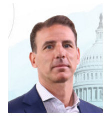
Mayday: Washington's Ticking Clock

With the X date and a new election cycle fast approaching, Washington contends with multiple time-sensitive challenges.



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The first four months of 2023 have flown by with little to nothing accomplished on Capitol Hill. With few exceptions, most Democratic and Republican priorities stand no chance at becoming law and serve only as campaign fodder heading into the 2024 election cycle. While the year before an election is typically productive, with Congress able to advance an agenda with some semblance of bipartisanship, our divided and polarized government has stood in the way of that this year. Both the Republican House and the Democratic Senate can and will continue to pass legislation, but both chambers can and will continue to reject the other's initiatives.

For now, the Senate continues to focus on moving along President Joe Biden's judicial and administration nominees, albeit rather slowly given the months-long absence of Sen. Diane Feinstein (D-CA). More pressing, though, are the three must-pass items of 2023, not the least of which is the debt-ceiling drama looming over Capitol Hill, and two bipartisan issues that may see success.

Key Points

- With the first four months of 2023 behind us, Congress is predictably off to a very slow start with seemingly no change on the horizon.
- Washington has resigned to confronting a number of critical must-pass measures in a polarized environment with a few exceptions for bipartisanship.
- May is a make-or-break month for the debt-ceiling debacle and will portend collaboration for the remainder of 2023 and 2024.

Debt Deadline or Doomsday?

Biden and House Speaker Kevin McCarthy (R-CA) have struggled to make any progress regarding the debt-ceiling crisis despite some attempts to find common ground. Given Biden's insistence on raising the debt ceiling without strings attached and the Republican success in passing a measure addressing the debt limit in the House, Republicans remain confident.

While some key players insist that a debt default will be avoided, many in Washington and on Wall Street remain unnerved as the debt deadline approaches. McCarthy and Senate Minority Leader Mitch McConnell (R-KY) have remarked that they are fully aware of the ramifications of not reaching a debt-ceiling agreement. Should the US fail to make payments on debt obligations, it faces potential economic catastrophe, political fallout, and global concerns over the full faith and credit of the US. Biden continues to encourage the four Congressional leaders (Senate Majority Leader Chuck Schumer (D-NY) and House Minority Leader Hakeem Jeffries (D-NY) included) to take default off the table, bifurcate the discussion, and tackle Washington's profuse spending problem separately.

As we approach Treasury Secretary Janet Yellen's declared X date (June 1 at the earliest), both sides are likely to bring forth issues they're willing to compromise on. That being said, don't look for a major deal any time soon. Biden and McCarthy will both have to make concessions and find a way to spin it as a victory—at what level and what cost is yet to be seen. While Biden is boxed in on one side, McCarthy doesn't have much wiggle room either, given the dissonance within his own party as seen in his January battle for the Speaker's gavel.

For now, short-term options to raise the debt ceiling are off the table, but that appears to be the most plausible outcome should negotiators inch too closely to the X date. Biden's threat of using the 14th Amendment (potentially allowing him to invalidate the debt ceiling without congressional sign-off) could be his Hail Mary and have a sobering impact at the negotiating table. It could, however, make things worse—adding a Constitutional crisis to the financial one we're already facing.

Appropriate Behavior

Once a budget blueprint for funding the US government is produced and passed, top-line numbers are established and allocated to the 12 Appropriations Committees. These committees are responsible for allotting those numbers to various government agencies. Given that there's no budget agreement in place (and we don't foresee one materializing any time soon), the committees in both the House and Senate have to operate and negotiate under different top-line numbers.

The good news is that appropriators on both sides of the dome have begun their work in earnest, hoping to pass their respective bills by the end of fiscal year (September 30). However, there's a good chance they may fall short and Congress and the White House will then be tasked with passing a continuing resolution (CR). A term we expect to hear repeatedly as the year progresses, CRs are temporary spending bills that allow federal-government operations to continue when final appropriations haven't been approved by Congress and the president. Meaning, that should Congress fail to reach an agreement, they will have to resort to passing a CR for fiscal year 2024, funding the government at 2023 levels until an agreement is reached. In fact, the House-passed debt-ceiling bill aims to hold 2024 spending to 2022 levels. If no budget agreement comes to pass and Congress fails to pass a CR, we would then be facing a government shutdown. We'll be watching this closely as the summer comes to an end.

Down on the Farm

Every five years, Congress passes legislation that sets national agriculture, nutrition, conservation, and forestry policy. The bill is critical to the US economy, and the current version expires on September 30 of this year. Priority items at the top of this year's farm to-do list include: crop insurance, conservation programs, international trade, and broadband access for rural communities. There are, however, some issues complicating this year's efforts: Industry consolidation, food inflation, foreign ownership of US farmland, and nutrition assistance tied to tougher work requirements for SNAP recipients could slow progress. Lawmakers are hoping to avoid any further partisan triggers that could delay the bill as the House and Senate committees work through their respective issues.

Tick Tock, TikTok

Mounting speculation about the future of TikTok (owned by China's ByteDance) and the potential for a forced sale has led to more discussion around the impact on competing social-media platforms and prospective buyers. If the Biden administration is genuinely prepared to act against TikTok, the ban or sale of the app would largely depend on the timing of any potential legal challenges. But that could soon change.

The RESTRICT Act, a bipartisan legislative proposal, could establish broader authority for the president to address national-security threats associated with communication products and services operated or sold by foreign adversaries. The bill, introduced in March, is already gaining support and has been endorsed by the White House. While noise about the issue has died down recently, don't let the silence fool you—the bill's increasing odds of passage could be a negotiating backstop for the administration.

Breaking the China

Back in late April, Schumer announced a bipartisan legislative package focused on China. The legislation, dubbed as China Competition 2.0, aims to limit the flow of US investments and advanced technology to China, corrals US allies to counter China's Belt and Road Initiative, and looks to deter an invasion of Taiwan. Schumer is directing Senate committee chairs to work with their Republican counterparts to agree upon and draft the contours of broader legislation over the summer. The first meetings will focus on US-China competition. Other issues we're tracking on the China front include:

- Tighter tech export controls
- Outbound investment restrictions
- Limits on cross-border data
- Supply-chain decoupling
- New regional economic alliances
- Defense deals and strategy

May is shaping up be a make-or-break month and will serve as a dysfunctional model for compromise ... or brinkmanship. Potential escape hatches to tackle the debt-limit crisis are dwindling as is the time left to pass "must-pass" legislation. Stalemates have been predicted since the midterms ushered in a divided government, and now we're weeks away from a potential default that would send shock waves through the economy and global markets. I think Washington will ultimately avoid default, but the lead-up and timing of an agreement could invite irreparable harm.

Talk to your financial professional to help make sure your portfolio is prepared for whatever happens in Washington D.C.

About the Author:

James R. (JT) Taylor serves as Senior Policy Analyst at Hedgeye Potomac Research. JT has extensive experience in both government and business in Washington, D.C., with a career spanning the legislative and executive branches as well as the financial-services industry. Prior to joining Potomac Research Group, he ran Pelorus Research, the US public-markets division of the Holdingham Group based in the United Kingdom. He previously led a policy research team as Managing Director at DeMatteo Monness. From 2002-2009, he was Managing Partner of Kemp Partners, a Washington, D.C.-based strategic consulting, business development, and marketing firm he founded with former Housing and Urban Development Secretary Jack Kemp in 2002. At Kemp Partners, he oversaw day-to-day operations and business development while managing client relationships in both the corporate arena and financial-service industries.