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Why Soros Has It Wrong

From *Why the Markets Can't Fix Themselves* by George Soros:

> *Market fundamentalism ["laissez-faire,"] is a false and dangerous ideology. It is false on at least two counts. First, it profoundly misapprehends the way financial markets operate.* ***It assumes that markets tend toward equilibrium and that equilibrium assures the optimum allocation of resources.*** *Academic economists have proceeded far beyond general equilibrium--multiple equilibriums (sic) are all the rage now--but market fundamentalists continue to believe they have solid science behind them, not just economics but also Charles Darwin's theory of survival of the fittest.* ***Second, by equating private interests with the public interest, market fundamentalism endows the pursuit of self-interest with a moral quality.***
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> *But if financial markets do not tend toward equilibrium, as the theory of reflexivity maintains, private interests cannot be equated with the public interest. Left to their own devices, financial markets are liable to go to socially disruptive extremes.*

This last paragraph is a total non-sequitur.

As Soros stated previously, markets are amoral. People go to markets to buy and to sell. They go to church or chapel to pray. Usually, when people try to influence markets for moral purposes, they tend to achieve nothing and often the opposite of their aims. The war on drugs is an example of the futility of mixing markets and morals. So was Prohibition and, mercifully, the American public finally woke up to the ghastly mistake they had made. The Cuban embargo is also a total failure. America's NAFTA partners are more than happy to trade with Cuba. A funny thing happened in South Africa during Apartheid. Some companies boycotted South Africa and others continued to do business there. When Apartheid mercifully ended, the companies that boycotted the white regime should have been welcomed with open arms. What happened is that the companies that continued to do business in South Africa despite the hateful politics, controlled the markets when racism ended and they continue to hold those markets. There was no mercantile payback for the boycotters.

There is no such thing as **public interest** apart, separate and distinct from individual interest. Public interest is the sum total of individual interests. Yes, there will be disagreements within society because some private interests are contrary to some other private interests but these reasonable differences between reasonable people have to be resolved by them, sometimes with the help of a Salomon or a court of law. If you have a hard time understanding this concept, I urge you to read *The Virtue of Selfishness* by Ayn Rand.

Paul Philp said:

> *I think he his searching for a complex systems-based model of financial markets.*

I don't think so. He is talking about complicated systems but not about complex systems. Never once did he use the word "complex" in his essay. Despite the fact that he talks about the lack of a single equilibrium point, the hallmark of classical economics and diminishing returns, he is not talking about complex systems. Here is what he says:

> *The prevailing wisdom holds that markets tend toward equilibrium--i.e., a price at which willing buyers and sellers balance each other out. That may be true of the market in widgets, but it is emphatically not true of financial markets. In financial markets a balance is difficult to reach because financial markets do not deal with known quantities; they try to discount a future that is contingent on how they discount it at present. What happens in financial markets can affect the economic "fundamentals" that those markets are supposed to reflect--which is why recent years have produced such a dramatic and seemingly irrational stock market rise, followed by an equally dramatic and seemingly irrational fall. Instead of a one-way connection between supply and demand via market prices, there is a two-way connection: Market prices can also alter the conditions of supply and demand in a*

> *circular fashion.* ***In my 1987 book The Alchemy of Finance, I called this two-way connection "reflexivity." And I think it better explains the current turmoil in financial markets than the more commonly accepted idea of equilibrium.***

No, "reflexivity" is not the answer. It is not a two way game but a multi agent game. But that does not mean that all agents directly affect all other agents. Agents affect their nearest neighbors with whom they have contact. The effect then moves outward like the ripples in a pond. A very good model is to be seen in **Boids.**

One of the difficulties that Soros is exhibiting is that he is looking for a damping mechanism, something that will prevent economies and countries from dying. He wants a lender of last resort to revive dead economies and dead countries. That is a hopeless task. The dead should be buried lest they stink up the place. As the English say, "The King is dead. Long live the King!" They bury the old king and get on with the new one.

Yes, countries die. The military Japan of the Samurai was killed by MacArthur [maybe they committed hara-kiri when they attached Pearl Harbor] and the old Japan has been replaced with a new Japan where the merchant class and not the military are in command. The NAZI Germany where I was born also was killed by the allies and has been replaced by a new democratic country. Colonial America was killed by the Revolutionary War and a new Union was born. Italy is not Rome. Greece is not Athens. Where is the Soviet Union buried?

We have to let dead countries die and we have to speed their burial so that a new country can take its place. Pinochet, with the help of the CIA, killed socialistic Chile and, with the help of The Chicago Boys, created a new capitalistic and very successful Chile.

Anyone who tries to tame the business cycle or who tries to keep alive dying countries just plain does not understand the way the world works. One of the best analogies of the way countries and economies work is the sand pile. As you slowly pour sand you start building a pile. With each grain the pile grows but every once in a while you get an avalanche. Some avalanches are small while others are large. You can never tell which grain of sand will produce an avalanche and you have no way of knowing if the next one will be small or large. Plot the avalanches and you get a so called "Power Curve" with many small ones and a few large ones. The Mother of All Chasms was a very large avalanche. All complex systems exhibit this phenomenon. The extinction of the dinosaurs was a mayor avalanche. Lots of species disappear all the time but they tend to be small avalanches.

Soros trying to fix the world is as wrong as a green trying to save the world. Complex systems grow by fits and starts with lots of small and large avalanches for excitement.

Soros is a master investor but a clueless economist. Who was that other master investor who made his alma matter rich by playing the market in bed during half an hour a day? He too has been discredited as an economist.

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