COMMENT

What Really Happened in 1981

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Timothy Muris's otherwise excellent piece "Ronald Reagan and the Rise of Large Deficits" (*Independent Review* 4 [winter 2000]: 365–76), necessarily misses some fascinating details known only to those of us who were actually there.

The transition team began operating out of David Stockman's congressional offices shortly after Christmas 1980. That team of part-time volunteers consisted initially of myself, Larry Kudlow, and John Rutledge, periodically accompanied by Alan Greenspan and Allan Meltzer. By February 1981, as permanent appointments were filled, we were joined by Murray Weidenbaum, Craig Roberts, and others.

The economic plan, dated February 18, 1981, was titled "America's New Beginning: A Program for Economic Recovery." The economic assumptions of that plan had been dramatically revised at the last moment despite the noisy protests of the monetarists (Meltzer and Rutledge) and the supply-siders (Kudlow, Roberts, and I). Contrary to folklore, the controversy had been entirely about inflation, not at all about an allegedly "rosy" real-growth forecast; real growth averaged only 3.9 percent per annum in both the original and the revised scenarios.

The original forecast had inflation dropping to 4.2 percent in 1983 and to 2.6 percent by 1986. As it turned out, inflation fell even more quickly, to 4.1 percent in 1983 and 2.2 percent in 1986. In 1981, however, senior advisors Greenspan and Weidenbaum, like all mainstream Keynesians, did not believe inflation could come down

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that quickly unless real growth remained feeble. At their urging, the inflation estimates were revised upward to 7 percent for 1983 and to 4.9 percent for 1986. That change of forecast happened to be a great relief to David Stockman because higher inflation appeared to reduce future deficits greatly, thanks to flawed estimating procedures in use at that time (inflation was assumed to generate "bracket creep," but not to increase spending, except for indexed programs).

The forecast for 1981 was that the economy would grow by only 1.1 percent, but the economy actually grew by 2.5 percent that year. We thought the recession would be sooner and shorter than it turned out to be, and that the Federal Reserve would not be squeezing as hard as it was by 1982. In both the original and the revised estimate, real growth was expected to average 4.5 percent after the recession ended. Too rosy? In fact, real growth averaged 4.3 percent over a much longer period, 1983 to 1989.

In Stockman's 1981 plan, federal spending was forecasted to drop from 23 percent to 19 percent of gross domestic product (GDP) by 1986, but actual 1986 spending turned out to be 22.6 percent of GDP. That excessive optimism about spending restraint had nothing to do with the economists' forecasts. After the Soviet Union disintegrated, defense spending was cut from 6 percent to 3 percent of GDP, making it easier to balance the budget. All the fuss about raising individual tax rates in both 1991 and 1993 was essentially irrelevant, except to the extent that real growth may have been slowed. Receipts from the individual income tax averaged only 7.9 percent in 1991–95 after two "tax increases," compared with the 8.1 percent average of 1983–90.