

Financial Times
January 9, 2012

A letter to capitalists from Adam Smith

By David Rubenstein

To: Capitalists of the World

From: Adam Smith

What has become of my beloved capitalism? Countries teeter, protests rage, unemployed multiply, deficits abound the virtues of capitalism are questioned. Based on a few hundred years of observation, I have some fresh thoughts on how to sustain this system for a few hundred years more, or at least do better in 2012 than it did in 2011.

I am pleased to see that capitalism has triumphed over communism and socialism in virtually every part of the world – and many of the most skilled capitalists are, ironically, in the countries where communism and socialism once prevailed (now endearingly called emerging markets).

This triumph has occurred because capitalism's greatest strength – productive economic activity – has succeeded in creating more opportunities for more people than anyone – including me – ever imagined. And with more wealth, billions of people now in the middle class can secure education for their progeny, purchase necessities and luxuries at once-unimagined levels, pursue leisure activities for a greater part of their lives and retire with higher levels of economic security.

All that is satisfying.

What is not satisfying is the view that capitalism has to work perfectly to justify its presence. I never said it would. I just said it was better than the alternatives, as Winston Churchill famously said about democracy.

I always felt there were two principal flaws – and we saw them come to a head over the past few years. The first is that unfettered exuberance about wealth creation will produce unsustainable booms and inevitable crashes. The great recession, fuelled by cheap credit, is a textbook example of this flaw.

The second is the inequality that results when the charge towards wealth creation leaves behind those less able (in most cases through no fault of their own) to adapt or to compete with the hard-chargers. The income disparity in many wealthy countries is now at its greatest level since I left the scene – and it was not so wonderful then either.

While there is no simple cure to capitalism's two big flaws, here is what I would do in 2012 to get the system back on its feet and to modulate income disparities.

1. **Save the euro** and the European Union. A functioning and vibrant EU – the world’s largest economic unit – is essential to global prosperity. The largest countries using the euro – and also those outside the eurozone or those dependent on a thriving EU – must dig deeply into their pockets now to save the euro. If they do not, the pain and cost will be greater in the future. And those of more modest means will suffer the most if the euro is abandoned.

2. Fix the **US debt** and deficit. To my amazement, when the super committee failed to reach an agreement the markets yawned, undaunted by a \$1.4tn deficit and accumulated debt in excess of \$16tn. Beware, though. At some point during 2012 the markets will wake up and say: “No! We cannot wait until after the presidential election to fix this problem.” The Obama administration and Congress must quickly cobble a credible debt-reducing package. Otherwise, as in Europe, the markets’ harsh solutions will be borne disproportionately by the low income and disadvantaged. This is not acceptable, nor is it good for capitalism.

3. Integrate the emerged markets. The world needs to acknowledge that the centre of capitalism is shifting to the emerging markets – where most of the growth will occur in 2012. But having emerged, China, India and Brazil, among others, need to be fully integrated into the global economic decision-making process. If they are not, the capital needed to solve many of the developed markets’ current problems, especially residual issues of the great recession, will not be available on tolerable terms. Again, this will hurt the poor more than the wealthy.

4. Educate. Educate. Educate. Perhaps the greatest cause of income inequality is the dismal state of primary and secondary education. The mismatch between job openings and qualified candidates is growing, which leads to reduced economic activity, a greater sense of disparity between the haves and the have-nots, and social unrest. To address these issues, governments need to embrace reform, ensure effective funding and allocate resources more efficiently. By educating all their children, reducing soaring high-school dropout rates, and re-educating and retraining adults, nations can more effectively prepare workers to embrace new technological realities.

Though much time has passed since I last put pen to paper, my faith in capitalism is steadfast. The problems you face – saving the EU, fixing the US budget, welcoming emerged nations as full partners and making education a real priority – are huge challenges that must be addressed now.

It is the only way to continue creating wealth for all nations and people, while giving capitalism the legitimacy it needs to thrive.

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