



Smaller Government Won!

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Well, New York City is not underwater, China did not sell bonds, oil did not stop flowing in the Bakken or Eagle Ford, the Cloud is still wherever it is, or was, the US stock market did not collapse, and the earth is still rotating on its axis. Democrats are still mad at Republicans, who are still mad at the Tea Party, who still fret about the path of fiscal policy.

In other words, nothing changed in the past three weeks...or, did it?

We subscribe to the "politics is backwards" school of thought and if you want to know why the S&P 500 hit a new high on Friday, you should try to understand how that thought process works.

Think back to 1995/96 - the last government shutdown. Conventional wisdom says President Bill Clinton pounded Newt Gingrich and the Republicans like Baylor pounded Iowa State this past weekend (71-7). That's what the polls said. Newt was done, finished, kaput, and Clinton got his mojo back.

But...is this really what happened? President Clinton signed welfare reform in 1996, and a year later, he agreed to a cut in the capital gains tax rate. These were Republican, free market-type, ideas, not liberal Democrat, ideas. So...who won?

Politics follows the laws of physics sometimes. Every action has an equal and opposite reaction – or – you can't have tons of noise without some blowback.

What is really happening is that for 48 years, taxpayers have been pushing receipts into the federal purse at a rate of about 18% of GDP. Now, that same generation is expecting to take out much more than that over their lifetimes in Social Security, Medicare, Medicaid and other federal programs. Unless the US gets serious with reform, federal spending will go to 30% of GDP in the decades ahead.

This thought belongs to Stanley Druckenmiller. We give him full credit, but also want to take it a step further.

The argument isn't all about generational politics. It's about the dead-end of the status quo. The shutdown and debt ceiling fights are just the beginning. Like Detroit, Greece, Italy, Spain, Illinois, and many others, the US has made promises that are probably impossible to meet, not just to today's older workers when they retire, but even to future workers for their retirements. Who seriously thinks the retirement age can stay around 65 as life expectancy keeps going up?

As a result, there will be changes that reduce the long-run path of government spending. It's not for nothing that the Sequester happened, and it's not for nothing that no one cares. The US is on an inevitable path toward smaller government than what's currently projected for the future.

The numbers are the first reason, but there is a second, and more important, reason, too. The US government has become so large and cumbersome that it cannot possibly keep up with the dynamism of the tech-driven, rapidly-moving, private sector. The government tries to use technology to centralize, but tech is designed to decentralize. Problems with ACA websites are not just technical, they're about information.

Government can't master or control information (i.e. markets) because it does not allocate resources in an efficient manner. As the world becomes more efficient, the inefficient are crushed. Sorry Blackberry. Sorry Post Office. Sorry Crown Books. Sorry Big Government, which either must get more coercive, or smaller. We're betting on smaller. That's why stocks are up. And, we expect them to keep going up.

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