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Limiting Government, 1980–2010

BY JOHN SAMPLES

Ronald Reagan won the 1980 presidential election decisively. He beat incumbent president Jimmy Carter by 10 points in the popular vote. In the Electoral College, Reagan carried 24 states by more than 10 points, 14 of them by more than 20 points. Reagan had a mandate to pare back the federal government.

In 1981 and again in 1995, Reagan or leaders inspired by him would try to realize that goal. To accomplish that would have required a domestic revolution that overthrew the institutions and policies of the New Deal and the Great Society. Reagan and his successors did have some success at restraining the growth of the state. But they did not overturn the old order. Why did the effort to limit government produce such modest results? American politics tends toward incremental changes absent a major crisis. The problems that brought Reagan to power (and later elected the 1994 Congress) were not deep enough to foster major liberalizations. But that does not mean the hope for limited government will come to nothing. The New Deal order will face future crises that may yet bring a revival of limited government. Understanding the successes and failures of past struggles can inform our future striving to limit government.

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SUCCESSSES

Let's begin with the (modest) successes of this era. In 1981, the president signed into law significant cuts in government spending and tax rates. Reagan's "historic" turnaround cut the projected spending of the federal government by 4.7 percent for the next fiscal year. Taking inflation into account, the Reagan cuts amounted to 5 percent of the total cost of government. Overall, discretionary domestic spending dropped about 14.2 percent during Reagan's first year. Several Great Society programs were sharply cut. The Community Development Block Grant program, for example, lost two-thirds of its funding. Re-

gan also won a 32 percent cut in mass transit spending.

Sen. Pete V. Domenici was correct to call the 1981 budget "the most dramatic reduction in the ongoing programs in the history of the country"—but mostly because federal spending had risen relentlessly for three decades both absolutely and relative to the nation's wealth. Had that trend continued, the federal government would have grown relative to national income by about 25 percent (from one-fifth of GDP to one-fourth). Instead of increasing, the relative size of government stayed roughly the same as it had been in

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Cato senior fellow in constitutional studies Ilya Shapiro speaks to the media after the landmark Supreme Court decision, *Citizens United v. Federal Election Commission*, which struck down decades of campaign finance regulation in a sweeping victory for freedom of speech. The Cato Institute filed an amicus brief during this important case, one of 26 such briefs Cato sent to the Court in 2009. **PAGE 3.**

“The New Deal order will face future crises that may yet bring a revival of limited government.”

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the 1970s. Reagan thus shrank the size of government compared to what it would have been if past trends had continued.

Reagan also reduced tax rates. The Economic Recovery Tax Act of 1981 was expected to return \$749 billion to taxpayers over the next five years. Two-thirds of both chambers of Congress voted for it, and Gallup found that the public approved the tax cut by two to one. Here again Reagan succeeded relative to a worse outcome. The last Carter budget foresaw steady increases in revenue, culminating in taxes taking 24 percent of GNP in 1986. The average federal tax burden from 1961 to 1980 was about 19 percent of GNP. In 1981, the Reagan administration predicted federal taxes would take just over 19 percent of GDP by 1984. In that sense, Reagan's tax cuts returned the nation to normal. Without the cuts, however, we would have paid unprecedented taxes.

The tax reform of 1986 stands as the major, and perhaps only, achievement in limiting government in Reagan's second term. That law lowered rates and eliminated many tax preferences or “loopholes.” Congress often says to a taxpayer: if you do something we want you to do (say, invest in “green technology”), we will grant you a partial dispensation from taxation. Such tax preferences represent a kind of political control through offers rather than threats. True, such tax breaks might seem like a tax cut, at least to those who receive them. But tax preferences do not reduce the power of government in general. Others must pay higher taxes unless spending elsewhere is cut just as much as the tax preference, and tax preferences have no relation to spending cuts. Hence, the amount of coercion remains the same.

Eliminating tax preferences—known as tax reform—faced serious opposition. Beneficiaries had reason to organize and defend their preferences. Only presidential leadership could give reform a chance. Some Democrats found preferences unfair and favored reform. Republicans were skeptical. They thought the Democrats saw in reform a chance to raise taxes on business. Ronald Reagan saw that reform might reduce government intervention in the economy and further lower tax

rates. He convinced the Republicans to support reform against their political instincts and voting histories. As a result of the 1981 and 1986 laws, Reagan obtained lower tax rates for most people. When Reagan took office, the federal marginal rate on income was 70 percent. After the 1986 reform, the marginal rate was 28 percent. What accounts for these achievements against the grain of history? Reagan's political judgment and popularity mattered. But larger forces helped him. Reagan's victory followed a decade of crisis for the New Deal political order. The old way of governing had promised to end risk, increase wealth, and assure justice. The Johnson-Nixon years delivered instead an unstable economy, rising taxes for all, and with time, a growing sense of stagnation and national decline. Things had to change. The only question was how much they had to change.

LIMITS OF REFORM

Less than one might have hoped, it turned out. Reagan failed to radically reduce the size of government. The 1981 budget eliminated one program: the Comprehensive Employment Training Act of 1974, a public sector employment boondoggle that had grown rapidly under Carter. Budget experts John Cogan and Timothy Muris discovered that overall domestic discretionary spending (including defense spending but not entitlements) grew only slightly less than the inflation rate during Reagan's presidency. By 1989, such spending almost equaled its 1981 level, adjusted for inflation. Initial cuts were followed by spending increases. Spending by the Department of Education, for example, which Reagan had promised to eliminate in 1980, rose by 14 percent during his two terms after being reduced in 1981. Between 1980 and 1987, the three largest entitlements (Social Security, Medicare, and Medicaid) increased their spending by 84 percent, a total of \$145 billion.

The Reagan administration tried to restrain Social Security spending. The proposals went nowhere, to put it mildly. A week after the proposals were introduced, the House Democratic Caucus unanimously adopted a resolution calling Reagan's changes “an unconscionable breach of faith.” Republicans ran in fear of the public reaction. On May 20, 1981, with Reagan at the peak of his popularity, a Republican Senate and the Democratic-controlled House approved resolutions rebuking Reagan's Social Security proposals. The administration backed off. A little over a week had passed from proposal to retreat.

The same story would be repeated in early 1982. Nonetheless, the administration and Congress had to deal with the financial crisis of the program. Reagan created a national commission led by Alan Greenspan that proposed tax increases, delays in cost-of-living adjustments, and taxation of benefits. These “reforms” also fostered larger government over time. The increase in taxes officially went into the Social Security “trust fund,” but Social Security is part of a unified federal budget. Increases in the payroll tax thus increased the revenues available for federal spending. If payroll taxes had not created a Social Security surplus, Congress would have had to raise taxes to pay for the current spending.

Medicare costs had been rising quickly, and Congress agreed they had to be controlled. The Reagan administration wanted to cut Medicare benefits and increase patient costs. Congress would have none of it. Eventually, Congress decided to empower bureaucrats to set prices for hospitals and physicians. Even so, Medicare spending continued to increase even as the power of the federal establishment over health care grew.

Reagan's tax cuts also failed in their larger goal of reducing spending. Reagan said at the beginning of his presidency: “Government spends all the taxes it gets. If we reduce taxes, we'll reduce spending.” If tax rates were cut and indexed to inflation and members feared voter wrath for running deficits, Congress would have to raise taxes to spend more. Forced to choose between higher taxes and more spending, Congress might well favor lower taxes and, therefore, less spending. As it turned out, Congress pre-

ferred to borrow rather than cut spending deeply or raise taxes.

Reagan's most radical effort to restrain the federal government also came to nothing. In 1982, as the economy declined, Reagan proposed turning over nearly \$50 billion in programs to the states and local governments over a period of eight years. State officials no doubt were tired of the heavy hand of Washington. But they did not wish to have the responsibilities that went along with the power, not least the responsibility of either paying for or ending the programs. Reagan's New Federalism went nowhere politically.

TYRANNY OF THE STATUS QUO

Reagan failed to radically cut back the federal establishment because American government is biased against big changes. All three branches of government must agree to changes in the status quo. The most crucial parts of Reagan's coalition in Congress had programs to protect. Conservative Democrats were willing to cut government spending except for farm subsidies, water projects, and the military. Liberal Republicans supported cuts except in transportation, fuel assistance, and education. Reagan's difficulties in Congress also reflected what might be called "the political strategy of the welfare state." Franklin Roosevelt and Lyndon Johnson both expected that programs once enacted would attract support and grow over time for two reasons. First, those who benefit from such spending are organized and motivated to protect it. Second, entitlement programs create an expectation that future benefits are earned by past contributions. Moreover, much of the general public also adapts to the increased government as time passes; what an earlier generation would have deemed tyranny, their grandchildren see as part of the status quo.

Big changes in the political status quo require a big crisis to sweep away the forces preventing change. By 1980, the order created by Roosevelt and Johnson was hampering economic growth and losing support. The 1970s crisis, however, was not severe enough to sweep away the old order. Reagan ended up reforming, not destroying, the New Deal order. Growth resumed. Most of the old ways survived to see "Morning in America."

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The struggle to limit government almost ended in 1988. Reagan's successor, George H. W. Bush, accepted tax increases in exchange for... nothing really. Yet the nation was entering a new crisis; this time the difficulties were more political than economic. Congress no longer worked. Corruption was rife. The Speaker of the House resigned from office for ethical shortcomings. Five senators—the infamous Keating Five—were investigated for wrongdoing. These failures notwithstanding, Congress seemed immune to change through elections. Incumbents rarely lost. Public confidence in government reached new lows, for good reason. The times seemed ripe once again for fundamental change.

THE SECOND TRY

In 1994, Congress itself changed. Republicans took control of the House of Representatives for the first time in 40 years. They appealed to voters on a platform of political reform and limiting government. The authors of the Contract with America said its economic proposals were “designed to enhance private property rights and economic liberty and make government more accountable.” Newt Gingrich, who led the 1994 effort, promised that there would be a “pretty big” package of spending cuts early in 1995. He remarked: “This is a genuine revolution. We’re going to rethink every element of the federal government. We’re going to close down several federal departments.” The GOP leadership seriously discussed abolishing the Departments of Energy and Hous-

ing and Urban Development.

But they were also cautious. The 1994 group promised not to cut Social Security, defense, and interest on the debt, the three largest kinds of federal spending.

The tax relief proposed by the GOP meant that the fourth largest category of spending—Medicare and Medicaid—would have to be cut. By 1996, Medicare was expected to cover 36 million people at a cost of \$178 billion, or 11 percent of total federal spending. Medicare spending on hospitalization insurance had experienced near double-digit annual increases or above from 1992 to 1994. The House Republicans decided to restructure the programs to reduce spending by \$430 billion over seven years. The largest previous reduction in Medicare had been \$56 billion in five years, enacted in 1993.

They seemed ready to enact the deep changes Reagan had failed to attain. But the president had to agree to such changes. President Bill Clinton vetoed the cuts, and the government shut down. Democrats found tax cuts easy to demagogue. Rep. Pete Stark (D-CA) said Republicans “have decided to reward their rich friends and stick it to the women and sick people.” Losing the battle for public opinion, the Republicans relented and sent Clinton appropriations bills. He used the veto to protect federal spending on education, job training, and the environment. The budget did reduce domestic spending from earlier baselines, but the new majority had suffered terrible political damage. A 1994 freshman House member concluded that the budget confrontation “was a disaster... the momentum of 1994 came to an end.”

House Republicans lost the battle for public opinion, but they did not suffer an electoral debacle in 1996. Seventy Republican freshmen ran for reelection. Fifty-nine of them won—an 84 percent reelection rate. These freshman incumbents, on average, received about the same proportion of the vote in their districts as they had in 1994. Analysts found no evidence that voting for less government hurt Republican incumbents in moderate to liberal districts. The political story was much the same as it had been with Reagan. Voters supported con-

straints on government spending and taxing but not the big changes the 1994 House freshmen sought to enact.

The summer of 1997 brought a budget deal and thereafter budget surpluses for a while. In retrospect, that summer marked the end of the struggle to limit government until the summer of 2009. After the budget deal, many Republicans concluded voters had lost their taste for cutting back the state. The Republicans, the only party that had shown any desire for cuts in theory (if not always in practice) were also changing politically.

Social conservatives, practicing a politics informed by conservative Christianity, had become a larger part of the GOP base. Republican leaders responded to their new voters, first by impeaching Bill Clinton, and then by nominating George W. Bush, who won the presidency on a modified Christian evangelical platform, “compassionate conservatism.” Bush proposed an active and “caring” government prepared to spend and regulate without restraint. Compassionate conservatism abroad fostered the war in Iraq which the president saw as part humanitarian mission and part crusade to transform the Middle East. The electoral consequences of the Republican turn away from limited government: bloated federal spending, declining presi-

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dential popularity, and disastrous electoral outcomes in 2006 and 2008.

THE CRISIS TO COME

What now? Just after the 2008 election, White House adviser Rahm Emanuel said, “You never want a serious crisis to go to waste.” Libertarians rightly reject Emanuel’s Big Government agenda. As we have seen, however, he was correct about a crisis. The problems of the 1970s and the early 1990s were serious enough to foster mild reforms restraining Big Government. They were not serious enough to bring fundamental liberalizing changes.

But the New Deal order faces deeper crises to come. Spending (and borrowing) seem set to increase until they cannot, leading to what may be an unprecedented fiscal crisis of the

state. Officials may try to raise taxes to cover the spending. Such unprecedented tax hikes may expose what might be called Big Government’s crisis of consent. In general, Americans are unwilling to pay for the government they have, much less additional spending equal to five percent of national income. Why should they? Except in times of severe threats to national security, a majority of Americans have never trusted the federal government. The fiscal crisis to come may simply reveal the lack of support for many of the institutions and policies enacted after 1937.

Cato scholars provide ideas to liberalize public policy. But it will take more than good policy ideas. A majority of Americans will have to truly want less government and persist in that desire when programs begin to be cut back. That majority must find their voice in leaders with the political skill and wide appeal of Reagan. But such leaders must also want less government. For a decade, the Republican Party has been dominated by social conservatives and crusading internationalists, two worldviews inimical to limiting government. A GOP that returned to market liberalism and social moderation might find in the crises to come an opportunity to restore the almost lost promise of America, the promise of liberty for all under the rule of law.



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