First Trust
Monday Morning OUTLOOK

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Government Failure and Socialism

The biggest political news of recent months is the rise of the Democratic Socialists of America. We suppose this started in New York City, with the election of Mayor Zohran Mamdani, but it has spread to Michigan and other states.

This is not the first time the US has tilted toward socialism, it happened in the 1930s when Franklin Roosevelt was President and his Brain Trust was enamored with Stalin and the Soviet Union.

What's interesting about this movement now is that it is being driven by the younger generation, where a majority of those under 30 years of age have favorable views of socialism. Part of this is philosophical (the young are often more liberal), but there are real economic issues as well.

Affordability (of housing, food, healthcare) has become a true political problem. Bernie Sanders and Elizabeth Warren both use "trillionaire" Elon Musk as a punching bag and complain about inequality.

Most people understand socialism isn't the answer and there is a real question about the staying power of this movement. Nonetheless, policies are changing. New York City will open government-run grocery stores. Many blue states are raising tax rates on high-income earners. Redistribution is on the rise.

We won't argue that inequality has been on the rise. Nor will we argue that affordability is a real issue. What we will argue about is why this has happened.

Almost every university class in economics teaches about "market failure." The idea being that markets don't take into account externalities, like the environment, or that markets allow greedy people to take advantage of others. What they rarely teach is "government failure." The idea that big government causes slower economic growth and creates more problems than it solves.

For example, we think the affordability crisis is actually caused by big government. The federal government spends 23% of GDP, state and local governments spend 17% of GDP, and the cost of complying with government regulations eats up 7% of GDP. Add that all up and 47% of private sector production is either taxed or borrowed and used to pursue government programs.

When nearly half of production is steered to government causes, what the government subsidizes gets more expensive (like college education and health care) while there is less income available to pay for everything else. It's not just that houses cost too much, it's that incomes are reduced by the size of government spending.

So, what about inequality? It's true that capitalism gives large rewards to the most productive. It's a feature, not a bug. But inequality today has been driven by the Federal Reserve's overly easy monetary policy.

Since 2008, the money supply has more than tripled. Just during COVID it increased by 42%. The US ended up with 9% inflation, a 40-year high. But what this really did was drive up the value of assets, houses, land, businesses, …everything.

If you are a Baby Boomer and had accumulated assets over your working life, you won. If you are Gen Z, and you haven't had time to accumulate assets, you lost. You are paying more for everything but you did not experience asset appreciation and your income barely kept up with prices. No wonder things are unaffordable.

Many in Gen Z are convinced the system is rigged in favor of the Baby Boomers. But it's not capitalism that's rigged; it's government failure. We grew government too much and we printed excess money.

The irony is that the failures of government are leading many to vote for even more government.

Throughout the history of the United States we have experimented with policies like this many times. Usually we course correct. The big question today is will that happen again? We hope so. We hope that people realize "government failure" is the problem. Not "market failure." But for the moment that is not the direction we are headed.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
8-17 / 7:30 am	Empire State Mfg Survey – Aug	10.0	**9.8**	20.6	15.6
8-18 / 7:30 am	Housing Starts – Jul	1.345 Mil	**1.335 Mil**		1.427 Mil
7:30 am	Import Prices – Jul	+0.1%	**-0.9%**		+0.3%
7:30 am	Export Prices – Jul	0.0%	**-0.6%**		-0.6%
8:15 am	Industrial Production – Jul	+0.3%	**+0.4%**		+0.1%
8:15 am	Capacity Utilization – Jul	76.3%	**76.3%**		76.1%
8-20 / 7:30 am	Initial Claims – Aug 15	211K	**204K**		209K
7:30 am	Philly Fed Survey – Aug	25.0	**18.8**		41.4