

Reagan's Freedom Worked
by Steve Pejovich

Issue 175 – March 9, 2011

During his first two years in the White House, President Barack Obama's major economic policies included deficit spending, bailouts, government take-over of private firms, the socialization of the health industry and slavish support for labor unions, especially public sector ones. Those policies were a mix of Keynesian economics and Saul Alinsky's political activism. Very adroitly, Obama exploited the economic downturn of 2008 to move the United States economy toward a mixture of European welfare statism and socialism. He openly spoke about a myriad of regulations, nationalization of privately owned resources, and spreading the wealth. The results of the 2010 elections are the best evidence of the response of the American people to Obama's economic policies during the first two years of his administration.

Obama got the message. In the State of the Union speech on January 2011, he announced "pro-business" economic policies, but they were top-down industrial policy rather than market capitalism. President Obama has not abandoned his conviction that the Federal government should control the direction of economic activities as well as the distribution of income. One week after the State of the Union speech, Obama told the US Chamber of Commerce that the federal government is in the game to stay. He then asked top American executives to share their profits with workers. While his request was unenforceable, it surely was backed by a not so subtle threat to do it himself if they refused.

Early in February 2011, Obama told Bill O'Reilly of Fox News that he has not raised a single tax. According to Americans for Tax Reform, Obama's statement is blatantly false (<http://www.atr.org/obama-makes-super-false-tax-claim-a5830>). During his first two years as president, Obama signed into law close to two dozen tax increases, in many cases violating his campaign pledge that no American earning less than \$250,000 would pay any additional tax. For example, on February 4, 2009, Obama signed a 156 percent increase in the federal excise tax on tobacco. The median income of smokers is only about \$36,000.

Is there another way? Ronald Reagan thought there was. He firmly believed in an American capitalism based competitive markets, credible private property rights and the equality of opportunities. He was deeply convinced that the ingenuity and industry of free and self-responsible individuals could do much more for the country than top-down policies concocted by a bunch of bureaucrats in Washington; that is, the Federal government should not do things that individuals can do in competitive markets.

The results of the 2010 elections forced Obama to modify his pro-socialist policies. However, his post-election speeches and actions show that Obama's commitments to the leading role of federal government in directing the economy and spreading the wealth have not changed. I conjecture that Obama's goal is to replace the American tradition of the equality of opportunities with a system that seeks equal outcomes. In the pursuit of that end, federal government has to restrict the freedom of individuals to act as they might independently choose.

Let me now briefly discuss the results of Reagan’s economic policies during his eight years in the White House. The proof of the pudding is in the eating. How well did he do in meeting his major challenges?

1. Fighting Recession. It is just not true that Obama inherited the worst economy since the Great Depression. In 1981, the first full year of Reagan’s presidency, unemployment, inflation, and interest rates were worse than in 2009, the first year of Obama’s presidency. In both years, economic growth was going downhill. Obama fought recession with the top-down economic policies, pro-unions measures, reckless monetary policies, and a total disregard for the credibility of private property rights. To fight recession, Reagan used bottom-up market policies, cut back on the power of labor unions (remember the strike of air-controllers), supported restrictive monetary policy, and substantially reduced taxes.

2. The Role of Entrepreneurship. Reagan believed that entrepreneurship is a major, if not the major, force propelling the economy forward. He also believed that reducing taxes was an effective way of encouraging entrepreneurship. Hence, a substantial cut in most taxes was one of his first major reforms. And the people responded to lower taxes in predictable and specific ways. Table 1 shows the percentage change in the number of business firms in three periods: the Reagan Years, the same period of time immediately following the Reagan Years, and the Clinton Years. In addition to percentage change in the total number of business firms, Table 1 also shows percentage changes in the number of S-corporations and private proprietorships; that is, the types of firms that are most likely to respond to entrepreneurial incentives. Following the Reagan years, taxes started creeping up and the rate of starting new firms declined. It is arguable that Obama’s policies so far have not been supportive of entrepreneurship in the private sector of the economy.

Table 1

Percentage Changes in the Number of Businesses by Form of Business

Form of Business	Reagan Years 1981-1988	Immediate Post Reagan Years 1989-1996	Clinton Years 1993-2000
Total Number of Businesses	36	19	18
S-Corporations	131	62	50
Private Proprietorships	43	19	13

3. Government Spending and Regulations. In 2004, Milton Friedman wrote a short piece about Reagan entitled “*Freedom’s Friend*” (Hoover Digest, No 3, 2004). In that essay, Friedman argued that federal non-defense spending and the number of pages added annually

to the Federal register are important indicators of the intrusions of federal government into the economy. Friedman pointed out (Figure 1) that the trend in federal non-defense spending before Reagan was one of galloping socialism. Reagan brought this trend to a standstill; between 1981 and 1989 domestic spending as a share of GDP fell from 15.3 to 12.9 percent. Judging by the first two years of Obama, socialism resumed its gallop.

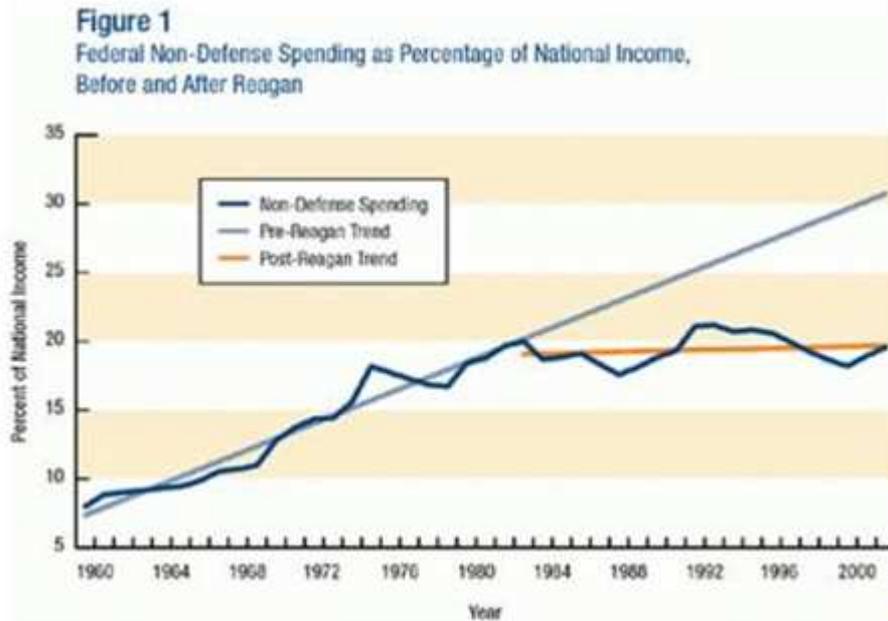
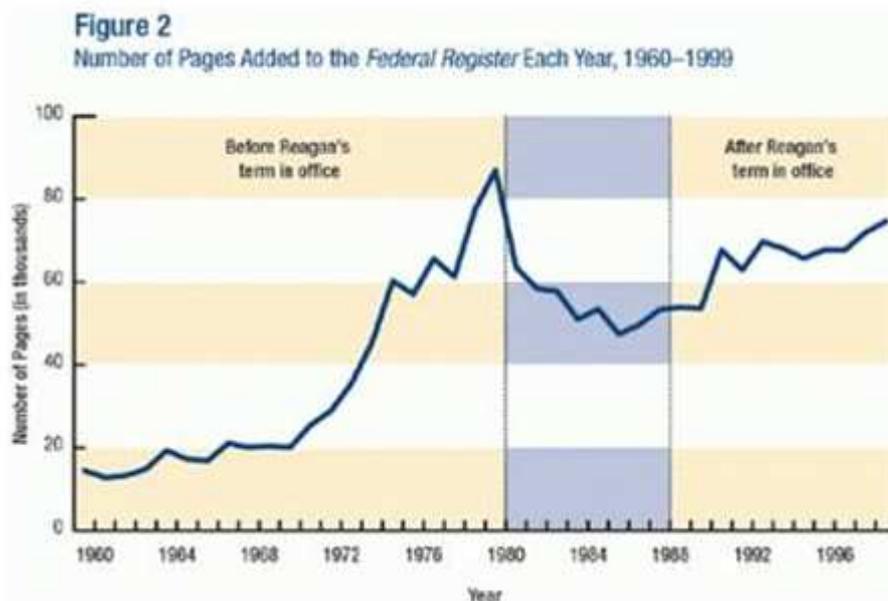


Figure 2 shows the number of pages added to the Federal register from 1960-1996. The Federal Register is the official daily publication for rules, proposed rules, and notices of Federal agencies and organizations, as well as executive orders and other presidential documents. It is considered a proxy for the intrusions of federal government into the economy. Changes in the number of pages suggest a strong trend toward socialism in the years before and after Reagan. It is arguable, that under Obama the trend is turning into one of galloping socialism.



Friedman said in “Freedom’s Friend” “We still have a long way to go to achieve the optimum degree of freedom. But few people in human history have contributed more to the achievement of human freedom than Ronald Wilson Reagan.”

4. Mobility of Individuals within the Distribution of Income. Obama tried very hard and failed to increase taxes paid by the wealthiest people in the country. The assumption implicit in his drive to raise the top marginal tax rate is that mobility of individuals between income groups is insignificant. This assumption that in American capitalism the rich are getting richer and the poor are getting poorer then justifies using tax policy to spread the wealth around.

This view is totally at variance with the history of entrepreneurship in the United States. Entrepreneurial activity, the trade mark of American economic history, is not a single event. It is a continuous process. Successful entrepreneurs keep moving up into higher income groups while others are dropping to lower ones. Hence, an unintended consequence of this process is the never-ending mobility of individuals between income groups.

In a remarkable book *Stealing From Each Other:: How the Welfare State Robs Americans of Money and Spirit* (Praeger, 2008), my colleague Edgar Browning offered an empirical evidence of considerable mobility up and down the economic ladder in the United States. He noted that since 2003 (when the Internal Revenue Services started publishing annually the tax status of the 400 richest Americans), 2,218 individuals were in the 400 richest Americans at least once, about 1,700 were on the list for only one year, and only about 23 taxpayers made the list in each and every year.

Reagan understood that entrepreneurship creates new wealth. To encourage entrepreneurship became a major purpose of his economic policies. Reducing marginal tax rates, specifically the top marginal tax rate, was one of such policies. Rational for lowering marginal tax rates was to increase potential benefits, and reduce the costs of uncertainty and risk associated with entrepreneurial activity. Lowering top marginal tax is then not about getting the rich people richer; it is about incentives to create new wealth. By implication, Reagan policy of encouraging entrepreneurship, totally at variance with Obama’s current policies, contributed to the mobility of individuals between income groups.

In *Climbing the Economic Ladder*, my colleagues Andrew Rettenmaier and Donald Deere (National Center for Policy Analysis, 2003) offered an interesting example of mobility from one group to another within the distribution of income. The income distribution in the United States is reported in five groups, each group containing one-fifth of all families. The total income of all families within each group is then added up and expressed as a percentage of the total income in all five groups. In their study, Rettenmaier and Deere used individual earnings (rather than family income) to observe transitions between quintiles based on earnings. They used the National Longitudinal Survey of Youth to compare the income groups in which workers of the sample (about 12,000) were in during the first year (1979) and fifteen years later (1994). Rettenmaier and Deere findings are presented in Table 2.

Table 2

Intragenerational Mobility: Probability for Moving Between Earnings Quintiles from 1979 to 1994

Percent in each quintile in 1994:

Earnings Quintile 1979	Bottom	Second	Third	Fourth	Top
Bottom	33%	23%	20%	14%	10%
Second	25%	29%	19%	14%	13%
Third	23%	22%	19%	22%	14%
Fourth	12%	17%	24%	23%	24%
Top	8%	10%	17%	26%	39%

Source: Based on authors' calculations for individuals in the National Longitudinal Survey Youth, 1979-1998

Table 2 shows that of all individuals who were in, say, the fourth quintile in 1979, 23% were likely to remain in the same quintile in 1994, while 12%, 17%, 24% and 24% had likely moved up to the bottom, second, third, and top quintiles restively. Clearly, mobility between income groups during the Reagan Years and shortly afterwards was considerable.

Of course, we have to wait for the end of Obama's presidency to evaluate the actual results of his policies. The best we can do at this time is to compare Reagan's economic policies to Obama's promises, ideological preferences, and, most importantly, his actions during the first two years in the White House. The result of the comparison is clear. President Obama is still mired in economic stagnation and Ronald Reagan's policies produced decades of prosperity. Reagan was easily reelected in 1984, winning all states except Minnesota. In 2010 congressional election, Democrats paid a tremendous price for supporting Obama's pro-socialist policies.

Let me finish this brief essay honoring the memory of a great president with another quote from Friedman's *"Freedom's Friend"*: "To Reagan, of course, holding down government spending was a means to an end, not an end in itself. That end was freedom, human freedom, the right of every individual to pursue his own objectives and values so long as he does not interfere with the corresponding rights of others. That was the end in every phase of his remarkable career."

Svetozar (Steve) Pejovich is Professor Emeritus, Texas A&M University.

Read More :: <http://www.conservative.org/acuf/issue-175/issue175news2/#ixzz1GC34UTI9>