

Three **REASONS** Why
Socialism
Always **FAILS**





Three Reasons Why Socialism Always Fails

By Dr. Mark J. Perry

*Professor of Finance and Business Economics
University of Michigan-Flint*

*Scholar
American Enterprise Institute*

INTRODUCTION

Socialism is the ultimate Big Lie. While it falsely promises prosperity, equality, and security, it delivers the exact opposite: poverty, inequality, and tyranny. Equality is achieved under socialism only in the sense that everyone is equal in his or her misery.

Socialism usually shows some early signs of success, but any temporary accomplishments quickly fade as the fundamental flaws of central planning, a key aspect of socialism, emerge. It is the initial illusion of success that gives socialism its destructive, seductive appeal. But in the long run, socialism has an unbroken track record of being a formula for tyranny and poverty.

The current situation in oil-rich Venezuela provides a perfect example of socialism's initial successes followed by predictable and catastrophic long-term failures. There were some initial signs of economic prosperity under Hugo Chavez's socialist regime in Venezuela in the early part of this century, but that "success" was brief and unsustainable.

Chavez was able to distribute to his people some of the bounty from stolen property when his government seized the country's oil production in 2006 and 2007. His regime forcibly took over the regional divisions of oil companies,



Socialist dictator Hugo Chavez ruled Venezuela for 14 years with destructive economic policies, which included seizing control of private oil companies.

including Exxon Mobil, France's Total, and Italy's Eni. Relatively high oil prices also artificially helped the socialist regimes of both Chavez and his successor, Nicolas Maduro, in the short run.

But the corrosive, demoralizing, and devastating effects of socialism have now been exposed, as the country has gone into an economic spiral of poverty, chaos, and death.

WHAT ROLE DO INCENTIVES PLAY?

The choice of economic systems is crucial in an imperfect universe with imperfect human beings and limited resources. In a world with scarcity, or limited resources, it is essential for an economic system to be based on clear incentives to promote economic efficiency. The real choice we face is between imperfect free enterprise and imperfect socialism. Given that choice, the evidence of history overwhelmingly favors free enterprise as the greatest wealth-producing economic system available, while socialist economies, like Venezuela, destroy wealth and leave its citizens impoverished, malnourished, sick, and desperate.



The residents of Caracas, the capital of Venezuela, suffer under the grip of socialist government policies.

Socialism is fraudulent and unsustainable in the long run because it is a flawed idea. Socialism does not work because it is not consistent with the fundamental principles of human behavior. The failure of socialism in countries around the world—like Venezuela, Cuba, and the former Soviet Union—can be traced to one critical defect: it is a system that ignores incentives.

Under socialism, incentives either play a minimal role or are ignored totally. In contrast, in the free enterprise system, which is based on competition and individual choices, incentives are of the utmost importance. The concepts of market prices—or prices determined by the supply and demand for goods—profits and losses, and private property rights provide an efficient, interrelated system of incentives to guide economic behavior.

A socialist economy—without market prices or profits, and where most of the property is owned or controlled by the government—is a system that doesn't respect



incentives to direct economic activity. By failing to emphasize incentives, socialism is an ideology inconsistent with human nature and is therefore doomed to fail. In fact, socialism is based on the idea that incentives don't matter.



Modern-day socialists like Representative Alexandria Ocasio-Cortez fail to tell the full story about socialism.

Modern-day socialists, such as Alexandria Ocasio-Cortez, compare a theoretically perfect version of socialism with a practical and imperfect free enterprise system. This comparison allows them to claim that socialism is superior to the free market. But, if perfection really were an available option, the choice of economic systems would be irrelevant. In a world with perfect human beings and infinite abundance, any system—socialism, free enterprise, or communism—would work perfectly.

The strength of the free enterprise system can be attributed to incentives based upon the three Ps: (1) **Prices** determined by supply and demand, (2) **Profits and Losses**, and (3) **Private Property Rights**. The failure of socialism in countries like Venezuela can be traced directly to its neglect of these three concepts.



REASON #1: SOCIALISM DISTORTS PRICES

Market prices in our free enterprise system guide economic activity so flawlessly that most people don't even realize that they are constantly at work on our behalf and never fully appreciate their profound importance to our lives and standard of living. Prices continuously communicate information about the scarcity of goods and services and then efficiently coordinate economic activity.



In the 1970s, Americans waited in long lines at gas stations across the country due to the federal government's artificial gasoline prices.

For example, look at what happened during the 1970s when U.S. gasoline prices were set by the government at prices below the price determined by supply and demand. Long lines of customers developed at gas stations all over the country because the price for gasoline was kept artificially low by the government. The full impact of scarcity was not accurately conveyed. As economist Milton Friedman pointed out at the time, we could have



eliminated the lines at the pump in one day by allowing the price to rise to the point determined naturally by supply and demand.

This example of artificial prices for gasoline, the long lines at the pump, and general inconvenience provides an insight into what happens under socialism when every price in the economy is controlled. The collapse of socialism is due, in part, to the chaos and inefficiency that result from artificial prices. The information that prices in a socialist economy communicate is always distorted.

This, in turn, distorts the incentives that result from artificial prices under socialism. Controlled prices are always either too high or too low, which then creates constant surpluses and shortages.

Market prices are the only way to communicate information that will create the incentives to ensure economic efficiency.



Due to perpetual shortages resulting from government control, Venezuelans are literally forced to search for food among piles of waste.

The situation in socialist Venezuela provides a current example of the chaos and inefficiencies that are guaranteed to result from government price controls. As



could be easily predicted, the widespread artificial prices imposed by the socialist regime in Venezuela in recent years have led to chronic shortages of basic goods—including milk, flour, rice, and toilet paper—and long lines of customers waiting for hours to buy groceries at stores that frequently have mostly empty shelves. Until market prices are restored in Venezuela to guide the efficient production, distribution, and sale of basic goods, the shortages and long lines will continue to inflict hardship on Venezuelans.



Price controls implemented by Nicolas Maduro's dictatorship have produced dramatic shortages of basic goods and supplies in grocery stores across Venezuela.



REASON #2:

SOCIALISM DOESN'T REWARD SUCCESS

Socialism also eventually collapses because of its failure to operate under a competitive system of profits and losses. Profits and losses are an effective way to continually evaluate the economic performance of every business. Businesses that are the most efficient and most



successful at serving consumers are rewarded with profits. Businesses that operate inefficiently and fail to serve consumers are penalized with losses.

By rewarding success and penalizing failure, the system of profits and losses provides a strong way to continually redirect resources away from weak, failing, and inefficient businesses toward those businesses that are the most efficient and successful at serving consumers.

Under socialism, there is no system of profits

and losses to accurately measure the success or failure of various businesses. This is because the government controls how goods are produced and distributed.



Therefore, there is no way to discipline businesses that fail to serve the public interest and no way to reward businesses that do.

In other words, without market competition, socialist economies do not have an effective way to coordinate individuals' economic behavior. The recent exodus of millions of people escaping socialist Venezuela due to widespread food and medicine shortages and growing malnourishment and illness demonstrates the inefficiencies and failures of a socialist economy to even provide basic provisions for its people.

REASON #3:

SOCIALISM IGNORES PRIVATE PROPERTY RIGHTS

A third fatal defect of socialism is its disregard for the role of private property rights in creating incentives that foster economic growth and development.



Overgrazing on collectively owned farms demonstrates the problem of the "tragedy of the commons."



In a socialist economy, property is owned collectively by individuals in that society. But when resources are publicly owned, there are no incentives in place to encourage responsible stewardship. While private property creates incentives for conservation and the responsible use of property, public property encourages irresponsibility and waste. If everyone owns something, people act as if no one owns it. And when no one owns it, no one really takes care of it. Public ownership encourages neglect and mismanagement.

The British experience during the 16th century—when certain grazing lands were communally owned by villages and were made available for public use—is a good example of this. The lands were quickly overgrazed and eventually became worthless as villagers exploited the communally-owned resource. This unfortunate outcome became known as the “tragedy of the commons.”



Despite Venezuela’s having the largest oil reserves of any country in the world, Venezuelan gas stations regularly display signs reading “No Gasoline.”

Socialism, by definition, is a system marked by the common ownership of the means of production. Much of the economic stagnation of socialism can be traced to the failure to establish and promote private property rights.



WHAT LESSONS DOES HISTORY TEACH US?

Without the incentives of market prices, profits and losses, and private property rights, socialist economies stagnate and wither. The economic disaster in socialist Venezuela is a direct consequence of the government's neglect of economic incentives. As we can learn from Venezuela and other socialist countries today, no amount of natural resources can ever compensate a country for its lack of an efficient system of incentives. Venezuela has the world's largest reserves of one of the most precious resources on the planet—crude oil. In fact, its reserves are 8.6 times greater than those of America's.



Russia's vast natural resources and beauty cannot compensate for the human cost of its socialist government policies.

Russia, as another example, is one of the world's wealthiest countries in terms of natural resources. It has some of the largest reserves of oil, natural gas, diamonds, and gold. Its



valuable farmland, lakes, rivers, and streams stretch across a land area that encompasses 11 time zones.

Yet, both Russia and Venezuela remain poor. Natural resources are helpful, but the ultimate resources of any country are the unlimited resources of its people—human resources.

By their failure to foster, promote, and nurture the potential of their people through incentives, socialist economies deprive the human spirit of its full development. Socialism fails because it kills and destroys the human spirit—just ask the millions of starving, malnourished, desperate people leaving Venezuela today for Colombia, Ecuador, Peru, and Brazil.

Unfortunately, despite these facts, we are witnessing a recent trend of government leaders, academics, and young people who are embracing socialist ideology and propaganda. The United States has an obligation to continue to fight the seductiveness of socialism around the world and here at home as promoted by modern-day socialists like Alexandria Ocasio-Cortez.

The attractiveness of socialism comes with the enticing offer: “Give up a little of your freedom, and I will give you a little more economic security.” Free college tuition, free healthcare, and guaranteed housing are just a few examples of this “security.” As the experience of Venezuela has clearly demonstrated, the bargain is tempting but never pays off in the long run. The unfortunate citizens of Venezuela have lost both their freedom and their economic security. These programs are all part of the dangerous Big Lie of socialism because they ignore the important role of incentives.

Socialism is being repackaged and recycled by many in America today. It is being taken seriously by a new generation, many of whom weren’t alive when the historic events of the 1980s and 1990s occurred, including the fall



of the Berlin Wall and the collapse of the Soviet Union. But the lessons from history about the defects, deficiencies, and failures of socialism are very clear. As we've learned, the main difference between free enterprise and socialism is this: free enterprise works.



The fall of the Berlin Wall in 1989 liberated millions from the tyranny of socialism and communism.



Dr. Mark J. Perry

ABOUT DR. MARK J. PERRY

Mark J. Perry is a professor of economics and finance in the School of Management at the Flint campus of The University of Michigan, where he has taught undergraduate and graduate courses in economics and finance since 1996. Starting in the fall of 2009, Perry has also held a joint appointment as a scholar at The American Enterprise Institute in Washington, D.C. Perry has been best known in recent years as the creator and editor of one the nation's most popular economics blogs, *Carpe Diem*. Perry holds two graduate degrees in economics (M.A. and Ph.D.) from George Mason University and has an MBA degree in finance from the University of Minnesota.



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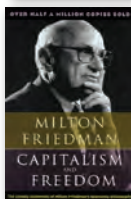
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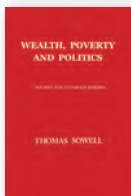
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