

## 'The Economy Fell off the Cliff'

**George Soros, 78, has made billions as a hedge-fund manager and investor. SPIEGEL spoke with him about the current financial crisis, how he expects President-elect Barack Obama to respond to the economic disaster and the responsibilities borne by speculators.**

**SPIEGEL:** Mr. Soros, in spite of massive interventions by governments and federal banks the financial crisis is getting worse. The stock markets are in free fall, millions of people could lose their jobs. More and more companies are in trouble, from General Motors in Detroit to BASF in Ludwigshafen. Have you ever seen anything like it?

**Soros:** Never. I find the present situation dramatic and overwhelming. In my latest book "The New Paradigm for Financial Markets: The Credit Crisis of 2008" I predicted the worst financial crisis since the 1930s. But to tell you the truth: I did not actually anticipate that it would get as bad as it did. It has gone beyond my wildest imagination.



REUTERS

George Soros has made a fortune with hedge funds. "I find the present situation dramatic and overwhelming."

**SPIEGEL:** What are your fears for the coming months?

**Soros:** I think that the dark comes before dawn. The financial markets are under great pressure because of the lack of leadership during the transition period. In the next two months, the markets will experience maximum pressure. Then we will see some initiatives from the Obama administration. How long the crisis lasts will depend on the success of these measures.

**SPIEGEL:** The markets don't seem to have much confidence in the new president -- in stark contrast to the enthusiasm in the population. Since Election Day on November 4, stocks have fallen by almost 20 percent.

**Soros:** I have great hopes for Barack Obama. But at the time of the election the financial community had not yet fully grasped the magnitude of the economic decline. They did not anticipate that the default of Lehman Brothers would cause cardiac arrest in the markets. The economy fell off the cliff, you begin to see mangled bodies lying at the bottom.

**SPIEGEL:** Was it a policy mistake to let Lehman Brothers go bankrupt?

**Soros:** It was a fatal mistake. I would have never expected that the authorities let such a big investment bank go.

**SPIEGEL:** Will there be more victims?

**Soros:** Possibly. CitiBank, one of the world's largest banks, is currently at the center of attention (*eds. note: The \$300 billion US government plan to stabilize CitiBank had not been approved by the time of this interview*). There are some other bodies lined up for potential trouble. The situation is very similar to the 1930s -- but it is going to unfold differently. We have learned not to allow the financial market to collapse. We will spend all the money in the world to prevent that from happening.

**SPIEGEL:** Obama is supposed to save the banks, bail out the auto industry and boost the economy in general. Can a single person ever live up to such high expectations?

**Soros:** Perhaps not, but the problems can be handled much better than they have been by the current administration.

**SPIEGEL:** Currently, Treasury Secretary Henry Paulson is in charge of the bail-out. What are your misgivings about his performance?

**Soros:** He reacted to problems as they arose; he had no capacity to anticipate them. When he allowed Lehman Brothers to fail, the breakdown of the financial markets found him totally unprepared. He went to Congress not with a plan but with a plan to develop a plan. And the plan he had in mind -- to purchase toxic assets -- was ill-conceived. Injecting equity capital into the banking system made much more sense and he eventually came to see that, but again he went about it in the wrong way. Then he stopped doing anything, leaving a vacuum in leadership, and the markets collapsed.

**SPIEGEL:** What are your expectations for the next Secretary of the Treasury?

**Soros:** I think we need a large stimulus package which will provide funds for state and local government to maintain their budgets -- because they are not allowed by the constitution to run a deficit. For such a program to be successful, the federal government would need to provide hundreds of billions of dollars. In addition, another infrastructure program is necessary. In total, the cost would be in the 300 to 600 billion dollar range.

**SPIEGEL:** In addition to the \$700 billion bailout for the financial industry?



DPA

Financial manager George Soros worries about a leadership vacuum during the transition from President George W. Bush to President-elect Barack Obama.

**Soros:** Definitely. I think this is a great opportunity to finally deal with global warming and energy dependence. The US needs a cap and trade system with auctioning of licenses for emissions rights. I would use the revenues from these auctions to launch a

new, environmentally friendly energy policy. That would be yet another federal program that could help us to overcome the current stagnation.

**SPIEGEL:** Your proposal would be dismissed at Wall Street as "big government." Republicans might call it European-style "socialism."

**Soros:** That is exactly what we need now. I am against market fundamentalism. I think this propaganda that government involvement is always bad has been very successful -- but also very harmful to our society.

**SPIEGEL:** Would you advise the new president to say that publicly?

**Soros:** He has already spoken about changing the political discourse . I think that it is better to have a government that wants to provide good government than a government that doesn't believe in government.

**SPIEGEL:** However, even a strong government can't perform miracles. It needs money from the taxpayers. There is a lot of talk in the US about the new role of the state and the government -- but no one seems to be willing to pay for it. Obama has announced to cut taxes for 95 percent of working Americans. Isn't that a contradiction?

### **"I Always Play by the Rules"**

**Soros:** At times of recession, running a budget deficit is highly desirable. Once the economy begins to recover, you have to balance the budget. In 2010, the Bush tax cuts will expire and we should not extend them. But we will also need additional revenues. Should the government not receive them, we will all get punished with higher interest rates.

**SPIEGEL:** Everybody says we have to regulate the financial markets more. That sounds good, but is it realistic? Can one really tame the markets?

**Soros:** Between regulators and market participants, there is a cat and mouse game going on which has been going on indefinitely...

**SPIEGEL:** ...where often the mice, the market participants, have the upper hand.

**Soros:** Because they got the extra boost from market fundamentalists. But the outcome was disastrous, as we see now. I think it is better to have a cat and mouse game where the cat has the upper hand than a cat and mouse game where the mice are ruling. Because the latter means that the market participants are given free range. That was actually the big misconception of our national hero Ronald Reagan who always talked about the magic of the market.

**SPIEGEL:** So, you support stricter regulation and more efficient control of the markets?

**Soros:** Indeed. However, you have to recognize that regulations will never be completely successful and they will always be full of holes. You must constantly be ready to fill new holes. Actually regulation should be kept to a minimum, but there has to be some cooperation between market participants and authorities -- as was the case in the early post war years. The Bank of England was a very successful regulator by cooperating with market participants. This cooperative spirit was broken by the market fundamentalists.

**SPIEGEL:** Not in Germany. We have many semi-private banks that largely dominate the market. Politicians serve on their supervisory boards. But they are in particularly bad shape.

**Soros:** These public-private partnerships are very, very dangerous. The most rotten part of the financial system in the US consisted of the government sponsored entities, Fannie Mae and Freddie Mac. They really kicked off this crisis. The state should set the rules and enforce them -- but not become involved as a market player.

**SPIEGEL:** You are one of the most powerful speculators in the world and have been heavily involved in your fund's activities over the past few months. How do you cope with the dilemma of being a speculator -- who often profits from a business transaction that might hurt society?

**Soros:** This is a false issue. I always play by the rules. At the same time, I try to improve the rules. In so doing I often suggest changes from which I would not personally benefit. I have the common interest at heart, not my personal interest.

**SPIEGEL:** But the perception many people have of you and your colleagues is very different. They blame speculators for the current financial crisis -- is that the reason for your decision to give billions of dollars to charity and your foundation?

**Soros:** People think I am giving money because I have pangs of conscience.

**SPIEGEL:** Isn't there some truth to it?

**Soros:** No. It is a total misconception. The big events in which I participated would have occurred whether I took part in them or not. For example, whether I had been born or not, the British pound would have been forced out of the European Exchange Rate Mechanism in 1992.

**SPIEGEL:** But are you really such a little wheel as you claim? If you bet against grain, rice or oil, many other investors follow suit. That could hurt consumers who can no longer afford essential foodstuffs or energy. You can definitely influence markets.

**Soros:** Since I became a public figure, the man who allegedly "broke the Bank of England," I have been cast as a financial guru who can influence markets. That has actually created more moral problems for me. It has forced me to impose certain self-constraints in my statements -- exactly because I can move markets, like the investor Warren Buffett. Therefore, we try to act very responsibly.

**SPIEGEL:** Does the world need hedge funds?

**Soros:** I think that hedge funds are a very efficient way of managing money. But I clearly see the risks. Hedge funds use credit and credit is a source of instability. My conclusion is that transactions involving credit should be regulated.

**SPIEGEL:** Now you sound like a person who runs to a police station and tells the officers: "Please, handcuff me -- I am dangerous!"

**Soros:** Not really. I think there need to be appropriate regulation of the financial markets, But it is impossible to prevent speculation. There is very little difference between speculation and investment. The only difference is basically that investments are successful speculations because if you successfully anticipate the future you make a speculative profit. I don't have a bad conscience at all. I am very proud to be a successful speculator.

**SPIEGEL:** Average citizens are not much impressed: They no longer trust Wall Street.

**Soros:** That mistrust is well placed. Those very prestigious institutions on Wall Street pursue their self-interest, and that is not identical to the common interest -- which needs to be protected.

**SPIEGEL:** Many people also no longer have confidence in the bailout measures taken by the Bush administration. Some critics claim that Treasury Secretary Henry Paulson is simply trying to bail out his former colleagues on Wall Street. Paulson was once the CEO of Goldman Sachs.

**Soros:** That may be going too far. But it is true that Paulson sees the problems too much from the perspective of a Wall Street banker.

**SPIEGEL:** He is also reluctant to push for salary caps for CEOs or bonus restrictions at

banks receiving government aid.

**Soros:** Giving government aid to a bank basically transforms it into a utility. The huge salaries in this sector are only a symptom of a more profound misalignment. The profitability of the finance industry has been excessive. For a while, 35 percent of all corporate profits in the UK and the US came from the financial sector. That was absurd.

**SPIEGEL:** We talked a lot about the losers of the current financial disaster. Do you also see winners?

**Soros:** China could easily emerge as the great winner if the Chinese leaders handle the situation well. On the other hand, they could also turn out to be the biggest losers if they handle it poorly. If the management turns out to be wrong, this could lead to a political crisis in China. It's still too early to declare winners and losers.

**SPIEGEL:** Could Obama be the first "post-American president" -- because his country loses economic force and "soft power"?

**Soros:** If Obama is wise, he will find common ground with China to solve this crisis. If he wants to do it alone, we will go into a worldwide depression because America is not in a position by itself to clean up the mess it created.

**SPIEGEL:** Mr. Soros, thank you very much for this conversation.

*Interview conducted by Mathias Müller von Blumencron, Gregor Peter Schmitz and Gabor Steingart*

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