Title	*A Panel Discussion with George Soros*
Description	Lessons from Financial Crises: Paradigm Failure and the Future of Financial Regulation In October, George Soros delivered a week-long series of lectures at the Central European University in Budapest discussing his latest thinking on economics and politics, and the way forward out of the current financial crisis. Soros argued that while the magnitude of the credit and leverage problem faced today is greater than in the Great Depression, the artificial life support given to the financial system has been successful. However, Soros believes that the recovery may run out of steam and sees a possibility for a "double-dip" in the next year. At this event, George Soros will lead a panel discussion to reflect on some of the key ideas that he put forward in those lectures. He will particularly invite discussion among both the panellists and the audience to engage with his ideas and understand the alternative they represent when compared with traditional economic theory.
Presenter(s)	Paul Beaudry, Ian Goldin, Roger Goodman, Anatole Kaletsky, David Soskice and George Soros
Recording	http://www.21school.ox.ac.uk/downloads/podcasts/200912_soros.mp3
Keywords	21school, economics, soros, panel, L100, 2009-12-11, 1
Part of series	*Public Lectures and Seminars from the James Martin 21st Century School*

Ian Goldin Good morning and welcome to The Sheldonian Theatre; delighted that so many of you have come today. The 21st school, of which I'm the director, is working on the great changes of the 21st century.

One of the things we've come to realise is that as George Soros has said "Uncertainty is pervasive." We are no better at projecting the future now than we were in the 1950s and a thick pea fog such as that we've had this morning affects airlines in the same way as it did in the 1950s.

So unfortunately Soros's plane was diverted to Bristol. He is on his way, as you might have picked up in the news this morning he was in Copenhagen last night where he was working on a hundred billion dollar fund for developing countries to address climate needs so I think we recognise that he needed to be in Copenhagen last night.

We expect him here between 11.30 and 11.45 but the show will go on and we hope that we will keep you intellectually challenged over this period and as soon as he arrives he will address you.

So what we're going to do is we're going to begin with a ten minute audio of his recent talk on reflexivity which will provide the context for what he would have said I think and give you some of the perspectives that he would offer us. And then we'll move to the panel discussion on that and then as soon as he arrives we'll break, the VC will come up and introduce him.

So let's begin with the audio of George Soros speaking in Budapest a few weeks ago.

George Soros In the course of my life I've developed a conceptual framework which has helped me both in making money as a hedge fund manager and in spending it as a policy oriented philanthropist.

But the framework itself is not about money, it's about the relationship between thinking and reality, a subject that is extensively studied by philosophers from early on.

I started developing my philosophy as a student at the London School of Economics in the late 1950s. I took my final exams one year early and I had a year to fill before I was qualified to receive my degree. I could choose my own tutor and I chose Karl Popper whose book 'The Open Society and its Enemies' had made a profound impression on me.

In his books Popper argued that the empirical truth can't be known with absolute certainty. Even scientific laws can't be verified beyond a shadow of a doubt, they can only be falsified by testing. One failed test is enough to falsify but no amount of confirming instances is sufficient to verify.

Scientific laws are hypothetical in character and their truth remains subject to testing. Ideologies which claim to be in possession of the ultimate truth are making a false claim; therefore they can be imposed on society only by force. This applies to communism, fascism and National Socialism alike.

All these ideologies lead to repression. Popper proposed a more attractive form of social organisation, an open society in which people are free to hold divergent opinions and the rule of law allows people with different views and different interests to live together in peace. Having lived through both Nazi and communist occupation here in Hungary, I found the idea of an open society immensely attractive.

While I was reading Popper I was also studying economic theory and I was struck by the contradiction between Popper's emphasis on imperfect understanding and the theory of perfect competition in economics which postulated perfect knowledge. This led me to start questioning the assumptions of economic theory.

These are the two major theoretical inspirations of my philosophy. So here it goes: today I shall explain the concept of fallibility and reflexivity in general terms. Tomorrow I shall apply them to the financial markets and after that to politics. That will also bring in the concept of open society. In the fourth lecture I shall explore the difference between market values and moral values and in the fifth I shall give some predictions and prescriptions for the present moment in history.

I can state the core idea in two relatively simple propositions. One is that the situation that has thinking participants, the participant's view of the world is always partial and distorted, that's the principle of fallibility.

The other is that these distorted views can influence the situation to which they relate because false views lead to inappropriate actions. That's the principle of reflexivity.

For instance treating drug addicts as criminals creates criminal behaviour. It misconstrues the problem and interferes with the proper treatment of addicts. As another example declaring that government is bad tends to make for bad government.

Both fallibility and reflexivity are sheer common sense. So when my critics say that I am merely stating the obvious they are right up to a point. What makes my propositions interesting is that their significance has not been generally appreciated.

The concept of reflexivity in particular has been studiously avoided and even denied by economic theory. So my conceptual framework deserves to be taken seriously not because it constitutes a new discovery but because something as commonsensical as reflexivity has been so studiously ignored.

Recognising reflexivity has been sacrificed to the vain pursuit of certainty in human affairs, most notably in economics. And yet uncertainty is the key feature of human affairs. Economic theory is built on the concept of equilibrium and that concept is in direct contradiction with the concept of reflexivity. As I shall try to show you in the next lecture the two concepts yield to two entirely different interpretations of financial markets.

The concept of fallibility is far less controversial. It is generally recognised that the complexity of the world in which we live exceeds our capacity to comprehend it. I've no great new insights to offer.

The main source of difficulty is that participants are part of the situation they have to deal with. Confronted by reality of extreme complexity we are obliged to resort to various methods of simplification: generalisations, dichotomies, metaphors, decision rules, moral precepts, to mention just a few. These mental constructs take on an existence of their own, further complicating the situation.

The structure of the brain is another source of distortions. Recent advances in brain science have begun to provide some insight into how the brain functions and they have substantiated Hume's contention that reason is the slave of passion.

The idea of a disembodied intellect or reason is a figment of our imagination. The brain is bombarded by millions of sensory impulses but consciousness can process only seven or eight subjects concurrently. The impulses need to be condensed, ordered and interpreted under immense time pressure and mistakes and distortions can't be avoided. Brain science adds many new details to my original contention that our understanding of the world in which we live is inherently imperfect.

The concept of reflexivity needs a little more explanation. It applies exclusively to situations that have thinking participants. The participant's thinking serves two functions; one is to understand the world in which we live, I call this the cognitive function. The other is to change the situation to our advantage. I call this the manipulating or participating function.

The two functions connect thinking and reality in opposite directions. In the cognitive function reality is supposed to determine the participant's views. The direction of causation is from the world to the mind.

By contrast in the manipulative function the direction of causation is from the mind to the world. That is to say the intentions of the participants have an effect on the world.

When both functions operate at the same time they can interfere with each other. How? By depriving each function of the independent variable that would be needed to determine the value of the dependent variable, because when the independent variable of one function is the dependent variable of the other neither function has a genuinely independent variable. This means that the cognitive function can't produce enough knowledge to serve as the basis for the participant's decisions.

Similarly the manipulative function can have an effect on the outcome but can't determine it. In other words the outcome is liable to diverge from the participant's intentions. There is bound to be some slippage between intentions and actions and further slippage between actions and outcomes. As a result there is an element of uncertainty both in our understanding of reality and in the actual course of events.

Ian Goldin Good, well I'm delighted to be joined on the stage by a group of people who I think I could wish for no better in thinking about Soros's ideas and helping us understand what they mean for different disciplines and of course for the University of Oxford.

I'd like to first ask Professor Roger Goodman who himself is a Professor of Japanese Studies but is also now the head of the Social Sciences Division at the University of Oxford to begin with his comments on and reflections on Soros's ideas.

Roger Goodman Well thank you very much, it's a slightly unusual experience to be sitting here next to a chair that's empty, it's a bit like a Malcolm Bradbury novel scene but let me just comment a bit on what we've just heard.

Perhaps I should preface my comments by saying unlike the rest of my colleagues on the panel I'm not an expert on finance although I should quickly hasten to say in front of the vice chancellor I can understand finance as I'm charged with the Social Sciences Division's budget.

But I'm a social anthropologist who specialises on Japan and there was some resonances in what George Soros said just now and what he's written which simply strike with both anthropologists and those who work on Japan but particularly I'd like to talk about the relationship between what George Soros is thinking and social science more broadly and his concept of reflexivity.

Social science as many of you will be aware – and I'm talking about social science here in the broadest sense of everything from law through to archaeology, psychology, through to business studies – is essentially the relationship of the study between the person and society.

And the key question since the European Enlightenment essentially has been this relationship between how people construct the world, the society around them, through ritual and symbolic systems, what George Soros called just now the 'manipulative function' and how those societies and worlds that they've constructed come to restrain their activity, what he called the 'cognitive function'.

And the key problem for social scientists in whatever field has been to understand what is meant by a person in a particular space or a particular time, what anthropologists have called 'the study of personhood' and what is defined as a society in a particular space, in a particular time since these as we all know are ever changing and highly contestable social constructions.

So an anthropologist would take as a given, as we're hearing, from the premise that what we call the person is divided between a self or an ego which should be understood as being separate from the persona or the role that that person is performing in a society.

And many of you will be familiar with the famous work of Marcel Mauss, 'The Category of the Person' who talks about the conflation of the ego and the persona into the concept of the individual, which lies at the heart of a lot of current economic thinking as of being a relatively recent invention. Indeed the philosopher Alan Macfarlane relates it to the development of proto-capitalism in certain Western societies.

Now for me what I found fascinating about George Soros's ideas of course is that the resonances are quite strong with much of the literature in the 1980s about the development of the Japanese capitalist system, which seemed to be based on very different ideas of the person and the relationship between people from capitalist systems that had developed in the West.

And there was a big literature on all the newsstands in airports in the 1980s trying to explain the basis of this different form of capitalism and why it worked and what the underlying assumptions were. And as you'll know because many of you will have read it, it would tell you that the Japanese word for different was the same as the Japanese word for wrong, that the Japanese word for the individual was the same as the Japanese word for selfishness and that the idea of rights in Japan was a relatively underdeveloped concept.

One of my favourite books talked about how in Japanese society – no, in Western society people were considered to be mature when they could do things by themselves and how in Japan nobody was considered to be mature until they realised they could do nothing by themselves, that they were dependent on other people in order to make social interactions work.

Now what's interesting, and this is why I think George Soros's ideas are so important, are these very different assumptions about the person, or what constitutes personhood, leads to very different ideas about economic exchange.

The Japanese model we were told at the time was based on very long-term effective relationships. They believed that people were basically good; they weren't self-maximising individuals who were looking always for the short-term rational return.

People in Japan didn't have contracts; there was a society that was based on an idea of 'kintract' and the workplace as an ideology was seen as a kind of extended family.

So anthropologists were taking it for granted for a long time that in societies the economic system should not be seen as separate from other spheres of life but deeply embedded in it, in the religious system, the kinship system, the political system and the cultural system. The idea of being an economist looking at the economy as something quite separate from these other spheres would be considered as rather strange.

And in many ways I would suggest that some of the triumphalism that I've found in some of the Western literature following the progress in the Japanese and the other tiger economies in the 1990s was because in a sense it shouldn't have worked because it didn't follow the normal economic models.

So what I take from George Soros's comments and very interesting ideas is not that one economic model is better than another economic model, rather that we need to be, to use his word, reflexive about our underlying assumptions about the very nature of what it means to be human and of the nature of human exchange when we want to make predictions about economics and economic functions.

In many ways I see this as a kind of clarion call for economists to if you like come back to the mainstream of social science and to eschew the models of natural sciences. He uses a wonderful expression in one of his papers of 'physics envy'. That social scientists want to be like the natural scientists, they want to measure themselves.

And it's asking us to come back and try and look at the social context in which economic structures actually develop and work and evolve. And of course as head of the Social Sciences Division in Oxford I think this is a wonderful message and I wish he was here so that he could hear that at the moment and I'm looking forward to him arriving in a few minutes. Thank you very much.

Ian Goldin Thank you very much Roger. We will make sure that conversation happens with George and I think it's absolutely reflective of his ideas.

Professor David Soskice is a research professor at Duke University. An interesting economist who was a professor of economics in London – now he's a professor of political science – he has written with Wendy Carlin recently really excellent macroeconomic introductory textbooks – well not so introductory textbooks – and has worked in many areas of economics and political science.

He's now at Nuffield College, we're fortunate to have him in Oxford and he's extremely well placed to think about the relationship between economics and politics and George Soros's ideas.

David Soskice Thank you very much. I share a great many of the thoughts which Roger Goodman so elegantly pointed out and I want to as it were go from many of those things to the notion that the financial crisis has exposed a crisis in the social sciences or at least exposed a major problem which has probably been in the social sciences for a long time and this is despite the great advances which have been made in the last 30 years in the social sciences, in economics, political science and in sociology.

But the major problem comes out of that because as I see it there is a real absence of well grounded big picture analyses of major events including obviously the financial crisis and an analysis which can integrate different social scientific disciplines.

Now there are marvellous exceptions to this. Whatever we may feel about Paul Krugman I think he's a tremendous example of someone who can do this. I think the late and very much lamented Oxford economist Andrew Glyn was another person who could make these very big pictures become clear to us. But we seem to have lost this ability. I'm not sure whether we ever had it but I sort of imagine that in the 50s and 60s we could think in this sort of way.

And it's clear that part of the reason why we've lost it has been because of the way research is now done. So I should say I'm not attacking social science research, my own research is very dependent on it, but it has been a price of the way in which research is now done that it's become increasingly specialised and technical. It's much harder to talk across boundaries of disciplines, even of sub-disciplines.

One might even use this very interesting idea that Mr Soros has in his lecture that markets can drive fundamentals and the idea being I take it that everybody in a market could acquire a belief about what they see as a fundamental and that belief then as he puts it eliminates this equilibrium between prices and fundamentals.

PPE offers a good example if one looks at it historically as to how the different social sciences have in many ways moved away from each other. Indeed bits and pieces of economics or particularly political science have themselves to some extent fragmented.

When PPE was set up in the early 1920s it was initially called Modern Greats and the idea was that you would have a – you'd give people tools of analysing holistically their own society, looking at economics and politics and philosophy in the same sort of way as people who did Greats were supposed to have the holistic tools to look at classical civilisation, to look at the history, the philosophy, at the literature, even the law of classical societies.

We've clearly in PPE – which I taught for many, many years in Uni – we've clearly moved away from that capacity of really integrating the different parts of the subject `[[?? 0:25:40]]`.

I did a class recently with a group of political science graduate students looking at the crisis and asking whether we could – how we would analyse the crisis and when I thought about it beforehand and when we talked about it it was clear that there were a whole number of different aspects of the economy which we needed to know about.

We needed to know about how modern political systems worked and how they'd evolved. We needed to know about how regulation and deregulation worked and why it was that in the American political system deregulation could be pushed at a certain point but couldn't have been pushed beforehand.

We needed to know about modern macroeconomics certainly and modern international macroeconomics. We needed to know about how financial systems worked, how financial crises actually imploded in the way in which they did. And above all we needed to have a rather good knowledge of economic history over quite a long period through the 20th century.

Now very, very few people learn that as a matter of course in the way in which they're educated nowadays and that I think has led to a situation where we no longer have, if we ever did have, a capacity for putting things together and I believe that this is something we should be thinking in terms of.

Ian Goldin Great, thanks very much David, we'll try and get you back to economics.

Paul Bodrie, Professor Paul Bodrie, is a recent arrival in Oxford. We managed to recruit him to our economics department from the Canadian Central Bank and the University of British Columbia. He's also at All Souls and he's one of the recent recruits to Oxford that has a very broad understanding of economics, so Paul you have the floor.

Paul Bodrie Thank you. Well it's certainly a pleasure being on this panel and I took part of the role of this panel to try to favour some discussion and maybe some controversy so I'm going to try to emphasise a few things that also I think a little bit different with Mr Soros. So I'll try to say where I think he's viewing, I'm going to concentrate a lot on the view of the crisis and the view in economics in general.

Now at the same time I do want to say that I actually agree with a lot of the aspects that Mr Soros is kind of putting forward, certainly it's a great time to be thinking kind of deeply about the issues in economics, of rethinking our system.

I also think he has a very good view – and we didn't get to hear him on this – but thinking about how we have boom and bust cycles, how bubbles form, he talks about this notion of reflexivity, how our actions often hide kind of certain realities and this actually generates these bubbles where we can't understand really what's happening because our actions actually hide the things behind it and kind of make it self-fulfilling. These are very interesting ideas.

I'd even go further in this whole idea of booms and bust. I think booms and bust are a very – not only a natural part of our economy, they are actually almost an inevitable part – and I think here again noticing this notion of fallibility or kind of unknowns, we have to remember what's happening.

Our market economy is always kind of going forward and testing new technologies and looking at new markets and that means we're going in uncharted waters, we're going towards the unknown. And in that type of environment it shouldn't be too surprising that most booms, that are often started by some idea of something in the background that's moving, then end up by a bust, because it's actually only by seeing the bust that we learn these limits of these new opportunities.

Now these are all ideas that Mr Soros is trying to kind of promote and kind of lead us to think but I arrived at slightly different conclusions than him and those are the things I'm going to try to slightly emphasise just making this whole debate going here.

And here I kind of defer on the way we might want to think about policy from that on, and really noticing what the main failures of economics as a body of knowledge in this whole crisis really are. So let me start with policy front.

And I think here in terms of the policy front it's kind of helpful to make a caricature of kind of thinking about two policy frameworks that we might favour as we go forward from here.

And one we can think about it as real macro-stability. Now we might think of real macro-stability as actually being policy that tries to aim at mitigating this kind of boom/bust cycle that we see in the market economy. And we could think about that as putting it in like mandates of central banks where this is something that they should be looking to do.

And this contrasts with the current view in most central banks that it's much more kind of normal stability, it is inflation stability that's the focus. And so that's kind of one aspect we can think maybe looking forward we should be thinking about real macro-stability.

On the other hand there's this notion of financial stability and this is more of a constrained notion which is looking to try to understand and organise our financial system to stop getting it to kind of concentrate risk in certain areas and that we get blow-ups and that we need bail-outs.

And both these policies would kind of interact and help each other if we – this real macro-stability would help financial stability and back and forth.

But there are conceptually different frameworks and if I understand Mr Soros's views on this he kind of favours kind of going, I'd call it the broader sense of saying "Let's favour this real macro-stability aspect." And I'm a bit in the camp of saying "Maybe it's really you want to concentrate on this financial stability." And to try to make the contrast and where my views come from I think it's very important to contrast this recent boom and bust with the one that – kind of the Tech boom and bust.

So if we go back in the 90s and the early 2000s we actually had another big boom and bust cycle, it was a very huge cycle and now when we look back was it a bad outcome? Well if you look over all of that whole boom and bust of Tech it's hard to kind of see it as the whole thing being bad.

We went through a period where we developed new technologies; we had quite a high growth. Unemployment went down; actually inequality went down from – one of the rare times in the last 20/30 years.

Now it did finish with a huge increase in unemployment, or a wide increase, not nearly as big as this time. And when you look at that we could say "Oh isn't that a problem? We should be attacking it." Well you think "Well maybe if we would have stopped the boom earlier what would we have got, maybe just got unemployment earlier?"

But the special aspect of that boom and bust, it's not that there was an irrationality, it wasn't that there was kind of over optimistic expectations, what's good about that period is those that wanted to take risks took risks but actually paid the price of it.

This was a boom and bust that was financed by equity so people that had money kind of took a chance and when they lost they lost and they actually had through that process.

And that I think is really a good reflection of kind of how an open society tries to – and these are ideas that are important to Mr Soros – brings in people to have these diverging views and allows them to work, but they actually took responsibility.

When we look at this more recent case, the housing boom and bust, we're really in a different situation. Now if we thought about this housing boom and bust, if it would have been financed by equity would we be discussing this today? Probably not.

We'd still have probably had a recession, we'd have house prices going up, people being over optimistic, but if it was only people that actually had the money that were kind of investing in it, it would have been a lot like the Tech boom and bust and we would have had a downturn. It wouldn't have looked anything as bad as what things look like now. So it's all about financing, that's really the main difficulty.

And that's why I think the main issue when we're looking forward is really in terms of a policy paradigm that really focuses on thinking about how we improve financial market stability.

Now this brings me to the second issue: where did the economic profession get it so wrong in this part? And again here I actually agree with a lot of Mr Soros's view on – the economic profession pushed kind of notions that are kind of called rational expectation and efficient markets, way beyond kind of a reasonable stance, it really became absurd.

However that's not really where I think the biggest errors in the profession were, this is not where it was lacking the most. It's really, again, you know when I look back, when we think about it that way it kind of emphasises this bubble view and I don't think the way of thinking of this period was no-one was seeing that a bubble was possibly building on housing.

I spent a lot of time over this whole period at central banks around the world and almost everywhere I went people would be talking about this potential bubble kind of building but where everyone, or almost everyone, missed out is figuring out how costly the bursting of this bubble would be. It's not the bubble itself was the problem; it's the bursting of it. It's the misunderstanding of how the financial markets were working.

And here we really have a dichotomy. When we're talking about the social sciences not being tied together, even within economics, there's kind of this lack of what again Mr Soros might call reflexivity between macroeconomics and finance. In macroeconomics the notion of banking in financial intermediation hardly plays a role, it's almost like this little veil, it's almost crazy when you see how it's done.

And at the other extreme in finance we have all this teaching of finance without any implication of what it's doing to the macro-economy and how there's any interaction between the two. And these kind of areas have just been divided up and this has to be brought in.

So when thinking about a paradigm change in the future we have to be thinking about how we're going to move forward and I think we shouldn't only be looking kind of – at least within economics, in trying to explain bubbles, I think that's actually the easy part.

We have a lot of things like behavioural economics, `[[?? 0:35:40]]`, there's ways of learning; there's lots of aspects there that we can move forward. What is really needed in any paradigm shift is really a rethinking about what the financial market's doing, what kind of role is it doing for society? Why has it grown so much, why do we have all this inter-connectedness? Why does it happen so often that it concentrates risk at certain places?

These are all questions that - may be surprising for non-economists we don't actually have answers to this in economics. And I think that's where we should be going.

Ian Goldin Great. Thank you very much and it's great to hear someone from right in the mainstream of our economics department having such broad views.

Anatole Kaletsky is a fascinating journalist, he's written very, very widely on the topic, he's in the pillar of the establishment, the Times newspaper, but his views aren't always that orthodox and I'm delighted to have him here. He's worked very closely with George Soros and has many insights into his work.

Anatole Kaletsky Thank you very much. Well I agree very much with well actually pretty much everything that others have said but particularly with what Professor Bodrie was saying about the inevitability of booms and busts in financial markets and in economies more generally and actually in their desirability.

Booms and busts are an evolutionary process, they are a contributor to the process of creative destruction which of course people like Schumpeter have written about a lot in the micro sense, in the structure of industries and so on.

But one of the things that intrigues me is that neither economics nor economic history as an intellectual discipline has really thought about this same concept of creative destruction at the political, economic, at the societal level.

Because the economic system itself is subject to an evolutionary process whereby it changes not quite with the same frequency as individual industries, not on an annual or even a decadal timescale, but over the period of let's say 300 years of existence of market capitalism.

The system itself has changed as a result of political and economic crises and has emerged from each of these crises as a system that is still recognisably a capitalist market system but one that is very very different from the one that went before.

And as I'm very much an applied guy as Ian said I've spent most of my career as a journalist and now actually I make a fairly decent living as an economist very much in financial markets working for institutions including in the past Soros Fund Management. What I'm going to do is take advantage of this opportunity to be here in Oxford is not talk about any of these applied financial issues but talk about the broader intellectual and historical aspects on which of course I'm not expert.

Now it strikes me that these ideas of reflexivity and fallibility, as George said, are very relevant at the level not just of financial `[[?? 0:39:09]]` force of this evolution in the political economy of capitalism which has now been going on for 300 years.

But where I slightly disagree with George is that he stresses that perfect knowledge, including perfect knowledge about the future, is a critical assumption of equilibrium economics which it obviously is but I think he tends to think that it's a critical assumption of all forms of market economics, of capitalist economies, which it really isn't.

The idea of perfect equilibrium and perfect knowledge I think was very much the kind of mechanistic ultra-rationalistic thinking that emerged in the early part of the 20th century and led ultimately to the pathological exaggerations which George mentioned of capitalism/fascism, both ultra-rationalist mechanistic views of the world.

But it also led in a somewhat more benign and successful way to the absolutism of market economics, of market fundamentalism that I think George was actually the man who coined that term in the 1990s.

But perfect market economics certainly depends on perfect knowledge but we've got to recognise that market fundamentalism is not the only or certainly not the most plausible and not the only possible theory of capitalism.

And what I just want to say very briefly is that it strikes me that really capitalism does not depend on perfect information at all, in fact the whole point of markets, as both Keynes and Hayek in their opposite way emphasise is to deal with the imperfection of knowledge, to deal with unpredictability and ignorance in a way that is going to be far more successful, because it's empirical and subject to constant correction, than any rationalistic system such as central planning.

The reason that Hayek got so excited about the market system and was so opposed to the neoclassical economics that was becoming dominant is that he could see by the 1940s that actually the neoclassical economics of perfect markets was actually a better argument for central planning than it was for market economics.

Because if you had perfect knowledge then actually an infinitely wise central planner with access to computing power, which at that time seemed almost inconceivable but now each of us has on our mobile phone, could actually do a better job than any market system. So that's why he was opposed. Keynes was opposed for opposite but ultimately converging reasons.

And it strikes me that the lesson we should draw from the current crisis or the crisis that's `[[reached a new curb 0:41:54]]` is that capitalism, as I said, is a political economic system which has gone through a number of these crises since it really was set up in the early 18th century.

I like to put the founding date of capitalism as one where it's actually one can be quite precise about it, I think it's 1776, which happens to be the date not only of Adam Smith's 'Wealth of Nations' but also of the Declaration of Independence in the United States. They came within three months of each other and that was the creation of the first self-consciously bourgeois capitalist democratic society in existence.

So that was the initial phase of capitalism but that phase of capitalism was actually itself created in a crisis, both an economic and a political crises which of course began with the American Civil War, the French Revolution and continued. And the world was in incredible turmoil really until the battle of Waterloo in 1815 and then you had a period of stability of classical capitalism which I would say is the first phase of genuine capitalism. Shall I interrupt or shall I finish `[[cross talking 0:43:03]]`?

Ian Goldin `[[cross talking 0:43:03]]` finish and then we'll `[[cross talking 0:43:04]]`.

Anatole Kaletsky Okay. So we have this marvellous period of stability then you had another crisis of capitalism at least as profound as the other one from 1914/1917 onwards through the Great Depression and you had the reinvention of a new economic theory. And what's crucial is that it wasn't just society that changed completely in the 1930s, economic theory also changed at the same time and the two in a very reflexive way went together. You could not have a complete change in political economy without a change in the theoretical underpinnings.

So that is what I would call the second phase of capitalism, from the 1930s. But that itself, as Marx predicted, fell victim to its own contradictions and by the 1970s that phase collapsed and you had another crisis, both of political economy and of economic theory and the emergence from the late 70s onwards of the market fundamentalist society and the market fundamentalist economic theory.

Now what strikes me is that we may now be in the fourth of these crises of capitalist political economy and capitalist economics and in order to move beyond this crisis and move to the next stage we need a new way of looking at the world intellectually just as much as we need a new form of regulation, new political balance in the markets.

And I think that's the phase that we're at and in order to develop this new approach we need precisely the qualities that Professor Soskice mentioned: an open-mindedness about different theories within economics, a multidisciplinary approach which brings back history, anthropology, financial markets, the experience of financiers, back into the mainstream of economics and a variety of methodologies within economics itself which recognise not just mathematical modelling which by its very nature makes it impossible to deal with the sort of issues that George has been talking about.

Because the whole point of mathematics in any discipline is to ensure logical consistency throughout. That is the one thing that mathematics achieves, it ensures that your model is logically consistent. If you're dealing with a world which is inherently not logically consistent mathematical models are always at some level going to lead you astray.

So these are the things that need to be brought together which is part of the reason why about a year ago I started talking to George about the need to give this process a push to create some kind of new institution or new funding mechanism to promote economic ideas and I'm very glad to say that George has now taken this up. The Institute for New Economic Thinking has been set up, it's going to be launched in April and I think this is exactly the time when we need it both for intellectual reasons and for political reasons around the world. Thanks.

Ian Goldin Thank you very much. Well we're delighted that at least for the short-term our uncertainty has been resolved and the pea soup fog allowed Mr Soros in and that he's joined us and I'd like to invite the Vice-Chancellor to introduce him.

Andrew Hamilton Thank you very much Ian and you could just hear the deep breath of relief on the stage when our distinguished guest walked through the door.

And ladies and gentlemen, my name's Andrew Hamilton, I'm the new Vice-Chancellor of the University of Oxford and it's my enormous pleasure to welcome today to Oxford a man who needs little introduction here or indeed anywhere else. Notwithstanding that fact I am not going to let him escape hearing a few words about himself and the importance that he has had to this university and to open society everywhere.

George Soros is both chairman of Soros Fund Management and the founder of The Open Society Institute. It is through his philanthropic activities that Oxford came to know him and he came to know Oxford.

Mr Soros came to the United Kingdom from his native country of Hungary and graduated in 1952 from the London School of Economics. It was at the LSE that he became acquainted with the theories of Karl Popper whose work on the open society in contrast to the regimes from which he had emigrated... that work has a profound influence on his own intellectual development.

From the UK Mr Soros emigrated to the United States becoming one of the most successful investors in the world, a status that has permitted his enormous range of philanthropic activities since. In 1993 Mr Soros founded The Open Society Institute but really it was his funding of the Soros Scholars in the 1980s, scholars drawn from Hungary, Poland and the Soviet Union that led to his induction as a founding member of the Chancellor's Court of Benefactors and the award of an honorary DCL from Oxford in 1990.

The Soros Scholarships have since been transformed into The Open Society Institute and Chevening Scholarships which today bring many talented students from Eastern Europe and the countries of the former Soviet Union to Oxford and to other leading UK universities. Oxford currently has nine Masters students and ten visiting DPhil students funded by this scheme.

And as many here will know The Open Society Institute aims to build vibrant democracies where none exist through a range of activities including education at all levels, economic reform, human rights, media and communication, public health and arts and culture.

The emphasis of these activities clearly differs depending upon the areas of the world in which they seek to address problems. Most recently for example the OSI has worked in Nigeria with the intention of preventing the spread of tuberculosis and HIV Aids.

So the threats to an open and free society change very much in nature between decades and continents but what is constant is the commitment of Mr Soros to combating them and his determination to transcend the limitations imposed by international institutions and national governments.

Mr Soros it's a great pleasure to be able to welcome you back to a fogbound United Kingdom and to a warm reception from a university that has benefited enormously from your vision for how society throughout the world should be structured and run.

I note sir that when you were admitted to your honorary degree on the 20th of June 1990 the Chancellor of Oxford University hailed you, and I quote, as "A perceptive philosopher, most munificent benefactor of learning, born in Central Europe, bringer of education on an expanding scale to Europe's people." You are certainly that.

On that occasion the public orator at Oxford in a flourish of what makes Oxford such a unique institution quoted `[[Aeschylus]]` to the members of congregation assembled here in the magnificent architecture of The Sheldonian Theatre. And he quoted "Quick as his word comes action, urging on whatever plans his active mind devises."

Mr Soros the citizens of the world have great cause to be grateful to your active mind. We look forward to hearing from you today and may your active mind clear the fog under which the rest of us labour and I have to say you have laboured this morning. And I'd like to invite you to the podium to address us.

George Soros Well my apologies for being late, actually I was quite lucky because we could land in Bristol so I could at least join you now. And I'd just mention that when I was given the doctorate, honorary doctorate, I suggested that I should be described as a financial, philosophical and philanthropic speculator but I wasn't taken up on that.

Now as Anatole mentioned I am the sponsor of the new Institute for New Economic Thinking but I'm also a protagonist and I'm definitely here in my capacity as a protagonist and maybe just very, very briefly I will sum up my conceptual framework that I put forward which extends beyond economics, it's I would say a more broader view of the world and at the most I would put it on four levels of abstraction.

The most abstract level I argue that human situations, human events have a different structure from natural phenomena and of course as a consequence of that social sciences face a different set of problems than the natural sciences. And the difference between the two is the role of thinking, the role that thinking plays.

In the case of natural phenomena it only has one function which I call the cognitive function; we try to understand those events. And because there is only that one function actually we do quite well in the field of natural science.

In human affairs thinking plays another role as well. On the one hand you have the cognitive role where you try to understand events but you also have a participating role, manipulative role, of trying to change events, naturally to your advantage.

And these two functions interfere with each other because in the cognitive function the situation that you want to understand is supposed to be given, in the manipulative function it's your will that is given. And when both functions work at the same time actually nothing is given because the independent factor in one function is the dependent one in the other. So both are dependent and that is the limitation. As a result neither function gives you determinate results and that has very far reaching consequences.

So they have got the manipulative function and the cognitive function and the interference between the two I call reflexivity. And reflexivity leads to feedback and the feedback can be either positive or negative. If the feedback is negative your understanding of the world is corrected and eventually your understanding. And that actual situation that you try to understand, you can get quite close to it.

But when you have a positive feedback then your misconceptions about the world actually change the world and this positive feedback can get quite far – your thinking can get quite far removed from reality.

Now this has then at the second level of abstraction very interesting applications in the financial markets. My explanation of how financial markets work is quite different from the official market theory which is based on the assumption of rationality. But here you have a situation where when you have negative feedback you can actually come quite close to an equilibrium but when you have a positive feedback you have a dynamic disequilibrium.

And that brings me to the third level of abstraction which is the theory of bubbles because when you have that positive feedback then you have a situation where events... I'm sorry, I'm not quite up to my... you have this situation where you have – bubbles have basically two components. You have a trend and that actually prevails in reality and you have a perception or a misconception with regard to that trend, a misinterpretation of that trend.

And when you have a positive feedback then the feedback reinforces both the trend and the misconception and that creates a bubble. The most common bubble I'd say occurs in real estate where the prevailing trend is the easy availability of credit. And the effect of that is it reinforces a rise in the price of the real estate. And because the prices are rising the willingness to lend is also reinforced so credit standards are relaxed and it reinforces the...

Now the misconception is – and it keeps on recurring – that the value of the property is independent of the willingness to lend. So you're willing to lend let's say X% or so on and actually when you have rising prices you may be willing to lend even more.

And that's how both the trend is reinforced and the misconception until the situation becomes untenable and you have a reversal and at that time actually credit is at its maximum extension and as values fall you then have forced sales which then accelerate the decline.

So a typical bubble has an asymmetric shape. It rises slowly and then when it's reversed its quite rapid, it's a crash. That's the simplest bubble.

And then I propose a specific hypothesis about the financial crisis that we have just been through and I call it a super bubble. And that super bubble is a very interesting one because it has the underlying trend which is an ever increasing use of credit and leverage and a misconception which is what I call market fundamentalism, namely that markets tend towards equilibrium and correct their excesses and revert to equilibrium.

And because that's a misconception the deregulation generates financial crisis. And when a financial crisis occurs the authorities step in to prevent the financial disturbance: default of a bank or to interfere with the economy. And what they do of course is that they make credit more easily available so that it reinforces the ever increasing use of credit but it also reinforces, or it has reinforced, the mistaken belief that markets tend towards equilibrium, because it wasn't the markets that have prevented disaster but the intervention of the authorities.

So it's really the interplay between markets and the regulators that creates the super bubble, has created the super bubble. And of course both markets and regulators work with misconceptions. And that is my explanation of how a series of financial crises where the authorities managed to protect us from serious consequences in the economy have led to this tremendous expansion of credit and when the collapse came it then was that much bigger.

Now we are at a very interesting point because effectively when Lehman Brothers failed the markets really did collapse. There was a week when one market after another really stopped functioning and Lehman Brothers went broke on Monday and by Friday the authorities put the financial system on artificial life support and effectively guaranteed all financial institutions that are systemically important that they will not fail.

And in fact they replaced the credit that has collapsed with the only source of credit that was still credible which was the credit of the state. And of course there were some countries where that guarantee was not so credible and their capital started to flee and that's why – for instance Eastern Europe and there was a small financial crash in Brazil and so on. That's when the periphery countries of the global system were affected by a financial crisis that originated at the centre of the...

And so effectively there's been an almost unlimited injection of liquidity into the markets, a quantitative easing. Now where do we go from here? Because it was absolutely the right thing to do because without it we would have ended in depression as in the 1930s and the collapse of the financial system and in fact when you – let's say a car skids, you have to first turn the wheel in the same direction as the skid is before you can correct it. So it's a delicate manoeuvre which has two steps and this was the first step which is in fact making credit available.

Now we are facing how are we going to do the second step? And it's very interesting that the manoeuvre was successful. The financial markets have recovered, they have stabilised, various risk premiums have shrunk and the whole collapse now looks like a nightmare and many people in financial markets would like to see it as a bad dream and forget about it.

And so there is this sort of revival of the animal spirit and the question is will we actually learn something from this crisis or do we try to put humpty dumpty together again? I think we can make an attempt but I don't think it can be done because we have globalised financial markets on false premises, namely that markets don't need to be regulated.

This is a very successful fundamentalist enterprise because it was irresistible because since capital is absolutely essential, financial capital is absolutely essential, once the main players – basically the United States and the United Kingdom started to deregulate and globalise the rest of the world had to follow. So it was irresistible. And we in fact have truly globalised financial markets, but deregulated markets.

Now we have learnt that this is unsound, a lesson that has cost us several trillions of dollars or sterling, whichever currency you like to look at. And if we want to have global markets we will need global regulations. This is the big challenge which I'm afraid we may not be able to meet because the process doesn't work in reverse, because basically regulations remained national and when the banking system had to be saved it had to be done on a national level.

And in Europe in particular it was basically Angela Merkel of Germany who said it has to be done on a national basis, it couldn't be done on a Europe wide basis. Because regulators have national interests and those interests don't coincide. And therefore the challenge of having global regulations, uniform standards, is going to be very difficult to achieve.

Now at the same time you have the emergence of an alternative. I would call the system that collapsed International Capitalism, The Washington Consensus. But there is an alternative that is emerging and I call that State Capitalism, represented by China in a very successful way, by Russia in a pretty unsuccessful way. But that's an alternative.

And because the Chinese alternative is in fact very successful unless we manage to have global regulations and reform the global financial system, because `[[we are 1:13:31]]` also dealing with developing a mechanism to deal with imbalances, so it's not just regulations but also the currency system that needs to be reformed, I think the state and bilateral system is going to come increasingly to the fore.

Now of course China is part of – and so is Russia – part of the International Monetary Fund but they're not really a significant part, they don't have the kind of representation – I'm talking now of China not Russia – that they would be entitled to. So while they have members and pay their dues and do all the things that they are supposed to as members the real thrust is a bilateral thrust.

So for instance I don't see the renminbi replacing the dollar as the international currency, the dollar will remain the main international currency but the renminbi will be used increasingly in bilateral transactions and capital accounts will remain regulated.

So that's the alternative that may well be the way things are going to go. So I think that probably gives you an idea of let's say the conceptual framework that I'm proposing and it has far reaching implications as far as regulations are concerned and many other things. So I think that might give you just a broad outline. Thank you.
