



## **BOOK REVIEW**

### **THE CRISIS OF GLOBAL CAPITALISM: OPEN SOCIETY ENDANGERED**

*By George Soros, London: Little Brown and Co., 1998, ISBN 0-316-849162 (Hardback), 0-316-849545 (c – Format), 245 pp.*

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The author claims that his motivation to write this book is rooted in his realization that in the post cold war era the real threat to capitalism is from within, and to present this idea systematically he had already planned to write a book but, “. . . was doing it in a leisurely fashion . . .” (p. xi). However the Asian financial crisis that started from Thailand in July, 1997 made him realize the urgency to put his thoughts together quickly and present it to the world. Consequently, he contacted the publisher on September 22, 1998 and it was agreed that the book would be ready for shipment on November 18, 1998 (p. v).

The author’s basic premise is that we live in a global capitalist economy in which “Interest rates, exchange rates, and stock prices in various countries are intimately inter related, and global financial markets exert tremendous influence on economic conditions. Given the decisive role that international financial capital plays in the fortune of individual countries, it is not inappropriate to speak of a global capitalist system,” (p. xix). Given the existence of a global capitalist system he points out that, “The development of a global economy has not been matched by the development of a global society,” (p. xx). By the term ‘global society’ the author implies a global network of international institutions founded by the mutual consent of nations to regulate the global financial markets based on mutually agreed upon rules. Instead, he recognizes that the key player remains the nation state which is not well equipped to deal with the global capitalist system, consequently, “Global financial markets are largely beyond the control of national or international authorities,” (p. xx).

Soros acknowledges that those who express concerns about this lack of a control mechanism of global financial markets are confronted by the proponents of global capitalism who strongly believe in the economic theory which argues “. . . that markets are self correcting and a global economy can flourish without any need for a global society,” (p. xx). This line of argument reflects the belief that the best way to serve common interest is to allow everyone to promote their own interests and any attempt to protect common interest by collective decision-making distorts the market mechanism (p. xx). The zeal with which this classical idea of self-correcting markets is being pushed on the

global economy as a panacea makes Soros declare it as “market fundamentalism” (p. xx). He considers market fundamentalism to be a serious threat to global capitalism as it seeks to impose, “. . . the supremacy of market values over all political and social values,” (p. xxvii). If market forces and market values are allowed to gain this dominance they could ultimately lead to the downfall of the global capitalist system.

In his discussion of market fundamentalism, he acknowledges that market capitalism is as bad as Marx and Engels had predicted, but argues that communism’s fault was that it abolished the market mechanism and imposed collective control over all economic activities. The success of the West, on the other hand, was in combining market with collective decision-making (i.e., democracy) which ensured a healthy balance between market values and social values. But now market fundamentalism has become a serious threat because it ignores collective decision-making and social values; and, instead, worships at the altar of individualism. An individual, when pursuing his goals in a capitalist system based on market fundamentalism, is concerned about his success only. It is interesting to see Soros taking a high moral ground here by criticizing those who practice market values as against social values, because in his fund management activities he can be found guilty of practicing the market values too. One would hope that with this new realization Soros would at least either regret or apologize for his past fund management record. But one is dismayed to find him justifying that record in the same breath in this book. He justifies it by saying, “But if I had tried to take the social consequences into account, it would have thrown off my risk/reward calculations and my chances of success would have been reduced,” (p. 196). He wastes no time to go beyond justification and claim that whatever he did was actually within the rules: “As an anonymous participant in financial markets, I never had to weigh the social consequences of my actions. I was aware that in some circumstances the consequences might be harmful but I felt justified in ignoring them on the grounds that I was playing by the rules. The game was very competitive and if I imposed additional constraints on myself I would end up as a lose,” (p. 196). These blatant contradictions make an informed reader wonder about the purpose behind his book.

By acknowledging that under the global capitalist system the conflict between the individual’s self interest and the interests of the society is very much alive and heating up, Soros uncovers the deep and wide cracks in the philosophical foundations of capitalism which, everybody believed, had been patched firmly and permanently by Adam Smith in his seminal work *The Theory of Moral Sentiments*. This realization is an eye opener and presents a serious challenge to those who believe in the ‘end of history’. In *The Theory of Moral Sentiments*, Adam Smith had established that a rational individual will not hurt the interests of the society. In his zeal to prove this point, Smith ignored the possibility of a situation where a rational individual actually would hurt the interests of the society to maximize his own interests. The issue therefore is: what should be done if there are those who actually practice

market values and maximize their own well being at the cost of the society, and claim to have done so within the existing rules. In response to this issue Soros had two choices. Either he could have said that such practices are wrong and these people should never indulge in such practices, or he could have said that the rules should be changed to prevent them from such acts forever. But Soros the intellectual (and also the author of this book) comes out with an ingenious third response. He indirectly points out that Soros the fund manager (practitioner of market values) can play Robin Hood by becoming Soros the philanthropist, championing the charitable causes, and thus be absolved of the guilt of practicing market values at the cost of the society. He acknowledges this by saying, "In 1979 when I had made more money than I had use for, I established a foundation, called the Open Society Fund. I defined its objectives as helping to open up closed societies, helping to make open societies more viable, and fostering a critical mode of thinking," (p. x).

As a logical consequence of the loss of faith in the individual's credibility to rationally harmonize his self interests with that of the society's due to the domination of market values, Soros now turns to the collective decision making process in the democratic societies in this regard. Can the (democratic) governments play an effective role in formulating and implementing rules which would ensure that individuals, operating under fundamentalistic market conditions, do not harm the interests of the larger society as happened during the Asian financial crisis of 1997? Answering this question in the light of his own experiences and observations, he does not seem to be very hopeful. This is because, "Although we are justified in playing by the rules, we ought also to be concerned with the rules by which we play. Rules are made by the authorities, but in a democratic society the authorities are chosen by the players," (p. 197). The voters' power to decide on the political fate of a candidate makes the political leaders hostage to various interest groups. "The candidates in turn attempt to appeal to voters' individual self interests. Since the candidates cannot satisfy all interests, particularly if they are in conflict with each other, they are practically forced into striking bargains with particular interests," (p. 201). He concludes by saying, "The corruption is complete when money comes into play. Certainly in the United States, only candidates who strike bargains with particular interests can get enough money to get elected," (p. 201). Thus, with a single stroke of the pen he rules out the very idea of introducing rules that will prevent money speculation.

Soros' argument that market fundamentalism is a threat to global capitalist system is reinforced when one looks at the causes of the Asian financial crisis of 1997. The book devotes one full chapter (Chapter 7) to this issue. He shows that in this crisis institutional investors, foreign banks, national private financial institutions and central banking authorities of various affected countries were responsible to varying degrees. He believes that the only way to check global financial instability is through a supra national system of regulation, when he says: "To stabilize and regulate a truly global economy, we need some global system of political decision making. In short, we need a global society to

support our global economy. A global society does not mean a global state. To abolish the existence of state is neither feasible nor desirable; but in as far as there are collective interests that transcend state boundaries, the sovereignty of states must be subordinated to international law and international institutions,” (p. xxix). In Chapter 8 entitled, **How to Prevent Collapse**, his main thrust is on the reform of the IMF. He proposes the establishment of an International Credit Insurance Corporation (ICIC) which could be either a part of the IMF or separate from it (p. 177). The ICIC would provide an international loan guarantee to the member countries borrowing in the international capital market. The proposal is very general and sketchy, and lacks specifics. Soros hopes to give a new shape to the IMF with this proposal. In this new role he envisions the IMF to be a kind of international central bank (p. 183). In this role, one of the important duties of the IMF would be to closely monitor the banking systems of the borrowing countries which “. . . would be obliged to provide data on all borrowings, public or private, insured or not,” (p. 182). He continues by saying that, “In short, the banks would have to be as closely regulated as U.S. banks were after the breakdown of the U.S. banking system in the panic of 1933,” (p. 183).

Soros admits that his approach is flawed and will come under serious criticism when he says that, “It is much more questionable whether such a scheme is politically feasible. There is already a lot of opposition to the IMF from market fundamentalists who are against any kind of market intervention, especially by an international organization,” (p. 184). Besides the distaste of market fundamentalists for market regulation, who are mainly concentrated in the North, Soros should have also appreciated the issue of the sovereignty of the borrowing nations (which happen to be mainly from the South) when proposing the international central bank. This issue becomes more thorny given the reality that the IMF itself is controlled by a handful of countries of the North which are at the center of the global capitalist system.

Soros also ventures into the realm of economic theory. In this context he elaborates his main framework of analysis which he calls ‘reflexivity’. The central idea of ‘reflexivity’ is that, given a certain phenomenon, the participants develop a certain set of expectations but when they act on that basis the outcome may change due to their action, and turn out to be different from what they had expected. Soros states that, “If a statement corresponds to the facts, it is true; if not it is false. Not so in the case of thinking participants. There is a two way connection. On the one hand, participants seek to understand the situation in which they participate. They seek to form a picture that corresponds to reality. I call this passive or *cognitive function*. On the other hand, they seek to make an impact to mould reality to their desires. I call this active or *participating function*. When both functions are at work at the same time, I call the situation reflexive,” (p. 7). It is the interference of the above two functions with each other due to which the dynamics of reflexivity may result in an outcome which is “. . . liable to diverge from their expectations,” (p. 7). In Chapter 3 of the book, he argues that financial markets are prone to

reflexivity. If participants in the stock market or foreign currency markets expect a decline in the market value (of a certain stock/currency), they will sell. As they all sell with this bias, prices fall further and beyond their expectations. Soros criticizes economics on the ground that it ignores reflexivity, "I have no quarrel with economics itself, as far as it goes, except that it does not go far enough. It leaves out of account the reflexive connections between market developments and conditions of demand and supply," (p. 42). This criticism comes as a surprise to economists as, generally, all recent literature on financial markets incorporates the idea of interdependence between the market prices and the expectations of the participants. Similarly, he strikes off the rational expectations theories about efficient markets as simply irrelevant, by saying, "I have to confess that I am not familiar with the prevailing theories about efficient markets and rational expectations, I consider them irrelevant and I never bother to study them because I seemed to get along quite well without them. . ." (p. 41). Such an extremist view of Soros on the crucial economic ideas may be difficult for economists to swallow, but one needs to be understanding here as Mr. Soros is not an economist himself, and has a right to have his own opinion on an issue so dear to the heart of economists.

The book's entire thrust is on the supervision and control of national banking and financial systems of the borrowing countries through international channels, and even that is subject to controversy as admitted by the author himself. There is little insight provided on the dynamics and strategies of institutional investors and their speculative activities, and its consequences for the stability of the financial system and the economies of developing countries in the global capitalist system. Similarly, the issue of regulating these speculative activities is also totally ignored by Mr. Soros. Anybody who bought this book with that goal in mind would be greatly disappointed after reading it. Mr. Soros has not shared his skills, insights and wisdom in this regard with the readers in this book. This is a major flaw of the book. One gets the impression that in the aftermath of criticism that was labeled against the foreign short-term institutional investors following the 1997 Asian financial crisis, this book is an attempt to defend them, and hence, leaves the reader with more questions than it answers.

The book makes a valid point when it argues that in democracies, governments lack the political will to change the rules of the game due to the influence of pressure groups. If this is true, and in reality it is, then Soros' proposal for the IMF reform is in serious trouble because, on the one hand, the governments, under the influence of pressure groups, would be unwilling to support it. On the other hand, the 'nation state' sentiment would also have kept the countries from pursuing it.

It is not uncommon to observe that sometimes a vast amount of literature is produced in response to a certain shock or crisis, but since the quantity does not necessarily imply quality, most of this type of literature is forgotten as the crisis fades away. When seen in this context, this book is one such contribution in response to the Asian Financial Crisis of 1997. However, the true value of

this work can be appreciated when our focus is not confined to the above crisis alone, and the book is instead seen in the larger context of the *future of capitalism* itself.

The last quarter of the 20<sup>th</sup> century has been a fascinating one. The fall of the Berlin wall and the triumph of both capitalism and democracy had given a new hope and healthy optimism for the future of humanity. In the post cold war era the sharp decline in oil prices helped foster the prosperity of the North which further strengthened the case in favor of capitalism. The 1991 Invasion of Kuwait by Saddam Hussein and the 1997 Asian financial crisis, both resulted in a massive transfer of resources from the South to the North. Given all these grand achievements to its credit, one expects capitalism to receive an excellent report card from the leading contemporary intellectuals of the West, but as the reality is slowly sinking in, the mood is changing. Immediately after the collapse of socialism, the euphoria led the western intellectuals to believe that the ideological evolution of humanity had reached perfection in the form of capitalism and western liberal democracy and, hence, Francis Fukuyama argued in favor of *The End of History* (1992). Those who knew that there were inherent weaknesses in the capitalist system and that the continuous high growth of the post colonial West rested partly on its defense expenditure and military hardware sales to conflict-ridden third world regions coupled with occasional massive transfers of resources from the South to the North, were alarmed by Fukuyama's thesis of global peace and one world of harmony. They feared that if accepted, Fukuyama's vision will spoil the party. Hence, Fukuyama's thesis was challenged by Samuel Huntington (1996) who advocated a *clash of civilizations*. Huntington's thesis was pushed on to support huge military expenditures by the North and also to justify the ongoing squeeze of resources of the Islamic civilization by legitimizing and perpetuating a vast network of undemocratic regimes in the Muslim world. Being a historian, Huntington knows all too well that the existence of a healthy democracy can rescue a civilization from its fall, while in its absence the march of folly will continue. This constructive role of democracy is beautifully articulated by Huntington himself when he says, "The open societies of the West have great capacity for renewal," (p. 83). However, as the jubilant celebrations on the triumph of capitalism have subsided and reality has slowly started to sink in, the Western intellectuals find themselves struggling with the problems and inherent weaknesses of both capitalism and liberal democracy. In this regard, the first pioneering contribution with a consistent methodological framework, and with an eye on the 21st century, was produced by Lester Thurow (1996) entitled, *The Future of Capitalism: How Today's Economic Forces Shape Tomorrow's World*. In this book, Thurow predicted that both capitalism and liberal democracy have inherent weaknesses that will threaten the West from within and their correction will require a systemic reform which will be a daunting task. It is in this context that one can appreciate Malaysia's stand on the Asian financial crisis and her demands for the reform of international financial architecture. Seen in this background, Soros' book is a strong endorsement of

Thurow's prediction about the uncertain future of capitalism. However, what is lacking in Soros' book is concrete suggestions and a global perspective. A truly global perspective is a holistic one and is equally concerned with the well-being of both the North and the South. Perhaps, this is an area where further intellectual discourse is urgently needed, i.e., discussions of global capitalism should also develop a global perspective where concerns for the well-being of both North and South should be addressed as mutually inclusive, and not as mutually exclusive, which is currently the case.

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