

Speech by Hendrik du Toit, Founder and CEO of Investec Asset Management, delivered at Cass Business School, London on 13 February 2013

The Future of Capitalism: Five years after the Western Financial Crisis, a challenge for tomorrow's leaders

Good evening Prof Haberman, Ladies and Gentlemen,

It is always a privilege to exchange ideas with the leaders of tomorrow. I also want to congratulate Professor Steven Haberman with his appointment to lead this important institution in the heart of the City of London. With all the banker-bashing going on in the media, the City may not be fashionable but it remains the most dynamic, pragmatic and international workplaces in the world. It remains at the centre of the modern global economic system. Long may this continue. By the way, I am not a banker!

In my role today as the founder and CEO of a money management firm which is a steward of \$100bn of other people's capital, the health of the capitalist system and effective functioning of financial markets matter. As an African, I am also acutely aware that, when properly directed and governed, capital is the difference between progress and stagnation in many developing nations. Investec Asset Management is the only firm of its kind which has fully globalised from African roots in a largely organic fashion. In that sense we represent the future. We want to be ambassadors for sensible global capitalism. Firms should be able to compete anywhere and start from anywhere. When I was a student in the 1980s global capitalism was a one-way street. US, European and Japanese firms had access to the resources and consumer markets of most developing countries, but the businesses of the rest of the world - especially in services - found it difficult to access capital directly and faced many barriers in the developed world.

More than five years after the beginning of the financial crisis, the developed world is struggling to regain its pre-crisis economic momentum. In addition to the clear power shift from West to East, and the rise of many other developing nations, the advanced economies have some serious domestic issues to deal with. The huge debts built up before and after the financial crisis, the loss of confidence caused by this crisis, ageing populations and the entitlement-driven agenda fostered by modern democracy, created a dangerous cocktail of challenges for the advanced economies. This situation, combined with the political backlash and increasing comfort with extreme interventionism in the West, as well as the rise of successful state capitalism in the developing world, has indeed created a debate around the merits and future of the capitalist system.

At an institution like this, it is our duty to encourage the future leaders of our society, like you, to engage in this debate. Your participation matters. Through your choices, you will ultimately influence the outcome.

Populist politics are becoming the norm in the West. Tax used to be a matter of rules and law, now it is a matter of judgement, as evidenced by the Starbucks fiasco. Disregard for contracts (albeit city employment contracts), vote-seeking attacks on success and profits resemble a world where mob rule seems to become increasingly acceptable. We need to smell the coffee as this behaviour merely encourages mob rule.

Tonight, I would like to offer a qualified defence of market capitalism, for it is the only system that could meet the expectations of the billions in the developing world and generate the energy to re-start the stuttering economic engines of the advanced economies. Winston Churchill's famous 1947 dictum that "*democracy is the worst form of government, except for all those other forms that have been tried from time to time*" should be applied to Capitalism as well. There is little doubt that since capitalism as we know it, started to manifest itself in Europe in the 16th century, humanity has achieved more prosperity and advancement than in all of the previous 250 million years on this planet.

Marx, the ultimate enemy of capitalism, is responsible for this term. Many supporters of this system subscribe to the description by the novelist Ayn Rand. I quote: *“A social system based on the recognition of individual rights, including property rights, in which all property is privately owned.... In a capitalist society all human relations are voluntary. Men are free to cooperate or not, to deal with one another or not, as their own individual judgements, convictions and interests dictate”.*

Personally, I am much more comfortable with Max Weber's definition and I quote from his **The Protestant Ethic and Spirit of Capitalism**: *“A capitalistic economic action is one which rests on the expectation of profit by the utilization of opportunities for exchange, that is on (formally) peaceful chances of profit.... Unlimited greed or gain is not in the least identical with capitalism, and is still less its spirit. Capitalism may even be identical with the restraint, or at least a rational tempering, of this irrational impulse. But capitalism is identical with the pursuit of profit, and forever renewed profit, by means of conscious, rational, capitalistic enterprise.”*

In the recent US election campaign, the desire to debate the big issues around the nature and future of capitalism manifests itself, in spite of the shallowness of that very debate. Instead of looking at cheap US election rhetoric, I suggest we think about the future of capitalism by starting with the one point of consensus between Marx and those who had a more positive view on the future of capitalism. Marx saw the constant transformation and alteration of the system as its Achilles heel which will ultimately cause its collapse, whereas the believers like the historian Joyce Appleby, talk about a “relentless revolution”.

This tendency for capitalist renewal and reform is captured by Anatole Kaletsky in his recent book, **“Capitalism 4.0”**. Over the past century we first experienced **Capitalism 1.0** which lasted until the end of WW1 in which business and politicians kept their distance. Initially successful, this eventually resulted in market excess and near collapse. Arising from the ashes of World War 2 and the Great Depression, Keynes, Roosevelt and others forged **Capitalism 2.0**. A consensus emerged that markets should not be trusted but influenced and that the economic cycle should be managed. **Capitalism 3.0** emerged in the 1970s under the influence of Milton Friedman and the Chicago School and peaked with the collapse of the Berlin Wall and the Soviet Union.

Now as the fourth phase establishes itself on the premise that both markets and governments get things wrong, there is room for *“pragmatism, experimentation and common sense”*. If thoughtfully applied, this could improve the functioning of politics, governance and markets. The pre-crisis model has to change without losing the **essence of capitalism**, namely freedom to pursue success, innovation driven by individually motivated endeavour and the mechanisms to match money with ideas.

The essence as described above depends on certain conditions which should not be negotiable:

1. **Respect for the institutions that support capitalism** namely the rule of law. (In his Theory of Moral Sentiments, Adam Smith describes the conditions very well).
2. **Let the market work on the downside as well as the upside.** It is too expensive to keep too many zombie firms on life support.
3. **Open markets for goods, trade and finance**
In spite of the excesses uncovered after the financial crisis, we must not throw the baby out with the bathwater. We need to deal with the culprits, we need to change the rules to limit future excess to the extent we can but we need to maintain and strengthen the capital allocation infrastructure of the world. London needs to play a leadership role in this process. Without capital and credit, business cannot function.

The following forces will be influential in shaping **Capitalism 4.0**:

1. **Environmental degradation and climate change**
Surely nobody needs to be convinced that climate change and environmental degradation is an undeniable reality, presenting an unrivalled challenge to humanity. The poorest people will be hurt most by this. Top down and bottom up pressure will modify profit-seeking behaviour and correctly so.

2. Inequality and poverty

Inequality is not typically at the top of the list of concerns for believers in free market capitalism. Given the well-documented trends towards income inequality across most economic regions, it is clear that the old mantra that a rising tide lifts all boards simply does not hold. A survey for the World Economic Forum meeting in Davos pointed to inequality as the most pressing problem for the coming decade (along with fiscal imbalances). The entire social contract that underpins capitalist societies implies that rising levels of inequality can only be tolerated so long as everyone is moving forward and that one group is not advancing at the expense of the next. More than 1 billion people still live on \$1 USD a day.

3. The emergence of a **multi-polar world** with more evenly distributed economic power will require different and more nuanced forms of capitalism will eventually lead to a convergence between “free-market “ and “state-led” capitalism. Today the State is prolific in Western Capitalism and the market free in nominally communist countries. Different cultures will be more assertive than in the old order.

This is how Wen Jiabao saw it when, as Premier of China, he gave a lecture at Cambridge University:

“In the 21st century, economic globalization and the information network have linked us all together. Different cultures live together and influence each other. No culture can flourish in isolation. How much a country or a nation contributes to the culture of humanity is increasingly determined by her ability to absorb foreign cultures and renew herself. That is why China will remain open and receptive, value her own traditions while drawing on others’ successful experience, and achieve economic prosperity and social progress in a civilized and harmonious way.” This future of capitalism is underwritten by a wise Communist Party!

4. Varied growth prospects will require a review of existing social contracts.

This specifically refers to the way the advanced countries respond to their levels of indebtedness and social entitlement. Societies will have to address the unsustainable levels of government and personal debt. In his book **Paper Promises** Philip Coggan expresses it very directly and I quote: *“the massive debts accumulated over the last 40 years can’t be paid in full, and they won’t be paid”*.

5. Social and interconnected Capitalism

In the era of “one to one” and “one to many” perceptions of cooperation, collaboration and competition will change. Examples of the phenomenon are open-source collaboration and crowd sourcing. Social capitalism could become integral to the free market over time. The cost of getting your message out there is lowering by the day. The days of all-powerful governments and corporations are over.

6. The sheer size of the opportunity to create wealth in today’s world

Today the world economy, in spite of the hangover of the crisis, offers more opportunity and bigger markets than ever before. I encourage you to go out and exploit those. In the words of Bill Gates, *“we live in a phenomenal age”*. Thanks to the victory of Capitalism over Communism and Autarky, 5 billion people are on the march to a better life. The debate often revolves around 1 billion indebted citizens of the rich world and the 1 billion poor people and not the 5 billion people who are collectively experiencing one of the great miracles of our time. Over the past 20 years they have been emboldened by renewed confidence and hope, whereas almost 500 million of them have been lifted out of absolute poverty is progress. Global GDP was \$23trn in 1991, \$57trn in 2007 and about \$70trn now! This presents opportunity for business and future returns for capital.

Conclusion:

Although the above-mentioned forces will re-shape the Capitalism, I am not only confident that the system will be with us for many years to come, but that your generation will determine the quality thereof.

We must ask ourselves what we can do to shape it. None of the above forces are in our control. What is in our control is our creativity, endeavour and the quality of our behaviour. The choices we make. The latter so badly let down great parts of the City of London in recent years.

Adam Smith held the view in *The Theory of Moral Sentiments* that if the fruits of a society's economic development cannot be shared by all, it is morally unsound and risky, as it is bound to jeopardise social stability. He was right but he also, and very importantly, defines the conditions under which his famed "invisible hand" of the market works to the benefit of society.

According to Smith a virtuous person embodies:

Prudence which moderates excess

Justice which limits the harm we do to others

Beneficence which prompts us to improve the lives of those around us

Self-command which moderates our passions and reins in our capacity for destructive action

If we remember this and act and lead accordingly, the capitalism of the future could be of an inclusive and sustainable kind. I have a simple question for you: Will you live up to the standards of Adam Smith, the intellectual father of modern capitalism?

I conclude with the words of Robert Kennedy:

"Few will have the greatness to bend history, but each of us can work to change a small portion of events. And in the total of all those acts will be written the history of a generation". Our generation has to improve. Your generation can do better.

Thank you.