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Potomac Perspective

This week's note looks at the agenda for the lame duck session, including scenarios for a year-end spending bill and the National Defense Authorization Act (NDAA). Legislation that could be added to either bill includes the SAFE Banking Act, SECURE Act 2.0, pay-go fixes, a credit card payments bill, disaster relief, and other items. There is a risk that Congress approves a spending bill that maintains fiscal year 2022 levels, which negatively impacts defense and infrastructure.

Congress is likely to attempt to block a possible strike by railroad unions, but political gamesmanship could scuttle a bill which would open the door to a strike.

Congress returns to Washington to address a long "to do" list before the current session ends within the next few weeks. The following is a brief overview of potential market-moving issues that Congress will attempt to address.

Rail Strike – Despite Democrats' reluctance to intervene in the dispute between railroads and unions, Congress is likely to pass legislation imposing a tentative deal that was reached earlier in the fall, absent a last-minute breakthrough in talks. There is some risk that legislation could fail if enough Democrats vote against a bill and Republicans – whose base is increasingly comprised of working-class voters – decide to vote against the bill in order to drive a wedge between the unions and Democrats. Both political parties would prefer to avoid the economic disruption that could be caused by a rail strike, so odds are in favor of the bill passing before the December 9 deadline. Politics, however, could complicate the vote, creating a low chance that Congress might fail to avert a rail strike.

Spending Bill – The current Continuing Resolution (CR) that funds the federal government will expire on December 16. Congress has several options to avoid a shutdown. 1. Pass an omnibus appropriations bill that would increase spending levels modestly over current levels; 2. Pass another CR (or a series of CRs) that buys Congress more time to negotiate an omnibus bill; or 3. Pass a full-year CR that would maintain last year's funding levels for the remainder of fiscal year 2023. Regardless of which option Congress pursues, odds of a government shutdown in December are remote.

Congress does not appear close to an omnibus bill, as lawmakers have yet to agree to the top-line numbers for a bill that would then lead to negotiations over levels for specific programs. It appears that Senate Republicans are reluctant to negotiate before the December 6 Georgia Senate runoff. Odds of a full-year omnibus bill passing by year end are declining.

If Congress has yet to agree to an omnibus bill by December 16, it will likely pass a CR to keep the government open. It could pass a one-week CR to allow more time to finish an omnibus bill. Congress could also decide to pass a longer-term CR that would last into early 2023 and let the next Congress figure out an omnibus bill.

Finally, Congress could pass a CR for the remainder of the fiscal year which would fund the government at fiscal year 2022 levels. This option would be opposed by many agencies including the Departments of Defense and Transportation because it would prevent any increase in spending for new or critical programs. This means scheduled increases in infrastructure funding that were part of the 2021 infrastructure law would be delayed. At the same time, a full-year CR would remove the risk of a government shutdown until at least October 1, 2023.

In addition to funding levels for defense and infrastructure programs, numerous other policy matters are tied to the spending bill. Congress could revisit the energy permitting reform bill proposed by Senator Joe Manchin (D-West Virginia) which was dropped from the September CR. Odds of including the Manchin proposals are low as numerous Democrats oppose any permitting reform, and Republicans think the Manchin bill is too weak and want to push for a broader bill.

There are at least two pay-go fixes that could be part of a spending bill – one for reimbursements for healthcare providers and the other impacting municipal finance. Although it seems likely that Congress will avoid the sequestration cuts in both areas, the uncertainty of the omnibus/CR increases the risk that pay-go cuts will be enacted.

It had previously looked like the SAFE Banking Act, which would allow depositories to bank the cannabis industry in states where cannabis is legal, could be attached to the NDAA. It now appears that SAFE stands a better chance of being attached to a spending bill. Key Democrats continue to push to include some social justice reforms (SJR) as part of the SAFE Act, but these provisions could drive away critical support from moderate Republicans that is needed to pass the bill in the Senate. This is a critical time for SAFE because if Senate Democrats continue to hold out for the SJR provisions and lose, the chances of passing the bill within the next two years would drop since the new Republican majority in the House is unlikely to prioritize SAFE. It's not quite a now or never situation, but the odds of passing SAFE get longer in 2023 than they are now.

Congress will also need to decide how to fund requests for disaster aid for Florida and other areas impacted by natural disasters, additional aid for Ukraine (and what, if any, strings are to be attached), as well as requests for additional COVID relief funding. Republicans are unlikely to agree to the last item and will, instead, push to re-purpose existing but unused COVID relief funds.

<u>National Defense Authorization Act</u> – The NDAA is a critical piece of the lame duck agenda because it is a key defense policy bill. It potentially impacts the level of defense spending in an appropriations bill (which in turn impacts non-defense spending), and serves as a vehicle for other legislation. Among the bills to monitor as possible amendments to the NDAA is a credit card payments bill sponsored by Senator Richard Durbin (D-Illinois). The Durbin bill would mandate that retailers be allowed to use multiple networks for processing credit card transactions. Chances of the Durbin bill passing are low, but it is an issue that bears watching.

<u>Georgia Runoff</u> – Georgia will hold a runoff on December 6 to determine the winner of its Senate race since neither Senator Raphael Warnock (D) nor Hershel Walker (R) won a majority in the November election. The outcome probably will not generate a market response since it will not affect the majority in the Senate. Democrats have already won 50 seats which maintains their majority. Despite not having a market impact, the race is important within Washington since it would impact Senate committee ratios which are currently set at 50-50 (reflecting the overall split in the Senate).

If Democrats win Georgia, then they would hold a 51-49 majority and would adjust committee ratios so Democrats would have a one vote majority on each committee. That would allow Senate committees to issue subpoenas without Republican support. This is something investors will likely overlook, but it could increase headline risk for some sectors such as technology and social media, financials, and healthcare as Senate committee chairs would have increased flexibility to call witnesses to testify before their committees. Senator Warnock is the slight favorite to win the Georgia runoff and give Democrats a 51-49 majority.

<u>House Speaker and Market Risk</u> - On January 3, 2023, a new Congress will convene and the House, under a new Republican majority, will elect a new Speaker. Due to the narrow GOP majority (currently expected to be 222-212 with one vacancy), it is possible that no candidate receives a majority on the House floor on that date which, in turn, could roil markets and create a risk-off trade.

Earlier in the month, House Republicans overwhelmingly nominated Rep. Kevin McCarthy (California) as the party's nominee for Speaker. However, Representative McCarthy will need a full majority on the House floor in order to be elected Speaker. All 212 House Democrats will oppose him and approximately five conservative Republicans have publicly announced they oppose him. If all five vote against McCarthy, they could block his election. Some Representatives could skip the vote, which could lower the threshold needed from 218 votes. Also, McCarthy could strike deals with Republican holdouts. This seems like the highest probability scenario since alternatives to McCarthy are unlikely to be more conservative than him. Rejecting McCarthy could lead some moderate Republicans to negotiate with Democrats to pick a consensus Speaker who would be far less acceptable to the conservatives than McCarthy. Investors cannot ignore the threats of the conservative Republicans to block McCarthy and create political chaos, but since alternatives to McCarthy are against the conservatives' political interests, odds still favor McCarthy being elected Speaker in January. At least for now.

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