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WASHINGTON POLICY STRATEGY

Potomac Perspective

2024 is off to a rough start in Washington, D.C. Despite agreements among congressional leaders on top-line budget numbers and a possible corporate tax deal, prospects for averting a partial shutdown and passing a tax bill are murky at best. Similarly, the chances of passing a foreign aid supplemental bill (which has long-term ramifications) don't look great either. A budget and foreign policy debate might not have immediate market implications but are still noteworthy for investors. The inability to pass a corporate tax bill would be a missed opportunity.

Chances of a Government Shutdown Lower But Still Likely

Chances of a government shutdown decreased slightly following an agreement between House Speaker Mike Johnson (R-Louisiana) and Senate Majority Leader Chuck Schumer (D-New York) regarding top-line numbers for fiscal year 2024 (FY24) spending. **Despite the agreement, a partial government shutdown remains our base-case, but we also expect little to no market impact.**

The Johnson-Schumer agreement was a positive step towards passing funding bills for the remainder of FY24 and averting a partial government shutdown on January 20. However, important hurdles remain, and time is short. Despite the agreement on a top-line number, leaders of the appropriations committees still have to agree on specific allocations, and these negotiations could be contentious. Furthermore, conservatives are upset by the agreement and think Speaker Johnson did not get enough in the deal. Passing the individual bills in the House will be a heavy lift. Conservatives would likely join with Democrats to defeat a procedural vote and block the bill(s). Alternatively, Johnson could bring spending bills to the floor on the "suspension calendar" which would circumvent the procedural vote, but would also require a two-thirds majority. Either way, conservative opposition could mean the spending bills will pass the House with more Democratic votes than Republican votes – a factor that contributed to former Speaker McCarthy's downfall.

If the House fails to pass the individual spending bills, there will be widespread Republican resistance to passing another short-term Continuing Resolution (CR). The September CR was a surprise move and ultimately cost former Speaker McCarthy his job. Mr. Johnson seems to be warming up to a short-term CR, but passing one would put him in a tight spot and another Motion to Vacate could be down the road.

If there is a shutdown, not all agencies will shut down at the same time. After January 19, funding for approximately 20 percent of the federal government will expire. Agencies impacted by a partial shutdown on January 20 include: the Department of Agriculture, Food and Drug Administration, Commodities and Futures Trading Commission, Department of Energy, Department of Veterans Affairs, Department of Transportation, Federal Aviation Administration, and Department of Housing and Urban Development. The remainder of the government (including the Department of Defense, the Department of the Treasury, and the Securities and Exchange Commission) is funded through February 2. Given the staged nature of the potential shutdown, there is more time to pass the required legislation. It is still not a forgone conclusion, however, that this will happen and these agencies might be shut down also if their current funding expires.

Odds of at least a partial government shutdown have decreased, but remain above 50/50.

Tax Legislation

The chairmen of the House Ways and Means Committee and the Senate Finance Committee appear close to an agreement on a tax bill that would suspend some of the corporate tax changes made in the Jobs and Tax Cuts Act of 2017 (JCTA). Despite the positive headlines, passing a corporate tax bill is far from a slam dunk.

The tax deal would temporarily suspend some of the JTCA's corporate tax provisions including:

- reinstating immediate expensing of R&D expenditures;
- reinstating bonus depreciation; and
- maintaining EBITDA as the formula used to calculate the business interest deduction.

The agreement would also probably include an extension of the Childcare Tax Credit.

Although the chairmen of the tax-writing committees are close to an agreement, the congressional leadership has yet to sign off, and members of the two parties might decide a corporate tax bill is not in their political interests in an election year. Some Republicans might think they get a better deal after the election, and some Democrats might think the increase in the Childcare Tax Credit is too small compared to the business tax provisions. In addition, some House Republicans, upset over the budget deal, might decide to vent their frustrations by blocking the tax bill. The prospects for the tax bill, therefore, remain unclear but could be clearer over the next week.

Foreign Aid Supplemental

Negotiations over immigration policy changes, which could be added to a foreign aid supplemental bill, have yet to produce a breakthrough, and without an immigration deal, the chances of passing the supplemental remain uncertain.

The supplemental includes $106 billion in aid for Ukraine, Israel, and Taiwan, but growing Republican resistance to additional aid for Ukraine (especially among House Republicans) and a growing desire among Democrats to place conditions on aid to Israel (something many Republicans would oppose) has delayed consideration of the supplemental. It had been thought that a deal on immigration policy could attract additional GOP support, but Republicans are now questioning whether it is politically smart to pass an immigration bill. An immigration deal could give President Joe Biden a political victory (and mean that Republicans own the issue, too). Instead, Republicans might reject an immigration deal, so that Mr. Biden has to contend with a border crisis during the upcoming campaign and to let Republicans pass legislation more to their liking if the party sweeps the 2024 elections.

If the immigration talks collapse, it would remove a possible sweetener for the foreign aid supplemental and put the package at risk. While failing to pass the supplemental might not impact markets in the near term, the message of American dysfunction and disengagement from parts of the world could embolden U.S. adversaries and increase geopolitical risk long term.

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