

**STATEMENT OF
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BEFORE THE
SENATE FINANCE COMMITTEE**

Tax Reform: Lessons from the Tax Reform Act of 1986

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Chairman Baucus, Ranking Member Grassley, and Members of the Committee:

Thank you for inviting me here today. My name is Dick Gephardt and I am honored to appear before you to talk about the landmark Tax Reform Act of 1986 and the lessons it continues to offer.

I represented Missouri's 3rd Congressional district from 1976 to 2004. I also served as Democratic Leader of the House of Representatives for 14 years, from 1989 to 2003. On my first day in Congress, I was appointed to both the House Ways & Means and Budget Committees. From that first day until my last here – 28 years I was privileged to serve – I worked for a fair, simple and transparent tax code. I strongly believe that we advanced those goals in 1986, and I also believe that today, more than ever, tax reform can play an important role in restoring public confidence in the American Government.

BRIEF HISTORY OF THE 1986 TAX REFORM

In the early 1980's, the tax code had become so complex that over 80,000 people in the Country made their livings preparing other peoples' taxes. This was coupled with the perception and, too often the reality, that the code had unintended consequences on our economy. As a result, the vast majority of taxpayers came to believe that the tax code was not created with their needs in mind.

The one place that the public comes into contact with their Government on an annual basis – in fact every time they see their paystubs – is the tax code. Simply filing out the 1040 EZ had become an exercise in futility, sending millions of Americans to tax consultants to help them fill out a tax form. Roughly 60 percent of Americans felt the need to pay to get their taxes prepared.

The public's confidence was at a historic low and, the code, as it existed, was distorting investment decisions. During the 1980's, there was a dramatic rise in tax avoidance plans – shelters, loopholes that had riddled the code and were easily accessible to taxpayers with the means to hunt down arcane provisions that could be used as an excuse to hide income.

In 1982, Senator Bill Bradley (D-NJ) and I introduced the Fair Tax Act which reflected our view that the tax code needed to be dramatically simplified to restore public faith, and trust that the

code's intentions were to promote sound economic growth for all, and not just narrow, shortsighted and often counter-productive benefits for a few.

Super Dairy Cows were a prime example of that. There were substantial benefits to taxpayers to invest in dairy cows that could produce higher quantities of milk. Yet, due to dairy programs in the Farm Bill, there was already a glut of milk on the market. There was so much milk in fact, that cheese was literally spoiling in federal warehouses, with no appropriate consumer for the product. Schools, nutrition programs and other users already had their fill. Yet, millions and millions of dollars were invested in these tax shelters – with the federal taxpayer underwriting the benefits – because of some talented lawyers who helped arrange the tax dodge.

We began an aggressive effort to promote our tax reform plan. Similarly, Congressman Jack Kemp (R, NY-13) and Senator Bill Roth (R-DE), came up with an alternative approach from the Republican side of the aisle. We worked closely with them and their offices to help promote the need for action, and regularly publicly debated each other on our plans.

But, it wasn't until President Reagan embraced the idea of tax reform that real action started. The President had commissioned a number of extensive studies by the Treasury Department to look at various options – such as sales taxes and the VAT. After full analysis, President Reagan came to the same conclusion that I did – that the best approach was to reform the current income tax system rather than abandon it.

House Ways & Means Chairman Dan Rostenkowski (D, IL-5) began comprehensive hearings that helped establish a thorough and fair understanding of the provisions in the tax code at that time, how the code might be altered and what the implications of each change would be. It was critical for members of Congress to come to a complete understanding of the interaction of the thousands of individual tax provisions. Without this level of understanding of the complex issues involved we could never have reached the bipartisan consensus that in the end passed the bill.

FACTORS KEY TO 1986 REFORM

I see many parallels between then and now. And in many ways, the need for action is more pressing in 2010 than it was in 1986. In 1986, memories of the deep recession of the early 1980's were fresh, as well as of the energy crisis of the 1970's, increased international competition and the sharp rise in unemployment across the Country. All of these factors exist even more starkly today.

And just as in 1986, in 2010 the public's faith in their Government is waning. Taxes remain the principal point of contact between the average citizen and the Federal Government, and during tight budget times, the American people want to make certain that their tax dollars are not only fairly spent, but also fairly collected.

And, we all know, with each passing year, the tax code has become once again more riddled with preferences and provisions that alter investment decisions, encourage bad policies, unnecessarily reduce revenue and favor a privileged few. Why, for example, do we continue to provide tax

benefits for companies that move jobs offshore, when we are in such dire need of enhanced investment and job creation here at home?

It is time for us to look again at whether we can dramatically simplify the tax code so that it is broadly understood and – while perhaps not loved, at least respected. We need to look over every provision in the code and ask: does this really serve the greater good, is this the best way to help grow the economy, can we really afford the myriad of provisions that only benefit the privileged? And finally, we have to make certain that the tax code itself is not the driver of everyday investment decisions, leaving those to the free market and the great commonsense of the American people.

In 1986, we had the benefit of a strong desire for change in Washington and across America. We had leaders in both parties, like President Reagan, who were willing to negotiate in good faith, and debate when needed, and not just block anything and everything from getting done. These were leaders who were true champions of their respective philosophies as conservatives and progressives, but who were not hamstrung by partisan extremists who question every opponent's patriotism, vilify compromise, and who have more in common with the Know-Nothings than with our Founding Fathers.

CHALLENGES TO THE 1986 TAX REFORM

By 1986, the tax code had become riddled with preferences, many perhaps with a fair reason to explain their existence, but nearly all of them with a class of beneficiaries determined to protect their privileges.

Additionally, the public was wary of the process. They were anxious for change, but skeptical of our ability to deliver. We did substantial polling and focus groups at the time, to understand how the public viewed taxes and the political system. People supported the goal, but wanted to retain the tax provisions they used. Not a surprise.

I went into the process with a determination that, at the end of the day, we need to simplify dramatically the tax code - in a way that would maintain its progressivity and would not lead to higher budget deficits. We were not trying to raise taxes on the rich, nor cut them either. And, we didn't want to add to the budget deficit that was already careening out of control.

You now face an even greater fiscal challenge. Today's deficit is nearly twice as large as a percentage of the Gross Domestic Product as it was in 1986. Then, the debt was projected to stabilize and eventually decline. Today, the best estimates have it growing substantially, particularly in the out-years at just the point when the vast pool of baby-boomers is retiring.

If the effort to reform the tax code is undertaken, I would recommend these five lessons that I learned in 1986. First, it is vital that the legislative process reflect the openness and transparency that existed 24 years ago. With the vast expansion in media and the rich resources of the internet, you must ensure that the public is aware, step-by-step, of what is going on.

Second, it needs to be a studied process. In 1986, prior to the first markup, the Committees,

aided by the Joint Committee on Taxation, evaluated and discussed every major tax area. The Committees conducted hundreds of hours of hearings – not for grandstanding, but for learning. The Administration was also involved with the analysis of the tax code and options within tax policy.

Third, it needs to be as bipartisan as it was then. Tax reform need not be a partisan issue and, indeed, if it is, it would be doomed to failure. We openly worked with the White House, even though we were Democrats and the President was a Republican. We understood from the start that any final agreement was inherently going to be a compromise and not a plank out of either of our party platforms.

Fourth, you need to go deeper into some of the areas that the 1986 effort skirted – most important being the international aspects of the tax code. Today, the impact of globalization is felt in all sectors of our society, far more than at that time. Our tax code needs to reflect this fact.

And fifth, and perhaps most important, nothing should be off-limits in terms of discussion about the design of the code. Remember, until 1986, Super Dairy Cows were also considered sacred.

CONCLUSION

The 1986 Tax Reform Act was not perfect, but it did dramatically simplify the code. The widespread stories about extremely wealthy individuals and prosperous corporations gaming the tax code to pay no taxes largely disappeared from the newspapers at the time. Today, the erosion that has occurred has allowed a myriad of provisions to be restored and new provisions to be added – many with appropriate policy goals when viewed in isolation – but that together create an economic labyrinth and often is at odds with itself, confuses nearly us all, and undermines public trust.

Thank you again for the opportunity to appear today. I am happy to answer any questions you may have.

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