stockholm Environment Institute, said we had entered the "anthropocene" geological age, where humans were now the cause of big changes in nature.

"If you look across the board from rising carbon dioxide levels to loss of biodiversity, man is the cause," he said. "The question we now have to ask is, how resilient is the Earth?"

Dominic O'Connell

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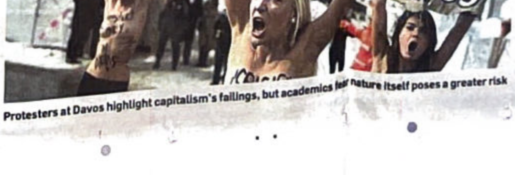

Protesters at Davos highlight capitalism's failings, but academics fear nature itself poses a greater risk