



CONFERENCE CALL SUMMARY: INSIGHTS ON THE ELECTION

Summary

- Big Republican gains in the 2010 election will lead to a Congressional stalemate, halting further Democratic influenced legislation and hopefully focusing more on pro-growth regulation and taxation.
- All of the Bush tax cuts will be extended during the lame duck session. These rates will be made permanent for the middle and lower classes, while the extension will likely be temporary for the highest income earners.
- Republicans should also expect significant gains in 2012 given the number of Senate seats up for reelection and the advantage the GOP will gain in the House from largely controlling the redistricting process throughout the country.

The following is an edited summary of Laffer Associates' post-election conference calls with James Carville, John Fund, and Congressman Jared Polis (D-CO).

2010 Election Results

The 2010 election is in many ways a replica of the 1994 election — the direction of the country was heading in the same direction, presidential approval, the raw vote, the number of people voting Republican as opposed to Democratic — these were very similar. Yet there is one big difference: Even among the 2010 electorate, which was a very old and very white electorate, the Republican Party was no more popular than the Democratic Party. In '94, when the Gingrich Republicans came into office, they were actually popular. This is not the case with the Boehner class coming in.

Independents behaved very Republican in this cycle. When you lose an election as badly as the Democrats lost this one — seven percent more voted for a Republican Congressional candidate than did a Democratic Congressional candidate — there are going to be big shifts, and there were, especially in independents¹. To put this in perspective, in the 2006 election the independents broke 57/30 for Democrats, and in this election broke 56/30 for Republicans. In this business, that's an enormous swing. The independents were much more Republican and much more Conservative in this election cycle.

House

This was an enormous election for Republicans, particularly on the House side, seeing the biggest shift in seats since 1948. This is also the third election in which a significant change in the composition of the House and the Senate occurred. In 2006, it was 30 seats in the House, and 6 seats in the Senate. It was 21 House seats in 2008, and another 8 Senate seats. And now you had 63, and 6 Senate seats.

The House races were a nationalized election. Incumbents lost all over the county, primarily because voters were dissatisfied with the state of the economy. They were especially dissatisfied that the House of Representatives, managed by Nancy Pelosi, took their eye off the ball, jobs and economic recovery, and focused on their own ideological pet-projects, such as cap and trade, nationalized health care, labor law reform, financial services, regulations, etc. The electorate accordingly punished the House Democrats. The voters once again found themselves in a change election, sending the message that they thought had been sent previously in 2006 and 2008: fix the economy and produce jobs. The House defeats were especially apparent among two groups. Blue Dog Democrats - the ostensibly moderate Democrats, who in most cases went along with Speaker Pelosi on the stimulus spending, cap and trade, and healthcare - lost half their members. Out of 60 Blue Dogs there are only about 30 left. The other Democrats that lost badly were those who had voted for the health care reform bill in districts that had also voted for John McCain. They were decimated.

Senate

Senate elections are much more personality focused, much more focused on individual races with individual candidates and individual agendas, and the Republicans did well but not nearly as well as in the House. There were clearly some races where there were two common mistakes made. First, the National Senatorial Campaign Committee, the Republican arm of the Senate that selects candidates, selected candidates that were too establishment in some states and they engendered Tea Party primaries. In most cases the establishment candidate lost the primary or left the primary process electorally, like Charlie Christ in Florida; in some cases, the Tea Party-backed-candidate won (i.e. Marco Rubio); and in some cases the Tea Party candidate lost (i.e. Sharon Angle). In part the Tea Party has brought an enormous amount of energy and revitalization to the Republican Party, but it's also a new phenomenon where quality control was left to be desired. In some cases they got it right. Rand Paul, for

¹ http://www.rasmussenreports.com/public_content/politics/mood_of_america/generic_congressional_ballot

example, turned out to be a good candidate. On the other hand, Christine O'Donnell, who was catapulted to a primary victory by the support of the Tea Party Express, didn't do well and cost the Republicans that Senate seat.

The Senate is clearly going to be influenced by the looming 2012 elections. There will be 23 Democratic Senate seats up for grabs and only 10 Republican seats. The Democrats are almost certain to lose seats, putting their Senate majority in jeopardy. There will be many Democratic incumbents from red states, including Bill Nelson (D-Florida), Ben Nelson (D-Nebraska), Jon Tester (D-Montana) and other Democratic incumbents who will be looking nervously over their shoulders and perhaps casting more conservative votes.

Governor

Moving now to the Governors races, Republicans did well, but lost some important ones. Generally, when there's a big wave election, the party that is the beneficiary of the wave wins all the close ones. In this one, to an extent, that wasn't true; look at the Connecticut Governor, Illinois Governor, and Colorado Senate.

For example, Illinois was expected to go Republican, but that did not materialize due to a suspiciously large voter turnout in Chicago. In Connecticut there were some ballot shenanigans in the city of Bridgeport, the most heavily Democratic area of the state. Polls were kept open for two extra hours and the mayor of Bridgeport actually issued reverse 911 calls to all voters reminding them that the polls had been kept open for two hours, a highly unorthodox maneuver that goes against city policy. Republicans were also hopeful of recapturing the Governorship in places like Oregon and Colorado, but for a variety of reasons that didn't happen. Nonetheless, the success story of the Republicans this year is that there are gains, even though they were somewhat uneven, that extended way down the ballot to the legislative level.

Democrats

Well, the food tastes different in the White House today. This is a crushing blow. Watching their body language, and listening to some of the interviews they're giving, and watching Obama on TV from a distance, they look like a fighter that's just taken a big hit, and they're sort of reluctant to engage again. That's understandable, but time is in a crunch, and the business of the country is going to go on. We're going to have to see how much they actually do. So far, the Democrats show very little evidence that they understand the magnitude of what has happened to them. It could just be a result of confusion and readjusting, but the White House is likely going to have to change pretty dramatically in a lot of different ways to adjust to what is a new reality.

Obviously the same thing is going to be true on this Hill. You'll have Nancy Pelosi as Minority Leader and you'll have Steny Hoyer, who was the number two, as the Minority Whip. The Democrats are going to keep the same leadership team, barring some major unforeseen circumstances. This shows they're really huddling around the legislative accomplishments of the last session. So, it's not a question of trying to show a different, more moderate image. It's a message of "we're proud of health care reform and we're here to defend it. We're proud of what we accomplished in the last session and we're not shying away." It's a very strong signal that they are proudly defending the accomplishments of the last session.

Moreover, because of the widespread defeat of Blue Dog Democrats, the House Democratic Caucus will be more liberal than ever. The 80 member Progressive Caucus of the Democratic Party now represents almost half of all House Democrats. It's going to be a very different Congress next time around. Many of the Democrats who lost were the more moderate Democrats. So you're going to see a Democratic caucus whose center of gravity is going to be further to the left than the Democrats in the last Congress. That's simply the direction they move because many of the pro-business and moderate members were defeated.

Redistricting

The Republicans gained control of numerous state legislatures and governorships, enabling them to deal with reapportionment. The Republicans picked up 680 state legislative seats, the greatest number gained by any party in over forty years. As a result Republicans will control both houses of state legislature in the majority of states and will have complete control of the redistricting process in 17 states. That means they have the Governor and both houses of legislature and that they can draw district maps as they see fit. That is a very important consideration because those maps set to be drawn next year will stay in place for a whole decade. Right now, the best guess is Republicans will control redistricting in states that have about 200 House seats, Democrats will control redistricting in states that have about 60 House seats, there will be split control of about 85 seats, and commissions and independent bodies will be drawing districts in states with about 88 seats. The upshot of those GOP gains is that this will be a very difficult time for Democrats. They used to control the redistricting process, and that was one of the reasons they were able to maintain control of the House from 1954 to 1994. For example, in 1990 Republicans controlled redistricting in states of only 5 congressional districts; now it's 200.

One of the reasons the redistricting situation is so favorable for the Republicans is because of what has unfolded in California. Sixty one percent of voters approved a ballot measure that takes congressional redistricting away from the state legislature, which is controlled by Democrats, and gives it to a 14 member citizen commission. That effectively means there cannot be a gerrymander in California of the kind there was in the 1980s and then the early part of this decade, and also means that there will be a fairer redistricting plan drawing the legislative lines.

The odds of the newly elected Republican majority being extended into future elections have risen dramatically. The GOP's new redistricting strength will probably add between 12 and 20 House seats. Consequently, states that expand add new seats, likely filled by Republicans. On the contrary, states that are contracting and losing house seats will squeeze two Democratic incumbents together in more instances, and you will have a general reordering of the lines.

Ballot Initiatives

The State of Washington gives us a political petri dish experiment showing how class warfare doesn't work in American politics. Bill Gates Sr., the father of Microsoft tycoon Bill Gates, and the labor unions, especially the Service Employees International Union, got together and spent well over \$10 million dollars to revote a ballot initiative in Washington State that imposes a state income tax, with a 9% top rate. This, they said, would have only affected the top 2% of income earners, and they included as part of the measure \$800 millions dollars in tax sweeteners for the middle class. So the vast majority of people in the middle class would have seen some sort of tax cut. There would have been an income tax put in but only for the top 2%, and the Democrats thought they had hit the sweet spot in how to sell redistribution as tax policy. It failed miserably, though, with 65% of Washington State voters rejecting it. At the same time Washington voters rejected various tax increases, and they also reinstated the state's requirement of a 2/3 majority to pass future tax increases. So, even though you have states like Washington and California often electing liberals in the statewide basis, when it comes to ballot initiatives, the electorate often exercises common sense.

California

We now have Jerry Brown 8.0 who says the lesson from his recent election victory is that while the voters wanted him as Governor, they also didn't want tax increases. As he told reporters on Wednesday, they don't want their pockets picked. So, he has promised to address the budget first through spending restraint rather than through tax increases.

The public employee unions did well by turning out their existing members for the statewide races. But 10 California cities had ballot initiatives that restrict the pension and benefit packages of public employees. These towns ranged from Menlo Park, which is very wealthy, to Bakersfield, which is very working class, and even San Jose, which is the third largest city in California. In 9 of the 10 cities where measures to curb public employee unions were on the ballot, they passed. The only exception was San Francisco, which is an exception to almost everything in California. The public employee unions are living on borrowed time in terms of retaining all of their privileges and all of their political power. While Jerry Brown was elected with the help of public employee unions, he will also have to challenge them if he's going to govern the state. He may be one of the few people who can provide intellectual leadership that tries to establish some kind of common ground.

Debt Ceiling

Republicans are going to reluctantly approve the debt ceiling. They will say, "The debt run-up occurred on the Dem's watch, at least most of it, and that future improvement is necessary." Although the politics involved are somewhat tricky, the Tea Party activists will reluctantly go along with that. It will be fascinating to see how the Democrats vote on the debt limit because in the past debt limits have passed with almost unanimous Democratic support and a few grudging Republicans. Now the situation may well be reversed.

State Bailouts

California and New York have very few Republican Congressmen even after this election. There is unlikely to be any appetite in the House Republican caucus to approve a bailout, as well in the Obama administration, because a bailout for California and New York may well queue the line for other states. These states are going to have to solve the problem themselves, and you're going to see lots of very ugly cost cutting and reevaluation of government priorities.

Administration

If there's a confrontation of some type, and the Democrats lose, they'll be in real trouble. It's going to be interesting to watch, and may occur later rather than sooner, but someone is going to pick a big fight somewhere. A lot of times the course of a war is determined by early battles.

So, President Obama will rhetorically move back to the center because he realizes the impact these recent events have had on his image, but there is no indication that he is surrounding himself with new people. It's still a very tight circle—David Axelrod, who is very left wing; Valerie Jarrett, who's an adjunct of the Daley machine in Chicago; and Rahm Emanuel, the sole moderate in the Obama inner circle, who has left the building. So unless we see new personnel, something beyond flowery speeches, we can presume that Obama remains an ideologue. Even though the election was a clear rebuke of his health care proposals, he continued to defend them in his post election remarks.

President Obama's rhetoric post- election indicates that he gets the message as to why his party was shellacked, and that he wants to work with Republicans. So far his actions have contradicted that. He left the country for over a week to travel to Asia. A President who is seriously interested in reordering his priorities probably would stay in Washington and be more involved in the process. The President will make rhetorical bows to the center but very few policy bows. He will hope for the Republicans to break up as tensions between the Tea Party and establishment Republicans manifest, and the President will be prepared to challenge Republicans, especially on anything that will repeal or roll back Obama Care.

Tax Cuts

One order of business before the end of the year is the tax cut situation. Neither the president nor the progressive Democrats in Congress want to see the tax cuts expire for the middle class. That is a powerful bargaining chip in that if they have to get the votes, they need to stomach the tax cuts for people making over \$200,000 and on dividends and capital gains. President Obama alluded to this soon after the election. The real question is what proposal the Republicans will come forward with to pay for the tax cuts for the people making over \$200,000. What cuts will be made or what tax increases will they propose elsewhere as part of that overall package.

At the end of the day, our speakers believe the tax cuts will be renewed prior to the end of the year. The tax cuts for the people making over \$200,000 will be renewed for a year or two, whereas the middle class tax cuts will be made permanent. There are probably not enough votes to make all the tax cuts permanent. That will kick the debate down the road and past the 2012 election and perhaps even remove a very contemptuous issue that frankly the Democrats thought they would have an advantage on because of playing the rich against the rest of the population. There is also some talk of raising the threshold, i.e. letting the tax cuts expire for those making over \$500,000 or over \$1,000,000. The true equation for the votes won't be seen until we know what the offsetting cuts are, what needs to be cut to extend the tax cuts for people making over \$200,000, and what less will need to be extended for people making over \$1,000,000. Once you have those sides of the equation, you'll have different members of the House and Senate weighing in and making their decisions known.

112th Congress

What will the next Congress accomplish? Well, the ball is in the court of the Republicans. If they want to simply make a demonstration in the House, and pass a complete agenda knowing it will be dead on arrival in the Senate, the Democrats certainly can't stop them. It's a question of if they are willing to make progress in inches and feet or insistent on putting down the marker for where they want the country to go, and not looking back. To what extent do they want to work with the Democrats and actually get things through the Senate, and get them signed by President Obama? And to what extent do they want to symbolically reward the base that elected them, and pass bills that aren't going to go anywhere. The repeal of healthcare reform is an example, which would be dead on arrival in the Senate, and if it somehow made it out of the Senate would be vetoed.

John Boehner is House Speaker, and he now has to deal with a Democratic Senate and a Democratic veto power in the person of President Obama. Because it's unlikely that GOP economic policies can actually be written into law, there is actually more likelihood the Republicans will be very principled in the House in an effort to build a case for a Senate and White House takeover in 2012. For that reason, they need to have a simple, clear pro-growth message. Someone like Paul Ryan may now be listened to, perhaps not so much on his entitlement reforms, but at least on tax policy and regulatory policy.

This recipe, of course, translates to gridlock. Divided government becomes an ineffective, stagnant government. Washington next January will be described in many ways, but it will not be described as one big happy family. Congressional Republicans will be pulled to the right by Tea Party activists. On the Democratic side of the aisle you'll see Senators moving to the right, but you'll also see divisions pushing Democrats in the House to the left.

Tax Reform

There's definitely interest in reforming the structure and rate of corporate taxes. Had the Democrats remained the majority, they might have pushed for something along the lines of the President's Deficit and Commission report, which recommends a reduction in the corporate tax rate to 28%, effectively paid for by closing special loopholes. With the new Congressional makeup, hopefully they're willing to bring that tax rate down to help make American businesses more competitive.

Spending

There is enormous pressure to continue opening the spending spigot, and honestly we have a lot of spending in the pipeline still. There are a lot of programs that enormous constituencies will try to keep going. President Obama is unlikely to make any new major initiatives because he realizes they are not going anywhere. But we have put so much new spending into the system, there is obviously going to be pressure for the baseline to continue to grow, and that's going to be the challenge.

Congressional Hearings

At least three kinds of hearings are a distinct possibility: 1) hearings on economic growth and job creation, building the case that there is an alternative policy approach than our current trajectory; 2) hearings on the shortcomings of ObamaCare and how much difficulty it's creating around the country in insurance premiums and companies dropping coverage; 3) targeted, judicious and careful analyses of how various Obama administration departments are exceeding their authority, especially the Justice Department, which has become much more politicized than anything we saw in the Bush administration.

2012 Presidential Election

The interesting and open ended question is: How does this election affect what is going to be one of the most interesting events in American politics? Every political person, as soon as the Congressional race is over, looks to the presidential race. In terms of the Democrats, it's unlikely that a Democrat will challenge Obama, although there's some chance that Obama may choose not to run again. He doesn't seem like a man who loves his job. If he runs, though, it would be highly unlikely that he would get a serious challenge in the Democratic Party.

In the Republican Party offers much more intrigue. There are a certain number of brands that can be competitive, and it looks like somewhere between 6 and 8 is how big a field you can have of those who are considered to be serious or have a chance to be president. Given the fact that there's a sense that the Republican nomination means something, they feel like they have a real shot to win, and their voters right now tend to be very energized.

Remember that in 2007, both now President Obama and then Senator Clinton were in the race by February. So you're going to start seeing Republicans announcing early and lining up. It's like warfare or anything else, once the shooting starts, the shooting starts.

The 2012 nomination process will involve competition between Tea Partiers, establishment Republicans, and those with loyalty to both groups. Newt Gingrich and Sarah Palin are the favorites right now of the Tea Party audience. Mitt Romney is the favorite of the more establishment Republicans who don't identify with the Tea Party, and other candidates don't really have enough name recognition yet to really register, but they will be increasing their visibility in coming months. The Republicans won't necessarily nominate a Tea Party candidate for President because the Tea Party is so fragmented it doesn't have centralized leadership. But because of their higher intensity — about 40 percent of the Republicans who vote in the 2012 Presidential primaries will basically be Tea Party adherents — it will be the largest single block that will be sought after.

Of the potential candidates Mitt Romney has a lot of strengths because traditionally Republicans have always nominated the next person in line, the person who did well in the previous set of primaries but didn't quite get the nomination. Examples of that include everything from George H. Bush to Bob Dole to John McCain, but despite all of his strengths Mitt Romney has not yet been able to establish how he allowed Massachusetts health care, which has a suspicious resemblance to ObamaCare, to become law and why he still defends it.

Jeb Bush is a big 500 pound gorilla in this, and he's a very skilled guy. Palin almost has to run. She has an entire brand out there, and once you have a brand like that, if you don't run for president, you evaporate. If Mike Huckabee would have never run for president, he would just be another ex-Southern governor who lost a lot of weight. But now he's kind of at the center of things and he's got a TV show, and he's out giving speeches, and writing books, and he's getting ready to run again because he knows that there's nothing that perpetuates your brand out there like that. That's why I think Palin is going to run.

Healthcare

Clearly the House is going to defund Obamacare, and there's going to be a big debate again over healthcare. When everybody's premium starts going up, if you did nothing everyone would say "you see it's because of Obama." The Democrats, though, are going to say the reason your premiums are going up is because the Republicans took all of the cost control measures out of the healthcare bill.

And Democrats are very open to improving the health care bill. Whether it was the Democratic or Republican Congress, they would have been very excited to continue to improve it, as it is seen as the landmark legislation of the last Congress. Nancy Pelosi especially takes a lot of personal ownership in this healthcare bill. She and many others will be very excited to improve it where they can. This would be done in conjunction with President Obama and, regardless of the outcome of the last election, it was anticipated that there would certainly be legislative fixes and improvements over the next session.

Education

One area where there can be legislative accomplishments in the next few years will be in education. There won't be much major legislation coming through, but certainly one that is possible would be the reauthorization of No Child Left Behind. President Obama has been very forward thinking in his education agenda, very oriented towards choice, charter schools, accountability, and teacher incentives. There's a lot of ample ground to traditionally work with where Republicans have been on that issue towards reauthorization product, which could be the major legislative accomplishment of this session.

Immigration

Don't anticipate much happening in the realm of immigration. It's possible that a few bills, like agriculture jobs or high tech visas or entrepreneur visas, could pass, but you're not going to see any type of comprehensive program that would pass.

Free Trade Agreements

There's strong bipartisan support in Congress for the Panama, Colombia, and South Korea free trade agreements. In fact there have been a number of bipartisan letters to the administration, basically encouraging them to deliver those free trade agreements. There's not a lot that can be done, though, until they arrive in Congress.

The Fed

Several freshman Republicans who have just been elected say, "You know, we're supposed to be in charge of the government and legislative branch, and the Federal Reserve, operating independently, just injected \$600 billion dollars into the economy in easing. This not only will have fiscal implications but future inflation implications." They think the Fed has gotten out of control. You're likely going to see hearings in the House to audit the Fed. And if the Fed's actions do not lead to the creation of jobs and they do lead to beginnings of insipient inflation, then you'll see the Fed become a very controversial populist issue.