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Reaganomics: A Historical Watershed

Abstract

The socio-economic impact of Reaganomics and its long-run deleterious legacy is documented. The preponderance of data indicate that economic growth was not particularly impressive in the wake of the tax cuts of 1981 or 1986. GDP did snap back to potential but failed to accelerate beyond the rates achieved in prior or subsequent decades. The supposed incentives of supply-side economics failed to materialize. People did not work more, they did not save or invest more than they did before, and the benefits trickled down like molasses and got stuck at the very top of the income distribution. Instead, Reagan's presidency was a watershed in U.S. economic development in the sense that it reversed many of the accomplishments of the New Deal and inaugurated an era in which low-skilled men's wages began a long period of decline, and labor's share of GDP continued to fall. Reagan's true legacy is a dual economy that accompanied the hollowing out of the middle class, a more business-friendly regulatory and oversight framework for Wall Street that ultimately led to the financial crisis, a stupendous increase in the national debt from 30% to 50% of GDP that put it on a path such that by 2012 it exceeded 100%, anti-statism that contributed to the rise of Trumpism, a remarkable rise in inequality that gave rise to an oligarchy, and the benign neglect of blue-collar workers who eventually became Hillary Clinton's "deplorables." Reagan put the economy on a trajectory to ultimately, even if not inevitably, led to the triumph of Trumpism and an economy of malaise.

JEL-Codes: B520, D690, H290, H690, N120, P160.

Keywords: reaganomics, Trumpism, tax cuts, supply-side economics, trickle-down economics.

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Introduction

Ronald Reagan's Presidency was a watershed in U.S. economic history, the kind that occurs but once in a generation or two. Reagan was elected in the Fall of 1980, when the economy was not in great shape. Inflation hovered around an unprecedented 13%, unemployment rate was an uncomfortable 7.7%, and productivity growth was mediocre (Modigliani, 1988).[1] In November the federal funds rate reached 16%.[2] Although real disposable personal income per capita was growing at a decent rate of 1.2% per annum, despite two recessions that followed two oil shocks in the 1970s,[3] it came to a standstill during the presidential campaign. Similarly, real GDP had been stagnant for two and a half years when the citizens went to the polls.[4] A stagnating economy with inflation became known as stagflation. So, the economy seemed topsy-turvy.

This essay presents empirical evidence that Reaganomics was not only a failure but that it inaugurated path-dependent socio-economic and political processes that paved the way to the triumph of Trumpism. Reagan's proposition that by decreasing the taxes of the superrich the economy would shift into overdrive remained wishful thinking. Economic performance was not exceptional at all under his presidency (Krugman, 2008). However, the long-term consequences of his policies were far-reaching because they set into motion policies that locked the society into an inferior set of institutions, ideology, income distribution, and educational system that had powerful deleterious impact in the decades to come (Arthur, 1989). The accumulated effect of his tax cuts, deficits, and the income inequality that increased enormously ultimately led to a business-friendly legal framework, more deficits, and more inequality. Hence, we argue that the year 1981 was a turning point in U.S. economic development inasmuch as so many variables, discussed below, reveal an obvious kink in their trend values. The inequality eventually led to

the accumulation of so much despair among the have-nots, the less educated, the evicted, and the downwardly mobile, that they eventually reached for the pitchforks to overthrow the establishment and put a strongman into the White House come what may. Trump, therefore, is Reagan's ultimate legacy.

We focus on the very inception of this trajectory in 1981. The economic policies of the subsequent four administrations as well as the concomitant forces of hyperglobalization, technological unemployment of the less skilled, and the financial crisis that impacted the economy along the way and amplified the socio-economic problems are discussed elsewhere (Komlos 2018). Suffice it to say here that these processes started later to make a major impact on the economy. They did not begin suddenly in 1981 and therefore could not have caused the kinks documented below. Path-dependency meant that, given the course set by Reagan, it was much easier thereafter to continue to govern within the parameters of the worldview that unfolded in 1981. Under the circumstances, to reverse course permanently and stop coddling the superrich would have been a formidable undertaking (Buffett, 2011).

Reaganomics: The Basics

The ills of stagflation were real, the proposed remedies bitter, and their potential for success more than doubtful. In doctrinaire fashion Reagan blamed the government for the subpar economic performance because: "…government regulation,… has increased production costs…. high taxes,… have reduced incentives to work and save…. [and] transfer payments for welfare and social security,… have reduced employment of the poor and of older workers" (Rothschild, 1982). The policy of economic freedom that Reagan embraced meant foremost breaking the fetters of supposed overregulation and overtaxation using the untried principles of supply-side economics, known also as trickle-down economics, or Reaganomics for short. Its philosophy was

to "redistribute income to people with a high propensity to save—who happen to be rich people—and hope that their high spirits or their thrift will in some manner inspire economic growth" (Rothschild 1982). However, the proposal was not framed in those terms. Rather, it was couched in terms of redistribution from welfare recipients to workers and investors: "It is not surprising that voters were very receptive to the message that taxes and government spending should be sharply reduced to redress the distribution of income between wage earners and welfare recipients" (Feldstein, 1993, p. 13). It was a question of spin.

Reaganomics was supported by an enthusiastic array of conservative economists led by Milton Friedman. However, the bold vision was conceived more on faith than on solid evidence (Galbraith, 1982). David Stockman, director of the Office of Management and Budget, conceded that the program was "premised on faith on a belief about how the world works" (Greider, 1981). It was all "a kind of convenient illusion—new rhetoric to cover old Republican doctrine" Stockman admitted, adding cynically, "The hard part of the supply-side tax cut is dropping the top rate from 70 to 50 percent..." The subtext was clear: to support "industrial workers, male, white, … [so that they can] get working again" and "to kick the poor by eliminating social programs" (Rothschild, 1981); this became known as "starving the beast" political strategy. Robert Hall of Stanford University referred to the supposedly wasteful programs as "pouring money down rat holes" (Hall, 1981). The "rat holes" he had in mind included employment and training programs, food stamps, school lunches and social services. However, military expenditure would remain sacred.

In short, Reagan advocated decreasing the taxes of the deserving rich which would provide incentives to increase savings and investments and thereby create jobs and subsequently "trickle down" to the masses so they would benefit from it in due course.[5] Moreover, lower taxes

meant an increase in take-home pay and that would provide an incentive for people to work harder and for entrepreneurs to take more risks, thereby growing the economy and boosting incomes further.

Arthur Laffer was a leading proponent of the view that a tax reduction would increase government revenue: “It is reasonable to conclude that each of the proposed 10 percent reductions in tax rates would, in terms of overall tax revenues, be self-financing in less than two years. Thereafter, each installment would provide a positive contribution to overall tax receipts” (Laffer, 1981, p. 21). Laffer was not only wrong, he was irresponsibly wide off the mark and reputable economists, even conservative ones, find his theory unacceptable (Mankiw and Weinzierl, 2006; Fullerton, 2008, p. 839; Feldstein, 1986, Galbraith, 1982). James Tobin, a Nobel-Prize winning economist, estimated that the tax rate on wages would have to be about 83% before tax cuts generated additional revenue, and modern calculations do not differ by much (Tobin, 1981; Trabandt and Uhlig, 2011).[6] Instead of revenues increasing, they fell so sharply that Reagan had to reverse course and sign into law several “revenue enhancements”—newspeak for “tax increases”.

To be sure, Reaganomics also had plenty of sceptics from the start. “Military Keynesianism—the large increase in military expenditure in the recession will hurt investments and innovation for long-term growth and will leave some segments of the labor market stranded including young black women of whom 41% were still unemployed at the end of 1981” (Rothschild, 1982). Furthermore, people who were already working full time would not likely increase their work hours. With the unemployment rate at 12% at the end of 1982, it was hardly obvious that people could find more work even if they wanted to. And additional investments would be unlikely, unless there were new opportunities offering a decent return and those were

not obviously at hand. And what if the rich spent their additional income on conspicuous consumption buying foreign luxuries, traveling or investing abroad? Then the benefits would be trickling to other parts of the world. And what if they purchased foreign or domestic government bonds instead of investing in physical capital? So, there were plenty of open questions if anyone cared to dig a bit deeper. The main point is that the road from tax cuts to economic growth in general is hardly an obvious one. It depends on the context.

Nonetheless, in 1981 "Congress enacted the major tax bill that has become the centerpiece of supply-side economics. The emphasis… was on changing marginal tax rates to strengthen incentives for work, saving, investment and risk taking" (Feldstein, 1986, p. 26). The act included "a 25 percent across-the-board reduction in personal tax rates…" Superficially that sounds fair except it meant a reduction of top tax bracket from 70% to 50% and of the lowest bracket from 14% to 11%. It is easy to see the change would mean hundreds of thousands of dollars at the top but miniscule amounts of money at the bottom of the income distribution. In 1986 the top tax rate was reduced further from 50% to 38.5% increasing inequality further.

Actually, the disposable income of the average tax unit in the $20-25,000 bracket was increased by $1,611 dollars which is nearly a 10% increase and worth $3,500 in 2017 dollars (Table 1). Although advantageous, it was not a game changer for them. To be sure, it would finance a little more consumption, but it failed to change the rate at which their income was growing. However, the real windfall accrued at the very top. Millionaires with an average income of $2.5 million gained $176,000 per annum. Although in terms of percentages this was not much different from that of the average taxpayer, for the top the changes were a huge windfall, because they were able to save much of it and thereby increase the rate at which their income was growing. Of course, that was hushed up. After two or three decades the gains would

accumulate sufficiently to be able to exert overwhelming influence on the political process and, in addition, to finance research and publications that would support the ideological foundations of Reaganomics until it became the dominant ideology of the land.

Table 1. Tax Savings in 1985 Compared to 1980

Income Bracket	Average Gross Income 1985	Tax rate Percent 1980	1985	Difference	Percent of 1980 tax rate	Change in Tax Payments Dollars 1985	2017
9-10	9	7.0	5.0	-2.1	-29.6	-187	-408
11-12	11	8.8	6.2	-2.5	-28.8	-278	-605
13-14	13	10.0	7.2	-2.7	-27.5	-356	-776
20-25	22	17.3	10.2	-7.2	-41.5	-1611	-3510
100-200	131	32.6	24.9	-7.7	-23.6	-10068	-21935
200-500	290	39.2	31.9	-7.3	-18.7	-21276	-46352
500-1,000	670	43.4	36.0	-7.4	-17.0	-49456	-107747
>1 million	2316	46.7	39.2	-7.6	-16.2	-175861	-383137

Note: Thousands of 1985 Dollars unless otherwise noted; CPI-U-RS is used for the final column

Source: https://www.irs.gov/statistics/soi-tax-stats-archive-1954-to-1999-individual-income-tax-return-reports

Deficits were supposedly not going to be a problem because, as Defense Secretary Caspar Weinberger, asserted, “You aren’t really adding substantially to your deficit when you add defense spending because the spending is frequently, if not matched, at least approached by the increased revenue that is generated by the defense expenditure” (Rothschild, 1982). In contrast, transfer payments were allegedly not so beneficial because they “generally go to non-durable consumer goods. These have a lower investment component and a lower multiplier effect” (Rothschild, 1982). So, reflecting the philosophy of the administration, Weinberger thought that deficits for the military were ok, but for welfare they were not.

By abandoning their established policy of fiscal conservatism that included balanced budgets, the Republican mainstream became cheerleaders of Reaganomics. According to Feldstein the “remarkable reduction of personal income tax rates… reduced the associated deadweight loss [by a substantial amount]” (Feldstein, 1989, p. 108). In a self-congratulatory

tone, he added that "the restructuring… is testimony to the power of economic ideas" (Feldstein 1989, p. 108). He merely forgot, as did all Reagan supporters, that the tax models they were using failed to consider the productive uses of taxes. When taxes are invested in public goods, such as infrastructure, education, health, or basic research they increase efficiency, productivity, and GNP in subsequent periods. These were disregarded not only by Feldstein but by all other backers of supply-side policies.

They also left out of consideration that the reduced revenues would lead to the burgeoning burden of the endemic budget deficits, the hollowing out of the middle class, the neglect of public goods including investments in infrastructure and education, the strengthening of the military-industrial complex, more finance-friendly laws that would become harmful, the benign neglect of the lower classes that radicalized them and turned them against the establishment, stagnating wages of low-skilled workers, the rise of inequality and the "steady slide toward economic oligarchy" (Hacker and Pierson, 2010; Temin, 2017; Prasad, 2012). These are the truly enduring harmful legacies of Reaganomics.

The Empirical Evidence: Reaganomics was a Failure

Ineffective Incentives: no economic variables responded as forecast

The deep cuts in taxes were supposed to spur investments, savings, and work hours. These they failed to accomplish (Modigliani, 1988; Friedman, 1988; Peterson, 1988; Leamer, 2001, p. 16). Instead of increasing, personal saving as a percentage of disposable income declined. During the three decades 1951-1981 personal saving as a percent of disposable income was steady at 11.4%. However, by 1985 it began to decline: in 1988 it was already down to 8.5% and hit rock bottom at 3.2% in 2005.[7] So the savings rate began its long march toward zero during Reagan's presidency and contemporaries recognized it: "The strategy did not work…,

Lower taxes led to a lower savings rate—not a higher savings rate" (Thurow, 1983). Without increased savings, investments were not likely to budge.

And they did not budge. To be sure, there was some pent-up demand for investments as the economy recovered from the double-dip recession in 1982, but that was over by 1984. Real gross private investments increased at a rate of 4.24% between 1950 and 1979 and by 4.26% between 1980 and 1988.[8] This was unremarkable. The deficits soaked up too much of the savings for investments to rise meaningfully.[9]

Most revealing, fixed investments even slowed from 6.5% to 4.2%.[10] Moreover, that investments stagnated thereafter for four whole years has been overlooked.[11] Thus, the empirical evidence contradicts the foundational tenets of supply-side theory. This was clear very early on: "The large government deficits now projected even for after the economy's return to full employment will constitute a substantial impediment to the U.S. economy's net capital formation" (Friedman, 1983, p. 93).

Savings failed to increase but, contrary to expectations, household debt did. In 1985, just as the savings rate began to drop, the debt rate began to rise and did so immediately. Household debt had been near 46% of GDP ever since 1965; in 1984 it was still 49%.[12] Then it soared. By 1988 it rose 9 percentage points. By 2000 it was 69%, an increase of 20 percentage points, and reached 98% in 2008. Credit card debt increased especially rapidly. In 1981 total debt outstanding was around $55 billion; by the end of 1988 it stood at $194 billion, an increase by an extraordinary factor of four.[13]

The roots of this jump in indebtedness can be traced to the rise in inequality. As the income of the middle class fell behind that of the rich and superrich, the only way they could keep up with the rising consumption norms of the society was to decrease savings and at the

same time increase indebtedness. Simultaneously, the increased income of the superrich meant that the banks had sufficient funds to accommodate the increased demand for loans. Moreover, the transfer of income to the top meant that aggregate demand would have been decreasing if it had not been buoyed up by rising debt. The reason is that the rich save a higher fraction of their income than the middle- and lower classes and therefore they also buy fewer goods per dollar of income. Growing inequality therefore creates a decline in aggregate demand unless the gap can be shored up through credit, which is precisely what happened. So, consumption of the middle class came to depend excessively on credit.

The work effort was also expected to rise to the supposed incentives but also failed to do so: the number of hours worked was 1,813 annually per capita in 1979 and the same at the end of Reagan's presidency (Leamer, 2001, p. 11).[14] This should also not be surprising. Americans were already living harried lives, working hundreds of hours more than their European counterparts (Linder, 1970). One should not be astonished that overworked Americans did not jump at the chance to spend even more time at the lathe, desk, or cash register. It would be very difficult to squeeze more effort into their schedule.

The labor force participation rate of men also did not budge. It was slightly down from 76.3% in 1981 and 75.4% in 1989.[15] To be sure, women's participation rate did continue to increase, but that had been increasing for decades in the midst of the feminist movement and not because of tax incentives. Even Feldstein had to admit finally that incentives failed to work: "Although we would expect some increase in work effort from the reduction in the highest marginal tax rates, past evidence all points to relatively small changes." However, there was "lack of evidence of an induced increase in the number of people wanting to work…" (Feldstein, 1986, p. 28).

Moreover, unemployment remained stubbornly high. The official rate was 7.5% at the outset of Reagan's term and still the same at the end of his first term due partly to the intervening recession and the Fed's high-interest-rate policy.[16] In the meanwhile, the rate rose to 10.8% in November 1982, but Reagan shrugged it off saying "Is it news, that some fellow out in South Succotash someplace who has just been laid off should be interviewed nationwide?"[17] (Weisman, 1982). To be sure, eventually the official unemployment rate did inch down to 5.4% but was still higher than during similar phases of prior business cycles (Leamer, 2001, p. 10). Furthermore, the true unemployment rate—also called underemployment (or U-6)—was much higher than the official rate: 9.3% in December 1989, the first date for which such data are available; among disadvantaged subpopulations it was still higher. For instance, among African Americans without a high-school diploma the true unemployment rate was 28% (Table 1).[18] So, the unemployment record also ought not be judged in superlatives.

Table 2. Underemployment Rate Among Disadvantaged Subpopulations in December 1989

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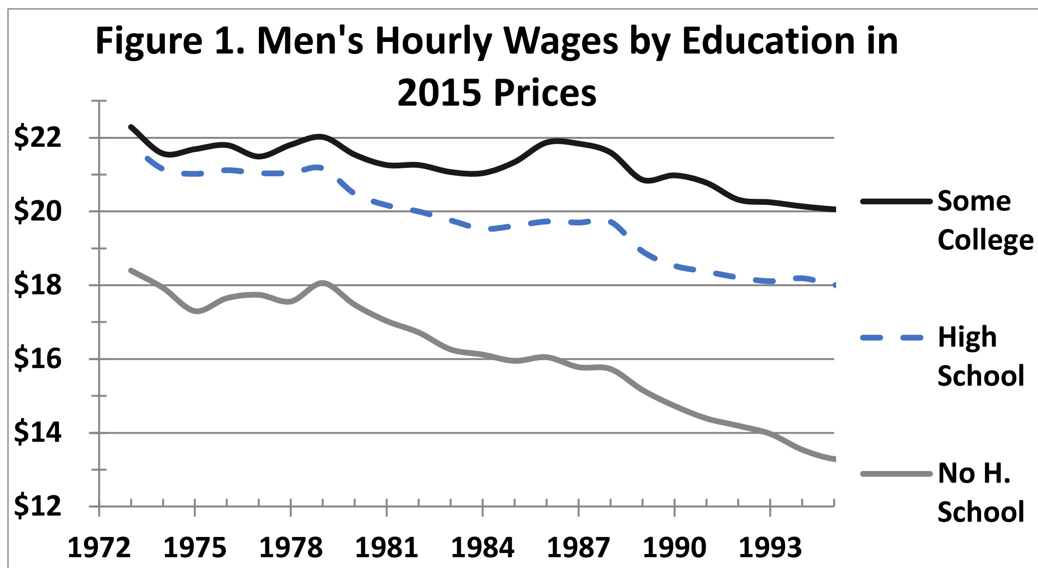
	Percent
Labor Force Average	9.3
Hispanics	14.5
African American	17.5
Ages 16-24	17.4
Less than High School	18.3
High School Diploma	9.9
Less than High School African American	28.3
High School diploma African American	18.0

Source: Economic Policy Institute, State of Working America Data Library "Underemployment."

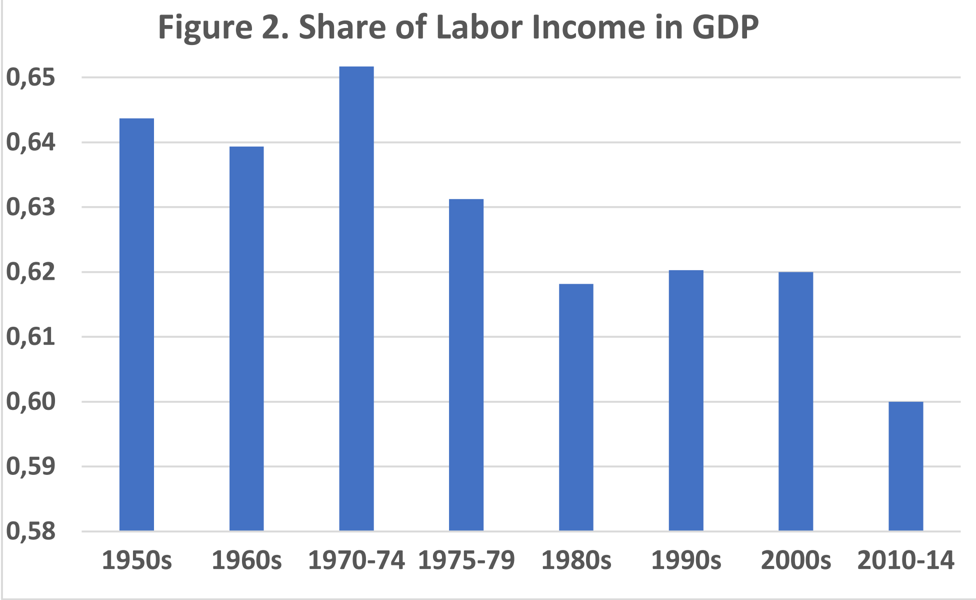
The windfall of the millionaires was supposed to trickle down so that salaries of typical workers would increase (Table 1). That was not successful either: wages of men with a high school education or less declined under the Reagan presidency (Figure 1). Only those with a college education experienced some gains but even their wages were declining during Reagan's first term and those with less than a college education experienced a decline throughout the period. The average hourly wage of men without a high-school diploma was $17.47 per hour in 1980 (in 2017 prices). The precipitous decline began in 1981; by 1984 it was down by $1.35 to reach $16.12; by 1988 it was $15.73. the annual median income of men working full time was $53,200 in 1980 and $53,350 in 1988.[19] Hence, the trickle-down effect of the tax cuts had the viscosity of molasses as next-to-nothing reached the less educated.



Source: Economic Policy Institute, *State of Working America Data Library*, "Wages by Education," https://www.epi.org/data/#?subject=wage-education&g=*

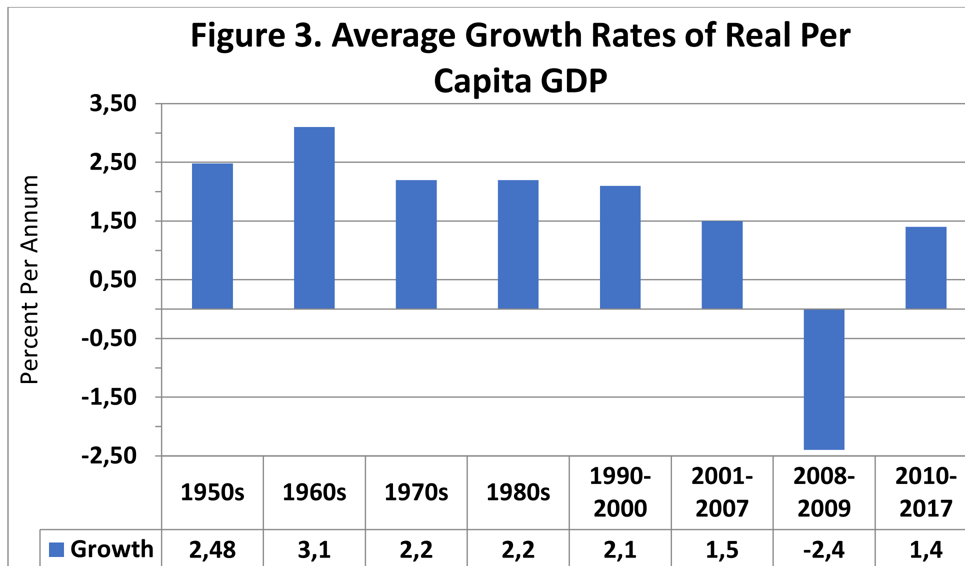
Because of wage stagnation or even decline and the inferior bargaining position of labor, their share of income in GDP declined from 63.1% in the latter half of the 1970s to 61.7% under Reagan (Figure 2). The reduction was permanent: labor never regained its earlier gusto.[20] This

1.4% drop in the share of GDP might not seem like much, but it amounted to a loss of some $73 billion for the 80 million full-time workers or nearly $900 per worker which equaled about two weeks' worth of wages, hardly a meaningless sum and for many compensating for the gains obtained by the decrease in the tax rate.[21]

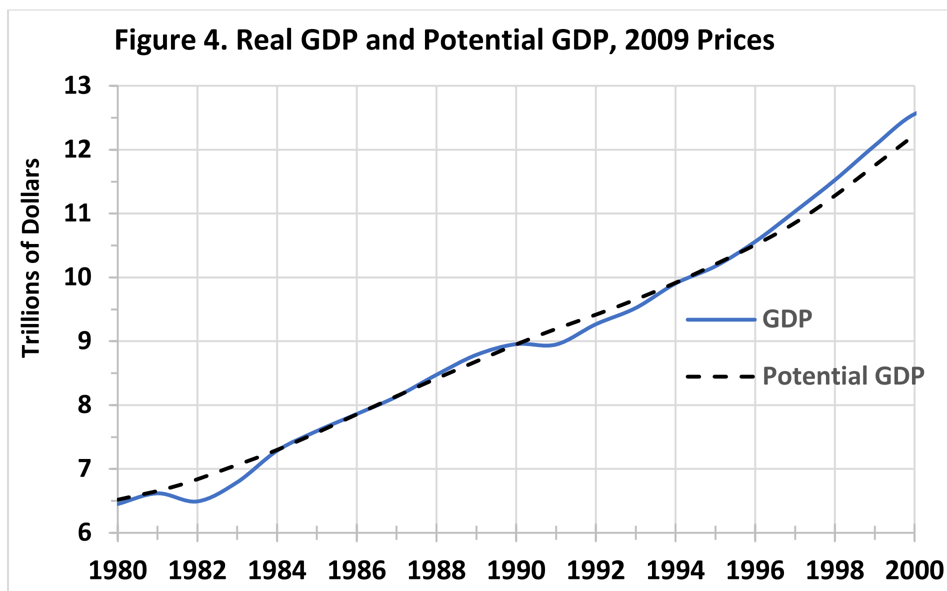


Source: Federal Reserve Bank of St. Louis, Share of Labour Compensation in GDP at Current National Prices, LABSHPUSA156NRUG

GDP growth also failed to accelerate. Instead of the boom Reagan and his advisors predicted, growth in the 1980s was on par with earlier and subsequent periods[22] (Figure 3). Growth meant merely that actual GDP caught up to potential GDP after the 1982 recession (Figure 4). The promised spectacular performance was nowhere in sight (Krugman, 2008).[23] Hence, no economic variable showed any sign of extraordinary performance under Reagan's watch.



Source: Bureau of Economic Analysis, Table 7.1 Selected Per Capita Product and Income Series https://www.bea.gov/iTable/iTable.cfm?reqid=19&step=2#reqid=19&step=3&isuri=1&1921=survey&1903=264

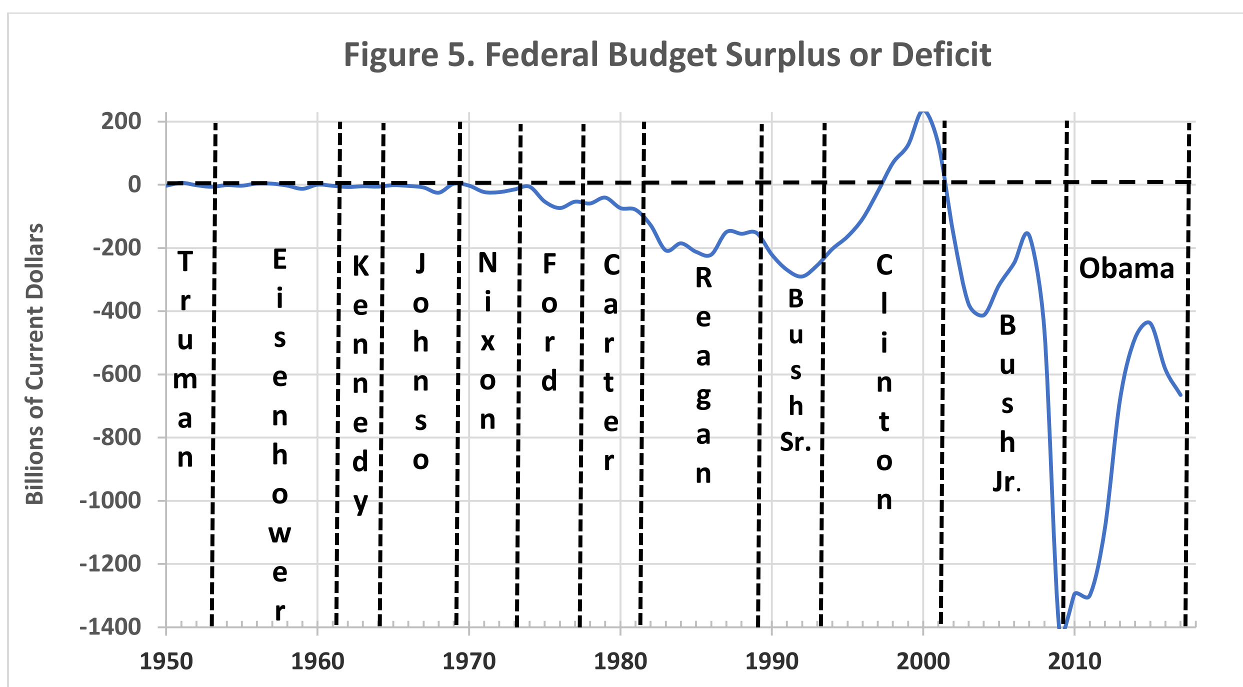


Source: Federal Reserve Bank of St. Louis, Series GDPCA and GDPPOT.

Endemic Deficits is a Major Enduring Legacy of Reaganomics

"Federal fiscal policy is adrift without a rudder," wrote Tobin in 1986. Although Reagan branded Carter's $59.6 billion budget deficit "excessively high" and promised that it "will be reduced and in a few years, eliminated," the exact opposite turned out to be the case. Deep tax

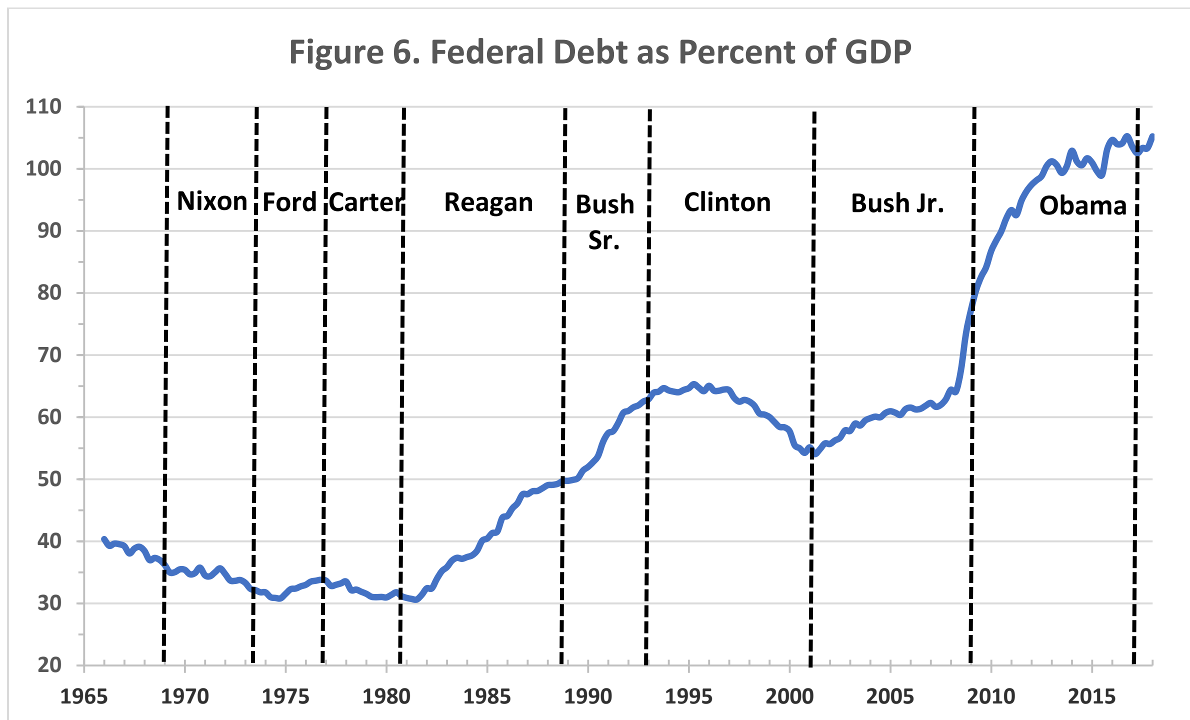
cuts coupled with slower-than-expected increases in GDP and revenues brought about the biggest surge in government deficits since World War II. In contrast, the administration forecasted that by 1984 "the Federal budget should be in balance… [and] actually generate a surplus in 1985 and 1986, for the first time since 1969" (White House, 1981). Instead of surpluses came an immediate torrent of red ink as the economic effects of the hypothetical incentives failed to materialize and revenues remained far behind expectations (Figure 5). Moreover, decreasing expenditures remained elusive. Vested interests were able to prevent that. So, 'starving the beast' was not a successful strategy and using credit to finance the deficit was the easy way out of the dilemma.



Source: Federal Reserve Bank of St. Louis, Federal Budget Surplus or Deficit, series FYFSD.

In 1981 the Congressional Budget Office had projected that revenues would rise to $1.0 trillion by 1985. They were off by not less than $266 billion or 29% since actual revenue was $734 billion (Timiraos and Shin 2017). Consequently, by 1986 the deficit reached $221 billion instead of the predicted $30 billion surplus (Figure 5). Altogether, Reagan increased the national

debt by an unprecedented $1,776 billion.[24] Total government debt in January 1981 was $965 billion; by January 1989 it was $2,740. In other words, Reagan practically tripled the debt and half of the increase went to the military.[25] Thus, total public debt as a percentage of GDP doubled from 30% to 60% by the end of Bush Sr.'s term (Figure 6).



Source: Federal Reserve Bank of St. Louis, Total Public Debt as Percent of Gross Domestic Product, series GFDEGDQ188S.

No other prognosis of the administration was so wide of its mark. This was a fundamental and ominous break with the past at the expense of unborn generations: "The fiscal burden facing all future generations over their lifetimes will be 17 to 24 percent larger than that facing newborns in 1989" (Auerbach et al., 1991). This was also the moment when the endemic trade imbalance began, a customary concomitant of government budget deficits (Figure 7) (Bernheim, 1988).

In addition, the high interest rates mandated by the Federal Reserve Chairman Paul Volcker brought about a large inflow of capital which meant that the value of the dollar

increased vis-à-vis foreign currencies.[26] In turn, this wrought havoc in the international economy *inter alia* leading to bankruptcies of Argentina, Brazil, Chile, and Mexico because their debt was denominated in dollars (Sinn, 2018). In addition, it led to cheap foreign goods flooding the U.S. market breaking the back of U.S. heavy industry from which many of them would not recover. At the same time, the overvaluation of the dollar led to a sharp decline in exports contributing to a negative trade balance (Figure 7).

Given that the unions were strongest in the manufacturing industry, their decline also contributed to the decline in union power and their voice in government. Without them the forces of globalization could penetrate the U.S. economy without much resistance. With the diminution of the countervailing power of heavy industry and of their unions, it also became easier for the financial industry to replace their influence in the halls of Congress.

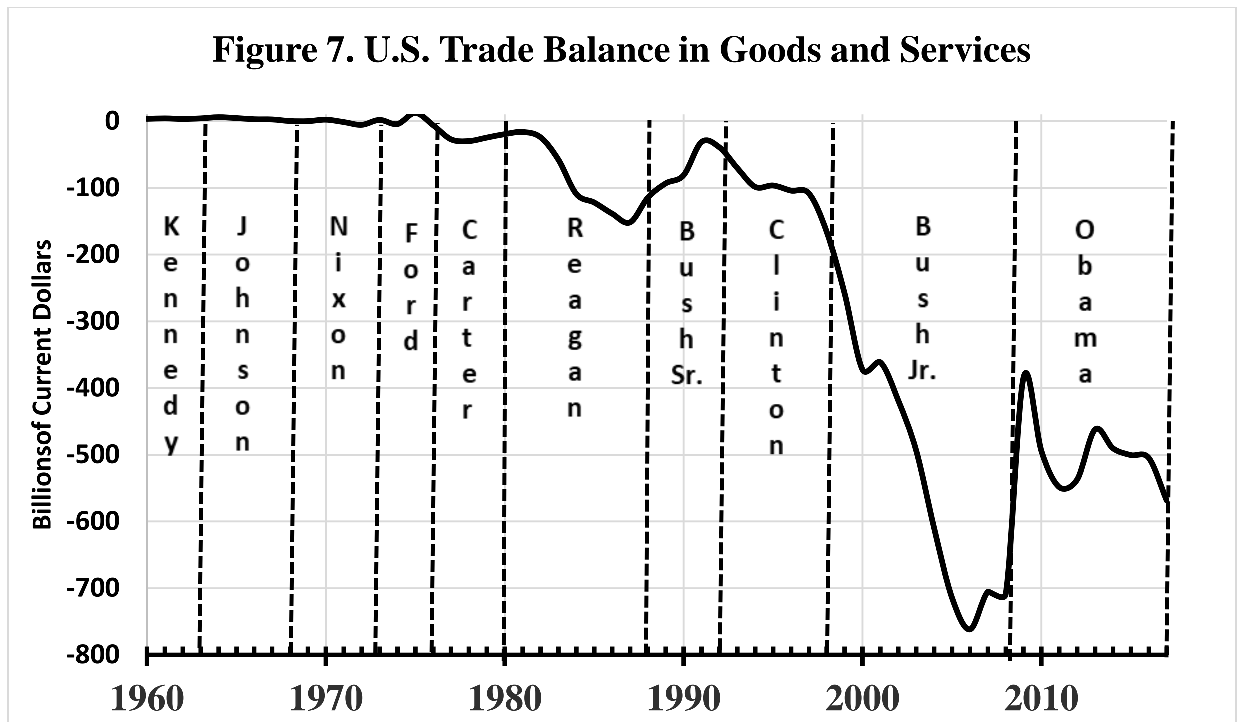


Figure 7. U.S. Trade Balance in Goods and Services

U.S. Census, Bureau, "Foreign Trade, Historical Statistics," https://www.census.gov/foreign-trade/statistics/historical/index.html

The flow of red ink became too difficult to reverse thereafter except briefly under the Clinton administration (Figures 5 and 6). Prior to Reagan the deficits were small and incurred when economic activity slowed. After 1981, however, deficits became endemic in good times as well as in bad.[27] As it were, the U.S. political establishment became addicted to spending more than collecting in revenue. Reagan steered the economy on a path of accepting deficits as the new normal and it would have needed strong leaders, such as FDR or LBJ, to reverse it. Once the deficit steamroller became endemic it could be halted episodically perhaps temporarily, but it was too difficult for policymakers to steer the economy onto a different trajectory. That is the logic of path dependence: societies can be locked into a suboptimal trajectory (Arthur, 1989). It is far easier to shift the burden to subsequent generations who are unable to send lobbyists to Washington. Obama was best situated to make a U-turn but wasted the opportunity afforded by the financial crisis and failed miserably to begin taxing the superrich realistically. So endemic deficits became the enduring legacy of Reaganomics. At the end of the decade Janet Yellen, future Chair of the Federal Reserve, observed that "In the view of most of the nation's economists these developments are profoundly disturbing" (1989). That recognition did not matter; Bush Jr. and then Trump continued to cut taxes. Even liberal Obama made permanent Bush's tax cuts that would have expired in 2013, thereby adding some $300 billion to the deficits annually.[28] This demonstrates that taxes are like a ratchet that allows motion in only one direction: taxes can be lowered easily but going in the other direction is difficult if not impossible. This is another reason why path dependency was such a powerful force since Reagan. Similar argument applies to the budget deficit. Once it is endemic it is extremely difficult to reverse. We have had deficits in 34 out of the 38 years since Reagan's term began (Figure 5).

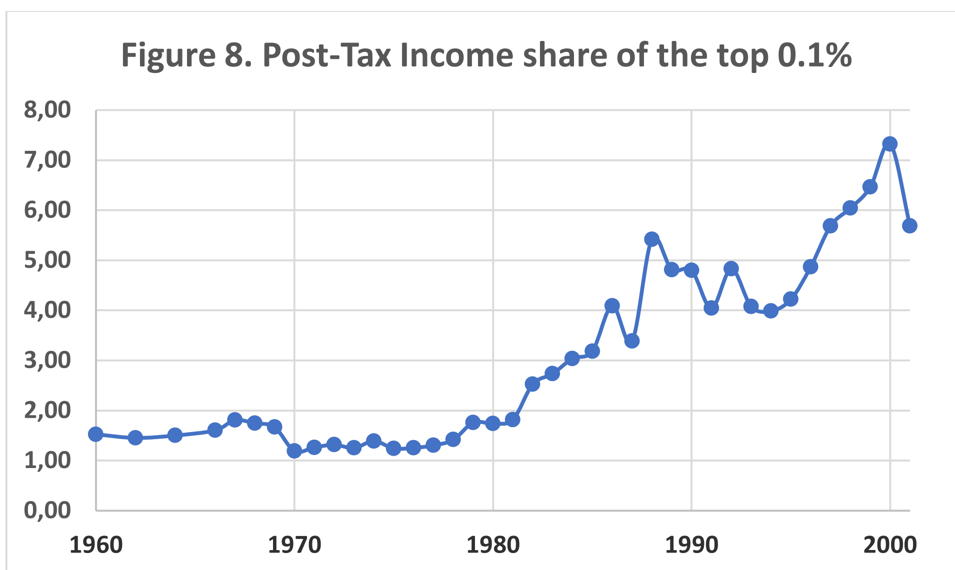
1981 was a Historic Turning Point

Reaganomics represented a fundamental change in the dominant philosophy of governence away from New Deal activism and away from responsible fiscal policy. In numerous economic indicators the beginning of the Reagan administration was a real turning point. To be sure, as with any major realignments bordering on being revolutionary, Reaganomics also had precursors. After all, which tiny creek or lake in Minnesota is the source of the mighty Mississippi River is controversial and the French Revolution, too, drew inspiration from the philosophers of the Enlightenment. Similarly, Reaganomics was not a lightning out of a blue sky. Well before Reagan, the neoliberal movement was gathering momentum boosted by intellectuals such as Milton Friedman and Friedrich Hayek, as well as by conservative think tanks with the founding of the Heritage Foundation (1973), Cato Institute (1974), and the Manhattan Institute (1977) which would become influential. These provided the intellectual support of Reaganomics and helped to legitimize its politics until it became the dominant ideology of the land (Phillips-Fein, 2009).[29] Reagan popularized these principles, advocating freedom and rugged individualism that fit well into the myth of American exceptionalism while translating the philosophy into policy. Reaganomics had these two intertwined aspects to it.[30]

It is not at all coincidental that similar political forces manifested themselves in the U.K. under Margaret Thatcher. She, too, was influenced substantially by the conservative wordly philosophers. Reagan, as well as Thatcher, were the executioners who put this coherent philosphy into successful political action (Smithin, 1990). However, the argument is emphatically not that Reaganomics caused Trumpism. Rather, the argument is that Reagan started a path-dependent process, which gathered momentum along the way and finally ended up

in the triumph of Trumpism (Turchin, 2016). In other words, Trumpism came at the end of a trajectory with many twists and turns in between.

Another sign of the gathering steam of the neoliberal ideology in the 1970s is that even the Carter administration began to leave behind several aspects of the New Deal consensus. The pressure from neoliberals was too pervasive for it to hold the line (Palley, 1998). So Carter acceded to more business-friendly laws governing airlines, trucking, and telecommunications. In spite of the efficiency gains obtained, these signaled a broad-based turn against government oversight in general which under Reagan reached Wall Street. That was risky, because finance is obviously much more fragile than the other sectors of the economy (Minsky, 1986). In 1982 the Garn-St. Germain Depository Institutions Act deregulated savings and loan institutions and allowed banks to write variable rate mortgages which became a hazard in the financial crisis. In 1984 the Reagan administration allowed private banks to securitize mortgages which contributed to the subprime mortgage crisis.[31] With that the stage was set for further similar Wall-Street-friendly laws under Clinton that ultimately ended in the Meltdown of 2008 (Ackerman, 1984; Komlos, 2018).



Source: Piketty and Saez 2007 supplementary Table A2
http://piketty.pse.ens.fr/files/capital21c/en/xls/

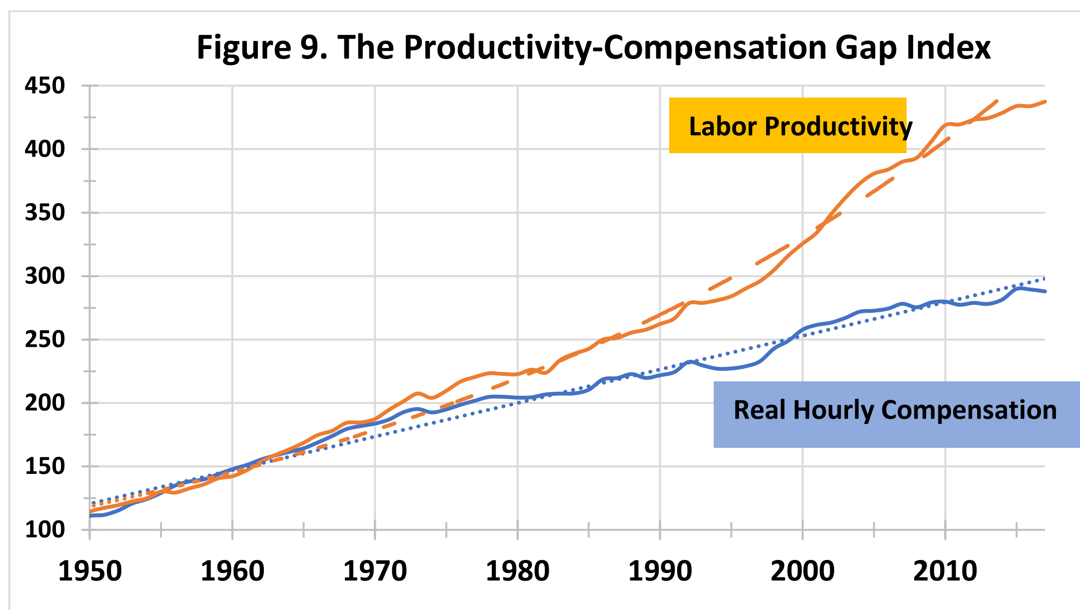
However, one has to look hard for economic indicators that might be considered precursors of Reaganomics but there are some possibilities at the tip of the iceberg. For instance, the trend in inequality represented by the share of income of the top 0.1% or 80,000 of the roughly 80 million households indicates that after declining in 1970 and then staying flat for the better part of the decade, inequality did begin to move a tiny bit in 1979 (Figure 8). To be sure, inequality was at a 20th-century nadir for nine years as the share of after-tax income of those top 80,000 households fluctuated only slightly in the range of 1.2%-1.4% between 1970 and 1978. Then in 1979 and 1980 their share rose suddenly to 1.75% (Figure 8). This was not yet a trend, and hardly problematic; it merely meant a return to the level of inequality of 1967 or 1968, commensurate with the decline in the average tax rate of the top 0.1% of income earners from 59.8% to 56.0% in 1978.[32] So these were just minor tremors, hardly a significant departure from the prior epoch, or harbingers of things to come.

The real shock came three years later when the trend was unleashed that extended into the next century: in 1981 the top 0.1% of the income distribution received 1.8% of total income, by 1982 2.5%, and by 1983 2.7%. So by 1983 the share of income of these 80,000 households doubled compared to 1977. Henceforth the floodgates were open and remained open: by 1988 their share reached 5.4% and by 2000 7.3% (Pikkety and Saez, 2007, Figure 3).[33] From 1.3% to 7.3% of national income is a game changer of immense historic proportions.[34]

The Gap between productivity and Compensation

From a theoretical viewpoint, firms should pay wages equal to the value of the marginal product of their workers. This fundamental theorem implies that real wages should keep pace

with the productivity growth of the labor force. Yet, this basic theorem is contradicted by the U.S. evidence, as the growth in compensation (wages, bonuses, and benefits) fell very far behind productivity growth after 1981 (Figure 9). Between 1947 and 1970 the growth in real wages equaled productivity growth exactly, just as theory predicted; both practically doubled in the intervening 23 years, growing at an impressive compounded annual rate of 2.7% (Table 3).



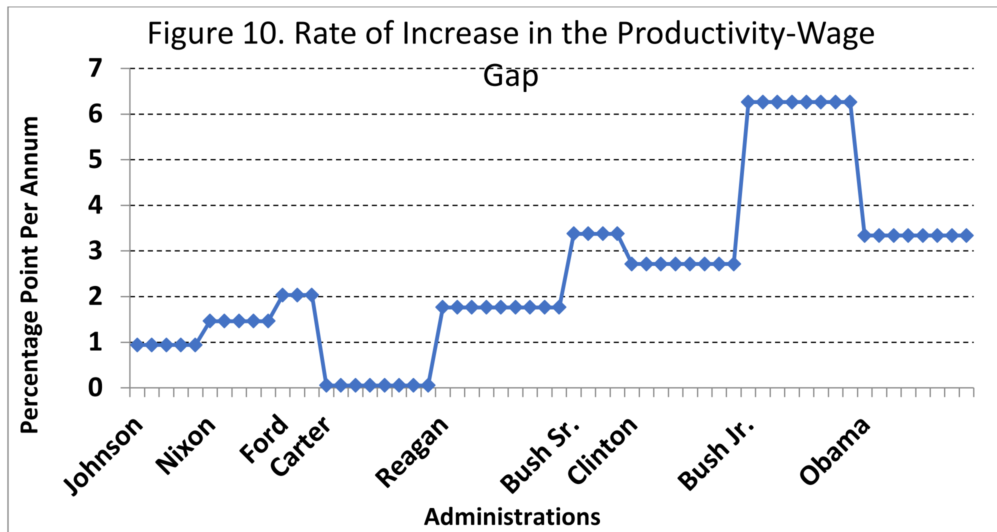
Note: Base year is 1947=100. The dotted lines are trend lines: exponential for productivity and straight line for wages.
Source: Susan Fleck, John Glaser, and Shawn Sprague, "The compensation-productivity gap: a visual essay," *Monthly Labor Review*, January 2011: 57-69. Data for 2012-2016 was kindly provided by Shawn Sprague of the Bureau of Labor Statistics.

Table 3. Growth in Productivity and Real Compensation, U.S. 1947-2011

	Years		Productivity growth %		Wages growth %		Ratio	Difference
			Total	Annual	Total	Annual	Annual	Annual(%)
1)	1947-1970	23	85	2.7	83	2.7	0.98	-0.0
2)	1970-1982	12	19	1.4	14	1.1	0.74	-0.3
3)	1982-1999	17	41	2.0	20	1.1	0.49	-0.9
4)	1999-2016	17	37	1.9	16	0.9	0.44	-1.0

Note: Total refers to the total percent increase during the period. Annual is the annual compounded growth rate. Ratio is the ratio of annual growth rates. 2017 refers to the first half of the year. Wages refers to total compensation.
Source: See Figure 9.

Then in the 1970s a tiny difference appeared, and wages grew 0.3% per annum slower than productivity (Table 3). However, under Carter both variables still increased at the same pace, so the gap did not widen under his watch (Figure 10). The real first sign of a structural break in the relationship between productivity and wages appeared in 1982, because under Reagan the gap widened substantially and continued to do so until the present day. After Reagan the growth in compensation was merely half of the growth in productivity (Table 3).

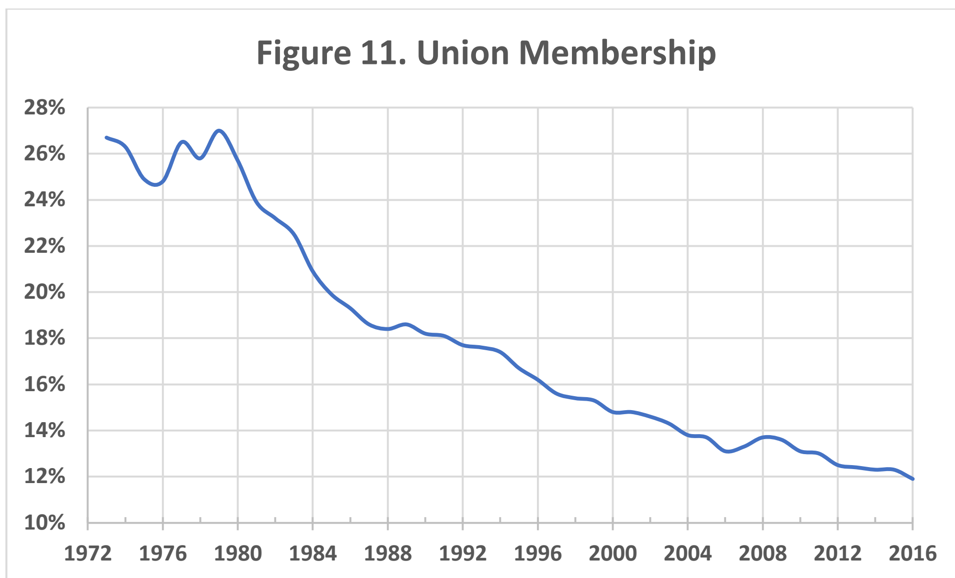


Note: Base year is 1947=100. Percentage point increase in the index relative to the base year. For example at the beginning of the Ford administration the size of the gap was 12.2 and at the end 18.3. Thus it increased by 2 percentage points per annum.
Source: See Figure 9.

Thus, after 1982 the gap widened continuously until the present, although each successive Democratic administration seems to have slowed somewhat the rate at which the gap was increasing (Figure 10). This dovetails well with Bartel's thesis that Republican presidents increased inequality more than Democratic ones (2016). So, under Clinton the gap increased at a slower rate than under Bush Sr. and similarly, under Obama it again increased slower than it did under Bush Jr. However, by the presidency of Bush Jr., the gap was growing at a rate of 6 percentage points per annum. At the beginning of 2017 the gap had reached 150 percentage points. That is to say, labor compensation had increased by 288% since 1947 but productivity had increased by 438%. So, productivity grew 2.3 times as fast as wages (Figure 9). The

difference accrued to profits which increased exponentially. The power of the unions was dissipating, and the government and courts were unsympathetic to labor, so workers were left to fend for themselves (Farber et al, 2018). Without countervailing power, labor was at a distinct disadvantage. So, Reaganomics failed to provide inclusive growth.

In addition to the tax cuts favoring the rich, another aspect of Reaganomics that contributed to the hollowing-out of the middle class was his suppression of the strike of the Professional Air Traffic Controllers Organization (Stiglitz 2013, p. 81). The union ceased to exist, and 11,000 employees were fired, signaling the end of the influence of big labor.[35] Organized labor became so intimidated that the number of strikes involving at least 1,000 workers declined thereafter from 235 in 1979 to just 17 by 1999,[36] and the share of the labor force in unions, still 26% throughout the Carter presidency, fell precipitously by fully 1/3rd, to reach 17%, by the end of Reagan's second term (Figure 11).[37] So union power was a thing of the past (Mishel, 2012).



Source: Economic Policy Institute, *State of Working America Data Library*, "Union Coverage," https://www.epi.org/data/#?subject=unioncov

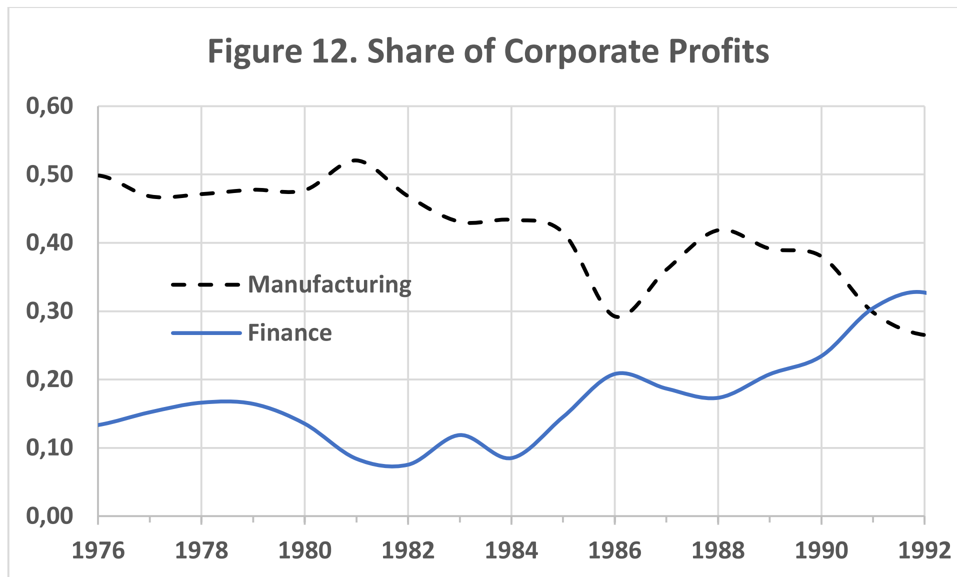
Unions had been the backbone of the middle class, especially the lower-middle class. They ensured that a share of the profits went also to workers and not only to executives and shareholders. Collectively workers could threaten to strike, thereby exercising sufficient countervailing power to obtain for themselves a little more than a living wage—a share of the rents the corporation was earning. Without such countervailing power most workers without a college education, especially those who had no special skills—were left on their own (Bivens et al., 2014). The upshot was devastating to this segment of the middle class. United, workers had some bargaining power; divided they had none. The result was that workers'pay lagged far behind their productivity growth (Figure 9).

As worker's power waned so did their ability to influence Congress. Accordingly, federal minimum wage shrank under Reagan from $9.03 (in 2016 prices) to $6.80, a $25% decline! The tax brackets were indexed to inflation (starting in 1985), but the minimum wage was not, and Reagan was proud of it: "the minimum wage has caused more misery and unemployemnt than anything since the Great Depression," he incorrectly claimed (Kwak, 2017, p. 7).

Table 4. Profits and Employment in Manufacturing and Finance

	Total	Employment						
	Labor	Millions of workers		Percent of Total			Profits Percent of Total	
	Force	MFG	Finance	MFG	Finance	Sum	MFG	Finance
1981	108.4	18.6	5.2	17.2	4.8	22.0	52.1	8.4
2000	142.6	17.3	7.7	12.1	5.4	17.5	24.9	27.4
2011	153.3	11.7	7.7	7.6	5.0	12.7	17.0	32.8

Source: See Figure 12 and Bureau of Labor Statistics, Establishment data. Historical Employment. Table B-1. Employees on nonfarm Payrolls by major industry sector



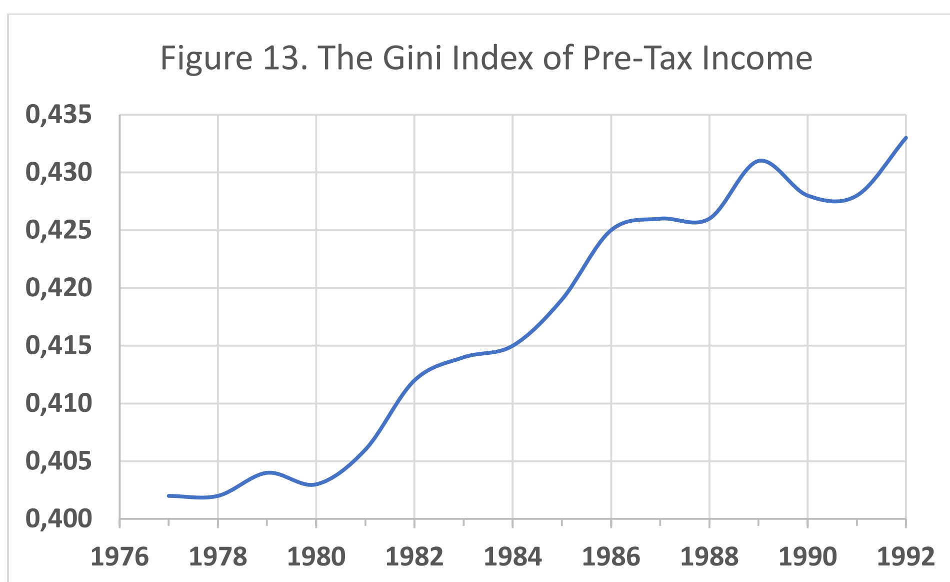
Another turning point came with corporate profits. This was the onset of financialization of the economy as well as the decline of manufacturing. Between 1963 and 1980 the share of corporate profits originating in the financial sector was 15% while the share of manufacturing was 49%.[38] But by the time Reagan left office the upward trend of the former and the downward trend of the latter was well underway (Figure 12 and Table 4). By 2000 the share of profits in the financial sector reached 27% and by 2011 it was 33%, while that of manufacturing sank to 17%. From 49% to 17% and from 15% to 33% was a big change. Financialisation posed a major challange, because while manufacturing shed jobs, the profitable finance sector was unable to absorb the workers released. The combined share of workers declined from 22% to 13% of the labor force.

The Inevitable Rise of an Oligarchy

As Piketty and Saez argue, across-the-board tax cuts invariably increase inequality. The evidence is quite consistent: "a comprehensive empirical analysis shows that there is a systematic and strong negative correlation between the evolution of top tax rates and the

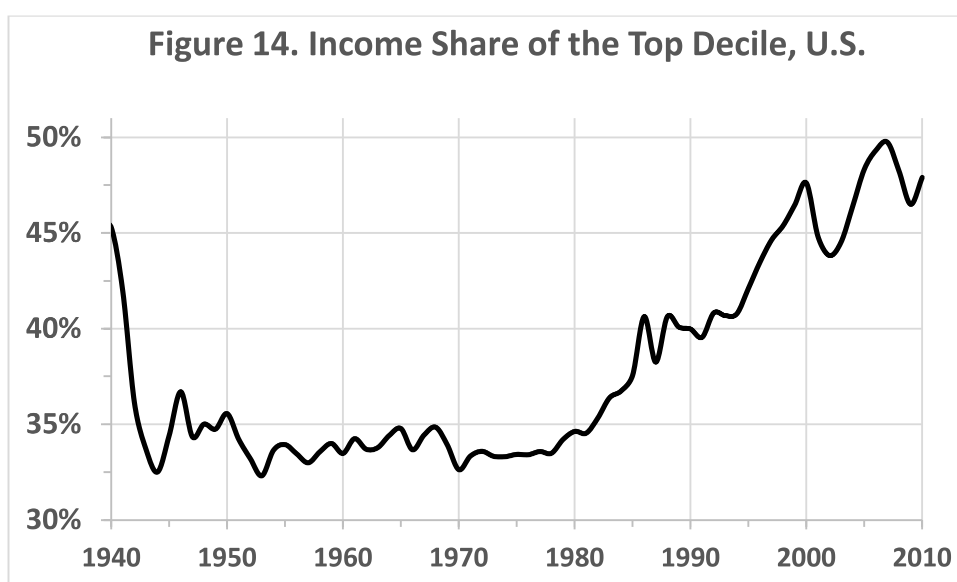
evolution of the pre-tax top percentile income share… In the United States, top income shares are high when top tax rates are low (before the Great Depression and after the Reagan administration) while top income shares are low when top tax rates are high (from the New Deal to the beginning of the Reagan administration). Across countries, there is a tight correlation between the cut in top marginal tax rates since the 1960s and the increase in the top percentile income share…" (2014, S2).

The reason is straightforward: an across-the-board tax reduction brings an immense windfall to those at the top of the income pyramid which they save and invest so that their income will grow substantially in subsequent periods (Table 1). In contrast, the typical worker or employee saves little, if anything, so that the increase in disposal income is inconsequential. It does not earn compound interest and therefore does not increase the growth rate of income. In wake of Reagan's tax cuts millionaires received 100 times as much money as the typical taxpayer (Table 1).



Source: Federal Reserve Bank of St. Louis, "Income Gini Ratio for All Households," series GINIALLRH.

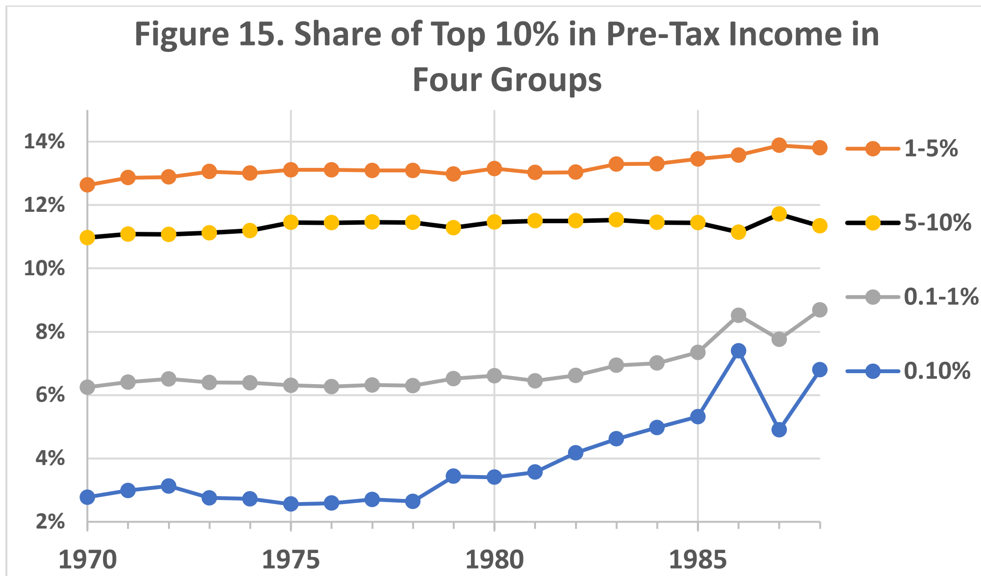
The Gini index summarizes the increase in inequality under the Reagan administration. The index, already high in international comparison, began to climb steeply immediately after the 1981 tax bill (Figure 13). Moreover, although the share of top decile in national income fluctuated somewhat between 1943 and 1981, it remained essentially unchanged at around 34.5%. Then it began to climb steeply and persistently to reach 40.6% by 1988 and 48% by 2010 (Figure 14). In sum, all indicators of inequality show an identical pattern at the top of the iceberg.[39]



Source: (Piketty, 2014, Chapter 0, Figure I.1 and Table TS1.1) http://piketty.pse.ens.fr/files/capital21c/en/xls/

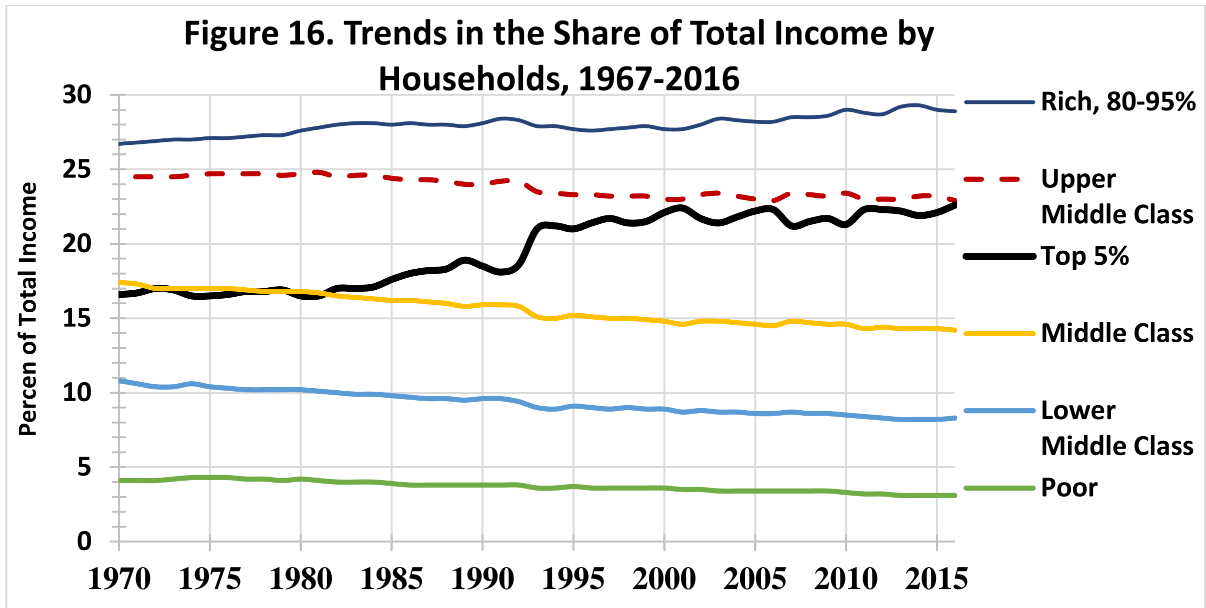
A breakdown of the top 10% into four groups indicates that most of the gains were registered at the tip of the iceberg: among the top 0.1% (Figure 15). Their share of total pre-tax income began to rise immediately, reaching 4.2% already in 1982, a level not seen since 1945. By the end of Reagan's tenure, the top 0.1% doubled its share from 3.4% to 6.8%. The portion of the rest of the top 1%, (from the top 0.1 to the top 1%), also increased by 2.1% but did so slower and started later. The 1%-5% group's share increased by just 0.6%. However, the 5-10% group's share did not increase at all. Hence, it's fair to say that the skewing of the income distribution

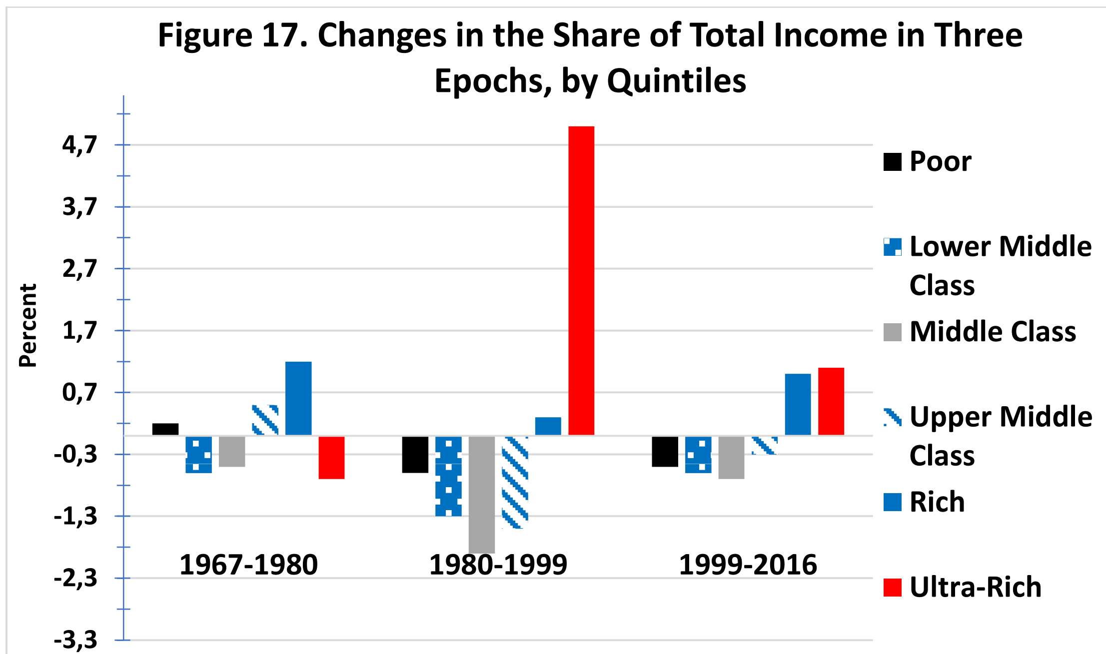
started immediately with Reagan's tax cuts and that absolutely nothing trickled down beyond the top 5% with the exception of the ideology coming from the top that justified their dominant position in society (Veblen, 1899).



Source: (Piketty, 2014, Table TS8.2) http://piketty.pse.ens.fr/files/capital21c/en/xls/

Another way to consider inequality trends is to note that until 1980 the share of income of the superrich (top 5%) equaled that of the middle class (the 3rd quintile) but under the Reagan presidency a wedge began to appear which by the beginning of Clinton's tenure reached 5.9%. All other groups lost share, even the upper middle class, although the rich (80-95 percentile) were at least able to hold their own (Figure 16).

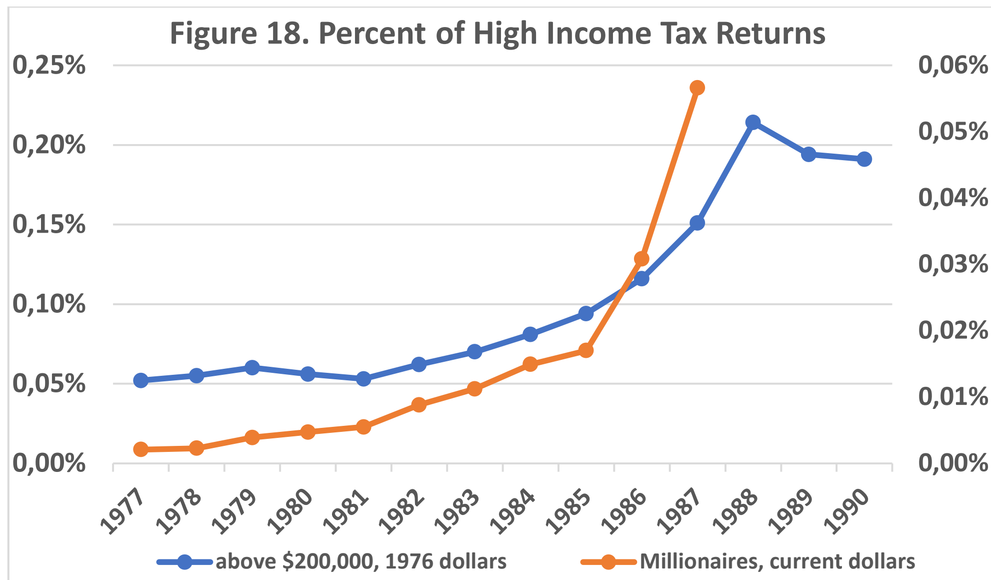




Note: The fifth quintile is divided into the Rich (80-95th percentile) and the Ultra-rich (Top 5%). Source: See Figure 16.

Figure 17 summarizes the changes in the share of total income in six groups and shows that in the 1970s changes were small and still uneven. The rich gained but the ultra-rich did not. However, thereafter only the rich and ultra-rich gained. All other groups lost share. This was particularly pronounced in the 1980s and 1990s for the ultra-rich whose share increased by

almost 5% at the expense of the middle class. The trend continued in the 21st century but at a much-muted rate.



Source: IRS Staff, 1994; and Individual Tax Returns for each year found at: https://www.irs.gov/statistics/soi-tax-stats-archive-1954-to-1999-individual-income-tax-return-reports

Tax returns indicate a similar pattern. The high-income tax returns became a larger share of all returns in the 1980s[40] (Figure 18). High-income is defined here as ones with income above $200,000 in 1976 dollars; so these are inflation adjusted. In 2018 prices that is equivalent to $880,000, which puts them in the top 1%. There is a kink in the trend line in 1982. Between 1981 and 1988 their share increased by a factor of 4. The trend in the number of millionaires (in current prices) also has a kink in 1982 and again in 1986. The large jump was no doubt due to the further reduction in the top tax bracket in 1986 from 50% to 38.5%. Some of the increase was due to the inflation rate but the big jump in the number of millionaires between 1985 and 1987 from 17,300 to 62,000 could not have been due to inflation because the prices increased by only 5.6% between those two years. Their share of total tax returns tripled in these two years. This is indicative of the general pattern of income gains concentrating at the very top of the income distribution.

Conclusion

This essay is an analytic narrative using such social science concepts and categories that are not quantifiable and therefore their relationship is not subject to such statistical analysis (Bates et al., 1998). We argue that a) Reaganomics did not come to an end in 1989 (Friedman, 1990); its legacy continues to the present day; b) it initiated a path-dependent process which would have been difficult to reverse; c) the skewed distribution of income increased the political power of the top 1%; d) they used this power to further their interests which included advocating for laissez-faire economic policies including globalization, financialization, and the IT revolution; e) the rise in inequality increased the frustration of the less skilled and less educated because they were experiencing downward social mobility; f) hence, relative incomes mattered in generating frustration; g) desperate people are easier to manipulate and will do desperate things including voting for an unqualified presidential candidate who promises to end their misery; this is linked to the phenomena of deaths of despair documented by Case and Deaton (2017).

Reaganomics was a watershed in the economic development of the U.S. in the sense that it unleashed powerful path-dependent processes that could be slowed down occasionally but would have been difficult to reverse. It also made it easier subsequently for the forces of hyperglobalization, technological change, and financialization to contribute substantially to the rise in inequality. The argument of this essay is that the kinks in the many graphs above imply that the beginning of the rise in inequality began suddenly in 1981 in response to the tax cuts (Figures 1, 8, 9, 13-16, 18). Furthermore, as a corollary, it is also important to note that the large windfall of the superrich also transferred political power to them. As a consequence, the government was not in a position to defend the economic position of the low-skilled segment of

the labor force by slowing down the rate of globalization or by subsidizing their reskilling costs. The superrich mandated globalization at full speed ahead and did not see any downside of technological unemployment, or of lax oversight of the financial sector. Certainly, they were immune to these forces and they could always invoke the American Dream of rugged individualism (or moral hazard) to maintain and even enhance their position in society and not provide aid to those who were in the lower segments of the totem pole. So, Reaganomics was just one aspect of the forces that led to the frustration of the lower echelons of society. But it was a crucial one.

To be sure one could well argue counterfactually that globalization and technological change would have been destruptive in any event, without Reaganomics. Well, surely these forces were on the horizon but the rate of transformation the U.S. economy could have been at a more measured pace. It was not necessary for globalization to become hyperglobalization and technological underemployment did not have to create despair among the undereducated. Optimal policy could have made sure that they would be Pareto optimal, i.e., that the losers were compensated by the gainers. Hence, the rate and way these transformative processes took place was endogenously determined by the socio-economic forces and political power imbalances determined by Reaganomics.

The general view among contemporary progressive economists was that supply-side economics was a "colossal theoretical failure of Reaganomics" (Peterson 1988, p. 3; Thurow 1983; Ackerman, 1982; Bartlett, 2009; Wilber and Jameson, 1990; Gandhi et al., 1987)). Even a conservative economist such as Feldstein, a strong supporter of Reaganomics, acknowledged as much: "The experience since 1981 has not been kind to the claims of the new supply-side extremists that an across-the-board reduction in tax rates would spur unprecedented growth,

reduce inflation painlessly, increase tax revenue, and stimulate a spectacular rise in personal saving. Each of those predictions has proved to be wrong" (1986, p. 29).[41]

It must have been obvious at the outset even to Reagan's advisors that they were trying to square the circle, as the admissions of David Stockman at the time imply "none of us really understands what's going on with all these numbers" (Greider 1981). He continued cynically, "'The hard part of the supply-side tax cut is dropping the top rate from 70 to 50 percent—the rest of it is a secondary matter,' Stockman explained. The original argument was that the top bracket was too high, and that's having the most devastating effect on the economy. Then, the general argument was that, in order to make this palatable as a political matter, you had to bring down all the brackets. But, I mean, Kemp-Roth [tax bill] was always a Trojan horse to bring down the top rate….' Yes, Stockman conceded, when one stripped away the new rhetoric emphasizing across-the-board cuts, the supply-side theory was really new clothes for the unpopular doctrine of the old Republican orthodoxy" (Greider, 1081).

Reaganomics was not a failure in the sense that it brought economic growth to a standstill; GDP growth remained within normal bounds.[42] Moreover, monetary policy of the Federal Reserve under the Chairmanship of Paul Volcker did bring inflation under control even if at a substantial pain to many. The economy also overcame the consequent recession of 1981 in 16 months but as Paul Krugman noted: "His supply-side advisers didn't promise a one-time growth spurt as the economy emerged from recession; they promised, but failed to deliver, a sustained acceleration in economic growth" (Krugman, 2004). In other words, economic performance in the short-run was bumpy but by no means out of the ordinary.

However, the long-run consequences were extraordinarily harmful because Reaganomics unleashed formidable socio-economic and political forces which eventually had major

detrimental effects. They paved the way to the triumph of Trumpism. The argument is not that Trump was foreordained; it is not that Reaganomics caused Trumpism; however, with path-dependent processes unleashed in 1981 it was much more convenient to continue to accumulate debt, continue to disparage government, continue to decrease taxes, and continue to rely on the market to distribute wealth. The growing number of millionaires also had the financial resources at their disposal to make sure that their dominant position was maintained economically, politically, as well as ideologically. So, the country and its economy was practically locked into the path defined by Reaganomics with seven major negative legacies.

The first was the sudden increase in **inequality** based on permanently lowering the taxes at the very top of the income distribution leading to a dual economy (Figures 8, 13-18) (Temin, 2017). Reaganomics reversed the decline in inequality unleashed by the New Deal and policies during World War II (Lindert and Williamson, 2016; Margo and Goldin, 1992). Nobel Prize winning economist, Joseph Stiglitz, in a section of his book titled "When did we go astray?" argued that the "election of President Ronald Reagan represented a turning point in the United States. Among the precipitating events were the beginning of ...the reduction in the progressivity of the tax system... the policy of lowering taxes at the top.... Then the taxes on forms of income received disproportionately by the rich (capital gains, more than half of which are earned by the top 0.1 percent) were lowered further, under Clinton to 20 percent in 1997 and then under Bush to 15 percent" (Stiglitz, 2013, p. xxxi).

Across-the-board tax cuts supposedly benefit everybody and average citizens can be manipulated by emphasizing that their take-home pay will increase, regardless of its size (Cochrane, 2017; Stanley, 2015; Frank, 2004). While true, the assertion is misleading. For Everyman on Main Street the tax cuts meant absolutely nothing for the improvement of their

long-term prospects (Table 1). On the contrary, it meant that their social services, and access to education, that is to say, their quality of life would diminish plus they would have more difficulty keeping up with the lifestyle of the rich and famous which made them take on excessive amounts of debt. Moreover, it also meant that their relative income declined and with that their political power as well.

The second of Reagan's lasting negative legacies, a consequence of the first legacy, was the beginning of the "**hollowing out" of the middle class** (Kwak, 2017; Palley, 1998). Stiglitz argues convincingly that "President Ronald Reagan began hollowing out the middle class and skewing the benefits of growth to those at the top…" (Stiglitz, 2016). This was clear from the outset. The Harvard economist Benjamin Friedman noted that "the average American family is losing ground, and knows it" (1990). Another commentator wrote, "The erosion of middle-class living standards is well documented, and Reagan's tax reform, which brings relief to the very rich, will make it harder than ever for working-class and lower-middle-class taxpayers to make ends meet" (Lasch, 1988). And so it did. The result was a decline in the savings rate and an increase in the burden of credit. In other words, contemporaries saw through the thinly-veiled arguments and the real political objectives: "to redistribute income and well-being toward the rich and away from the poor; to redistribute health and education and security toward much the same people who would already have enjoyed them before the second World War…" (Rothschild, 1982).

The third of Reagan's lasting negative legacies is **business-friendly regulation** at the expense of workers and consumers, a bias, which, just as the hollowing out of the middle class, lasted with minor interruptions to this day (Faux, 2012; Komlos, 2016a). Stiglitz, argued that "the beginning of the deregulation of the financial sector... led to the excessive financialization

of the economy....The path of deregulation upon which Reagan set the country was unfortunately, followed by his successors." (2013, p. xxxi).[43] Lax oversight of the financial sector and business-friendly politics continued unabated and culminated in the financial crisis of 2008 and the subsequent Great Recession which, in turn, hurt and radicalized millions, thereby strengthening the political forces that led to the rise of Trump (Komlos, 2014).

The fourth enduring negative legacy was legitimizing **deficit financing** of government expenditures until it became endemic. So, Benjamin Friedman was right to be concerned at the outset of Reaganomics that the deficits would become "a permanent feature of the economy's ongoing development" (1983, p. 80). After Reagan it was no longer a taboo. It became the new normal which led to the accumulation of debt in excess of 100% of GDP by 2012, not seen since World War II. It would not have been bad if the deficits had been invested in improving education, repairing infrastructure, expanding basic research, or fostering renewable energy so that they would have provided a return over time, by but they were not. Instead, they were used mainly for the military and for lifting current living standards by increasing consumption. Thus, the deficits did not improve the long-term prospects of the U.S. economy (Sornett and Cauwels, 2014).

To be sure, the increase in the national debt was discontinuous (Figures 5 and 6). However, once the electorate became accustomed to its living standard at the expense of future generations, who had no lobbies in Washington, it would have been nearly impossible to reverse permanently the tendency for debt to accumulate. The well-being of future generations were not on the politicians' or the electorate's mind. "America has thrown itself a party and billed the tab to the future. The costs,… will include a lower standard of living…." (Friedman, 1988).

Admittedly, Reagan himself did try to backtrack a bit and Bush Sr. did raise taxes in 1991 but that affected only the rate at which the deficit was increasing. It still kept on growing relentlessly relative to GDP until 1995 (Figures 5 and 6). Then Clinton did manage to reverse the trend temporarily but, at 55%, the debt ratio still exceeded the level when Reagan left office. However, his successor, Bush Jr., followed in Reagan's footsteps. This was easier to do because the floodgates had been opened by Reagan and the Republican Party abandoned its orthodoxy of fiscal conservatism.

The Bush Jr. tax decreases were made easier inasmuch as experience had showed that the deficits did not pose an immediate insurmountable problem. International financial markets were eager to soak up U.S. I.O.U.s. So, even before the financial crisis erupted in 2008, the U.S. debt ratio reached 64%, climbing back to its previous peak in 1995. Consequently, the U.S. treasury was not well prepared for the financial crisis and the Great Recession that followed during which expenditures increased and revenues declined sharply catapulting the debt ratio to 100% by the 4th quarter of 2012.[44] Then came Trump's tax cuts of 2017 which will exacerbate inequality further (Bump 2017). Politicians failed to see that the Reagan tax cuts did not work, that tax cuts are not the solution to the structural problems faced by the U.S., and adopted the supply-side rhetoric of Reaganomics, adding $1.5 trillion to the debt supported again by economists such as Martin Feldstein and Robert Barro (2017) of Harvard University, some of whom had supported the Reagan tax cuts as well.[45] The same political party, the same arguments, and the same economists supporting it. That was the continuity between the Reagan and Trump tax cuts (Sinn, 2018). To be sure, the road from Reagan's indulging the superrich to Trump's tax bill was not a direct one. There were lulls along the road. However, the spirit is the same, the arguments are the same, and the consequences will be the same as well (Krugman, 2018).

Burdened by this legacy of the past, which generation would muster the courage to put a voluntary end to this process of debt accumulation? They would have to accept a lower standard of living and start paying higher taxes. It is not likely that they would be willing to do so. Instead, they will most likely choose the easy road and pass on this burden to future generations who cannot put up any resistance. That is why Reagan's legacy of debt accumulation, continued by Bush Sr., Bush Jr., Obama, and Trump has catastrophic implications for the future since debt accumultion cannot continue indefinitly.

The fifth negative legacy is the **disparaging of the government** which fostered and legitimized the dominant ideology that it should be eyed with suspicion and "that government has no real capability to solve any of our major problems. It is a theme that the administration and its conservative supporters have been relentlessly drumming into the public consciousness" (Peterson, 1988). This philosophy promoted rugged individualism that was more appropriate for a 19th-century frontier economy than to the one at the threshold of the IT revolution. There was not an iota of recognition that the new economy desperately needed government support to prepare its citizens educationally for this new age. Reagan's was the age of the Marlboro Man, who is independent and does not need to rely on government in any way. So, the government did not need to fund job programs or retraining support. In short, the uneducated, those who had banked on blue-collar jobs and thought that finishing high school was unnecessary, had it rough in the new economy. Instead, the rhetoric of hatred for government tended to turn the society upon itself, thereby permanently fraying the fabric of the social contract. This philosophy endured through the decades and Trump capitalized upon it. The anti-statism captured by the quip "Government is the problem" became more extreme with the "deep state" being the problem and "Drain the swamp!" became the new slogan but the spirit and implications were

quite similar. Another sign of continuity is that the slogan “Make America Great Again“ was also used extensively in Reagan’s campaign of 1980.[46]

Sixth, the tax windfall of the superrich not only led to inequality and to the hollowing out of the middle class but to the rise of an **oligarchy** which (aided by the courts) meant the beginning of the transformation of the political system into a plutocracy (Bartels, 2016; Formisano, 2015; Gilens and Page, 2014; Schlozman et al., 2012; Hacker and Pierson, 2016; Mann and Ornstein, 2012; Page and Gilens, 2017). The windfall of millions of dollars strengthened immensely the vested interests that Mancur Olson had warned us about and put them in a position to overpower the society, its economy, and its politics (1982, p. 42). So, the corporate world and the superrich accumulated immense financial resources with which they formed distributional coalitions to manage the free-enterprise system to their advantage and lobbied for more legislation to lower taxes further, to continue to enact business-friendly regulations and thereby gain additional economic and political power (Komlos, 2016b). Stockman conceded as much cynically: “’weak clients’ suffered for their weakness…. ‘unorganized groups can’t play in this game’” (Greider, 1981).

In contrast to the typical taxpayer, for millionaires the Reagan tax cuts were a genuine game changer (Table 1) (Galbraith, 2008). They used their windfall strategically to further their economic and political power (Bartels, 2016). Sure, they might speculate on the stock market or increase their conspicuous consumption but the smart money invested much of the windfall into strengthening their political power by lobbying for deregulation and by funding think tanks that hired economists to support their ideology (Burch, 1997).[47] This was crucial in spreading the free-market ethos that advocated small government, free trade, and deregulation until it became

the dominant ideology (Smith, 2010).[48] Everyman on Main Street was no longer capable of discerning their own self-interest and came to support the interests of the superrich.

The seventh adverse legacy is Reagan‘s **benign neglect of blue-collar workers** (the Reagan democrats) whose support brought him to the White House in the first place. They were the less-educated low-skilled segments of the lower-middle class who were vulnerable to the decline of economic vitality in the Rust Belt. Until then the unions provided some countervailing power and the government provided them some relief and protection too. “Each year during President Carter’s term in office about 4 million economically disadvantaged persons received training and job opportunities under the Comprehensive Employment and Training Act alone” (Marshall, 1981). But Reagan cut funding for training programs drastically from $22 billion to $8 billion (Bartels, 2016, p. 52). And those who were hurt had nowhere to turn. They dropped out of the labor force by the millions and collected disability payments (Charles, Hurst, and Notowidigdo, forthcoming). Even the federal minimum wage, which buoyed up the income of those whose hourly wage was just above it, declined precipitously and failed to recover thereafter to the level of the late 1960s.

In other words, less than nothing trickled down to the masses. The rich and the super-rich kept all the benefits to themselves. These same blue-collar workers received attractive promises by subsequent administrations as well: they were tempted by other across-the-board tax cuts which, however, did not help those who were paying little or no taxes to begin with; they were attracted by the promises of trickle-down economics that failed to trickle and the benefits from the elimination of regulations and waste did not reach them; globalization was portrayed as a great stride forward but instead plants were closed and their jobs exported. All these developments were supposed to have made Americans better off and they did make many

Americans better off but the blue-collar folks had to fend for themselves, although they did not have many resources to lean on. Many of them took their own life (Case and Deaton, 2017). No wonder that they were disappointed enough to revolt against the establishment and take their chances with a self-proclaimed genius with extravagant promises, however implausible.

Reaganomics was followed by the one-two punch of hyperglobalization and skill-biased technical change that accompanied the IT revolution. Suddenly, a high school diploma no longer sufficed for even a lower-middle-class income. Obviously, this added to labor's considerable frustrations especially that of the less educated. Technological change increased the demand for skills and the employees released from manufacturing and manual labor were unable to find employment in the expanding sectors. For example, the number of employees in computer-related occupations rose from 450,000 in 1970 to 4.6 million in 2014 but 22% of them had at least a master's degree (Beckhusen, 2016.). So, laid off textile workers did not have a chance to find employment in the expanding IT sector. Consequently, the increased demand was met by importing foreigners: a quarter of the 4.6 million employed in IT were born outside of the U.S. Hence, technological unemployment no doubt contributed to the anxiety of the same low-skilled segment of the workforce neglected by Reaganomics and hurt by hyperglobalisation. Downward social mobility radicalized many of them and turned them against the system.

It is necessary to note that neither hyperglobalization nor the IT revolution appeared suddenly in 1981. They unfolded slowly over time and their main impact came later. NAFTA came into being in 1994, the World Trade Organization in 1995, and China did not join the WTO until the year 2000. Hence, the share of imports stood at 9.5% of GNP between 1981 and 1986 only in 1987 it did climb slightly to 10.4% and stayed at that level until 1993.[49] Thereafter the real increase began: by the year 2000 it was 14.3% and by 2008 it peaked at 17.2% a multiple of

what it was under Reagan's first term. Similarly, the IT revolution was in its infancy in the 1980s. For instance, merely 15% of U.S. households had a computer in 1989.[50] Hence, the fact that wages, and so many other variables discussed above, turned suddenly in the negative direction in and around 1981, can only be ascribed to the sudden change in economic policy at the outset of the Reagan era.

We are well aware that *post hoc* is not *ergo hoc*, but it would be rather surprising if the abrupt changes in trend represented by the kinks in innumerable variables immediately following Reagan's tax cuts would be a mere coincidence. Admittedly this essay does not answer the important question how much did one or another of these socio-economic forces contribute to the hollowing out of the middle class. That remains to be done, but it is another question from the one posed in this essay the focus of which is to document that the process began in 1981. The economy "turned on a dime", as it were. And once the hollowing-out process began it was easier for the other forces to exert their impact.

While the deleterious consequences of Reaganomics were obvious to contemporaries, that its long-run path-dependent impact would be irreversible was less so. Benjamin Friedman came close when he noted that, "the Reagan legacy—the consequence of having sustained that imbalance for so long—is still very much with us. By now the objective realities created by an entire decade of over-borrowing and under-investing, including especially the shrinking supply of 'good' jobs and the parallel failure of the average worker's wage to keep up with inflation, are familiar enough" (1990). Janet Yellen, future chair of the Federal Reserve, had similar premonitions: "the tab for throwing a deficit-financed party may not come due for decades" (1989). Well, it took two decades for the financial crisis and three for the triumph of Trumpism (Komlos, 2018). So, her prognosis was of the right order of magnitude.

Thus, from a very-long-run perspective Reaganomics was more than the failure noted by many contemporaries; it came close to being catastrophic because it unleashed tectonic forces that frayed the social fabric, the body politic, and the structural health of the economy. These forces had such a long reach that we can discover in them the roots of the current socio-economic malaise and the political dysfunction associated with the rise of Trump, himself an oligarch surrounded by oligarchs and generals.

Hopelessness is a mighty political force and therefore it should not be so surprising that after the failed promises and benign neglect of three Republican and two Democratic administrations spanning a third of a century, the have-nots came to believe that only a strongman will change the course of the ship of state. The uneducated, those who experienced the alienation of downward social and economic mobility, or the disappointment of wage stagnation for a generation while others were living the lifestyle of the rich and famous, those who were clobbered subsequently by the tsunami of hyperglobalization, and those who were evicted from their homes while the Lords of Finance were being pampered, were ripe to revolt and turn against the establishment elites (Turchin, 2016; Goldstone, 2016). Trump was able to harvest the anger of those who reached for the American Dream and found a nightmare instead (Gilbert, 2016; Smith, 2012). We conclude that the path to that nightmare began in 1981 with the deleterious policies of the Reagan administration which unleashed the "darkest spirits of capitalists" (Rothschild, 1982).

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Endnotes

[1] Federal Reserve Bank of St. Louis, Consumer Price Index: Total All Items for the United States, series CPALTT01USA659N.
[2] Federal Reserve Bank of St. Louis, Effective Federal Funds Rate, series FEDFUNDS.
[3] From $20,000 in 1973 to $21,700 in 1980 in 2012 dollars. Federal Reserve Bank of St. Louis, Real Disposable Personal Income: Per Capita, series A229RX0Q048SBEA.
[4] Federal Reserve Bank of St. Louis, Real gross domestic product per capita, series A939RX0Q048SBEA.
[5] Dubbed the horse-and-swallow theory: "If you feed the horse enough oats, some will pass through to the road for the sparrows" (Galbraith, 1982).
[6] The consumption tax Laffer curve does not have a peak at all, implying that the tax can be increased without decreasing revenue. The 83% bears an uncanny similarity to modern estimates which suggest that the income tax rate could be as high as 70% without having a negative effect on either revenues or output. (Trabandt and Uhlig, 2011, p. 314).
[7] [7] Federal Reserve Bank of St. Louis, Personal saving as a percentage of disposable personal income, series A072RC1A156NBEA.
[8] Federal Reserve Bank of St. Louis, Real Gros Private Domestic Investment, series GPDICA.
[9] Besides the deficits, another reason why investments were not accelerating was the excess industrial capacity. Capacity utilization was generally falling and peaked at 86.7% under Carter but under Reagan the peak was slightly lower at 85.2%. Federal Reserve Bank of St. Louis, Capacity Utilization: Total Industry, Series TCU.
[10] Federal Reserve Bank of St. Louis, Real Gros Private Fixed Investment Nonresidentail, Equipment, series Y033RX1A020NBEA.
[11] Federal Reserve Bank of St. Louis, Real Gross Private Domestic Investment, Series GPDC1.
[12] Federal Reserve Bank of St. Louis, Total Credit to Households and Non-Proft-Insttitutions Serving Households, Series QUASHAM770A.
[13] Board of governors of the Federal Reserve System, "G. 19, Consumer Credit Outstanding: Revolving," https://www.federalreserve.gov/releases/g19/HIST/cc_hist_r_levels.html.
[14] Federal Reserve Bank of St. Louis, Average Annual Hours Worked by Person Engaged for United States, Series AVHWPEUSA065NRUG.
[15] Federal Reserve Bank of St. Louis, Civilian Labor Force Participation Rate: Men, series LNU01300001.
[16] That did not keep him from airing "Its Morning in America Again," advertisement during his reelection campaign that was silent on the unemployment rate; https://www.youtube.com/watch?v=EU-IBF8nwSY.
[17] Federal Reserve Bank of St. Louis, Civilian Unemployment Rate, series UNRATE.
[18] Underemployed include discouraged workers, those who would like to work but have not searched within the last month, and part-time workers who would like to work full time.
[19] In 2016 dollars. U.S. Census, Historical Income Table P36. Full-Time, Year-Round Workers by Median Income and Sex. Weekly earnings show the same pattern. Federal Reserve Bank of St. Louis. "Employed full time: Median usual weekly real earnings." U.S. Department of Labor, Bureau of Labor Statistics, Weekly and Hourly Data from the Current Population Survey, Series ID LEU0252881900, http://www.data.bls.gov/cgi-bin/surveymost?le. The difference between the

two data sets is that for weekly wages the worker does not have to be employed the whole year to be included in the sample.

[20] This labor's share includes the increasing income of executives, because it is also considered labor income, even though most of it is rent coming out of profits. So, the actual worker's share must have declined by even more than the 1.4% implied.

[21] Dividing the average annual income of men and women of $24,000 by 52 yields $460 of income per week.

[22] White House Report on the Program for Economic Recovery, February 18, 1981. http://www.presidency.ucsb.edu/ws/index.php?pid=43427; Federal Reserve Bank of St. Louis, Real Gross National Product, series GNPCA; and Real Gross National Product Per Capita, series A791RX0Q048SBEA.

[23] During the expansionary phase of the business cycle real GDP grew at 4.2% per annum whereas under Ford/Carter it grew at 4.4% (Leamer, 2001, p. 6).

[24] Federal Reserve Bank of St. Louis, Total Public Debt, series GFDEBTN and "Federal Surplus or Deficit," series FYFSD. Congressional Budget Office, Supplements to The Budget and Economic Outlook: 2014 to 2017," Historical Budget Data, February 2014; https://www.cbo.gov/about/products/budget-economic-data.

[25] Military expenditures increased during Reagan's administration by $805 billion. Congressional Budget Office, Supplements to The Budget and Economic Outlook: 2014 to 2017," Historical Budget Data, February 2014; https://www.cbo.gov/about/products/budget-economic-data.

[26] The value of the dollar increased from 1.8 Deutsche Mark in 1980 to 3.3 DMark in 1985. Federal Reserve Bank of St. Louis, series EXGEUS.

[27] "What is extraordinary about the U.S. government deficits projected for 1984-88, therefore is not just that they will be large but, more importantly, that they will represent a fundamental imbalance between the government's revenues and its expenditures…. [They] are increasingly deficits at full employment." (Friedman, 1983 p. 80).

[28] American Taxpayer Relief Act of 2012.

[29] There were other non-economic developments that made many voters susceptible to Reagan's message including the reaction to the Supreme Court's decisions Brown vs the Board of Education and Roe v. Wade coupled with the Civil Rights movement which lost the South to the Democratic Party and by the 1970s energized the right wing of the Republican Party, as well as the evangelicals (Hacker and Pierson, 2010; Mayer, 2016; MacLean Nancy, 2017).

[30] Trumpism differs from this in that it does not have such intellectual roots and is more of an ad-hoc approach to economic populism with an authoritarian political bent.

[31] Volatility also increased in the financial sector culminating in the crash of 1987 (Chen, 2010).

[32] However, the tax-rate reduction affected only the top 0.5%; the tax rates of the other half of the top 1% actually increased (Pikkety and Saez, 2007, Table 2).

[33] The data are at: https://eml.berkeley.edu/~saez/.

[34] Moreover, the top 0.01% of income recipients have the exact same trend but the rest of the top 1%, i.e., those between the 99th and 99.9 percentiles began to climb three years later.

[35] "The PATCO strike signalled a profound decline in organized labor's power in the late twentieth-century United States" (McCartin, 2007, p. 1126).

[36] Ibid.

[37] Bureau of Labor Statistics, "Table 1. Union affiliation of employed wage and salary workers," https://www.bls.gov/webapps/legacy/cpslutab1.htm accessed September 17, 2017.
[38] Without considering profits originating in the Federal Reserve Banks and profits from overseas. The latter are not stratified by industry.
[39] It is not a coincidence that Ivan Boesky proclaimed that "Greed is good" in 1986 (Dickerson, 1993). One of the episodes of a CNN miniseries on the "Eighties" aired in 2016, was titled "Greed is Good." Hence, Reaganomics also affected the culture and arguably increased the degree of greed leading to the large increase in CEO salaries.
[40] The number of earners above 200K is greater with expended concept of income such as plus tax exclusions. IRS, "Individual Income Tax Returns," 1982, p. 103; https://www.irs.gov/statistics/soi-tax-stats-archive-1954-to-1999-individual-income-tax-return-reports
[41] He forgot that he was a fervent advocate of those policies himself while Chair of the Council of Economic Advisers and that he continued to support the similar Trump tax cuts (Feldstein, 2017).
[42] Alternative policies that envisioned rescuing the Rust Belt through a Reconstruction Finance Corporation was not given ample consideration (Rohatyn, 1981).
[43] Quotation is from the 2013 paperback edition.
[44] Federal Reserve Bank of St. Louis, series, GFDEGDQ188S.
[45] And 137 other economists. CNBC, 2017. "An open letter to Congress signed by 137 economists supporting GOP Tax reform bill." November 29.
[46] The only difference was that Reagan inserted the word "Let's" in front of the slogan. Wikipedia Contributors, "Make American Great Again."
[47] They also invested heavily in academia (Ravitch, 2017).
[48] For the damage done by the war on government see Hacker and Pierson (2016).
[49] Federal Reserve Bank of St. Louis, series IMPGSA and series GNPA.
[50] statista, "Percentage of households with a computer at home in the United States from 1984 to 2010."