



Joint Economic Committee

Representative Kevin Brady • Chairman

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CHAIRMAN KEVIN BRADY

Lessons from Reagan:

How Tax Reform Can Boost Economic Growth

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America's current tax code is too costly, too complex, and unfair, but mostly unfair.

It's unfair to families. Whether you're single or raising children, starting your career or experiencing retirement, the tax code is impossible to understand. It's more time-consuming than ever. And you're always wondering—is the next guy paying the same as me?

You can't possibly keep up with the 4,000 changes Washington has made the past decade. That's a new change in the tax code every day. Few taxpayers even know the tax provisions to which they are entitled. For example, there are 15 different tax provisions for higher education—each with its own set of rules. The 'simple guide' for these provisions is 90 pages long! And if you accidentally make a mistake, the IRS is unforgiving.

Today's tax code is unfair to businesses.

It costs too much for businesses to keep up with their taxes—especially if you're a small business. Most have to rely on outside tax preparers. It's not fair that many small businesses pay higher tax rates than big businesses. And it's not fair that American companies face the highest tax rate among developed countries.

Our outdated tax code often double-taxes American companies—forcing them to shift workers and research overseas just to try to compete on a level-playing field against foreign competitors.

Today's tax code is unfair to America.

The complex and burdensome tax code drains over \$160 billion out of America's economy each year. It makes it too hard to start up new businesses and create new jobs. America has fallen behind its global competitors in Europe and China—saddled with a tax code that costs us sales, contracts, and jobs when we compete.

Experts predict a simpler, fairer, flatter tax code for families and businesses could create up to 1 million new jobs in the first year and make us competitive again in the 21st century.

We need a simpler, fairer tax code that protects taxpayers—not special interests—and helps Americans compete and win.

So what can we learn from the last comprehensive rewrite of the American tax code?

When President Ronald Reagan took office on January 20, 1981, the top individual income tax rate was 70 percent. The *Economic Recovery Tax Act of 1981* reduced the top individual rate to 50 percent by the end of his first term. The *Tax Reform Act of 1986* reduced the top individual rate to 28 percent by the end of his second term.

Contrary to the claims of Reagan’s critics at the time, these rate reductions neither starved the Treasury for revenue nor undermined the progressivity of the income tax.

Income taxes as a share of our economy remained virtually unchanged. The share of income taxes paid by the richest Americans increased dramatically.

For example, the share of federal income taxes paid by the top 1 percent rose from 19.1 percent in 1980 to 27.6 percent in 1988. In contrast, the federal income tax burden on the middle class fell. Indeed, the share of federal income taxes paid by the bottom 50 percent fell from 7.1 percent in 1980 to 5.7 percent in 1988.

The *Tax Reform Act of 1986* reduced the top corporate income tax rate from 46 percent to 34 percent. But the positive effects of lower corporate rates were largely offset by the repeal of the Investment Tax Credit, longer depreciation schedules especially for buildings, and the repeal of the 60 percent exclusion of capital gains from taxation, effectively raising the top tax rate on capital gains from 20 percent to 28 percent.

The tax reforms enacted under President Reagan were not perfect, yet collectively they boosted economic growth and employment. Tax changes in Reagan’s first term increased real GDP by more than 10 percent, while tax changes in Reagan’s second term partially offset these earlier gains by less than one percent.

The overall success of Reagan’s tax policies brought about a worldwide revolution in taxation. Over the next two and a half decades, nearly every developed country in the world reduced tax rates on both individuals and corporations.

The average combined corporate tax rate among the countries in the Organization for Economic Cooperation and Development (OECD) declined from approximately 48 percent in the early 1980s to 25 percent in 2013. After Japan recently cut its corporate income tax rate, the United States now has the highest combined corporate tax rate in the OECD at 39.2 percent—the worst.

Despite President Obama's individual income and capital gains tax rate increases in January which have slowed the U.S. economic recovery, the President still asserts the wealthy are not paying their fair share of federal taxes.

However, the facts don't support his assertion.

An objective study by the OECD, found that the highest-earning 10 percent of the U.S. population actually paid the largest share among 24 countries examined, even after adjusting for their relatively higher incomes.

The richest ten percent in the United States pay 1.35 times their share of income in taxes compared to the OECD average of 1.11. "Taxation is most progressively distributed in the United States," the OECD study concluded.

Unfortunately, as other countries have moved forward in reducing their individual and corporate income tax rates, the United States has reversed course, undoing much of the earlier rate reductions. Including President Obama's latest tax increases, our top individual income tax rate is now nearly 44 percent.

The purpose of today's hearing is to review the lessons we should have learned from previous tax reform efforts. What worked, what didn't, and why?

And most importantly, given our anemic recovery from the current recession—the weakest recovery since World War II—how can we improve our tax system to get the most economic bang for the buck?

What I've seen as a member of the tax-writing House Ways and Means Committee is that our current complex tax system diverts productive resources into wasteful lobbying and tax avoidance schemes. It favors consumption over investment, debt over equity, large businesses over small, and some industries over others.

Tax reform should eliminate these distortions and promote economic growth. Hopefully, today's hearing will help us identify the steps we need to take to achieve this goal.

I look forward to the testimony of our witnesses.