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The 25 Fat Years

Ronald Reagan's election marked America's economic turning point.

By Pete du Pont

In 1981 Ronald Reagan became our 40th president, the hostages were released from Iran, Walter Cronkite retired after 19 years as "CBS Evening News" anchorman, and Sandra Day O'Connor became the first female Supreme Court justice.

But a quarter of a century later we should remember 1981 as the year the kaleidoscope turned in America, a dividing point between the previous two decades' big-government beliefs and the individualism and market economy thinking of the next 20 years. We have seen sharply different opportunities--in jobs, incomes, economic growth and inflation--between the governmental years of the 1960s and '70s and the market decades of the '80s and '90s and the new century.

In the 1980 election the American people chose a new course. For the first time in half a century we retreated from the expanding-government philosophy established by Franklin D. Roosevelt and pretty much adhered to by every subsequent president through Jimmy Carter. Ronald Reagan's emphasis on individual opportunity--as opposed to the liberals' on government-created opportunity--was to have a substantial and positive impact on the prosperity of the American people.

As Robert Samuelson recently noted in The Wall Street Journal, in the 13 years before 1981 there were four recessions lasting a total of 48 months. In the next 23 years--nearly twice as long--there were just two recessions, lasting 16 months.

Real annual growth in gross domestic product averaged just over 2.3% a year in the late 1960s and '70s. From 1982 to 2000 GDP grew an average of almost 3% a year.

From the late '60s until 1982, an average of 1.6 million jobs were added to the American economy each year; from 1982 through 2000 the average added was 2.3 million. There was a recession in 2002, but since the full enactment of the Bush tax cuts in the spring of 2003, nearly five million new jobs have been created.

In the '70s unemployment began to rise, growing during the Carter presidency and peaking at 10.8% in 1982 in Reagan's second year. Reagan got it down to 5.3%, Clinton to 3.8%; today it stands at 4.7%, lower than the average for the 1970s, '80s and '90s.

The famous "misery index"--inflation plus unemployment--annually averaged 13% from the late 1960s to 1982; since then it has averaged just 9%. Inflation peaked at more than 13% in the last year of the Carter administration; Federal Reserve Chairman Paul Volcker drove it down to 3.2% by 1983. Under four presidents of two political parties--Reagan, George H.W. Bush, Bill Clinton and George W. Bush--inflation has averaged just 3.1% for the past 23 years.

Two decades of economic growth show up in the stock market too. The Dow Jones Industrial Average declined to 875 in 1981 from 995 in 1965; in the next 18 years it rose to 11497.

Finally comes the share of the annual GDP spent by the federal government. It peaked at 23% in 1983 and fell to less than 19% in 2001 before Congress and President Bush began increasing it again.

So how did all this progress come to pass? It was in fact president Reagan's 1981 tax reductions that turned America's kaleidoscope and began the economic revolution that has so greatly improved things over the past quarter century.

Over four decades, income tax rate reductions have helped grow the economy. President Kennedy's tax cuts, proposed before his death and enacted in 1964, lowered the top marginal rate to 70% from 91%, and real economic growth jumped by more than 40%. Reagan's rate reduction to 28% raised real economic growth by one-third, and income tax receipts went up an average of 7% a year. President Bush's 2003 tax cuts lowered the rate to 35% from Mr. Clinton's 39.6% and created the economic growth that has increased tax revenues each year--by 5.5% in 2004 and 14.5%--the largest in a quarter century--in 2005.

So what of the future? Will we continue to steer the course that has been so successful for our country, or will we allow the kaleidoscope to turn in the opposite direction?

To keep on course, four policy choices are important. One is to continue President Bush's lower tax rates on income, dividends and capital gains that have gotten us where we are. As Kennedy, Reagan and Mr. Bush have proved, tax cuts create economic growth, and more growth creates more individual opportunity.

The second is to move to a flat tax, which would make much of the eight billion hours that people annually spend filling out tax forms (costing the economy $200 billion each year) available for productive work that would increase opportunities and incomes. Steve Forbes estimates that enacting the flat tax would, in the first 10 years, "generate $56 billion more in net government income tax receipts than the current tax code." The flat tax would raise revenues and end the frustrating complexity taxpayers face in trying to comply with an incomprehensible tax law.

Third, we must bring the rapid growth of government to an end. Domestic discretionary spending rose 7.1% a year in President Bush's first term, the highest of any modern president. Education spending is up 139% in the president's first five years, and government energy spending has doubled. The 2002 farm bill added $8 billion a year to spending, the Medicare prescription drug bill will cost at least $33 billion a year, and ethanol subsidies are up $2.3 billion. Congressional earmarks have grown too, from almost none in the 1980s to some 13,000 last year. Some 6,373 of them, costing $24 billion, were in the recent highway bill. Some vision, some vetoes and some fiscal discipline are needed to control and then decrease annual spending growth.

Finally, we should move from static to dynamic economic calculations. Static calculations say that when income tax rates are cut by 10%, federal tax receipts will decline by 10%. But that is erroneous thinking, for when income taxes are cut some individuals decide to work more and some companies to invest more, so tax revenues increase. Harvard economist Martin Feldstein calculates that income tax rate reductions give back one-third of their projected revenue loss to the government. But it can be even more dramatic: When the Bush capital gains and dividend tax cuts were enacted in 2003, the Congressional Budget Office's static analysis estimated that tax revenues would decline by $27 billion over the subsequent two years. In fact, the tax rate reductions increased governmental tax revenues by $26 billon. So static scoring put the CBO $53 billion in error.

Since America's economic thinking changed in 1981, the economy has grown, recessions are far less frequent, job opportunities are increasing, inflation has not been a problem, and individual income tax burdens have declined. President Reagan's economic morning in America has lasted a while, and we must make sure it lasts a great deal longer.

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