

## Stress Test Government

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The Federal Reserve just finished its annual round of large bank stress tests. The banks all passed – meaning they had enough capital to withstand a massive financial shock and deep recession.

These stress tests are the political result of the government blaming banks, and not Fannie and Freddie, for the 2008 Panic and are designed to prevent another “market failure.” The idea is that free markets have a tendency, all on their own, to lurch into panics, recessions or depressions. But if the federal government really wanted to develop stress tests to help maintain prosperity, we think it’d do a lot more good to stress test government, not the banks.

The biggest threat to prosperity has never been market failure; instead, the biggest threat is “government failure.”

Markets didn’t fail in the Soviet Union, North Korea, Puerto Rico, Detroit, or Illinois. Government failed.

There are three main types of government failure. One, government policies, even if well-intentioned, often cause poor investment decisions that either lead to the very panics and depressions that some accuse free markets of causing or simply lower the long-term growth potential of the economy.

Two, the tendency of government to kick the can down the road for others to fix later. And, three, the fact that government, which claims to know how to keep private companies from collapse, can’t stop government entities from collapsing because they don’t operate like business.

For example, right now the great state of Illinois has no budget, has not run a balanced budget in more than 15 years, and is technically bankrupt. Why has no one stopped this?

Where are the stress tests, regulations and “claw backs” to punish those responsible for this financial mess? Government

employees in Illinois seem to think they have more claim to the incomes and assets of the citizens of the state than the citizens themselves. This is a disaster that could – and should - have been avoided.

How can the Federal Government run deficits year after year, and project deficits for decades into the future, yet keep spending as if all was well? The US is in the midst of one of its longest recoveries ever and government still couldn’t pass any kind of reasonable stress test.

Government failure has always been, and will always be, a bigger threat than market failure. A free people have a natural incentive to fix incorrect consensus judgements in the market. Are a company’s stock or bonds overvalued? Is a bank overlending? If so, then markets work to correct them. The market punishes bad business decisions. Even if you don’t think markets always fix themselves, at least you have to admit others have an incentive to do so.

Not so with mistakes by the government. If anything, government policies are more prone to create “herding” behavior because these policies are backed by government sanctions, like fines, or even jail. Take rules that require banks to lend for reasons other than the expected return on investment, like the Community Reinvestment Act. Ignoring this, if you think its bad business, could get you in big trouble.

We won’t hold our breath waiting for the government to stress test itself, something many companies already do on their own without any government prodding. The reason we won’t is because we already know what an honest assessment would say. The present course of government policy in many states - and the federal government as a whole - is unsustainable. Who’s going to stress test that?

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
6-26 / 7:30 am	Durable Goods – May	-0.6%	<b>-0.8%</b>	<b>-1.1%</b>	-0.9%
7:30 am	Durable Goods (Ex-Trans) – May	+0.4%	<b>+0.4%</b>	<b>+0.1%</b>	-0.5%
6-29 / 7:30 am	Initial Claims - Jun 24	240K	<b>244K</b>		241K
7:30 am	Q1 GDP Final Report	1.2%	<b>1.2%</b>		1.2%
7:30 am	Q1 GDP Chain Price Index	2.2%	<b>2.2%</b>		2.2%
6-30 / 7:30 am	Personal Income – May	+0.3%	<b>+0.3%</b>		+0.4%
7:30 am	Personal Spending – May	+0.1%	<b>+0.1%</b>		+0.4%
8:45 am	Chicago PMI - Jun	58.0	<b>57.9</b>		59.4
9:00 am	U. Mich Consumer Sentiment- Jun	94.5	<b>94.5</b>		94.5

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