Memorandum

From: **The Smith-Free Group**

Date: **January 9, 2018**

RE: **The Big Picture**

Overview

Happy New Year everyone. After surviving the worst 10-day cold snap in recent memory, we offer some thoughts on policy and politics for the beginning of 2018.

When assessing the political lay of the land, we expect more of the same this year. The president and his administration are determined every single day to win what they see as a messaging knife fight with their opponents and the media. This creates a noisy, chaotic environment that can easily distract policy makers who often cannot help but keep one eye on today's episode of the president's "show". Republicans in Congress were able to remain focused enough to pass a major tax bill just before Christmas, and now we will see if they are able to build on that momentum when trying to unravel all of the intertwining issues in a knotty CR. We have written before of the challenge facing Republicans of converting the president's winning electoral coalition into an effective governing coalition, and to our minds that remains when it comes to public policy the preeminent question for 2018.

During the last three mid-term elections, the party holding the White House was trounced at state and congressional ballot boxes. Early indications are that 2018 will be a good year for Democrats. Both parties recognize this and how they respond both strategically and tactically will be key in determining what happens on the Hill. Will Democrats continue all-out opposition to the president? Senate Republicans seem to have prevailed initially in arguing for work on bipartisan initiatives (infrastructure?), as opposed to entitlement reform Speaker Ryan wants; but, will that approach hold steady?

Even-numbered years usually do not see Congress passing much in terms of legislation, so the smart early bet is on fewer rather than more legislative achievements. But, other important factors are at work and could affect legislative outcomes. If the economy continues to improve, would this help to change the dynamic? Rumors continue to swirl of coming news stories accusing a large number of Members of sexual harassment, revelations that if true could spur or delay legislation. This recent piece by Paul Kane points out the aging of the Senate and underscores the obvious in how the frail health of senators can affect scheduling and vote outcomes. Finally, always lurking is the silent specter of the Mueller investigation.

Legislation

We know at least the first two months of the year are going to be dominated by work on the CR. Congress next week will pass another short-term extension, lasting to anywhere from mid-February to the beginning of March. At issue will be what, if any, outstanding issues can be resolved either on a standalone basis or as part of the next stopgap bill.

We are near-certain there will be no government shutdown, although it might take multiple short-term CRs to resolve matters. In the meantime, it is most likely the outstanding issues will be resolved in order of the breadth of their bipartisan support (more support = earlier action). A rough ordering would be: disaster spending, FISA Sec. 702 extension, CHIP reauthorization, flood insurance reauthorization, and perhaps some tax extenders. The obvious two most challenging holdouts are immigration (DACA plus some sort of increased security measures) and Obamacare fixes (Alexander/Murray).

We expect the Senate to be in session more frequently than the House this year. As Leader McConnell recently remarked at several events: "I have one incumbent in a difficult election; they have a bunch. What do you think we are going to do?" We suspect many of the Monday and Friday votes will be judicial confirmations, votes that get the attention of both Democratic and Republican bases.

Here is how we see things in several specific legislative areas:

<u>Transportation/Infrastructure</u> – For years we have believed there is formidable bipartisan support in Congress for a transportation/infrastructure bill, and we continue to think it is possible to pass an ambitious proposal in 2018. The recently-enacted tax bill provides a possible template: congressional leaders working with the White House on a broad framework of principles, then letting the Hill committees of jurisdiction get to work supported by "air cover" and sometimes directional cajoling from the president. There is no structural reason why this effort could not be done in a bipartisan manner.

For months, White House staff has shopped to the Hill and downtown the outline of a proposal that would radically change the paradigm of transportation funding and regulation, shifting the bulk of funding and project decisions to states and localities while shrinking the federal role. So far we do not think they have converted many believers to the cause, and if there is a bill we expect it will resemble a more traditional transportation authorization measure. One policy wild card is how broadly "infrastructure" would be defined. Decisions to include, or not, items as "infrastructure" could have a real impact on the consideration of legislation.

<u>Financial Services Legislation</u> – We believe Congress is poised this year to pass the most significant changes to Dodd-Frank since the Act was passed in 2010. For years, the House has sent a steady stream of bills to the Senate to amend DFA, and only a handful have been enacted. But recent passage by the Senate Banking Committee of a bipartisan bill has set the stage for floor consideration as early as February. After years of legislative spade work, a core group of Democrats and Republicans has fashioned a bill and we expect them to remain locked in arms against poison pill amendments on the floor.

In the years since TARP, one recent study concluded the largest banks combined now have double the capital and triple the liquidity they had before the financial crisis in 2008, and the handful of "money center" banks have on their balance sheets enough loss-absorbing capacity to withstand the loss of the 34 largest bank holding companies. In fact, the six largest banks have raised more than double the equity capital of the TARP issuance for the entire industry. While the Senate bill, and any likely new law, focuses more on regulatory relief for smaller, community banks, we expect the White House to begin to talk about this bill in terms of job creation and economic growth.

Regulations and Nominations – After almost a year in office, the Trump Administration has yet to fill a number of senior positions in the agencies. Despite a flurry of confirmations at the end of last year, 131 nominations were carried over and are still pending in the Senate. Part of this continues to be due to Democratic obstruction in the Senate, and part is due to slow processing of nominees by the White House. Additionally, as we have pointed out before, the president has no plans to fill some slots as a way of stifling underling career civil servants he views as hostile to his agenda.

But no matter the reason the Administration has begun to leave its mark at the regulatory level, delivering solid victories to the conservative base throughout 2017. For instance, in the last week: DoJ ended the Obama Administration's lenient approach to marijuana; the Interior Dept. announced the opening of vast stretches of federal waters to oil and gas drilling; State announced it was withholding military assistance to Pakistan; HUD delayed the compliance date of an Obama-era rule requiring state spending of federal funds on anti-discrimination policies; and, the ITC approved a 96% increase in duties on Chinese tool chests and cabinets.

For all of the discussion about the slow start for Republicans on the legislative front last year, the accomplishments on the regulatory front have been tangible. This trend will continue, and we expect it will continue apace especially when it comes to more controversial matters, like Obamacare, where Congress might not act.

Tax Bill – Coming on the heels of the ACA collapse, passage of the tax bill from not much more than scratch in less than five months was an impressive feat. Like many, we were skeptical it would happen up until the very end. But now in the wake of enacting a new tax law what lessons can we draw from the effort?

- 2017 ain't 1986. Parts of the recently-enacted bill constitute real, serious reform, especially on the international side. Overall the legislation is serious but not as sweeping as the 1986 effort. Interestingly, a review of polling by Gallup from after passage of the 1986 law shows middling support for the effort; it was only years later that the proposal gained its mythic reputation.

- Some form of a state and local deduction has been in the code since its inception, and while shrunken by the new law still endures.

- Professional practitioners agree on the need for a "technical" bill to fix obvious, non-policy errors in the bill. There had already been a bipartisan effort underway for several years by technicians on the Hill to update parts of the code, and while we think it is possible for a package of corrections and fixes to pass Congress this year, we believe it will be tightly limited to items that in no way affect policy or revenue.

- There will be an ongoing communications effort surrounding the new law all year. Republicans feel that Democrats did a good job at the outset in characterizing the bill as a giveaway to the rich, and the GOP has worked over the holidays to counteract this message by circulating news stories about corporate investment following enactment.

- A number of provisions that were not part of the bill were included in an extenders package introduced by Sen. Hatch. Because of skepticism by Speaker Ryan and Chairman Brady, we are skeptical a package will be enacted this year, but many of the provisions (expired energy provisions, medical device tax) have solid bipartisan support so the possibility of passage cannot be completely discounted.

- The bill sets up a series of expiring provisions in future years – medical expense deduction (2018), employer credit for time certain granted under the Family and Medical Leave Act (2019), craft beverage provisions (2019), Individual rates/personal deduction exemptions/expanded child credit/pass-through rates (2025), bonus depreciation (2016). There will be many serious efforts to revisit this new law in the near future.

2018

Slowly but surely the next federal election cycle is coming into focus. Coming off strong showings in November state elections and the Alabama Senate race, most of the traditional metrics the professional politicos use point toward a good year for Democrats up and down the ballot. But Trump is not a traditional politico, seeking to dominate every single daily news cycle and to upend seemingly most every norm of politics.

So far, 51 House members (16 Democrats, 35 Republicans) have left or announced their departure, and we believe there will be several more announcements in the coming weeks. This list includes seven committee chairs, a clear sign of unease on the Hill. The next scheduled House elections are: Texas primaries on March 6, PA18 (Murphy) on March 13, Illinois primaries on March 20, and AZ08 (Franks) special election on April 24.

Our friend, Glen Bolger, recently posted a memo on suggestions for Republicans running in what is shaping up to be a challenging environment. As a reminder, 23 House GOP are running in seats won by Hillary Clinton in 2016; 12 Democrats are similarly running in Trump seats. Sen. Heller is the only Republican running in a Clinton state, while eight Democratic senators are running in Trump states. So while supporters of the president will note that in 2016 he ran ahead of final polling numbers in key states by anywhere from 7-11 points, he is not on the ballot in 2018 and his low job approval numbers (under 40% in the most recent analysis by Real Clear Politics) give cold comfort to Republicans.

Taking a step back, over the last decade we have seen voters swing wildly back and forth: strong showings by Democrats in 2006 and 2008, a House Republican surge in 2010, a solid victory by

Obama in 2012; Republican gains in 2014; and, the surprising Trump win combined with Senate Republicans overcoming a formidable map to maintain control in 2016. To be blunt, many of the DC pundits failed to predict a good number of these events and polling has become less and less reliable.

Bottom line for us at this early point in 2018: going by traditional metrics for measuring mid-term elections (presidential approval ratings, retirements) the signs are ominous for Republicans, but we will wait before jumping on any bandwagon racing toward November 6th.

Worth a Read

Women outpace men in American medical school enrollments for the first time.

The truth is out there.

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So you think you are not addicted?

More of us are shopping online than you think.

Calendar

Jan. 19	FY2018 continuing resolution expires
Jan. 30	State of the Union
Feb. 4	Super Bowl LII
Feb. 14	Washington Nationals pitchers and catchers report to spring training
Mar. 6	Texas primary elections; beginning of primary season
Mar. 18 – Apr. 1	Russian Elections
Mar. 29	Baseball Opening Day
Mar. 31	FAA and CHIP authorizations expire
Late Mar.	Federal government hits the debt ceiling
May 5	114th running of the Kentucky Derby, the greatest two minutes in sports