Nationalization, Price Controls, Welfare Programs and Economic Collapse: Lessons from the Venezuelan Experience

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Abstract: The experience of Venezuela provides a clear illustration of how socialism gradually destroys an economy. During the early stages of its implementation, socialist policies will initially show positive signs of improvement in the conditions of the poor because of the provision of welfare state programs in the form of free education, health care, housing, food, cash transfers and generous pensions for the elderly. This is also accompanied by the control of prices and the use of subsidies to keep products affordable, along with the government ownership of the means of production to ensure the continuous flow of goods and services in the economy.

However, these policies are not sustainable and will always lead to inefficiency, the misallocation of resources, corruption, the accumulation of public debt, chronic high inflation (and in severe cases hyperinflation) and higher taxation which destroys the incentives to invest, produce, innovate and compete. Inflation caused by government through excessive deficit spending and the monetization of public debt, actually makes the poor worse off by increasing the cost of living way beyond the wages that workers are able to earn.

Venezuela initially funded its socialist programs with enormous oil export revenues during the period of rising world oil prices under the Hugo Chavez administration. However these oil revenues decreased when oil prices declined, and with an economy whose productive capacity was weak and underdeveloped, could not generate enough taxation to finance government spending. The country became dependent on domestic debt which was unsustainable that led to chronic hyperinflation and its economic collapse.

Key Words: nationalization; price controls; subsidies; welfare state programs; public debt; hyperinflation

1. INTRODUCTION

The promise of providing free education, health care, food and housing alongside conditional and unconditional cash transfers, unemployment benefits, and generous pensions through a government program is conventionally used by politicians to get votes and win an election campaign. Regardless of whether the position is an executive or a legislative post, the promises of free benefits will always attract more political support particularly from voters who believe that government is the solution to all economic problems and that there is a need for direct public intervention in order to correct the inequitable distribution of income and wealth in society and achieve greater equality.

Unfortunately, history has shown that massive government intervention in the form of public programs that provide free benefits actually results to unintended bad outcomes which include destroying the incentive to work, reducing productivity, increasing voluntary unemployment, increasing public debt, raising taxes, discouraging investment and innovation, decreasing the efficiency and competitiveness of industries, destroying productive capacity and worsening chronic inflation.

This situation is further worsened by the fact that welfare state programs are also accompanied by aggressive government intervention in the form nationalizing firms and industries, imposing price controls, granting subsidies and protecting local enterprises with special privileges under a crony capitalist arrangement using tariff and non-tariff barriers, and industrial regulations which restrict the entry of other potential competitors into the industry. These policies are imposed by politicians with the justification of promoting the interest of the poor, but in reality, result to bad economic outcomes for both the poor and the non-poor , and only tend to solidify their hold on political power.

The failure of massive public intervention through government ownership of the means of production or "Socialism", is clearly shown in the experiences of countries who suffered severe economic collapse such as the Soviet Union in 1991 ((Yergin,and Stanislaw 2002) and China during the great famines in 1958 to 1962, along with its widespread poverty problem which worsened up to 1979 (Wood, 2020). Britain and the India had implemented a form of socialism by allowing government to take over heavy industries, impose protectionist policies, use restrictive regulations and provide welfare state programs after the second world war. Both countries experienced severe economic crises (Britain in 1979 and India in 1991) which can be attributed to the socialist policies that led to the accumulation of enormous public debts, high fiscal deficits, large trade deficits, a balance of payments crises, rising chronic inflation and high interest rates resulting to a severe economic downturn. This forced the two countries to consequently abandon their primary socialist policies by dismantling government ownership and relinquishing control of heavy industries, removing protectionist policies, and reducing government regulations that discouraged new investment and competition (Yergin,and Stanislaw 2002).

Chile, adopted socialist policies which provided various entitlement programs to its citizens along with the nationalization of industries and expropriation of firms, the imposition of higher minimum wages, price controls, subsidies and high tariff rates on imports to protect local industries. Socialism, the welfare state and heavy government intervention in almost all activities of the citizenry became an excuse for excessive government intervention (Pinera, 2001). Alongside inadequate tax collections, the socialist policy created enormous public debts, high chronic inflation, negative economic growth and a highly unstable economy. The economy of Chile was in crisis by 1972, inducing a military coup that ousted the Marxist President Salvador Allende by 1973 (Pinera, 2001)

Although socialism is conventionally defined as a system that involves government ownership of the means of production, this definition has been expanded to include the imposition of a progressive tax system alongside the implementation of welfare state programs designed to improve income distribution and move towards an egalitarian state (Hayek, 1976). This is the reason why the provision free education, health care, food and housing alongside conditional and unconditional cash transfers, unemployment benefits, and generous pensions through a government program are socialist policies by nature, because of the intent to improve income distribution and achieve more equality in society. Such policies destroy free markets because it ends up eliminating property rights, removing the opportunities to engage in individual production and trade, taking away the incentive to work, encouraging voluntary unemployment and encouraging dependence on the state which consequently suffers from inadequate tax collections because of a weak and failing economy.

The objective of this paper is to illustrate the relationship between socialist policies which involve massive government intervention (which is always financed by increasing domestic debt) and the consequent economic crisis which is its primary outcome. The Venezuelan experience provides a modern example of how socialist policies always lead to economic collapse and how this outcome further strengthens the explanation behind the past experiences of other failed economies which had used the socialist system.

2. METHODOLOGY

The study uses a descriptive approach in illustrating the problems created by socialism which has always involved excessive deficit spending, growing public debts and high chronic inflation (in severe cases: hyperinflation) as shown by the Venezuelan experience.

3. THEORETICAL FRAMEWORK

3.1 **Inefficient production under government ownership (nationalization of firms and industries)**

Government ownership of the means of production particularly through the nationalization of firms or of the entire industry (such as the creation of government monopolies) always leads to inefficient production as shown by low product and service quality, high average costs, high prices and the need for subsidies in order to continue operations (Bresiger, 2017).

This is a standard outcome for government owned firms because it is not exposed to competition in the absence of other producers. Government protects its monopoly position by preventing the entry of other investors into the industry which eliminates competition and allows the public enterprise to continue producing low quality products and services at high average costs, sold at higher prices and continuously demand subsidies from the national government in order to cover rising operational costs (Sowell, 2015 and Bresiger, 2017).

Under free markets, inefficient firms fail and close down when they cannot stay competitive and cannot convince buyers to purchase their goods. This is the natural penalty for inefficient operations in a free market. This penalty however, does not exist when a government enterprise operates as a monopoly (Sowell, 2015).

Moral hazard

Government owned monopolies are not allowed to fail despite their inefficiencies and this makes the public enterprise behave even more inefficiently in the long run because of the absence of any penalty or discipline imposed by the market.

Government administrators do not have any incentive to improve efficiency because even when the public enterprise incurs deficits (or losses), it will not be allowed to fail and will be bailed out or subsidized in order to continue operations with the subsidies being shouldered by the tax payers (Sowell, 2015 and Bresiger, 2017).
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When a firm is owned by government, there is realistically, no individual in society, which has a personal claim or stake in the enterprise. Therefore when the firm suffers losses, no individual or citizen will take the initiative to correct its inefficiencies, because there will be no personal incentive to do this. In general, every citizen benefiting from the public enterprise will just rely on government subsidizing the firm's operations in order to continue its inefficient and wasteful existence.

3.2 **Inefficient production under price controls, subsidies and restrictive government regulations**

Price controls such as price ceilings are supposed to make goods more affordable to the consumer by setting a price lower than the prevailing market price. However, this has the effect of discouraging production and investment because it drastically reduces the opportunity to earn profits. Price controls consequently create prolonged shortages, making it more difficult for consumers to get access to goods and services. Products disappear from the shelves of groceries and department stores when price controls are imposed on a permanent basis (Friedman M., 1962 and Sowell, 2015).

Subsidies granted to government owned and or protected private sector firms ensure the continuation of inefficient, high cost and wasteful operations which penalizes the consumer with higher prices and poor product quality alongside higher taxation in the future in order to fund the subsidies (Friedman M., 1962 and Sowell, 2015).
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Restrictive government regulations such as requiring the payment of huge franchise fees in order to enter an industry along with unreasonably high quality control standards and strict production facility and storage requirements all have the effect of limiting entry into the market, discouraging new investment and eliminating competition. Without competition, the industry fails to develop, falls behind its foreign counterparts and remains uncompetitive to the detriment of the consumer and the productive capacity of the economy overall (Friedman M., 1962 and Sowell, 2015).

3.3 Efficiency under free markets

The freedom to trade goods and services with very minimal intervention by government always provides opportunities and incentives for individuals to produce what consumers need and are willing to pay for. The entrepreneurial ability of individuals is harnessed when they know that they can directly benefit from the profits derived from the production and sale of goods and services, and as long as there are no barriers which prevent the entry of other entrepreneurs into the industry, competition will occur and will introduce more improvements in product quality, will lower prices, reduce average costs and encourage more creativity, invention and innovation that promotes the development of industries. As long as individuals have the economic freedom to produce the goods and services that they are capable of , and can directly use the resources available to them, the incentive of benefitting from the profits earned from the production and sale to consumers will encourage more entrepreneurial activity and increase output in the economy (Friedman M., 1962).

Countries that have produced enormous wealth and prosperity over the last three centuries are those that had provided the economic freedom, opportunities and incentives for its own people to produce goods and services using their own capabilities and resources (Friedman M., 1962)

In a competitive market economy, the role of government is confined to protecting life, liberty and property alongside allowing individuals to freely engage in the production and exchange of goods and services. The enforcement of laws and contracts and the protection of property rights support the workings of a free market which leads to efficient resource allocation where goods and services are produced based on the interactions of consumers and firms (Friedman M., 1962).

3.4 Fiscal deficits and inflation

Chronic fiscal deficit spending financed by monetizing public debt is responsible for creating inflation that reduces the value of money, increases the cost of all goods and services and reduces the value of real income leading to a deterioration in living standards. Inflation over several years reduces the value of real wages and salaries, savings, pensions and other retirement benefits. Inflation is a hidden tax and is shouldered by every income earning individual. Deficit spending funded by the Central Bank's creation of new money allows government to continually spend beyond its means and transfer this cost to the general public in the form of inflation and a guaranty of more taxation in the future. Deficit spending financed by monetizing public debt hurts every individual in the economy through inflation, the certainty of more taxation in the future and reduced benefits from government because of larger allocations for debt service payments taken from the national budget (Greaves, (2021)

3.6 Fiscal deficits and chronic exchange rate depreciation

Deficit spending funded by foreign loans increases the country's foreign debt which in the long term, exerts a substantial amount of pressure on its foreign currency reserves and the exchange rate. Future debt payments lead to exchange rate depreciation particularly if foreign currency reserves are inadequate and the export sector is weak. Exchange rate depreciation makes foreign debts larger in domestic currency which in the long term requires a larger budgetary allocation for debt servicing.

Excessive Central Bank money creation that funds fiscal deficits increases the demand for foreign currency and leads to exchange rate depreciation in a country with limited foreign exchange reserves, huge trade deficits and weak local productive capacity (Makin, 1989).

4. RESULTS AND DISCUSSION

The modern example of economic failure as a result of imposing socialist policies is shown by the experience of Venezuela. This country used to be the wealthiest economy in South America with a per capita income higher than Japan and China and close to that of the United States during the decade of the 1950's and 1960's (Brodie, 2017) It has the largest oil reserves in South America and one of the largest in the world rivalling that of Saudi Arabia, Kuwait and Iraq. Venezuela was certified to have the world's largest proven oil reserves between 2007–2011, standing at 316 billion barrels (Ramirez, 2021)

When oil prices crashed during the decade of the 1980's and the 1990's, the Venezuelan economy experienced downturns which consequently became severe recessions that prompted the public to elect a new president by the name of Hugo Chavez. He was elected President in December 1998 and took office in February 1999. Upon assuming the presidency, Hugo Chavez implemented socialist policies that were primarily funded by rising oil revenue exports caused by soaring oil prices during the year 2000 (Abrahamson, 2020). Tax revenue collection was inadequate due to the weak performance of all the other sectors in the economy outside of the oil industry.

As president, Chavez re-wrote the Venezuelan constitution guaranteeing citizens the right to free health care, college education, housing and other government granted benefits that would move society towards greater equality in income, wealth and opportunities (Council on Foreign Relations, 2022)

Socialism totally engulfed Venezuela when Chavez was re-elected in 2006 and was fully in control of the courts and the legislature (Council on Foreign Relations, 2022) . Authorized government agencies were to seize privately owned wealth and property from Venezuela's citizens all in the name of achieving fairness and equity (Council on Foreign Relations, 2022 and The Policy Circle, 2019). Hugo Chavez took control of the nation's oil industry, expelled all foreign investors, nationalized power companies, broadcast and telecommunication firms, farms, mines, banks and grocery stores (Daniel, 2009 and the Policy Circle, 2019).

Hugo Chavez died from cancer in 2013 and his successor, Nicolas Maduro continued to implement Chavez' socialist plan with greater impunity on the Venezuelan people (Council on Foreign Relations, 2022).

At present, Venezuela is descending into anarchy with record numbers of Venezuelan migrants fleeing northward desperately trying to reach the border of the United States (Acevedo and Cirocco, 2019). Riots and violent political protests are common in the streets, while shops , groceries and department stores have empty shelves (Acevedo and Cirocco, 2019). There are severe shortages in all basic goods and services which have driven the poor, the lower and middle income households to desperation, particularly to the point of slaughtering pets and zoo animals and rummaging through garbage in order to find food. Some household are settling for rotting beef if and when it is available and crime rates have increased, particularly the incidences of murder, robbery and theft (Acevedo and Cirocco, 2019).

Hyperinflation

Based on figures released by the Central Bank of Venezuela, the inflation rate of the country was at 5,500 per cent in 2021. Hyperinflation (defined as 50 per cent inflation per month) began in 2014 at 62.2 per cent and has continually increased to reach its peak at 65,374 per cent in 2018. Double digit inflation has occurred regularly from 1984 up to 2014 with peaks at 84.5 per cent in 1989, and 99.9 per cent in 1996. Triple digit hyperinflation began in 2015 at 121.7 per cent and has continually increased to become a five figure hyperinflation rate by 2018 (Banco Central de Venezuela Annual Report, May 2019).

The Central Bank of Venezuela intentionally does not release any money supply data, however, it can be stated with certainty that the hyperinflation is fuelled by Central Bank money creation considering that the Venezuelan government is spending beyond the amount of tax revenues it is collecting and its limited access to foreign loans only means that it is resorting to more domestic borrowing from its Central Bank

In addition, the drastic devaluation of its local currency (the Venezuelan Bolivar Soberano VES) which was at Bs248,493.89 for every $1 US in January 2021 indicates an excessive amount of local currency being printed by the Central Bank that is consequently being used in the foreign exchange market to purchase the American dollar to pay for importation..

The weak local productive capacity in all industries outside of the oil sector in the Venezuelan economy has resulted to the greater importation of goods and services which requires foreign currency that is either earned through exports or borrowed from foreign banks. The enormous amount of local currency needed to buy $1 US indicates a huge demand for foreign currency being fuelled by the excessive printing of the Bolivar.

Deficit Spending

For the year 2017, the estimated ratio of public debt to Gross Domestic Product (GDP) was at 26 per cent. This increased to 180.8 per cent in 2018, 232.8 per cent in 2019, and 304.1 per cent in 2020 (Banco Central de Venezuela Annual Report, May 2019). .

The ratio of the fiscal deficit to GDP was at 22.99 per cent in 2017, 31 per cent in 2018, 10 per cent in 2019 and 5.05 per cent for the year 2020 (Banco Central de Venezuela Annual Report, May 2019). . This also confirms that the Venezuelan Central Bank has been excessively printing local currency because the main outcome of financing fiscal deficits and public debt with money creation is the five digit hyperinflation recorded in 2019 and 2020 and the four digit hyperinflation figures shown in 2021. A reduction in hyperinflation only becomes possible if lesser Central Bank money creation is used to finance public debts and the fiscal deficit.

During the year 2000, the Chavez administration substantially increased government spending on social programs resulting to fiscal deficits which could not be covered by oil revenues despite rising oil prices (Acevedo and Cirocco, 2019). Spending on education as a percentage of GDP grew from 3.4 per cent in 1998 to 5.1 percent in 2006. The ratio of health expenditures to GDP also increased substantially from 1.6 per cent in 2000 to 7.71 per cent in 2006, while spending on housing as a percentage of GDP increased from 1 per cent in 2000 to 1.6 per cent by 2006 (Restuccia, 2018). Although poverty was initially reduced during the first few years of the Chavez administration, it began to increase in 2010 which prompted the government to further increase spending on social programs to the point of raising the fiscal deficit by three times as much (Restuccia, 2018). This led to accelerating inflation to more than 40 per cent by 2013, alongside a series of devaluations of the Venezuelan currency, drastically reducing the real value of wages.

Negative Growth in Gross Domestic Product (GDP)

Growth in Gross Domestic Product (GDP) has been negative from 2014 up to 2022, with the largest decline recorded in 2019 at -35 per cent, followed by 2020 at -30 per cent, 2018 at -19.6 per cent, 2016 at -17 per cent and 2017 at -15.7 per cent (Banco Central de Venezuela Annual Report, May 2019).

The lowest declines in GDP recorded during this period was at -3.9 per cent in 2014, followed by -5 per cent in 2022, -6.2 per cent in 2015 and -10 per cent in 2021. The Venezuelan economy shrank with real GDP declining from $562.1 billion in 2013 to $144.7 billion by 2020 (Banco Central de Venezuela Annual Report, May 2019).

Double Digit Unemployment

From 1999 to 2006, double digit unemployment was recorded with the highest at 18.2 per cent in 2003 and the lowest at 10 per cent in 2006. This outcome was repeated from 2016 to 2019 with unemployment rising from 20.9 to 27.9, 35.5 and 44 per cent respectively. Unemployment rates for 2020 up to 2021 were not reported (Banco Central de Venezuela Annual Report, May 2019). Reduced job creation because of the lack of new investments in the private sector along with the excess supply of graduates coming from state colleges and universities has contributed substantially to the double digit unemployment from 1999 to 2006 and from 2016 to 2019.

Peaks and Troughs in Oil Prices

The Venezuelan recessions from 2002 to 2003 as well as from 2009 to 2010 are both associated with reductions in oil prices in the world market. International crude oil prices decreased from $55 per barrel in November 2000 to $31 per barrel in January 2002, and the economy shrank by -8.9 per cent and -7.8 per cent in 2002 and 2003 respectively.

World crude oil prices also fell from $182 per barrel in June 2008 to $56 per barrel in June 2009, and the economy contracted by -3.2 per cent and -1.5 per cent in 2009 and 2010 respectively.

When international crude oil prices fell from $122 per barrel in May 2014 to $20.9 per barrel in April 2020, the economy continuously shrank from 2014 up to 2020 with GDP falling from $562.1 billion in 2013 to $144.7 billion by 2020.

World oil prices increased to $95.72 per barrel in February 2022, but the economy continued to be in a recession with the GDP falling by -10 per cent in 2021 and is further expected to decline by -5 per cent in 2022.

Although recessions in Venezuela can be related to the occurrence of declines in world oil prices, the fact remains that the economy is weak and largely underdeveloped in the productive capacity of its other industrial sectors outside of oil from 1999 up to the present.

The economy is heavily dependent on only one productive sector which is oil and despite the many years of rising oil prices in the 1970's, the 1990's, the period from 2002 up to 2008, 2009 to 2011, 2016 to 2018 and from 2020 to 2022, there have been no improvements in the ability to produce in the other sectors of the economy. The Venezuelan government with its nationalized oil industry had squandered the gains from high international oil prices and did not make any attempts to invest its enormous oil revenues in developing the productive capacity of the other sectors of the economy.

This is the impact of socialist policies that have destroyed the productive capacity of the Venezuelan economy. When world oil prices fell, the country could not depend on any other sector to save the economy from a recession. The lack of development in the other productive sectors is caused by the absence of new investments, non-existent competition and no opportunities for other prospective businessmen because of : 1) the government ownership of the means of production (nationalization of industries); 2) the special privileges given to crony capitalists through protectionism and strict regulations that limit entry into industries and consequently eliminates competition: 3) price controls that create shortages and discourage production and investment into heavily demanded goods; 4) subsidies that allow firms (both public and private enterprises) to continue operations even if average costs are high, product quality is poor and prices are exorbitant and: 5) welfare state benefits that increase public debt, and induce more money creation by the Central Bank which leads to hyperinflation and severe economic collapse.

A Deteriorating National Oil Industry

Venezuela's hydrocarbons industry has completely collapsed after seven years of mismanagement and political purges, the dismantling of Petróleos de Venezuela S.A.'s (PDVSA) managerial structures and deviations in longstanding company policy implemented by the government of Nicolás Maduro since 2014. These actions have undermined the sector and destabilised the national economy (Ramirez,2021) .

The last report by the Organization of Petroleum Exporting Countries (OPEC) shows that Venezuela produced only 527 thousand barrels of oil per day in September 2021 (OPEC Report, 2021). This is equivalent to a reduction of 2.49 million barrels per day, or an 82.9 per cent decline in oil production capacity compared to the output levels in 2013 (Ramirez,2021)

This decline is unprecedented in the history of any oil-producing country that has not suffered a depletion of reservoirs, war or internal armed conflict (Ramirez, 2021).

While the oil sector also suffered from the global collapse of oil prices starting in 2014, the policies implemented by the Maduro government have further accelerated the decline (Ramirez, 2021).

Price controls

During the year 2003, price controls were imposed on roughly 400 basic food items in an attempt to control inflation and help the poor by making these goods more affordable (Pearson, 2007). In 2009, twelve basic food items that included white rice, cooking oil, coffee, sugar, powdered milk, cheese, and tomato sauce were subject to minimum production quotas under a price control scheme which further worsened the shortage (Grant, 2009). This outcome occurred because the production quotas could not be met as the average cost of production of these goods went beyond the price controls. Price controls which are designed to keep goods and services affordable, have always resulted to shortages because it eliminates the opportunity to earn profits which consequently discourages production and new investments into the industry.

Nationalization of industries

The nationalization of production enterprises beginning in 2006, included industries such as cement, telecommunications, electric power, steel, construction, and food processing (Daniel, 2009). This led to substantial decreases in the production of output which can be attributed to the appointment of inept government administrators, inefficient management, non-existent competition (as government owned firms were protected with tariffs, non-tariff barriers, and strict regulations along with subsidies) the absence of innovation and finally, the lack of new investments to replace worn out capital after the government took over operations .

Bad outcomes from welfare state programs

Welfare state programs may have good intentions but tend to create more bad outcomes for the economy in the long term. Free education at the tertiary level produces an excess supply of college graduates who cannot find work which requires the use of their acquired skills (this partially explains the consistent occurrence of double digit unemployment for more than two decades). The quality of education declines when it is provided for free by government because of the absence of competition from other educational institutions and the failure of students to take courses seriously because it does not require them to shoulder its true cost.

Free health care creates long lines of patients in public hospitals who cannot provide enough services and equipment to meet demand. Initially, public hospitals received enough financial support when government allocations were funded by oil revenues during the period of high oil prices in the world market. But as the world oil prices fell, the financial resources of the Venezuelan government decreased substantially with the public health sector receiving lesser funding support for its operations.

Free housing always begins with the construction of new facilities but in the long term always leads to poorly maintained tenements and the creation of inner city ghettos with high poverty and crime rates. Residents will not spend on maintenance or improvement as long as they do not own the housing facility. Cash transfers and unemployment benefits destroy the incentive to work and increase voluntary unemployment. Generous pensions for the elderly lose their value in the long term because of hyperinflation, as government attempts to finance deficit spending by borrowing more printed money from a Central Bank.

Inefficiencies of price controls, nationalization and crony capitalism

Price controls with the intention of keeping goods and services affordable have always resulted to shortages. The government ownership of the means of production leads to the absence of any form of competition, creating a situation with higher production costs, higher prices, poor product quality and the lack of new investments to raise productive capacity. Because government owned firms are not allowed to fail (because of inefficiency), these enterprises continue to depend on subsidies funded through public debts in the absence of adequate taxation. Nationalized firms become fertile grounds for corruption as appointed government administrators use their positions to channel the financial resources of the enterprise into personal bank accounts as their operations continue to be subsidized and not allowed to fail.

The few private firms allowed by government under a crony capitalist arrangement, are protected using both tariff and non-tariff barriers and industrial regulations which limits competition and eliminates the opportunities for other investors to enter and compete in the economy.

Venezuela initially funded its socialist programs with enormous oil export revenues during the period of rising world oil prices under the Hugo Chavez administration. However these oil revenues decreased when oil prices declined, and with an economy whose productive capacity was weak and underdeveloped because of socialism, could not generate enough taxation to finance government spending. The country became dependent on domestic debt which was unsustainable that led to chronic hyperinflation and its economic collapse.

5. CONCLUSIONS

During the early stages of the implementation of socialism , initial positive signs of improvement in the conditions of the poor may be observed, because of the provision of welfare state programs in the form of free education, health care, housing, food, cash transfers and generous pensions for the elderly. This is accompanied by the control of prices and the use of subsidies to keep goods affordable and the government ownership of the means of production to ensure the continuous flow of goods and services in the economy.

However, these policies are not sustainable and always lead to inefficiency, the misallocation of resources, corruption, the accumulation of public debt, chronic high inflation (and in severe cases hyperinflation) and higher taxation which destroys the incentives to invest, produce, innovate and compete . Providing welfare state programs without adequate taxation leads to the accumulation of larger public debts. Inflation caused by government through excessive deficit spending actually makes the poor worse off by increasing the cost of living way beyond the wages that the workers are able to earn. Inflation reduces the value of income and savings and individuals relying on pensions consequently realize that they cannot live as comfortably as they used to, when the cost of living rises.

Fiscal deficit spending allows government to expand, accumulate more public debt and impose more taxation which in the long run discourages private sector investment , stifles entrepreneurial activity, reduces the capacity of the economy to produce goods and services and decreases the rate at which jobs are created. Unemployment increases the incidence of poverty and unfortunately, this situation induces more calls for government to further intervene which makes economic conditions far worse. Sustained growth, low inflation and reduced unemployment can only be achieved in the long term when huge fiscal deficits are eliminated, public debts are reduced and the role of government as the welfare state is dismantled along with the creation of more opportunities for production, trade and investment.

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