Soros to Mahathir: I am not a moron

From the prepared text of the speech by George Soros at the IMF-World Bank meeting in Hongkong, Sept. 21.

Let me start with the obvious. We do live in a global economy. But it is characterized not only by the free movement of goods and services but, above all, by the free movement of ideas and of capital. This applies both to direct investments and to financial transactions. Both have been gaining in importance ever since the end of the Second World War; but the globalization of financial markets, in particular, has accelerated in recent years, until it reached a point where movements in exchange rates, interest rates and stock prices in various countries are intimately interconnected. In this respect, the character of the financial markets has changed out of all recognition during the 40 years that I have been involved in them. So in talking about the global economy, it may be more appropriate to speak about the global capitalist system.

There can be no doubt that global integration has brought tremendous benefits. . . .

But global capitalism is not without its problems. I shall devote most of my speech to these problems, because they are not well understood, and we need to understand them better if we want the system to survive. . . .

Financial markets are inherently unstable and international financial markets even more so. International capital flows are notorious for their boom-bust pattern. During the boom period, capital flows from the center to the periphery; but when confidence is shaken, it has a tendency to return where it came from. During the 40 years I have spent in international financial markets, I have seen many ebbs and flows and booms and busts. I fully recognize that international capital markets have become much more institutional in character and demonstrate much greater resilience, but I cannot believe that the present boom will not be followed by a bust until history has proven me wrong.

This risk of a breakdown is greatly increased by the fact that our theoretical understanding of how financial markets operate is fundamentally flawed. Economic theory has been built on the concept of equilibrium, and in my view, that concept is quite inappropriate. In my view there is no such thing as equilibrium in financial markets because market participants are trying to discount a future which is itself shaped by market expectations. This renders the outcome indeterminate and it is only by accident that the actual course of events will correspond to the prevailing expectations. . . . I am told that economic theory itself has gone a long way towards recognizing and studying disequilibrium situations. Nevertheless, the laissez-faire idea that markets should be left to their own devices remains very influential. I consider it a dangerous idea. The instability of financial markets can cause serious economic and social dislocations. The question poses itself: What should be done to preserve the stability of the financial system? Dr. Mahathir's suggestion yesterday to ban currency trading is so inappropriate that it does not deserve serious consideration. Interfering with the convertibility of capital at a moment like this is a recipe for disaster. Dr. Mahathir is a menace to his own country.

But the recent turmoil in Asian markets raises some thorny issues about currency pegs, asset bubbles, inadequate banking supervision, and the lack of financial information, which cannot be ignored. Markets cannot be left to correct their own mistakes, because they are liable to overreact and to behave in an indiscriminate fashion. For instance, it is a grave mistake not to discriminate between Malaysia and Indonesia. . . .

Since the end of the Second World War, the state has played an increasing role in maintaining economic stability, ensuring equality of opportunity and providing a social safety net, particularly in the highly industrialized countries of Europe and America. But the capacity of the state to look after the welfare of its citizens has been severely impaired by the globalization of the capitalist system, which allows capital to escape taxation much more easily than labor. Capital will tend to avoid countries where employment is heavily taxed or heavily protected, leading to a rise in unemployment. That is what has happened in Continental Europe. I am not defending the antiquated social security systems on the continent of Europe, which are badly in need of reform; but I am expressing concern about the reduction in welfare services both in Europe and in America. . . .

If social services are cut too far while instability is on the rise, it may well engender popular resentment and lead to a new wave of protectionism both in the United States and in Europe, especially if and when the current boom is followed by a bust of some severity. This could lead to a breakdown in the global capitalist system, just as it did in the 1930s. . . .

I should like to stress one particular aspect of the open society which is of critical importance at the present moment: the freedom of information.

For example, I have been subjected to all kinds of false and vile accusations by Dr. Mahathir. He is using me as a scapegoat to cover up his own failure. He is playing to a domestic audience and he couldn't get away with it if he and his ideas were subject to the discipline of independent media inside Malaysia. The freedom of information is as indispensable in Asia as in the rest of the world.