Tom McClintock's Capitol Commentaries

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Last month, I was honored to be asked by the Young America's Foundation to give the keynote address to mark the anniversary of President Reagan signing the Kemp-Roth Tax Cut at Rancho Del Cielo. Here is what I said:

Reagan Tax Cut Anniversary

Young America's Foundation
Rancho Del Cielo
August 13, 2015

A year after Ronald Reagan died, the U.S. Postal System issued a memorial stamp with the iconic image painted by Michael Deas. It is Reagan at his happiest – a broad smile, eyes twinkling – he was the essence of a confident, optimistic leader on top of the world.

Deas based his portrait on a photo taken by White House photographer Jack Knightlinger right here at this ranch, 34 years ago today, August 13, 1981 – the moment when President Reagan signed the Economic Recovery Tax Act – better known as Kemp-Roth – best known as "The Reagan Tax Cut."

A gloomy fog engulfed the ranch that morning, as if to symbolize the despair most Americans felt after four years of what was called "stagflation:" double digit unemployment, double digit inflation and interest rates approaching 20 percent.

As Reagan signed the bill, they say, the clouds parted and a beam of sunlight caught Reagan's face. Knightlinger said that's the moment when he pulled out his telephoto lens and started taking one picture after another. And what he captured was the first glint of a new morning for America – the Reagan economic recovery.

Reagan had taken office just seven months earlier. In his famous inaugural address he had diagnosed the nation's condition with the memorable words, "In this great economic crisis, government is not the solution to our problems – government IS the problem."

Reagan instinctively understood that the more burdens an economy bears, the worse it performs.

Let me repeat this complex economic principle: the more burdens heaped on an economy, the worse it does. The fewer burdens, the better it does. Are there any questions?

If that sounds like simple common sense – it IS. But common sense isn't commonly shared by many policy-makers on the Left – in either party. It wasn't then and it isn't now.

Reagan's economic team drew heavily from the work of legendary economist Arthur Laffer, famous for the Laffer Curve, who served on Reagan's economic advisory board.

What Reagan understood instinctively, Laffer understood analytically.

The Laffer Curve explained a simple economic phenomenon. A zero percent tax rate, of course, produces zero revenues. But so does a 100 percent tax rate. If all income is confiscated, there is no point to produce it.

As the tax rate rises, the incentives to produce new wealth slowly diminish and the incentives to avoid or evade the tax slowly increase until the curve reaches a point of equilibrium in which any INCREASE in tax RATES actually produces LOWER tax REVENUES.

History teaches us that lesson very clearly. In the last sixty years, the top income tax rate has been as high as 91 percent and as low as 28 percent, but income tax revenues have stayed remarkably steady at between 13 and 20 percent of GDP. Indeed, some of the lowest income tax revenues came when the top tax rate was at its highest. Some of the highest revenues came when the top rate was quite low. But although the tax rate within this envelope has remarkably little effect on revenues, it has a huge impact on economic growth.

On that historic August day in 1981, the top income tax rate stood at 70 percent. At the core of "The Reagan Tax Cut" was a phased in 25 percent across-the-board cut in tax rates. He also slashed the windfall profits tax that day; he indexed tax rates for inflation and he more than tripled the amount of an estate protected from the death tax. No wonder he looked so happy.

Combined with later legislation in 1986, Reagan took the top marginal rate from 70 percent down to 28 percent.

Kemp-Roth became the centerpiece of the Reagan roadmap for economic recovery. Supporters called this supply-side economics. Detractors called it voodoo economics and trickle-down economics.

We now remember it simply as "Reaganomics," a term that Reagan's political adversaries used derisively – for a while, anyway. But as Reagan once quipped, "you can tell (our policy) is working, because… they don't call it 'Reaganomics' anymore."

Reaganomics wasn't just tax cuts. It was a combination of policies that Laffer calls the four kingdoms of the economy: fiscal policy, regulatory policy, monetary policy and trade.

Reagan and Laffer understood:

- That fiscal policy must recognize the role of incentives in productivity;
- That regulatory policy must recognize the hidden costs on commerce;
- That monetary policy must be conservatively applied to protect the integrity of the dollar; and
- That trade benefits all who engage in it.

Reagan was an unabashed free trader. He aggressively expanded American trade around the world and based his policy on what he said was "the inescapable conclusion that all of history has taught: The freer the flow of world trade, the stronger the tides of human progress and peace among nations."

Meanwhile, against the dire warnings of

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the Keynesians of the day, Reagan backed the Federal Reserve as it wrung the excess dollars out of the monetary base, taming a savage inflation rate that had peaked at 13 percent and stood at just four percent the day he left office.

But Reagan's two greatest successes were in reducing the tax and regulatory burdens on the economy. And in this, he wasn't alone. John F. Kennedy pursued the same policies in the early 1960's. So had Warren Harding and Calvin Coolidge in the early 1920's. All produced periods of profound economic expansion.

So did Harry Truman, who abolished the excess profits tax in 1945 and slashed federal income tax rates a year later. In Fiscal Year 1946, Truman cut federal spending from $85 billion to $30 billion, firing ten million federal employees – it was called "war demobilization." The Keynesians at the time predicted 25 percent unemployment and a second great depression. Instead, we had the post-war economic boom.

Bill Clinton raised the income tax rate in 1993. He quickly realized that his policy wasn't working, especially after he took a drubbing in the 1994 congressional elections.

After that, Clinton channeled his own inner Reagan, and in his 1995 State of the Union address to the newly-elected Republican Congress, he proclaimed -- in Reaganesque terms -- "The era of big government is over."

He reached across the aisle and together with Newt Gingrich accomplished miraculous things. They cut federal spending by four percent of GDP. They approved what amounted to the biggest capital gains tax cut in American history. They slashed entitlement spending by -- in Clinton's words -- "ending welfare as we know it." Once again, the result was rapid economic expansion.

(In fact, if you look solely at Bill Clinton's economic policies AFTER his 1994 epiphany, a strong case can be made that he was not only the MOST Republican president since Ronald Reagan – he was the ONLY Republican president since Ronald Reagan.)

Reagan's policies weren't perfect, of course. Instead of taking effect immediately, the tax cuts took two years to fully phase in. Arthur Laffer remembers the day Reagan called him with the news that Kemp-Roth had passed. Reagan told the subdued Laffer, "What's the matter Art? I thought you'd be more excited." And Laffer said, "Well, of course, Mr. President, it is a great victory. But the tax cuts won't take full effect for two years."

"That's right," said Reagan. "It's a compromise we had to make. Is that a problem?" And Laffer replied, "Well, Mr. President, let me ask you this: How much shopping do you do at a store TODAY when you know they'll be slashing their prices TOMORROW?"

Laffer's concern turned out to be well-founded. As the country pulled back to await the phase in, the economy languished, revenues slumped, the deficit soared, and Reagan's adversaries had a field day.

To compound their woes, tough monetary policy was necessary to extinguish the raging inflation that was decimating savings. And at the same time, Reagan had to take decisive action to stop the disintegration of America's armed forces, a move now credited with winning the Cold War.

Democrats – and some Republicans – proclaimed Reaganomics a dismal failure and demanded the tax cuts be rescinded before they had fully taken effect. Reagan had broken every rule in the liberal economic textbook, and the country was paying the price, they said.

Yet all the while, Reagan remained supremely confident. "Stay the course" was his response. "Stay the course." America stayed the course. And one day it awakened to the realization that Reaganomics was indeed working. When the tax cuts finally culminated, pent up demand exploded, productivity soared, and the economy boomed. One day we awakened to realize that it was indeed morning again in America.

While the top income tax rate plummeted under Reagan from 70 percent to 28 percent, personal income tax revenues soared from $285 billion to $456 billion. Total federal revenue increased from $599 billion to $991 billion. Put more simply, Reagan cut tax rates by more than half and tax revenues nearly doubled.

Liberals accused Reagan of being a "rich man's President." Ironically, because the tax cuts made tax shelters less appealing, the share of personal income taxes paid by the top 1 percent of wage earners nearly doubled, from 17.6 to 27.5 percent. The share of income taxes paid by the bottom 50 percent of all wage earners dropped during the same period.

So what can we learn from the events that began here on this spot 34 years ago today?

Two in particular. The first is that policy matters, because policy determines outcomes. The second is that elections matter, because elections determine policy.

As a simple, practical matter, conservative economic policies produce prosperity; liberal economic policies produce poverty. Or as Churchill put it long ago, "The inherent vice of capitalism is the unequal sharing of blessings. The inherent virtue of socialism is the equal sharing of miseries."

We are again living through another round of the same sort of liberal economic failure that Jimmy Carter's policies produced and that finally gave way to the Reagan Revolution.

In 2009, Barack Obama diagnosed our nation's economic problems very differently than Ronald Reagan did in 1981. Instead of reducing the tax and regulatory burdens on the economy as Reagan did, Obama dramatically increased them.

Remember the earlier economics lesson: more burdens – bad; fewer burdens, good? Obama missed that class completely.

It shouldn't surprise us that the opposite policies have produced the opposite results. Indeed, Phil Gramm observed last year that "if Mr. Obama's recovery had been as strong as the average of the Reagan-Clinton recoveries, (an average individual's income) would be ($6,700) higher (than it is today) and 15.8 million more Americans would be at work today."

Once the Reagan tax cuts took effect, annualized economic growth took off like a bat out of hell. In the quarter before Kemp-Roth kicked in, annualized economic growth barely registered at less than a half percent. The quarter immediately following the tax cut, growth jumped to over five percent and the next quarter to over nine percent. Real GDP grew 35 percent during the Reagan years. It has grown just 10.7 percent during the Obama years.

Under Reagan, unemployment dropped by half from 10.8 percent to 5.4 percent. That's about where it is today—with one important difference: during the Reagan years, the unemployment rate fell DESPITE the fact that millions of workers were flooding the market. During the Obama years, unemployment

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has fallen specifically BECAUSE millions of workers are FLEEING the market. Obama's policies have produced the lowest labor participation rate this country has seen since – you guessed it – Jimmy Carter.

Young people are particularly harmed by these policies. During the Reagan years, youth unemployment dropped from 18 percent to 10.7 percent. Today, it's back to 18 percent.

And just to keep this bi-partisan, just as Reagan's policies produced prosperity under both Republican and Democratic administrations, we should remember that Obama's policies have produced misery under both Democratic and Republican administrations.

Lest we forget, Herbert Hoover addressed the recession of 1929 with stunning tax hikes, beginning with the Smoot-Hawley tariff act that imposed a steep tax on some 20,000 imported products. Hoover increased the federal income tax rate from 25 percent to 63 percent. He increased federal spending by 60 percent in just four years. And he turned the recession of 1929 into the depression of the 1930's.

The Reagan economic recovery came to an end when George H.W. Bush broke his campaign promises, reversed Reagan's policies and imposed a crushing tax increase in 1990. The broken promise and the recession that followed ended what could have been an American Golden Age.

The second lesson, then, is that elections matter. How different would have been the course of our nation if Republicans had nominated Jack Kemp – author of the Kemp-Roth bill that we celebrate today – rather than George Bush -- to succeed Ronald Reagan in 1988.

Kemp was the ideological heir to Reagan, who exemplified Reagan's optimistic belief in the fact that freedom produces prosperity – and that prosperity is the only answer to improve the lives of the millions of Americans trapped in poverty by government policies and programs – no matter how well-intended.

As Peggy Noonan ruefully observed, Bush had been elected to serve Ronald Reagan's third term, but he never understood that, he never appreciated it and he utterly squandered it.

As a new election approaches, this is a lesson to take to heart. The policies of Barack Obama have mirrored those of Jimmy Carter and so too, have the results of those policies. But there is hope in that. As Laffer observed, "It took four years of Jimmy Carter to give us eight years of Ronald Reagan. Which means that eight years of Barack Obama should give us the second coming of Christ."

Or at least, a fleeting opportunity to restore the policies that Reagan once used to save our nation.

I remember the Carter years. I remember grocery store prices going up almost every week. I remember waiting hours in gasoline lines because government regulations had botched up distribution. I remember graduating in 1978 into a hopeless job market. I remember Jimmy Carter telling us that it was OUR fault for being too materialistic and selfish and polluting. I remember how, as America declined, our enemies rallied. And I remember wondering what was to become of my nation.

And I watch my children, today, at about the same age as I was then, wondering the same thing.

But I also remember when Ronald Reagan announced his candidacy and began the campaign of 1980. We all realized that this election mattered – that it might be the last chance our generation had to set things right before it was too late.

And I remember what it was like to awaken one day and realize that after this long cold night of doubt and despair that it truly was morning again in America.

There was no other feeling like it in the world. Our country was back. The future began looking bright again – all things seemed possible again.

I miss that feeling – and more importantly, I want my children to know what that day was like when we realized the country was turning back in the right direction. I want to grow old knowing that our children will inherit an America just as prosperous, strong, happy and free as the America our parents gave to us.

The good news is that our nation hasn't been struck down by some mysterious act of God beyond our control. These are all acts of government – deliberate policy choices that we make through the votes we cast in every election.

And because of what happened here 34 years ago, we have the promise that we can choose to make the world over again – that we can still choose that bright and promising future for the 21st Century.

You see, the Reagan Revolution wasn't about economics or policy or politics. It was about something far more profound than any of that. It touched upon the very heart of the American experiment in freedom and self-governance.

Reagan could see the plain common sense of these policies clearly because of his deep and abiding belief in the uniquely American principles of individual liberty, constitutionally limited government and personal responsibility that had built the most successful and prosperous society in human history.

For Reagan, this wasn't about the Laffer curve, GDP growth, or macro-economic theory. This was about freedom. The right of an individual to enjoy the fruit of his own labor. The feeling of dignity and accomplishment that comes from a fair day's wages for a fair day's labor. The uniquely American notion that individuals are endowed by their Creator with the inalienable right to make their own decisions, chart their own course, pursue their own happiness.

He believed in the American people. He believed that each of them is more capable of making their own decisions in their own lives than he could ever be trying to make their decisions for them. He understood that prosperity is created by the freedom that two individuals have to enter into voluntary exchanges of their goods or labor without politicians butting into those decisions. He understood that freedom works – and he put it back to work.

The Reagan Revolution was really about renewing the American Revolution, and by so doing, renewing America and all the promise it has for the future of mankind.

During the 1980 campaign, Reagan told the story of the little girl who said to her mother, "You know that vase that you said was passed down through our family from one generation to the next? Well, this generation just dropped it."

Let that not be the epitaph of our generation. Of our generation, let it be said that just when it looked that America had lost the vision of the American founding, this generation of Americans rescued it, renewed it, and passed it on inviolate to the generations to come. ❑

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