

quired to return a specific percentage of metal to the Ministry of Industry (supposedly for recycling but mostly to ensure that it wasn't all stolen). Ministry officials report that the amount of steel returned for recycling is less than half what they received before 1990, a sign that steel is being used in production, not wasted or stolen.

## Conclusion

F. A. Hayek identified the basic problem facing an economy as that of identifying and choosing among all the possible ways that resources might be used to satisfy people's wants. Central planners simply don't have enough information or the incentives to make resource-use choices that can sus-

tain consumer satisfaction and economic growth. In Romania, this meant that products were produced that nobody wanted and raw materials were wasted.

In contrast, markets channel competitive pressures into a process in which individuals, acting as entrepreneurs, have the incentive to discover new and better ways to use resources. Facilitated by a legal system that protects private property rights, markets create a level of social wealth and satisfaction unrivaled by any alternative structure. In Romania in 1993, the importance of that system became clearer to me than ever before. □

---

1. Roman Frydman, Andrzej Rapaczynski, John S. Earle, *The Privatization Process in Central Europe* (New York: Central European University Press, 1993), p. 255.

---

# Why Socialism Failed

by Mark J. Perry

**S**ocialism is the Big Lie of the twentieth century. While it promised prosperity, equality, and security, it delivered poverty, misery, and tyranny. Equality was achieved only in the sense that everyone was equal in his or her misery.

In the same way that a Ponzi scheme or chain letter initially succeeds but eventually collapses, socialism may show early signs of success. But any accomplishments quickly fade as the fundamental deficiencies of central planning emerge. It is the initial illusion of success that gives government intervention its pernicious, seductive appeal. In the long run, socialism has always proven to be a formula for tyranny and misery.

A pyramid scheme is ultimately unsus-

tainable because it is based on faulty principles. Likewise, collectivism is unsustainable in the long run because it is a flawed theory. Socialism does not work because it is not consistent with fundamental principles of human behavior. The failure of socialism in countries around the world can be traced to one critical defect: it is a system that ignores incentives.

In a capitalist economy, incentives are of the utmost importance. Market prices, the profit-and-loss system of accounting, and private property rights provide an efficient, interrelated system of incentives to guide and direct economic behavior. Capitalism is based on the theory that incentives matter!

Under socialism, incentives either play a minimal role or are ignored totally. A centrally planned economy without market prices or profits, where property is owned

---

*Dr. Perry is Director at the Center for World Capitalism of the James Madison Institute, Jacksonville University, Jacksonville, Florida.*

by the state, is a system without an effective incentive mechanism to direct economic activity. By failing to emphasize incentives, socialism is a theory inconsistent with human nature and is therefore doomed to fail. Socialism is based on the theory that incentives don't matter!

In a radio debate several months ago with a Marxist professor from the University of Minnesota, I pointed out the obvious failures of socialism around the world in Cuba, Eastern Europe, and China. At the time of our debate, Haitian refugees were risking their lives trying to get to Florida in homemade boats. Why was it, I asked him, that people were fleeing Haiti and traveling almost 500 miles by ocean to get to the "evil capitalist empire" when they were only 50 miles from the "workers' paradise" of Cuba?

The Marxist admitted that many "socialist" countries around the world were failing. However, according to him, the reason for failure is not that socialism is deficient, but that the socialist economies are not practicing "pure" socialism. The perfect version of socialism would work; it is just the imperfect socialism that doesn't work. Marxists like to compare a theoretically perfect version of socialism with practical, imperfect capitalism which allows them to claim that socialism is superior to capitalism.

If perfection really were an available option, the choice of economic and political systems would be irrelevant. In a world with perfect beings and infinite abundance, any economic or political system—socialism, capitalism, fascism, or communism—would work perfectly.

However, the choice of economic and political institutions is crucial in an imperfect universe with imperfect beings and limited resources. In a world of scarcity it is essential for an economic system to be based on a clear incentive structure to promote economic efficiency. The real choice we face is between imperfect capitalism and imperfect socialism. Given that choice, the evidence of history overwhelmingly favors capitalism as the greatest wealth-producing economic system available.

The strength of capitalism can be attributed to an incentive structure based upon the three Ps: (1) *prices* determined by market forces, (2) a *profit-and-loss* system of accounting and (3) *private property* rights. The failure of socialism can be traced to its neglect of these three incentive-enhancing components.

## Prices

The price system in a market economy guides economic activity so flawlessly that most people don't appreciate its importance. Market prices transmit information about relative scarcity and then efficiently coordinate economic activity. The economic content of prices provides incentives that promote economic efficiency.

For example, when the OPEC cartel restricted the supply of oil in the 1970s, oil prices rose dramatically. The higher prices for oil and gasoline transmitted valuable information to both buyers and sellers. Consumers received a strong, clear message about the scarcity of oil by the higher prices at the pump and were forced to change their behavior dramatically. People reacted to the scarcity by driving less, carpooling more, taking public transportation, and buying smaller cars. Producers reacted to the higher price by increasing their efforts at exploration for more oil. In addition, higher oil prices gave producers an incentive to explore and develop alternative fuel and energy sources.

The information transmitted by higher oil prices provided the appropriate incentive structure to both buyers and sellers. Buyers increased their effort to conserve a now more precious resource and sellers increased their effort to find more of this now scarcer resource.

The only alternative to a market price is a controlled or fixed price which always transmits misleading information about relative scarcity. Inappropriate behavior results from a controlled price because false information has been transmitted by an artificial, non-market price.

Look at what happened during the 1970s

when U.S. gas prices were controlled. Long lines developed at service stations all over the country because the price for gasoline was kept artificially low by government fiat. The full impact of scarcity was not accurately conveyed. As 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 clear the market.

From our experience with price controls on gasoline and the long lines at the pump and general inconvenience, we get an insight into what happens under socialism where 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 content of a controlled price is always distorted. This in turn distorts the incentives mechanism of prices under socialism. Administered prices are always either too high or too low, which then creates constant shortages and surpluses. Market prices are the only way to transmit information that will create the incentives to ensure economic efficiency.

## Profits and Losses

Socialism also collapsed because of its failure to operate under a competitive, profit-and-loss system of accounting. A profit system is an effective monitoring mechanism which continually evaluates the economic performance of every business enterprise. The firms that are the most efficient and most successful at serving the public interest are rewarded with profits. Firms that operate inefficiently and fail to serve the public interest are penalized with losses.

By rewarding success and penalizing failure, the profit system provides a strong disciplinary mechanism which continually redirects resources away from weak, failing, and inefficient firms toward those firms which are the most efficient and successful at serving the public. A competitive profit system ensures a constant reoptimization of resources and moves the economy toward greater levels of efficiency. Unsuccessful firms cannot escape the strong discipline of

the marketplace under a profit/loss system. Competition forces companies to serve the public interest or suffer the consequences.

Under central planning, there is no profit-and-loss system of accounting to accurately measure the success or failure of various programs. Without profits, there is no way to discipline firms that fail to serve the public interest and no way to reward firms that do. There is no efficient way to determine which programs should be expanded and which ones should be contracted or terminated.

Without competition, centrally planned economies do not have an effective incentive structure to coordinate economic activity. Without incentives the results are a spiraling cycle of poverty and misery. Instead of continually reallocating resources towards greater efficiency, socialism falls into a vortex of inefficiency and failure.

## Private Property Rights

A third fatal defect of socialism is its blatant disregard for the role of private property rights in creating incentives that foster economic growth and development. The failure of socialism around the world is a "tragedy of commons" on a global scale.

The "tragedy of the commons" refers to the British experience of the sixteenth century when certain grazing lands were communally owned by villages and were made available for public use. The land was quickly overgrazed and eventually became worthless as villagers exploited the communally owned resource.

When assets are publicly owned, there are no incentives in place to encourage wise stewardship. While private property creates incentives for conservation and the responsible use of property, public property encourages irresponsibility and waste. If everyone owns an asset, 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.

Since socialism, by definition, is a system marked by the "common ownership of the means of production," the failure of socialism is a "tragedy of the commons" on a

national scale. Much of the economic stagnation of socialism can be traced to the failure to establish and promote private property rights.

As Peruvian economist Hernando de Soto remarked, you can travel in rural communities around the world and you will hear dogs barking, because even dogs understand property rights. It is only statist governments that have failed to understand property rights. Socialist countries are just now starting to recognize the importance of private property as they privatize assets and property in Eastern Europe.

## Incentives Matter

Without the incentives of market prices, profit-and-loss accounting, and well-defined property rights, socialist economies stagnate and wither. The economic atrophy that occurs under socialism is a direct consequence of its neglect of economic incentives.

No bounty of natural resources can ever compensate a country for its lack of an efficient system of incentives. Russia, for example, is one of the world's wealthiest countries in terms of natural resources; it has some of the world's largest reserves of oil, natural gas, diamonds, and gold. Its valuable farm land, lakes, rivers, and streams stretch across a land area that encompasses 11 time zones. Yet Russia remains 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 incentive-enhancing institutions, centrally planned economies deprive the human spirit of full development. Socialism fails because it kills and destroys the human spirit—just ask the people leaving Cuba in homemade rafts and boats.

As the former centrally planned economies move toward free markets, capitalism, and democracy, they look to the United States for guidance and support during the transition. With an unparalleled 250-year

tradition of open markets and limited government, the United States is uniquely qualified to be the guiding light in the worldwide transition to freedom and liberty.

We have an obligation to continue to provide a framework of free markets and democracy for the global transition to freedom. Our responsibility to the rest of the world is to continue to fight the seductiveness of statism around the world and here at home. The seductive nature of statism continues to tempt and lure us into the Barmecidal illusion that the government can create wealth.

The temptress of socialism is constantly luring us with the offer: "give up a little of your freedom and I will give you a little more security." As the experience of this century has demonstrated, the bargain is tempting but never pays off. We end up losing both our freedom and our security.

Programs like socialized medicine, welfare, social security, and minimum wage laws will continue to entice us because on the surface they appear to be expedient and beneficial. Those programs, like all socialist programs, will fail in the long run regardless of initial appearances. These programs are part of the Big Lie of socialism because they ignore the important role of incentives. Socialism will remain a constant temptation. We must be vigilant in our fight against socialism not only around the globe but also here in the United States.

The failure of socialism inspired a worldwide renaissance of freedom and liberty. For the first time in the history of the world, the day is coming very soon when a majority of the people in the world will live in free societies or societies rapidly moving towards freedom.

Capitalism will play a major role in the global revival of liberty and prosperity because it nurtures the human spirit, inspires human creativity, and promotes the spirit of enterprise. By providing a powerful system of incentives that promote thrift, hard work, and efficiency, capitalism creates wealth.

The main difference between capitalism and socialism is this: Capitalism works. ☐

# The New Nihilism

by Michael D. Weiss

On the streets of New York City, not far from the complacent New Age ambience of the touristy West Village cafes and uptown Sushi bars, terror culture is afoot. Arising from post-modernism, terror culture is the “voice” of a new movement. With growing force and articulation, not to mention federal funding, this terrible voice echoes from Columbia’s Philosophy Hall to the trendy coffee bars of SoHo and the squatters’ “apartments” of Manhattan’s midtown. This new movement has been called the paradigm of the twenty-first century, but its philosophy signals nothing less than the death of civilization.

Although the stench of death is strongest below 14th Street, the signs of it are everywhere. From phone sex ads and the club listings in underground newspapers, a careful observer glimpses the cultural terrorists. Ghoulish books called *Hunting Humans* and *The Atrocity Exhibition* fill their shelves. *Faces of Death* (a movie available at most video rental stores containing spliced footage of actual killings) and hard-core pornography sit next to their VCRs. Tattoos and piercing deface their bodies. Dressed in torn jeans or in the all-black uniform of their movement, they frequent the nightclubs, galleries, and bookstores of the City.

What is truly frightening about terror culture is that it is gaining ground, making

its way into the mainstream. One of the bestselling books and most popular American movies in recent years, *Silence of the Lambs*, was decidedly terroristic. The serial killer, Hannibal Lecter (played by Academy-award winner Anthony Hopkins), was transformed into a Sherlock Holmes-type hero. On television, talk shows and real-life crime shows popularize violence and fringe lifestyles. After the Jeffrey Dahmer case, a California trading-card distributor released serial killer cards for kids. Rock album covers are no longer for the squeamish and many would shock a forensic physician.

College fashion is ugly. Women sport black hair and nose rings, wear men’s “Doc Marten’s” shoes or cowboy boots, ripped jeans, and t-shirts sporting bizarre, horrifying, or obscene logos. According to Lola, a pink-haired, nose-ringed student at New York’s Parsons School of Art, “Post-modernism is the rage in art schools. Everybody dresses in black. It’s fashion.” In fact, every person I talked to, whether a self-proclaimed devotee of terror culture or not, conceded that terror culture has affected the contemporary cultural scene. Terror historian Arthur Kroker describes the new post-modernism as “playing at your local theater, TV studio, office tower, doctor’s office, or sex outlet.”<sup>1</sup>

Borrowing much from the relativists, terror culture has at its core radical nihilism, a complete subversion and rejection of value. Terror culture goes beyond the relativist observation that all concepts of value or quality are contingent and socially con-

---

Mr. Weiss is a fellow at the Texas Public Policy Foundation, an adjunct professor of law at the University of Houston Law Center, and an associate at the Law Firm of Daniel & Lezar, L.L.P.