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Introduction

Alberto Alesina and Geoffrey Carliner

When Ronald Reagan won the presidential election of 1980 and the Republicans gained control of the Senate for the first time since 1954, did American voters reject past policies and indicate a permanent shift to the right? Or was the 1980 election a predictable response to the perceived mismanagement of the economy in the late seventies with no long-run implications? Did the economic policies that were adopted during the 1980s reflect a long-term shift toward conservatism, or were they merely extensions of past policies with, at most, a short-lived shift to the right during the two years (1981–82) when Republicans had effective control of the White House and Congress? More generally, how did politics influence the economic policy decisions in the 1980s?

The eight chapters included in this volume examine the evidence. They study voting patterns, monetary and fiscal policies, welfare spending, tax reform, minimum-wage legislation, the savings and loan debacle, and international trade policy. Taken together, they indicate that a sharp temporary shift to the right followed the 1980 election, as evidenced by the policies adopted during the early years of the first Reagan administration. Subsequently, the Democratic gains in the congressional elections of 1982, 1984, and especially 1986, contributed to moderate the administration's policies.

Voting

Morris P. Fiorina's analysis of voting patterns in the 1980s supports this view. He notes that Jimmy Carter faced the 1980 election with double digit

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inflation and a stagnant economy. Carter probably would have lost in 1980 on economic issues alone, even leaving aside the problem of the hostages held by Iran. In fact, several studies of previous elections have emphasized that slow growth and (to a lesser extent) high inflation significantly hurt incumbent presidents.[1] Thus, Carter's defeat does not imply a sharp realignment of the electorate toward the right.

The Democrats' loss of the Senate in 1980 was more unusual than their loss of the presidency, but again, it was a reaction to the specific events of the late 1970s rather than the result of a long-term shift in party allegiance. In fact, the large number of Republican victories in the Senate was not repeated in subsequent elections. In particular, the elections of 1982 and 1986 continued the pattern of midterm voting cycles in which the party holding the White House loses votes and seats in Congress. The presidential elections of 1984 and 1988 are also consistent with historical patterns. Reagan's reelection and Bush's victory confirm that voters favor incumbents and look at the rate of change in income and in prices in the election year when choosing presidents.[2]

In summary, Fiorina finds that the election results of the 1980s can be largely explained by the short-run performance of the economy in election years, and by the midterm cycle. In his comments to this paper, William D. Nordhaus notes that the apparent popularity of Republicans and their grip on the presidency could evaporate at the first reappearance of recession or inflation.

However, Fiorina also reports a longer-term shift in voters' attitudes in favor of the Republican party, especially in the upper middle class. The percentage of voters who identified themselves as Republicans in surveys rose from about 33 percent in 1962–82 to about 40 percent in 1984–88. Measures of party identification are obtained by asking voters in surveys whether they perceive themselves as Democrats (weakly or strongly), Republicans (weakly or strongly), or independents. Party identification reflects the voter's ideological bias in favor of a party and is influenced by several economic and noneconomic factors. Thus, voters may identify themselves as Democrats, even if they occasionally vote for a Republican candidate: party identification reflects long-run attitudes of the electorate and may differ from the actual voting behavior in each election. For instance, Jimmy Carter in 1980 was defeated when many voters who identified themselves as Democrats voted for Ronald Reagan as a reaction to Carter's perceived failures. Fiorina's results suggests that some of these voters may now consider themselves "permanently" Republican.

Voting in the eighties, particularly in the second half, also confirms a pattern that is becoming increasingly common in American political history: divided government—that is, a situation in which the same party does not control the presidency, the House, and the Senate. One explanation, formalized elsewhere by Fiorina and others, suggests that divided government is the result of a conscious attempt by the voters to achieve moderate policy.[3] Accord-

ing to this view, the American electorate has to choose between two parties that offer different policy options. Voters in the middle of the political spectrum desire policies in between those advocated by the median members of the two parties. These voters may prefer divided government rather than unified government: if different parties hold the presidency and Congress, they balance each other, and the resulting policy outcome is more centrist than would be with a unified government.

This desire for moderation may explain both split-ticket voting when Presidential and Congressional elections are held simultaneously, and the midterm voting cycle. Both phenomena occurred in the 1980s; in this respect the last decade was far from unusual. In fact, a recurring theme of this book is the constraint placed on the ability of the Reagan administration to pursue conservative policies after the 1982 elections increased Democratic strength in the House, and especially after the Democratic party regained the majority in the Senate after the 1986 mid-term elections.

Monetary Policy

James E. Alt's study in this volume of monetary policy in the 1980s also emphasizes the importance of the balance of power between Congress and the president. He suggests that the Federal Reserve can be viewed as an agent with three principals: the president, Congress, and the financial community. The chairman of the Federal Reserve has a certain amount of independence, which he wants to preserve for himself and for the institution. Alt emphasizes that an agent with multiple principals enjoys a fair amount of autonomy when the principals disagree, which may be the case when the presidency and Congress are held by different parties. In addition to the goal of independence, Fed chairmen may want to enhance their chances of reappointment. Alt examines how different politicoeconomic models can explain the Fed's behavior, given this principal-agent relationship and the chairmen's goals of independence and reappointment.

Earlier studies have suggested two explanations for political influence over monetary policy. The first suggests that Democratic administrations are more expansionary than Republican administrations because the former care relatively more about unemployment (and less about inflation) than the latter.[4] The second emphasizes that presidents are almost exclusively concerned with reelection and thus engage in preelectoral manipulations of monetary policy to boost growth.[5]

Alt blends these two approaches by arguing that, at the beginning of a new administration, Fed chairmen tend to accommodate the president's partisan goals. When an election approaches, the Fed tends to follow a prudent course of action for two reasons. On one hand, the Fed wants to avoid preelectoral contractions in order not to jeopardize the incumbent's performance at the polls. On the other hand, the Fed avoids policies that are too clearly expan-

sionary and thus favorable to the incumbent. In fact, the Fed wants to preserve its reputation for independence and avoid displeasing the challenger who, after all, may be the next president. Finally, the Fed may need to balance these political influences with the financial community's preference for stability in financial markets.

Monetary policy in the eighties was largely consistent with traditional Fed behavior, as described by these models. By 1979, inflation was perceived as the most serious economic problem, and the Carter administration and the Federal Reserve were held at least partly responsible for it. In the fall of 1979, one year before the presidential elections of 1980, Carter needed to support anti-inflationary policies to avoid losing control of the economy and of the election.[6] Therefore, he appointed Paul Volcker as chairman of the Fed, who immediately shifted monetary policy to target the money supply instead of interest rates and began to slow the growth of the money supply to reduce inflation.

In 1981 and 1982, with a new Republican president and a conservative Congress, the Fed received full political support for its tough, anti-inflationary policy. In these years, the United States experienced the deepest recession since the thirties, but inflation was quickly reduced. The weak Democratic contingent in Congress could do little to oppose this course of action.

In the summer of 1982, the Fed loosened its policy and started to rely less on monetary targeting. This change of policy can be explained by the feeling that inflation had been reduced substantially and the economy needed help to recover. Also the threat of financial crises due to the less developed countries' (LDCs') debt problem and the difficulties of the savings and loan institutions (S&Ls) may have influenced the Fed's decision. After 1982, Democratic gains in Congress reduced the political support for further anti-inflationary policies.

In his comments on Alt's paper, Benjamin M. Friedman notes that the Fed decreased its reliance on monetary targeting after 1982 because of the collapse of the relation between money growth and the growth of nominal income. In addition, Friedman emphasizes how the Fed's independence is enhanced not only by the multiplicity of principals, but also by the fact that each of the principals (Congress, the administration, and the financial community) may not have homogeneous preferences.

Fiscal Policy: Taxing, Spending, and the Deficit

Some of the most dramatic changes in economic policy during the 1980s involved fiscal policy, particularly in the first two years of the Republican administration. Military spending grew substantially, many social programs were cut back; tax rates fell sharply and the federal budget deficit soared. Some of these policies reflect traditional Republican views; in addition, some of these changes, like an increase in military spending, were initiated at the end of the Carter administration. However, Reagan's fiscal policies in

1981–82 viewed together represent a substantial departure from the seventies, including previous Republican presidents.

One dramatic piece of evidence of Reagan's departure from previous fiscal policy is the budget deficit. The most economically relevant measure of accumulated deficits is the debt/GNP ratio. This ratio shows a downward trend in the post–World War II period. Starting from a peak of 1.17 in 1945, this ratio was 0.23 in 1980. The large deficits in the eighties clearly reversed this trend: the debt/GNP ratio was 0.35 in 1985 and about 0.30 in 1989.[7] The deficit's share of GNP peaked at 6.3 percent in 1983, and then fell gradually for the next six years, particularly after the defense buildup slowed after 1986. By 1989, the deficit was 2.9 percent of GNP, about its share of output at the beginning of the decade.

Republican presidents traditionally have vigorously opposed budget deficits. In contrast, Reagan spoke out most strongly against tax increases and used his political power to oppose legislation that would raise tax rates and revenue, even if that opposition meant continued high deficits. Congressional Democrats, traditionally less concerned with deficits than Republican presidents, refused to cut spending, even though that also meant high deficits.

Mathew D. McCubbins in his contribution to this volume suggests that the increase in budget deficits was the result of "divided government," particularly of the control of the Senate and the House by different parties. He suggests that such divided control leads to fiscal deadlocks and prisoners' dilemmas, which resulted in spending in excess of tax revenues. Republicans and Democrats in Congress favor different spending programs. If the two legislative branches are controlled by different parties, they reconcile their differences by increasing spending on both parties' favored programs. The result is higher spending than would occur if either party had undivided control of the legislature.

A different explanation is that the large deficits in the early eighties were the result of miscalculations.[8] First the supply-siders in the administration vastly overestimated the incentive effects of the 1981 tax cut. Second, the recession of 1982 turned out to be the worst in post–World War II history and worse than was predicted. Third, inflation fell faster than anticipated, further decreasing revenues below their expected levels. The indexation of the individual income tax, which took effect in 1985, permanently eliminated the automatic source of increased revenues brought by inflation. When revenues fell sharply below planned expenditures, political and legislative inertia and the combined effects of various pressure groups made it difficult to correct the mistake. That is, politically costly decisions needed to stop the growth of the debt were postponed because of the difficulty of reaching a compromise over budget cuts or tax increases of the size needed to balance the budget.

A third political explanation, which does not rely on large miscalculations, is that the debt accumulation of the early eighties was a strategic attempt by the Reagan administration to constrain spending by future Democratic Con-

gresses or future Democratic presidents. By creating large deficits whose effects would persist after the Republicans lost control of the Senate, the Reagan administration reduced the flexibility available to Democratic legislators to increase nonmilitary spending. With a large deficit and a rapidly increasing interest bill, it is difficult to justify major increases in spending programs, particularly if tax increases are viewed as economically and politically costly. Thus, the debt is the legacy of the Reagan administration to the future.[9] According to this argument, Reagan accepted large deficits because he was more committed to a reallocation of spending priorities than previous Republican presidents.

In his comments on McCubbins, Robert J. Barro argues that a large part of the history of the U.S. budget can be explained by the tax-smoothing model.[10] This theory suggests that it is optimal to finance unusual increases in spending, such as those occurring during wars or severe recessions, primarily with debt rather than with tax revenues. Smooth tax revenues and fluctuating deficits (and surpluses) distort the economy less than balanced budgets and fluctuating taxes. Indeed this theory is broadly consistent with the steady decline, with minor deviations for recessions and local wars, in the ratio of debt to GNP since its peak at the end of World War II.

Whether or not the tax-smoothing model explains the deficits in the 1980s is debatable: the debt/GNP ratio almost doubled in a decade without major wars. The military buildup of the eighties can be viewed as once-and-for-all effort to win the Cold War, for which it would have been optimal to run temporary deficits. The collapse of the Soviet bloc lends some support to this view, but recent events in Eastern Europe have deeper roots than the American military buildup. Furthermore, increased military spending accounts for only a fraction of the increase in the deficit. The tax cut of 1981 played a larger role: the tax-smoothing model may explain why deficits may have grown to finance the military buildup in a cold war period, but it cannot explain why taxes were cut.

One of the recurrent themes in these explanations of the deficits is the politicoeconomic struggle over allocation of government expenditure to domestic versus defense programs. Thus, it is important to analyze whether this allocation has substantially changed in the eighties. Although the military buildup was a major theme in Reagan's agenda, the buildup was in fact started by President Carter. Military spending in real terms fell steadily from 9.6 percent of GNP in 1968 to 4.8 percent of GNP in 1977. After two years of constant real spending, military spending increased in response to the Soviet invasion of Afghanistan. The Reagan administration sharply accelerated this buildup by raising military spending from 5.3 percent of GNP in 1981 to 6.5 percent in 1986, when Democrats regained control of Congress and ended the increases. By the end of the decade, before the startling events of the fall of 1989, military spending had fallen to less than 6 percent of GNP.

The military buildup was accompanied by reduction of spending in various

social programs, particularly in the first half of the first Reagan administration. As John A. Ferejohn observes in his contribution to this volume, the programs that were cut the most or eliminated entirely, were those narrowly directed at the poor, such as CETA, Job Corps, Head Start, and other education programs. Spending on broadly based social insurance programs that benefited primarily the middle-class elderly, such as Social Security and Medicare, continued to grow untouched during the 1980s.

Ferejohn attributes this difference in treatment to the structure of the legislative process. He argues that the structure of Congressional committees insulated middle-class programs from attacks; thus, advocates of those programs could resist administration pressure for cuts more effectively than could supporters of programs beneficial to the poor. Ferejohn also notes that the administration, to a certain extent, managed to circumvent congressional opposition by tightening eligibility standards administratively. In addition to congressional committees, the pressure of public opinion created great obstacles to any attempt of reducing Social Security benefits. There was no similar outcry of voters when the administration proposed cutting poverty programs.

Ferejohn observes that, after the high water mark of Republican power in 1981–82, Democrats resisted further cuts in social programs. Even before they regained control of the Senate in 1986, they were able to stop further efforts by the Reagan administration to change federal spending patterns. He concludes the social spending cuts of Reagan administration were less widespread than commonly perceived and concentrated in a two-year period. Ferejohn also emphasizes the importance of the Congressional committee structure in protecting middle-class programs from further cuts advocated by the administration.

It is interesting to note that once the Democrats regained control of Congress, they made few attempts to introduce new poverty programs or to return existing ones to their former size. In part, this may have been due to the constraints in spending imposed by the accumulated deficits of the eighties. On the other hand, it may indicate a changing attitude: American voters and politicians were willing to support such spending under both Republican and Democratic presidents from the early 1960s until 1980, but during the 1980s this support diminished. This is in sharp contrast to the continued strong support for middle-class entitlement programs, which remained essentially untouched throughout the decade.

Tax policy also underwent substantial and frequent change during the 1980s. Although the changes that were passed into law, and the debates associated with them, reflect the traditional views of Republicans and Democrats, the emphasis of the Reagan administration was somewhat different from those of Eisenhower, Nixon, and Ford.

Charles H. Stewart III, in his contribution to this volume, describes the major tax changes that occurred during the decade. The largest was the Eco-

nomic Recovery Tax Act of 1981 (ERTA), passed in the first months of the new administration at the peak of Reagan's power. ERTA cut marginal tax rates, substantially increased tax incentives for corporate investment, and indexed the personal income tax for inflation.

The following year, Congress had second thoughts about the size of the 1981 tax cut, and repealed many of the business tax incentives that had been introduced in ERTA. Excise taxes on cigarettes and telephone calls were also raised. Then, in 1983, taxes were raised again, as new federal employees were subject to the Social Security payroll tax, and the payroll tax rate and the maximum income subject to this tax were increased. Finally, the 1986 Tax Reform Act (TRA) continued the trend to lower marginal tax rates but eliminated many of the tax incentives for business investment that had been favored by Republicans for many years. For instance, the 1986 reform eliminated the investment tax credit and raised the maximum tax on capital gains from 20 percent to 28 percent. TRA was designed to be revenue neutral: its significantly reduced personal income tax revenues and offset this loss with increased corporate income tax receipts.

The end result of all this legislation was a major change in the structure of federal taxation. The marginal tax rate on the highest income bracket fell from 70 to 28 percent, many low-income individuals were dropped from the income tax roles, payroll tax rates and ceilings rose, some personal income tax deductions were scaled back, and many corporate tax benefits were eliminated.

A recurring theme in the debates over tax policy during the eighties was over the need to raise tax revenues after the very large reductions put in place by ERTA. If these reductions had not been so large, the debate over tax policy probably would not have been so sharp. Stewart emphasizes the decreased control by Congressional leaders in setting tax policy as an explanation for the size of the 1981 tax cut. When Republican and Democratic leaders in Congress reasserted their control in later years, tax favors to special interests were reduced.

Stewart also notes that in previous decades inflation pushed taxpayers with constant real incomes into higher tax brackets and thus automatically raised real tax revenues. Congress could then decide to spend these revenues or to take credit with constituents by voting to decrease taxes. When ERTA eliminated this bracket creep by indexing the personal income tax, revenues no longer increased automatically. Any change in taxation that raised total revenue or cut the taxes of one group required an explicit action to raise taxes on another group. Thus, indexing the personal income tax, along with Reagan's opposition to tax increases, also intensified the debate over tax policy.

David F. Bradford's comment on Stewart's paper discusses the paradox of a Republican administration introducing tax changes in ERTA that were extremely generous toward business investment and then supporting their elim-

ination only five years later in TRA. The explanation for this reversal in policy may lie in Reagan's commitment to lowering marginal tax rates. He was willing to abandon the investment incentives traditionally favored by Republicans in order to bring down the tax rates.

This decline in the top marginal tax rates coupled with the change in spending priorities indicate a shift of emphasis in fiscal policies toward "efficiency" at the expense of more "inequality."

Deregulation

An important theme of the Reagan administration's agenda was the need to deregulate the economy. At best, the Reagan administration claimed, government interference imposed costs on workers and consumers that far outweighed the benefits to society. More often, government regulations simply created red tape that confused the efficient operation of market forces while restricting personal freedom. Cutting regulation, along with cutting social spending and marginal tax rates, was thus an area of major policy change during the 1980s.

Like other policy shifts examined in this volume, the deregulation of the Reagan administration was preceded by actions taken by earlier presidents. In particular, the Carter administration eliminated long-standing government regulation of airlines, railroads, trucking, and telecommunications. This policy was designed to encourage competition in industries where regulation was perceived as benefiting the regulated producers. The purpose of President Carter's deregulation was to reduce prices and improve service for consumers by increasing competition. In contrast, the deregulation of the Reagan years involved the loosening of health, safety, environmental regulations which were considered unnecessary and inefficient, more generally constraining "market forces."[11] Much of this deregulation was accomplished through changes in enforcement rather than changes in law.

An important and long lasting legacy of the eighties is the collapse of much of the savings and loan industry and the cost to the government of bailing out depositors. The industry's problems began in the 1970s, when inflation and nominal interest rates rose sharply. Since most S&L assets were in long-term fixed-interest residential mortgages, a large number of firms in the industry suffered a loss of all their equity. Even after interest rates fell in the 1980s, the market value of the liabilities of many S&Ls exceeded their assets.

In most industries, insolvent firms go out of business. Because of federal deposit insurance, insolvent S&Ls could continue to operate. With their equity already gone, they could "gamble for resurrection" by lending money to very risky projects. If the projects were successful, the S&Ls won. If the projects failed, the government insurance fund lost.

To prevent this type of gambling, as well as the outright fraud that also

contributed to the S&L debacle, regulators needed to close down "the walking dead." This required tighter regulations, additional staff for the regulatory agencies, and infusions of cash to pay off the insured depositors.

Thomas Romer and Barry R. Weingast, in their contribution to this volume, examine how a problem that started out as a loss of a few billion dollars for the government insurance fund exploded into a debacle that may eventually cost much more.[12] They emphasize the role of Congress in responding to interest-group pressure from the S&Ls. By offering campaign contributions to members of Congress, especially those with key positions on committees concerned with regulatory agencies, the S&L industry was able to persuade these Congressmen to intervene on their behalf with these agencies. During the mid-1980s Congress also blocked, delayed, or watered down measures to raise the insurance premiums on S&Ls, increase the amount of capital required of owners of S&Ls, and increase the staff at the regulatory agencies. These steps would have allowed the regulators to limit the costs of the S&L collapse.

The administration also played a role in the S&L debacle. Robert E. Litan's comment on Romer and Weingast underscores the importance of 1982 legislation, supported by the administration, that allowed S&L owners to use federal insurance guarantees to expand rapidly without putting in any of their own money. He argues that loosening the capital requirements for S&Ls "invited high rollers and crooks into the industry." In addition, the administration, given its antiregulation policy, encouraged further loosening of regulations and opposed increases in staff and budgets of the regulatory agencies.

Romer and Weingast argue that congressional behavior on this issue was simply business as usual: that is, support for narrow interest groups unless there is widespread pressure from other parts of society. They observe that the president typically represents the interests of the society at large. However, the ideology of the Reagan administration favoring deregulation meant that regulations were loosened when problems first arose, and that measures to correct the industry's problems were delayed until they were extraordinarily costly. An administration less opposed to government interference in the economy might not have allowed the crisis to grow so large before taking steps to correct it. Like health, safety, and environmental deregulation, the deregulation of the S&L industry during the early 1980s represents a substantial shift from the policies of previous administrations.

Another aspect of regulation policy is government intervention in setting wages. The history of the federal minimum wage during the 1980s reflects very closely the political trends of the decade. Legislation passed under President Carter raised the nominal value of the minimum to $3.35 an hour on 1 January 1981, just as the Reagan administration was about to enter office. For most of the decade, Congress took no steps to raise the minimum wage. As a result, inflation eroded its purchasing power, so by 1986 its value in 1981 dollars had declined to $2.69.

As Keith T. Poole and Howard Rosenthal observe in their contribution to this volume, this is entirely consistent with history: no legislature with a Republican majority has ever voted to increase the minimum wage. By examining roll call voting, Poole and Rosenthal argue that the minimum-wage issue is in fact, highly ideological. Legislators who can be classified as "right wing" according to their overall voting record, tend to be consistently against increases in the minimum wage. Ideology explains voting on the minimum wage better than the socioeconomic composition of the legislator's constituencies.

It is quite interesting to note that when the Democrats regained control of the Senate in January 1987, they failed to pass any minimum-wage legislation for more than two years. When Reagan left office, the real value of the minimum wage in 1981 dollars had declined to $2.41. Even after two years of Democratic control of the legislature, the minimum wage in real terms was lower than in the sixties and seventies.

Once Reagan left office, the Democratic Congress wasted no time in negotiating a higher minimum wage with President Bush. Even this increase, however, supports the hypothesis that there was an ideological shift to the right. Poole and Rosenthal show that the roll call votes in 1989 followed the same right-left pattern that explained earlier votes on this issue, but they find that the $3.85 minimum wage passed in 1989 provided for a significantly smaller increase than past experience would have predicted.

In his comments, Charles Brown expresses some doubts over Poole and Rosenthal's calculation showing a decline in the real minimum wage desired by Congress. Their conclusion relies upon comparisons of congressional votes in the sixties and in 1989. Brown argues that these votes were on bills that were too different to use as the basis for inferences about Congressional views on the minimum wage.

Unlike the minimum wage, which can be described with one number and a few measures of coverage, policies that regulate U.S. international trade include a wide range of decisions that are often difficult to quantify. I. M. Destler's paper describes the major trade issues of the 1980s—the formal or informal protection for autos, steel, textiles, motorcycles semiconductors, and machine tools; a free trade agreement with Canada; legislation that created new reasons for restricting imports; and more generally harsh rhetoric favoring "fair trade" rather than "free trade." Do these changes constitute a basic shift in trade policy?

Destler's answer is no. He argues that the fundamental pattern of trade policy remained steady over the decade, in spite of unprecedented pressures for protection. This pattern includes demands by Congress for import protection for specific industries, but a willingness to let the administration make most specific decisions on trade policy, and an administration that expresses a firm commitment to free trade but occasionally gives in to political pressure and approves import restraints.

Perhaps the biggest change in trade policy in the 1980s was the intensity of the pressure for protection. As Destler shows in table 8.1, the U.S. trade deficit rose from about 1 percent of GNP in 1977–82 to 3.5 percent of GNP in 1987, and then fell to 2.1 percent of GNP in 1989. At the same time that imports were rising sharply in the early 1980s, the United States experienced its deepest recession in over 40 years. Although the loss of sales due to the recession was often larger than the loss due to imports, the combination of the two was enough to cause several politically powerful industries to seek import protection from the government. Such demands continued even after several years of recovery, since the trade imbalance did not disappear.

Another longer-term source of political pressure for protection was the decline in U.S. dominance in the world economy. As the U.S. technological lead over other developed countries has eroded, there has also been a long-term erosion in support for free trade. Although outright protectionism is still unpopular, political pressures have grown for "fair trade" and for unilateral actions by the United States that go against the spirit if not the letter of international trade agreements. This long-term pressure is likely to continue even if the trade deficit shrinks to pre-1980s levels.

Anne O. Krueger, in her comment on Destler's paper, questions how many small changes are necessary to add up to a substantial change in U.S. policy. She cites, in particular, the import quotas and VERs on autos, the U.S.–Canadian free trade agreement, and the bilateral negotiation over Super-301 status as steps that undermined the open multilateral trading system.

Whether these actions constitute a substantial shift in policy is of course a matter of judgment. Certainly the Reagan administration did not come into office in 1981 urging that the United States abandon free trade philosophies espoused since World War II. There was no ebbing of protectionist sentiment after the elections of 1982 or after the Democrats regained control of Congress in 1986. Rather, the Congressional Democrats were the ones urging a change in trade policy, and the Reagan administration defended, in rhetoric if not always in practice, the policies of past administrations.

Conclusion

As the 1980s began, prices were soaring, growth was stagnant and unemployment was rising. In reaction to these events, American voters turned against the incumbent party and gave the Republicans control of the White House and the Senate. Conservative Democrats in the House who were sympathetic to the goals of the Reagan administration gave Republicans effective control of the entire Congress.

This sharp reaction against the Democratic party lasted only until the recession and midterm election of 1982, which returned effective control of the House to the Democrats and eroded Republican power in the Senate. However, this two-year period at the beginning of the decade was enough time for

the Reagan administration to make substantial changes in several areas of economic policy.

As this introduction has summarized, and the papers in this volume examine in more detail, during 1981–82 the president proposed and Congress passed a large income tax cut that reduced marginal rates and set the stage for an unprecedented increase in the budget deficit, sharp cuts in social spending for the poor, and an increase in the military buildup begun under President Carter. The Reagan administration considerably weakened enforcement of health and safety regulations that had become law during the 1970s and discontinued most antitrust enforcement. In addition, the administration supported the Fed's anti-inflationary effort. In many areas then, the early eighties saw the implementation of policies traditionally advocated by the right.

After the 1982 election, and especially after the 1986 election that returned full control of Congress to the Democrats, the Reagan administration had difficulty implementing conservative policies. However, there may also have been a longer-term turn to the right that lasted beyond 1982 and beyond 1986. One indication of this is the increasing percentage of voters who identify themselves as Republicans. Another is the failure of the Democrats in Congress to introduce new social spending programs once they had majorities in both houses of Congress.

One area in which the Reagan Administration clearly departed not only from the seventies but also from traditional conservative values is that of budget deficits. These deficits are, in part, the result of an inability of liberals and conservatives to agree on tax and spending policies, but they are also the result of a significant change in the attitudes of conservatives and Republicans on the relative importance of low deficits versus low taxes and low social spending. Republican presidents before the 1980s chose to reach compromises with Democratic Congresses that produced smaller deficits, perhaps because the distance between the two sides was smaller or because deficits were considered more harmful. In either case, persistent large budget deficits and the accumulation of debt that they produced are the gift of the 1980s to the future.

Notes

1. For instance, Kramer (1971) and Fair (1978, 1988). For a discussion on whether the effect of preelection income growth on voting is rational or myopic, see Alesina, Londregan, and Rosenthal (1991).

2. On the advantage of incumbents, see Kramer (1971), Fiorina (1981) and Fair (1978, 1988).

3. See Fiorina (1988, 1991) and Alesina and Rosenthal (1989a,1989b). An interesting question is why divided government usually has Republican control of the executive and Democratic control of Congress, rather than the other way around. One answer might be that voters prefer a Republican president in charge of foreign policy and

a Democratic Congress setting domestic spending policies. Furthermore, given the incumbency advantage, once a large number of seats in the House is held by Democrats, it may take a long time to reverse this situation. Thus, if voters prefer divided governments, they will elect Republican presidents *because* of the Democratic dominance in the House.

4. Seminal work in this area is by Hibbs (1977, 1987). See also Alesina (1987).

5. This is the approach followed by Nordhaus (1975) and Tufte (1978). For two recent surveys that provide somewhat different views regarding the literature on the politics of monetary policy, see Alesina (1988) and Nordhaus (1989).

6. Note that the timing of Carter's macroeconomic policy is opposite from the "political business cycle" hypothesis (Nordhaus 1975). Rather than expanding the economy immediately before the election, Carter followed an anti-inflationary policy in 1980. This does not imply that Carter was not interested in reelection: at that time, inflation was perceived by the voters as the most pressing economic problem.

7. This measure of the debt does not include debt held by the Federal Reserve and other Government agencies. McCubbins (in this volume) uses a different measure.

8. The "miscalculation theory" is suggested by Stockman (1987). For a critical discussion of this view, see Friedman (1988).

9. For a nontechnical exposition of this argument, see Friedman (1988). For a formal treatment, see Persson and Svensson (1988) and Alesina and Tabellini (1990).

10. For a more extensive treatment of this theory see Barro (1985, 1986, 1987).

11. Viscusi (forthcoming) notes that the Reagan administration sharply reduced the enforcement of health and safety regulations during its first two years but made little attempt to reform or rationalize the regulations that they considered objectionable. After this initial period, according to Viscusi, regulatory policy "resembled that of the pre-Reagan era."

12. Kane (1989, 87) estimates that the cost to the federal government of paying off insured depositors at insolvent thrifts rose from $3 billion in 1982 to $63 billion in the middle of 1988. Since then, the cost of the bailout has undoubtedly risen considerably.

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