

SPOTLIGHT REPORT

September 9, 2021

The Path Forward for a Dysfunctional Congress to Pass Multi-trillion Dollar Legislation

What's Happening: The year's starting (for Jews), the year's ending (for appropriators), and in DC, a year's worth of legislating is about to come to a head.

Why It Matters: The post-August recess is always a busy time of the year as deadlines (real and political) loom that force a procrastinating and deliberating Congress to act. That's especially true in years where one party holds unified control of government as reconciliation enters into the mix. Democrats' top legislative priority is completing the two-track legislative process of Build Back Better reconciliation and the Infrastructure Investment and Jobs Act (IIJA). But neither are happening in a vacuum and both require near-unanimous Democratic support to pass given the lack of Republican support. **While "Democrats in disarray" for infrastructure and "political chicken" for government funding and the debt ceiling will be drummed up over the Fall legislative agenda, there's a discernible process here to pass both the partisan and bipartisan measures.** That's not to say the process isn't messy. There's always a risk of things falling off the rails. But we're not at that point (yet).

What's Next: Democrats in the House are in the process of marking up reconciliation legislation. While they may complete committee markups by their desired goal of September 15th, there's more negotiations to be had within the House and with the Senate in order to garner sufficient support. Given the breadth of the Democrats' reconciliation agenda, they will be hard-pressed to have a bill done by the time an IIJA vote is scheduled for September 27th. **In the end, our current base case is that Democrats will coalesce around a reconciliation bill in the \$2-3 trillion range, but final passage, along with the IIJA, won't occur until October at the earliest.** At the same time, government funding ends on September 30th and the X-date for the debt ceiling is projected for some time in October. Both Democrats and Republicans are in their respective corners, waiting for the other side to blink. But there are policy carrots (e.g. disaster aid, small business relief) that can be employed to help grease the wheels for enough Senate Republicans to at least support a short-term extension of the debt ceiling.

The Partisan Agenda

House Democrats are moving forward on marking up their Build Back Better agenda this week and next.

The timeline is for all the relevant House committees to complete markups by September 15th. We expect that to occur. We also expect this initial reconciliation bill to be at approximately \$3.5 trillion with at least half of it offset. House Speaker Nancy Pelosi (D-CA) yesterday said, "We are marking at \$3.5 [trillion]... We will pay for more than half, maybe all of the legislation."

Below is our current forecast on offsets:

Potential Offsets (in millions \$)					
Scorable Admin Tax Offsets					
Admin Tax Proposals	Admin Estimate	1/2 estimate	1/3 estimate	Beacon Prediction	Notes
Raise corp. rate to 28%	\$857,817	\$428,909	\$285,939	\$409,600	Raise to 25% (JCT estimate)
Revise GILTI/limit inversions	\$533,503	\$266,752	\$177,834	\$177,834	Pare back to ~1/3 admin proposal
Eliminate FDII	\$123,943	\$61,972	\$41,314	\$30,986	Pare back to ~1/4 admin proposal
Replace BEAT	\$390,051	\$195,026	\$130,017	\$97,513	Pare back to ~1/4 admin proposal
Limit financial interest deductions	\$18,588	\$9,294	\$6,196	\$18,588	Fully includes
Modify and eliminate fossil fuel taxation/breaks	\$121,253	\$60,627	\$40,418	\$0	Manchin nixes
Implement 15% minimum book tax	\$148,344	\$74,172	\$49,448	\$0	Tax writers nix
Raise top individual rate to 39.6%	\$131,920	\$65,960	\$43,973	\$131,920	Fully includes
Cap gains as ordinary income + eliminate step-up	\$322,485	\$161,243	\$107,495	\$100,000	Keep step-up, maximize rev (~28%)
Apply NIIT/SECA tax for pass throughs	\$236,500	\$118,250	\$78,833	\$236,500	Fully includes
Close "loopholes" (carried/1031/excess biz loss limit)	\$63,878	\$31,939	\$21,293	\$44,328	Keep 1031, eliminate/curtail others
IRS bank reporting requirements	\$462,646	\$231,323	\$154,215	\$231,323	Pare back to ~1/2 admin proposal
Total Scorable Admin Tax Offsets	\$3,410,928	\$1,705,464	\$1,136,976	\$1,478,592	
Scorable Non-Admin Tax Offsets					
Proposals	Estimate	1/2 estimate	1/3 estimate	Beacon Prediction	
Reform section 199A	\$110,000	\$55,000	\$36,667	\$55,000	Pare back to ~1/2 Wyden proposal
Mark-to-market carried and derivatives	\$63,900	\$31,950	\$21,300	\$0	Other tax writers nix
Other?	???	???	???	???	Carbon tax/plastic tax/estate tax/buyback, exec comp tax
Total Scorable Non-Admin Tax Offsets	\$173,900	\$86,950	\$57,967	\$55,000	
Scorable Non-Tax Offsets					
Proposals	Estimate	1/2 estimate	1/3 estimate	Beacon Prediction	
Elijah E. Cummings Lower Drug Costs Now Act (Title I)	\$456,000	\$228,000	\$152,000	\$304,000	Senate Finance version ~2/3 House leg
Eliminate Medicare rebate rule/Apply inflation caps	\$200,000	\$100,000	\$66,667	\$200,000	Fully includes (CQ Roll Call report)
Carbon polluter tariff	\$110,000	\$55,000	\$36,667	\$0	Admin nixes (Reuters report)
Labor enforcement and penalties	\$39,000	\$19,500	\$13,000	\$13,000	Parliamentarian pares back
Other?	???	???	???	???	Mega IRAs
Total Scorable Non-Tax Offsets	\$805,000	\$402,500	\$268,333	\$517,000	
Total Scorable Offsets	\$4,389,828	\$2,194,914	\$1,463,276	\$2,050,592	
Non-Scorable Offsets					
Proposals	Estimate			Beacon Prediction	
IRS funding to close tax gap	\$200B-\$815B			\$325,000	Admin's estimate
Macroeconomic effects	NA			???	Whatever Manchin accepts
Total Non-Scorable Offsets				\$325,000	
Total Offsets				\$2,375,592	

Note: Admin tax estimates come from Treasury green book; Non-admin tax estimates come from JCT; Drug pricing estimate comes from CBO; Carbon tariff estimate comes from avg. in NYT report; Labor estimate comes from CBO; Tax gap estimate comes from CBO and Sarin/Summers/Kupferberg

We will gain more clarity when the House Ways and Means Committee releases its revenue provisions next week.

But what's initially released and marked up in the House isn't what's going to make the final cut. Democrats were aiming to complete the markup and bring a single package to the floor the week of September 20th. That timeline would have allowed them to pass a reconciliation bill and then the Infrastructure Investment and Jobs Act (IIJA) by September 27th. As the process is getting underway, that ambitious timeline for both reconciliation and the IIJA looks to be falling by the wayside.

Here's a look at some of the Democratic negotiating dynamics:

- **Progressive left:** The last time Democrats were able to do reconciliation back in 2009/2010, there were 76 members of the Congressional Progressive Caucus (CPC), making up 30 percent of the House caucus. Today, there are 96 members, making up 43 percent of the House caucus. As the largest ideological bloc in the

House, they are keen on flexing their negotiating muscles in what they see as a once-in-a-generation opportunity. They [don't view](#) \$3.5 trillion as an arbitrary number, but rather a compromise they made for long-held progressive investments. After the House passed the budget resolution that included a promised vote on the IIJA, CPC Chair Pramila Jayapal (D-WA) said in a [statement](#) that the CPC "will only vote for the infrastructure bill after passing the reconciliation bill." **We believe they have the votes to deny passage of the IIJA if they are dissatisfied with the state of reconciliation, as there are only a couple dozen House Republicans in play to support the IIJA. But holding the IIJA hostage for reconciliation may only go so far.** It keeps the rest of the caucus in the House and Senate engaged, but it's not enough for someone like Senator Joe Manchin (D-WV) to completely cave on his reconciliation demands. Progressive leaders know they aren't going to get the whole loaf of what they are asking for, so it's a matter of finding a final number they can live with.

- **Loyal middle:** The middle of House Democrats can be best characterized by the New Democrat Coalition. This 95-member group is most in line with Democratic leadership's thinking and is less likely to make public noise on the process. New Democrats Chair Suzan DelBene (D-WA) yesterday said, "We should be focusing on the substance, not the dollar amount of the reconciliation bill. These are smart investments in our future. If lawmakers say they want to shrink the bill, they must articulate what programs they'd cut." Of the 32 "[Frontline Democrats](#)" who are viewed as the most vulnerable in 2022, 22 are part of the New Democrats. **They will ultimately go along with whatever the final bill will be, but they also have power in electoral value and being team players to work with committee chairs and leadership. One way this is playing out is over the healthcare fight.** New Democrats are focused on [shoring up](#) the Affordable Care Act for the long term and not [letting it be curtailed](#) due to a push by progressives and Senate Democrats to expand Medicare.
- **Centrist right:** Back in 2009/2010, there were 54 members of the Blue Dog Coalition, making up 21 percent of the House caucus. Today, there are just 19 members, making up nine percent of the House caucus. Six Blue Dogs are Frontline Democrats. "Fiscal responsibility" is their MO but what fiscal responsibility means is in the eye of the beholder. It could mean less spending, less debt, less taxation, or some combination of the three. The no votes on a large reconciliation bill will come from this group. The Mod Squad that forced Pelosi to set a date for an IIJA vote also came from this group. **Most aren't against reconciliation, but it's clear they are not going to go along with progressives.** Blue Dog Co-Chair Stephanie Murphy (D-FL) and Member Henry Cuellar (D-TX) [sent a letter last week](#) to Democratic leadership laying out three conditions for support: 1) Pre-conferencing any House bill with the Senate so what they are voting on will not get pared back by the Senate; 2) the spending should be offset with the "possible exception" of climate change provisions; and 3) there are 72 hours to evaluate the final bill before it's considered on the floor. At the Ways and Means Committee markup today, Murphy said she would vote no in the markup as the process is being rushed and there's no

accompanying score and offsets. While she's supportive of several of the spending efforts, she reiterated that tough tradeoffs need to be made to ensure this is paid for. **None of these demands are seen as barriers for ultimate reconciliation passage, but it also depends on broader congressional dynamics (re: Manchin). It also depends on a slower pace than what Democratic leadership wants.**

- **The Senate and Manchin factor:** Senate Democrats have held sway over House Democrats this year. A [function](#) of being a split Senate but also the White House's Senate leanings, the House will likely be forced to defer to the Senate on issues like drug pricing. Then there's Manchin. **Manchin should be taken seriously, not literally.** He is willing to support a final reconciliation bill. Yet Democratic pressure only goes so far to get him on board without adhering to his demands. We have discounted some of Manchin's spending and offsets concern this year, but the continued drip of vocalness in opposing the size of reconciliation has made us reconsider our views of him. [CNN yesterday reported](#) he has met with several Senate committee chairs to explain his opposition to the size and scope of numerous spending measures. As the Senate Energy and Natural Resources Committee chair, he is reportedly hard-pressed to support anything like a clean energy standard. He has held multiple discussions with the Senate Finance Committee on his views of taxation and offsets. [Axios also reported](#) that he's willing to support a bill that spends just \$1-1.5 trillion that's fully offset. That range hasn't been explicitly said by Manchin and we don't view it as a red line. However, most of the Senate understands this Manchin factor and knows it's hard to roll him. That, of course, frustrates the more progressive House. But House progressives may take a cue from a Senate progressive like Senator Bernie Sanders (I-VT), who may lead the way to counterbalance Manchin. When asked about the topline number this week, Sanders said, "So to my mind, this bill, that \$3.5 trillion, is already the result of a major, major compromise. And at the very least, this bill should contain \$3.5 trillion." Senate progressives don't have leverage with the IIJA already passing the chamber, but there's some leverage in the House vote. But even Sanders knows he's not going to get a yes vote from Manchin on \$3.5 trillion.
- **Leadership:** For Democratic leadership, the bid-ask spread on reconciliation spending is between \$1.5 trillion and \$3.5 trillion. If leadership had its way, they would pass a \$3.5 trillion bill. Pelosi and several others in leadership and committee chair positions see reconciliation as a legacy marker as Republicans are primed to win back control of the House and many leaders and chairs aren't going to stick around for the next time Democrats have unified control of government. As much as congressional power is held among the few with top-down run operations, it's not a dictatorship, especially with razor-thin margins. **As such, our current outlook is a final reconciliation package in the \$2-3 trillion range, a reduction from our previous outlook of a \$3+ trillion package.** Where that final number lands depends on leadership employing reconciliation "life hacks" to provide a win-win outcome among all the Democratic contingencies.

- o **Life hacks to increase the size of reconciliation:** Centrists like Manchin want the legislation to be fully offset but they also are not keen on raising taxes all that much. Our current offset estimate (see table above) is at \$2.38 trillion, so in the low- to mid-\$2 trillion range. But there are ways to increase the offsets without really increasing offsets in order to match higher spending. **This includes dismissing the official score** from the Congressional Budget Office (CBO) and Joint Committee on Taxation (JCT), something Senate centrists did with the IIJA and Republicans did with the Tax Cuts and Jobs Act (TCJA). While Democrats need that score to reach a reconciliation minimum of no less than \$1.75 trillion in deficits, they could point to alternate scores, whether for [closing the tax gap](#) or [macro effects](#), to say more revenue is raised than officially scored. **Another option is manipulating the official score** by including scorable offsets that aren't real or can be phased-in and never implemented. The IIJA included [several gimmicks](#) like delaying an unimplemented Medicare rebate rule. The TCJA delayed implementation of R&D amortization until 2022, which Congress is poised to [further delay](#). The Affordable Care Act's [excise tax](#) on certain health insurance was delayed until 2018. But subsequent legislation further delayed and [eventually repealed](#) it without ever being implemented. As Democrats [scrounge for new pay-fors](#), the fake offsets could produce real revenue for purposes of increasing the size of the reconciliation package.
- o **Life hacks to decrease the size of reconciliation:** The corollary here are life hacks to get progressives to accept a smaller spending bill. **One way to decrease the size of the spending is to sunset provisions earlier**, but assume that they will be further extended. Democrats are [reportedly looking](#) to extend the enhanced Child Tax Credit for just three years, but it could be even shorter. Still, if that's what's needed to get a provision included, champions of the measure will tout it and dare Republicans to take away such a benefit from voters in the future. **Another hack is to just shift the goalposts and declare victory on a smaller bill.** House Majority Whip Jim Clyburn (D-SC) indicated as much, yesterday saying, "You may not need \$3.5 trillion to do what the president wants done and what the current country needs done." Whatever the final package looks like, leadership is undoubtedly going to champion it as a major win for Democrats and the Biden agenda. It will be up to leadership to ensure these life hacks are enough on either side to keep all but three House Democrats and every Senate Democrat together in a final vote.

The Bipartisan Agenda

When asked yesterday if debt ceiling action would be paired with a continuing resolution, Pelosi said, "I'm not here to talk about where we will put the debt limit, but it won't be on reconciliation." In Kentucky today, Senate Minority Leader Mitch McConnell (R-KY) said, "The debt ceiling needs to be raised. The issue is who should do it. And under these

uniquely unprecedented circumstances, it's [Democrats'] obligation to do it. And they have the votes to do it, and they will do it." The game of political chicken is in full swing. Treasury Secretary Janet Yellen [sent a letter to Congress yesterday](#) saying the "most likely outcome is that cash and extraordinary measures will be exhausted during the month of October."

While centrist Democrats are pushing back on the reconciliation agenda, they are the reason Democratic leadership did not include a debt ceiling increase in the budget resolution. **We expect there's unity on the Democratic side for leadership's strategy of forcing Republicans to play ball.** It's also the least complicated route as amending the budget resolution and then holding a separate vote (given the challenge of passing reconciliation by the X-date) will take up time. **Of course, taking up time and complicating the reconciliation agenda is part of McConnell's ploy.** In the end, we don't see much of a long-term political price to pay over this game of political chicken of whether there's a shutdown or even default, as bad as that may appear in the near term. That could lead to a prolonged standoff resulting in a government shutdown and perhaps even a close brush with the X-date. At the same time, we don't see a long-term political price over voting to raise or suspend the debt ceiling. **Someone like McConnell is an appropriator at heart and there are other GOP appropriators and market-oriented individuals who we believe will more likely than not find a way to support at least a short-term suspension of the debt ceiling tied to a continuing resolution (CR) and disaster relief aid (something the Louisiana GOP contingency wants). That continues to be our base case.** In what could be a Christmas tree package, there could be aid for small businesses like restaurants, something that has bipartisan support. There also could be a short-term extension of surface transportation authorization included if the House can't get its duck in a row to pass the IIJA by the end of the month. That may have to also contain a general fund transfer of the Highway Trust Fund (HTF) which is set to run dry very soon.

This short-term outlook will pave the way for potentially more permanent action in the winter. That includes finishing up the National Defense Authorization Act (NDAA) and passing full-year FY2022 appropriations. Only in DC is a potential solution to a debt ceiling crisis to have more spending. But if Democrats agree to a larger hike in defense spending, it could bring GOP appropriators and defense hawks on board for a long-term suspension of the debt ceiling. When asked about tying increased defense money with the debt ceiling, House Armed Services Committee Ranking Member Mike Rogers (R-AL) said, "Whenever they're talking about adding defense money, everything's negotiable."

