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Government Shutdown Update and What the Divide Might Mean for the Next Congress

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When Speaker Mike Johnson (R-LA) initially pulled his negotiating continuing resolution (CR) with the Democrats, our view was that a government shutdown was unlikely. Yes, we might have technically had one over the weekend, but we thought the leadership would work out an agreement and avoid a real shutdown. Obviously, now the odds of a shutdown have jumped to at least 50/50.

Ultimately, we expect the **healthcare extenders** and **PBM reforms**, the provisions to allow year-round **E15** in gasoline, extra **defense funds** for the Virginia class and Columbia class submarines, will largely stay intact as previously proposed and eventually be enacted, though not necessarily as part of the next CR.

Why did we think a shutdown was unlikely and even now still ascribe odds that some might consider to be low? Well, in our view during his tenure as Speaker, Johnson has consistently wanted to avoid a shutdown. He bought into the fact that Republicans lose shutdown fights and the same is likely here.

In fact, we think that desire to avoid a shutdown was on display in the CR he negotiated with the Democrats. He knew he was going to need Democratic votes to pass a CR since there are a couple of dozen House Republicans at least—as evidenced last night when 38 House Republicans voted against the new Trump-endorsed spending bill—who seemingly will never vote for a CR.

It would appear to us that the incoming Trump administration *also* wants to avoid a shutdown, but we our confidence level isn't that high. Trump probably doesn't have strong views either way but, on the margins, would prefer a deal to his liking. Johnson knows the endgame warrants Democratic votes. Whether relying on those Democrats occurs now or during a shutdown, he very likely will pass a bill that conservatives don't like. We think Johnson understands that a shutdown where Republicans are blamed—and by and large, they will be—doesn't do much good for Republicans or their agenda in the next Congress. In fact, we believe it's harmful in that Trump and congressional Republicans must expend political capital and focus on government spending versus his other priorities for an endgame that is basically preordained.

Today's Drama

As for how today progresses, we think it is likely we see another Republican-only plan(s) emerge that fails to garner the necessary 218 votes. If Johnson is going to go back hat-in-hand to the Democrats, he needs to show Trump and congressional Republicans that: 1) he can't pass a measure with only GOP votes— and 2) to get to 218 votes, he needs Democratic votes and to secure that step, he will have to give them policy wins.

If Republicans can't pass a bill on their own and Johnson refuses to re-negotiate with the Democrats, the odds of a shutdown will jump. Johnson also faces additional pressures as the race for Speaker in just a couple of weeks away on January 3. It seems to us that unless Trump comes out forcefully in his favor, Johnson will not be Speaker next year. And given that 38 Republicans voted against the CR, a Trump endorsement of Johnson may not even matter. So, if there were a shutdown lasting into January, Congress might not be able to address it until after a Speaker is elected. Recall it took three days to elect Speaker Kevin McCarthy (R-CA) in 2023.

However, in the *unlikely* event that Republicans can pass a watered-down version of the CR that doesn't include any poison pill provisions that would be objectionable to Democrats, the Senate would likely support the measure to avoid a shutdown. If a bipartisan bill passes the House, then obviously that will almost certainly pass the Senate. In our view, President Biden who has been mostly missing in action, is signing any spending bill sent to him.

As all of this plays out, we could very well also see a short-term CR into mid-January. But that might just delay a shutdown until then and will Trump want to risk the government being shut down during his inauguration? Well, the answer is likely no.

What Happens to the Various Policy Items in the Original Reconciliation Bill?

If we get a CR in the next few days, many of the items that were included in the first bipartisan deal are unlikely to be included.

If Congress doesn't settle on a broader spending bill over the next few days, we could see them passed in a final CR/omnibus appropriations bill in Q1. If not, they might have to wait until the next round of appropriation bills near the end of the year. We think the **healthcare package** needs to be done in Q1 and can't wait until YE'25. Funding for the **submarines** could make it into a reconciliation bill early next year, which we go over below.

Tax Cuts: One Reconciliation Bill or Two?

Finally, while we believe that the incoming GOP Congress will try and pass two reconciliation bills, the inability to pass a CR gives ammo to the Republicans who believe this strategy risks failure of the tax bill as it will be tough to corral votes for two reconciliation bills.

Right now, the tentative plan is to pass the first reconciliation bill in the first couple of months of Trump's administration. That bill would include funds so Trump can carry out his immigration plan, maybe some energy provisions (such as opening up ANWR and permitting reform, which we think would violate the Byrd rule) and potentially an increase in defense spending.

The second plan would extend and expand the 2017 Trump **tax cuts**. Given the difficulties Republicans have shown in passing a CR, we believe such legislation wouldn't likely pass until Q4.

As a result, we anticipate the volume to rise from congressional Republicans who want a single reconciliation strategy as we enter into the new year.

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