Chapter 10

THE CRISIS OF GEORGE SOROS

Some books evoke as much interest because of their authorship as because of their content. George Soros's new book (*The Crisis of Global Capitalism*, Public Affairs, $26, 284 pages) qualifies on both counts. Soros himself acknowledges that his views "enjoy widespread respect and recognition not because of my philanthropy or philosophy, but on account of my ability to make money in the financial markets. . . [and my] reputation as a financial wizard."

Soros is the multibillionaire head of Soros Fund Management, which oversees the Quantum Fund. Quantum is putatively one of the world's largest and most nimble hedge funds, a genre whose descriptive label is ironic because its purveyors often court, rather than hedge, risk, if the associated rewards appear attractive. Soros is also the founder of a network of well-endowed "Open Society Foundations" in Eastern Europe, Russia and the United States dedicated to the promotion of more open and democratic societies and politics.

The book (hereafter referred to as *Crisis*) is an unusual amalgam of political philosophy, personal memoir, and dissection of the global capitalistic system. It is also unusual because it presents a virulent assessment of capitalism, its advocates, and its prospects. Soros's assessment employs a harsh and exaggerated rhetoric that recalls Marx, Engels, and Lenin, rather than the bland prose of the financial press or academic texts on comparative economic systems.

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In the realm of political philosophy, to which he devotes nearly half the book, Soros forcefully endorses the goal of "open society," generously acknowledging the debt he owes to Karl Popper, both for the original concept and its classic exposition in *The Open Society and Its Enemies* (Princeton, 1950). Soros tries to enlarge Popper's concept of "Open Society," defining it as "an imperfect society that is always open to improvement." Yet, he actually short-changes Popper by ignoring one of the central precepts of the Open Society—namely, its social mobility and the access to opportunities it affords its members. And, whereas the "enemies" of the Open Society targeted by Popper were totalitarianism in general, and communism and fascism in particular, in Soros's hit list the principal enemies are "market fundamentalists" and the global capitalist system. Indeed, in terms of the gap between their grand intentions and "disappointing outcomes," Soros explicitly places "market fundamentalism" in the same quadrant with communism! And in terms of the "imperialistic tendencies" of the "global capitalist system" to be "hell-bent on expansion" and eventual collapse, Soros contends that the system is "little different from Alexander the great or Attila the Hun"!

In Soros's lexicon, "market fundamentalism" is synonymous with "laissez-faire ideology." It presumes that government intervention in the economy yields negative results, that unregulated markets are perfect markets, and that without the distortions introduced by governments, markets will generate equilibrium between demand and supply, producers and consumers, buyers and sellers, lenders and borrowers.

Soros emphatically disagrees with all of these postulates, even if they are simply formulated as tendencies and probabilities, rather than as steady-state actualities. He asserts that "market fundamentalism came to dominate policy around 1980," which he unmistakably and repeatedly attributes to Ronald Reagan and Margaret Thatcher.

Crisis assigns to market fundamentalism primary responsibility for development of the global capitalist system, a system that Soros asserts is fundamentally flawed. Its flaws include the sharply escalating and asymmetrical "boom/bust cycles" generated by a large unregulated international banking system, and by the huge movements of financial capital from Western financial centers into and out of the "periphery" of Asia, Russia, and Latin America. This boom/bust instability leads to acute "pain" in the poorer periphery regions, a choice by individual countries (for example, Malaysia) to "opt out of the global capitalist system, or simply fall by the wayside" (Indonesia and Russia), and an inability of the international monetary authorities "to hold [the system] together."

These inherent flaws lead Soros to predict the imminent disintegration of the global capitalist system, and to assert that ". . . the global capitalist system will succumb to its own defects." In support of his apocalyptic forecast, Soros recounts his own prominent role in trying to forestall the Russian financial meltdown in August 1998 by proposing the injection of a minimum package of $15 billion of G-7/IMF funds to stabilize the ruble and the Russian stock exchange—a recounting accompanied by more than a hint of *schadenfreude* because Soros's advice was rejected by the IMF and the U.S. Treasury, and, incidentally, his hedge fund experienced major losses!

To delay, if not reverse, his dire prediction of systemic collapse, Soros proposes establishing an International Credit Insurance Corporation to guarantee loans made to periphery countries—such as Korea, Thailand, and Brazil—which otherwise "are doomed to languish in depression for an extended period." Funds for the ICIC would be provided by the G-7 governments, hence by their taxpayers.

Soros's diagnosis of the flaws in "market fundamentalism" and global capitalism displays more flaws than the objects of his criticisms.

The flaws in his arguments include the following:

1. The canonical free market system (i.e., "market fundamentalism") that *Crisis* deplores *requires,* rather than *precludes,* clear and explicit rules of the game to function effectively. These include the rule of law, protection of property rights, legally-binding and enforced contracts, established and reliable modes of dispute resolution, and free and open ("transparent") competition among producers, consumers, lenders, borrowers, and investors. Effective markets are not "untrammeled" markets, as Soros claims, and "market fundamentalists" do not eschew certain "trammels"—instead, they require them!

2. The “crisis” in international financial markets—triggered by the Asian financial turmoil since July 1997 is not properly assigned, as Soros asserts, to the operation of free markets. Instead, the burden lies mainly in departures from free markets—specifically, in promotion of excessive amounts of short-term lending and borrowing, and protracted support for overvalued, pegged exchange rates, underwritten by a tacit *non-market* assumption that governments and multilateral aid agencies would intervene to protect lenders if circumstances turned sour (an assumption unfortunately validated by subsequent events).

3. Market “fundamentals” and the “global capitalist system” have an inherent resilience based on feedback and adjustment—what in biological systems is called homeostasis—which Soros largely ignores. To be sure, this resilience can be significantly abetted by prudent public policy measures, such as the Fed's recent and moderate lowering of short-term interest rates.

Scattered throughout Soros’s *tour d’horizon* are numerous distracting factual errors. The Chinese currency was devalued in 1994, not 1996 (actually, the yuan *appreciated*, not depreciated, between 1994 and 1996); so it’s a mistake to offer, as Soros does, yuan depreciation as a cause of the Asian financial debacle of 1997. Another example: Soros mistakenly contends that social goals “such as providing employment” have taken “second place” in the EU due to international competition, ignoring the effects of a swollen and perverse welfare system in contributing to Europe’s high unemployment rates. It is equally erroneous, if not foolish, to proclaim that “the dismantling of the welfare state” is well underway, at a time when welfare expenditures, in Europe especially and in the United States, comprise the dominant share of the respective government budgets. It is also worth noting, contrary to Soros’s contention, that the most “fundamental” capitalist system (viz., the United States) is the one in which the “social goal” of low unemployment has lately been farthest advanced.

Finally, Soros’s emergency prescription of a publicly- (hence, taxpayer-) funded ICIC is belied by his own insightful analysis of the miscarriages of the IMF, its protection of bank lenders rather than borrowers, its role in aggravating the moral hazard problem, and his own conclusion that the “IMF is part of the problem, not part of the solution." Inevitably, Soros's ICIC would intensify the moral hazard in international financial markets, perversely protecting imprudent behavior while penalizing prudence.

Although Soros advocates humility and the redemptive effects of acknowledging personal "fallibility"—a term that is central to his personal philosophy—he rarely displays either characteristic. In one of his rare professions of humility, Soros concludes by affirming that "All I wanted to do was to stimulate a discussion out of which the appropriate reforms may emerge." At least in this respect, *Crisis* achieves its author's objective.

Postaudit

As this review of George Soros's book suggested in 1998, his forecasts about capitalism's doom were and are flawed. But Soros himself remains an interesting enigma.