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Robert L. Bartley, Editor
The Editorial Page, The Wall Street Journal

George Soros
Investor and Philanthropist
Chairman, Soros Fund Management

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Questioners: Cassie Seifert, Co-Anchor
Nightly Business Report, PBS

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Introduction

(No introduction on recording – recording starts with Robert Bartley’s speech in progress)...

Robert L. Bartley

The Editorial Page, The Wall Street Journal

...Libertarianism of the left. This is kind of encapsulated as the American Civil Liberties Union going around and citing all sorts of lawsuits and judges undertaking to outlaw flag burning or various other things that are a little hard to find in the Constitution. One of the effects of this has been to seriously impede the schools because the result, the cumulative result of all of these legal decisions has been to undermine discipline in the schools. A similar sentiment gave us a juvenile justice system that seemed to be designed around the principle that no sanctions should be imposed on anyone until he has reached an incorrigible age. And I think this has had a lot to do with our difficulties with crime and social disintegration in general.

We now witness Libertarianism of the right, a kind of very individual Libertarian, explicitly Libertarian philosophy. It’s very prevalent among Silicon Valley entrepreneurs, among internet youths, and among what I otherwise consider very admirable people. But I would hope that they would think a little bit about the possibility, which I think is more than a possibility, that we have gone too far on individual rights and that communities, in order to maintain some kind of moral

compass, have to have some rights too, that we have to be able to ask for some disciplinary responsibility from the individuals that we live with.

This is, of course, what the American civilization Asian critics say. Now I have been in debates with some of them during my excursions through and around Singapore. And they say explicitly that you are too individualistic and we need to have more discipline and that sort of thing. And I have to say they're right, though you have to wonder to what extent their societies will be able to avoid the problems that we found as they undergo the same kind of rapid change and the same kind of prosperity that we have enjoyed and which they will almost certainly enjoy in the coming century.

Now I'm happy to say that in the United States, there are fairly substantial reasons to believe that the pendulum is now starting to swing back. One way to understand the current state of our politics, I think maybe the best way to understand our current state of politics, and in particular the Republican victories in 1994, is that we are undergoing a kind of religious revival, that there is a growing concern at the grass roots of society with moral questions. And obviously Ralph Reed had a lot to do with the elections and the Christian Coalition, but it's not just the Christian Coalition. It's also Liberal factions of society. You have Amitai Etzioni, for example, talking about the Communitarian Ethic, and you have even the Clinton Administration making bows in the directions of traditional morality. Robert Fogel, the University of Chicago Nobel Prize Economic Historian, has christened the current mood, The Fourth Great Awakening, that really

in his view is a kind of religious revival that will affect society in many ways, not only in politics but in other ways.

But it's somewhat paradoxical, in the midst of this we reelect Bill Clinton who is obviously a morally questionable figure, but on the other hand, his reelection I don't think has changed the basic trend particularly considering the way he postured himself during the election. Walter Dean Burnham is our leading academic student of electoral cycles and he wrote after 1994 that this was a real old-fashioned re-aligning election. It was going to influence a generation or more. Despite Clinton's victory, he has now come to the conclusion that actually the 1996 elections confirm that. An article that we will be, he's written that article and now we have to condense it to the Wall Street Journal size and we hope to run it.

And I think that what's striking here is that our society for all its faults, for all its problems, has an enormous capacity for self-renewal, and that for all its disarray, it's really basically a tough-minded society. Now even as it's currently kind of fashionable to deride the 1994 elections and the Contract with America and all that because so much of it was unfulfilled, some of it perhaps for the better, but nonetheless, I think the Welfare Reform Bill is enormously important because I think the welfare system has had a lot to do with the disorganization of the lower classes of society. And it's been very remarkable that welfare rolls started to drop rather sharply even before the law actually went into effect. And this is the first time that we have repealed, or at least drastically cut back any of our Federal entitlements. Now it's not altogether encouraging

that it was an entitlement for the lower class because there's all sorts of middle class welfare that ought to be attacked as well, but I take a little heart from the fact that the new Congress also provided to pare back farm subsidies which are a very large middle-class entitlement.

The second example of tough-mindedness, we do have the crime rate going down. It's still high by historical records but it at least is headed down, especially here in New York City. And here there are some arresting statistics on this as well. In 1974, 218,000 inmates were incarcerated in Federal and state prisons. That's 218,000 in 1974. By 1995, this figure was over a million. So despite all of the problems of our criminal justice system, we did succeed over that period in incarcerating an awful lot of criminals. And these incarceration rates are also three or four times what are typical in Europe. Now this is not an elegant solution to the crime problem, but it certainly does show a tough-mindedness for all the problems in our society. And in terms of a better solution, I do notice that quite a number of states are now reforming their juvenile justice system and impose sanctions, smaller sanctions at an earlier age which I think is much more promising development.

A third example I would talk about is the Cold War victory. If you look back throughout this whole period, it is absolutely amazing that the United States and the West in general persisted with a containment policy that was outlined in 1948. And it worked just the way George Cannon did, although he was talking about 15 years and not 40. But nonetheless, we stuck with that policy for 40 years and it worked. And who would have thought that in the middle of the Vietnam War or the Persian Missile Crisis or these traumas that we went through. And the

society turned out to be much more tough-minded than we expected it to be.

Now this capacity for renewal is the great strength of our union and our civilization. Back in 1989, everyone was worried about American decline after the Paul Kennedy book and so on. And my colleague Karen Elliot House did a whole series of articles on it. And the thing that I remember from it was, Seza Boro Ashato(?), the Japanese political scientist and Prime Minister ___ telling her, the 20th century was the American century and the 21st century will be the American century. And I believe that's true, and I only hope we can make the best of it. Clearly we are already leading the world toward democracy, free markets, and a new era of individual autonomy. I hope that we can also lead it in dealing with the costs of success with the social problems the new era is creating. Thank you. (Applause)

Chairman William J. McDonough: Thank you, Bob, for some very provocative and thoughtful remarks. Our second speaker this evening is a man who is in fact a legend, George Soros. George was born in 1930 in Hungary and spent the next 17 years there – not an easy time to live in Hungary – and then went to London where he was a star student and a graduate of the London School of Economics, and fortunately for the United States, he migrated to our shores in 1955.

I don't need to even comment on, and it would be impossible to exaggerate on his extraordinary success as an individual investor, as the manager of the firm that runs the Quantum Fund, but I think what is really even more extraordinary is that instead of deciding that he could live the rest

of his life as an increasingly seriously rich man, he has devoted virtually all of his energies in recent years to philanthropy but not just giving away money and seeing what happens, but rather in following the money into places in the United States and into Eastern Europe to be sure that the money is used wisely and well to reconstruct societies and to help construct ours, I suspect, very much in the direction that Bob Bartley has been suggesting. It is a pleasure for me to introduce George Soros.

George Soros

Investor and Philanthropist

Chairman, Soros Fund Management

Thank you, Bill, for your kind introduction. As you probably all know by now, I wrote an article in the Atlantic Monthly under the title, “The Capitalist Threat.” The article created quite a stir. Here is an arch capitalist attacking the capitalist system. The trouble is that I didn’t mean to attack the capitalist system, but only the excesses of capitalism, and in particular, the laissez faire ideology.

The failure of socialism doesn’t mean that markets are perfect, and we are currently putting too much faith in the magic of the marketplace. Markets provide a wonderful mechanism for error correction, but they are quite inadequate as a mechanism for allocating resources. For one thing, the financial markets where the allocation occurs are inherently unstable. More importantly, the argument that the common interest is best served by the unhindered pursuit of individual self-

interest is simply false. It is based on a misuse of the theory of perfect competition which is a theoretical construction with little relevance to reality.

I pointed out in the article a curious affinity between laissez faire ideology and Marxism. Both lay claim to scientific validity. The Marxist claim has been fully discredited by Karl Popper and Hayek and others, but in the case of laissez faire, the job still needs to be done. This led me to a discussion of economic theory which has aroused the ire of the economists and more recently Newsweek and other papers.

The theory of perfect competition was originally based on the assumption of perfect knowledge which is all right as an assumption but all wrong as a description of reality. That brought me to my main point. I argued that our understanding of the world in which we live is inherently imperfect, that perfection is unattainable, and the best form of social organization is one that recognizes this fact. I call it open society after Karl Popper, and most of the article was devoted to a discussion of what I mean by open society. My original title for the article was “Open Society Reconsidered.” It was the editors of the Atlantic Monthly who suggested the title, “The Capitalist Threat,” and I’m glad they did because the article got a lot more attention than it would have gotten without it. (Laughter)

But the controversy it aroused has had the unfortunate effect of obscuring the message that I wanted to deliver. So I should like to do so on this occasion. It can be summed up in three key

words – fallibility, reflexivity, and open society. The first two are abstract philosophical concepts and I shall focus on them because I can't discuss the concept of open society unless they are properly understood.

Philosophical concepts are not a very suitable subject for after dinner speeches, so I shall try to be brief. What do I mean when I say that our understanding of the world is inherently imperfect? I mean that we cannot base our decisions on knowledge. Knowledge is attainable and it can be very helpful in guiding us in making our decisions. But however much knowledge we accumulate, we can't base our decisions on knowledge alone for the simple or not so simple reason that most situations we have to deal with are not suitable subjects for knowledge.

Knowledge consists of true statements. Statements are true if they correspond to the facts to which they relate. To allow for such a correspondence to be established, the facts must be totally independent of the statements which relate to them. They must belong to one universe and the statements to another. That's the case in natural science and indeed scientific method has been very successful in establishing theories which yield valid predictions of our future events. But it is not the case in situations with which we have to deal with as participants. When we make decisions, our thinking relates to events which are contingent on our decisions. The separation between statements and facts which is necessary to be able to speak of knowledge is missing.

Consequently, even if a decision brings about the desired results, or a prediction turns out to be

true, it doesn't qualify as knowledge. In the absence of knowledge, many predictions turn out to be false, and as a general rule outcomes don't correspond to expectations and actions have unintended consequences. And that's what I mean by imperfect knowledge.

I'll go even further. I work with the hypothesis that all human constructs, whether they are ideas or institutions, are in some ways deficient or distorted, but I recognize that the hypothesis itself is deficient and distorted. I call it a fertile fallacy, and I contend that fertile fallacies play an important role in the development of ideas. My own working hypothesis has served me very well in the financial markets.

The generally accepted theory holds that rational expectations prevail and markets always discount the future accurately. I have a different interpretation. I see a two-directional reflexive process at work. On the one hand, market participants try to discount the future. On the other, their decisions help to shape the future. The two activities interfere with each other, and market participants are not dealing with something independently given to which their expectations could correspond, but with something contingent on their expectations. And since they can't act on the basis of knowledge, they need to bring their own bias to bear on the situation which then influences that situation.

Conventional wisdom holds that financial markets tend towards equilibrium. In my view, that is an illusion created by this two-way feedback mechanism between the participants' views and the

actual state of affairs. I call it reflexivity. Sometimes the participants' views don't diverge too far from the actual state of affairs. We can then speak of a near equilibrium situation. But there are other times when the prevailing bias influences the course of events in an initially self-reinforcing but eventually self-defeating way setting up a boon-bust sequence which is characteristic of financial markets. At such times, there is no tendency towards equilibrium. Both the participants' views and the actual state of affairs will be different at the end of the process from what they were at the beginning.

What is true of financial markets is true of all situations which have thinking participants. It's particularly true of history, and I interpret financial markets as an historical process. I don't think that I'm saying anything particularly new or surprising. What is surprising is that my perspective is not widely shared. (Laughter) We have been so impressed by the success of the natural sciences that we want economic theory to produce similarly deterministic explanations and predictions. But that's impossible given the reflexive interaction between thinking and reality. We end up with a false theory of financial markets and a false ideology which tries to establish its validity by claiming scientific status.

I suggest that we ought to recognize that in dealing with social and human affairs, we can't possibly replicate the achievements of natural science. Natural science can rely on an independent criterion but as participants we don't enjoy the benefit of such an independent criterion because the facts are contingent on what we think and do. The facts remain important.

They determine our fate. But they are not as impervious to our thinking as they are in natural science.

As a consequence, the world we have to deal with is a much more contingent and uncertain world than the world of natural phenomenon. And this creates some special difficulties for the social sciences. The facts don't necessarily obey universally valid laws. What is worse, they're not as impervious to the theories which relate to them as in the natural sciences. When Heisenberg established the Uncertainty Principle, it didn't alter the behavior of any quantum particle, but theories in the social sciences can influence history. Think of what Marxism has done.

Ironically, the natural sciences have come to recognize complexity and uncertainty much better than the social sciences. But then, they were also much better at establishing universally valid laws. There is, however, an additional element of uncertainty in the social sciences that has not yet been recognized – that is the uncertainty that comes from the impact that theories can make on the facts to which they relate.

This brings me to the concept of open society. Open society is based on the recognition that our understanding is inherently fallible. Since nobody is in possession of the ultimate truth, we need institutions which allow people with different opinions, different backgrounds and interests to live together in peace. We need markets, but we also need laws, and we need the separation of

powers to prevent the abuse of power and so on.

We are living in a more or less open society today and we enjoy the benefits of global markets, but there is something missing. Few people recognize that we live in an open society and even fewer believe in the values of an open society. Everybody is fighting for survival. Nobody is willing to make any sacrifices for the sake of an open society. Insofar as there is a dominant belief, it is the belief in laissez faire which holds that the common interest is best served by everybody pursuing his own particular interests.

I'm convinced that this ideology, quite apart from being false, is inadequate for holding our open society together. The danger of a collapse is not so great at home because we have well established democratic institutions which can withstand temporary excesses especially as the excesses don't all come from the direction of laissez faire. At present, there is an uneasy alliance between the advocates of market values and the champions of fundamental values which is unlikely to endure because the two positions are essentially inconsistent.

My main concern is with the international situation because there we lack the institutions which are necessary to preserve peace and prosperity and we even lack a consensus that such institutions are necessary. The laissez faire position is that markets should be left to their own devices and dual political realism dictates that each country should pursue its own national interests. This makes the present situation very precarious. Nobody protects the common interest.

I'm convinced that stability in global markets needs to be actively maintained either by close cooperation between existing national institutions or by the creation of international institutions especially charged with the mission. The same applies with much greater force to the preservation of peace.

Admittedly, the institutions concerned are bound to make mistakes, but it doesn't follow that we can do without them. Rather, we need institutions that recognize their own fallibility. These are the institutions of an open society. I contend that the concept of open society, which not only recognizes the multiplicity of cultures and traditions, but actively advocates pluralism, could serve as a unifying principle for our global society. The trouble is that the concept is neither recognized nor accepted.

I realize that it's not easy to establish a belief system which is based on our own fallibility, but it can be done. I've done it and it has served me well personally. Fallibility has a negative sound to it, but it has a positive side which in my judgment outweighs the negative. What is imperfect can be improved, so the recognition of our fallibility opens up limitless vistas for improvement and progress.

We have now lived in the age of reason for more than two centuries. And that is long enough to realize that reason has its limitations. It's time to enter the age of fallibility. This will make new demands on our capacity to think because we shall be confronted with a lot more complexity and

uncertainty than we have been willing to tolerate. But it is a challenge we cannot avoid because the successes of natural science and technology have increased our capacity to make an impact on the world. And unless our capacity to understand the world keeps pace with it, there's a real danger that we may destroy the civilization we have created.

I must apologize that these remarks are rather abstract and somewhat grandiose, but I really believe that the concepts of fallibility and reflexivity and open society can help to make sense of an otherwise very confusing world. And I hope to come down to earth and be a little more specific in the question and answer period. (Applause)

QUESTION AND ANSWER PERIOD

CHAIRMAN WILLIAM J. MCDONOUGH: Well, thank you very much George. I think that you and Bob have no doubt made the task of the two questioners very easy because your remarks have been so stimulating. Our two questioners this evening are Cassie Seifert, the co-anchor of the Nightly Business Report on PBS, and Robert H. (Bob) Stovall, who is the President of Stovall Twenty-First Advisers, Inc. I was tempted to say that we would start with Cassie Seifert because that's alphabetical order, but I'm guided by Bob Bartley's suggestion that we move in the direction of community values and one of those should be that ladies should go first. Cassie.

CASSIE SEIFERT: Thank you. Mr. Soros, I wonder if you can explain to the many of us who

have been left wondering this evening, and from reading your article in the Atlantic Monthly, how you came to your views and to your great concerns about the excesses and volatility in the financial markets when you so clearly benefitted from those excesses and the extraordinary volatility. I presume that at the time when you were actively involved, personally and directly, in the financial markets that you didn't hold the views that you hold now?

GEORGE SOROS: No, no, I hold exactly the same views as I held before. And I would say that to the extent that I've been successful, it's because I hold those views. Because, you know, if I didn't realize that markets are imperfect, if I didn't have some insight in the boon-bust process which incidentally is rarely carried to its fruition – there are more, let's say aborted boon-busts than there are real full processes – I don't think that I would have been able to benefit from them. So I think that my practical experience has led me to believe that markets are inherently unstable, has led me to this theory which I've held all along and has been my guiding principle.

CASSIE SEIFERT: So you're telling us that this, what we perhaps have all wanted to know, that this is George Soros' secret of success?

GEORGE SOROS: Well, maybe. If so, it's no longer a secret. (Laughter)

ROBERT H. STOVALL: George Soros, as you say you were on an abstract bent this evening, and I regret that the questioners aren't Rabbis or Jesuits or even a Mullah here to penetrate that,

but in regard to fallibility, any married man in the room shares my experience that he's reminded of his fallibility daily (Laughter) over the breakfast table. And as a graduate of 12 years of Catholic school, I know that we have one person who is deemed fallible, infallible rather by fiat which is constantly questioned. So that's one of your several premises that I have trouble coping with, the idea that we assume that there's infallibility. I think it's just the opposite. And also as far as the idea of laissez faire being a strict discipline, that too is not generally endorsed by everyone. As you said, I believe, we do have a great many traditions and laws which prevent laissez faire from really being in the same league as the rigid disciplines that we've just defeated. So I have trouble with that. But let's move on to something specific.

GEORGE SOROS: May I say something on this because...(Laughter)...I think you pose a very relevant question and it has been placed by others too. Of course, the real world does not resemble this ideological world of laissez faire, perfect competition, etc. But let's say the situation in the Soviet Union was very far removed from the ideas of Marxism. So you have a sort of ideological underpinning which is the one that I'm trying unpin. And I think that economists have come a very long way in understanding the real world. And if you take Greenspan's testimony and Humphrey-Hawkins, it's a wonderful exercise in reflexivity. So in practice it is recognized, but the theory is still there and the arguments that many people base their values on are on those original...

ROBERT H. STOVALL: The theories may be in the background, but for example in this global

market that we're enjoying and operating in, should in fact offshore trusts be supervised and regulated by some global organization or should they be allowed to be as free as any organization currently...

GEORGE SOROS: Well, I think that by now we are also supervised. We are often asked by Bill McDonough's organization to provide some data of our activities and we tend to always respond to those requests. (Laughter)

ROBERT H. STOVALL: Or should the Federal Reserve Board use as its purview comments on the markets? Is that their area or should they be more restricted to what...

GEORGE SOROS: I personally admire Greenspan for tackling the issue because markets obviously have a great deal of influence on what happens in the economy. It's a wealth effect. And there can be a negative effect if the market were overheated and there was a collapse. So actually when I look at the situation in the economy which is really remarkably well-balanced, one of the potential dangers of things getting off the track would be an overheating of the market. It hasn't, I don't think, occurred. I mean prices are pretty fully valued and all that, but I don't see any real excesses in the market. But I think it's very appropriate to draw attention to it because if you really did have a more sort of rapid rise, a runaway kind of market rise, you couldn't then speak about it because a remark like Greenspan made could actually precipitate a collapse. So he has to make that warning very early which is what he has done, and in a way, that he could

afford to make it indicates that at the present time there aren't any real excesses in the market.

CASSIE SEIFERT: Let me change the subject here. Bob Bartley, in your remarks about the rapid change in our society, one of the areas that you did not discuss is technology and its contribution to the rapid change and whether or not you see technology as contributing to the problems of our society or helping to solve some of them.

GEORGE SOROS: Well, I think I mentioned...

CHAIRMAN WILLIAM J. MCDONOUGH: It's for Bob...the question is for Bob...(Laughter)

GEORGE SOROS: Oh, I'm sorry.

ROBERT L. BARTLEY: You can answer it if you'd like. Obviously, I perhaps too briefly did mention technology as a driving force in all of this. And like the invention, we're still living off the invention of the transistor, and I think there's some reason to hope that the real productivity gains from that are still ahead of us. When the railroads were built, that big investment didn't pay off immediately in productivity, but over time it did. And I think that we can hope that this new invention that we're living off and is totally reshaping our society has gains still ahead of it. Now as with all change, this creates problems. The changes just become so rapid that people lose their jobs, have to find new jobs because of advancing technology. You do have, particularly in the

medical technologies, new moral questions that you have to deal with. You know, how long do you prolong life, for example? We have this cloning thing that we're kind of scratching our heads over now. Those are all things we have to deal with. But I think that net we're all living off technological change and the notion that because it creates problems we ought to go stop it would carry enormous cost, and I hope no one is really suggesting that.

ROBERT H. STOVALL: Bob Bartley, among your duties, of course you're a brilliant editor/writer, and have staked out a position for yourself and your newspaper that's very visible and unique in the country, but you also sit on the Dow Jones Management Committee. And maybe you can make some comments regarding what we're hearing about General Electric and Tom Murphy and Reuters and Bloomberg all sniffing around the periphery of your preserve there.

ROBERT L. BARTLEY: I'd be glad to make some comments on that. We have two big business interests. One is print and the other is what we call financial services which is basically electronic, Telerate, real time financial data. Three years ago, the financial services side of the company was carrying the print side. We faced enormous newsprint costs and advertising was sagging, and they were growing along at double digits every year. And, in fact, over the last six years, Telerate threw off \$500 million in cash flow. It continues to throw off cash flow even in '96 and we think in '97, despite the large investments that we have in prospect for it. Now over those three years the print side got healthy and the financial services side encountered a bunch of

problems and basically a leveling off of growth and we are now putting into place plans to correct that after six months of core deliberation and outside investment counselors and really some pretty serious thought. Then kind of as we're getting into this, Fortune magazine runs this article about us written by, the editorial chairman of Time, Inc, is Norman Pearlstine, he used to be managing editor of the Journal, the editor of Fortune is John Hewitt, who used to work for the Journal. And they wrote this article and it was, you can't argue too much with the article because what it basically said is the stock price has underperformed – clearly true – Telerate's a problem – clearly true. And the kind of first cracks have appeared in the owning family, the Bancroft family, and there are two members of it who are now going public with some of their complaints. Now the article was constructed in a way that kind of suggested that the company was in play. Now it didn't really dwell on the fact that these two Bancroft cousins control something like one percent of the stock and that under the weighted voting system you'd have to have a very serious split in the family to do anything serious about the company and that four senior members of the Bancroft family sit on the board and had participated in all of these deliberations and supported the course of action that management had agreed on. Now it's a great illustration in a way in the power of the press because now all of a sudden we get, because of Norman's article, we get all of this excitement around Dow Jones. And it really does create a lot of distraction and turmoil in the business. And I think, we don't think that anything factual is nearly as important as the way it's being played in the press. But I have to say that I have a little more sympathy with some of the businessmen out there who may have suffered the same thing especially when Norman was back at the Journal churning up the same kinds of articles about your companies. (Applause)

CASSIE SEIFERT: George Soros, I wonder if you would share with us your views on the progress and prospects for a currency union in Europe, both from an economic standpoint and from the viewpoint of those who make their living trading currencies?

GEORGE SOROS: Well, it's a very complex question, and the odds are rapidly shifting. I would say that two months ago, the beginning of the year, everything was on track and the destination was clear, the timetable was there, and something would have to happen to derail it. And the engine was Chancellor Kohl of this train. Now with the publication of very bad unemployment figures in Germany, well, the rails are a little shaky. And there could be a derailment or at least a slowdown because we can't move ahead so fast. So I think there has been a significant shift in the outlook. Now I've always been a believer that if you have a common market, in the long run you need a common currency because currencies are unstable and unless you have a single currency, there will always be, or there could always be some disruptions. But I'm afraid that the construction of the common currency, the economic conditions that were imposed basically have in them the roots of a potential disaster after it's introduced because you have a totally independent central bank so the governments have no monetary policy tools. You have, of course naturally, no influence over the exchange rate. And the Stability Pact imposes very strict limitations on fiscal policy. So when you have a very high level of unemployment, you have no macroeconomic policy tools for stimulating the economy...

(Recording ends abruptly – Question and Answer Period Not Complete)