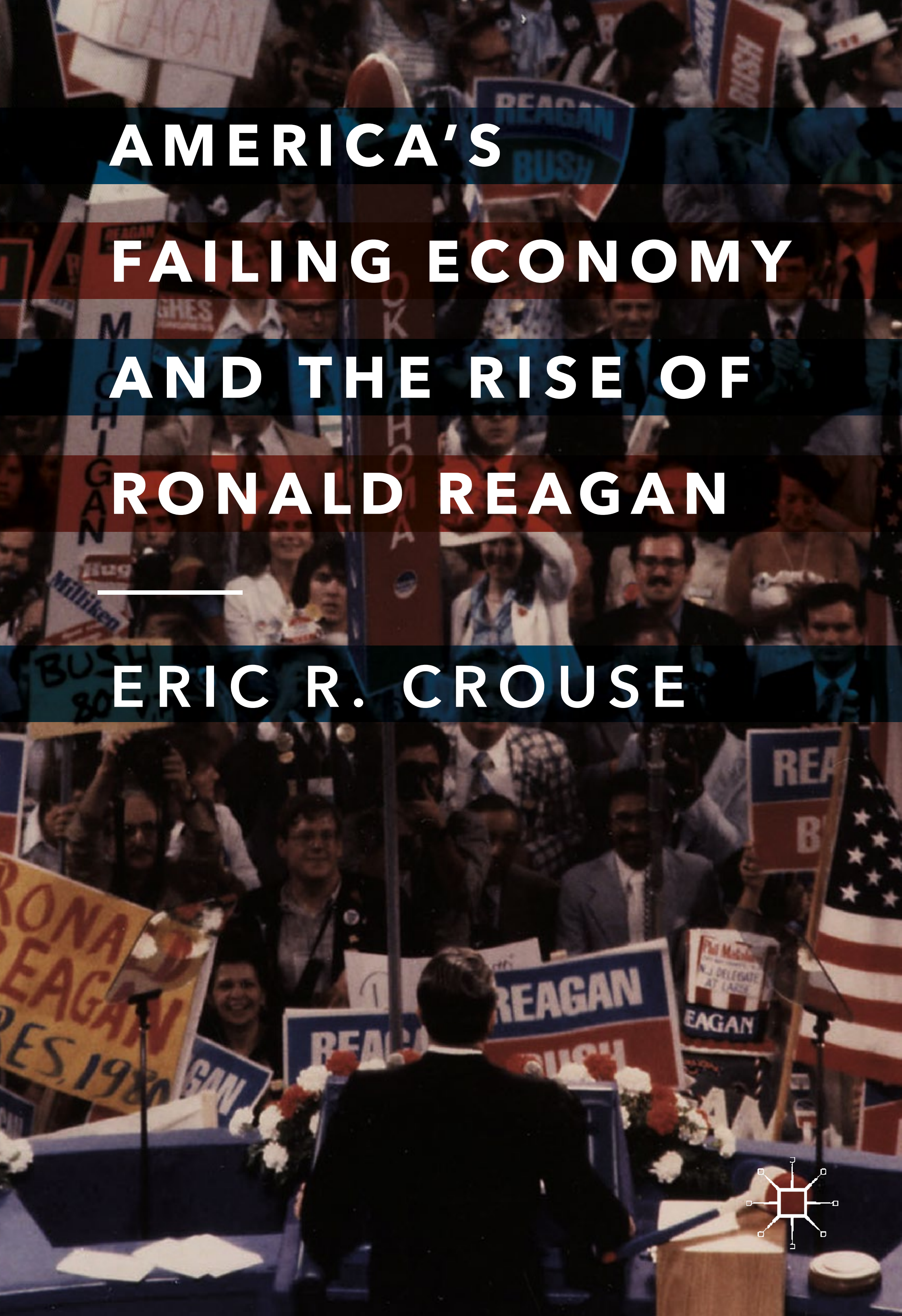

AMERICA'S FAILING ECONOMY AND THE RISE OF RONALD REAGAN

ERIC R. CROUSE

America's Failing Economy and the Rise of Ronald Reagan

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In memory of David George Ellis (1936–2016)

Preface

When I graduated from high school in 1978, I had no clue about stagflation. As I pursued my dream of racing professional motocross, I did not think of the stagnant economy and high inflation that made it difficult for young people to find good-paying jobs. Often on the road in the years 1979 and 1980, I witnessed the high inflation that contributed to the rising cost of gasoline and high interest rates. It was no fun taking a financial hit when I could only pay the minimum monthly credit card payment. I had assumed all this was normal. It was probably a good thing that I was unaware of how bad the economy was, and how a Keynesian mindset often steered the economy in the wrong direction with fewer employment opportunities. After my motocross career was over by the mid-1980s, I had more time to think about the economy and decisions by leaders who favored politics over economics.

It was only about 10 years ago, however, that I began the process of focusing on economics in my academics. My first book on economic history, published in 2013, was on Reaganomics during the 1980s. Writing about President Reagan's economic policies was exciting, but I realized that I needed to say more about the pre-1980 period. This book, *America's Failing Economy and the Rise of Ronald Reagan*, examines those earlier years and attempts to explain Reagan's window of opportunity to win the White House. The story is about the demise of Keynesianism (1965–1980) as it failed to solve the stagflation that caused many Americans to suffer economic hardship.

I have a passion for reading economic theory and engaging in discussions with anyone who enjoys talking economics, but I find the focus of economic specialists is often too narrow to capture the interest of most students who do not have a background in economics. This is not a book written primarily for economists. Focusing on the big picture, I have avoided technical jargon and attempted to demonstrate that economic history can be very interesting. My approach was to harvest the work of many economists, politicians, and journalists and to see what type of composite would emerge.

Toronto, ON, Canada Eric R. Crouse

Acknowledgments

I have benefited greatly from numerous discussions with Derek Chisholm who teaches economics at Tyndale University College. Given my fascination with the writings of John Maynard Keynes and the Keynesian literature that followed, it was a bonus that Derek's Ph.D. in economics is from the University of Cambridge—the academic home of Keynes. I appreciate his feedback on the early chapters of this book. The comments by the two anonymous readers were also excellent. They prompted me to explain some statements better and to include the research of important books that I had missed. Of course, I am fully responsible for any mistakes in this book.

Palgrave Macmillan has an impressive history of publishing major economics works, and Keynes's majestic *The General Theory of Employment, Interest, and Money* is one of many examples. I am thankful for editor Megan Laddusaw and her assistant Christine Pardue. Their level of professionalism and politeness has been great.

I am also grateful for my wife's proofreading. Ann-Marie is an English high school and journalism teacher who has done an amazing editorial job, year after year, with her school's yearbooks. A book's index requires much work, and I depended heavily on the assistance of my daughter Emily.

This book is in memory of David George Ellis, a wonderful father-in-law and friend who we miss very much.

Contents

Abbreviations

AEI	American Enterprise Institute
AFDC	Aid to Families with Dependent Children
AFL-CIO	American Federation of Labor–Congress for Industrial Organization
AFSCME	American Federation of State, County and Municipal Employees
CBO	Congressional Budget Office
CEA	Council of Economic Advisors
CETA	Comprehensive Employment Training Act
COWPS	Council on Wage and Price Stability
CPI	Consumer Price Index
DOE	Department of Energy
EPCA	Energy Policy and Conservation Act
EPG	Economic Policy Group
FAP	Family Assistance Plan
FCC	Federal Communications Commission
FEA	Federal Energy Administration
Fed	Federal Reserve
FEO	Federal Energy Office
GNP	Gross National Product
HEW	Department of Health, Education, and Welfare
HUD	Department of Housing and Urban Development
JEC	Joint Economic Committee
MIT	Massachusetts Institute of Technology
NEPA	National Environmental Policy Act

NHI	National Health Insurance
NRA	National Recovery Administration
NWRO	National Welfare Rights Organization
OMB	Office of Management and Budget
OPEC	Organization of Petroleum Exporting Countries
PBJI	Program for Better Jobs and Income
SDS	Students for a Democratic Society
UMWA	United Mine Workers of America
URPG	Urban Regional Policy Group
WIN	"Whip Inflation Now"

CHAPTER 1

Introduction

Three weeks before the presidential election of 1980 the polls had President Jimmy Carter and Republican challenger Ronald Reagan dead even in the popular vote poll. Political journalist Elizabeth Drew described the intense buildup for the upcoming televised election debate as "the world heavyweight championship and the Super Bowl combined." Would one of the contenders make a major blunder? On debate night, Carter's eyes were puffy and tired-looking whereas Reagan, 69, appeared "to be in robust health." Success for Reagan hinged on his ability to convince American viewers that he was not an angry, "dangerous" conservative. Under the lights and in front of the cameras, his easygoing manner did the job as did his closing question to the American people concerning the state of the economy: "Are you better off than you were four years ago?"[1]

Carter had genuine concern for those hurt by a floundering economy but were his economic policies the answer? The American people gave their verdict. On November 4, 1980, the United States witnessed the political defeat of Jimmy Carter and the policy defeat of Keynesianism. The Keynesian Revolution had continued uninterrupted for close to four decades in America, struck down when voters responded to the failure of their economic managers to deliver economic growth and price stability.

The election results questioned Keynesian economics that said active government intervention and management of the economy was essential for the economic well-being of society. In the final year of Carter's administration, economists Robert L. Heilbroner, John Kenneth Gailbraith, and

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other Keynesians saw higher taxation, comprehensive regulation, and price controls as the correct method to solve America's economic woes. Many had benefited from the economic stewardship of Democratic presidents Harry Truman, John F. Kennedy, and Lyndon B. Johnson, but the economic malaise of Jimmy Carter's administration was another matter. It was a major reason for his political trouncing; he won only 6 states to Ronald Reagan's 44. The weakening of Keynesianism allowed Reagan to reach the White House.

There is much literature on Carter's failure to unite the Democratic Party, disentangle the Iranian hostage crisis (1979–1981), and win the votes of the Religious Right who were generally supportive of free-market thinking—a fact missed by scholars more interested in the social conservative opposition to Carter.[2] Although acknowledging that all these issues were important to Reagan winning the White House, this book focuses on the economic shortcomings of Carter's policies that were decisive in presenting the former actor a window of opportunity.

Politicians, political pundits, journalists, and Main Street Americans all responded in various ways to the record of Keynesian macroeconomic management and the emergence of stagflation—that is, persistent high inflation and high unemployment.[3] For this transformative era, there was a colorful cast of characters, some with economic expertise and many others without economic schooling. If few commentators were aware of the finer points of Keynesian economics, they all recognized "malaise."

I

One only had to look at the post-World War II years to the mid-1960s to find evidence of a vibrant American economy and a sense of optimism at what government could achieve. With noble intentions, politicians devised policies to improve the lives of the poor and the middle class. But something changed during the 1970s—a change that Carter completely missed. Several weeks after his defeat by Reagan, he wrote in his diary that Republicans exaggerated the problems of the economy. As he saw it, "with the exception of interest rates, everything is going surprisingly well."[4] An economic history of the rise and decline of Keynesian ideas explains much about competing visions on the role of the government and the major shift in economic thinking that few envisaged.[5]

The high mark of Keynesianism was during the 1960s. On the issues of inequality and poverty, many had faith in the government—more so than at any other time in history—to find solutions. Before President Lyndon Johnson's "Great Society" programs began to tarnish, there was much confidence in government intervention. Progressive Americans viewed centralized economic planning as the reason for the Soviet Union's transformation from a primitive peasant nation. Basically, a handful of experts could "substitute their judgment for the billions and trillions of decisions that go on in a free market." Keynesianism was not socialism, but both shared the idea of using central planning to "correct" the free-market system.[6]

American intellectuals found European economic ideas appealing. As a better way to protect the public from difficult economic times, Western European countries and elsewhere viewed "government knowledge" superior to "market knowledge." Careful not to completely stifle the market, Western governments sought to modernize and "propel economic growth" while delivering "equity, opportunity, and a decent way of life." Most citizens approved. In 1945, British voters, not wanting a return to the economic hardships of the 1930s, replaced Winston Churchill, their victorious war leader, with social worker Clement Attlee, head of the Labour Party that promised an expansive welfare state.[7]

In the United States, high-ranking officials in government saw that policy drove the budget rather than the budget driving policy; thus, it was more important to get government policies through than make them effective.[8] This was especially true for the 1960s. Government was to intervene in the economy, and it was not only Democratic leaders who acted. Republican President Richard Nixon saw that voluntary price and wage targets were ineffectual, and he believed that the American economy was stronger when government interference was minimal. Yet, to the dissatisfaction of conservatives, he went ahead with wage and price controls in 1971, causing economic problems for the rest of the decade. He also allowed economic regulation to thrive in other sectors. With both Democratic and Republican presidents, America had its own special "brand of regulatory capitalism."[9]

Pursuing the 1976 Democratic nomination for president in a strong field of competitive candidates, former governor of Georgia (1971–1975) Carter, mastered the technicalities of the political process and won the nomination. On the campaign trail against President Gerald Ford, who narrowly defeated Reagan for the Republican nomination in August, Carter promised integrity and openness. The memory of the traumatic Watergate crisis was still fresh for many and Ford's economic record was not great. With his victory over Ford in November, the former naval engineer and self-identified "planner" appeared to have the skills to fix America's most pressing economic problems.

On the issue of economics, Carter did not start on a good footing. As president-elect, he decided it was a good idea to congratulate by phone the American Nobel laureates of 1976, including economist Milton Friedman (1912–2006)—the most influential free-market scholar in America. Friedman's scholarship and mentorship at the University of Chicago, and a *Newsweek* column on economic matters over the years, put him in a special category; he was a scholarly economist able and willing to present insightful analysis in layman's terms for people outside of the field of economics. When Carter told his secretary to call Friedman in December 1976, however, she contacted the wrong Milton Friedman and got the speechwriter with the identical name who had served President Ford. After the mistaken identity episode, Carter finally talked with the correct Friedman; it was their only direct contact ever.[10]

Having faith in Keynesian management of the economy, President Carter and his economic advisors saw no benefit in consulting the free-market Nobel laureate who saw government intervention as more of a problem than a solution. In the summer of 1979, when the White House invited many commentators to Camp David to discuss the malaise with Carter, there were no notable economists with new ideas, and certainly no one with ideas like Friedman's.

Friedman was a formidable critic of Keynesianism and its central idea that free-market economies were inherently unstable, requiring continuous active government intervention. His monetary theory tore down the mainstream consensus that economies required government management to succeed. His grasp of economic theory and history alongside his evidence-based arguments for free-market policies were obvious to anyone paying attention to his *Newsweek* column that began in 1966. With decades of research and university teaching under his belt, the mild-mannered, five-foot Friedman wrote with authority when he targeted the economic shortcomings of Carter's administration. He was a dynamic ball of energy who made people think with his "bewildering array of questions, statements, and relentless logic." He was an "intellectual's intellectual" who went beyond abstractions.

Economist Martin Anderson wrote: "There are many intellectuals who care only for the abstractions they glory in, not the people the abstractions represent. Friedman is driven more by what ideas and policies do to and for people than the theoretical beauty of an argument."[11] With a Jewish immigrant background (both parents were from Europe) and humble origins, his demeanor was not of someone who appeared heartless, only concerned about defending the rich. Friedman's ability to statistically evaluate the evidence on Keynesian policy shed light on government's inability to solve the brutal problem of stagflation. The destructive combination of a stagnant economy (high unemployment) and rising inflation was a heavy burden on the American people during the 1970s.

Other free-market (conservative/libertarian) economists joined in the criticism as the nation struggled with the 1970s' dismal economic conditions.[12] Arguably the most influential American free-market economist after Friedman, at least at the popular level, was Arthur Laffer—a supply-side "showman" known for his Laffer curve, which illustrated the adverse effect of high taxation on productivity and wealth creation. He was of the school that viewed high taxation as a retarding force on economic growth. A graduate of Yale University, Laffer did his graduate studies in economics at Stanford University where he distinguished himself as "one of the brightest students they ever had."

The University of Chicago hired Laffer in 1967 and he worked closely with economics Professor Robert Mundell, a Canadian citizen and reclusive gentleman who many have since acknowledged as "the godfather of modern supply-side economics."[13] Mundell and Laffer teamed up and studied the effects of taxation. In fact, Laffer popularized the work of Mundell, a future Nobel-Prize winner. Building steam in the late 1970s with its emphasis on tax cuts, the "Mundell-Laffer Hypothesis" poked holes in Jimmy Carter's Keynesian attempts to fix the economy.[14]

Even economist Paul A. Samuelson, the Keynesian Nobel-Prize winner who wrote a *Newsweek* column on alternating weeks to Friedman's column showed less enthusiasm for Carter's performance. Under the prevailing Keynesian paradigm, stagflation was supposedly a theoretical impossibility. The Carter years exposed many to the intellectual shortcomings of Keynesian thinking.

II

For analysis of the macroeconomic disappointments of the 1970s, economist Thomas Sowell's identification of two major visions is helpful, each one with a specific framework of assumptions, which dominated the political landscape in the post-World War II period. There were those confident in the human capacity to solve problems with sweeping schemes. Decision making used "the special talents and more advanced views of the few."[15] In America, political economist Alvin H. Hansen of Harvard University became the "leading proponent of Keynesianism," influencing countless students and future high-ranking officials. For three decades after his arrival at Harvard in 1937, Hansen expected the federal government to manage the economy with proper tax and spending decisions.[16] Economist Lester C. Thurow was one of many who demanded government action, arguing in a 1977 *Newsweek* article that the state needed to go further with planning and spending.[17] Both moderate liberals and progressives were confident about such government action.[18]

There was a great deal of faith in government planning and conservatives seldom experienced victories when they presented empirical evidence that pointed to the difference between the noble intentions of liberals and actual outcomes. Sowell argued that the progressive vision was "dangerously close to sealing itself off from any discordant feedback from reality." Supportive of those favoring government planning, much of the media and academia reassured those confident in government effectiveness that they were "morally on a higher plane."[19]

As Sowell saw it, in contrast to the vision of expert management of the economy were those who saw economic "tradeoffs" as the norm, which unfortunately could never satisfy the wishes of all parties. Known as the father of economics, Adam Smith (1723–1790) warned of the doctrinaire who "seems to imagine that he can arrange the different members of a great society with as much ease as the hand arranges the different pieces upon a chess-board."[20] The vision critical of progressivism held that human nature placed restrictions on idealistic schemes. There were people problems, linked to personal choices, unfixable by any amount of government programs and spending. Opponents of progressivism warned of the limitations of any elite group's attempt to "legislate bliss."

Free-market economist Friedrich Hayek wrote: "Compared with the totality of knowledge which is continually utilized in the evolution of a dynamic civilization, the difference between the knowledge that the wisest and that which the most ignorant individual can deliberately employ is comparatively insignificant." Looking back in history one could learn more from "the experiences of the many, rather than the articulated rationality of a talented few." When Hayek received the Nobel Prize in economics in 1974, he drove this message home in his acceptance speech.[21]

For Hayek and others who questioned the less activist position came charges that they lacked compassion. With its government programs, the

Democratic Party saw itself as the party for the poor. Was it not the party of the people contrasted to the Republicans as the party of the rich? Joseph A. Califano Jr., Jimmy Carter's Secretary of Health, Education, and Welfare (HEW) sought "to prove that HEW can be run, that those Great Society programs can work." Demonstrating what government could achieve was vital, Califano wrote to Carter, "because there are still in this nation millions of people whose needs can be met only by Government—and they are the most vulnerable among us."[22] To *Newsweek* readers, conservative journalist George F. Will pointed out that "[t]here is nothing gray about Califano, whose mind is a rainbow of redistributionist plans."[23]

The Keynesian approach of managing the economy to achieve full employment and low inflation appeared to be the only moral option; thus, free-market rivals were at a disadvantage in articulating that they too desired improvement for all citizens. Democrats pointed to the "greed" and "mean-spiritedness" of conservatism. Conservative economists were critical of some of Nixon's policies, but he understood the difficulties they faced with the promotion of free-market ideas: "Conservatives are always at a disadvantage when speaking about economics because their belief that some pain may be necessary now to save the patient later is conventionally interpreted by liberal politicians and commentators as 'heartlessness' or 'callous indifference to human suffering.'"[24]

Conservatives rarely scored points with their arguments that the focus of tax-and-spend politicians was on the next election not the next generation. They lamented that most journalists, society's so-called whistleblowers, seldom questioned whether progressive policies were effective in improving the economy. If there was acknowledgment of a government policy not working, often the solutions were more government spending, smarter management, or some tinkering. Of course, there were some business leaders who hardly helped the conservative cause. There were real people struggling with low-paying jobs and indifferent bosses who seemed to care more about company profits than employee morale. The employers who were uncaring about workers or appeared to be ruthless, often diverted attention from an objective assessment of policy.

It was daunting to win the day against emotion-laden positions that overshadowed empirical evidence marshaled by those critical of Keynesianism. Concerns over "cost or budget limitations were often equated with the voice of right-wing reaction." In the eyes of progressives:

"*Either you want to help people or you don't.*"[25] For example, when Hayek provided analysis that labor union wage increases came at the expense of others, that real wages often rose "much faster when unions were weak," and that it was "a myth" that union efforts caused the standard of the living of the working class to rise as fast as it could, many opponents adopted name-calling tactics rather than addressing the evidence of union activity causing unemployment.[26]

It would take a significant amount of time for challengers of Carter's economic policies to gain ground on the prevailing vision that said Keynesian economics was the only answer to restore equilibrium to an economy subject to boom-and-bust cycles and unemployment. Certainly, the post-World War II economic record of Keynesianism in the United States was impressive. Americans were responsible for the production and consumption of more than one-third of the world's goods and services, despite representing only five percent of the world's population.

III

By the 1970s, all politicians were politically vulnerable given the state of the economy. Both Ford and Carter faced economic difficulties that seemed unsolvable. Carter had his own set of problems, notably his rift with establishment Democrats and dissent from the left flank of the party. Some Democrats accused Carter of being too conservative on economic issues. Carter himself saw three major reasons for his failure to win a second term: a divided Democratic Party with progressives opposing him for supposedly abandoning Democratic principles, the Iran hostage ordeal (1979–1981), and the weak economy at election time.[27] The most progressive of the party scorned Carter's less-than-enthusiastic support for their liberalistic reform ideas.

In addition, the consequences of the Iranian Revolution clearly damaged Carter's image as a competent and strong leader. He showed more interest in redefining America's role in global affairs than domestic economic policy; thus, his weakest record of performance was the economy. Two months before the 1980 election, polling revealed that 61 percent of respondents identified "the high cost of living" as America's most important problem.[28]

Judging Carter's performance as weak, free-market economists saw little evidence of conservatism in his economic policies. Some wrote of "the left-wing administration of Jimmy Carter."[29] Chairman Karl D. Bays of the American Hospital Supply Corporation lamented Carter's attacks on the oil companies: "If he's capable of taking on the oil industry … any of us could be next."[30] In the eyes of conservative economists and business leaders, his failure to escape Keynesian thinking was good reason to retire Carter from the White House. Pointing to the historical record, they noted that economic growth averaged 3.3 percent from the years 1945 to 1973, significantly higher than the 1.8 percent during the "stagnation decade" of 1973 to 1982.[31] Even Carter's insistence of wanting "to know every detail about everything" did not appear to bring much awareness of the shortcomings of his economic thinking.[32]

In 1980, American voters had two distinct choices. Republican nominee Ronald Reagan, viewed by many in Washington as an outsider, had been an economics major in college, a mid-twentieth-century Hollywood star, and governor of the largest state in the union. "Politicians are notoriously uninterested in economics," but Reagan was different with his passion for economic ideas. He also presented an economic policy distinct from the traditional economic message of the Republican Party: "Political history was being made: a Republican candidate promising growth, not austerity; calling for prosperity, not sacrifice."[33] Did Reagan really mean what he said on the campaign trail? Was America willing to support his economic plan?

America witnessed economic malaise, but, as this book argues, the Keynesian mindset did not die easily in political circles; Carter's supporters were hopeful of a victory over Reagan. In the face of strong media support for government management of the economy and suspicion for any "crackpot" economic theory that pushed for tax reduction amid inflation, acceptance of new free-market ideas came slowly. Even Republicans were slow to abandon the idea that tax cuts overstimulated the economy and caused higher inflation.

Progressives favored Keynesianism, and they knew little about dissenting economists. Writing in the *Nation*, Robert Skole admitted that when an American won the Nobel Prize in economics in 1976, there were journalists who asked: "Who the devil is this Milton Friedman?"[34] Economic ideas associated with the Republican Party were suspect. The Democratic Party did an impressive job of establishing itself as the compassionate party for the poor and middle class, and the shift in public opinion mainly occurred because Americans experienced harder times. Without this reality, the theory or philosophy articulated by free-market voices could only go so far.[35]

In the eyes of free-market economists, the Leviathan of big government rumbled on, only slowing when a significant number of Americans experienced, firsthand, the consequences of a stagnant economy and high inflation. It was this experience that offered an opening for non-Keynesians to state their case more broadly to the American people. From his vast experience, economist Allan Greenspan was certain that "macroeconomic forecasts are far more art than science."[36] It is certain that American politicians could be creative with the views of economists. But in the end, it came down to timing as stagflation hit Americans hard. By the late 1970s, there was so much disillusionment with "big-government liberalism" that in the past seemed to be successful.

There was an economic showdown during the 1970s as colorful as its main participants. After years of back-and-forth defeats and partial victories, free-market proponents finally saw the climate of opinion change enough to see Ronald Reagan—a genuine economic conservative—elected president of the United States. The rise of this "entrepreneur" to the White House is a story of "revolutionary change."[37] Nevertheless, the narrative begins many years earlier with the brilliant British economist named John Maynard Keynes. The 1970s confrontation between conservatism and a progressive vision of the economy had its roots in the economic and political response to the Great Depression. There was a winner. In the post-World War II years up to the Johnson administration, it was not much of a contest—Keynesianism dominated.

Notes

1. Elizabeth Drew, *Portrait of an Election: The 1980 Presidential Campaign* (New York: Simon & Schuster, 1981), 305, 310–312, 319, 322, 325.
2. On the Religious Right and economics, see Eric R. Crouse, *The Cross and Reaganomics: Conservative Christians Defending Ronald Reagan* (Lanham, MD: Lexington Books, 2013). On the important role of cultural issues generating votes for Reagan, see Donald T. Critchlow, *Phyllis Schafly and Grassroots Conservatism: A Woman's Crusade* (Princeton, NJ: Princeton University Press, 2005); and Donald T. Critchlow, *The Conservative Ascendancy: How the Republican Right Rose to Power in Modern America*, Section Edition (Lawrence: University Press of Kansas, 2011).
3. Contrast to microeconomic attention on individuals and businesses, macroeconomics involves the study of the effects of government on the national economy.

4. Jimmy Carter, *White House Diary* (New York: Farrar, Straus and Giroux, 2010), 496–497.
5. A study that explores this occurring beyond the United States is Daniel Yergin and Joseph Stanislaw, *The Commanding Heights: The Battle Between Government and the Marketplace That Is Remaking the Modern World* (New York: Simon & Schuster, 1998).
6. William E. Simon, *A Time for Truth* (New York: Reader's Digest Press, 1978), 26, 31.
7. Yergin and Stanislaw, *The Commanding Heights*, 12, 20.
8. Kenneth W. Thompson, ed., *The Carter Presidency: Fourteen Intimate Perspectives of Jimmy Carter* (Lanham, MD: University of Press of America, Inc., 1990), 32–33.
9. Yergin and Stanislaw, *The Commanding Heights*, 12.
10. Milton Friedman and Rose D. Friedman, *Two Lucky People: Memoirs* (Chicago: University of Chicago Press, 1998), 458–459.
11. Martin Anderson, *Revolution* (New York: Harcourt Brace Jovanovich, 1988), 172–173.
12. I adopt George Nash's definition of the conservative movement as being composed of three major components: libertarians, new conservative traditionalists, and anti-Communists. Consequently, I mostly use the term *conservative* to describe free marketers, but technically *libertarian* would be a more accurate term in some cases, especially for those who refused to identify as a "conservative." See George H. Nash*, The Conservative Intellectual Movement in America Since 1945,* Thirtieth-Anniversary Edition (Wilmington, DE: ISI Books, 2008).
13. Anderson, *Revolution*, 146.
14. Brian Domitrovic, *Econoclasts: The Rebels Who Sparked the Supply-Side Revolution and Restored American Prosperity* (Wilmington, DE: ISI Books, 2009), 11, 15.
15. Thomas Sowell, *The Vision of the Anointed: Self-Congratulation as a Basis for Social Policy* (New York: Basic Books, 1995), ix–x, 3–4, 111–112. Although not adopting Sowell's categories of "anointed" and "benighted," my study appreciates Sowell's point that the dominant intelligentsia appeared reluctant to test competing ideas. At least in the popular press that I used in my research, it is difficult to find any close analysis of free-market ideas by supporters of progressivism. A similar study of visions that is more historical and less polemic is Thomas Sowell, *A Conflict of Visions: Ideological Origins of Political Struggle* (New York: Basic Books, 2007).
16. John E. Miller, "From South Dakota Farm to Harvard Seminar: Alvin H. Hansen, America's Prophet of Keynesianism," *The Historian*, 64, nos. 3–4 (2002): 603–622.
17. *Newsweek*, February 14, 1977, 11.

18. There are many difficulties in defining the terms *liberal* and *progressive*. Sometimes I use them interchangeably, but I usually categorize moderate liberals and progressives under the general banner of liberalism. However, I use the term progressive whenever it is relevant to clarify that a progressive is further to the left than a moderate liberal. For example, in publications, such as the *Nation*, the authors were progressives. I prefer not to use the term "left-wing" (and for that matter, "right-wing") as it complicates the field, notably when one adds socialists, who have had their own battles with liberals, in the mix.
19. Sowell, *The Vision of the Anointed*, 1, 3. Also, Tom Bethel, "The Myth of an Adversary Press," *Harper's*, January 1977, 34. According to Bethel, "[h]aving chosen the only important side—that of big government and all its works—the media can affect an Olympian stance with regard to mere squabbling of factions."
20. Sowell, *The Vision of the Anointed*, 112–113.
21. Ibid., 4, 125, 129. See Hayek's Nobel Memorial Lecture in Friedrich A. Hayek, *New Studies in Philosophy, Politics, Economics and the History of Ideas* (Chicago: University of Chicago Press, 1978), chapter 2 ("The Pretence of Knowledge").
22. Joseph A. Califano Jr., *Governing America: An Insider's Report from the White House and the Cabinet* (New York: Simon & Schuster, 1981), 16, 437.
23. George F. Will, "The Hot Seat," *Newsweek*, March 7, 1977, 96.
24. Richard Nixon, *RN: The Memoirs of Richard Nixon* (New York: Grosset & Dunlap, 1978), 522.
25. Ken Auletta, *The Streets Were Paved with Gold* (New York: Vintage Books, 1980), 216. Italics in original.
26. On Hayek's arguments on labor and employment, see Friedrich A. Hayek, *A Tiger by the Tail: The Keynesian Legacy of Inflation* (San Francisco: Cato Institute, 1979), 63–86.
27. Jimmy Carter, *Keeping Faith: Memoirs of a President* (Fayetteville: University of Arkansas Press, 1995), 576–577. Carter, *White House Diary*, 527–530.
28. See W. Carl Biven, *Jimmy Carter's Economy: Policy in an Age of Limits* (Chapel Hill: The University of North Carolina, 2002), 1–3.
29. For example, Anderson, *Revolution*, xvi. According to Anderson, "American liberalism is but a pale cousin of real socialism, and a very distant relation to the real thing, communism" (8).
30. *Newsweek*, October 24, 1977, 39.
31. Domitrovic, *Econoclasts*, 5.

32. Many high officials in the White House learned of this Carter trait. Shirley Hufstedler, secretary of education in 1979–1981, states: “The fact is that President Carter wanted to know every detail about everything. He knew all the details about all the programs of all the departments….” See Thompson, ed., *The Carter Presidency*, 31.
33. Rowland Evans and Robert Novak, *The Reagan Revolution* (New York: E. P. Dutton, 1981), 9, 83.
34. Robert Skole, “En-Nobeling Milton Friedman,” *Nation*, January 22, 1977, 68.
35. Friedman makes this point in his 1982 preface in *Capitalism and Freedom*, xiii.
36. Alan Greenspan, *The Age of Turbulence: Adventures in a New World* (New York: Penguin Press, 2007), 55.
37. Evans and Novak, *The Reagan Revolution*, xiv, 8–9. According to Evans and Novak, Reagan’s “whole life was entrepreneurial. His career was deeply affected by the management and organization and financial success of a business enterprise, however personal the ventures” (9).

The Keynesian Revolution, 1936–1965

When 50-year-old economist Alvin H. Hansen arrived at Harvard University from the University of Minnesota in 1937, it was the beginning of a new era of economic thinking. An excellent representative of Keynesianism, he made good use of his subsequent decades at Harvard, sharing his passion for Keynesian ideas to “improve the lot of humanity.” He taught hundreds of economics students including future Nobel-Prize winner Paul Samuelson, the author of an economics college textbook loaded with Keynesian ideas that sold millions of copies.[1] Following the teachings of Hansen and Samuelson, young economists recommended planned deficit spending and public debt as the best way to invigorate the American economy to get it out of recessions and depressions. Consequently, these economists received a warm welcome from many Washington politicians.

In politics, the main beneficiary of the rise of Keynesianism was the Democratic Party. From the years 1860 to 1932, the Democrats held the presidency for 16 years, far short of the 56 years for Republicans. From 1933 to 1969, the Democrats held the presidency for 28 years compared to 8 years for Republicans. Before the Great Depression, government spending at the federal, state, and local levels rarely exceeded 12 percent of the national income; however, by the 1970s government spending rose to more than 40 percent of the national income.

As Milton Friedman saw it, there was “a major change in both the public’s perception of the role of government and the actual role assigned to

E. R. Crouse, *America’s Failing Economy and the Rise of Ronald Reagan*,
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government." These numbers were evidence of the shift "from belief in individual responsibility, laissez-faire, and a decentralized and limited government to belief in social responsibility and a centralized and powerful government."[2] Whether they agreed with Friedman's choice of words, Keynesians viewed this development as positive for America. Having the electorate on their side made it all the easier for politicians to tax and spend.

I

The early history of Keynesianism is about fascinating personalities. Born on the United Kingdom's Isle of Wight, A. C. Pigou (1877–1959) was a bright scholar who became known as the father of modern welfare economics, mainly for his work on the tradeoff between economic growth and equity for workers. The redistribution of money to the poor (via progressive taxation) made sense to him providing the economic well-being of the nation stayed strong.[3] In the years 1908 to 1943, Pigou was chair of Political Economy at the University of Cambridge, a position previously held by Alfred Marshall (1842–1942), one of the most influential economists in history who "helped make economics a field of study in its own right." Pigou taught his students that understanding economics was one way to "see through the bogus economic arguments of the politicians."[4]

Known for his frugality, vanity, and idiosyncratic character, he cut a distinctive figure walking through the Cambridge campus, poorly dressed, with his head down, seemingly unaware of the centuries-old university buildings he passed. In the 1950s, Pigou continued to wear a suit he had purchased before World War I. Polite social etiquette was for others; while in retirement, he showed no enthusiasm to welcome a visit by Milton Friedman who viewed the eccentric Pigou as a "great economist."[5]

As impressive as his Cambridge academic position was, Pigou worked at the same time as John Maynard Keynes (1883–1946), another University of Cambridge graduate in economics and a Pigou rival who gained worldwide fame as the most influential economist of the twentieth century. On Keynes's celebrated work, *The General Theory of Employment, Interest and Money* (1936), in 1951 Pigou wrote: "We frequently read of 'the Keynesian revolution.' Indeed, Keynesianism, or perhaps I should rather say Keynesianism without the tears—for how many Keynesians, or, for that matter, anti-Keynesians either, have seriously studied his own book?"[6] During the Jimmy Carter presidency, economist Edward Meadows of the

University of South Carolina declared "that not one Keynesian economist in a hundred has ever read the *General Theory*."[7]

In Pigou's day, Keynes's "inconsistent use of terms" caused his book to be "barely intelligible" even for professional economists. Few took the time to plow through Keynes's contorted and obscure writing, including run-on sentences loaded with semicolons. Nonetheless, Pigou spoke as one who had professional friction with Keynes; they were two scholars—both homosexuals—who tore apart each other's academic work. An early opponent of Keynesianism, Pigou had reprimanded Keynes for his arrogant statements in *The General Theory*.[8] As it turned out, it did not matter that people did not read Keynes. The basic ideas from his work were enough for those advocating government interventions to smooth jarring boom–bust business cycles.

John Maynard Keynes was born in England to a distinguished family, his father a professor at the University of Cambridge and his mother the mayor of Cambridge. He attended the best schools, completing his education at the University of Cambridge where he was part of a group that embraced bohemian ideas. Historians describe him as a promiscuous man who fit well into the Bloomsbury Group that rejected Victorian conventions.[9] Years later he admitted the group's dismissal of traditional morals and wisdom. As he wrote in his memoirs, "We were, that is to say, in the strict sense of the term, immoralists."[10]

Keynes was, historian Margaret MacMillan writes, a "very clever, rather ugly young man."[11] He was both charming and intimidating. Free-market scholar Friedrich Hayek (1899–1992), who later won a Nobel Prize in economics, crossed swords with Keynes on many occasions, but he recognized his good fortune to experience "the magnetism of the brilliant conversationalist with his wide range of interests and his bewitching voice."[12] Hayek was one of the few who did not allow Keynes to browbeat him, thus earning his respect.

After graduating from Cambridge, the gifted Keynes scored second place on the British Civil Service exam that led to a two-year civil service position in India. Following his return, he taught economics at Cambridge. During World War I, he worked at the British Treasury, a job that caused him emotional pain. In a December 1917 letter to Duncan Grant, one of his lovers, Keynes admitted: "I work for a government I despise for ends I think criminal."[13] His criticism of the British government gained broader attention with the publication of *The Economic Consequences of Peace* (1920), which argued that the Versailles Peace Treaty was too harsh on

Germany. This was one of several books that brought him international fame. There was praise and there was denunciation. Historian Paul Johnson claims it was "one of the most destructive books of the century" for contributing "to the future war Keynes himself was so anxious to avert."[14]

To no one's surprise, his main message won over many Germans. The verdict of the jingoistic press was that the "pro-German" Keynes should be awarded Germany's highest award—the Iron Cross. By June 1920, sales of *The Economic Consequences of Peace* were at more than 100,000 copies worldwide, having been translated into many languages including German.[15] Certainly, Keynes spared no feelings with his attacks on the Versailles politicians he disliked. For example, in his memoirs he penned "a characteristically cruel sketch" of France's minister of finance. Louis-Lucien Klotz was "a short, plump, heavy-moustached Jew, well groomed, well kept, but with an unsteady, roving eye, and his shoulders a little bent in an instinctive deprecation." Keynes claimed that the minister attempted to slow food shipments to starving Germans.[16]

Next was his *A Tract on Monetary Reform* (1923); the book argued that central bank monetary management was the best way forward for domestic macroeconomic prosperity. In the early 1920s, the disastrous effects of inflation were obvious in places—for example, Germany where inflationary taxation was at "a preposterous and suicide point."[17] By the summer of 1923, a German needed to have a million marks to exchange for one U.S. dollar. German children played with worthless bank notes as though they were wooden blocks.

Seven years later, *A Treatise on Money* was Keynes's analysis of the savings–investment relationship as the main reason for cyclical movements in national economies. He claimed that both savings decisions by people and investment decisions by businesses needed to be equalized by the central bank, either by lowering or raising interest rates.[18] Intervention by money experts in the economy was the answer, so said Keynes.

These books and other writings were impressive, but none matched the importance of Keynes's *The General Theory*, which sought to explain the forces behind production, employment, and cyclical movements such as the 1929 to 1933 worldwide depression. This marked the arrival of a new branch of economics called *macroeconomics*. Pointing to the "misleading and disastrous" consequences of classical theory (laissez-faire policy) that had guided macroeconomic thinking since the days of Adam Smith, *The General Theory* opposed the two arguments that said full employment was