SHOWDOWN AT GUCCI GULCH

Lawmakers, Lobbyists, and the Unlikely Triumph of Tax Reform

JEFFREY H. BIRNBAUM
ALAN S. MURRAY

With an Introduction by

Albert R. Hunt

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Introduction

by Albert R. Hunt

The Tax Reform Act of 1986 was the best political story of its time, full of suspense, and with a vivid cast of characters. It marked the most significant achievement of the second Reagan administration. Indeed, in the history of the Republic, very few pieces of legislation have more profoundly affected so many Americans.

This saga was all the more dramatic because it was so unlikely. When the Ninety-ninth Congress convened, tax reform barely was on the agenda. Ronald Reagan, of course, won a resounding reëlection victory in 1984, but so did 95 percent of incumbent congressional Democrats, many of whom had spent the previous four years challenging the president. The only tax message in that campaign was a rejection of Walter F. Mondale's call for a tax increase. The issue of tax reform never was joined in that campaign; so clearly no consensus on what to do could be formed.

Further, most political scientists, lawmakers, and informed analysts were convinced that radical or fundamental change was impossible. Even the first Reagan term produced only a modest amount of really significant change, and second terms traditionally are less productive. Above all, any fundamental change that affected the powerful, growing special interests seemed a political pipe dream. The importance of special-interest campaign contributions caused many to suggest that this was the "best Congress money could buy."

The 1986 tax bill endured a roller-coaster existence for almost two years. Tax reform never has been easy, and its rare successes have been aberrational. In 1969 Congress cracked down on abuses by foundations and initiated a minimum tax for the wealthy, but only after outgoing Treasury Secretary Joseph Barr caused a national uproar when he revealed that hundreds of millionaires didn't pay any income taxes. In 1975, the oil depletion allowance was repealed for major oil companies, but only after long gas lines and soaring prices made the oil industry public enemy number one.

That this measure even was considered defied the conventional wisdom. No modern president has so opposed the concept of corporate taxes or had as many rich friends who benefited from tax loopholes as Ronald Reagan. Yet the Reagan tax-reform initiative involved the largest corporate tax increase in history and the most drastic crackdown on loopholes for the affluent.

On Capitol Hill, there was never much enthusiasm for the measure, reflecting, in part, what the lawmakers were hearing at home. Most of their constituents viewed the current tax system as a disgraceful sop to the privileged, but this never translated into public support for any tax-reform proposal. A skeptical public generally felt that as bad as the current tax system was, any changes probably would compound the inequities and increase taxes for the average citizen.

And there were powerful economic and political interests arrayed against any sweeping changes in the tax law. While the public opposed special tax breaks for the other guy, attitudes changed when it came to provisions that might benefit them: home-mortgage deductions, write-offs for charitable contributions, or union dues.

Even when it came to the hundreds of loopholes benefiting only the narrower and wealthier interests, the politics were difficult. Many Americans resent these special tax breaks, but their elimination is not a top priority for them. The intensity of the beneficiaries of such favors, however, is overwhelming. They marshall sophisticated economic arguments on the economic cataclysms that would result in changing the tax code; some of these claims are even legitimate. If those arguments fail, many of these interests are able to muster something even more persuasive to certain lawmakers: money in the form of campaign contributions.

Money is the engine that fuels much of our politics. A few simple facts: From 1974 to 1984 the money spent on House general elections soared to $182.9 million from $45.1 million, more than a fourfold increase; in the Senate it skyrocketed in the same period to $146.7 million from $28.9 million. The average winner in 1974 House contests spent about $75,000; in 1984, that same typical victor spent almost $300,000. In 1984, Senate winners averaged almost $3 million per race, with North Carolinian Jesse Helms alone spending $17 million. Most politicians spend enormous time raising these funds; rarely does a night go by in Washington without a political fundraiser populated chiefly by special interests.

Nowhere are vested interests, through their political action committees, more omnipresent than in tax writing. The possibility of a sweeping tax bill that would touch virtually all these interests brought the campaign money merchants out in droves. In 1985, when the tax-writing panels were considering tax reform, political action committees gave $6.7 million to fifty-six members of the House Ways and Means and Senate Finance committees, according to a reliable survey by the self-styled citizens lobby Common Cause. This was two and a half times more money than was given to members of the same committees two years earlier. Where did the money

come from? Insurance companies, banks, oil-and-gas interests, real estate, big Wall Street investment concerns, and labor unions, to name a few—all the groups that would be affected by the tax-reform initiative.

But as Alan Murray and Jeffrey Birnbaum demonstrate, these obstacles were overcome by some very forceful political personalities and a very powerful idea. One of the more unusual heroes stands as the very antithesis of the fat cats who so often dominate Washington: Bob McIntyre, the young Ralph Nader–trained, labor union–backed tax-reform advocate whose studies showing corporate nonpayment of taxes were a catalyst for this entire endeavor.

Then there were the political heavyweights: On Capitol Hill, there was Dan Rostenkowski, a longtime Chicago machine politician who learned the legislative process at the knee of Wilbur Mills, the legendary chairman of the Ways and Means Committee and the bane of most tax reformers. In the Senate, there was Bob Packwood, the smart Finance Committee chairman whose brand of Republican moderation—conservative on business issues, liberal on social issues—saw the tax code as a critical vehicle for economic and social goals.

These two veteran lawmakers were unlikely heroes of tax reform, but ultimately their political prowess and reputation rested on its success; in a political institution, that counts far more than philosophy. Yet both Rostenkowski and Packwood almost blew their opportunities on several occasions.

In the House, Rostenkowski's vaunted toughness started to crumble as even some of his closest allies began to desert him. In the end, the veteran lawmaker pulled it off with a deal that infuriated the Reagan administration but enabled him to get a bill sufficiently attractive that the White House couldn't disown it.

In the Senate, the political venality of the Finance Committee surfaced as the panel dismembered every remnant of tax reform and actually began approving new loopholes. Packwood almost beat a strategic retreat at a critical moment, but with the encouragement of a couple of pitchers of beer, he and his top aide decided to gamble instead on a bold but highly risky approach.

In the Reagan administration, the cast of characters was as improbable. Few of the rich Wall Street set suspected that Donald Regan, one of their own, would propose killing most of the tax breaks that enabled some of them to avoid paying taxes. Later the initiative would be shepherded by Treasury Secretary James Baker, a man whose political professionalism was antithetical to "reform" efforts and whose main interest in taxes had been to protect the Texas oil-and-gas interests that would surely be clipped by any tax-reform measure. The guiding strategic thinker was Deputy Treasury Secretary Richard Darman, a man with New England blue-blooded roots who could see the populist appeal of this undertaking, and a political intellectual whose public-policy insights were rivaled only by an ego that was large even by Washington standards.

These top principals all had their shortcomings and made their share of mistakes. Don Regan's political handling of the measure was inept from the inception; nevertheless, without his steadfast determination, the bill would have died several times along the way to passage. Jim Baker's loyalty to his Texas oil-and-gas buddies made some enemies and rarely picked up any converts to the tax-reform banner, but without Baker's political instincts and skills, which were second to none, there would have been no bill. Dick Darman's intellectual arrogance sometimes threatened the fragile support for this measure, but his rare appreciation of both the politics and the substance of this undertaking provided indispensable assistance to key lawmakers at critical moments.

Finally, there were two pivotal figures, both of whom made lots of money at a young age in the entertainment field and paid what they thought were confiscatory tax rates. This would motivate these two very disparate men to push tax reform with a resoluteness and intensity without which the measure clearly would have died.

The first was Bill Bradley: Rhodes scholar, former star forward for the New York Knickerbockers professional basketball team, and the U.S. senator from New Jersey. In 1982 Bradley proposed a sharp reduction in tax rates accompanied by a dramatic broadening of the base by eliminating many tax preferences. The idea received scant attention at first, but Bradley, with the same dedication and determination that made him a basketball legend, persevered, even though in a major blunder, the 1984 Democratic presidential nominee, Walter Mondale, rejected the Bradley approach. Like many of his liberal soulmates, Bradley believed the tax code was unfair and full of loopholes that made the economy less efficient, but he also appreciated the need for a tax system that encouraged entrepreneurialism and economic growth. He won the confidence of skeptics ranging from Don Regan to Jack Kemp to Dan Rostenkowski to Bob Packwood. At every critical juncture Bradley stepped in to provide an important push; rarely has a legislator with no formal leadership role or committee chairmanship played such an instrumental role in a major piece of legislation.

The other pivotal figure was Ronald Wilson Reagan, who abhorred high tax rates even back when he was a Democrat. The president's ignorance of the specifics of his own proposal was startling; throughout, he misrepresented or misunderstood the measure's tax increase on business. But President Reagan's attachment to lower rates was real and his commitment to the concept of this tax reform was even more powerful than his ignorance of the details. He never quite convinced the public, but his political persona and communicative skills commanded such respect that they scared off a lot of potential opponents. Only a few years ago, intelligent men and women were lamenting that our political system doesn't work, that presidents can't govern in a first term because they're fixated on

reelection and can't govern in the second term because they become almost-instant lame ducks. Reagan refuted the former contention in his first term, and the passage of the sweeping tax bill in 1986 refuted the latter.

The coalition put together to support this measure borrowed from two important, but quite different, movements. The first was that of the tax reformers of the 1960s and 1970s, mainly liberal Democrats, guided by the late Stanley Surrey of the Harvard Law School and Joseph Pechman of the Brookings Institution. These liberals made compelling cases against an inequitable and inefficient tax code ridden by special-interest loopholes. But, more often than not, they wanted to close these loopholes to raise taxes, a losing political proposition.

The other group was the supply-siders, launched by economist Arthur Laffer and popularized by Congressman Jack Kemp in the late 1970s. They convincingly argued that cutting marginal tax rates would significantly enhance incentives and productivity; an important convert was Ronald Reagan. But they rarely talked about closing any existing tax preferences in the process; thus the rate cuts would inevitably lose revenue at a time of huge budget deficits, also an unacceptable political proposition.

Merging the lower rates of the supply-siders with the base broadening of the liberal tax reformers was the glue that held the 1986 tax bill together. Neither the supply-siders nor the liberals trusted one another, and each periodically examined the bill with an eye to understanding why their ideological adversary supported it. But both agreed it was preferable to the existing situation.

The ability of this unholy alliance to stick together throughout an arduous process—ironically with two former professional athletes, Democrat Bill Bradley and Republican Jack Kemp, as the political point men—was the key to success.

What emerges in this story, and in this book, is a fascinating human dynamic. Readers learn a lot about complicated aspects of the tax code, some of which are surprisingly interesting. They also see important institutions—Congress, the Treasury, the business lobbying forces, even the outgunned public-policy advocates—at work. And there are the human dimensions—the Bob McIntyres, the Dick Darmans, the Jim Bakers, the Dan Rostenkowskis, the Bob Packwoods, the Jack Kemps, the Bill Bradleys, and above all, the Ronald Reagans—that provide the real sustenance of this story.

Above all, this is a drama about a powerful idea whose time arrived to the surprise of many so-called insiders.

In our system, Congress, especially the House, with little party discipline or ideological rigidity, is often like a seamless web of floating coalitions. This was vividly present in the making of the tax bill; the conservative president's initiative was supported by some liberal Democrats and opposed by some conservative Republicans. The way the leading opponents and proponents tried to piece together a winning coalition, with help from the narrow-interest groups, made this an exciting saga.

To be sure, the way this legislation was fashioned, careening between extinction and dramatic revival, wasn't a very neat or efficient process; the dance of legislation rarely is. In the last century Bismarck observed that two things one never should watch being made are sausage and legislation. Compared to the Tax Reform Act of 1986, a sausage factory is tidy and orderly.

Moreover, the ultimate impact remains uncertain. Prominent economists like Alan Greenspan remain ambivalent as to how it will affect the economy; the initial consensus is it will be a small negative in the short run and a slight plus over the longer haul. It is, however, easy to find distinguished economists who disagree with both those scenarios. Political analyst Kevin Phillips is convinced the bill ultimately will prove a political loser; in the 1986 Congressional elections the most sweeping tax legislation ever passed by Congress was barely mentioned.

Whatever the economic and political effects, the tax-reform bill is a monumental piece of social legislation. It takes more than four million poor people off the federal income tax rolls, the most important antipoverty measure enacted over the past decade. And the attack on individual and corporate tax shelters makes it unlikely that wealthy individuals or businesses will be able to escape paying any taxes and thus might restore some of the eroding confidence Americans feel in the tax system.

In economic, political, social, and human terms, this bill touches most Americans in a significant way. This legislation and its impact will be debated for years; it may even become one of those rare defining issues in the American political system.

In this book Jeffrey Birnbaum and Alan Murray give us a factual and fascinating blueprint for appreciating and understanding how and why this historic measure became the law of the land, the same sort of insights they displayed in *The Wall Street Journal* for two years. I am the *Journal*'s Washington bureau chief, but other more detached observers credit Birnbaum and Murray with very special reporting that enabled the entire range of interests—rich and poor, business and labor, consumer and investor, scholar and practitioner—to follow, in vivid detail, one of the most remarkable legislative feats in years.

The authors brought different perspectives to this task. Birnbaum covered the Congress, spending most of his waking—and a few sleeping—hours in the corridors of the tax-writing committees, alternating between Gucci-clad lobbyists, earnest and sometimes naïve young staff assistants, and the elected politicians who so closely mirror this heterogeneous melting pot of a nation. Murray viewed it from downtown Washington: the executive branch with top political appointees exercising more influence and impact than they ever dreamed, the still-entrenched bureaucracies, and the business interests that were so affected by any major change in the tax system.

These two bright, industrious young journalists genuinely appreciate and believe in the political process and politicians, as well as understand that an informed public is the centerpiece of democratic government.

Note on Sources

This narrative reflects the fruit of the nearly three years we both spent covering the tax bill for *The Wall Street Journal,* from the time the Treasury began its work in early 1984 until the bill was signed in October 1986. In addition to our reporting for the paper, we spent nearly 150 hours in the summer and fall of 1986 interviewing those who were responsible for this legislative achievement. All of the principal actors in the drama—including James Baker, Bill Bradley, Richard Darman, Bob Packwood, Donald Regan, and Dan Rostenkowski—were generous in giving their time to ensure that our story was complete and accurate. We interviewed at length all of the major participants in the reform effort except President Reagan, who in late 1986 was preoccupied with the Iranian arms crisis.

Some of the dialogue in the book is taken from transcripts of proceedings; other dialogue is based on the recollections of people interviewed or on the notes of people present at the meetings. Wherever possible, the dialogue has been confirmed by more than one source. In cases where the accuracy of the dialogue is open to question, we have explicitly identified the source. Whenever people are said in the text to have "thought" something, the source for that information is the person who was doing the thinking. Nothing in the book has been invented; it is a carefully documented story.

In addition to our own reporting, we have relied heavily on the work of our many colleagues at the *Journal* who had a hand in the tax coverage. Especially helpful were Paul Blustein, who led the coverage during the inception of the tax plan in the Treasury Department; Brooks Jackson, who provided invaluable stories on the role of campaign contributions in the tax debate; Monica Langley, whose work on tax lobbying was especially useful; and also David Rogers, David Shribman, John Yang, Laurie McGinley, Rose Gutfeld, Jane Mayer, and many others.

We also owe a debt to reporters at other publications whose excellent reporting enriched our efforts. These include Pamela Fessler and Eileen Shanahan of *Congressional Quarterly;* Dale Russakoff and Anne Swardson of *The Washington Post;* Gary Klott and David Rosenbaum of *The New York Times;* Mark Kirchmeier, a Washington writer; and Jeffrey Levey of the Bureau of National Affairs. On matters of tax history, we have relied greatly on the work of John Witte at the University of Wisconsin and Joseph Pechman at the Brookings Institution. For historical information on members of Congress, we have made use of *Politics in America*, edited by Alan Ehrenhalt, and *The Almanac of American Politics*, by Michael Barone and Grant Ujifusa.

Chronology

1982

August 5: Senator Bill Bradley and Representative Richard Gephardt introduce their Fair Tax Act, the Democratic version of tax reform.

1984

January 25: President Ronald Reagan calls for a Treasury study of tax reform in his State of the Union address.

April 26: Representative Jack Kemp and Senator Robert Kasten introduce the Republican version of tax reform.

November 27: Treasury Secretary Donald Regan unveils Treasury I.

1985

January 8: Secretary Regan and White House Chief of Staff James Baker swap jobs.

May 28: President Reagan and Chairman Dan Rostenkowski of the House Ways and Means Committee appear on national television to endorse tax reform.

May 29: President Reagan unveils his own plan, which is the handiwork of Secretary Baker and Deputy Treasury Secretary Richard Darman.

October 1: After a summer's worth of hearings, the House Ways and Means Committee begins serious drafting sessions, using a plan devised by its staff as the starting point.

October 15: The committee nearly kills reform by voting to expand a tax break for commercial banks.

October 23: The bank vote is reversed after Rostenkowski agrees to retain the deduction for state and local taxes.

November 23: The Ways and Means Committee approves its version of tax reform without the endorsement of President Reagan.

December 11: House Republicans stage a rebellion that defeats the "rule" on the House floor, preventing the tax-reform bill from being considered.

December 16: President Reagan comes to Capitol Hill to make a personal plea to the GOP to keep tax reform alive.

December 17: The House passes the Tax Reform Act by voice vote.

1986

:h 19: The Senate Finance Committee begins drafting a tax-reform bill, using a plan devised by its chairman, Bob Packwood, as the starting point.

il 18: Packwood withdraws his tax plan, battered by special-interest amendments, and goes to lunch with his aide Bill Diefenderfer to consider the alternatives.

il 24: Packwood unveils a new, low-tax-rate plan to his members.

il 25: Packwood disowns the new plan and blames it on David Brockway, the director of the Joint Committee on Taxation.

ril 29: Packwood unveils revised approaches with a top individual tax rate of no more than 27 percent.

y 7: The Finance Committee approves its tax plan by a unanimous 20–0 vote.

ıe 4: The Senate begins to debate tax reform.

ıe 24: The Senate passes tax reform by a vote of 97–3.

ly 17: The House-Senate conference begins with Rostenkowski as chairman.

ıgust 12: With the conferees at an impasse, Senator Russell Long suggests the two chairmen go off by themselves to draft the legislation.

ugust 16: The conference report, the final version of tax reform, is approved.

ptember 25: The House affirms the bill by a vote of 292–136.

ptember 27: The Senate passes the bill and sends it to President Reagan by a vote of 74–23.

)ctober 22: President Reagan signs the Tax Reform Act of 1986 in a ceremony on the South Lawn of the White House.

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