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The Californization of Washington

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- By DAVID WESSEL

California's economy is large, rich and vibrant. It accounts for more than $1 of every $7 of goods and services produced in the U.S. and is bigger than all but seven countries. California has less taxpayer-backed state debt per person than Massachusetts and less as a percentage of its economy than New York, according to rating agency Standard & Poor's.

By such measures, California, though hit hard by the recession and housing bust, would seem an unlikely candidate for a government that might not pay its debts. But it is, the result of a dysfunctional political system that combines well-financed referendums, super-majorities in the legislature and politicians unable to grapple with fundamental issues. Talk, now fading, is that only a constitutional convention can fix things.

The future, it's often said, arrives in California first. Is Washington next? The stalemate over health-care legislation, despite widespread acknowledgment that the status quo is unsustainable, underscores the inability of the political system to cope with complex, long-term fiscal issues. Call it the Californization of America.

Today's big budget deficit is not the problem. It is swollen by following the textbook prescription in a deep recession in which the Federal Reserve has cut interest rates to zero. The government-borrowing surge has been matched by a decline in private borrowing.

Associated Press

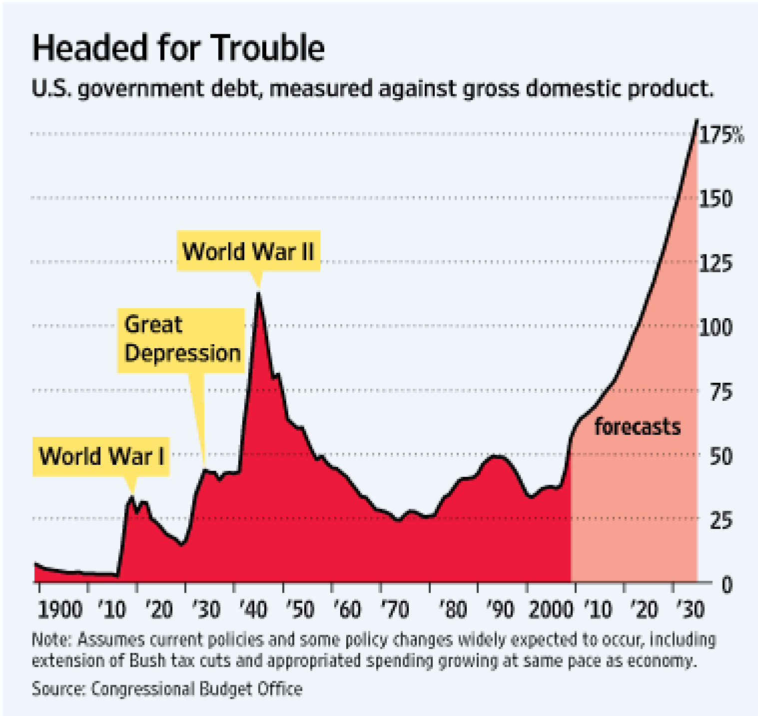
But this won't last. The recent past is reassuring, falsely so. Over the past 40 years, the U.S. government has expanded benefits and avoided massive tax increases by cutting defense spending and borrowing heavily with ease. That is no longer feasible. When deficits grew uncomfortably large, congressional and White House deal makers emerged to alter course. They always muddle through, the markets and the public concluded.

Today, the deficits projected are bigger than ever, baby boomers are beginning to retire, health-care costs keep rising and, surely, we're closer to the day when Asian governments grow reluctant to lend ever-greater sums to the U.S. Treasury at low interest rates.

The Congressional Budget Office projects current policies would take the deficit from today's 10% of gross domestic product to over 20% by 2020 and over 40% by 2080. Yet today's politics appear more toxic, and the ranks of congressional leaders with the skill and desire to fashion compromises instead of talking points are depleted.

So what happens? One possibility is a political miracle: A sudden attack of leadership or bipartisanship, perhaps the rise of another Ross Perot to galvanize public angst about deficits. Another is a plunge in the U.S. dollar or spike in bond-market interest rates that spurs government belt-tightening, perhaps forcing spending cuts and tax increases before the economy is strong enough to take them.

It could be worse. "A far worse situation would be for interest rates to stay low while we accumulated unprecedented amounts of debt only to respond very suddenly when financial markets or foreign lenders decide that the U.S. is not a good credit risk," Leonard Burman of Syracuse University and economists from the Urban Institute told a recent conference at the University of Southern California. "That could produce a catastrophic financial meltdown, similar to the one triggered by the bursting of the housing market boom, but with one important difference....The [U.S.] government will not be able to borrow to deal with its effects."



Imagine this plausible scenario: Public confidence in government continues to decline. Unemployment remains high. Americans demand more government services, more benefits and lower taxes. Politicians, seeking re-election, go along. Exhibit A: John McCain, the Arizona Republican who called for cutting Medicare as a presidential candidate last year and now, fighting for reelection to the Senate, proposes to erect new parliamentary obstacles to Medicare cuts.

In this scenario, even deficit-fearing politicians avoid taking on the long-term deficit. Mr. Burman imagines a White House political adviser saying: "Mr. President, if you raise taxes or cut popular programs, you or your party will be defeated in the polls and the bad guys will take over. The bad guys do not share your priorities and they do not care about the deficit. Therefore, you cannot effectively deal with the deficit?"

The challenge isn't coming up with options. The CBO has a book full of them, ranging from raising the retirement age to taxing carbon. It's arithmetically possible to eliminate the deficit exclusively by cutting spending. Wisconsin Republican Rep. Paul Ryan's Roadmap does. But there's no political majority for those proposals. It's arithmetically possible to eliminate the deficit by raising taxes, but the resulting tax rates would be politically and economically devastating. The challenge is fashioning a compromise that both solves the problem and is politically viable.

In August 1982, President Ronald Reagan went on TV to defend a package of spending cuts and tax increases that undid some of his earlier tax cuts: "Do we tell...Americans to give up hope, that their ship of state lies dead in the water because those entrusted with manning that ship can't agree on which sail to raise? We're within sight of the safe port of economic recovery. Do we make port or go aground on the shoals of selfishness, partisanship, and just plain bullheadedness?"

Good question.

Write to David Wessel at capital@wsj.com