

The Only Failure We Have to Fear Is the Fear of Failure

Dwight R. Lee and
Richard B. McKenzie

Socialism has been, by any measure of economic success, a total failure. The hope of socialism was that it would promote wealth and distribute it fairly by transferring power away from capitalists interested only in profits and give more control to political representatives concerned with economic growth and social justice. That hope has been dashed. Socialism has succeeded only in providing special privileges to a few by imposing grinding poverty on everyone else.

With socialism a sinking ship, the goal in country after country that has been impoverished by the legacy of Karl Marx is to achieve the wealth-creating power of capitalism. The most dramatic examples of the rejection of socialism and the move to embrace capitalism have come from Eastern Europe and the Soviet Union, countries that have experienced the poverty of socialism first-hand. But countries in Africa, South America, and other parts of the world that have been beguiled by the false promises of socialism also are anxious to trade socialism for capitalism.

While the embrace of the market economy has been widespread, it has been cautious. Everyone wants the wealth created by capitalism, but at the same time the marketplace is seen as harsh, calloused, and unfair. Isn't the marketplace littered with the victims of those who have suffered the failures of bankruptcy, unemployment, and poverty at the merciless hands of market competition? Isn't there some way to accept the wealth that capitalism offers without having to endure the constant failures it imposes? The calls have been for a market economy with a human face, or for a third way between the productivity of capitalism and the compassion of socialism. There is no end of proposals to reform the marketplace in order to protect its innocent victims.

It would, of course, be nice to unbundle the economic package known as capitalism or the free market, and keep the sweet while rejecting the bitter. It also would be nice if everyone had an above average I.Q. and income. Unfortunately, the only way to avoid the failures that result from capitalism is to pass up the wealth created by capitalism.

Understanding Failure

Failures in the marketplace serve an indispensable function in the production of wealth: they provide information on the most productive use of resources and the motivation to respond appropriately to that information. Failures are part of the steering mechanism that directs an economy toward prosperity. Attempting to improve the marketplace by preventing economic failure is equivalent to attempting to improve an automobile by removing the steering wheel. It is no surprise that socialistic economies that were applauded initially for eliminating unemployment, bankruptcies, and economic failure of every variety have themselves been colossal economic failures. By allowing economic failures in the small, and converting these failures into useful information, market economies have produced economic success in the large. In economics, overall success depends on a constant supply of small failures.

Thus, the general economic failure that is most feared in all societies stems, paradoxically, from the fear of economic failure. The best antidote for this fear is an understanding that economic failure is a necessary ingredient in the market process that leads to higher overall living standards.

The Market Process vs the Political Process

While economic failure is a positive force in the market economy, it is commonly converted into a destructive force in the political process.

Every economy is a political economy and, for the very reason that economic failure promotes wealth in the marketplace, it promotes political responses that can undermine market productivity. A public understanding of the importance of economic failure is the best way to moderate harmful political responses to that failure. The lack of understanding of the essential role of economic failure is the biggest political obstacle to achieving free market prosperity in formerly socialist countries. The same lack of understanding prevents the market process from yielding the full measure of its potential wealth in those political economies that are predominantly capitalistic.

It is easy to see the failures imposed by market forces as isolated occurrences rather than as an integral part of a wealth-creating process. When viewed in isolation, it is natural to see economic failure as unnecessarily harsh and unfair, and conclude that government can protect people against these failures without harming economic productivity. But government cannot protect everyone against failure. The best government can do is to protect a privileged few against failure by diminishing the opportunity for success of everyone else. Obviously such special interest protection is neither efficient nor fair.

Ironically, for the very reasons that the market economy is both more efficient and fair than alternative economic systems, it appears to be unfair to the

superficial observer. Conversely, for the very reasons that the political process is typically less efficient and fair than the market process, it appears to be fair to the superficial observer. Unfortunately, harmful political policies are often fuelled by superficial impressions.

The efficiency of the market process derives from the fact that it holds people accountable for the costs of their actions. This accountability is imposed in ways that are difficult to ignore, such as bankruptcy, unemployment, and other forms of economic failure. Although this market accountability conveys long-run benefits to all by promoting productivity, each economic interest group prefers special protections against the accountability of the market while benefiting from the accountability the market is imposing on others. The fundamental fairness of the marketplace is that it does not allow such free-riding on the contributions of others. In the marketplace we all have to contribute to the general well-being by accepting the failure as well as the success that comes our way.

However, because the benefits from market accountability are general, they are easily ignored and taken for granted. Because the costs and failures of market accountability are concentrated, they easily dominate the public's perception of the market and create the impression of unfairness. Indeed, the failures inflicted by the market appear all the more unfair against the backdrop of economic success made possible by those failures.

The inefficiency of the political process results from the fact that it provides opportunities for people to acquire benefits without being held accountable for the costs. Political action commonly concentrates benefits on a well-organised few while spreading the costs thinly over the general public. As opposed to the fairness of the market process, the political process encourages some to free-ride on the contributions of others. Because political benefits are concentrated, however, they are easily noticed, greatly appreciated, and readily associated with particular policies and politicians. Because the costs are diluted over so many, they are easily ignored. The impression conveyed is that the political process motivates generosity and mitigates the unfairness of the marketplace. The larger the number receiving political benefits, and the more poorly the market operates because of the greater burden of government, the more it is that fairness seems to demand extending political benefits to yet additional recipients.

The impression that failure in the marketplace is unfair, and government action to moderate that failure is fair, is accentuated by special interest politics. No matter how well a group is organised politically, it isn't likely to be successful in obtaining special interest subsidies, protections, and other exemptions from the discipline of market competition by arguing that its members want to benefit at the expense of the general public. A far more effective technique is for a special interest to claim that they, and the public interest, are

being threatened with bankruptcy, job losses, and dislocations by unfair market forces. Whether it is farmers facing foreclosure, steelworkers facing indefinite layoffs, or the Chrysler Corporation facing bankruptcy, their chances of appealing to public compassion and obtaining political protections against market pressures are increased with a persuasive argument that those pressures are unfair.

Compassion and the Poor

Of course, with public compassion being fanned by interest groups using economic failure as a pretence for capturing special privileges, the result is unlikely to be very compassionate. Certainly there are people who for reasons beyond their control are left behind in the marketplace, and who deserve our sympathy and help. Unfortunately those who need help the most are the ones whom political action in the name of compassion helps the least. Pointing to the problem of poverty has long been the most effective way of disparaging the market economy and persuading the public that in the absence of government programs the marketplace would be littered with the poor and the impoverished. What has been almost completely ignored is the government's impotence in helping the poor. Indeed there is reason to believe that by lowering the productivity of the marketplace, government transfer programs have reduced the income of the poor. By concentrating attention on economic failure in the marketplace to justify the expansion of political control over economic decisions, the influence of special interest groups has grown and the scope of economic failure has been enlarged.

Unless economic failures are understood as integral to the successful performance of market economies, they will be seized upon by political interests as justification for expanding government action that stifles general economic productivity for the short-run advantage of the politically influential few. As long as the economic failures that impose the guiding discipline in market economies are widely perceived as unnecessary and unfair, a threat remains to the prosperity of existing capitalistic economies, and a roadblock stands in the path of economic progress in those economies that are trying to escape the blight of socialism.

*Dwight R. Lee is the Ramsey Professor of Economics at the University of Georgia, Athens. Richard B. McKenzie is the Hearin/Hess Professor of Economics at the University of Mississippi, Oxford. This article was originally published in the May 1991 issue of **The Freeman: Ideas on Liberty**. It is reproduced with the kind permission of the Foundation for Economic Education, Irvington-on-Hudson, New York 10533.*