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Chairman's Message

What Should We Expect from Divided Government?

For the past several years, as you may know, I have been studying the major effects of divided government, in which the presidency and at least one house of Congress are controlled by different parties. The major effects of a divided government, relative to those by a unified government, are the following:

- The rate of growth of real per capita federal spending is significantly lower.
- The probability of a war is much lower.
- The probability of a major increase in entitlements is much lower.

The apparent reason for those effects is that each party has the opportunity to block the most divisive measures proposed by the other party. In addition, fortunately, a mixed government does not preclude some major policy reforms.

Democratic control of the 110th Congress, I expect, will lead to each of those effects. The rate of growth of real per capita federal spending is likely to be lower than in any prior year of the Bush administration, in part because many congressional Republicans will remember their commitment to fiscal responsibility, and maybe Bush will remember where he lost his veto pen. The U. S. military role in Iraq will probably phase down over the next two years, and Congress will not authorize an expansion of the war to Iran and Syria. And congressional Democrats are not yet ready to propose a major new entitlement such as universal health insurance.

On the other hand, divided government is likely to lead both Bush and Congress to a combination of misleading rhetoric and mischievous legislation such as Bush's energy proposals and Speaker Pelosi's one-hundred-hour agenda. And both Bush and Congress will again defer addressing the major long-term problems, such as the looming explosion of entitlement spending. But all is not lost. There is not likely to be a major new threat to limited government in the next two years, and we can use the time to refine and promote the reforms necessary to address the major long-term problems.

And there is some opportunity for the 110th Congress to approve several important reforms. Remember that the tax reform of 1986 and the reforms of agriculture, communications, and welfare legislation in 1996 were all approved by a divided government.

The most important prospect for a major near-term reform is a comprehensive immigration bill, one that addresses the 12 million illegal aliens now in our country as well as improved border control. Such a bill was proposed by President Bush in 2005 and passed the Senate last year but was blocked by the House Republicans; the current Democratic majority in the House is likely to lead to a bill more like last year's Senate bill. As I argued in this space last year, the primary problems of uncontrolled immigration would best be addressed by building an effective fence around the welfare state, not around the country.

The most surprising opportunity for a limited near-term reform is to change the most costly provisions of the Sarbanes-Oxley Act, the consequence of several reports documenting the nature and magnitude of those costs and the concentration of the financial community in northeastern states now represented by Democrats. The new chairmen of the House and Senate banking committees have announced that they will hold hearings on the issues raised by those reports, one of which was cosponsored by Sen. Charles Schumer (D-NY), and the Securities and Exchange Commission has already made some of the changes recommended by the reports. The outcome of this process, however, will not be a major reform and may be somewhat of a mixed blessing if paired with controls on executive compensation.

Two other domestic programs *ought* to be subject to serious attention even if the administration and Congress are not yet ready for a major reform: agriculture and health.

The administration's proposal for the 2007 farm bill, unfortunately, is a hodgepodge of the good, the bad, and the ugly, an insufficient reform to rescue the Doha Round of multilateral trade negotiations. And congressional Democrats seem most inclined to renew the expensive and trade-distorting 2002 farm legislation. One or two provisions of the administration's proposal, however, merit serious attention as steps toward a broader reform. Price floors on major crops would be set at 85 percent of a rolling prior-year average of market prices, and the limits on subsidy payments per farmer would be substantially reduced.

President Bush's innovative health care proposal would provide a standard tax deduction of $15,000 for families and $7,500 for individuals who have health insurance, however that insurance is purchased and whatever the cost of the insurance. This would eliminate the current tax bias in favor of employer-provided health insurance and allow people to choose a policy more consistent with their preferences. Bush also proposed to allow states to reallocate about $30 billion of federal funds to assist people in buying private health insurance. The administration estimates that these provisions would increase the number of insured by three to four million people. A major health care reform may be too complex to negotiate as a package, and the Bush proposal would be a good first step.