# THE LESSONS OF REAGANOMICS

**by Burton Yale Pines**

I want to talk to you about economics. If I were doing this in the United States, I probably would want to make apologies to you because economics is viewed by Americans with some amusement. There are very many jokes about economics. It is said, for example, that an economist is a person who knows tomorrow why the things he said yesterday didn't happen today. Or that an economist is a man who states the obvious in terms of the incomprehensible. Or that an economist is a person who knows exactly what is going to happen, except he is not quite sure.

Probably the worst thing said about economics was that by Thomas Carlyle. Surveying life in early 19th century England, he declared that economics is the "dismal science." He called it dismal for reasons we can appreciate. After all, economics then--and often sinc unpleasant, grim reality of resource shortages and scarcities. Such shortages and scarcities, it was said, create perpetual human suffering. Analyzing this of course is dismal.

Economics can be dismal also because economists mainly talk about statistics, numbers, aggregates, inputs, outputs, marginality and other factors. These may be important, but they also lack life and excitement.

Yet economics can be full of life and it can be exciting. It need not be dismal at all. This is because the most important economic factors are not statistics or prices or inputs or aggregates. Rather the key economic factors are human imagination and creativity. The proper study of economics thus is the study of human creativity. The proper task of economics is to devise the best ways to unleash, to liberate, to encourage and to stimulate men and women to be creative.

This brings me to the main point of my remarks to you today: The economic policy of Ronald Reagan, the policy called Reaganomics, is a policy which has one goal. This goal is to unleash human imagination and creativity.

Reagan has learned the lesson taught two centuries ago by Adam Smith. This lesson is that the wealth of nations is caused by human intellect, wit, discovery and innovation. Ronald Reagan has designed his policies on these concepts. Because of this, economic conditions in the U.S. have been improving dramatically in the past six years.

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Perhaps it seems to you simply common sense for us to say that human creativity is the most important economic factor. Yet throughout history, this has been forgotten by many otherwise very clever and educated men.

Let me give you some examples. In 1899, the director of the U.S. Patent Office recommended that his agency be closed because, he said, "everything that can be invented has been invented." A Nobel Prize physicist in 1923 declared emphatically that "man cannot ever tap the power of the atom." And the president of Britain's Royal Society proclaimed at the end of the 19th century that "heavier than air flying machines are impossible."

**Unleashing Human Creativity**

All these very wise men made such foolish statements and predictions because they forgot about human creativity. They forgot about how resourceful man can be if he is determined to solve a problem. Such human creativity did tap the power of the atom and did invent the airplane. And it is human creativity which has made the U.S. Patent office busier than it ever was in the 19th century. Since 1899, in fact, nearly 4 million patents have been awarded for new inventions.

Much of the American economic difficulty in the 1970s was the result of policies devised by wise men who had forgotten about the explosive power of human creativity and imagination. Indeed, these "wise men" attacked and laughed at Ronald Reagan's economic strategy after he became president. It was they who invented the word "Reaganomics"--a word designed to ridicule his policies.

Today the word Reaganomics is used by Reagan and his supporters as a term of pride. The critics have stopped talking about Reaganomics because Reaganomics has succeeded. This is clear from even a quick look at what has been happening to the U.S. economy. More Americans are working than ever before--more in terms of numbers, nearly 113 million, and more in terms of the share of U.S. adults, some 65 percent. These numbers are higher than at any time in American peacetime history.

Another important indication of the success of Reaganomics is that the economy has been growing steadily for 53 consecutive months. This breaks the damaging stop-and-go economic cycle of the 1970s.

This has led to increased social and economic upward mobility. Blacks and other minority groups have been benefitting most from this sustained economic expansion. Meanwhile what experts call net disposable income has been climbing for nearly five years. This reverses the long decline suffered by Americans in the l970s. Net disposable income is that income which families have left after taxes and inflation are deducted.

Most important of all, perhaps, is the explosion of new businesses. For the past couple of years, Americans have been starting new businesses at the rate of more than 12,000 per week, or some 600,000 per year. In 1970, only 266,000 new businesses were started. It is from new businesses, not from established enterprises, that new jobs, new products and new methods are created.

Because of all of this evidence, I conclude that Reaganomics has succeeded. The question for us today is: Why Does It Work?

To answer this we should view Reaganomics as more than an economic theory. Reaganomics also is a theory of how the world works and a theory of what man can do to change the world.

### Fundamentals of Reaganomics

Reaganomics is based on several concepts. First, it is based on the inherent optimism of the American experience. Americans are optimistic. From our experience we feel confident that frontiers are not limits or barriers; rather we believe that frontiers are to be conquered. We do not believe in limits. Throughout U.S. history, America has been able to expand internally. Americans have been able to devise ways to harvest more crops from the land, to invent assembly lines to manufacture more goods from the factories, and to create newer products in the laboratories.

From the lessons of history, Americans have learned to be confident that there are no limits to growth. This lesson was forgotten in the 1970s. In those years some American leaders and intellectuals accepted the Club of Rome ideas. You may remember the Club of Rome. It is a group of about 100 so-called thinkers. In 1972 they warned that the world had entered an era of limits to growth. The Club of Rome warned that we faced mounting shortages of resources. This warning was believed by many leaders in the West and in the U.S. Reaganomics rejects this kind of pessimism. Instead of such pessimism, Reaganomics reaffirms America's traditional optimism.

So first, Reaganomics is based on traditional American optimism. Second, it is based on a recognition of the inherent dignity of man. In Western cultures this belief is found in Greek and Roman philosophy and in the Jewish and Christian view that man is created in the image of God. The Jewish-Christian view of man also teaches that individuals possess enough power to solve problems.

The Jewish-Christian tradition, of course, also says that man is sinful. Because he is sinful, man makes mistakes and does evil things. Reaganomics recognizes this. Reaganomics thus encourages a social and economic arrangement which prevents any single individual or group from having too much power. There must be a balance. On one side, individual efforts must not be blocked by excessive government obstacles. On the other side, competition must be encouraged to prevent any individual or group from getting too much power.

The third concept on which Reaganomics is based is the knowledge that frontiers are conquered by human energy and creativity. This means that the most important economic activity of government is to adopt policies which unleash and liberate human energy and creativity. One important policy, for example, is to give creative men and women confidence that if they take risks and succeed, then they will be rewarded. U.S. history teaches that the most important rewards for Americans are material rewards.

### Five Principles of Reaganomics

Reaganomics is not new. It simply has rediscovered and reaffirmed elements of an old, time-tested system of organizing an economy and unleashing human energies. Reaganomics has rediscovered five important principles. The Five Principles of

Reaganomics are: 1) Growth; 2) the Entrepreneur; 3) Fair Government; 4) Competition; and 5) Dynamism.

The first principle is growth. It is a simple concept. It assumes that the economic activity of man can lead to more than an exchange or redistribution of existing resources and goods. The principle of growth teaches that the economic activity of man can increase a society's resources. Therefore, the result of economic activity can be that everyone can have more goods.

Opposing the principle of growth is the concept of no-growth. No-growth ideas dominated economic thinking and policies through much of human history, certainly in the West. It was said that the amount of wealth remained constant. It was believed that if one individual or nation gained wealth, then another individual or nation would have to lose some wealth. Every gain for one person meant a loss for another person. Every gain for one nation meant a loss for another nation.

This no-growth view was the West's economic theory for one thousand years. In medieval Europe, there were elaborate rules and customs to protect existing wealth. Monopolies were created. Standards and complicated procedures were established to defend existing products and techniques of production against competition from new products and techniques. The mood of society, of course, was defensive. On a national level, the economic theory of no-growth was called mercantilism--a system designed to defend the nation's wealth.

Two centuries ago this no-growth theory was challenged. The most famous argument against it was made by Adam Smith, a Scotsman who in 1776 published his book The Wealth of Nations. The title of the book is very revealing. Smith wrote about wealth. But instead of giving advice on how one nation could take wealth away from another nation, Smith explained how nations could create new wealth. His lesson was simple: economies do not need to be stagnant. Economies can grow.

It is only growth, for example, which has allowed the U.S. to welcome tens of millions of immigrants and create jobs for them. It is only growth, for example, which has created the conditions for social mobility. This gives poor families the real chance to move upward economically and socially.

Perhaps most important, it is growth which makes it possible for living standards to increase for nearly every American. President John Kennedy explained this when he told Americans that the U.S. economy should be like the tide of the ocean. Kennedy said that a rising tide lifts all ships.

This is a basic principle of Reaganomics. It is that the aim of government economic policy should be to encourage growth. What does this mean? It means that before an economic action is taken by the U.S. government, officials should ask the question: Will this action help growth?

**Entrepreneur as Hero**

The second principle of Reaganomics is that the hero of the American economy is the entrepreneur. "Entrepreneur" is a French word that now is widely used in the American language. What "entrepeneur" means in French roughly is someone who undertakes to do something, someone who undertakes an enterprise. And it is the entrepreneur who is the engine of growth. He or she is the essential ingredient of growth.

Why do I say this?

I say this because it is the entrepreneur who gets the new ideas, who takes the risks, who tries new things. It is the entrepreneur who works long and hard, who finds the money for a risky investment, who breaks the rules. It is the entrepreneur who is the pioneer and the inventor. And it is the entrepreneur who knows how to transform a good idea into reality, who can take a good idea and make a new product or new technique.

The entrepreneur is the hero of a growing American economy. Big economic advances usually come from him, not from the big, established American companies. History is full of examples of this. The giant office equipment companies did not invent one of the most important office machines of the past quarter century. No. The machine which makes fast, dry copies of documents was not developed by the established companies; it was developed by two businessmen in Rochester, New York. They started the Xerox company.

Kodak is the giant camera company. But Kodak did not invent one of the most important new cameras of the past quarter-century. No. The instant camera was invented by Edwin Land who then started the Polaroid company.

One century ago, the promise of electricity was not developed by the big companies which were making candles or were making gas lights. No. Electricity was developed by dozens of new companies.

One century ago, the promise of the new vehicle that was called the automobile was not developed by the big companies that were making horse carriages. No. The promise of the automobile was exploited by dozens of small companies whose names later became world famous.

Revolutionary inventions and revolutionary techniques rarely come from America's big companies. The officials of big companies are not stupid. The problem is that America's big companies by necessity become big bureaucracies. They cannot avoid it. This helps them perform very well in becoming productive and in serving a big market. But it also prevents them from being flexible. It prevents them from responding quickly to new opportunities.

The lesson from this is clear. If the U.S. economy favors big companies and places obstacles in the way of an entrepreneur, then the U.S. economy is not going to grow very much. For example, in the past 15 years in the U.S., about 28 million new jobs have been created. Almost none of these new jobs were created by America's 500 biggest companies. Instead, the new jobs come from small companies and from the entrepreneurs who start small companies.

The statistics prove this. More than 70 percent of all new jobs are created by firms which have 100 or fewer employees. Almost 40 percent of new jobs are created by new companies.

Reaganomics recognizes this important role of the entrepreneur. During Ronald Reagan's campaign for president in 1980, he promised the American people: "If we put incentives back into society, everyone will gain." What he meant by this is that the government must create an environment which encourages the entrepreneur.

What is such an environment?

First, the U.S. government should not make laws that protect large American companies from competition. Big companies perform essential functions in the economy, but they should not be given monopolies or other privileges. If big American companies have special privileges, then American entrepreneurs will be discouraged from trying something new to challenge the big companies.

Second, the U.S. government should make it easy for new companies to be established. There should not be extensive and complicated rules and regulations for starting new companies.

The third aspect of an environment for entrepreneurs is that the U.S. government must allow the entrepreneur to enjoy the rewards of success. If taxes take away most profit, then the entrepreneur will have less incentive to take a risk. If there are great restrictions on how the entrepreneur can use his profit, then there is little reason for the entrepreneur to take a risk. The entrepreneur's courage to take a risk is what leads to new American discoveries and what drives the U.S. economy forward. Reaganomics knows this. It is one of the reasons why Ronald Reagan has reduced American taxes dramatically.

Another aspect affecting the environment for the entrepreneurs is related closely to what we just said. Government must allow entrepreneurs to fail. We noted a moment ago that about 600,000 new businesses were started in the U.S. last year. Of these, about 400,000--or two-thirds--will fail and close their doors within five years.

Some observers may regard this as very wasteful and inefficient. It is not inefficient. To the contrary. It is the most efficient way to test new ideas, products and techniques. No group of American wise men or no U.S. computer can know which new product will succeed. This only can be learned by allowing all new ideas and products to compete with each other in the market place.

**Low Taxes and Lower Regulation**

The third principle of Reaganomics is Fair Government. During the 1980 presidential election campaign, Ronald Reagan often declared: Government is the problem, not the solution. He still says this. By this, he means two things. The first is that individuals and groups of individuals almost always can solve problems better than government can.

The second thing Reagan means is that the U.S. government is a problem when it places unfair heavy burdens on American economic activity. The heaviest burdens are government regulation and taxes. During the late 1960s and through the 1970s, economic regulation and taxes in the U.S. increased very much. This heavy burden was the main reason why the American economy performed so poorly in those years. Since then the main reason why the economy has improved is that much of this unfair burden has been lifted off of the economy.

First we can look at regulation. Regulation takes many forms. Great burdens are imposed on the American economy when U.S. government regulations decree what products can be sold, how products can be packaged, how products can be advertized, what the prices of products and services must be and what the wages of workers must be. The economy is burdened when government regulations prevent some products from being imported into the U.S. and prevent others from being exported out of the U.S.

Other burdens come from regulations which limit currency transactions or control the days and hours which stores can be open and which factories can operate. One of the heaviest economic burdens comes from regulations which limit competition by preventing new companies from entering an industry.

All these regulations and many others place a heavy burden on economic activity. Nations may decide that some of these regulations are good for their people. Certainly each sovereign nation has the right to regulate any economic activity that it desires. However, when government makes economic regulations, it must recognize that every regulation adds a new cost to the operation of the economy. Reaganomics teaches that the U.S. government cannot pretend that there is no cost to regulation. There is a cost and it is high.

The cost of regulation has become clear to many Americans after Reagan ended some existing regulations. For example, the cost fell for using the telephone after the U.S. government reduced the regulation of the telephone industry.

The cost also fell for transporting products across the U.S. after the government reduced the regulation of the truck industry. This has resulted in lower prices for food and other products that are carried by trucks. The main reason transport costs fell is that the end of regulation made it easier to start small, new companies to compete with the established giant truck companies. In the first two years after trucking regulations were reduced, 9,000 new truck companies were started in the U.S.

Similarly, a dramatic reduction of regulation of the airline industry has encouraged entrepreneurs to start new airline companies. This has created tremendous new competition which has improved airline service for almost all American cities. Most important, the competition has forced down the prices of airline tickets. This saves Americans about $10 billion every year.

The second government activity which often is unfair to the economy is taxation. Of course, taxes are needed to pay for government operations. The question is: What kind of burden do taxes place on the economy? Here Reaganomics teaches a simple lesson; it is that when you tax something you get less of it. People will be very clever and creative in finding ways to avoid activities which are taxed.

What is most dangerous is when work is taxed heavily. Then people will look for ways to avoid work. This is explained by Jude Wanniski, an American economist who has had great influence on Reagan economic policies. Wanniski has written: "Most people have to work simply for physical survival. But after providing minimum necessities for survival, the individual is free to choose between work and leisure." When too many individuals choose too much leisure rather than work, the economy suffers.

Wanniski makes good sense. He writes that when tax rates are raised on individual earnings, a worker substitutes leisure for work. That is, once a worker earns enough money to provide for physical survival, this worker then may prefer to relax. He probably will prefer leisure.

This preference for leisure can be changed and corrected by government policies. Government can encourage workers to work extra hours. Wanniski writes that "government can...make work more attractive than nonwork." The most effective way for government to do this is to allow the worker to keep and enjoy the money he would earn from the extra work.

This is what Reaganomics has been doing. It is doing this by reducing taxes. For example, the top federal tax rate for an individual in 1980 was 70 percent; Reagan cut this to about 30 percent. And for more than 80 percent of all Americans, the top federal tax rate has dropped down to 15 percent.

Because taxes climbed so high in the 1970s, many Americans at that time chose leisure instead of extra work. This was one reason for the very poor performance of the U.S. economy in those years. This now has changed. Reagan's reduction of taxes allows Americans to keep more of the money which they earn. This encourages Americans to work longer, to work more and to invest more. And this is one of the main reasons for the continued steady expansion of the American economy in the past 53 months.

**Virtues of Competition**

The fourth principle of Reaganomics is competition. It is the pressure from competition which breeds creativity. Competition turns the marketplace into a battleground. The need to fight to win customers is what forces companies to find better ways of doing what they do.

The American economy benefits in many ways from competition. There are better products. There are lower prices for products. There is greater efficiency. There are new products and new techniques.

Most important, perhaps, it is competition which solves the most difficult economic problems. No brilliant American president, no clever committee of Congress, no federal agency of wise professors and no super computer have the abilities to solve the problem of how to allocate America's resources. Wise men and computers cannot determine how many automobiles U.S. factories should manufacture or how much housing to build or how other important economic problems should be solved. These are solved in the American marketplace by the competition of dozens or hundreds or thousands of economic actors.

Reaganomics teaches that the U.S. government has a great responsibility to encourage healthy competition. The U.S. government cannot create competition. And the U.S. government should not be part of the competition. Instead, according to Reaganomics, the U.S. government should provide the environment in which competition can thrive.

U.S. government policies that encourage competition are:

1) Do not put regulations on the economy. We already have discussed the dangers of regulations.

2) Do not impose tariffs, quotas or other restrictions on imports because imports create valuable competition for American domestic companies.

3) Do not give government subsidies or other kind of preferential help to an industry. Such help allows that industry to escape competition. For example, in the 1970s the U.S. government protected the U.S. steel industry from foreign imports. Today the U.S. steel industry is economically weak.

4) Do not create obstacles that prevent new companies from starting operations. As we have noted before, the best ideas come from America's new companies. Such new companies must be allowed to compete with the established companies.

5) Do not try to control wages or prices. The economic decline of the Roman Empire, to a great extent, began when Emperor Diocletian in the year 301 imposed wage and price controls on almost all economic activity in the empire. In doing this he destroyed the free market. The result was that Roman productivity and living standards began dropping.

**History's Lessons**

Of course, there are some aspects of competition which worry some American theorists. Competition seems like chaos; it seems like anarchy. With competition, there is no way to control the result. There is no way to guarantee that a certain company or a certain product will win the competition. Some American officials are not pleased with this kind of situation. They want to be able to control the result. Some American officials do not like the appearance of anarchy in the economy.

These officials are ignoring the lessons of American economic history. This history teaches that the market is not really in chaos, but is functioning in its own way in an orderly manner. Adam Smith, the Scottish economist of the 18th century, wrote that there is an "invisible hand" guiding the market. Attempts to control competition damage competition very seriously. And if competition is damaged, the economy suffers greatly.

**The Secret of Dynamism**

The fifth principle of Reaganomics is dynamism. This is something which results from the four other principles. Growth, the entrepreneur, low taxes, and competition create a dynamic economy that is always changing and evolving.

The opposite of the dynamic view is the static view. The premise of the static view is that basic economic conditions cannot change very much. These unchanging basic conditions will always limit man's ability to solve economic problems.

To understand the differences between the dynamic view and static view, we can look at the petroleum situation as an example. A static approach will declare with certainty that there will be a very serious and very long term energy crisis in the future. The static view assumes that the current rate of petroleum production and the current rate of petroleum consumption will continue unchanged into the future. If this is true, then indeed the world is heading towards a very serious energy crisis.

Reaganomics says that this is not true. It says that free market economic activity will avoid an energy crisis. Reaganomics teaches, for example, that when the price of petroleum goes up, the supply of petroleum and the demand for petroleum do not remain static. Instead they become dynamic; they change. This change happens in several ways.

1) More expensive petroleum will encourage the search for new supplies of petroleum. Some new supplies will be found. Thus the supply of petroleum will grow. The supply will not remain static.

2) More expensive petroleum will encourage users of petroleum not to waste petroleum and to use less of it. Thus the consumption of petroleum will decrease. It will not be static.

3) More expensive petroleum will encourage technological innovation that tries to find substitutes for petroleum. Some of this innovation will succeed. Substitutes will be developed. This will reduce the demand for petroleum and thus demand will not be static.

Throughout history, there have been warnings that important resources are going to run out. For example, in the past century there have been warnings that there would be world shortages of timber, rubber, whale oil, tin and charcoal. There have been many predictions of an energy crisis. Let me give you some examples from the American experience.

In 1891, the U.S. Geological Service predicted that oil would not be found in Texas. In 1926, the Federal Oil Conservation Board predicted that the U.S. had only seven years' supply of oil left in the ground. In 1949, the U.S. Department of the Interior predicted that the U.S. very soon would have no oil left.

These predictions, of course, were all wrong. Wrong also were the predictions about crises developing from shortages in timber, tin and the other resources which I mentioned. What prevented these crises was the dynamic response of the economy. But the crisis would have developed if the U.S. government would have created obstacles that prevented the dynamic operation of the economy.

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To summarize what I have said. Reaganomics is Ronald Reagan's economic philosophy and strategy. It is a vision of how the world operates. Reaganomics is optimistic about man's ability to change his world. It believes that individuals can change America if the U.S. government will allow them to do so.

The role of the government, Reaganomics teaches, is to remove obstacles from the operation of the marketplace. In Ronald Reagan's view, the government is the problem, not the solution.

Reaganomics is not new. It was not invented by Ronald Reagan. What he has done is read history and learn the lessons of history. These lessons have been very valuable for the United States. If we remember the lessons of Reaganomics, I believe that the U.S. will continue to enjoy a healthy, growing economy.

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