

POLITICAL PULSE

Does AHCA Kill Tax Reform?

Monday, March 27, 2017

Donald Luskin

This fiasco teaches the GOP to keep it simple, stupid. That means no border adjustment.

Clients we've talked to are as despondent about the failure of the House of Representatives to pass the American Health Care Act as some were exuberant a month ago when it seemed that the Trump growth agenda was unstoppable. We cautioned in early March that with expectations so high, it was finally time for the inevitable "Trump correction" (see ["A Trump Correction at Last?"](#) March 3, 2017). We missed the top by just a day – but for all the talk about a ["staggering defeat"](#) for Donald J. Trump and the [widespread chatter](#) that tax reform is now dead, the S&P 500 closed Friday still without even a 3% correction from the all-time highs on March 2. Even with this morning's weak opening, as of this writing it is only off 3-1/4%.

NO ONE SHOULD BE SURPRISED THAT OBAMACARE ISN'T BEING REPEALED Democrats won't help do it – and the GOP alone doesn't have the votes and never did. We pointed out in the euphoric aftermath of the election the simple reality that Trump doesn't effectively possess a ruling mandate (see ["Trump and the 'Reflation Trade'"](#) November 15, 2016). While it was an attention-getting surprise that the GOP kept control of the Senate and the House, it lost seats in both, running counter to the usual "coat-tails effect."

- Besides, while it is GOP dogma that repealing Obamacare is the Holy Grail, it's actually one of those issues that is only salient to political activists. Last week's oft-cited [Quinnipiac poll](#) found that only 42% of GOP voters favor outright repeal.
- So even abstracting from the GOP's imperfect ruling mandate, within the party itself there is a less of a mandate to repeal Obamacare than one might think.

NO ONE SHOULD BE SURPRISED THAT THE GOP COULDN'T AGREE ON PARTIAL REPEAL That same poll found that 55% of GOP voters favored *partial* repeal – and powerful voices of reason on the Right, such as [the Wall Street Journal editorial page](#) – argued the American Health Care Act was a compromise worth making. But as we warned, having lost six seats last November, the GOP House majority is insufficiently wide to keep unruly factions from blocking party-line votes (see ["Elections Have Consequences"](#) October 20, 2016).

- It's too simple to write off the blockers – primarily the members of

Update to strategic view

US MACRO: With narrow congressional majorities, it shouldn't have been a surprise that the GOP could not repeal Obamacare, or even make a partial repeal with AHCA. Passing AHCA may have been only a Pyrrhic victory – now Democrats still own failing Obamacare, and the GOP can campaign on it in 2018. Trump comes away from the episode looking pretty good, having never made it a high priority in the first place, and coming off like a tough and principled negotiator. This puts a demand effect on Ryan and the GOP Congress to get tax reform done. The border adjustment scheme is complex and divisive, and is likely to be set aside. We think Priebus mis-spoke and spooked markets by suggesting on Sunday that Trump favored it. The issue will be how much of a tax cut the GOP Congress is willing to advocate without scoring as revenue-neutral. A good initial sign is that the Freedom Caucus, the swing bloc in the House, is setting that concern aside.

[\[Strategy dashboard\]](#)

the [House Freedom Caucus](#) – as being nothing but right-wing nut-jobs from safe districts willing to let the perfect be the enemy of the good.

- That caricature doesn't explain why thoughtful power-players like the Koch Brothers [feel the same way](#). Indeed the Kochs [announced last week that they would help](#) any congressman who dared to vote "no" and, as a result, got challenged in the 2018 elections.
- What are the Kochs thinking? A reasonable guess would be that they fear that *[AHCA, while a step in the right direction, would be an ineffective fix, a Pyrrhic victory. Obamacare will continue to disappoint, but with AHCA in place, the GOP will take the blame for the further decline of an already doomed system created by Democrats. In a nutshell: when someone else already has his fingerprints all over the murder weapon, why add your own?](#)*
- *[As Obamacare continues to unravel, it could create the ideal set-up for 2018, in which ten incumbent Democrats in the Senate face re-election in states carried by Trump in 2016. Then, in 2019, you really repeal Obamacare.](#)*

TRUMP COMES OUT OF THIS LOOKING PRETTY GOOD To be sure, the dominant narrative is that ["the master deal-maker failed."](#) Scott Adams, the best observer of Trump's skills as a master-persuader – to whom we have linked many times – notes that [this is a key transition-point](#) from the prior narrative that "Trump is Hitler." We mention this because all one has to do to prove that one is not Hitler is not be Hitler. To prove you are not incompetent is more difficult – you have to be competent. We actually think Trump showed himself to be quite competent in the AHCA affair – and new media narrative to the contrary doesn't persuade us any more than the Hitler narrative did.

- *[This isn't Trump's failure.](#)*
- Again, Obamacare repeal is a totem for GOP activists, but not for mainstream conservative voters. Trump always mentioned it in his campaign speeches, but it was never a signature issue. As president he chose not to conduct any sort of barnstorming campaign to support the American Health Care Act, the way President Barack Obama did in 2009 to promote the Affordable Care Act in the first place.
- As clients who listened to our conference call last month with [entitlements expert Charles Blahous](#) know, Trump never tasked anyone in the White House to be either a policy or political point-person on repeal.
- *[Yet that same Quinnipiac poll showed 64% of GOP voters approved of "the way Donald Trump is handling health care." Quite a contrast to only 41% approving of the proposed American Health Care Act, with 24% outright disapproving.](#)*
- Trump did lend his prestige and persuasiveness to last week's legislative maneuverings, meeting with and calling GOP representatives and trying to sweeten the deal. Ultimately, late Thursday, he executed one of the most basic – yet most difficult to execute – maneuvers in negotiating: [he walked away](#), leaving the

Contact TrendMacro

On the web at
trendmacro.com

Follow us on Twitter at
twitter.com/TweetMacro

Donald Luskin
Chicago IL
312 273 6766
don@trendmacro.com

Thomas Demas
Charlotte NC
704 552 3625
tdemas@trendmacro.com

Michael Warren
Houston TX
713 893 1377
mike@trendmacro.energy

[\[About us\]](#)

Recommended Reading

[The Floating Utopias of the Future](#)

Shlomo Angel
Wall Street Journal
March 25, 2017

[Mortality and morbidity in the 21st century](#)

Anne Case and Angus Deaton
Brookings Papers on Economic Activity
March 23, 2017

[Some Fake News About Me from Bloomberg](#)

Scott Adams
Scott Adams' Blog
March 23, 2017

[\[Reading home\]](#)

GOP House with the choice of accepting the sweetened deal or living with Obamacare.

- To be sure, Trump didn't get what he seemed to want – the passage of AHCA. But a master-negotiator knows that you can't always get what you want ([the iconic Rolling Stones song](#) by that name, by the way, is always played at Trump rallies). *Threatening to walk away is what you do at the last minute to try to get what you want – and sometimes you will get it, or at least what you need.*
- In the [aftermath](#), Trump credibly [blamed Democrats](#) and the [hard-right in the House](#) – making himself look smart for walking away.
- *Walking away both kept Trump from getting what he didn't want, and now sets him up as a more fearsome negotiator for the next deal, because people know that he means it when he says he will walk away.*



realDonaldTrump Donald J. Tr... 17h
Democrats are smiling in D.C. that the Freedom Caucus, with the help of Club For Growth and Heritage, have saved Planned Parenthood & Ocare!

THE AHCA FAILURE MAY BE A GOOD SET-UP FOR GETTING TAX REFORM DONE *If Trump's political capital is intact, that puts a demand-effect on Paul Ryan (R-WI) and on the GOP Congress to show they can move forward and get tax reform done.* [Ryan and the administration have both already been very clear](#) that this is now Job One.

- Even before getting to Job One, the GOP Congress has the opportunity to get the perception of momentum back – by daring to use the so-called “nuclear option” to overcome Democratic opposition to the confirmation of Neil Gorsuch to the Supreme Court (a nomination which, by the way, demonstrates Trump's competence, as excessive Democratic opposition to it validates).
- *The demand effect to get tax reform done reduces the risk that it will get bogged down in a debate about “border adjustment” – and reduces the risk that the economically toxic border adjustment scheme could be enacted* (see [“The Border Adjustment Tax and Its Victims”](#) February 10, 2017).
- We'll explain the logic of that conjecture in a moment, but we are well aware that *it cuts against a troubling statement by White House Chief of Staff Reince Priebus on “Fox News Sunday”, which is our best candidate for explaining the risk-off move in markets overnight.*
- Priebus was asked whether Trump is having “second thoughts after health care on following the lead of Paul Ryan, particularly when it comes to the border adjustment tax and tax reform in general.” Priebus didn't answer the implied question about Trump's confidence in Ryan. But after some boilerplate taking-points about reducing taxes for all Americans, and a rather bizarre statement about “Democrats coming on board as well,” he said:

I think another point that's important to the president is a potential border tax, that we start evening up the playing field between our country, countries around the world...

He's not backing off of that. It's something that's very important to him.

- *If markets are reacting to this, it's because it is such a surprise – Trump has in fact given almost no indication that this is important to him, and has said almost nothing about Ryan's border adjustment scheme from which he could "back off." That actually makes us think that Priebus mis-spoke.*
- First, Trump's detailed tax proposals went through various small evolutions during his campaign but at no point ever included a border adjustment, or for that matter tariffs or other protectionist features of any kind.
- To our knowledge, [the only kind thing he has said](#) about Ryan's border adjustment scheme was, immediately following a meeting with manufacturers last month, that "It could lead to a lot more jobs."
- Other than that, [Trump had said in January](#) that it's "too complicated... Anytime I hear border adjustment, I don't love it, because usually it means we're going to get adjusted into a bad deal. That's what happens."
- As far as we know, he has spoken *favorably* of a "border tax" only in an entirely different context – as a targeted tariff to discourage future offshoring of American manufacturing jobs.
- And as for his confidence in Ryan, on Friday, [Trump tweeted](#)  [realDonaldTrump](#) Donald J. Tru... 1d
Watch [@JudgeJeanine](#) on [@FoxNews](#) tonight at 9:00 P.M.
"Watch [@JudgeJeanine](#) on [@FoxNews](#) tonight at 9:00 P.M."
– at which time his friend [Jeanine Pirro called for Ryan](#) to step down as speaker.
- *Trump is right that Ryan's border adjustment scheme is "too complicated" – not just economically, but even more so politically. After the AHCA fiasco, that's the last thing Trump or the GOP will want.*
- Conservative thought-leaders such as [Martin Feldstein](#), [Douglas Holtz-Eakin](#) and [Greg Mankiw](#) argue that it will level the playing field with foreign companies that do something similar with their value-added taxes, and move the US tax system toward a less distortive consumption-tax basis. On the other hand, [Arthur Laffer](#), [Phil Gramm](#), [Larry Lindsey](#), [Steve Forbes](#), [Steve Moore](#), [Larry Kudlow](#), [the Kochs](#) – [and we ourselves](#) – are strongly opposed to it as protectionist and disruptive.
- Vast industry-funded armies of lobbyists have [formed on both sides](#), already [running extensive advertising campaigns](#) the likes of which were completely absent in the AHCA debate.
- Within the White House, [China-basher Peter Navarro](#) and ["economic nationalist" Steve Bannon](#) are candidly supportive of the protectionist aspects. On the other hand, Treasury Secretary [Steve Mnuchin](#) and National Economics Council head [Gary Cohn](#) are skeptical to negative, particularly concerned about the effect on the US dollar exchange rate.

- In the legislative arena, [House leadership](#) is supportive – it is [Speaker Ryan’s brainchild](#), after all. Within the key [Freedom Caucus bloc](#), sentiment is mixed but tending to negative. [In the Senate](#), there is a great deal of strong opposition – and the GOP majority in that chamber just isn’t big enough to survive even token opposition.
- Evoking Trump’s view that border adjustment is “too complicated,” [Mnuchin said on Friday](#) that “Health care is a very, very complicated issue,” while tax reform “is a lot simpler.” Later, turning to border adjustment, he said “It is a very complicated issue... Whatever we do, we want to make sure it’s simple and it works.” He also said, “We are designing it from scratch,” seemingly ruling out using Ryan’s border adjustment scheme as a starting point.

THE BIG UNKNOWN IS THE GOP’S APPETITE FOR TAX CUTS THAT ARE NOT “REVENUE-NEUTRAL” One of the cudgels that was used last week – unsuccessfully – to bring opponents of AHCA into line was [the claim that it would create \\$1 trillion in budget savings over ten years](#) that could be used to offset tax cuts. [The lead editorial in this morning’s Wall Street Journal](#) headlines the risk that, without this, there is more temptation to implement the border adjustment scheme as a revenue-raiser.

- We suppose it’s just part of the inevitable “Trump correction” (again, see [“A Trump Correction at Last?”](#)).
- *Otherwise, we don’t see the salience of the AHCA budget issue. The political optics of apparent revenue losses from a proposed tax cut aren’t really helped just because some other earlier legislation – AHCA – created offsetting savings. We think it actually makes the optics worse – imagine the field day Democrats would have if Republicans tried to argue that we can now afford tax cuts for corporations because we have cut middle-class health care spending.*
- Without AHCA to make the optics worse, the optics are what they’ve always been.
- As to the Senate rules – even if [claims heard all last week](#) are true that AHCA net budget savings could have been used to offset tax cuts, of which we are far from positive – and even if that offset didn’t make the political optics worse, which they do – the most they could offset is \$1 trillion over ten years, which really isn’t much of a tax cut.
- So we have pretty much what we have always had – the opportunity to use “budget reconciliation” to pass a tax cut with as few as 50 votes in the Senate, with the unfortunate but small disadvantage that it would “sunset” after ten years.
- So we have the same uncertainty we have always had: can the GOP, under pressure to be “fiscally conservative” and subject to Democrats’ demagoguery about “income inequality,” pass a real tax cut? *Nothing really has changed – except that a month ago it seemed that Trump had the momentum to make all things possible (which wasn’t true) and now it seems that nothing is possible for him (which isn’t true either – again, we think he came out of this looking pretty good).*

- Now, the starting point is still what it has always been. Trump – before he had to care what congressmen and senators think – campaigned on broad and simple corporate and personal tax cuts that he claimed were revenue-neutral. Surely they never would have “scored” that way under Congress’s arcane rules. But just as surely, they would in fact have been better than revenue-neutral. We have no doubt that giving American firms relief from the highest tax rate in the world would unleash growth that would end up being strongly revenue-positive.
- The latest data-point is [the statement Sunday on ABC’s “This Week” by Mark Meadows \(R-NC\)](#), the leader of the House Freedom Caucus, who in his own way comes off like something of a supply-sider:

...you're asking a fiscal conservative...does it have to be...revenue neutral...do you have to have an offset like with the border adjustment tax? ...there has been a lot of flexibility in terms of some of my contacts and conservatives in terms of not making it totally offset. And that's a move that we're trying to do to provide real relief and economic growth. ...lowering taxes, you know, will create and generate more income.

- *Trump was elected because, among other things, the American public liked those ideas. Trump’s seeming power to influence events day by day may wax and wane, but the fact remains that the American people revealed that preference, just as the British people revealed their preference to exit the European Union. At the margin, politicians are going to have to honor those revealed preferences* (see [“2017: It’s Bigger than The Donald”](#) December 30, 2016).
- And as the [late great columnist Robert Novak](#) said, “God put the Republican Party on earth to cut taxes. If they don’t do that, they have no useful function.”

Bottom line

With narrow congressional majorities, it shouldn’t have been a surprise that the GOP could not repeal Obamacare, or even make a partial repeal with AHCA. Passing AHCA may have been only a Pyrrhic victory – now Democrats still own failing Obamacare, and the GOP can campaign on it in 2018. Trump comes away from the episode looking pretty good, having never made it a high priority in the first place, and coming off like a tough and principled negotiator. This puts a demand effect on Ryan and the GOP Congress to get tax reform done. The border adjustment scheme is complex and divisive, and is likely to be set aside. We think Priebus mis-spoke and spooked markets by suggesting on Sunday that Trump favored it. The issue will be how much of a tax cut the GOP Congress is willing to advocate without scoring as revenue-neutral. A good initial sign is that the Freedom Caucus, the swing bloc in the House, is setting that concern aside. ▶