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A Settling of Accounts

By Richard W. Rahn

"What I am ready to predict and to promise is that the effect of the president's program will not be—as he so confidently and repeatedly predicts—to cut the present inflation rate more than in half.

Whatever effects it would have on the inflation rate surely would work in the opposite direction—unless there is a great deal to the supply-side argument . . ."

"The administration's projection is that inflation in the consumer price index will decline from 11.1% in 1981 to 4.2% in 1986—that, I think, would truly be a miracle."

—Gardner Ackley
former chairman
Council of Economic Advisers
in congressional testimony
March 4, 1981.

"The engines of economic growth have shut down here and across the globe, and they are likely to stay that way for years to come."

—MIT's Lester Thurow
New York Times Magazine
Oct. 17, 1982

I picked these quotes almost at random from a collection I keep of the collected pronouncements and predictions of liberal/Keynesian economists of our time. They are worth recalling as we mark the longest American peacetime economic expansion since 1796.

The fact is, of course, that one month after Thurow pronounced his apocalyptic vision, expansion began. And Prof. Ackley was rather wrong about inflation; the CPI fell from 12.4% in 1980 to 1.1% in 1986. It is pleasant, in these weeks after the pope's departure, to be able to point to such palpable "miracles."

We have recently lived through one of those rare periods in which there has been a distinct and deliberate change in economic policy. There were great disagreements about this dramatic change. Liberal-establishment politicians and economists had been arguing that we were close to a permanent situation of stagflation such as that which characterized the late 1970s. They insisted little could be done to reduce inflation and spur economic growth. They insisted government needed to grow and become more active in order to ensure a better distribution of income under their zero-sum society. The major opposition to this view came from the supply-side economists—the intellectual contras, if you will, who fought on the bloody fields of The Wall Street Journal editorial and op-ed pages for freedom against greater government control and for economic opportunity.

In the late '70s and early '80s, the supply-siders argued that noninflationary economic growth would occur if high marginal tax rates were reduced, if government regulation and spending were restrained, and the rate of monetary growth gradually reduced. The liberal/Keynesians argued that the supply-side program would result in a big increase in inflation, greater poverty and an ultimate economic decline.

They were wrong. At this point we can say that flat out. Despite the fact that Ronald Reagan's program of supply-side economics was only partially implemented—the tax cuts were delayed, the spending goals were never achieved, and the Federal Reserve didn't follow the initial plan—the achievements of the supply-side revolution have been very impressive.

In January 1981, members of the Carter administration (liberal/Keynesian) made their last projection of what they believed was the best that could be expected from their policies. For the 1983-86 period they projected an average real economic growth rate of 3.7% and an average inflation rate of 7.6% (GNP deflator). In March 1981, Reagan administration officials (supply-side) made their economic projection of what they believed was the best that could be expected from their policies. For the 1983-86 period they projected an average real economic growth rate of 4.5% and an average inflation rate of 6.0%. The actual numbers for the 1983-86 period were 4.1% for economic growth and 3.4% for inflation.

We have achieved not only the aforementioned period of longest peacetime economic growth, we have also achieved the highest continuous peacetime real rate of average economic growth during any five-year period in our nation's history. We now have a record number of Americans at work, a record high percentage of our adult population at work, a record rate of high- and middle-wage new job creation, a record rate of industrial output, a record rate of new business incorporations, a record rate of real per-capita personal income and the highest absolute rate of manufacturing productivity of any country in the world.

Seven years after the supply-side revolution found its political voice, it is irrefutably true that opponents were basically wrong and advocates were essentially right.

It is true that there is a budget deficit that it is very big and requires our attention. But it is equally true that the deficit can fairly be blamed on all the major players in economic policy making. The Reagan administration has achieved its goal of reducing the federal tax burden to 19.6% of GNP but it has not reached its goal of reducing spending to 19.5% of GNP. The president is correct that an immovable Congress is a major culprit. (Congress increased spending by a total of $92 billion over the president's requests during the 1981-86 period.) But the administration, too, shares some of the blame: Much of the president's leadership in the area of cost cutting has been limited to rhetoric. And in this case it would have been better to "war war than jaw jaw." And finally, the Federal Reserve Board, by collapsing the money supply in late 1981 and early 1982, did bring down inflation, but also largely caused the recession and a permanently higher level of government spending.

Still, seven years after the supply-side revolution found its political voice, we can conclude at least this: It is simply and irrefutably true that supply-side's opponents were basically wrong and its advocates were essentially right.

And now we are faced with a new set of economic questions; we are in need of policies aimed at keeping our economic expansion going. To whom should we look for guidance? Many of the politicians and economists who have been wrong for the past seven years are now advocating tax increases, some trade protectionism, re-regulation and increased government spending. On the other hand, most of the politicians and economists who have been right for the past seven years are advocating more spending restraint, increased deregulation and privatization, some sort of price rule to guide Federal Reserve monetary policy, and further reduction of tax impediments on productive economic activity.

If we look at the record, the debate should be rather short. The winners obvious. The only tragedy—and it's an amazing one—is that most Americans don't even know what has been accomplished and how it came about.

Uncelebrated, Maligned

What of the architects of this imperfect triumph? The supply-side economists, writers and politicians not only continue to go uncelebrated, they continue to be maligned, by the establishment, the media and the academics of the major universities. It is not surprising that those who show no great interest in expanded economic liberty refuse to cheer, but it is strange that freedom's natural allies forget to. I do not know why the winners of a philosophical war that has gone at least 50 years are not hailed and applauded as the victors they are. But I am reminded of the observation that the quickest drying substance that exists is tears of gratitude.

The administration is about to celebrate its great economic achievement with a series of speeches and events. Let me not be alone in the back of the crowd as I tip my hat to my longtime colleagues on the economic barricades: Thank you, Mr. Gilder, Mr. Kemp, Mr. Laffer, Mr. Mundell, Mr. Roberts, Mr. Ture, Mr. Wanniski, and all the others who helped invent this economic miracle.

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