

Capitalism vs. Socialism

As we wrote last week, it's not possible to analyze the economy these days without focusing heavily on what government is doing. Between the Federal Reserve, fiscal policy, and COVID-related restrictions, little in our lives avoids governmental influences.

The easiest way we can describe the current environment is that in the short-term, forecasting is easy. As the virus wanes and the U.S. rides a wave of easy money and debt, the economy, earnings, and equity values will rise. Inflation will too, and so we favor hard assets and equities over longer duration fixed income.

As we look out further, forecasting becomes much tougher. Certainly government has grown, in sheer size, and also in power. When the CDC, a health agency, can impose a moratorium on evictions (in violation of property-owners rights), the U.S. has moved a long way from its historic roots. If, after passing \$5 trillion in emergency pandemic spending, the government can be talking about \$4.5 trillion more, we have entered new territory.

The history of the world has been a battle between two competing ideologies of how resources should be distributed: Capitalism and Socialism.

Capitalism distributes resources to the most productive use through markets and competition, while at the same time putting brakes on greed and selfishness. In order to accumulate resources in a capitalist system, you must provide goods or services for which someone else is willing to pay. If your cost of production is greater than what the market is willing to pay, you will not create much wealth. Or, if a competitor can provide the equivalent or better for a lower price, you will lose market share and therefore your wealth.

As a result, while it may be true that some people in a capitalist system become extremely wealthy, they do it by creating goods or services that people want and in a way that competitors have a difficult time copying.

Under Socialism, on the other hand, politicians distribute resources. They tax individuals who have been able to create

income and wealth and then transfer those resources to their favored causes or group, often while shutting down competition. Governments do not create wealth, they spend it.

Just to be clear, Capitalism does not mean zero government, and it does not mean anarchy. There are things that government can do that benefit all citizens without redistributing wealth or income. Public safety (police and fire), electrical grids, courts, sanitation, and national defense, for example. This government spending can generate huge benefits. Unlike in the U.S., no one has built a \$1 billion paper mill in Afghanistan. Why? It wouldn't last very long under the rule of the Taliban.

It would be good if government could do these things as efficiently as the private sector, and we could make a case that many of these things should be competitively bid out, but government creates monopolies in order to defend power, sometimes for better, sometimes for worse.

In the end, because the government doesn't create wealth, it only redistributes it, the bigger it gets relative to the private sector, the harder it is to create more wealth in an economy. During the 20-years ending in the year 2000, non-defense, non-interest government spending averaged 13.2% of GDP, while U.S. real GDP grew an average of 3.4% per year. In the past twenty years (2000-2020) non-defense, non-interest government spending averaged 15.9% of the economy, while U.S. real GDP grew just 1.8% per year.

The bigger the government gets, the slower the economy grows. So far, the U.S. private sector has been able to grow, increase profits, and continue to lift wealth, although at a slower pace. We believe that's because of the power of entrepreneurs and the new technologies they create. Eventually, this may not be the case.

During the Obama years, we described the economy as a Plow Horse. It got a little pep in its step from 2016-2020, but the spending, and tax hikes, that are being proposed right now could give it shin splints. Smothering capitalism has a cost. The open question right now is how much government and how much political allocation of resources Washington agrees on.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
8-16 / 7:30 am	Empire State Mfg Survey – Aug	28.5	33.0		43.0
8-17 / 7:30 am	Retail Sales – Jul	-0.2%	-0.5%		+0.6%
7:30 am	Retail Sales Ex-Auto – Jul	+0.2%	+0.7%		+1.3%
8:15 am	Industrial Production – Jul	+0.5%	+0.4%		+0.4%
8:15 am	Capacity Utilization – Jul	75.7%	75.6%		75.4%
9:00 am	Business Inventories – Jun	+0.8%	+0.8%		+0.5%
8-18 / 7:30 am	Housing Starts – Jul	1.600 Mil	1.584 Mil		1.643 Mil
8-19 / 7:30 am	Initial Claims – Aug 15	365K	395K		375K
7:30 am	Philly Fed Survey – Aug	23.5	31.1		21.9