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Standoff on the Hill

By JIM MCTAGUE

Our call: The Democrats will keep control of Congress this fall—barely. A strengthened GOP could reshape crucial issues.

GET READY FOR THE END OF BIG GOVERNMENT. Though the Democrats are likely to retain control of Congress in this fall's elections, they will lose enough seats to make it virtually impossible for the Obama administration to keep pushing through its aggressive social agenda. Everything from energy policies to taxes and financial markets will be affected.

Those are the overarching conclusions of a *Barron's* analysis of the coming elections. We examined each House and Senate Race across the country. We zeroed in on each candidate's fundraising prowess, often highly predictive. We picked the brains of some of the best political consultants in the business. Our tally: The next House of Representatives will have 220 Democrats and 215 Republicans, for a net GOP gain of 36 seats. That is just three seats shy of what the party would need to seize control of the House and oust Speaker Nancy Pelosi. In the 100-seat Senate, the Democrats' majority will fall to 51 from 57 now, making it far harder to garner the 60 votes required on most important issues.

That the Democrats can even maintain majorities may seem surprising in view of the administration's plummeting popularity. As a result of missteps, such as the handling of the BP oil spill, and plain bad luck, like General Stanley McChrystal's free-wheeling interview with Rolling Stone, the administration is, in key districts, nearly as unpopular as the Bush administration that preceded it. A recent poll by Democrat Stan Greenberg and Republican Glen Bolger found that in 70 congressional districts considered in play this year, 54% of the voters disapprove of the president's performance and 40% approve.



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Scott Pollack for Barron's

Although Obama is more popular nationally than in those 70 districts, the ratings have been falling; Gallup says 47% approve and 45% disapprove. Obama's 52-week high was 62% in the summer of 2009. His ratings now aren't far from where Bush's were in 2006. In fact, President Barack Obama is being compared unfavorably with Jimmy Carter, long a symbol of ineffectiveness. If you overlay polling numbers for Carter and Obama, as Gallup does, they track very closely.

The Democrats can partly weather Obama's negatives because there are more people in the party, thanks

to Obama's remarkable get-out-the-vote drive in 2008. That increased voter turnout by five million over 2004, to 131 million people. Democrats should hold on to most of their existing seats in big states like New York, Texas and California, but some of the Democrats' best states will lose seats in redistricting by 2012.

OBAMA CAN SCARCELY afford to lose any support in Congress. The president already has problems enlisting the help of the more conservative members of his own party. His universal health-care package narrowly made it through the House. The financial reform bill that he wanted on his desk by July 4 may get there sometime this month if he's lucky—minus some controversial Democratic provisions. Think how unpalatable it will become for Democrats seeking reelection in 2012 to go along with Obama's Big Government policies if the party gets its wings clipped in November.

Democrats may well have to compromise on a raft of tax increases expected next year, when cuts initiated by George W. Bush expire. Even a widely assumed rise in the capital-gains tax, from 15% to 20% for the wealthy, could get tempered by the new Congress. Government spending could be reined in, as the Republicans use their increased strength to promote greater austerity.

"This two-year period of activist government greatly will subside," says Greg Valliere, chief political strategist for Potomac Research Group in Washington, an investment-advisory firm. "Obama isn't going to have the numbers." Allegiance to the president among Democrats will be seriously eroded by the realization that Republican Sen. Scott Brown's election to the late Ted Kennedy's seat in Massachusetts was no fluke -- Americans want government to slow down, says Valliere.

Republicans look likely to have strong showings in Pennsylvania, Ohio, Indiana and Virginia, where voters were more anti-Bush than pro-Obama in 2008 and took out their frustration on John McCain. Voters in economically depressed Ohio and Pennsylvania could prove especially testy. They believed Obama when he promised to stimulate the economy and turn the Rust Belt into a vibrant green-energy manufacturing zone. Bailing out General Motors certainly saved some United Auto Worker jobs. Some of the road projects nudged up construction employment. But if you look at a breakdown of the unemployment numbers, a large amount of the stimulus simply funded bureaucracy.

As of June, the unemployment rate among construction workers was 20.1%, down from 27.1% in February but still a jaw-dropping figure. Manufacturing joblessness stood at 9.9% in May, retail at 9.3%. The unemployment rate for government workers, on the other hand, was 4.4%.

CAPITALISTS ON WALL STREET may have wrecked the economy, but polls show the public still favors a free-market economy, as opposed to a command-and-control economy. A Pew Foundation poll found in April that 78% of Americans do not trust big government.

With that thought in mind, pay attention on election night to Indiana Rep. Baron Hill, the Democrat representing the state's 9th district, which borders Kentucky. Hill voted for the stimulus and Obamacare. He was first elected in 1998. Voters dumped him for a Republican in 2004. But in 2006, he was elected again, riding the wave of anti-Bush anger. If voters dump Hill this year, then it is probably all downhill for the Democrats nationwide from now to 2012.

Although the Republicans don't hold a primary in Arizona until August 24, even a generic challenger could

knock off incumbent Democratic Rep. Gabrielle Giffords, who represents the 8th district, which includes Tucson. Giffords has a commanding money lead, but she isn't raising nearly as much cash as Republicans on her home turf. Opposition television ads that accuse her of being Nancy Pelosi's "Puppet" seem to be doing some damage.

The same dynamic seems to be at work in New Hampshire against incumbent Democratic Rep. Carol Shea-Porter. She has the biggest war chest, but three GOP challengers campaigning in advance of a September primary have outraced her in-state -- and in-state fundraising can be the most telling. After all, out-of-staters can't vote.

Wisconsin will surprise a lot of pundits if our calculations hold true: We see Democratic incumbents Ron Kind and Steve Kagen both being ousted by GOP challengers. Kind, from Western Wisconsin, and Kagen, a physician from Appleton whose district encompasses Green Bay, ordinarily would be shoo-ins. But Republican challengers are raising more money in-state.

Kagen's district went for Obama in 2008 but for Bush in 2004. He faces the tougher challenge. Kind's district has been solidly Democratic, and he has raised more than \$1 million, a huge amount for that state. But a lot of the cash is from Washington D.C. and New York. And an estimated 20,000 Republican crossover votes that his party attracted in 2008 won't be there this time, at least not in such numbers. If Kagen falls, it will be because those Republicans will have turned out and the Democrats will have stayed at home on election day.

In the Senate, look for the GOP to add six seats, including Joe Biden's old one; they would need 10 for control of the chamber.

We don't expect Democrats in California to throw out Barbara Boxer for Carly Fiorina. Nor is Connecticut likely to vote against Democrat Richard Blumenthal simply because he sometimes claimed service in Vietnam, rather than in the Vietnam era. North Carolina voters look ready to toss out incumbent Republican Richard Burr for Democratic challenger Elaine Marshall, the state's popular secretary. Burr's problem is that he is an incumbent who has been reluctant to bash Wall Street in a year in which anti-incumbent and anti-Wall Street passions run high.

Currently there are 57 Senate Democrats (including the seat of the late Robert Byrd), 41 Senate Republicans and two independents. The next Congress is likely to see 51 Senate Democrats, 47 Senate Republicans, and two independents, who usually vote with the Democrats.

Of course, it is one very long news cycle from now to November. Pollster Scott Rasmussen of Rasmussen Reports contends Boxer and Blumenthal and other blue-state candidates could get pummeled if the unemployment rate goes back to 10%, the oil spill is unabated, and the Standard & Poor's 500 Index falls to, say, 500, which some bears see as a real possibility.

GOP EXPERTS think *Barron's* is underestimating their party's prospects in the House. The Republicans believe some 65 Democrats in conservative and moderate districts could be in danger, because they voted for Obama's unpopular universal health-care plan, which will add billions to an alarming federal deficit.

A Day at the Races

Here are some of the most intriguing races to watch as the campaign season unfolds. Check marks by the photos signify the likely winners, based on *Barron's* analysis. Our forecasting method focuses on each candidate's fundraising prowess

Retired

Republican analyst/demographer John Morgan sees the GOP picking up between 40 to 50 House seats in November. One ignores Morgan at considerable peril because his predictions are often dead-on. Back in 2006, when we were about to predict that the GOP would hold the House by one seat, Morgan warned the call would end up looking foolish -- and it did. He correctly predicted months in advance of that contest that his Grand Old Party would be grandly swept out of power by a tidal wave of voter anger.

Those elections were clear evidence that our analytical method isn't foolproof. The method isn't complicated: The candidate with the most money generally wins, though we also look at other factors. The approach did especially well in 2002, when it correctly predicted the GOP's history-defying rout of the Democrats. Not only did we predict that the GOP would add to their majority in the House, we foresaw them taking control of the Senate. This was heresy, because only two presidents since the Civil War had seen their party make gains in a mid-term election: FDR in 1934 and Bill Clinton in 1998. George Bush became the third one.

The complication this year is that although voters are at the boiling point, their anger is directed at politicians in general and incumbents in particular, regardless of party affiliation.

Democratic demographers Morley Winograd and Michael Hais maintain the Democrats won't do as badly as Morgan thinks, saying the majority of Americans continue to identify with the party. They won't make a specific prediction, however, because the party may have "mobilization issues." Simply put, getting voters aged 18-27 to the polls this cycle may be a challenge because excitement is lacking -- Obama isn't on the ballot.

Because young people move so often, many who registered in 2008 must re-register this year. Democrats plan to spend \$50 million to mobilize the cohort, but it's unclear exactly how the party will reach them. In any event, Winograd and Hais say, though the tide may be receding for Democrats, there is no incoming GOP wave.

But there could be at least a tide. Republicans believe their voters are more pumped up about voting, a theory born out by local contributions. Angry independents will vote for Republicans too, the GOP hypothesizes, simply because the Democrats are the party in power and nominally responsible for the rotten economy.

IF THE ELECTIONS GO the way we think, there will be big pluses for the GOP. For one thing, the party will go into the 2012 general election as an underdog able to blame the ruling Democrats for everything that is wrong with the country. By not taking the House, Republicans avoid having to share the blame. Also, with 36 more house members and six more senators, the GOP would be able to exert more muscle in debates on pivotal financial issues. Even if Democrats managed to power legislation through the House, they would risk an even bigger voter backlash in 2012.

HOUSE

		Democrats	Republicans
CALIFORNIA District 11	 ✓ Jerry McNerney Incumbent	 David Harmer Businessman	WHAT'S AT STAKE Republicans rap McNerney for voting down the line with Obama. But he has more dough than businessman Harmer.
	PENNSYLVANIA District 11	 ✓ Paul Kanjorski Incumbent	 Louis Barletta Mayor of Hazleton
NEW MEXICO District 2	 Harry Teague Incumbent	 ✓ Steve Pearce Former Congressman	Teague will go down. He upset voters by supporting bailout and stimulus bills, and Pearce has better local fundraising.

Chris Edwards, head of tax policy at the Cato Institute in Washington, says that if *Barron's* is right, the GOP wouldn't be able to keep the Democrats from raising income taxes on the rich -- but it would be able to force other tax cuts and

SENATE

		Democrats	Republicans
KENTUCKY	 Jack Conway Attorney	 ✓ Rand Paul Incumbent	WHAT'S AT STAKE Paul, a Tea Party favorite, should win despite his disastrous criticism of the Civil Rights Act. Conway's strong local funding isn't enough.
	MISSOURI	 ✓ Robin Carnahan Incumbent	 Roy Blunt Congressman

Clockwise from top left: Bloomberg News; AP Photo; Scott J. Ferrell/Getty Images; Roll Call/Getty Images; Billy Suratt/Newscom; Brendan Hoffman/Bloomberg; UPI Photo/Bill Greenblatt; AP Photo/John Wright; AP Photo/Susan Montoya Bryan; Andrew Herrer/Bloomberg

compromises. Plans by the Democrats to boost taxes on the middle class sometime after the election could be derailed. Under pressure by Republicans, the Democrats would probably extend these middle-class cuts on an annual basis. If they extend cuts by one year, it adds less to the national debt than changing them for, say, the next 10 years.

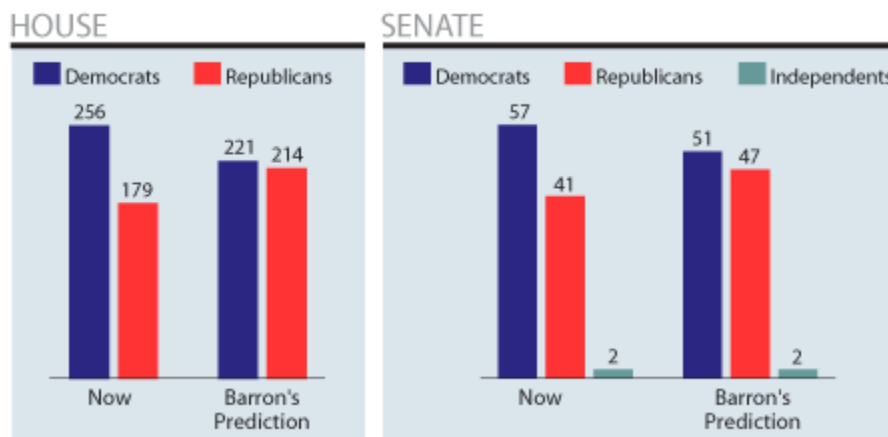
The Republicans also might be able to force Democrats to back off from increasing the capital-gains rate for wealthy persons from 15% to 20%, especially if the economy stays soft. And their strengthened hand might convince Democrats who are already feeling the heat from owners of farms and small businesses to accept a lower permanent rate on the estate tax, which is scheduled to revert from zero this year to the 45% levy in place when Bill Clinton was president.

Valliere of Potomac Research says GOP gains would be positive for the fixed-income market, because Congress would be more inclined to rein in spending, resulting in lower yields and higher prices for government bonds.

In the stock market, winners would include industries that stand to be hurt by Obama's activist agenda -- notably the oil-and-gas companies, multinationals faced with the loss of tax breaks, and manufacturers worried about taxes on carbon. Those threats would ease with greater Republican strength in Congress.

GOP Narrows the Gap

Barron's projects the Republicans will pickup 36 seats in the House and six in the Senate, though Democrats will maintain majorities in both chambers. Our tally is based chiefly on each candidate's fundraising prowess, especially in home states.



The casualties? Prospects for green technologies would dim, because Congress would eschew Obama's approach to creating a new energy infrastructure. The new Congress would be inclined to let the American consumer, not some bureaucrat at the Department of Energy, pick winners and losers.

Our predicted outcome is as close to political gridlock as you can get, and the stock market as a rule loves gridlock -- on the theory that an inactive congress is better than an active one. So it might not be bad timing to wade back into the market.

NONE OF THIS is to say the president's hands would be tied. He would still have a majority in Congress.

But he would have to reach out to the GOP to get things done, and this portends a Clintonesque shuffle from left to the center.

The scale of many Obama proposals would have to be modified. His party already is talking about legislation to price carbon emissions that would focus on electric utilities, rather than on all of the emitters, from the manufacturer to the local bakery, as originally envisioned.

Obama also would be better positioned to cut government spending, should he so choose, because he could gather enough votes from fiscally conservative Democrats and Republicans to rein in the more fiscally liberal members of Congress now in control. And if he moves to the center, he might be able to get the parties to agree on sensible tax reform ahead of 2012.

Bill Clinton was stunned when the Republicans seized control of Congress in 1994. "We got the living daylights beat out of us, losing eight Senate seats and 54 house seats, the largest defeat for our party since 1946," he recalled in his 2004 autobiography.

He says that the day after that election, he tried to make the best of a bad situation and invited the Republicans to work with him in the center of the public debate. "For the time being there was nothing more that I could do," he said. He ended up working with the Republicans to reform welfare, one of his own policy goals.

Obama will have to look at his own goals and find those on which he can stand on common ground with Republicans. Instead of giving in to the left wing of his party, he can work with centrists in both parties -- if he wants to do it.

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