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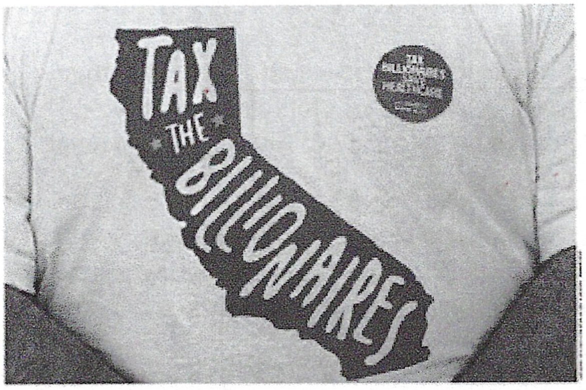
'Political risk,' usually the precinct of Third World despotisms, could soon be a concern for U.S. locales.



A T-shirt at the California Democratic Party convention in San Francisco. JEFF CHIU/ ASSOCIATED PRESS

What if California Becomes a 'Failed State'?

By Richard J. Shinder

Contemporary American conservatives largely consider federalism an unalloyed good. As " laboratories of democracy," the 50 states can each implement novel economic and social policies without endangering the entire country if they fail. But the rise of radical policies championed by progressives, particularly the ascendant Democratic Socialists of America, could push U.S. states into a category usually only of interest to international investors dealing with unstable, developing countries: unacceptable political risk.

Because individuals, businesses and capital have always been able to vote with their feet and move within the U.S. to more attractive locales if a policy mix proved toxic, on all but the most hot-button issues the major political parties have generally accepted that federalism works. Even when in violent disagreement with a given state's policies, each party knew that other states could maintain different standards. The Constitution's Commerce Clause historically provided a federalist guardrail of sorts, limiting interstate contagion from rogue state-level governance.

balance of forces or interests

Note

This equipoise between the major parties and among the states may be coming to an end, to the detriment of all. The DSA and other progressives are pushing the public-policy Overton window into uncharted territory— a policy mix that could saddle U.S. states with what international investors call "political risk." In economic terms, political risk is the additional required return on an investment due to the possibility a sovereign jurisdiction may seize an asset or otherwise diminish its value. In extreme cases —war-torn regions, full-blown kleptocracies—Western companies might decline to invest or do business.

Note

Certain progressive jurisdictions in the U.S. risk falling into this latter category, which is usually the precinct of benighted despotisms. Pricing risk of any kind relies on predictive inputs. Actuarial analysis, consideration of historical performance and precedent, trend analysis, Monte Carlo scenario modeling and the like help determine probabilities so an investor can calculate the "excess" return required to compensate for a risk. When investors choose not to transact in a region due to political risk, it implies it has become impossible to price. The political environment is too volatile or unknowable to derive the required return.

A slate of progressive policies and proposals could make the risks of doing business or even residing in certain American states and cities too unpredictable to calculate—or a compensating gain too difficult to obtain. These include wealth taxes (such as California's "billionaire tax" initiative on the ballot this fall), exit taxes, novel property levies (such as the pied-à-terre tax in New York City), and slavery reparation task forces (including in California, always a free state). There's also lawfare advanced for ideological or partisan ends: regulatory harassment (as seems to be the case in California's suit against Paramount's merger with Warner Bros.), abuse of consent decrees to direct public resources to partisan ends, and general regulatory overreach.

These policies are radical and unprecedented. Historically, Americans saw a trade-off with the downsides of living, working and investing in a durably high-tax state in the form of significant investments in infrastructure and other public goods. People and businesses could decide whether the services were worth the incremental taxes to pay for them. Even in places where the direct costbenefit analysis between taxes and government services may have seemed poor, there were other compensating qualities that state and local policy weren't caustic enough to destroy. Think of New York for the past several decades. The return derived from the accumulated social capital associated with the region, such as Wall Street, might have been worth the direct economic loss of income from a value-leeching public sector.

But these new policies could easily overwhelm any compensating values of living in certain U.S. cities and states. That they have energetic backing also raises the specter of unpredictable decline. While Americans have always left one part of the country for better opportunities elsewhere, this forces people and businesses to weigh the odds of future financial or personal calamity at the hands of unforeseeable government action. That's political risk. Note

Without such predictability, residents and businesses may simply call it quits. California best exemplifies the chill of government caprice. After losing a congressional seat in 2021 due to population loss for the first time since becoming a state, California's population has declined. Several companies—including Tesla, Oracle, CBRE and Chevron—have moved their headquarters out of state.

Americans could soon have to grapple with a question that more often concerns international investors: What comes of a failed state?

California, New York City, Seattle and other progressive states and cities are the backwash of federalism. Policies misleadingly sold as "onetime" or to advance "fairness" exploit the ignorance of a gullible, historically ignorant electorate soaked in social-media-induced class envy such that they give primacy to resentment over reason. These are bad policy prescriptions, and no rational person can credibly assert they'll work as intended as long as talent and capital remain mobile.

Maybe they aren't supposed to work. An Atlantic article in 2018 popularized a phrase later used to malign the policies of the first Trump administration: "The cruelty is the point." That today's progressive policies could be proposed and packaged as they are in the face of overwhelming evidence of their inefficacy suggests their promoters haven't stated their true goals. Perhaps the cruelty of the DSA and their fellow travelers is indeed the point.

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