

Dead Cat Bounce for Socialism

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The Social Welfare State is dying. Like the Berlin Wall and the Iron Curtain, the cradle-to-grave social welfare experiment must eventually collapse. A system of taxing work and profits, while subsidizing leisure, sloth, and retirement, must eventually fail.

The end of the Social Welfare State is painful for many, and it will not end quickly or quietly as the elections of this past weekend prove. Francois Hollande, a Socialist, was elected president of France, while Greece saw a surge in votes for “anti-bailout” political parties in parliament.

These elections are described as blows against “austerity.” They are also seen as anti-German. Germany resisted bailouts and pushed spending cuts.

In theory, a rejection of austerity could be a good thing. Some people include tax hikes in the concept of austerity and avoiding tax hikes would be a good thing for Europe. France has a top income tax rate of 45%, a wealth tax of 0.5% and a Value Added Tax (VAT) of 21.2%. Greece has a top income tax rate of 45% and a VAT of 23%. These burdensome tax rates hinder growth, investment and work effort and still don’t cover all the spending.

To solve the deficit problem, Francois Hollande wants to raise France’s top income tax rate to 75%. Greece’s “anti-bailout” parties, mostly on the left, also want higher taxes on the upscale, plus defense cuts. The Greek military helps break up domestic riots, so this is a self-serving demand.

So, in reality, French and Greek rejection of austerity does not mean policies that would enhance long term economic growth. Instead, it means they want to temporarily pull the wool over their own eyes, resist the obvious need to reduce government spending, and just hope for the best.

This chapter of the French story will not end well. The country has already gone much further along the road to socialism than the US, with general government spending equal

to about 56% of GDP, very near the highest of any advanced or emerging market in the world. Greece, at 49%, is not far behind. Yet, voters are doubling down.

Markets already sense the problems this will cause. The Euro is weaker and stock prices are down around the globe. Many fear that pressure on the European Central Bank to buy more Euro debt and help avoid austerity will create inflation. This is happening despite the fact that Hollande was a huge favorite to win and this should have been built into the market already. It was the ease of victory, combined with the vote in Greece that made the day feel even more anti-market.

But even easy money would ultimately be a dead end, leading to higher interest rates and less capital investment. Anyway, the Germans would never go along with a euro as weak and inflationary as many in Greece and France want. And Germany has huge leverage: if the ECB gets too loose, only Germany could leave the euro, go back to its old currency, and not get hammered by financial markets.

In the end, this is a battle the socialists are simply not going to win. Greece is too small to be convincing; France is about to show the world what doesn’t work.

With any luck, after dabbling in folly, France will reverse course quickly. Maybe Hollande himself, not an unintelligent man, will realize the mistake of fighting the end of the social welfare state. The citizens of Europe who think austerity is unnecessary are about to get a lesson in reality. In the end the only way out is more capitalism.

And this brings us to our most important point. Financial markets in the US moved abruptly to a “risk off” trade as these election results were finalized. Stocks sold off and bonds rallied. But those who think these elections will hurt the US are wrong. The end of the social welfare state in Europe is a precursor for the US. It’s a Dead Cat Bounce for Socialism.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
5-7 / 2:00 pm	Consumer Credit – Mar	\$9.8 Bil	\$10.0 Bil		\$8.7 Bil
5-10 / 7:30 am	Int’l Trade Balance - Mar	-\$50.0 Bil	-\$50.5 Bil		-\$46.0 Bil
7:30 am	Import Prices - Apr	-0.2%	-0.1%		+1.3%
7:30 am	Export Prices - Apr	+0.2%	+0.1%		+0.8%
7:30 am	Initial Claims - May 5	369K	371K		365K
5-11 / 7:30 am	PPI – Apr	+0.0%	-0.1%		0.0%
7:30 am	"Core" PPI - Apr	+0.2%	+0.2%		+0.3%
8:55 am	U. Mich. Consumer Sentiment	76.0	76.5		76.4