



Freedom Works

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There are certain political leaders who take on an almost mythical stature. Ronald Reagan is one such leader. For many free market advocates, Reagan has become synonymous with the ideas of individual freedom, economic prosperity, and American revival. So influential is his legacy that it continues to act as a guiding force in American politics.

Even President Obama, by no means conservative, paid tribute to Reagan's legacy in 2008. Speaking to the editorial board of the *Reno Gazette-Journal*, Obama praised Reagan for being a transformational president. 'He put us on a fundamentally different path,' said the then presidential candidate. 'He tapped into what people were already feeling, which was, we want clarity, we want optimism, we want a return to that sense of dynamism and entrepreneurship that had been missing'.

But what is Reagan's legacy? Ronald Reagan was an unusual presidential candidate. A former Democrat, actor, and President of the Screen Actors' Guild, Reagan won the Republican nomination with a radical platform of economic and political reform.



In the late 1970s, the US economy was experiencing what was then the greatest economic crisis since the great depression. Inflation was in double digits (13.3 per cent in 1979) and unemployment was on the rise (reaching 7.9 per cent in 1980).

In the two years before Reagan entered office, the price of crude oil more than doubled from \$51 to \$102 per barrel in real terms. The Carter administration was unable to resolve the Iranian hostage crisis. These factors created a feeling of pessimism and decline in America—‘a crisis of confidence’, Carter declared.

Reagan sought to combat this perception with a set of reforms to revive the economy and increase US influence in the world. His election platform called for a balanced budget within three years, tax cuts of 30 per cent, less government interference in the economy, a stable monetary policy, and a significant build-up of the US military.

The public responded to Reagan’s ideas by electing him in a landslide. Reagan carried 44 of 50 US states, winning 489 electoral college votes to Carter’s 49. From the moment he was elected, Reagan began the process of implementing his reforms.

Less than a month after his inauguration, Reagan outlined his economic approach in a speech, stating that ‘It is our basic belief that only by reducing the growth of government can we increase the growth of the economy’.

Tax reform was at the centre of this agenda, and in his first year in office, Reagan signed into law the *Economic Recovery Tax Act of 1981* (ERTA). The ERTA slashed income tax rates over a period of three years, with the top marginal rate falling from 70 per cent to 50 per cent, and the lowest rate dropping from 14 per cent to 11 per cent. Capital gains taxes were also cut from 28 to 20 per cent. These were some of the measures enacted in the ERTA to lower America’s tax burden.

Reagan followed the ERTA with further tax cuts throughout his presidency. The top marginal income tax rate was eventually cut to 28 per cent, and corporate taxes were cut from 46 per cent to 34 per cent.

These tax reforms set the groundwork for the longest peacetime economic expansion in US history. Almost every economic measure substantially improved after Reagan’s reforms took effect.

Seventeen million new jobs were created from 1981-89, with the unemployment rate falling from 7.6 per cent to 5.5 per cent over the same period. GDP growth reached a staggering 7.9 per cent following the passage of the ERTA, with annual GDP growth averaging 3.1 per cent over Reagan’s presidency—an improvement on the 2.4 per cent under Carter.

Median household incomes went up by \$4,000 in real terms—an increase of 11 per cent from 1981 to 1989. By the end of Reagan’s term, the US economy was almost one third larger than when he took office. Even the high inflation, which had characterised the 1970s, was brought



under control.

Reagan's policies, along with the support of Federal Reserve Chairman Paul Volcker's tough monetary policy, saw inflation fall from 13.5 per cent in 1980 to 6.2 per cent in Reagan's second year, according to the Consumer Price Index (CPI). By the end of his presidency inflation had fallen to 4.1 per cent.

Many of Reagan's critics allege that this extraordinary economic revival only benefitted the wealthy. Coining the term 'trickle-down economics', these critics argue that the reforms lead to rising inequality, causing the rich to get richer and the poor to get poor. But this is simply not the case.

Every income group, from richest to poorest, benefitted from Reagan's economic reforms. In 1989, there were 5.9 million more Americans who had salaries exceeding \$50,000 (adjusted for inflation) than when Reagan took office—an increase of 60 per cent.

There were 2.5 million more Americans who had salaries exceeding \$75,000—an 83 per cent increase—and, most importantly, there were 3.4 million fewer Americans earning below \$10,000 per year—a fall of 5 per cent. That is 3.4 million fewer Americans living in poverty.

Reagan's critics also ignore the benefits of increased income mobility. 86 per cent of households that were in the poorest income quintile in 1980 had, by the end of the decade, moved up the economic ladder.

In their 1996 paper published by the Cato Institute, authors William Niskanen and Stephen Moore commented that, 'Incredibly, a poor household in 1980 was more likely to have moved all the way up to the richest income quintile by 1990 (15 per cent) than to still be in the poorest quintile (14 per cent)'. Even those who remained poor benefitted, as the poorest 20 per cent of Americans gained 6 per cent income growth in real terms.

Clearly the benefits of these reforms were universal. By reducing America's tax burden, Reagan's reforms removed the impediments that were stifling human ingenuity. This provided an enormous stimulus to the economy, which affected all sections of American society. Even government revenues benefitted from the stronger economic growth.

Despite the significantly lower tax rates, federal revenues grew by 20 per cent, in real terms, from 1981 to 1989. Revenue from the now much lower income taxes rose by 16.3 per cent in real terms.

This economic revival is at the heart of Reagan's legacy. By implementing radical tax reform, Reagan created the conditions for a growth in confidence and a revival of American influence around the world.

There are, however, a number of caveats to Reagan's success. Despite his soaring rhetoric, Reagan ultimately failed to reduce the size and scope of government. During his presidency, the rate of spending growth was cut from 4 per cent to 2.5 per cent per year. But by the time he left office, Reagan had presided over a 22 per cent increase in government spending (in real terms).

This is the second highest increase in the size of government for any president since Lyndon Johnson's Great Society—only surpassed by George W. Bush's increase of 53 per cent (in real terms). However, both Carter and Ford increased spending at much quicker rates than Reagan, with increases of 17 per cent and 18 per cent (in real terms), despite only serving one term each.

Much of this growth in government spending was due to Reagan's 44.2 per cent increase in military spending, in real terms. But even domestic spending grew by 5.8 per cent in real terms—although as a percentage of the economy it fell from 15.3 per cent of GDP to 12.9 per cent.

The military build-up may have been necessary at the time. The U.S. was facing a geopolitical superpower—the Soviet Union— whose founding ideology was fundamentally hostile to individual freedom. By increasing pressure on the Soviet Union through increased military spending, Reagan arguably hastened the collapse of the communist bloc and the end of the cold war.

Nevertheless, this increased government spending was the cause of what Reagan viewed as the 'greatest disappointment' of his presidency—the growth in America's national debt.

As a result of his failure to pay for spending increases, Reagan presided over continual budget deficits and a doubling of the national debt, with gross federal debt rising from \$2 trillion to over \$4 trillion in real terms (2009 dollars).

Even despite the growing economy, the national debt climbed from 27 per cent to 42 per cent of GDP. This is a fraction of the current U.S. federal debt, which is now over \$17 trillion.

But by failing to pay for his spending increases, Reagan placed the burden of his spending on future generations, and may have helped set the foundations for a potential debt crisis.

Even in the area of tax reform, Reagan was not without fault. After the radical cuts at the beginning of his term, Reagan presided over several minor tax increases from 1981 to 1987.

This has led historian Bruce Bartlett to argue that the tax increases over the course of his presidency took back half of the tax cut of 1981. But Reagan should not bear all the blame for these tax increases. Reagan's biggest tax increase was the *Tax Equality and Fiscal Responsibility Act* of 1982 (TEFRA). This raised taxes by 1 per cent of GDP, making it the biggest tax increase from 1968 until the passage of Obamacare. But the passage of TEFRA was based on an agreement with Congress that there would be \$3 in spending cuts for every \$1 of tax increases.

These spending cuts would have significantly reduced Reagan's budget deficits. However, whilst the tax increases immediately took effect, the spending cuts never came.

Reagan's attempt at compromise was a departure from his principled, pro-freedom agenda and it represents a significant mark against his legacy.

This serves as an important reminder for Australian policy makers. Economic freedom works. Tax cuts work. But they must be accompanied by cuts to government spending. Australia, thankfully, is



not faced with an ideological and strategic enemy like the Soviet Union. So there is no reason to avoid significant, across-the-board cuts in government spending.

Reagan entered office with a bold and radical reform agenda to reduce the burden of government. He made significant changes that improved the lives of millions of Americans.

But his legacy was not only the sum total of the laws he passed. By championing a principled agenda of freedom, Reagan's influence continued long after he left office.

Reagan's presidency fundamentally transformed the Republican Party and the American conservative movement. Even today, Republican presidential candidates attempt to pitch themselves as the heirs to Reagan's legacy.

In the first ten 2012 Republican primary debates, Reagan was mentioned 53 times. This was more than all other ex-presidents combined, who were only mentioned 38 times.

In the lead-up to the 2016 election, Republican candidates Rand Paul and Ted Cruz have both sought to define their (conflicting) foreign policy agenda as a return to the policy of Reagan's administration.

So far, no Republican president has lived up to Reagan's legacy. Indeed, many Republican candidates fail to grasp fundamental aspects of Reagan's approach. But the mere fact that they must pay lip-service to Reagan shows the power of the ideas he advocated.

If Australian politicians want to leave a lasting legacy, if they want to change Australia for the better then it is clear what they must do.

They must advocate for principled reform. They must cut taxes and reduce spending. They must allow people the freedom to pursue their own happiness, unleashing prosperity in the process. Freedom works: that is the lesson of Reagan's legacy.