Murray Weidenbaum evaluates Reaganomics two-and-a-half years after it was enacted and examines the effectiveness of these policy initiatives, showing that the results are mixed at best.
Reaganomics: Success and Failure
by Murray L. Weidenbaum

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Success and Failure
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After two-and-a-half years, the time seems appropriate to evaluate the Reagan economic program. I will do just that, indicating failures as well as successes. In the process, I am likely to disappoint liberals and conservatives alike, but I will try to provide as careful and balanced an appraisal as I can.

Let me begin the analysis with the fundamentals of Reaganomics announced by the White House in February 1981, in what we called the economic White Paper. In that key policy document, we stated that the basic objective of Reaganomics is to shift the balance of power from the Federal government to the rest of society. This important shift was to be accomplished by a four-pronged approach: (1) cutting tax rates, (2) slowing down the growth of Federal spending, (3) curtailing the burden of regulation, and (4) reducing the growth of the money supply.

The hoped-for results were to be rapid and sustained economic growth coupled with declining inflation. Well, what has occurred in the way of translating the rhetoric into reality? What have been the

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effects on the American economy? As we will see, actions have been taken in each of the four areas, but the results have been very uneven. As a professor, I will grade the Reagan economic program. But please be patient. As in class, the grades will come at the end.

**Tax Cuts**

On the revenue side, the President urged the Congress back in February 1981 to enact a 25 percent across-the-board reduction in personal income tax rates over three years plus a major liberalization of business depreciation allowances. That was done. But, in the course of the legislative process, a "bidding" war occurred, which resulted in many costly items of special legislation being added to the tax bill. These included the temporary "all savers certificates" designed to aid the hard-pressed thrift institutions. More fundamental and expensive were the added structural changes such as indexing the personal income tax system. That is scheduled to begin in 1985. Other add-ons include savings incentives and reducing the so-called marriage tax penalty.

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Hindsight tells us that the Administration might have been better off if it had agreed to the early compromise suggested by key Congressional leaders. These members of Congress wanted to make the third installment of the tax cut contingent on progress in reducing the deficit. That would have obviated the "bidding war," which resulted in various new tax "loopholes" being opened up. Also, the compromise would have eliminated the special spending increases—such as the sugar subsidy—which were required to attain sufficient support for the tax bill from dissident Democrats (the so-called "bollweevils").

In any event, as a result of the tax cuts, the Treasury's share of the national income has been declining—from 21 percent in 1981 to 19 percent in 1983. The modest increase in selected taxes last year (the infamous "revenue enhancements") slowed down this trend but did not reverse it. That downward shift stands in marked contrast to the 1970s, which witnessed a rise in the per capita federal tax burden. A two-percent drop in the federal share of the national income may not sound like much, but let us remember that two percent of a $4 trillion economy is $80 billion a year. That could generate a substantial contribution to the national pool of private savings to finance economic growth.

But that is not how these developments were viewed in financial markets. There, the large tax cuts were interpreted as meaning an extended period of deficit financing. An extremely optimistic official economic forecast—what came to be known as "Rosy Scenario"—aggravated the situation. Financial markets responded with a significant rise in interest rates which directly increased interest on the national debt and, hence, the budget deficit. The rise in interest rates also weakened the capital-intensive sectors of the economy. That decline in business activity also contributed to higher deficits in the budget.

In one particular respect, the economic fates have not been kind to Reaganomics. Reducing marginal tax rates and lowering the inflation rate have not so far generated the expected rise in the saving ratio.
Rather, personal saving has been a declining percentage of personal income.

**Spending Cuts**

But what about all the spending cuts? On the surface, the growth in federal spending has slowed down, but only in what economists call nominal terms. Government spending has increased rapidly in real terms—that is, when we boil out the effects of inflation. Important shifts in priorities—that is, among specific budget categories—were made. These shifts were mainly from welfare to warfare. Nevertheless, government spending is a larger factor in the American economy today than it was in January 1981.

I know that this finding may come as a surprise to those who read so much about all those budget cuts. During my first year in the Reagan Administration, I used to describe the budget restraint effort with an old budget office motto, "Good budgeting is the uniform distribution of dissatisfaction." I stopped saying that because only a few of the spending agencies—and their allies—are greatly dissatisfied.

To be sure, tens of billions of dollars of reductions have occurred in proposed Federal expenditures. Yet those unprecedented cuts (mainly reductions in proposed increases) have been made entirely in a few civilian areas, such as grants to state and local governments and selected social welfare programs. But those decreases were more than offset by simultaneous rapid expansions in military outlays, farm subsidies, and interest payments, and by the continuing and almost inexorable rise in so-called "entitlement" outlays.

The initial budget report of the new Administration (issued in March 1981) had a line for "unspecified savings," supposedly a large amount of budget cuts presumably to be specified at a future date. What ensued reminds me of the words of the old song, "Tomorrow, I'll be leaving, but tomorrow never comes." Overall, federal spending has been rising, from 23 percent of GNP in fiscal 1981 to 25 percent in fiscal 1983. What these numbers mean is that taxes were cut substantially more than originally planned and expenditures far, far less—and not cut at all in real terms. The result is now large and growing budget deficits.

I suggest that these undesirable results are not an inherent failing of the basic policy of Reaganomics. After all, the White Paper called for both large tax cuts and large budget reductions. But the shortcoming in execution turned out to be critical. The resultant large budget deficits represent an unresolved contradiction in the conduct of Reaganomics.

The large budget deficits are not an inherent failing of the basic policy of Reaganomics, but rather represent an unresolved contradiction in the conduct of Reaganomics.

The annual flow of red ink has risen from $62 billion in fiscal 1981 to $110 billion in fiscal 1982 and to the neighborhood of $200 billion—a very rough neighborhood—in fiscal 1983. Similar flows of red ink are anticipated in 1984 and 1985. Financing such large deficits during a period of expansion will mean competing with private investment for the limited supply of saving.

The White House has blamed the Congress for not reducing the swollen budget, while members of Congress respond that the President has submitted the deficit budgets in the first place. The fact of the matter is that both the President and the
Congress have been shy when it comes to real budget cutting. Because of the inability to cut spending in the face of rising deficits, it has become fashionable in Washington to debate whether deficits matter and whether tax increases do more harm than budget deficits. If the powers that be would make the tough decisions required to curb government spending, Administration spokesmen would not have to dance around the fundamental budget quandary in that fashion.

Regulatory Reform

Let us turn to the third pillar of Reaganomics—reducing the burden of government regulation. The major accomplishment in the regulatory reform area has been undramatic, but significant. For the first time in decades, no new major regulatory activities have been started. In fact, many burdensome regulations have been modified or rescinded as the result of instituting a comprehensive program of regulatory review, including the requirement for performing benefit/cost analysis of proposed regulations. Savings from these regulatory relief efforts are approximately $10 billion a year in current operating expenses plus a one-time saving of another $10 billion in capital outlays.

Unfortunately, progress on regulatory reform has slowed very substantially in recent months. The largest regulatory body, the Environmental Protection Agency, has gone through a period of turmoil in the course of which many key officials resigned. The new head of the agency has cautioned that the present is not an appropriate time to seek basic changes in regulatory statutes. Moreover, the actions and statements of former Secretary of the Interior James Watt aroused many segments of the environmental movement which previously had avoided engaging in partisan political controversy.

In any event, in August 1983 the Vice President announced the termination of the Task Force on Regulatory Relief, which he had headed since the early days of the Administration. The Task Force was established to provided leadership for the Reagan Administration's regulatory reform efforts. It set in motion the initial and useful regulatory review efforts.

Simultaneously, in another key area of government involvement in business decision making, several serious backward steps have been taken since January 1981. I am referring to new restrictions of foreign trade. Many of these actions have reduced imports, but some have curtailed our exports. These contradictory actions have ranged from cajoling the Japanese to impose limits on their exports of automobiles to the U.S., to direct limits on imports of steel and meat, to preventing U.S. firms from participating in building the natural gas pipeline between Western Europe and the Soviet Union.

The Administration's trade policy has its shortcomings, but they are overwhelmed by the Congress' willingness to pander to virtually every protectionist interest

Pressures for further restrictions on imports are very strong. A current example is the Congressional proposal to rigidly limit Japanese automobile imports via detailed "domestic content" rules. At first blush, that may sound fair—until you stop and think about it. How many jet airplanes would we export if each consumer nation required that a major portion of every airliner it bought had to be produced
domestically? Clearly, the Administration's trade policy has its shortcomings, but they are overwhelmed by the Congress' willingness to pander to virtually every protectionist interest.

On balance, I cannot really say that, as a result of policy actions since January 1981, the federal government will be intervening less in the American economy than in the 1970s. At best, we can describe crosscurrents, in terms of shifts since January 1981 in the composition of government intervention. If you sense a note of disappointment in these words, that is not accidental.

**Slower Monetary Growth**

With regard to monetary policy—the fourth part of the Reagan program—the Administration strongly supported the Federal Reserve System's efforts in 1981 and 1982 to bring down inflation by reducing the growth in the money supply. The Fed accomplished that objective and, thus, also deserves the credit for the decline in nominal or market interest rates. Surely the large budget deficits have not helped. The Fed should get all the credit for bringing down inflation—but also for bringing down employment! We must acknowledge, of course, that progress on inflation was accompanied by a substantial rise in unemployment. The most optimistic projections show the unemployment rate in January 1985 to be higher than it was in January 1981.

On the positive side, inflation is down from double digits to about 4-5 percent and is likely to stay there for a while. There is also a new sense of realism in economic decision making in the United States today. Ill-conceived company investments and expense commitments are no longer automatically bailed out by inflation. At the consumer level, purchases of art and gold and postage stamps once again are looked upon as consumption activities, rather than primarily investments in what had been a continually rising price level.

Employees are learning that their wages, salaries, and fringe benefits are vitally dependent on the future success of their companies. Although not universally, and always grudgingly, workers are increasingly willing to accept changes in work rules and job practices necessary to ensure their company's future. But the new sense of realism is quite recent. It could readily be reversed if the Federal Government decides to bail out declining industries, whether through an "industrial policy" or through protectionism.

**An Appraisal of Reaganomics**

Let me now turn to an appraisal of Reaganomics. I remind my listeners of a point that I made repeatedly in 1981 and 1982, when I was in office. I do not equate Reaganomics with supply-side economics and certainly not with the simple-minded view that tax rate cuts will reduce budget deficits. Rather, the Reagan economic program is a blend of contributions from several contemporary schools of conservative thought.

*In real terms, the estimates for President Carter's swansong budget are lower than the estimates contained in the Reagan Administration's most recent budget report.*

The tax cuts—focusing on the need to reduce those punishingly high marginal rates—were, of course, based on the notions described as supply-side economics. Monetary policy, however, was expressed in terms of controlling the money supply, a
Surely, the initial policy of monetary restraint succeeded in bringing down inflation. We must recall that inflation was the number one problem according to virtually every public opinion poll taken in the United States in 1980. During the past year, however, the Federal Reserve System has followed a more eclectic approach, one closer to its earlier tradition of concern with money market conditions and interest rates. Leading monetarists contend that the Fed is no longer following a monetarist approach, but rather that it has returned to Keynesian stop-and-go policy. Certainly, money supply movements since January 1981 cannot be described as adhering to the guidelines in the Reagan Administration's economic White Paper of February 1981—gradual and persistent reduction of the growth of the money supply. Moreover, with the President's reappointment of Paul Volcker as Chairman of the Fed, the Administration implicitly has endorsed the actions that he and his colleagues have taken. However, the White House apparently has resumed the practice of publicly needling the Fed, an activity that generally has been counterproductive.

With the benefit of hindsight, it is clear that the costs of carrying out the Reagan economic program have been significantly greater than originally anticipated. Interest rates—especially real rates—are far higher than initially projected, and so is unemployment. Yet the progress on inflation has been greater than most observers expected and, at least for a while, the economy is on a growth trajectory once again.

The international aspects of the Reagan Administration's domestic economic policies are troublesome. The basic problem has arisen as a result of the interaction in 1981-82 of tight monetary policy and easy fiscal policy. Unlike most previous
experiences, the budget deficits were not financed by monetizing them via inflationary expansions in the money supply. Rather, the Treasury competed with private investment demands for the limited supply of saving, thus pushing up interest rates, particularly real interest rates. Although the movement was not exactly parallel, the value of the U.S. dollar in foreign exchange markets rose over this same period, reflecting the increase in interest rates in the United States.

All this forced many other nations to higher levels of interest rates, in order to stem capital flows to the United States. At times, that ran counter to the needs of their domestic policies, which called for stimulus to begin a process of recovery from recession. Particularly in the developing nations, the result of rising interest rates and a stronger dollar meant that it was more expensive to service their international indebtedness and that the burden of repayment also was heavier.

By no means should we attribute all economic problems to the American budget deficits. Nevertheless, the prospect of those outsized deficits becoming a durable fixture on the economic scene has set in motion a variety of adverse trends, in both the United States and elsewhere. The domestic costs to the United States have included a striking loss of competitiveness on the part of American products in relation to foreign goods.

The powerful interactions between domestic and international developments are not truly appreciated by the American public. Nevertheless, they have generated some of the special costs that have arisen under an ambitious economic program attempting simultaneously to accelerate defense spending, cut taxes, and slow down inflation.

On reflection, that was a tall order, encouraging reliance on easy answers. All this provides some economic lessons for the future. Perhaps the overriding lesson is the need to make tough choices among desirable alternatives—in other words, to set priorities. For many people, supply-side economics was seen as the latest version of the promise of a free lunch. In any event, visions of rapidly rising revenues dampened for many the ardor to cut government spending.

We must label as wishful thinking the notion that the way to cut government spending is to cut taxes. The most effective way to cut spending is the more conventional route, to reduce appropriations.

Thus, a more specific economic lesson from the past three years is clear: We must label as wishful thinking the notion that the way to cut government spending is to cut taxes. In its extreme form, this idea had been expressed as the "only way to reduce spending is to reduce revenues." As many of us had suspected, and recent experience has confirmed, the most effective way to cut government spending is the more conventional route, to reduce appropriations. Easier said than done—or many a slip between the cut and the lip.

Conclusion

On balance, how do I grade Reaganomics thus far? I must confess to a certain amount of ambivalence. I do, however, find the general thrust of Reaganomics as attractive as ever.

It is always pertinent to advocate reducing the tendency to look to the Federal Government to solve all of our societal ills.
The whole gamut of social welfare "entitlements" needs to be controlled. High marginal tax rates need to be reduced. Our military establishment needs to be strengthened. The private sector needs to be elevated in terms of its role in society. Inflation needs to be kept under control. Yet, as we have seen, the specifics of the Reagan economic program are not entirely consistent with that litany of objectives. The present state of the economy is not devoid of serious problems. In fact, quite a few of them are more severe than they were in January 1981.

On balance, I find the most satisfactory way of appraising the Reagan economic program is in terms of the four pillars of the program. Thus, the high marginal income tax rates have been reduced. But that action did not generate the increases in private saving that it was designed to achieve. If the personal saving rate had risen—instead of falling—the huge deficits could have been financed with less upward pressure on interest rates. To tax policy, I give a B.

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With reference to government spending, I find it hard to say that, on balance, any progress has been made. For the failure to cut government spending, I must award a grade of D. Thus, I am in effect giving fiscal policy an overall grade of C. Clearly, fiscal policy is the Achilles heel of Reaganomics.

The resultant large deficits have contributed to the high interest rates that have bedeviled our domestic economy as well as international financial conditions. Budget cuts are still high on the agenda of unfinished business.

For regulatory reform, I grade the Administration C. It did not face the key statutory problems in the regulatory area. It undermined public confidence in environmental controls, and it—albeit reluctantly—embraced many protectionist measures.

In the monetary area, I give the Administration a B+, mainly for supporting Paul Volcker's leadership, albeit with a bit of counterproductive public needling from time to time.

If we have learned anything in the field of economic policy in the last three years, it is to be wary of simple solutions. I have no panaceas to offer, other than the strong belief that there are no panaceas.

What, then, is the overall grade for Reaganomics? According to my calculations, it is a disappointing C+. But, of course, this is in the nature of midterm grades which, it is always hoped, inspire the student to do much better in the remainder of the course. Moreover, some historical perspective is essential. The grade that I gave the preceding Administration was far lower.

Let me offer a final point. If we have learned anything in the field of economic policy in the past three years, it is to be wary of simple solutions. Many difficult problems face modern societies. We can deal with those problems only by making hard choices. I have no panaceas to offer, other than the strong belief that there are no panaceas. The alternative is to embrace
Yet another set of economic nostrums. For example, the continuing pressure for a return to the gold standard shows that the panacea approach to economic policy is alive and well. At the other end of the political spectrum, the burst of interest in "industrial policy" or reindustrialization is another example. It is simply the old, activist government wine (or vinegar) with another label, but not really of a different vintage.

I see no alternative—in the public sector—to making the budget cuts that earn the tax cuts. In the private sector, the responsibility for increasing international competitiveness is on management and labor in each industry, who are responsible for increasing productivity and controlling costs. The long-run future of the American economy will be determined by our own ability to take tough actions in both the public and private sectors. That is the basic lesson that we should have learned since January 1981.