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HEADLINE: GEORGE SOROS: BILLIONAIRE, GENIUS, FOOL;
THE FABLED SPECULATOR AND PHILANTHROPIST IS BECOMING NOTORIOUS AS A CRITIC OF THE VERY CAPITALISM THAT MADE HIM RICH--BUT HIS ARGUMENTS ARE WACKY AND WEAK.

BYLINE: ROB NORTON, RESEARCH ASSOCIATE KERRY L. HUBERT

BODY:

George Soros, it goes without saying, is a very smart guy. You don't get to be a billionaire stock trader by being stupid. He's also by all accounts very well intentioned. Years ago, Soros had made more money than most people could ever imagine spending, and then instead of squandering it on a mansion or simply trying to make more and more--as some less high-minded billionaires have been known to do--he started giving it away by the millions to spread democratic ideas across the former East Bloc.

But Soros is not content to be a billionaire and philanthropist. He wants to be known as a thinker, a philosopher of economics and history and society--even as a seer. Unfortunately, no number of billions can conceal the fact that here, he's a loser: as a thinker, hopelessly muddled; as a philosopher, woefully ignorant; and as a seer, oddly bereft of insight or imagination. Soros's most recent and appalling foray into the realm of ideas is the cover story of the February 1997 issue of the Atlantic Monthly. Its title is "The Capitalist Threat," and in it Soros declares not only that modern capitalism is fundamentally rotten but that it also constitutes a threat to world society on the order of communism and fascism in earlier eras.

Upon examination the article reveals itself as a rodomontade of sloppy thinking. Soros starts by setting up a straw man of epic proportions: Modern capitalism, he asserts, embraces a "laissez-faire ideology" that "invokes the doctrine of survival of the fittest," "has effectively banished income or wealth redistribution," and has become a guiding principle of society. Really? Where, exactly, does this laissez-faire ideology reign? Surely not in America, where wealthy people pay 50% of their income in taxes so that federal, state, and local governments can redistribute it and where the largest redistribution programs--Social Security and Medicare--are favored, even beloved, by huge majorities. Certainly not in Western Europe, where governments take--and redistribute--an even larger share of income and wealth.

No such laissez-faire ideology holds sway in the economics profession either--a field in which Soros is especially shaky. He seems to think economists generally believe that there is perfect competition in real-world markets and that markets invariably move toward equilibrium. In fact, only a very few extremist academic economists endorse those views, and they've never been successful in converting their peers, let alone the general public.

Turning to history, Soros analyzes capitalism, Western democracies, and "the open society" (a phrase made famous by the philosopher Karl Popper) in a narrow cold war framework. "If the open society is to serve as an ideal worth striving for, it can no longer be defined in terms of the Communist menace. It must be given a more positive content," he writes. To which one can only ask, How about the positive content of the first 170 years of the American Republic--of the development of English common law? No; for Soros, history begins in 1945.

Soros's real gripe is that the Western democracies didn't snap to, back in 1989, to aid Russia and its former satellites--specifically by shipping them billions in the manner of the post-World War II Marshall Plan. Soros--in common with many other people--doesn't like the societies that have sprung up in the East since then, rife as they are with crime, confusion, and poverty. But could it be that too little time has passed to judge them? That there's nothing wrong with capitalism, except that neither it nor anything else could instantly correct the problems that festered under decades of political, economic, and religious repression?

The danger in Soros's ranting is that it will win undeserved attention because of who he is. A billionaire--a speculator, no less--who trashes capitalism: Now, there's a man-bites-dog story that sits up and barks! Already it's becoming one of those ubiquitous parenthetical clauses, as in: "...even George Soros admits that brutal capitalism has replaced Communism as the main threat to democratic societies..." Watch for it in a newspaper near you.

RESEARCH ASSOCIATE Kerry L. Hubert

GRAPHIC: COLOR PHOTO: JAMES ANDANSON--SYGMA, Soros fancies himself a thinker, a philosopher--even a seer. [George Soros looking at himself in mirror]

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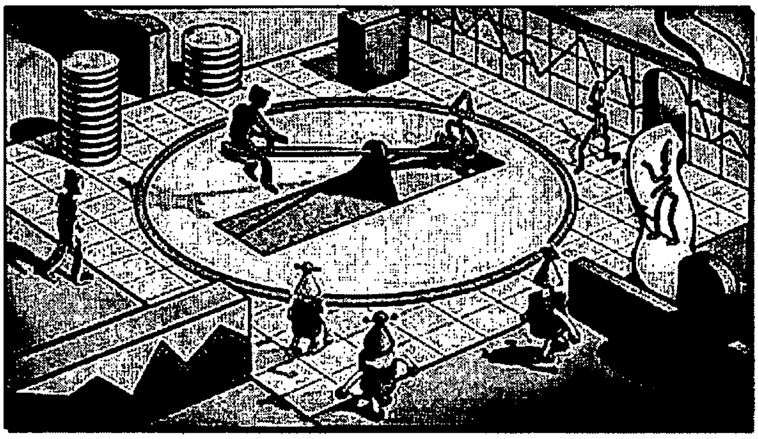
The Atlantic Monthly



THE ECONOMY

# Toward a Global Open Society



***A billionaire financier, wrongly accused of being a hypocritical capitalist for his February* Atlantic *cover story, "The Capitalist Threat," returns to the fray***

**by George Soros**

**Discuss this article in the Global Views forum of Post & Riposte.**

**From the archives:**

**"The Capitalist Threat," by George Soros (May, 1995)**
"What kind of society do we want? 'Let the free market decide!' is the often-heard response. That response, a prominent capitalist argues, undermines the very values on which open and democratic societies depend."

LET me start with the obvious. We do live in a global economy. But it is important to be clear about what we mean by that. A global economy is characterized not only by the free movement of goods and services but, more important, by the free movement of ideas and of capital. This applies to direct investments and to financial transactions. Though both have been gaining in importance since the end of the Second World War, the globalization of financial markets in particular has accelerated in recent years to the 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 forty years that I have been involved in them. So the global economy should really be thought of as the global capitalist system.

Global integration has brought tremendous benefits: the benefits of the international division of labor, which are so clearly proved by the theory of comparative advantage; dynamic benefits such as economies of scale and the rapid spread of innovations from one country to another, which are less easy to demonstrate by static equilibrium theory; and such equally important noneconomic benefits as the freedom of choice associated with the international movement of goods, capital, and people, and the freedom of thought associated with the international movement of ideas.

But global capitalism is not without its problems, and we need to understand these better if we want the system to survive. By focusing on the problems I'm not trying to belittle the benefits that globalization has brought, as some readers of my previous *Atlantic* article assumed. The benefits of the present global capitalist system, I believe, can be sustained only by deliberate and persistent efforts to correct and contain the system's deficiencies. That is where I am at loggerheads with laissez-faire ideology, which contends that free markets are self-sustaining and market excesses will correct themselves, provided that governments or regulators don't interfere with the self-correcting mechanism.

Let me group the deficiencies of the global capitalist system under five main headings: the uneven distribution of benefits, the instability of the financial system, the incipient threat of global monopolies and oligopolies, the ambiguous role of the state, and the question of values and social cohesion. The categories are of course somewhat arbitrary, and the various problem areas are interconnected.

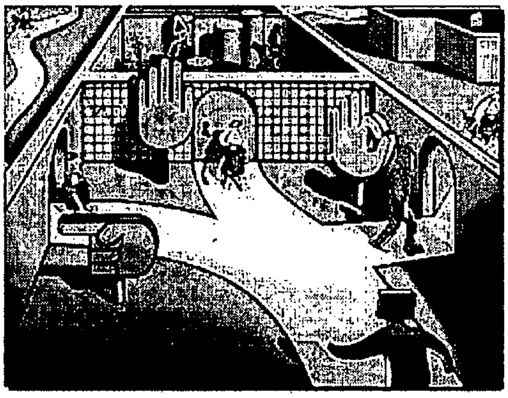
1. The benefits of global capitalism are unevenly distributed. Generally speaking, capital is in a much better position than labor, because capital is more mobile. Moreover, financial capital is better situated in the global system than industrial capital; once a plant has been built, moving it is difficult. To be sure, multinational corporations enjoy flexibility in transfer pricing and can exert pressure at the time they make investment decisions, but their flexibility doesn't compare to the freedom of choice enjoyed by international portfolio investors. There is also an advantage in being at the center of the global economy rather than at the periphery. All these factors combine to attract capital to the financial center and account for the ever increasing size and importance of financial markets.

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

The 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 misleading concept of equilibrium. In my view, equilibrium is elusive because market participants are trying to discount a future that is itself shaped by market expectations. For instance, a company whose stock is overvalued can use that to justify the inflated expectations of its shareholders, but only up to a point. This renders the outcome indeterminate, and it is only by accident that the actual course of events corresponds to prevailing expectations. Market participants, if they are rational, will recognize that they are shooting at a moving target rather than discounting a future equilibrium. The theory of rational expectations makes the heroic assumption that market participants as a group are in a position to discount the future accurately. That assumption may yield a hypothetical equilibrium, but it has little relevance to actual market behavior -- and neither market operators nor regulators have ever fully accepted the theory, exactly because they are rational people. I am told that economic theory has gone a long way toward 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? This cannot be answered in the abstract, because every situation is different. Financial markets are best understood as a historical process, and history never quite repeats itself. The recent turmoil in Asian markets raises difficult questions 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 likely to overreact and to behave in an indiscriminate fashion.

3. Instability is not confined to the financial system, however. The goal of competitors is to prevail, not to preserve competition in the market. The natural tendency for monopolies and oligopolies to arise needs to be constrained by regulations. The process of globalization is too recent for this to have become a serious issue on a global level, but since we are dealing with a historical process, in time it will.



4. But whose job is it to prevent undue concentration of power and to preserve stability in financial markets? This brings me to the role of the state. Since the end of the Second World War the state has played an increasing role in maintaining economic stability, striving to ensure equality of opportunity, and providing a social safety net, particularly in the highly industrialized countries of Europe and North 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 can. 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 European social-security systems, which are badly in need of reform; but I am expressing concern about the reduction in social provisions both in Europe and in America.

This is a relatively new phenomenon, and it has not yet had its full effect. Until recently the state's share of GNP in the industrialized countries taken as a group was increasing; it had almost doubled since the end of the Second World War. Although the ratio peaked in the 1980s, it has not declined perceptibly. The Thatcher and Reagan governments embarked on a program of reducing the state's role in the economy. What has happened instead is that the taxes on capital have come down while the taxes on labor have kept increasing. As the international economist Dani Rodrik has argued, globalization increases the demands on the state to provide social insurance while reducing its ability to do so. This carries the seeds of social conflict. If social services are cut too far while instability is on the rise, popular resentment could lead to a new wave of protectionism both in the United States and in Europe, especially if (or 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. With the influence of the state declining, there is a greater need for international cooperation. But such cooperation is contrary to the prevailing ideas of laissez-faire on the one hand and nationalism and fundamentalism on the other.

**From the archives:**

□ **"How the World Works," by James**

The state has played another role in economic development: in countries deficient in local capital it has allied itself with local business interests and helped them to accumulate capital. This strategy has proved successful

**Fallows (December, 1993)**
"Americans persist in thinking that Adam Smith's rules for free trade are the only legitimate ones. But today's fastest-growing economies are using a very different set of rules. Once, we knew them -- knew them so well that we played by them, and won. Now we seem to have forgotten."

□ **"Was Democracy Just a Moment?" by Robert D. Kaplan (December, 1997)**
"The global triumph of democracy was to be the glorious climax of the American Century. But democracy may not be the system that will best serve the world -- or even the one that will prevail in places that now consider themselves bastions of freedom."

□ **"Jihad vs. McWorld," by Benjamin Barber (March, 1992)**
"The two axial principles of our age -- tribalism and globalism -- clash at every point except one: they may both be threatening to democracy."

to accumulate capital. This strategy has proved successful in Japan, Korea, and the now wounded tigers of Southeast Asia. Although the model has worked, it raises some important questions about the relationship between capitalism and democracy. Clearly, an autocratic regime is more favorable to the rapid accumulation of capital than a democratic one, and a prosperous country is more favorable to the development of democratic institutions than a destitute one. So it is reasonable to envisage a pattern of development that goes from autocracy and capital accumulation to prosperity and democracy. But the transition from autocracy to democracy is far from assured: those who are in positions of power cling tenaciously to their power.

Autocratic regimes weaken themselves by restricting free speech and allowing corruption to spread. Eventually they may collapse of their own weight. The moment of truth comes when they fail to sustain prosperity. Unfortunately, economic dislocation and decline do not provide a good environment for the development of democratic institutions. So the political prospects for the Asian economic miracle remain cloudy at best.

5. This brings me to the most nebulous problem area, the question of values and social cohesion. Every society needs some shared values to hold it together. Market values on their own cannot serve that purpose, because they reflect only what one market participant is willing to pay another in a free exchange. Markets reduce everything, including human beings (labor) and nature (land), to commodities. We can have a market economy but we cannot have a market society. In addition to markets, society needs institutions to serve such social goals as political freedom and social justice. There are such institutions in individual countries, but not in the global society. The development of a global society has lagged behind the growth of a global economy. Unless the gap is closed, the global capitalist system will not survive. When I speak of a global society, I do not mean a global state. States are notoriously imperfect even at the national level. We need to find new solutions for a novel situation, although this is not the first time that a global capitalist system has come into being. Similar conditions prevailed at the turn of the century. Then the global capitalist system was held together by the imperial powers. Eventually, it was destroyed by a conflict between those powers. But the days of the empires are gone. For the current global capitalist system to survive, it must satisfy the needs and aspirations of its participants.

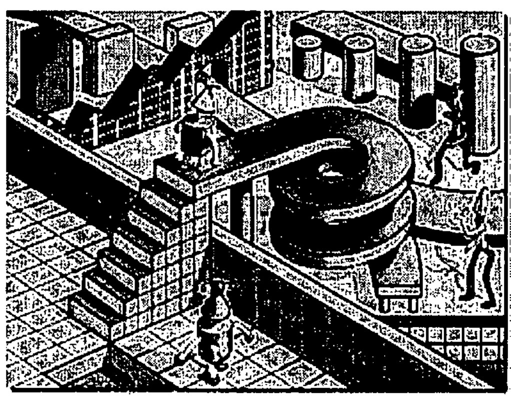
Our global society contains many different customs, traditions, and religions; where can it find the shared values that would hold it together? I should like to put forward the idea of what I call the open society as a universal principle that recognizes the diversity inherent in our global society, yet provides a conceptual basis for establishing the institutions we need. I realize that gaining acceptance for a universal principle is a tall order, but I cannot see how we can do without it.

WHAT is the open society? Superficially, it is a way to describe the positive aspects of democracy: the greatest degree of freedom compatible with social justice. It is characterized by the rule of law; respect for human rights, minorities, and minority opinions; the division of power; and a market economy. The principles of the open society are admirably put forth in the Declaration of Independence. But the Declaration states, "We hold these truths to be self-evident," whereas the principles of the open society are anything but self-evident; they need to be established by convincing arguments.

There is a strong epistemological argument, elaborated by Karl Popper, in favor of the open society: Our understanding is inherently imperfect; the ultimate truth, the perfect design for society, is beyond our reach. We must therefore content ourselves with the next best thing -- a form of social organization that falls short of perfection but holds itself open to improvement. That is the concept of the open society: a society open to improvement. The more conditions are changing -- and a global economy fosters change -- the more important the concept becomes.

But the idea of the open society is not widely accepted. On the contrary: the epistemological argument has not even been properly considered, and the idea of a global open society is often explicitly rejected. There are those, for instance, who argue that values are different in Asia. Of course they are different. The global society is characterized by diversity. But fallibility is a universal human condition; once we acknowledge it, we have found a common ground for the open society, which celebrates this diversity.

Recognition of our fallibility is necessary but not sufficient to establish the concept of the open society. We must combine it with some degree of altruism, some concern for our fellow human beings based on the principle of reciprocity.



Any variety of Asian, or other, values would fit into a global open society, provided that some universal values reflecting our fallibility and our concern for others -- such as the freedom of expression and

the right to a
fair trial -- were also respected. Western democracy is not the only form that an open society could take. In fact, that the open society should take a variety of forms follows from the epistemological argument. This is both the strength and the weakness of the idea: it provides a conceptual framework that needs to be filled with specific content. Each society, each historical period, must decide on the specifics.

As a conceptual framework, the open society is better than any blueprint, including the concept of perfect competition. Perfect competition presupposes a kind of knowledge that is beyond the reach of market participants. It describes an ideal world that has little resemblance to reality. Markets do not operate in a vacuum and do not tend toward equilibrium. They operate in a political setting, and they evolve in a reflexive fashion.

The open society is a more comprehensive framework. It recognizes the merits of the market mechanism without idealizing it, but it also recognizes the roles of other than market values in society. At the same time, it is a much vaguer, less determinate concept. It cannot define how the economic, political, social, and other spheres should be separated from and reconciled with one another. Opinions may differ on where the dividing line between competition and cooperation should be drawn. Karl Popper and Friedrich Hayek, two champions of the open society, parted company over just this point.

Let me summarize my own views on the specific requirements of our global open society at this moment of history. We have a global economy that suffers from some deficiencies, the most glaring of which are the instability of financial markets, the asymmetry between center and periphery, and the difficulty in taxing capital. Fortunately, we have some international institutions to address these issues, but they will have to be strengthened and perhaps some new ones created. The Basle Committee on Banking Supervision has established capital-adequacy requirements for the international banking system, but these did not prevent the current banking crisis in Southeast Asia. There is no international regulatory authority for financial markets, and there is not enough international cooperation for the taxation of capital.

But the real deficiencies are outside the economic field. The state can no longer play the role it played previously. In many ways that is a blessing, but some of the state's functions remain unfulfilled. We do not have adequate international institutions for the protection of individual freedoms, human rights, and the environment, or for the promotion of social justice -- not to mention the preservation of peace. Most of the institutions we do have are associations of states, and states usually put their own interests ahead of the common interest. The United Nations is constitutionally incapable of fulfilling the promises contained in the preamble of its charter. Moreover, there is no consensus on the need for better international institutions.

**From the archives:**

- **Flashback: "Nations of the World, Unite!" (August, 1997)**
The League of Nations fell victim to America's aloofness. Does the United Nations face the same fate?

- **Flashback: "Cold War, Part II?" (February, 1997)**
How did NATO come into being? Why does it persist to this day? Should it persist? *Atlantic* articles discuss the history and possible future of NATO.

- **"Changing the World on a Shoestring," by David Bornstein (January, 1998)**
"An ambitious foundation promotes social change by finding 'social entrepreneurs' -- people who have new ideas and the knack for implementing them."

What is to be done? We need to establish certain standards of behavior to contain corruption, enforce fair labor practices, and protect human rights. We have hardly begun to consider how to go about it.

As regards security and peace, the liberal democracies of the world ought to take the lead and forge a global network of alliances that could work with or without the United Nations. NATO is a case in point. The primary purpose of these alliances would be to preserve peace; but crisis prevention cannot start early enough. What goes on inside states is of consequence to their neighbors and to the world at large. The promotion of freedom and democracy in and around these alliances ought to become an important policy objective. For instance, a democratic and prosperous Russia would make a greater contribution to peace in the region than would any amount of military spending by NATO. Interfering in other countries' internal affairs is fraught with difficulties -- but not interfering can be even more dangerous.

Right now the global capitalist system is vigorously expanding in both scope and intensity. It exerts a tremendous attraction through the benefits it offers and, at the same time, it imposes tremendous penalties on those countries that try to withdraw from it. These conditions will not prevail indefinitely, but while they do, they offer a wonderful opportunity to lay the groundwork for a global open society.

With the passage of time the deficiencies are likely to make their effect felt, and the boom is likely to turn into a bust. But the ever-looming breakdown can be avoided if we recognize the flaws in time. What is imperfect can be improved. For the global capitalist system to survive, it needs a society that is constantly striving to correct its deficiencies: a global open society.

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**George Soros** is an investor and a philanthropist, and the chairman of the Open Society Institute, an international charitable foundation based in New York. His article "The Capitalist Threat" was *The Atlantic*'s cover story last February.

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Illustrations by Barton Stabler


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BYLINE: Soros, George

BODY:

In The Philosophy of History, Hegel discerned a disturbing historical pattern-the crack and fall of civilizations owing to a morbid intensification of their own first principles. Although I have made a fortune in the financial markets, I now fear that the untrammeled intensification of laissez-faire capitalism and the spread of market values into all areas of life is endangering our open and democratic society. The main enemy of the open society, I believe, is no longer the communist but the capitalist threat.

The term "open society" was coined by Henri Bergson, in his book The Two Sources of Morality and Religion (1932), and given greater currency by the Austrian philosopher Karl Popper, in his book The Open Society and Its Enemies (1945). Popper showed that totalitarian ideologies like communism and Nazism have a common element: they claim to be in possession of the ultimate truth. Since the ultimate truth is beyond the reach of humankind, these ideologies have to resort to oppression in order to impose their vision on society. Popper juxtaposed with these totalitarian ideologies another view of society, which recognizes that nobody has a monopoly on the truth; different people have different views and different interests, and there is a need for institutions that allow them to live together in peace. These institutions protect the rights of citizens and ensure freedom of choice and freedom of speech. Popper called this form of social organization the "open society." Totalitarian ideologies were its enemies.

Written during the Second World War, The Open Society and Its Enemies explained what the Western democracies stood for and fought for. The explanation was highly abstract and philosophical, and the term "open society" never gained wide recognition. Nevertheless, Popper's analysis was penetrating, and when I read it as a student in the late 1940s, having experienced at first hand both Nazi and Communist rule in Hungary, it struck me with the force of revelation.

I was driven to delve deeper into Karl Popper's philosophy, and to ask, Why does nobody have access to the ultimate truth? The answer became clear: We live in the same universe that we are trying to understand, and our perceptions can influence the events in which we participate. If our thoughts belonged to one universe and their subject matter to another, the truth might be within our grasp: we could formulate statements corresponding to the facts, and the facts would serve as reliable criteria for deciding whether the statements were true.

There is a realm where these conditions prevail: natural science. But in other areas of human endeavor the relationship between statements and facts is less clear-cut. In social and political affairs the participants' perceptions help to determine reality. In these situations facts do not necessarily constitute reliable criteria for judging the truth of statements. There is a two-way connection-a feedback mechanism-between thinking and events, which I have called "reflexivity." I have used it to develop a theory of history.

Whether the theory is valid or not, it has turned out to be very helpful to me in the financial markets. When I had made more money than I needed, I decided to set up a foundation. I reflected on what it was I really cared about. Having lived through both Nazi persecution and Communist oppression, I came to the conclusion that what was paramount for me was an open society. So I called the foundation the Open Society Fund; and I defined its objectives as opening up closed societies, making open societies more viable, and promoting a critical mode of thinking. That was in 1979.

My first major undertaking was in South Africa, but it was not successful. The apartheid system was so pervasive that whatever I tried to do made me part of the system rather than helping to change it. Then I turned my attention to Central Europe. Here I was much more successful. I started supporting the Charter 77 movement in Czechoslovakia in 1980 and Solidarity in Poland in 1981. I established separate foundations in my native country, Hungary, in 1984, in China in 1986, in the Soviet Union in 1987, and in Poland in 1988. My engagement accelerated with the collapse of the Soviet system. By now I have established a network of foundations that extends across more than twenty-five countries (not including China, where we shut down in 1989).

Operating under Communist regimes, I never felt the need to explain what "open society" meant; those who supported the objectives of the foundations understood it better than I did, even if they were not familiar with the expression. The goal of my foundation in Hungary, for example, was to support alternative activities. I knew that the prevailing Communist dogma was false exactly because it was a dogma, and that it would become unsustainable if it was exposed to alternatives. The approach proved effective. The foundation became the main source of support for civil society in Hungary, and as civil society flourished, so the Communist regime waned.

After the collapse of communism, the mission of the foundation network changed. Recognizing that an open society is a more advanced, more sophisticated form of social organization than a closed society (because in a closed society there is only one blueprint, which is imposed on society, whereas in an open society each citizen is not only allowed but required to think for himself), the foundations shifted from a subversive task to a constructive one-not an easy thing to do when the believers in an open society are accustomed to subversive activity. Most of my foundations did a good job, but unfortunately, they did not have much company. The open societies of the West did not feel a strong urge to promote open societies in the former Soviet empire. On the contrary, the prevailing view was that people ought to be left to look after their own affairs. The end of the Cold War brought a response very different from that at the end of the Second World War. The idea of a new Marshall Plan could not even be mooted. When I proposed such an idea at a conference in Potsdam (in what was then still East Germany), in the spring of 1989, I was literally laughed at.

The collapse of communism laid the groundwork for a universal open society, but the Western democracies failed to rise to the occasion. The new regimes that are emerging in the former Soviet Union and the former Yugoslavia bear little resemblance to open societies. The Western alliance seems to have lost its sense of purpose, because it cannot define itself in terms of a Communist menace. It has shown little inclination to come to the aid of those who have defended the idea of an open society in Bosnia or anywhere else. As for the people living in formerly Communist countries, they might have aspired to an open society when they suffered from repression, but now that the Communist system has collapsed, they are preoccupied with the problems of survival. After the failure of communism there came a general disillusionment with universal concepts, and the open society is a universal concept.

These considerations have forced me to re-examine my belief in the open society. For five or six years following the fall of the Berlin Wall, I devoted practically all of my energies to the transformation of the formerly Communist world. More recently I have redirected my attention to our own society. The network of foundations I created continues to do good work; nevertheless, I felt an urgent need to reconsider the conceptual framework that had guided me in establishing them. This reassessment has led me to the conclusion that the concept of the open society has not lost its relevance. On the contrary, it may be even more useful in understanding the present moment in history and in providing a practical guide to political action than it was at the time Karl Popper wrote his book-but it needs to be thoroughly rethought and reformulated. If the open society is to serve as an ideal worth striving for, it can no longer be defined in terms of the Communist menace. It must be given a more positive content.

## The New Enemy

Popper showed that fascism and communism had much in common, even though one constituted the extreme right and the other the extreme left, because both relied on the power of the state to repress the freedom of the individual. I want to extend his argument. I contend that an open society may also be threatened from the opposite direction-from excessive individualism. Too much competition and too little cooperation can cause intolerable inequities and instability.

Insofar as there is a dominant belief in our society today, it is a belief in the magic of the marketplace. The doctrine of laissez-faire capitalism holds that the common good is best served by the uninhibited pursuit of self-interest. Unless it is tempered by the recognition of a common interest that ought to take precedence over particular interests, our present system-which, however imperfect, qualifies as an open society-is liable to break down.

I want to emphasize, however, that I am not putting laissez-faire capitalism in the same category as Nazism or communism. Totalitarian ideologies deliberately seek to destroy the open society; laissez-faire policies may endanger it, but only inadvertently. Friedrich Hayek, one of the apostles of laissez-faire, was also a passionate proponent of the open society. Nevertheless, because communism and even socialism have been thoroughly discredited, I consider the threat from the laissez-faire side more potent today than the threat from totalitarian ideologies. We are enjoying a truly global market economy in which goods, services, capital, and even people move around quite freely, but we fail to recognize the need to sustain the values and institutions of an open society.

The present situation is comparable to that at the turn of the past century. It was a golden age of capitalism, characterized by the principle of laissez-faire; so is the present. The earlier period was in some ways more stable. There was an imperial power, England, that was prepared to dispatch gunboats to faraway places because as the main beneficiary of the system it had a vested interest in maintaining that system. Today the United States does not want to be the policeman of the world. The earlier period had the gold standard; today the main currencies float and crush against each other like continental plates. Yet the free-market regime that prevailed a hundred years ago was destroyed by the First World War. Totalitarian ideologies came to the fore, and by the end of the Second World War there was practically no movement of capital between countries. How much more likely the present regime is to break down unless we learn from experience!

Although laissez-faire doctrines do not contradict the principles of the open society the way Marxism-Leninism or Nazi ideas of racial purity did, all these doctrines have an important feature in common: they all try to justify their claim to ultimate truth with an appeal to science. In the case of totalitarian doctrines, that appeal could easily be dismissed. One of Popper's accomplishments was to show that a theory like Marxism does not qualify as science. In the case of laissez-faire the claim is more difficult to dispute, because it is based on economic theory, and economics is the most reputable of the social sciences. One cannot simply equate market economics with Marxist economics. Yet laissez-faire ideology, I contend, is just as much a perversion of supposedly scientific verities as Marxism-Leninism is.

The main scientific underpinning of the laissez-faire ideology is the theory that free and competitive markets bring supply and demand into equilibrium and thereby ensure the best allocation of resources. This is widely accepted as an eternal verity, and in a sense it is one. Economic theory is an axiomatic system: as long as the basic assumptions hold, the conclusions follow. But when we examine the assumptions closely, we find that they do not apply to the real world. As originally formulated, the theory of perfect competition-of the natural equilibrium of supply and demand-assumed perfect knowledge, homogeneous and easily divisible products, and a large enough number of market participants that no single participant could influence the market price. The assumption of perfect knowledge proved unsustainable, so it was replaced by an ingenious device. Supply and demand were taken as independently given. This condition was presented as a methodological requirement rather than an assumption. It was argued that economic theory studies the relationship between supply and demand; therefore it must take both of them as given.

As I have shown elsewhere, the condition that supply and demand are independently given cannot be reconciled with reality, at least as far as the financial markets are concerned -and financial markets play a crucial role in the allocation of resources. Buyers and sellers in financial markets seek to discount a future that depends on their own decisions. The shape of the supply and demand curves cannot be taken as given because both of them incorporate expectations about events that are shaped by those expectations. There is a two-way feedback mechanism between the market participants' thinking and the situation they think about-"reflexivity." It accounts for both the imperfect understanding of the participants (recognition of which is the basis of the concept of the open society) and the indeterminacy of the process in which they participate.

If the supply and demand curves are not independently given, how are market prices determined? If we look at the behavior of financial markets, we find that instead of tending toward equilibrium, prices continue to fluctuate relative to the expectations of buyers and sellers. There are prolonged periods when prices are moving away from any theoretical equilibrium. Even if they eventually show a tendency to return, the equilibrium is not the same as it would have been without the intervening period. Yet the concept of equilibrium endures. It is easy to see why: without it, economics could not say how prices are determined.

In the absence of equilibrium, the contention that free markets lead to the optimum allocation of resources loses its justification. The supposedly scientific theory that has been used to validate it turns out to be an axiomatic structure whose conclusions are contained in its assumptions and are not necessarily supported by the empirical evidence. The resemblance to Marxism, which also claimed scientific status for its tenets, is too close for comfort.

I do not mean to imply that economic theory has deliberately distorted reality for political purposes. But in trying to imitate the accomplishments (and win for itself the prestige) of natural science, economic theory attempted the impossible. The theories of social science relate to their subject matter in a reflexive manner. That is to say, they can influence events in a way that the theories of natural science cannot. Heisenberg's famous uncertainty principle implies that the act of observation may interfere with the behavior of quantum particles; but it is the observation that creates the effect, not the uncertainty principle itself. In the social sphere, theories have the capacity to alter the subject matter to which they relate. Economic theory has deliberately excluded reflexivity from consideration. In doing so, it has distorted its subject matter and laid itself open to exploitation by laissez-faire ideology.

What allows economic theory to be converted into an ideology hostile to the open society is the assumption of perfect knowledge-at first openly stated and then disguised in the form of a methodological device. There is a powerful case for the market mechanism, but it is not that markets are perfect; it is that in a world dominated by imperfect understanding, markets provide an efficient feedback mechanism for evaluating the results of one's decisions and correcting mistakes.

Whatever its form, the assertion of perfect knowledge stands in contradiction to the concept of the open society (which recognizes that our understanding of our situation is inherently imperfect). Since this point is abstract, I need to describe specific ways in which laissez-faire ideas can pose a threat to the open society. I shall focus on three issues: economic stability, social justice, and international relations.

## Economic Stability

Economic theory has managed to create an artificial world in which the participants' preferences and the opportunities confronting participants are independent of each other, and prices tend toward an equilibrium that brings the two forces into balance. But in financial markets prices are not merely the passive reflection of independently given demand and supply; they also play an active role in shaping those preferences and opportunities. This reflexive interaction renders financial markets inherently unstable. Laissez-faire ideology denies the instability and opposes any form of government intervention aimed at preserving stability. History has shown that financial markets do break down, causing economic depression and social unrest. The breakdowns have led to the evolution of central banking and other forms of regulation. Laissez-faire ideologues like to argue that the breakdowns were caused by faulty regulations, not by unstable markets. There is some validity in their argument, because if our understanding is inherently imperfect, regulations are bound to be defective. But their argument rings hollow, because it fails to explain why the regulations were imposed in the first place. It sidesteps the issue by using a different argument, which goes like this: since regulations are faulty, unregulated markets are perfect.

The argument rests on the assumption of perfect knowledge: if a solution is wrong, its opposite must be right. In the absence of perfect knowledge, however, both free markets and regulations are flawed. Stability can be preserved only if a deliberate effort is made to preserve it. Even then breakdowns will occur, because public policy is often faulty. If they are severe enough, breakdowns may give rise to totalitarian regimes.

Instability extends well beyond financial markets: it affects the values that guide people in their actions. Economic theory takes values as given. At the time economic theory was born, in the age of Adam Smith, David Ricardo, and Alfred Marshall, this was a reasonable assumption, because people did, in fact, have firmly established values. Adam Smith himself combined a moral philosophy with his economic theory. Beneath the individual preferences that found expression in market behavior, people were guided by a set of moral principles that found expression in behavior outside the scope of the market mechanism. Deeply rooted in tradition, religion, and culture, these principles were not necessarily rational in the sense of representing conscious choices among available alternatives. Indeed, they often could not hold their own when alternatives became available. Market values served to undermine traditional values.

There has been an ongoing conflict between market values and other, more traditional value systems, which has aroused strong passions and antagonisms. As the market mechanism has extended its sway, the fiction that people act on the basis of a given set of nonmarket values has become progressively more difficult to maintain. Advertising, marketing, even packaging, aim at shaping people's preferences rather than, as laissez-faire theory holds, merely responding to them. Unsure of what they stand for, people increasingly rely on money as the criterion of value. What is more expensive is considered better. The value of a work of art can be judged by the price it fetches. People deserve respect and admiration because they are rich. What used to be a medium of exchange has usurped the place of fundamental values, reversing the relationship postulated by economic theory. What used to be professions have turned into businesses. The cult of success has replaced a belief in principles. Society has lost its anchor.

## Social Darwinism

By taking the conditions of supply and demand as given and declaring government intervention the ultimate evil, laissez-faire ideology has effectively banished income or wealth redistribution. I can agree that all attempts at redistribution interfere with the efficiency of the market, but it does not follow that no attempt should be made. The laissez-faire argument relies on the same tacit appeal to perfection as does communism. It claims that if redistribution causes inefficiencies and distortions, the problems can be solved by eliminating redistribution-just as the Communists claimed that the duplication involved in competition is wasteful, and therefore we should have a centrally planned economy. But perfection is unattainable. Wealth does accumulate in the hands of its owners, and if there is no mechanism for redistribution, the inequities can become intolerable. "Money is like muck, not good except it be spread." Francis Bacon was a profound economist.

The laissez-faire argument against income redistribution invokes the doctrine of the survival of the fittest. The argument is undercut by the fact that wealth is passed on by inheritance, and the second generation is rarely as fit as the first.

In any case, there is something wrong with making the survival of the fittest a guiding principle of civilized society. This social Darwinism is based on an outmoded theory of evolution, just as the equilibrium theory in economics is taking its cue from Newtonian physics. The principle that guides the evolution of species is mutation, and mutation works in a much more sophisticated way. Species and their environment are interactive, and one species serves as part of the environment for the others. There is a feedback mechanism similar to reflexivity in history, with the difference being that in history the mechanism is driven not by mutation but by misconceptions. I mention this because social Darwinism is one of the misconceptions driving human affairs today. The main point I want to make is that cooperation is as much a part of the system as competition, and the slogan "survival of the fittest" distorts this fact.

## International Relations

Laissez-faire ideology shares some of the deficiencies of another spurious science, geopolitics. States have no principles, only interests, geopoliticians argue, and those interests are determined by geographic location and other fundamentals. This deterministic approach is rooted in an outdated nineteenth-century view of scientific method, and it suffers from at least two glaring defects that do not apply with the same force to the economic doctrines of laissez-faire. One is that it treats the state as the indivisible unit of analysis, just as economics treats the individual. There is something contradictory in banishing the state from the economy while at the same time enshrining it as the ultimate source of authority in international relations. But let that pass. There is a more pressing practical aspect of the problem. What happens when a state disintegrates? Geopolitical realists find themselves totally unprepared. That is what happened when the Soviet Union and Yugoslavia disintegrated. The other defect of geopolitics is that it does not recognize a common interest beyond the national interest.

With the demise of communism, the present state of affairs, however imperfect, can be described as a global open society. It is not threatened from the outside, from some totalitarian ideology seeking world supremacy. The threat comes from the inside, from local tyrants seeking to establish internal dominance through external conflicts. It may also come from democratic but sovereign states pursuing their self-interest to the detriment of the common interest. The international open society may be its own worst enemy.

The Cold War was an extremely stable arrangement. Two power blocs, representing opposing concepts of social organization, were struggling for supremacy, but they had to respect each other's vital interests, because each side was capable of destroying the other in an all-out war. This put a firm limit on the extent of the conflict; all local conflicts were, in turn, contained by the larger conflict. This extremely stable world order has come to an end as the result of the internal disintegration of one superpower. No new world order has taken its place. We have entered a period of disorder.

Laissez-faire ideology does not prepare us to cope with this challenge. It does not recognize the need for a world order. An order is supposed to emerge from states' pursuit of their self-interest. But, guided by the principle of the survival of the fittest, states are increasingly preoccupied with their competitiveness and unwilling to make any sacrifices for the common good.

There is no need to make any dire predictions about the eventual breakdown of our global trading system in order to show that a laissez-faire ideology is incompatible with the concept of the open society. It is enough to consider the free world's failure to extend a helping hand after the collapse of communism. The system of robber capitalism that has taken hold in Russia is so iniquitous that people may well turn to a charismatic leader promising national revival at the cost of civil liberties.

If there is any lesson to be learned, it is that the collapse of a repressive regime does not automatically lead to the establishment of an open society. An open society is not merely the absence of government intervention and oppression. It is a complicated, sophisticated structure, and deliberate effort is required to bring it into existence. Since it is more sophisticated than the system it replaces, a speedy transition requires outside assistance. But the combination of laissez-faire ideas, social Darwinism, and geopolitical realism that prevailed in the United States and the United Kingdom stood in the way of any hope for an open society in Russia. If the leaders of these countries had had a different view of the world, they could have established firm foundations for a global open society.

At the time of the Soviet collapse there was an opportunity to make the UN function as it was originally designed to. Mikhail Gorbachev visited the United Nations in 1988 and outlined his vision of the two superpowers cooperating to bring peace and security to the world. Since then the opportunity has faded. The UN has been thoroughly discredited as a peacekeeping institution. Bosnia is doing to the UN what Abyssinia did to the League of Nations in 1936.

Our global open society lacks the institutions and mechanisms necessary for its preservation, but there is no political will to bring them into existence. I blame the prevailing attitude, which holds that the unhampered pursuit of self-interest will bring about an eventual international equilibrium. I believe this confidence is misplaced. I believe that the concept of the open society, which needs institutions to protect it, may provide a better guide to action. As things stand, it does not take very much imagination to realize that the global open society that prevails at present is likely to prove a temporary phenomenon.

## The Promise of Fallibility

It is easier to identify the enemies of the open society than to give the concept a positive meaning. Yet without such a positive meaning the open society is bound to fall prey to its enemies. There has to be a common interest to hold a community together, but the open society is not a community in the traditional sense of the word. It is an abstract idea, a universal concept. Admittedly, there is such a thing as a global community; there are common interests on a global level, such as the preservation of the environment and the prevention of war. But these interests are relatively weak in comparison with special interests. They do not have much of a constituency in a world composed of sovereign states. Moreover, the open society as a universal concept transcends all boundaries. Societies derive their cohesion from shared values. These values are rooted in culture, religion, history, and tradition. When a society does not have boundaries, where are the shared values to be found? I believe there is only one possible source: the concept of the open society itself.

To fulfill this role, the concept of the open society needs to be redefined. Instead of there being a dichotomy between open and closed, I see the open society as occupying a middle ground, where the rights of the individual are safeguarded but where there are some shared values that hold society together. This middle ground is threatened from all sides. At one extreme, communist and nationalist doctrines would lead to state domination. At the other extreme, laissez-faire capitalism would lead to great instability and eventual breakdown. There are other variants. Lee Kuan Yew, of Singapore, proposes a so-called Asian model that combines a market economy with a repressive state. In many parts of the world control of the state is so closely associated with the creation of private wealth that one might speak of robber capitalism, or the "gangster state," as a new threat to the open society.

I envisage the open society as a society open to improvement. We start with the recognition of our own fallibility, which extends not only to our mental constructs but also to our institutions. What is imperfect can be improved, by a process of trial and error. The open society not only allows this process but actually encourages it, by insisting on freedom of expression and protecting dissent. The open society offers a vista of limitless progress. In this respect it has an affinity with the scientific method. But science has at its disposal objective criteria-namely the facts by which the process may be judged. Unfortunately, in human affairs the facts do not provide reliable criteria of truth, yet we need some generally agreed-upon standards by which the process of trial and error can be judged. All cultures and religions offer such standards; the open society cannot do without them. The innovation in an open society is that whereas most cultures and religions regard their own values as absolute, an open society, which is aware of many cultures and religions, must regard its own shared values as a matter of debate and choice. To make the debate possible, there must be general agreement on at least one point: that the open society is a desirable form of social organization. People must be free to think and act, subject only to limits imposed by the common interests. Where the limits are must also be determined by trial and error.

The Declaration of Independence may be taken as a pretty good approximation of the principles of an open society, but instead of claiming that those principles are self-evident, we ought to say that they are consistent with our fallibility. Could the recognition of our imperfect understanding serve to establish the open society as a desirable form of social organization? I believe it could, although there are formidable difficulties in the way. We must promote a belief in our own fallibility to the status that we normally confer on a belief in ultimate truth. But if ultimate truth is not attainable, how can we accept our fallibility as ultimate truth?

This is an apparent paradox, but it can be resolved. The first proposition, that our understanding is imperfect, is consistent with a second proposition: that we must accept the first proposition as an article of faith. The need for articles of faith arises exactly because our understanding is imperfect. If we enjoyed perfect knowledge, there would be no need for beliefs. But to accept this line of reasoning requires a profound change in the role that we accord our beliefs.

Historically, beliefs have served to justify specific rules of conduct. Fallibility ought to foster a different attitude. Beliefs ought to serve to shape our lives, not to make us abide by a given set of rules. If we recognize that our beliefs are expressions of our choices, not of ultimate truth, we are more likely to tolerate other beliefs and to revise our own in the light of our experiences. But that is not how most people treat their beliefs. They tend to identify their beliefs with ultimate truth. Indeed, that identification often serves to define their own identity. If their experience of living in an open society obliges them to give up their claim to the ultimate truth, they feel a sense of loss.

The idea that we somehow embody the ultimate truth is deeply ingrained in our thinking. We may be endowed with critical faculties, but we are inseparably tied to ourselves. We may have discovered truth and morality, but, above all, we must represent our interests and our selves. Therefore, if there are such things as truth and justice-and we have come to believe that there are-then we want to be in possession of them. We demand truth from religion and, recently, from science. A belief in our fallibility is a poor substitute. It is a highly sophisticated concept, much more difficult to work with than more primitive beliefs, such as my country (or my company or my family), right or wrong.

If the idea of our fallibility is so hard to take, what makes it appealing? The most powerful argument in its favor is to be found in the results it produces. Open societies tend to be more prosperous, more innovative, more stimulating, than closed ones. But there is a danger in proposing success as the sole basis for holding a belief, because if my theory of reflexivity is valid, being successful is not identical with being right. In natural science, theories have to be right (in the sense that the predictions and explanations they produce correspond to the facts) for them to work (in the sense of producing useful predictions and explanations). But in the social sphere what is effective is not necessarily identical with what is right, because of the reflexive connection between thinking and reality. As I hinted earlier, the cult of success can become a source of instability in an open society, because it can undermine our sense of right and wrong. That is what is happening in our society today. Our sense of right and wrong is endangered by our preoccupation with success, as measured by money. Anything goes, as long as you can get away with it.

If success were the only criterion, the open society would lose out against totalitarian ideologies-as indeed it did on many occasions. It is much easier to argue for my own interest than to go through the whole rigmarole of abstract reasoning from fallibility to the concept of the open society.

The concept of the open society needs to be more firmly grounded. There has to be a commitment to the open society because it is the right form of social organization. Such a commitment is hard to come by.

I believe in the open society because it allows us to develop our potential better than a social system that claims to be in possession of ultimate truth. Accepting the unattainable character of truth offers a better prospect for freedom and prosperity than denying it. But I recognize a problem here: I am sufficiently committed to the pursuit of truth to find the case for the open society convincing, but I am not sure that other people will share my point of view. Given the reflexive connection between thinking and reality, truth is not indispensable for success. It may be possible to attain specific objectives by twisting or denying the truth, and people may be more interested in attaining their specific objectives than in attaining the truth. Only at the highest level of abstraction, when we consider the meaning of life, does truth take on paramount importance. Even then, deception may be preferable to the truth, because life entails death and death is difficult to accept. Indeed, one could argue that the open society is the best form of social organization for making the most of life, whereas the closed society is the form best suited to the acceptance of death. In the ultimate analysis a belief in the open society is a matter of choice, not of logical necessity.

That is not all. Even if the concept of the open society were universally accepted, that would not be sufficient to ensure that freedom and prosperity would prevail. The open society merely provides a framework within which different views about social and political issues can be reconciled; it does not offer a firm view on social goals. If it did, it would not be an open society. This means that people must hold other beliefs in addition to their belief in the open society. Only in a closed society does the concept of the open society provide a sufficient basis for political action; in an open society it is not enough to be a democrat; one must be a liberal democrat or a social democrat or a Christian democrat or some other kind of democrat. A shared belief in the open society is a necessary but not a sufficient condition for freedom and prosperity and all the good things that the open society is supposed to bring.

It can be seen that the concept of the open society is a seemingly inexhaustible source of difficulties. That is to be expected. After all, the open society is based on the recognition of our fallibility. Indeed, it stands to reason that our ideal of the open society is unattainable. To have a blueprint for it would be self-contradictory. That does not mean that we should not strive toward it. In science also, ultimate truth is unattainable. Yet look at the progress we have made in pursuing it. Similarly, the open society can be approximated to a greater or lesser extent.

To derive a political and social agenda from a philosophical, epistemological argument seems like a hopeless undertaking. Yet it can be done. There is historical precedent. The Enlightenment was a celebration of the power of reason, and it provided the inspiration for the Declaration of Independence and the Bill of Rights. The belief in reason was carried to excess in the French Revolution, with unpleasant side effects; nevertheless, it was the beginning of modernity. We have now had 200 years of experience with the Age of Reason, and as reasonable people we ought to recognize that reason has its limitations. The time is ripe for developing a conceptual framework based on our fallibility. Where reason has failed, fallibility may yet succeed.

GRAPHIC: Illustration; Cartoon

MEMORANDUM FOR HILLARY RODHAM CLINTON

From: Michael O'Mary
Date: Jan 13, 1997
Re: Soros Article in Atlantic Monthly 1/98

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George Soros followed up his previous article extolling the virtues of a global open society with an essay in this month's Atlantic Monthly. This time Soros lays out his argument much more convincingly and his style is much more focused. As in the previous article, Soros attempts to show the dangers of pure laissez-faire economics and in doing so, build a case for organizing society based upon the principles of a global open society.

Soros begins by arguing that the global economy is, "characterized not only by the free movement of goods and services but, more importantly, by the free movement of ideas and capital." Because of the resultant economic interdependence between nation-states, Soros feels that he global economy, "should really be thought of as the global capitalist system."

While Soros feels that global integration, "has brought tremendous benefits," he also sees 5 principle weaknesses inherent in the global capitalist system:

- "The benefits of capitalism are unevenly distributed." The global capitalist system tends to attract capital to financial centers, accounting for, "the ever increasing size and importance of financial markets." Furthermore, because of the qualitative differences between capital and labor, capital is in a much better position to take advantage of the global economy.

- "Financial markets are inherently unstable." To support this argument, Soros returns to his theory of reflexivity, which states that it is impossible to, "discount a future that is itself shaped by market expectations." Because of this imperfect understanding of financial markets, there is a fairly substantial risk of breakdown. Furthermore, because markets are, "likely to overreact and behave in an indiscriminate fashion," they, "cannot be left to correct their own mistakes."

- There is a natural tendency for oligopolies and monopolies to arise in a global capitalist system. "The goal of competitors is to prevail, not to preserve competition in the market." And while Soros feels that globalization is too recent for this problem to have become serious, it is something worth considering.

- The state's role in a global capitalist system is ambiguous. Globalization is simultaneously increasing, "demands on the state to provide social insurance while reducing its ability to do so," because of the difficulty in taxing capital. "This carries the seeds of social conflict. If social services are cut too far while instability is on the rise, popular resentment could lead to a new wave of protectionism both in the United States and in Europe." In turn, this could lead to, "a breakdown of the global capitalist system," similar to what occurred during the 1930s. Finally, since autocratic regimes are, "more favorable to the rapid accumulation of wealth than," democratic regimes, there exists that danger that the transition to democracy may never occur in many countries.

- "Markets reduce everything, including human beings (labor), and nature (land), to commodities. <u>We can have a market economy but we cannot have a market society.</u>" Society needs more than just markets to function, it, "needs institutions to serve such social goals as political freedom and social justice." And because markets around the world have grown interdependent at such a rapid pace, "the development of a global society has lagged behind the growth of a global economy." Soros believes that the current global capitalist system will only survive if it satisfies, "the needs and aspirations of its participants."

Because of the failure of laissez-faire economics as a method of social organization, Soros believes that society must find the, "shared values that hold it together," in the concept of a global, "Open Society." This universal idea, "superficially ... describe(s) the positive aspects of democracy." The concept of the open society must also contain a recognition of human fallibility combined with, "some degree of altruism, some concern for our fellow human beings based on the principle of reciprocity."

This framework, of democratic values combined with an openness for improvement, "is better than any blueprint (for society), including the concept of perfect competition." The open society, "recognizes the merits of the market mechanism without idealizing it, but it also recognizes the roles of other than market values in society."

However, because the development of institutions, "for the protection of individual freedoms, human rights, and the environment, or for the promotion of social justice -- not to mention the preservation of the peace," has lagged behind the development of the international economy, "real deficiencies," exist.

To remedy this situation, Soros believes that, "We need to establish certain standards of behavior to contain corruption, enforce fair labor practices, and protect human rights." Furthermore, "the liberal democracies of the world ought to... forge a global network of alliances," for which, "the promotion of freedom and democracy," becomes, "an important policy objective."

"With the passage of time the deficiencies are likely to make their effect felt, and the boom is likely to turn into a bust. But the ever-looming breakdown can be avoided if we recognize the flaws in time. What is imperfect can be improved. For the global capitalist system to survive, it needs a society that is constantly striving to correct its deficiencies: a global open society."

MEMORANDUM FOR HILLARY RODHAM CLINTON

From: Michael O'Mary
Date: Jan 9, 1997
Re: Soros Article in Atlantic Monthly 2/97

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George Soros authored Atlantic Monthly's cover story for its February 1997 edition. The story, entitled "The Capitalist Threat" essentially makes two arguments: 1) Laissez-faire economics as a doctrine has become as dangerous to global society as communism and totalitarianism once were, and 2) The Open Society, based upon a realization of our own fallibility, should become the dominant framework for social organization.

Soros lays the foundation for his first argument by disputing the basic assumptions of economic theory. Instead of taking the factors of supply and demand as independent and given, he puts forth his own theory of reflexivity, which argues that buyers and sellers are making decisions based upon their expectation of future events, which are in turn affected by the decisions made in expectation of them. Because of this, there is no such thing as an independent and natural long-term economic equilibrium. By disputing these preconditions of economic theory, Soros contends that economics and the market mechanism are not the hard science they portend to be.

Soros further makes the claim that all theories of social science, not simply economic ones, are reflexive in nature. For unlike the natural sciences, social science theories, "have the capacity to alter the subject matter to which they relate." He compares this reflexivity to Heisenberg's uncertainty principle, which argues that merely observing an object can change its very nature.

According to Soros, because few people are willing to challenge the assumptions of elementary economics, and instead have adopted laissez-faire economics as the ultimate truth, capitalism poses a significant threat to democratic beliefs and more specifically to his ideal of an "Open Society." "Belief in the magic of the marketplace," Soros states, has led to the theory that, "the common good is best served by the uninhibited pursuit of self-interest." He argues that such excessive individualism, "can cause intolerable inequities and instability," because, "market values," have, "served to undermine traditional values." Where before, "people were guided by a set of moral principles that found expression in behavior outside of the market mechanism," today people are guided by the principles of the marketplace itself. We attribute goodness and success to accumulated value and blame an 'outdated theory' of social Darwinism for the inequities and suffering in society. And because Soros disputes the scientific basis for laissez-faire economic theory, he feels that the market ideology, "is just as much a perversion of supposedly scientific verities as Marxism-Leninism is."

Thus, he believes, our supposedly open society faces a rather unforseen threat. By adopting laissez-faire economics as the ultimate truth, modern society indulges in the same arrogance which plagued communist and totalitarian regimes. Furthermore, the unhampered pursuit of self-interest, without recognition of shared values apart from those espoused by market ideologues, can only be detrimental because of the imperfection inherent in the market mechanism. These imperfections, he feels, will lead to a decline in economic stability and eventually a, "closed society."

He extrapolates his ideas to international relations. In modern times, "States have no principles, only interests." He feels there is a contradiction in attempting to banish the state at the national level, yet enshrining it with absolute authority on the international level. Furthermore, geo-politics fails to recognize a common interest above and separate from the national interest. He cites the reluctance of the international community to give aid to the former Soviet republics and Eastern Bloc countries, as well as the, "robber capitalism," occurring within these nations as evidence in support of his critique of geo-political theory and laissez-faire economics.

Because of the threats capitalism poses, Soros feels that the dominant form of social organization should be that of an "Open Society." Rather than trying to identify any ultimate truths (such as communism and totalitarianism do, and capitalism is becoming dangerously close to doing), we should base society on the recognition of our fallibility. Whereas most cultures, "regard their own values as absolute, an open society, which is aware of many cultures and religions, must regard its own shared values as a matter of debate and choice." In order to promote this debate, institutions must be put in place which safeguard individual rights while promoting the common interest as defined by ongoing debate. Building an open society takes more than simply removing the vestiges of communism and totalitarianism. It requires the construction of new structures which, rather than attempting to identify truth, realize the impossibility of such a task and instead seek to promote the definition of shared values beyond the dogmatic tendencies of capitalist, laissez-faire theories.

According to Soros, open societies which are based upon the acceptance of, "the unattainable character of truth," offer a much better chance at success and prosperity than other forms of social organization. Because of this, Soros feels, we must strive towards the goals of a open society, rather than characterizing laissez-faire economics, or any other ideology, as the ultimate truth.

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BYLINE: GEORGE SOROS, Chairman, Open Society Institute, NEW YORK, N.Y.

BODY:

MY ATLANTIC MONTHLY ESSAY, "THE Capitalist Threat," has aroused the ire of Robert J. Samuelson ("Crackpot Prophet," JUDGMENT CALLS, March 10) for its perceived attack on the capitalist system. I wasn't attacking capitalism, only its excesses and laissez faire ideology.

I pointed out a curious affinity between laissez faire ideology and Marxism: both lay claim to scientific validity. The Marxist claim has been fully discredited. But laissez faire ideology is derived from the most respectable of social sciences, economics, and its claim to scientific validity still requires debunking. I suspect that Samuelson prefers to dismiss my ideas as jumbled, rather than to entertain the possibility that the scientific foundations of laissez faire are less than secure.

Our understanding of the world in which we live is inherently imperfect. This creates difficulties for the social sciences from which the natural sciences are exempt. Scientific method has discovered universally valid generalizations that can explain and predict events in the natural world. To make such generalizations possible, the events must be independent of statements that relate to them.

But in society, participants must make decisions about events that are contingent on their decisions. The separation between statements and facts, a characteristic of science, is lacking. Participants are obliged to act on the basis of imperfect understanding, bringing biases to bear, with unfortunate consequences for the social sciences. Participants' thinking introduces an element of indeterminacy missing from the natural sciences.

Economic theory has sought to imitate 19th-century physics by introducing the concept of equilibrium. The postulate of a long-run equilibrium is indispensable to turning economics into a hard science. Unfortunately, the participants' bias can wreak havoc with equilibrium, particularly in financial markets. The participants' bias can influence the future that the markets are supposed to discount.

Sometimes the interaction between the participants' thinking and the actual state of affairs sets off a self-reinforcing process that doesn't leave the underlying reality unaffected. The absence of equilibrium deprives economics of its claim to being a hard science and also deprives laissez faire ideology of its scientific underpinnings. Outcomes do not necessarily correspond to expectations, and actions have unintended consequences. Instead of perfect markets, this leads to the concept of open society.

Since nobody is in possession of the ultimate truth, we need institutions and attitudes that allow people with different views and interests to live together in peace. Markets are the best mechanisms for correcting individual errors, but government intervention and collective action are needed to protect common interests and correct inequities in the capitalist system. Laissez faire ideology -- which holds that the common interest is best served when each individual pursues his own particular interest -- is inadequate for holding our open society together.

My main contention in the Atlantic Monthly essay is 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.

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BYLINE: BY ROBERT J. SAMUELSON

HIGHLIGHT:
George Soros has made billions in the market, but don't trust his economic philosophy

BODY:

WE ALL RECALL HOW MICHAEL JORDAN DID IN baseball. He bombed. He couldn't make it into the majors, let alone become a superstar. Even at the AA Birmingham Barons, he batted a miserable .202 (88 for 436, with 114 strikeouts). There's an insight here. Call it the Jordan principle: genius doesn't travel well. Applying the Jordan principle to George Soros -- the fabulously successful investor who is among the world's wealthiest men -- we find that getting rich doesn't make you an economic philosopher. In Soros's case, just the opposite: as a seer, he's a crackpot.

I know this because I've recently read his essay "The Capitalist Threat" in the February Atlantic. It argues that "the spread of market values into all areas of life" is now the main threat to "open and democratic society." Powerful stuff. Also rubbish. Soros's essay is rambling and incoherent. In some ways, it resembles the Unabomber Manifesto in its sweeping, unsupported and disconnected generalizations. For example:

"Species and their environment are interactive, and one species serves as part of the environment for the others. There is a feedback mechanism similar to reflexivity in history, with the difference being that in history the mechanism is driven not by mutation but by misconception."

Got it? The truth is that if Soros weren't the author, this gibberish wouldn't have made it into print. Its only appeal is its shock value: capitalist condemns capitalism. "There was a man-bites-dog quality to this," says Atlantic editor William Whitworth. The result is that we get assertion instead of analysis. "Insofar as there is a dominant belief in our society today," Soros claims, "it is the belief in the magic of the marketplace." Really? If that were so, governments everywhere would be shrinking radically.

They aren't. Government spending, as a share of economic output (gross domestic product), is near record peacetime levels in most advanced nations. In the United States it was 33 percent of GDP in 1995, down slightly from 34 percent in 1992 and up from 31 percent in 1980. In Germany it was a record 50 percent in 1995, up from 48 percent in 1980. In France it was 54 percent, a bit lower than 1993's 55 percent but up from 1980's 46 percent.

The very illogic and obscurity of Soros's diatribe may, ironically, enhance its appeal. It panders to a fashionable anti-capitalist chic. And ordinary readers may assume that, though these matters are unfathomable, Soros must be a trustworthy authority. After all, he ranks 43d in Forbes's latest list of the 400 wealthiest Americans, with an estimated net worth of $ 2.5 billion. In 1992 he gained notoriety when his currency speculation helped cause the British pound's devaluation. Who better to expose modern capitalism?

Maybe anyone. In most rich democracies, the central problem of the political economy now is the reverse of what Soros says. It is not how to curb rampaging markets. It is how to maintain a large welfare state without suffocating a productive economy. The resulting dilemma is this: only higher economic growth can make the welfare state affordable; but higher economic growth often requires cutting benefits (for the unemployed, the poor, the elderly and the sick).

In Europe the conflict is already acute. Since 1970, the unemployment rate has nearly quadrupled. In 1996 it was 9 percent in Germany, 12 percent in Italy and 12 percent in France. Generous jobless benefits, rigid wages, high taxes and overregulated industry stifle growth. Governments respond by trying to pare benefits and promote competition. But even modest changes trigger outcries. Here are some recent headlines about France: "French Trucker Strike Ends With Indirect Defeat of Government"; "French Transit Workers Press Retirement at 55"; "Actors, Musicians Stage Strike in Paris to Protest Cutbacks in Social Services."

People want what they've been promised. Nor can Europe's problems be laid to global competition or capricious markets, because the United States -- with unemployment of 5.4 percent in 1996 -- faces the same competition and has freer markets. The danger is that welfare commitments continue to mount (because the jobless and aged increase) while economies continue to slow. At some point, the system could lose its capacity to deliver promised benefits. Higher taxes become impossible, and financial markets (that is, savers) refuse to lend. Or both.

Will that happen -- and if it does, what then? No one knows. But this is the issue facing almost all advanced societies. It's not capitalism versus compassion, as Soros implies, but where to draw the lines between market power and government power for the larger good. The good of market capitalism occurs because it maintains "incentives." People and companies profit from their successes and suffer for their blunders through a random process of buying and selling. The incentives remain powerful. In 1996 the Forbes 400 included 43 new people. Three quarters of them made it because they had built businesses, from billboards to software.

But because the market is unsettling and often unfair, all modern societies have tempered it through welfare and regulation. In 1913 government spending was only 8 percent of GDP in the United States and 9 percent in France. Governments are now torn between the impulse to intervene and the knowledge that too much intervention can backfire. (Indeed, "free market" philosophy has truly surged only in the former Soviet bloc, China and India, where intervention was pervasive.)

Soros might have advanced this ongoing debate with specific ideas over where government is -- and isn't -- needed. Instead, he delivers drivel. Editor Whitworth should have heeded the Jordan principle; that he didn't makes The Atlantic a dupe to Soros's grander ambitions. Yes, this is the same Soros who helped finance California's pro-marijuana campaign and whose charities reach around the world. Others will judge his politics and philanthropy. But as an economic prophet Soros is no more entitled to be taken seriously than Jordan is to play major-league ball. Unless he makes sense, we shouldn't listen.

GRAPHIC: Picture, no caption

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