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Can long-term global growth be saved?

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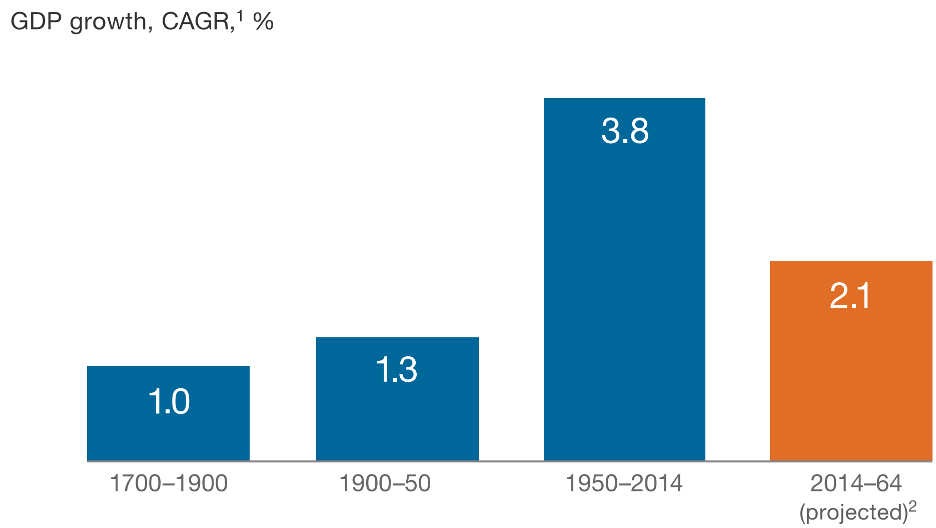
Without action, global economic growth will almost halve in the next 50 years. A new McKinsey Global Institute report offers a solution: a dramatic improvement in productivity.

Over the past 50 years, global economic growth was exceptionally rapid. The world economy expanded sixfold. Average per capita income almost tripled. Hundreds of millions of people were lifted out of poverty. Yet unless we can dramatically improve productivity, the next half century will look very different. The rapid expansion of the past five decades will be seen as an aberration of history, and the world economy will slide back toward its relatively sluggish long-term growth rate (Exhibit 1).

Exhibit 1

Global economic growth is set to slow dramatically.



[1]Compound annual growth rate.
[2]Assumes 1.8% productivity growth, equal to average for 1964–2014.
Source: McKinsey Global Institute analysis

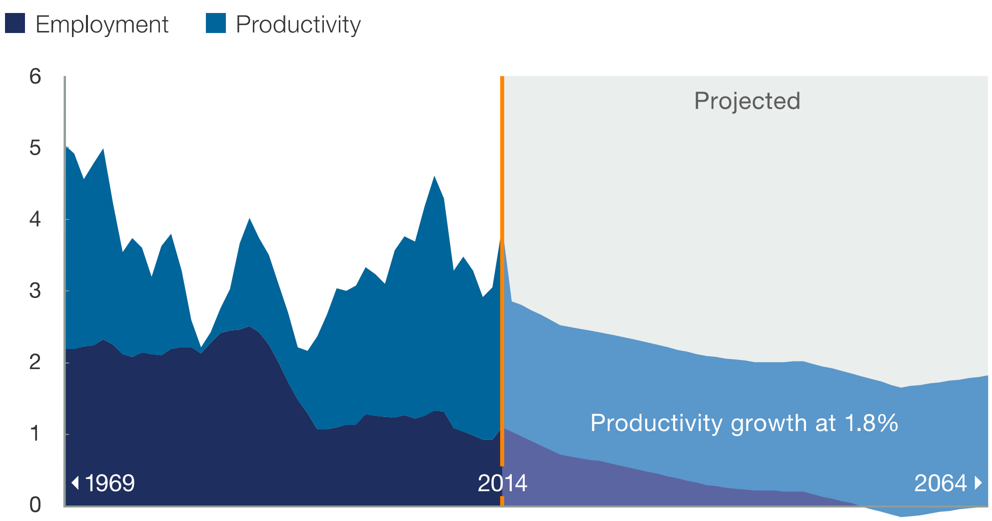
The problem is that slower population growth and longer life expectancy are limiting growth in the working-age population. For the past half century, the twin engines of rapid population growth (expanding the number of workers) and a brisk increase in labor productivity powered the expansion of gross domestic product. Employment and productivity grew at compound annual rates of 1.7 percent and 1.8 percent, respectively, between 1964 and 2014, pushing the output of an average employee 2.4 times higher. Yet this demographic tailwind is weakening and even becoming a headwind in many countries.

The net result is that employment will grow by just 0.3 percent annually during the next 50 years, forecasts a new report from the McKinsey Global Institute (MGI)—Global growth: Can productivity save the day in an aging world? Even if productivity growth matches its rapid rate during the past half century, the rate of increase in global GDP growth will therefore still fall by 40 percent, to about 2.1 percent a year (Exhibit 2). Our new normal would then be economic growth slower than it was during the past five years of recovery from the Great Recession and during the energy-crisis decade of 1974 to 1984. Per capita income and living standards, in both the developed and the emerging worlds, will rise more slowly.

Exhibit 2

Labor's contribution to GDP growth is disappearing, so productivity must pick up the slack.

GDP growth, rolling 5-year periods, CAGR,[1] %



[1]Compound annual growth rate.

Source: The Conference Board Total Economy Database; International Labour Organization; United Nations Population Division; McKinsey Global Institute analysis

The employment challenge

Global employment growth has been slowing for more than two decades. By around 2050, our research finds, the global number of employees is likely to peak. In fact, employee headcounts are already declining in Germany, Italy, Japan, and Russia; in China and

South Korea, they are likely to begin falling as early as 2024. While there is significant scope for policies that boost labor-market participation among women, young people, and those over the age of 65, that will be far from easy. Employment growth could double, to 0.6 percent, in the countries we studied: the G19 (the G20 without the European Union as a composite member) plus Nigeria—economies that account for 63 percent of the world's population and 80 percent of global GDP. But that will happen only if each gender and age group, throughout these countries, closes the employment gap with the high-performing economies. In any case, even a doubling of employment growth won't fully counter the erosion of the labor pool.

So productivity growth must drive the expansion of GDP in the longer term. Indeed, it would have to reach 3.3 percent a year—80 percent faster than its average rate during the past half century—to compensate fully for slower employment growth. Is this possible? Actually, our case studies of five sectors (agriculture, automotive, food processing, healthcare, and retailing) found scope to boost annual productivity growth as high as 4 percent, more than enough to counter demographic trends.

The productivity solution

The world isn't running out of technological potential for growth. But achieving the increase in productivity required to revitalize the global economy will force business owners, managers, and workers to innovate by adopting new approaches that improve the way they operate.

Our study found that about three-quarters of the potential productivity growth comes from the broader adoption of existing best practices, or catch-up improvements. The remaining one-quarter—counting only what we can foresee—comes from technological, operational, or business innovations that go beyond today's best practices and push the frontier of the world's GDP potential. Efforts to improve the traditionally weak productivity performance of the large and growing government and healthcare sectors around the world will be particularly important.

Business must play a critical role: aggressively upgrading capital and technology, taking risks by investing in R&D and unproven technologies or processes, and mitigating the labor pool's erosion by providing a more flexible work environment for women and older workers, as well as training and mentorship for young people. In an environment of potentially weaker global economic growth, and definitely evolving growth dynamics, executives need to anticipate where the market opportunities will be and the competitors they will meet in those markets. Above all, companies need to be competitive in a world where productivity will increasingly be the arbiter of success or failure.

The past half century has been a time of extraordinary economic expansion. Yet without significantly boosting the one engine the world economy still has—productivity growth—this period may prove to be a historic anomaly. Our report has identified ten enablers that could lift global GDP growth closer to its potential by increasing transparency and competition, creating incentives for innovation, mobilizing labor, and further integrating the world economy. But all this will be hard. Only sweeping change by the private and public sectors—and a smarter approach to growth—will overcome the forces that now threaten global economic prosperity.

For more on the issue of how economic growth is determined, see "Is GDP the best measure of growth?"

To read more on the topic of global growth, see our series of contributions from leading thinkers on how to sustain rising prosperity for the long term.

About the author(s)

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