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Ronald Reagan and the Spirit of Free Enterprise

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The following is adapted from a speech presented on May 24, 2004, at a Hillsdale College National Leadership Seminar in Seattle, Washington.

Since Ronald Reagan's death, many inspiring speeches have been delivered and adulatory articles written about his presidency. But few of the tributes have recognized Reagan's greatest achievement, which was indispensable to the U.S. triumph in the Cold War and is crucial for the current war on terrorism. Reagan tapped the creativity of America's entrepreneurs to bring about a global, not just a national, economic revolution.

Poets describe creativity as "Promethean," referring to the mythical hero who brought fire to the earth. A Promethean era in world history, the Reagan presidency lit the fires of American creativity, fires that have been roaring ever since. Fire brings heat and light, destruction and transformation: It incinerates waste and energizes wealth, impels industry and envy, riches and unrest, arouses fear and anneals character.

Reagan's ideas transformed American finance, global economics, and world politics. They reverberated through Eastern Europe, the Soviet Union and China with the power of Joshua's trumpets. They made South Korea a more economically important and promising country than France or Germany. To the defenders of the old order — Third World despots, legal monopolies, land trusts, gold

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funds, oil cartels, bureaucracies and tyrannies of all kinds – the Promethean roar was an insufferable racket. They mustered all their powers to put Prometheus back into the bonds of a static and establishmentarian age.

The facts reveal the statist's failure: Since 1980, U.S. marginal tax rates fell some 40 percent on income and 75 percent on capital gains and dividends, and the American added close to 50 million jobs. At the same time, Europe and Japan created scarcely any net new employment outside of government. American companies now constitute 57 percent of global market capitalization, and the U.S. commands close to one half of the world's economic assets. America, responsible for one fifth of global GDP in 1980, produced one third of global GDP in 2003. That is Ronald Reagan's legacy.

The Lasting Impact of Supply-Side Economics

The key to this awesome and unprecedented triumph was Reagan's dismantling of the confiscatory tax codes that had been imposed on the capitalist world during World War II. Supporting Reagan's tax rate reductions was a movement of economists and journalists called supply-siders. We were so unpopular, Bob Dole used to crack a "good news/bad news" joke about a Greyhound bus going over a cliff. The good news was that it was "full of supply-side economists."

A central component of supply-side economics is the Laffer Curve – named for its inventor, the economist Arthur Laffer – which shows that low tax rates produce more revenues than high rates. Ronald Reagan understood and embraced the Laffer Curve: He would regale White House visitors with a story about actors and producers in Hollywood who simply stopped working when their marginal tax rates rose over 50 percent. A rate high on the Laffer Curve, as Reagan knew, means more work for more income pays less well than maneuvers to avoid taxes on existing income. According to my research, the correct curve shows that tax rates should be kept very low – well below 20 percent – and that higher tax rates tend to reduce long run government income and massively reduce private sector wealth.

In the media and in the academy, however, the Laffer Curve is widely discredited. Even Republicans speak of "paying" for tax cuts with spending cuts and claim that the real burden of

government on the economy is what it spends rather than how it taxes. But if you believe that tax cuts cost money, you imply that current tax rates do not obstruct economic activity, and therefore reductions are unnecessary. If you agree that tax cuts reduce government revenues, you cannot defend the cuts effectively in a democracy in which at least one third of the voters are directly dependent on government spending for their livelihoods and most of the rest cherish some kind of government program.

Reagan's genius was to show us a way out of this dilemma: The real undeniable test of tax policy is not short term shifts in revenue but long term shifts in spending that are most clearly manifested by increases in the federal budget. Between 1981 and 2004, current government spending in terms of dollars increased fivefold while the total hovered a little above 20 percent of GDP.

In the mid-1980s, World Bank economist Keith Marsden showed how this is possible: Low tax countries increase their spending three times faster than comparable high tax countries. This is because the low tax economies grow six times faster. For most of the period since World War II, the fastest growing economy in the world, with the fastest growth in government spending, was Hong Kong, with a top rate of 16 percent. A study by Jude Wanniski at Polyconomics extended the analysis through the Reagan era, with the same results. In recent years, Ireland, New Zealand and Russia massively increased spending after drastically reducing tax rates. Russia has increased outlays by some 60 percent after enacting a 13 percent flat tax.

Why do I stress government spending, after a long career of attacking it? The reason is simple: What is crucial is not the absolute level of government but the size of government compared to the size of the private sector. In every country that enacted tax rate reductions, the absolute growth of the private sector enormously outpaced the growth of government.

The growth of the private sector is measured not merely by output but also by assets. In the 25 years since Reagan assumed office, U.S. household assets have more than tripled, to a current record of \$52 trillion. Driven by a surging stock market, America's increase in private wealth dwarfs the increases in debt that cause such agony for the one-handed economists in Washington who dutifully gauge the swell of liabilities but seem blinded to the mountainous growth of assets.

By cutting tax rates, Reagan was able to fund a 50 percent increase in defense spending. This expansion of the military was crucial to winning

the Cold War. Social spending also grew by some 25 percent. Much of this domestic spending was of course inconsistent with the limited government of our Constitution, but without changes in an electorate shaped by New Deal thinking, it was politically inevitable.

I should hasten to add that Reagan reduced the nation's debt sharply by negotiating a Social Security Commission regime that extended the age of retirement and cut back the implicit liabilities in the Social Security program by some six trillion dollars. Completely dwarfing all the budget deficits put together, the Social Security changes radically improved the fiscal position of the government compared to the 1970s when real Social Security liabilities doubled. The 1970s ended with a budget (minus Social Security) that was nearly balanced and a balance of payments surplus. When Reagan assumed office in 1981, the government was apparently in the black. But most of the private sector was in the red, with bankrupt Savings and Loans and interest rates over 15 percent.

Reagan knew that all government spending ultimately depends on the output and assets of the private sector. While the federal budget deficit (exclusive of Social Security) swelled under Reagan in absolute terms as he confronted the Soviet Union in the Cold War, the federal debt shrunk sharply as a share of national assets. Far from losing ground in high technology, the U.S. began a 20-year surge of innovation in computers and communications that has made the U.S. the world's dominant source of technical advance and new wealth. Personal computers and networks became central to world economic growth.

Meanwhile, with the top tax rate dropping from 50 to 28 percent under Reagan, tax contributions by the top five percent of earners rose from nine percent of the total to 18 percent, while contributions from the bottom 20 percent dropped from six to two percent. The top 50 percent of taxpayers paid 94.5 percent of the federal income taxes. Lower tax rates resulted in much larger tax payments by the rich.

Reagan's economic policies proved to be so popular that they were extended for the most part under President Clinton and a Republican Congress. Whatever Clinton's intentions were, he could not reverse the Reagan momentum. While Clinton hiked the top rate to 39 percent (compared to 50 percent when Reagan took office), Congress enacted and Clinton signed a drop in the capital gains tax to 20 percent, and the U.S. became a nation of stockholders as Reagan had prophesied repeatedly.

Leading the Global Economy

The key Reagan accomplishment is rarely recognized at all: We are now in a global economy. While economists constantly parse statistics about the United States, as if our economy were isolated from the world, the real impact of economic policy today can only be gauged by global data. Overall, the Reagan program led to an awesome shift in the global economic balance of power as dramatic as the victory in the Cold War and vital to it.

Far from falling behind Japan and Europe as the experts had predicted throughout the 1980s, the U.S. surged into global economic dominance. Beginning in 1980 with a GDP of one fifth of the global total, the U.S. has attained a national output of \$11 trillion by 2003, fully one third of a global GDP of \$33 trillion. This is an awesome, unprecedented change. In the entire history of the peacetime world economy, nothing like it has ever happened. Coming after the "malaise" of the 1970s, the American ascent is directly attributable to the program of low marginal tax rates, deregulation of energy prices, collapse of inflation, expansion of trade, and active globalization launched by Ronald Reagan.

Why then do critics still speak of "voodoo economics"? Why is it that even some supply-siders insistently deny that lower tax rates pay for themselves with higher revenues, when Reagan's tax-cutting regime brought about a fivefold rise in federal spending without increasing the government share of GDP? Why does the current administration still speak of \$1.6 trillion tax cuts and \$300 billion stimulus packages, as if it could use money to reduce perverse and counterproductive government burdens?

One key reason is the stultifying grip of the demand-side model on the entire economic community. University and media economists still find themselves far behind Reagan in grasping the dynamics of an international economy. The economics profession functions like a covenanted establishment of flat earth physicists still patiently waiting for the ships of supply-siders to fall off the edge of the world.

While the economics profession remains lost in a maze of equilibrium models, Ronald Reagan knew the facts of entrepreneurial disequilibrium and creativity. To a supply-sider, government is a kind of business. It competes with other governments around the world. It competes to attract entrepreneurs and capital to it.

jurisdiction and to foster expansion of existing enterprises. By lowering marginal tax rates – the rates on additional activity – governments can induce people to produce and invest within their borders. By raising tax rates, they drive entrepreneurs to other jurisdictions and to non-taxable activities. That is why high tax rates do not redistribute incomes. They redistribute taxpayers out of taxable activities and onto golf courses, into barter exchanges and among foreign regimes with lower rates.

Moral Foundations of the Free Market

The reason for tax cuts is not to allow the rich to keep their money. It is to enable entrepreneurs to invest it by making their investments profitable. Through the investment process, entrepreneurs give money to others in their own businesses or in others. By earning the money, they learned how to identify the best people to increase its worth. They learned how to use the money in ways that respond to the needs of their customers. They mastered the magic of lowering prices in order to increase revenues; they reached out to the largest untapped markets of the world economy, which are always the domains of billions of currently poor people struggling to gain wealth.

As Reagan understood, high tax rates do not stop someone from *being* rich: Those who are already rich can move their money to some protected haven. High tax rates stop poor people from *getting* rich. They stop entrepreneurs from supplying new goods and services that generate more wealth and jobs and value and tax revenues. In truth, defending tax cuts as a way to keep more of one's money is the opposite of the case. Tax cuts are good because they allow us to give our money to others in an ever-expanding spiral of economic opportunity. In the end, the rich can keep only what they give away, that is, what they entrust to others in the ever-spreading process of investment and growth.

These rules of giving and trust are no less important today, as the U.S. becomes an information economy. American entrepreneurs are, as we all are, not without sin, but their every decision has met an empirical test beyond appeal – a marketplace crucible beyond their control. Thus they are necessarily the world's true realists and most proven pragmatists. All of them know deeply that to reach the top, they first have to get to the bottom of things. To lead,

they first have to listen. To save themselves, they must serve others and solve others' problems.

“Do unto others as you would have them do unto you” and “Give and you will be given unto” are the central rules of the life of enterprise. Because you cannot give what you do not own, enterprise requires the rights of property. Because successful entrepreneurs often defy the conventional wisdom, the life of enterprise requires personal freedom. Because entrepreneurs have to serve and collaborate with others, they must be men and women of character and faith. Character enables an entrepreneur to commit his work and wealth over a period of years to bring into the world a new good that the world may well reject. Character is essential to the act of putting one's fate into the hands of unknown others in a market of voluntary choice.

Bullheaded, defiant, tenacious, and creative, America's entrepreneurs continue to vindicate the faith of Ronald Reagan and the teaching of Hillsdale College. They continue to solve the problems of the world faster than the world can create them. Confronting the perennial perils of human life and the often overwhelming odds against human triumph, the entrepreneur finds strength in a deep faith and proves genuine charity is not to be found in government largesse. His success is a triumph of the American character.

Today is a heyday for entrepreneurs. As Reagan's policies have taken hold, the proportion of new jobs created through self-employment and proprietorships has risen from five percent in the 1980s, to nine percent in the 1990s, to 31 percent today. President Bush's low tax rates on capital gains and dividends have unleashed a new surge of entrepreneurship.

The ultimate source of American entrepreneurial character is our educational system. Today, more than ever, that educational system is in disarray. Too many schools are losing contact with the sources of the American character in family, faith, freedom and limited, constitutional government. Too many universities are pandering to their students rather than teaching them.

In a contrarian spirit, Hillsdale boldly countervails this tide of mush and mediocrity, continuing the entrepreneurial struggle and earning the faith of American entrepreneurs. And in its fealty to the cultivation of American character, it has become an American treasure.



Whatever Happened to Free Enterprise?

Ronald Reagan (1911-2004)

President of the United States (1981-1989)



The following is excerpted from a speech delivered on November 10, 1977, on the Hillsdale College campus as part of the Ludwig von Mises Lecture Series. Originally published in Imprimis in January 1978, the speech was reprinted in Educating for Liberty: The Best of Imprimis, 1972-2002 (Hillsdale College Press, 2002).

[G]overnment, by going outside its proper province, has caused many if not most of the problems that vex us.

How much are we to blame for what has happened? Beginning with the traumatic experience of the Great Depression, we the people have turned more and more to government for answers that government has neither the right nor the capacity to provide. Unfortunately, government as an institution always tends to increase in size and power, and so government attempted to provide the answers.

The result is a fourth branch of government added to the traditional three of executive, legislative, and judicial: a vast federal bureaucracy that is now being imitated in too many states and too many cities, a bureaucracy of enormous

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power which determines policy to a greater extent than any of us realize, very possibly to a greater extent than our own elected representatives. And it can't be removed from office by our votes. . . .

More than anything else, a new political economic mythology, widely believed by too many people, has increased government's ability to interfere as it does in the marketplace. Profit is a dirty word, blamed for most of our social ills. In the interest of something called consumerism, free enterprise is becoming far less free. Property rights are being reduced, and even eliminated, in the name of environmental protection. It is time that a voice be raised on behalf of the 73 million independent wage earners in this country, pointing out that profit, property rights, and freedom are inseparable, and you cannot have the third unless you continue to be entitled to the first two.

Even many of us who believe in free enterprise have fallen into the habit of saying when something goes wrong: "There ought to be a law." Sometimes I think there ought to be a law against saying that there ought to be a law. . . . It is difficult to understand the ever-increasing number of intellectuals in the groves of academe, present company excepted, who contend that our system could be improved by the adoption of some of the features of socialism. . . .

In spite of all the evidence that points to the free market as the most efficient system, we continue down a road that is bearing out the prophecy of Tocqueville, a Frenchman who came here 130 years ago. He was attracted by the miracle that was America. Think of it: Our country was only 70 years old and already we had achieved such a miraculous living standard, such productivity and prosperity, that the rest of the world was amazed. So he came here and he looked at everything he could see in our country trying to find the secret of our success, and then went back and wrote a book about it. Even then, 130 years ago, he saw signs prompting him to warn us that if we weren't constantly on the guard, we would find ourselves covered by a network of regulations controlling every activity. He said if that came to pass we would one day find ourselves a nation of timid animals with government the shepherd. . . .

It all comes down to this basic premise: If you lose your economic freedom, you lose your political freedom and, in fact, all freedom. Freedom is something that cannot be passed on genetically. It is never more than one gen-

eration away from extinction. Every generation has to learn how to protect and defend it. Once freedom is gone, it is gone for a long, long time. Already, too many of us, particularly those in business and industry, have chosen to switch rather than fight.

We should take inventory and see how many things we can do ourselves that we have come to believe only a government can do. . . .

The most dangerous myth is that business can be made to pay a larger share of taxes, thus relieving the individual. Politicians preaching this are either deliberately dishonest, or economically illiterate, and either one should scare us. Business doesn't pay taxes, and who better than business could make this message known? Only people pay taxes, and people pay as consumers every tax that is assessed against a business. Passing along their tax costs is the only way businesses can make a profit and stay in operation.

The federal government has used its taxing power to redistribute earnings to achieve a variety of social reforms. Politicians love those indirect business taxes, because it hides the cost of government. During the New Deal days, an undersecretary of the treasury wrote a book in which he said that taxes can serve a higher purpose than just raising revenue. He said they could be an instrument of social and economic control to redistribute wealth and income and to penalize industries and economic groups.

We need to put an end to that kind of thinking. . . .

To win this battle against Big Government, we must communicate with each other. We must support the doctor in his fight against socialized medicine, the oil industry in its fight against crippling controls and repressive taxes, and the farmer, who hurts more than most because of government harassment and rule-changing in the middle of the game. All of these issues concern each one of us, regardless of what our trade or profession may be. Corporate America must begin to realize that it has allies in the independent businessmen and women, the shopkeepers, the craftsmen, the farmers, and the professions. All these men and women are organized in a great variety of ways, but right now we only talk in our own organizations about our own problems. What we need is a liaison between these organizations to realize how much strength we as a people still have if we will use that strength. . . .

We have had enough of sideline kibitzers telling us the system they themselves have dis-



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rupted with their social tinkering can be improved or saved if we will only have more of that tinkering or even government planning and management. They play fast and loose with a system that for 200 years made us the light of the world and the refuge for people all over the world who just yearn to breathe free. It is time we recognized that the system, no matter what our problems are, has never failed us once. Every time we have failed the system, usually by lacking faith in it, usually by saying that we have to change and do something else. A Supreme Court Justice has said the time has come, is indeed long overdue, for the wisdom, ingenuity, and resources of American business to be marshaled against those who would destroy it.

What specifically should be done? The first essential for the businessman is to con-

front the problem as a primary responsibility of corporate management. It has been said that history is the patter of silken slippers descending the stairs and the thunder of hobnail boots coming up. Back through the years we have seen people fleeing the thunder of those boots to seek refuge in this land. Now too many of them have seen the signs, signs that were ignored in their homeland before the end came, appearing here. They wonder if they will have to flee again, but they know there is no place to run to. Will we, before it is too late, use the vitality and the magic of the marketplace to save this way of life, or will we one day face our children, and our children's children, when they ask us where we were and what we were doing on the day that freedom was lost?



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