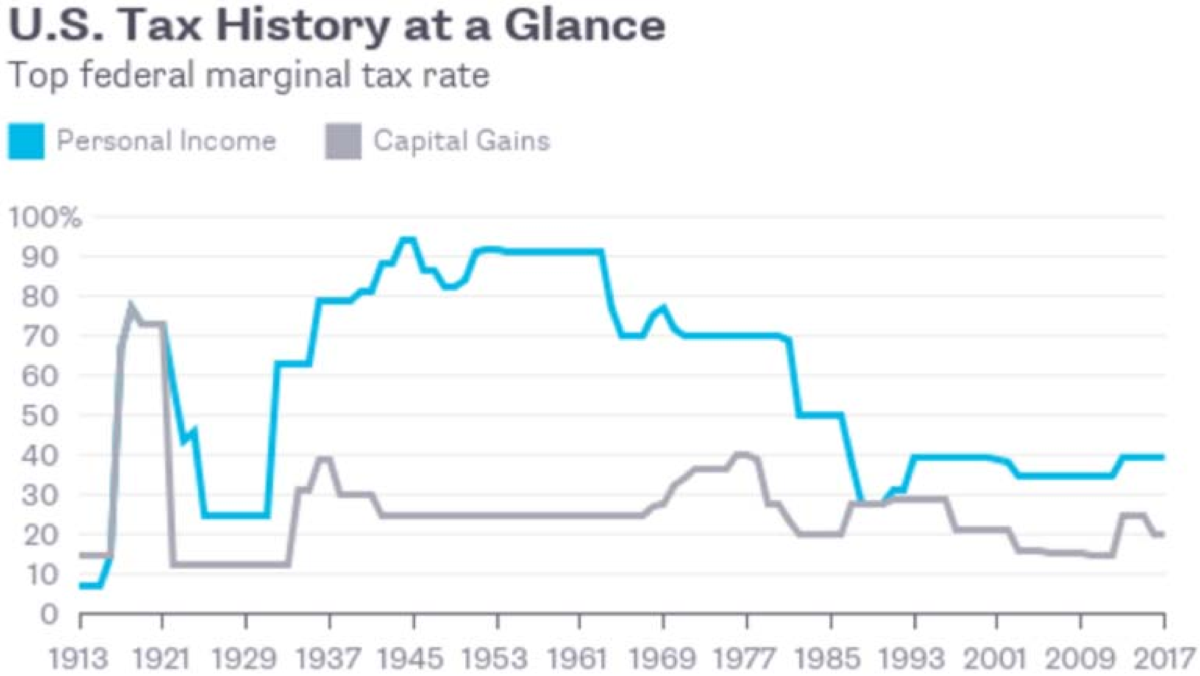
Why It's Been 31 Years Since the Last Tax Reform



Sources: Inside.gov & Internal Revenue Service

President Donald Trump has promised the most comprehensive overhaul of the tax system since 1986. That was when a Republican president joined forces with a Democratic House of Representatives and a Republican Senate to lower personal income-tax rates and simplify a messy and outdated tax system.

Today, Republicans control both houses of Congress as well as the White House. Democrats agree with them that the system has once again become messy and outdated. So in theory it should be easier to reach agreement now than it was then.

Forget that theory. Passing tax reform this year will be a much tougher slog than it was 30 years ago, or than Republicans expect it to be today.

Republican opposition would have doomed President Ronald Reagan's plans without Democratic support, and the bipartisanship and skilled political leadership needed to push them through don't exist today.

Thus while a sweeping tax-reform bill is a top priority of both Trump and House Speaker Paul Ryan, with a goal of passing it by July, the odds are that it won't happen. A look at what took place in 1986 helps explain why.

The architect of the 1986 tax bill was a Democratic senator, Bill Bradley, who was a relentless and effective advocate. The concept was embraced and proposed by Reagan, who delegated the responsibility for getting it through to Jim Baker, the most politically skillful Treasury secretary of modern times, and his brilliant deputy, Richard Darman, a genius at navigating the intersection of policy and politics.

On Capitol Hill, the chairmen of the two tax-writing committees surprisingly rose to the occasion. The Democratic Ways and Means Chairman Dan Rostenkowski transcended his roots as a Chicago machine politician to become a national legislator. Senate Finance Committee Chairman Bob Packwood stopped defending tax benefits tailored for some of the business interests he and other Republicans had faithfully championed.

The result was a comprehensive bill that slashed individual and corporate rates while compensating for the lost revenue by closing loopholes. That meant eliminating tax advantages enjoyed by powerful interest groups like the oil and real-estate industries and overcoming their formidable allies in Congress.

On the way, the 1986 tax bill nearly died on multiple occasions as lobbyists pressed their cases. Throughout almost two years of debate and negotiation, the conventional wisdom was that the proposal would not survive. It was defeated once in the House. The Senate, with Democrats and Republicans equally beholden to special interests, appeared to be a certain graveyard.

Then, as the bill reached final passage, Senate Republican Leader Bob Dole marveled that in a matter of days, it went from "immovable to unstoppable." It cleared the Senate by 97 votes to 3. A combination of will, skill and ideological flexibility made it possible.

For example, conservatives got the lower individual rates they favored by giving liberals something they wanted: stiff increases in corporate taxes (something Reagan chose not to talk about in public). Liberals suppressed their horror at the idea of a 28-percent rate for wealthy people (down from 70 percent just six years earlier) because conservatives overcame their fears about constraining economic growth.

Today, that spirit of horse-trading is gone. Many Republicans are dead-set against raising any taxes, even if needed to offset cuts elsewhere. Some Democrats are unbending on reducing high U.S. corporate tax rates despite widespread agreement that they are counterproductive. It's hard to see why either side would give ground.

The Trump administration's tax-reform effort, for now, is being guided by a top White House economic adviser, Gary Cohn. Until a month ago he was president of Goldman Sachs Group Inc., and undoubtedly is knowledgeable about taxes. When it comes to Washington politics, though, he's no Jim Baker.

In Congress, Paul Ryan is a committed tax-policy wonk, as are a number of other Republican leaders. At this stage there is no Democrat who might be a Bradley or Rostenkowksi. In the Senate, Finance Committee chairman Orrin Hatch, who once worked across the political aisle, has become an aging partisan, lacking the dexterity Packwood displayed.

The reason personal heft matters so much is that tax reform is so hard. It directly affects as many, if not more people, than a health-care overhaul. By definition, there are winners and losers -- somebody gets something at somebody else's expense. The losers always feel more passionate and make more noise.

"Doing major tax reform with familiar income or consumption taxes has proved remarkably difficult -- even when everyone agrees that reform is necessary," notes Michael Graetz, a Columbia Law School professor and former Treasury Department tax official who has written extensively on the issue.

The machinations Republicans are starting to go through attests to that wisdom. Ryan says the final product won't reduce government revenue and Treasury Secretary Steven Mnuchin says the wealthy won't get a net tax cut. Those claims are overtures to moderates. But given Republican fondness for lowering rates, especially for the wealthiest taxpayers, neither result is likely.

Republicans envision a new sales tax on domestic and imported goods and services dubbed a "border adjustment tax," a variation of a European-style value-added levy that would favor exporters like Boeing and Caterpillar over equally powerful consumer-product companies like Wal-Mart and Target, not to mention consumers themselves. There's economic merit to the idea since it would raise money to enable rate cuts and avoids the crude protectionism that Trump has championed.

But it would create a big new tax, and already some House conservatives are objecting. So has the right-wing advocacy group Americans for Prosperity, which was founded by the Republican mega-donors Charles and David Koch.

Politics aside, Graetz, who's supported a form of a value-added levy, warns that the border-tax idea proposes "a unique tax used nowhere in the world with big but uncertain economic effects, which certainly will produce major legal challenges both here and from our trading partners."

Thus, concludes Len Berman of the Tax Policy Center, "The theory of this tax looks good but the politics may prove impossible." U.S. retailers already are rallying in opposition.

Another source of revenue could be a special lower rate on corporate income from foreign sources intended to allow companies to invest that money in the U.S. instead of banking it abroad to avoid high corporate taxes. Perhaps Democrats could be brought on board by a promise to use some of the resulting revenue to finance infrastructure improvements, as Trump has promised to do.

But those revenues would be temporary while the tax cuts, Ryan insists, would be permanent. Democrats, skeptical of cutting any deal, sense a trap where Republicans subsequently would come back with big spending cutbacks to make up for the deficits.

It may not be that tough for Republicans to cut taxes, mainly on a party-line vote. But as they struggle to pass comprehensive tax reform by this summer, expect sometime this spring for them to start wondering: Where are Bill Bradley and Jim Baker?

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