Annelise Anderson

Slaying the Dragon of Debt: Fiscal Politics and Policy from the 1970s to the Present

A project of the Walter Shorenstein Program in Politics, Policy and Values

Interviews conducted by
Patrick Sharma
in 2010

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Sharma: This is Patrick Sharma on September 27, 2010, here with Dr. Annelise Anderson, tape one. Okay, Dr. Anderson, I’d like to start with your personal and intellectual background and if you could give us a sense of how you got involved in politics. I know you worked for the Nixon campaign. How did you come to work in the Nixon campaign and if you could give some thoughts about your time there.

Anderson: Well, I got interested in politics actually in 1962 when I volunteered for someone who was running in a Republican Senate primary, Laurence Curtis. He was running against George Cabot Lodge and he lost in Massachusetts in the Senate primary. I volunteered in 1964 in the Goldwater campaign, where I contacted voters in an election district in New York City. My husband was also interested in politics and he was the one who got involved in the Nixon campaign in 1967 when he did a paper for Nixon that Nixon ultimately adopted on abolishing the draft, the military draft. So that was how he got involved and he was involved in policy and policy research. He traveled with Nixon and I was working in the office on domestic policy and keeping track of Nixon’s positions on the issues. They sent me out some of the time to travel with Agnew after he was selected to be the vice-presidential candidate.

Sharma: And can you go into a little bit of detail about your specific role within the campaign. Were you focused on that particular area? Was it economic?

Anderson: Well, I was studying business and finance, getting a PhD at Columbia University at the business school and so I was involved in the economics. But in general in the campaign I kept track of all of Nixon’s issues and helped prepare a book summarizing Nixon’s position on all the issues from his own words—extracting sections of speeches that he had given to summarize his positions on different issues. And I worked on some policy stuff. I wrote a few statements, answered a lot of questions from the road, from the traveling crew. My husband was traveling with the tour. At that time it was very difficult to keep connected with the office and the resources that you had in an office in terms of books and so forth because we did not have cell phones and the internet and transmission of documents as attachments to an e-mail. We didn’t have any of that. So we had a telephone and a telex and a digiphone that transmitted like a modern day fax machine but took six minutes to transmit one page. So that was the situation. And we would answer all kinds of questions for the speechwriters or the candidate if he was preparing for a
debate or an appearance of some kind and they wanted some background on
issues.

01-00:03:30
Sharma: Do you remember if the budget deficit was a big issue or if budgetary politics
was a big issue at this time and, if so, how did the Nixon campaign think
about the federal budget?

01-00:03:41
Anderson: I don’t think that it was as much of an issue as it is today, as I recall. 1969 was
a year when we had a budget surplus. And there had been budget deficits
continually up to that time. I don’t remember when the previous surplus
existed. There was a war in Vietnam. As that war wound down there was
more money available. And the other thing that was characteristic of the
situation at that time is that tax brackets were not indexed. This was extremely
important. As you had inflation people automatically got pushed into a higher
bracket, so that the amount of the paycheck would be higher, although what it
bought wasn’t necessarily higher. But the taxes would also increase, because
instead of making 40,000 you’d be getting fifty and the amount between forty
and fifty was taxed at a higher bracket. This meant that Congress never had to
increase taxes. In fact, after World War II until the Reagan Administration
took office in 1981, Congress had cut taxes twenty-one times according to the
civil-service head of the Office of Management and Budget at that time. His
name was Pete Modlin. Congress had increased taxes only once, which was
the ten percent surcharge that Johnson imposed during the Vietnam War. So
you had a continual increase in revenues. As you projected the budget, there
was always money available. Taxes would always be going up, from eighteen
to twenty to twenty-three percent of gross domestic product. So that was a
nice situation.

01-00:06:15
Sharma: Was that something that was already a concern in the late sixties? The bracket
creep, if you will.

01-00:06:28
Anderson: I don’t recall that bracket creep was a major concern. I think we were
concerned with the Vietnam War, with protests in the streets, with crime.
There was a lot of crime. Welfare was a problem. I don’t remember the budget
issue coming up specifically as a focus at that time.

01-00:07:01
Sharma: So in retrospect it seems as if the budget has become a much more central part
of American politics over the last four decades?

01-00:07:09
Anderson: Yes, I think so.
Sharma: It’s sort of a fair assessment.

Anderson: I think so.

Sharma: Okay. Were you ever offered a position in the Administration?

Anderson: In the Nixon Administration?

Sharma: Yes.

Anderson: Not at that time. But I asked for a position in the Law Enforcement Assistance Administration. I think it was a Schedule-C job because I was writing a PhD dissertation on organized crime. And I got a job over there so I was not a policymaking official in the Nixon Administration or on any policymaking group. The Law Enforcement Assistance Administration was a relatively new organization that was designed to help address the problem of crime from a federal level and do some programs nationally.

Sharma: I see. Well, let’s fast forward a little bit then to your service in the Reagan Administration. And if you could just describe for us how you came to serve in the Reagan Administration and your role in the early stages, particularly the campaign.

Anderson: I first started working with the Reagan Administration in 1976 when Reagan ran against Gerald Ford. Basically Marty was working for him, my husband Martin Anderson, and I got involved because Marty was involved and I wanted to be involved. I went to the convention, where I was doing basically research and answering questions about Reagan. Until it was clear that Reagan was not going to get the nomination and that Ford was going to win we were very busy because there was a possibility that Reagan would get the nomination in ’76, which he didn’t.

In the seventies I was teaching at California State University at Hayward. I was teaching finance and economics. In ’79, I spent the summer in Los Angeles where the campaign headquarters was located and got acquainted with all the people. In 1980 I went to the convention where my husband, Martin, was Reagan’s liaison with the platform committee and I was specifically assigned to the economic policy subcommittee of the platform and I worked very closely with him on what was going in the platform. The
delegates ultimately vote on the platform and hold debates about it. So I helped him out with that. They had a lot of questions and details and so forth and I did that. Then we had a meeting in Los Angeles after the convention where Reagan and George Bush came in for a day and Martin and Richard Allen and various other people and we discussed what some of the policy issues were during the campaign, and I attended those meetings.

Lyn Nofziger was Reagan’s press secretary at that time and Lyn Nofziger asked me if I would like to travel with the Bush tour. George Bush had been selected as the vice-presidential candidate and he wanted someone from the Reagan organization to travel with him to be a policy advisor to him. He had a policy advisor who he asked to stay at home and he’d talk to him by phone, Steve Halpern, but he wanted me on the road with him. So there were basically four of us who did substantive things traveling. There was his press secretary Peter Tealy, his speechwriter Vic Gold, the chief of staff Dean Burch and sometimes Charlie Greenleaf, who substituted for Burch, and me as the policy advisor. And the four of us helped Bush, briefing him, speechwriting, editing, everything like that.

01-00:12:00
Sharma: Let me just stop you right there because the ‘80 campaign is so fascinating. The Republican primary campaign and specifically, of course, Bush’s charge that Reagan’s budget plan was voodoo economics. Can you talk a little bit about the substance of that critique and whether, more broadly, there were divides within the Republican Party during that time, particularly in drafting the platform, for instance.

01-00:12:24
Anderson: Well, once you get to the convention, it was clear at the convention in ’80 that Reagan was going to have the nomination. At that point there is no more argument. It’s done. In ’76 there was a debate about the platform and there was competition in terms of whose delegates were on the platform committee and so forth. So there were some debates. And the ’76 platform was a major issue. For instance, one of the events at the ’76 convention was the plank on morality in foreign policy. The plank on morality in foreign policy basically opposed the Nixon/Kissinger/Ford approach to détente. This annoyed Ford and Kissinger. They were furious about this. They were very angry. They were advised by their top political advisors not to have a roll-call vote on it on the floor of the convention because it was extremely likely that the plank would win and would be seen as a defeat for Ford. So instead of having a floor vote, they had a voice vote and they said, “All in favor, say aye.” It passes. That’s it. Bam, done.

Now, in ’80 there is no debate about what’s in the platform because Reagan and the people working for Reagan are in charge and the delegates are fully supportive of Reagan. He is going to be the nominee and that’s it.
And were there any divides within the Reagan camp over, say, the importance of cutting taxes versus balancing the budget at this early point, at least?

No. I don’t think it’s a question of one thing or the other at that point. And you simply state things that you think are good to do and the party in power points with pride and the party out of power views with alarm and it’s basically what you do. No, it’s not. So the delegates on the platform committee as I talked to them felt that both monetary and fiscal policy were important and they wanted to be sure everything gets included. But a platform is not really a question of prioritizing within a budget.

Well, there was a question at that time. I think it was Jules Witcover and Jack Germond wrote that this was blue smoke and mirrors, that you could not increase defense spending, which Reagan had clearly called for. He clearly felt that tax cuts were necessary. So you increase defense, you cut taxes and balance the budget and Reagan certainly campaigned on those three points. Witcover and Germond said that that was blue smoke and mirrors. So it was important later on in the campaign to be very specific about the possibility that all three of those things were possible.

This critique about the Reagan budget being smoke and mirrors seems to have been picked up in—

It was an article they wrote, one of their columns.

Do you remember having to do a lot of work convincing George H.W. Bush of the validity of Reagan’s economic plans?

No, no. I’ll tell you why not. Because when George H.W. Bush was selected as vice president, one of the things that he agreed with Reagan was that he would fully support the platform and the positions of the President. And he did that. He was extremely concerned. Actually, I was surprised in the last campaign with John McCain and Sarah Palin, at the disagreements within that, because George Bush was a loyal supporter of Reagan and the last thing that they want is to get crosswise with each other and have the news focus on that instead of on what they are offering to the American people in comparison to the opposition. So it was only his press secretary, not George Bush himself, who called Reagan’s program voodoo economics. George Bush himself never used the term voodoo economics.
Martin Anderson prepared the tables that went with the September 9, 1980 speech that Reagan gave on the economy. Alan Greenspan helped work on the numbers. The speech was based on the August 27, 1980 Senate budget committee projections of the economy. These projections did not show a recession. They showed an increase in tax revenues to twenty-three percent of gross domestic product. So there was not a recession projected. This projection of the Senate budget committee was consistent with the blue chip forecasters. So at the time, and in the early Reagan Administration, we had no reason to expect the economy to go into the kind of recession that it went into. It had been in a short recession during 1980, which was sort of aborted, if you want, by a run up in the money supply. There’s a lot of money that was put into the economy in the summer of 1980 that basically sort of stopped the downward trend. As economists look at it now, the whole period may be one of recession. But actually, it was a decline and then an upturn.

01-00:19:52
Sharma: So right after Volcker’s initial tightening of the money supply, then there’s a loosening of monetary policy?

01-00:19:56
Anderson: Yes, right. Right.

01-00:19:58
Sharma: I see. And eventually there was a reversion to a tighter money supply.

01-00:20:01
Anderson: That’s right. That’s right.

01-00:20:02
Sharma: This is jumping ahead a little bit. Was there any feeling of frustration within the Reagan Administration over the Fed’s monetary policy, specifically when it gets tightened up again at the beginning of the term? Is that seen as a cause of the recession at all?

01-00:20:20
Anderson: It is seen as the cause of the recession. But I think that Reagan expected that the extent of inflation—there were two back-to-back years of double-digit inflation in the consumer price index. Interest rates were high. The prime rate was over twenty percent. The mortgage rates were thirteen and fifteen percent. Imagine that in comparison to what we are used to now. And so there was a difficulty in the economy and Reagan understood that it was going to be difficult to control inflation and to get rid of inflation. He was extremely concerned to do so. He thought that it would be what he called a bellyache.

And Milton Friedman was important as an advisor to Reagan. Reagan had many significant economists, important economists, who had been in government before advising him. Milton Friedman was one of them. And
Milton Friedman had been making the point that unemployment and inflation were not a long-term tradeoff. The view of the Phillips Curve that was sort of enshrined in economics until the late sixties, until Milton Friedman opposed that point of view, was that you could not reduce unemployment without increasing inflation and vice versa and this was the long-term situation. Now, in the seventies that didn’t seem to be working anymore, so you had higher inflation and higher unemployment at the same time and this was stagflation. You weren’t getting growth but you weren’t getting lower inflation either.

Reagan thought that it was going to be difficult. Then Milton Friedman’s argument was that this was a short-term tradeoff, that you do something about inflation by controlling the money supply. Of course, Friedman was entirely focused on the source of inflation. “Inflation is always and everywhere a monetary phenomenon,” is Friedman’s quote. And so Reagan knew that it was going to be difficult to wring inflation out of the economy and he supported Volcker in doing that.

Now, interest rates remained high, and later on, in the Reagan Administration, Reagan expresses in his diary, which is very interesting because he kept a diary and that was not published until 2007. And in its entirety in 2009, especially with some of the economic stuff which was left out of the 2007 version. He makes a lot of comments about the economy and he hopes that Volcker realizes that he ought to be easing up a little bit and aiming toward the high end of the range that the Fed has set for itself. Reagan met with Volcker.

01-00:23:42 Sharma: The height of the inflation rate.

01-00:23:44 Anderson: No. The monetary supply. The band for the money supply.

01-00:23:53 Sharma: Okay.

01-00:23:53 Anderson: Okay. And that Volcker ought to be aiming at the high end of that range rather than the low end and that aiming toward the low end was being extremely hard on the economy. So Reagan knew it was going to be tough and he supported Volcker. You see, the reason Volcker in 1980 increased the money supply is that he did not have Carter’s support for what he was doing. He was under a lot of pressure and it took support at the top. The Fed eventually comes under severe political pressure from both the President and Congress. So if the President isn’t supporting the Chairman of the Fed in doing something difficult that’s creating a lot of pain, unemployment, all kinds of difficulty, if the President doesn’t support that, it’s very hard to sustain.
Sharma: Right. This must be sending a signal to the market’s future inflation levels.

Anderson: Well, that’s right. Yeah.

Sharma: Okay. Let’s get back sort of to the chronology. After the election, I know you served as a key member staffing various departments. You’re sort of in charge of personnel.

Anderson: Right. During the transition I was one of the four people working for Pen James, who was in charge of Presidential personnel, and we were working on sub-Cabinet positions. Not the Cabinet but all of the other positions that are Presidential appointments in the Administration.

Sharma: I don’t know how much you can speak about it but what were some of your main goals or what was the Administration’s primary goals in restaffing Washington?

Anderson: Well, these are all Presidential appointments. We wanted people in the area in which they would be working who supported Reagan’s policies. Reagan’s policies were very clear. He’d been talking about a lot of things for a long time and we knew what he thought and we wanted people who were supportive of his positions and had some expertise and skills in the area in which they were working and would be people of integrity whom we believed would do a good job.

Sharma: And how did you get to OMB?

Anderson: I looked around as I was doing this. Initially I had no intention of doing that. I was trying to figure out what kind of a job I would like to have in the Administration. I became aware that how you spend money has a great deal to do with policy. And as someone told me, if you’re not moving money, you’re not changing policy. So I thought that was very important and with my background in economics and in finance and in fiscal and monetary government policy, what policy ought to be, I thought that was a good fit. So I became associate director of the Office of Management and Budget for Economics and Government. I had five cabinet departments and forty agencies whose budgets I was overseeing and working on. That’s what I did.
Sharma: Now, the initial months of the Reagan Administration, particularly with OMB, are really an important historical moment. David Stockman’s made these months famous, as he’s called it a blitzkrieg in which the drafting of Reagan’s first budget takes place. I was hoping if you could somehow give us a sense of what it was like within OMB during those initial weeks and months of the Reagan Administration.

Anderson: We had a meeting during the transition, David Stockman and Marty and me and some other people. David Stockman was designated to become the director of the budget and he wanted to know whether everybody around Reagan, probably Ed Meese was there, I don’t remember, whether we wanted to try to completely revise the budget that was already on the Hill.

Sharma: Carter’s budget.

Anderson: Carter’s budget. Which is the base and whether we wanted to send out major revisions to that budget early by—we send it out March 10th, I think. And we started working on it before the Administration took office. It was a wild time. We were working very long hours and Stockman was developing many details on programs that could be cut and the associate directors were reviewing them and OMB had a staff of almost 600 people. And so the staff of OMB was working developing the numbers in detail so that we could present amendments to the budget that was already on the Hill, which was the Carter budget. And we did that.

Sharma: Okay. So it was a process of amending the previous budget rather than drafting a completely new budget?

Anderson: Yes, it has to be. We could not have drafted a completely new budget. So it’s major amendments. It’s an inch thick. And they are changes to the fiscal 1982 budget that is before Congress already.

Sharma: Okay. And was there any resistance from staff to the budgets? I want to get a sense of how the policy moved through the organization of OMB specifically.

Anderson: These are professional civil servants. And so Stockman has the people that he’s brought in or that the Administration has asked him to bring in, including me, as associate directors. He’s got legislative affairs, he’s got an economist who was Larry Kudlow and the people who are working for me as an
associate director. There were sixty-five people working for me. They are all civil servants. They are the best civil servants in the government. But in that sense, I’m like the shop foreman. I’m the lowest level of management, right, and everybody working for me is civil servants. Everybody above me is appointed by the Administration, by Stockman or the President.

Sharma: And was there a sense that this was really Stockman’s plan to reform the budget in this way?

Anderson: Stockman was entirely supported by the rest of the Administration and the President in terms of the people who had been working for Reagan in the campaign on policy. That the government was too big. It was spending too much money in many areas. That while there may be an argument for any individual program, the total was too much and that we had to cut that back. The deficit was running at sixty something billion. It turned out to be eighty, I think. And that the government was simply too big and spending too much money. The OMB staff, the professional civil servants, were actually going into—before the budget is sent out in January, the months before that, the late fall, October, November, December, are periods of a lot of work. And now they went into total revision. So having just done a budget and finished it and sent it up, now the new Administration comes in and says, “We’re going to revise everything.” And so there may be some things that we didn’t look at in detail but basically we did a huge amount of work and sent up a huge amount of revisions.

It included a $7.8 billion supplemental for 1981 which was already in effect. This is the ’82 budget we’re talking about. ’81 was already running. We’re talking about the ’82 budget that we’re revising. So there was a $7.8 billion supplemental. There were also rescissions. So we said, “Congress has passed this but we want to take it away. We want Congress to rescind that appropriation of funds and we want them to add 7.8 billion to the national defense budget for 1981,” which Congress did. And a lot of that money was spent in 1981, fiscal ’81.

Sharma: Was there ever a sense within OMB of the political difficulties that the Reagan Administration would encounter in actually implementing its budget in anticipation of the problem with that Stockman—

Anderson: The staff was delighted. The staff was absolutely delighted.

Sharma: The OMB staff?
Anderson: The OMB staff. The OMB staff generally is inclined toward budget control rather than just spending and towards procedures that lead toward making good decisions about the budget. And so it has its own views as an agency. Every agency sort of has an outlook about how things should be. And OMB had that view and generally they liked what we were doing a lot. They did.

Sharma: I see. And this is sort of OMB being almost a countervailing force against the Cabinet agencies, which tend to want more money.

Anderson: Yes, that’s true. OMB also thought that during the Carter Administration there had been a difficulty arriving at decisions. They would arrive at one decision. Then somebody would walk in the back door of Carter’s office on Saturday afternoon and the decision would be reversed. They thought that that was not good, that they weren’t getting good, straight consistent decisions out of the Administration that were rationally made. And they try very hard to support the policies of the people in office. That is their goal generally.

Sharma: Right, outside the agenda of the political system?

Anderson: That’s right.

Sharma: And I don’t know if you at OMB during this period of time were involved in some of the broader debates over economic policymaking but I’d certainly be interested in your perspective, particularly with respect to whether there was any burgeoning concern over the relative importance of cutting taxes and cutting spending and balancing the budget. Was there any worry about the budgetary impact of the coming tax cuts?

Anderson: No, I don’t think so. [ADDED DURING EDITING: There was a recognition that domestic spending needed to be controlled to allow for the tax reduction and defense increase.]

Sharma: No?

Anderson: There was a debate early on. When the people in the Treasury, primarily people that I had helped recommend for appointment, and OMB had a meeting, David Stockman and Alan Greenspan were there, and this was during the transition. And we had a debate about the extent to which inflation
would affect the budget. I think that David Stockman had the view, as I recall, that cutting inflation was good for the budget because of the cost of living adjustments that were built into so many aspects of the budget. The problem was that when you cut inflation you also cut revenues dramatically because people were not forced into higher brackets. Greenspan expressed the view that if you reduce inflation fairly rapidly, you’re going to have budget problems. So one of the major debates in the Administration, and we spent hours and hours on this, was making a projection of the future. We weren’t arguing about whether it was good to cut spending or to cut taxes. That was in the mix. That was already a policy that we wanted to control both spending and tax increases. The debate was how to project and what rate of inflation you projected and what rate of growth and spending and how these interacted. And so we had a lot of debates about how the numbers worked but not really about the policy.

01-00:37:46
Sharma: Not about the policy but about the accounting.

01-00:37:48
Anderson: About the economic projections. Now, there was a budget review group. Marty was part of that, Stockman was part of it, there were a couple of other people who reviewed proposals for changing the budget. OMB and the people involved would present these changes and they would be approved by this White House group, including David Stockman. So Stockman wasn’t doing this all on his own. He got approval of the Administration policymakers to proceed with proposals that would go in this revised budget to the Congress.

01-00:38:27
Sharma: Right. And this was Stockman’s creation, though, to—

01-00:38:30
Anderson: The budget review group? I would say that that was probably Ed Meese’s creation. Stockman may have wanted the budget review group. But the budget review group, I think it included somebody from Treasury, Tim McNamar, who was then set up to be Deputy Secretary of the Treasury, and Murray Weidenbaum, Chairman of the Council of Economic Advisers, I’m not sure who else was part of that. That was an informal group that I think Stockman wanted because I think he wanted the rest of the Administration to know what he was proposing so that they didn’t get any surprises, that all of a sudden there’s a proposal to cut a program ten or fifteen percent. When you talk about budget cuts, you’re always talking about cuts from a projected level in the future.

01-00:39:30
Sharma: From that base line.
Anderson: Yes. From a Carter budget, which may already include increases. So when you say you want to reduce a budget, whether you’re actually going below what is being spent this year or not is an open question. And, in fact, that’s what Stockman meant when he said none of us really understands these numbers, is that you say, well, we’re going to cut this by five percent. Five percent from what? From the ten percent increase that will occur if we do nothing? What are you talking about? And so before you can understand the numbers you’ve got to understand all the baselines. Remember that we’re dealing with twenty to twenty-five percent of the gross domestic product of the United States. This is a fourth of everything spent in the United States in a year. This is huge and it’s complicated and every agency’s a little different. All the means of appropriating funds are different and so it’s really complicated stuff.

Sharma: And any small difference in projection then translate into a huge difference in dollar figures, right?

Anderson: Well, probably. I think one of the things that Stockman admits doing is negotiating with Weinberger over the defense budget. And they agree on a certain percentage annual increase. And Stockman doesn’t realize that the baseline has already been increased.

Sharma: That’s right. During the last years of the Carter Administration.

Anderson: He knows that but there’s another agreement that’s also been reached. So the five percent is on top of something and he gets into that. Then he tries to back off that and get the defense budget cut later on. Weinberger, and with Reagan’s support, works on getting everything they can for defense.

Sharma: Can I just press you a little bit on this topic, because the defense buildup is really such a central part of the Reagan Administration and a really fascinating story, not just with respect to the Cold War but with respect to budgetary politics in the United States. Did you get a sense during the initial years that there was any tension within the Reagan Administration over the proposed defense buildup? Was Stockman alone in his concerns about the budgetary impact of expanding defense at such a high rate?

Anderson: I think he was primarily alone. I think Stockman’s objective was to be the first budget director in a long time who had balanced a budget. And he discovered that he could not do that without cutting defense and that that was going to be
crucial. He worked very hard on doing this and he desperately wanted to cut
the defense budget. And the people in office, Cap Weinberger at Defense,
William Casey at CIA. Richard Allen was the first National Security Advisor.
Bill Clark was the second one. I don’t think either one of them wanted to cut
defense. They wanted to essentially get what they could while they could.

Now, under Carter the defense budget, as a percentage of gross domestic
product, which is the way that I tend to think about these things, defense had
fallen below five percent. It was 4.7 percent even in 1980. So although Carter
had proposed some increases, they never happened while he was in office. So
he never got any consequences of actually having higher outlays in terms of
the budget. But Congress eventually, the committees on the Hill, got
cconcerned with the state of defense and said we have to increase this. It was
basically Congress that pushed higher budget numbers and said we’re getting
defense down to a point where this is not good. We’re under five percent. And
historically five percent is low. There’s only a year or two after World War II,
when we send the troops home and shut down the factories, when defense
falls below five percent. So when we’re going to 4.7 and so forth, we’re going
back to a pre-World War II level essentially and way below the levels that
sustained the Korean War and Vietnam and we’re getting to the point where
we’re not paying our troops, not supporting the all volunteer military
efficiently to get a lot of good people. Weakness in training, weakness in
procurement. Carter was canceling or postponing all kinds of weapon systems.

So I think that it was only Stockman’s Office of Management and Budget, and
not even his Assistant Secretary for Defense and International Affairs, who
was Bill Schneider. Bill Schneider was working with John Tower. And
Schneider wanted to increase defense and had a lot of things that ought to be
done. So basically they were getting everything they could while they could.
And Stockman wanted to cut that and he did not succeed.

01-00:46:06
Sharma: One of many, in his view, failures as far as cutting the budget.

01-00:46:10
Anderson: Well, he concluded later—he said in 2003, in a [September 7] New York
Times article, “I was absolutely wrong about national defense and Reagan was
absolutely right and it was the buildup in national defense that enabled us to
finally make arrangements with the Soviet Union and end the Cold War and
resulted in later cuts in defense.” Now, Clinton gets the defense budget down
to three percent of GDP, before 9/11 when we have the towers in Manhattan
attacked and then the budget again increases in order to meet the requirements
of Afghanistan and Iraq. But Stockman concluded, he said at that time—now,
what he said more recently may have been different. But he said that Reagan
was right about defense. [ADDED DURING EDITING: Defense spending
pays off when Reagan negotiates major nuclear weapons control—he and
Gorbachev sign the INF treaty in December 1987—and end the Cold War.]
Sharma: It’s interesting to me that you seem to be describing a consensus within the Reagan Administration, even among the budgetary people with the need to increase defense spending and that this was more or less accepted as a central part of Reagan’s policies.

Anderson: Well, it was supported by everybody who had been working with Reagan. Yes.

Sharma: And would you say the same thing about the tax cuts? We haven’t really discussed the coming of the Kemp-Roth tax cuts.

Anderson: Yes. Now, the details of the tax cuts and the negotiations over them are another matter. But Reagan’s economic program was well defined. We’re talking about details. He wanted to reduce marginal tax rates, “cut taxes” in shorthand, control federal spending except for defense, reduce regulation and bureaucracy and unnecessary regulation, stable monetary policy. Those are the four points. And the fifth point was to keep at it. Carter had had five economic programs. My husband counted five and a half economic programs in the four years Carter had been in office.

And so the other problem with inflation and all these different economic programs is uncertainly. You don’t know what’s going to happen. You don’t know what they’re going to do about taxes. You don’t know what they’re going to do about monetary policy and right now the things that we’re experiencing in the economy, there’s a lot of uncertainty in terms of what programs we’re going to have, what taxes are going to be, whether we’re going to keep some or all of the Bush tax cuts. That uncertainty is very difficult for an economy. And so the Reagan program, while there were details about negotiations with Congress and so forth and so on, his overall direction was clear from the beginning and never changed.

Sharma: Now, this is something that we’re trying to get a grip on. Although there is a tremendous amount of cohesion in the Reagan team—it’s really striking when one compares it to the Carter Administration, for instance—there still seems to be, if not tension, then at least some competing viewpoints within the Administration or different points of emphasis. So we already talked a little bit about people who are concerned about budgetary balance versus those who are primarily focused on tax cuts.

Anderson: There is concern about the deficit.
Reagan was getting some advice to reduce or postpone tax cuts in order to reduce projected deficits and help get the program through Congress. Reagan consistently resisted this pressure. He considered tax cuts essential to economic recovery. He was supported in this position by many of his advisers and by his outside economic advisory group, the President’s Economic Policy Advisory Board, chaired by George Shultz. Reagan’s personal diary entries show his commitment. He also writes there, frequently, that Congress wants higher taxes, higher domestic spending, and lower defense spending. He wants federal spending—domestic spending—controlled. Reagan is concerned about the deficit but he’s more concerned about economic recovery—about the long-run vitality of the economy.

In the end Reagan negotiated with the Congress and accepted income tax cuts of 5 percent in marginal tax rates the first year, beginning October 1, 1981, instead of January 1, 1981 (the original proposal) and 10 percent each of the two following years, and a reduction (requested by the Congress) of the highest marginal rate, which was 70 percent.

Can you help us get a sense of who stood on which side as far as prioritizing tax cuts and so those people who, for instance, thought that tax cuts would actually increase revenue, like Art Laffer and others, versus maybe some of those like Stockman who are more—I don’t want to say realistic, because that’s a loaded term, but who were more fiscally conservative in a way, or risk averse as far as that’s concerned.

Stockman basically started out very much wanting to reduce federal spending. So did everybody else. And also, to reduce taxes. Now, there was the 10-10-10 proposal to cut marginal tax rates across the board ten percent the first year, ten percent the second year from the level you’d reached in the first year and ten percent the third year. Everybody’s marginal tax rates. That was the income tax proposal. Then there was a business tax proposal. In fact, the business tax proposal ended up being much larger than had initially been included in the estimates that were made. The business tax cuts were much larger than were originally projected. The decline in inflation from support of the Fed was much more rapid. So by the end of ’82, we were down to something like four percent inflation and that was huge and that knocked the hell out of revenues because you don’t have people being put into higher
brackets. And so when you have less inflation you’ve got less increase in salaries and lower tax rates.

01-00:52:34
Sharma: Now, I guess we can continue talking about it on the next tape. It’s really interesting the importance of the projections. Stockman made famous the Rosy Scenario, initial budgetary projections that more or less optimistically foresaw rapid economic growth and high level—

01-00:52:57
Anderson: Well, they were rosy but every administration tries to project the best. Certainly the current Administration is doing that in terms of growth. You project the lowest possible unemployment you can. You try to make things look good because if you’re under budgetary pressure, if you don’t, you have higher budget deficits that you’re projecting. Congress and the public are concerned about the deficits. They are. There’s no doubt about that. But you have to look at even the Congressional Budget Office projects in, say, June of ’81. They are projecting positive economic growth. They are not projecting a recession. They are also projecting a little bit higher rate of inflation than in fact occurred. And so you’ve got both growth and inflation. You’ve got tax revenues coming in. You’ve got surpluses.

01-00:54:10
Sharma: Okay. And so it was really the economic downturn that led, in your view, to the increasing deficits?

01-00:54:13
Anderson: Well, there’s an economic downturn. And so the peak is July of ’81, the National Bureau of Economic Research reference peak. And November of ’82 is the trough. That entire period of time is a period of economic contraction. It’s not only that. It’s also the fact that you’ve got inflation declining dramatically.

01-00:54:48
Sharma: Reduces federal revenues.

01-00:54:50
Anderson: It reduces federal revenues. It also increases federal spending for welfare programs—more people qualify. Interest rates remain relatively high. So the interest on the federal debt—the interest rates drop later. It isn’t until people are convinced that there is going to be in the future a lower rate of inflation that the interest rates start coming down.

01-00:55:14
Sharma: Right. It’s sort of a lag.
Anderson: It’s a lag. And Reagan is extremely frustrated with the high interest rates in September when he meets with his outside economic advisors, George Shultz, Alan Greenspan, Milton Friedman, Paul McCracken, Bill Simon are part of that President’s Economic Policy Advisory Board, the external advisors who come in and meet with him. He’s very frustrated. He writes in his diary, “Nobody can explain why interest rates continue to be so high.”

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Meeker: I wanted to ask a few follow-up questions and so this means we’re going to spin back a little bit, back into the Ford/Nixon era. One thing that we didn’t ask yet is, given your involvement in Nixon’s election, and I’m sure that during the time you are teaching economics and business, I’m wondering, looking back on Nixon’s period in office, if you have any general reflections on his economic record and his fiscal policy.

Anderson: Well, when you look back on the Nixon record, the real start of difficulty with the federal budget comes with the passage of Medicare and later on Medicaid. And that happens in the Johnson Administration. In the Nixon Administration, there is an enormous increase in a lot of these programs. A colleague of mine was pointing out that Nixon federalizes food stamps, that he increases programs that are set to cost more money as they play out but that he increases the benefits in them and supports them. He flirts with a welfare, a family assistance program, that is defeated. So this is pretty much a liberal approach. Now, this is where the country is at this point. There’s a lot of pressure. There’s no way he could say, “Well, we ought to get rid of Medicare or we ought to do something different with it.” But the spending during the Nixon Administration, the domestic spending, increases a lot. The national defense spending declines because the Vietnam War is being wound down. He’s getting out of that. And that continues during Ford. Then there’s inflation of something like six percent. They’re horrified and so they impose wage and price controls, which is a pretty disastrous move. I think it’s Great Britain that asks for gold and Nixon has to close the gold window. So economically, and in terms of the budget, it’s not a good period of time.

Meeker: Well, it’s interesting thinking about that because one of the things you mentioned was that during this period of time there was only one tax increase and they were mostly tax decreases because of the fact that tax brackets were not indexed to inflation.

Anderson: Tax increases are built into the code.
Meeker: Precisely. So I’m wondering if during Nixon’s Administration there was maybe an emerging concern about spending that was perhaps new to Republican politics, that previously was not a major feature of Republican politics.

Anderson: One of the things that Arthur Burns, who was Richard Nixon’s—one of his two major domestic policy advisors. The other one is Daniel Patrick Moynihan. One of the things that Arthur says is that the federal budget is so large that it cannot be understood, and that which cannot be understood cannot be controlled. And he says that at that time. That’s nothing compared to what it is now, right? So there is concern about all of these different programs. But I don’t know how much specific concern there is about the deficit.

Meeker: What I’m thinking about is during Nixon’s term, as he is expanding really what entitlements are going to entitle people to, was there an emerging concern amongst more conservative leaning economists that the government is now starting to—

Anderson: Do things it shouldn’t do?

Meeker: Yes.

Anderson: I think some people are concerned about that, yes.

Meeker: Okay. And so let’s fast forward to ’76. I wonder what inspired you to support Reagan in the face of an incumbent, Ford, running for the Republican nomination of the Presidency.

Anderson: Well, Reagan was presenting both domestically and in foreign policy basically limited government and opposition to détente and appeasement of the Soviet Union. He was presenting what you could call conservative ideas. They were his own views.

Meeker: And you saw Reagan’s ideas as standing in fairly clear contrast to Ford’s ideas?
Anderson: Yeah. Of course, he kept Kissinger as Secretary of State and so it was a continuation of the Kissinger approach to the Soviet Union. And Kissinger’s view, and the view of a lot of people who were academicians looking at the Soviet Union, was that it was very difficult for the United States as a free market democratic country, republic, to compete with a totalitarian government that could spend the money the way it wanted to and extract whatever tax revenues it wanted from its population. That it could repress dissent, that it did not have to respond to a public that said we don’t want to pay such high taxes and we want more programs. We want more from the government. We want the government to do things for us. We want less defense spending. That the Soviet Union did not have to respond to those kinds of pressures because it was a centrally controlled economy and government and that we could not compete. The United States could not compete effectively on that basis.

Now, Reagan disagreed with that. He said we can compete. He had confidence in the American people and the American economy. That if you kind of let it loose and didn’t try to control it too much, didn’t tax people or businesses too much, that we could do brilliantly. And, of course, he turned out to be correct in terms of—that was one of the lessons that George Shultz tried to teach Mikhail Gorbachev, was that in a period of openness in communications, computer communications and all of these things, if you tried to close off a society you reduce creativity and growth. That you can’t live in this world isolated, that it doesn’t work. And Reagan already knew that and that was partly what he was supporting.

Meeker: And this is apparent as early as 1976 to you?

Anderson: Yes.

Meeker: Okay. Back to, again, ’76. You had mentioned some of the debates around the platform, particularly around foreign policy, as you just discussed. But for the ’76 platform, you said there were also some debates, particularly around domestic economic policy. Do you remember how those were articulated in the different positions that people were taking at that point in time?

Anderson: No, I don’t remember. I think that Reagan was concerned about excessive spending, a lot of spending, and the growth in federal government—spending and taxying.
Meeker: Okay. Primarily from his experience in Sacramento, do you think, or was it a federal issue?

Anderson: Well, he certainly argued against the Family Assistance Plan. He testified in Congress against the Family Assistance Plan, I think. So as a governor he was aware of the influence of Washington. As a governor he had a line item veto. In November ’73 Reagan does something very unusual that he’s criticized for as being unrealistic. He works on Proposition 1. Proposition 1 is an initiative that he places on the ballot in a special election to control—the California budget already has some spending controls, that you can’t deficit spend, but it doesn’t have taxing controls. And he wanted to relate the taxing and spending and to limit the size of the government. His view then, and later on when he was President, is that the pressure on legislatures to spend is so great that you need an external control. Okay? Now, that’s in ’73. And he does that in spite of the fact that he doesn’t have time to explain the complexity of this legislation to people. It goes on the ballot quickly. It’s complicated. If X rises above Y for Z period of time then this will happen. So it’s hard to understand exactly how this works and how it integrates with the California Constitution, but he supports Proposition 1.

One of the things he does as President in ’82 is that the Senate passes SJ Res. 58, which is a balanced budget tax limitation amendment, and he goes all out, and everybody in this Administration, goes all out. They pass that by the two-thirds majority that is necessary to send it to the states. And then they worked very hard, the entire Administration, and I was heavily involved in this, to get that legislation out of committee and onto the floor in the House and have a vote on it. It does not get the required majority to send it out to the states for ratification as a Constitutional amendment. But the Administration goes all out on that. It’s supported by Weinberger. I talked to Cap Weinberger about it. Defense is one of the areas that will be hurt. And so Reagan is extremely aware that there are pressures to spend. He writes one letter where he says, “I think we’ve learned that government’s wants are unlimited.” So you need some kind of external control over spending. And, of course, he had line item veto in California, which he would have liked as President, but everybody was advising him that it would be unconstitutional.

Meeker: And, of course, Proposition 1 is what leads eventually to Proposition 13, correct?

Anderson: Prop 1 was general and much better than Prop 13, because Prop 13 simply controls property taxes. So that wasn’t really what Reagan wanted. Thirteen was fine. That was good as far as it went but basically he wants an overall limit on what government can tax and spend.
Meeker: Well, okay. So that’s a segue to my next question: There’s a tendency in the literature that we’ve been reading, particularly looking at the first, say, term of the Reagan Administration, for historians and even economists to conflate monetarists with supply-siders with people interested in limited government. The way that we read it, there are actually some distinctions between at least those three groups of people, maybe even further divisions within them. And, in particular, Stockman comes across as someone who is primarily interested in limiting the scope of government. Basically, he thinks government has gotten too big, government is taking up too much of the GDP. Therefore it’s limiting private enterprise in the United States and some of the things that you talked about. But then there’s the Laffer Curve believing supply-siders who basically say that if taxes are reduced then that will stimulate the private sector, which will actually increase revenues to the federal government. Which is sort of a peculiar thing. So it’s like this is always used in argument, that using a Laffer Curve is actually going to increase revenues to the federal government. And Stockman came out and said that he didn’t believe that, that that was sort of a bunch of baloney was the Laffer Curve. And so I’m wondering in the OMB and amongst economists who were involved in the Reagan Administration during this period of time, did you see that there was a theoretical debate amongst those who were primarily interested in limiting the size of the federal government and those who believed, say, for instance in the Laffer Curve was actually—

Anderson: There was nobody in the Reagan Administration who actually believed in the Laffer Curve. Now, Art Laffer himself didn’t believe in the Laffer Curve. Art Laffer’s Curve was saying that there were two points at which you could raise the same amount of revenue. One was a lower tax rate and one was a higher tax rate. And so he was enthusiastic about reducing taxes for the purpose of encouraging economic growth. In the long run he argued that that would increase revenues. Nobody argued in the short run that you would recover the entire amount of a tax cut. The calculations based on the projections of the Reagan Administration in his September 9, 1980 speech was that the feedback was seventeen percent. So that if you cut taxes by a hundred million you would actually only reduce your tax revenue by eighty-three million. Okay? Now, that results from a little bit higher growth that you project, that’s the way you do it. There are two really good sources on supply side economics in the Reagan Administration. One is Marty Anderson’s book on revolution called *Revolution*. The other is Bill Niskanen’s book called *Reaganomics* and he says there is no supply side theory. There’s no school. There are no arguments. It’s not an overall view of the economy. It’s not a substitute for normal fiscal and monetary policy.

I worked very hard on the platform in 1980 and I was a major part of the press conference following the release of the platform and made the argument that this was a supply side platform and that the point was that incentives do
matter. And this is neoclassical economics. This is standard stuff. There is nothing new here. There is only a change of emphasis, that we’re forgetting that people respond when you tax them too much. People are responding now to the fact that instead of working they can get ninety-six months or something of unemployment insurance. So the idea that people respond to these incentives that are placed before them is not new. The projections that were being made of the budget, if you introduced a budget cut, if you said, “Well, let’s reduce the marginal tax rate by ten percent,” that a hundred percent of that was revenue loss. The argument was that not a hundred percent of it is revenue loss, only maybe eighty-three percent. There is an argument ultimately that either you have a downward spiral of increasing tax rates, of higher taxes and people avoiding those taxes and people avoiding work, people working off the books. There are people working in different countries, people moving. All kinds of ways to deal with a high marginal tax rate. Or you have an upward spiral where people are encouraged to work and save and invest and look at the future and pay the taxes on the income that they earn and so forth. So you’ve got an increasing pie and eventually that increasing pie enables you to do a lot of things, including collecting more revenues than you would if you were on the downward spiral with the smaller pie.

Meeker: Okay. Was there like a temporal horizon that was understood in the consensus way about, after the tax cuts were made, when the revenues would sort of equalize to that, say, eighty-three percent?

Anderson: There was an initial prediction that the budget could be balanced in ’83, primarily through spending control. Eventually that was moved to ’84.

Meeker: So it was a fairly short horizon then. Three or four years?

Anderson: Yes. And that was before the recession came along.

Meeker: Okay. And so one final question and I’ll hand it back to Patrick. Basically it’s January through March ’81. You’re just getting established in the OMB and Stockman wants to do this blitzkrieg approach that it seems like everybody is eager for. And this is in ’81 so it’s basically for the fiscal year ’82 budget. And you had mentioned that actually there was—

Anderson: With some amendments for ’81.
In ’81, particularly, the increase in defense spending. And you said that there were also some rescissions from the ’81 budget. What were those rescissions? How were the cuts determined? What were some of the sort of, not pet projects, but more like the pet peeves, if you will, of the Stockman OMB to make some cuts in the already passed budget?

I don’t know what the specifics were. I know that, for instance, the Small Business Administration for 1981 had a huge problem. It had a disaster relief program. And this disaster relief program was for farmers who’d been caught in a drought. And the grants or the loans that the Small Business Administration was making under this program were at such a low interest rate that if you got a loan at something like three percent you could turn around and invest in Treasury bills at twelve percent. The amount of money that you would like to borrow under this arrangement is infinite, okay, and so at the time when my staff came to me—the Small Business Administration was one of the agencies—they said, “We have 3.7 billion in loans that we can’t fund with the current appropriations, so we have to go for a supplemental and we have to ask for more money.” And David Stockman said, “Disaster relief? Small business? No.” And so what we did, because the Small Business Administration is allowed to issue regulations on an emergency basis, is we changed the regulations. And Congress was extremely upset and Lowell Weicker demanded that I come and testify. It was quite upsetting but we prevented the 3.7 billion and we changed the Small Business Administration’s regulations so that the problem went away. Now, that’s something that didn’t happen as a result. A dog that didn’t bark. It was a lot of work to get that done.

I have one more question and then I’ll hand it back over to Patrick. And it’s this larger question around defense spending, moving it back above the five percent of GDP. It’s interesting to look at the political discourse around increasing defense spending and it’s been hard for me to get a handle on the thinking about increase in defense spending and what it was going to buy. And it seemed like there are two possibilities and I’m wondering what people in the Administration were thinking. On the one hand, increased defense spending was justified in that it was going to actually buy specific new systems, technologies, increased number of troops that then the Soviet Union would look at those very specific new innovations or increased number of troops or new subs or aircraft carriers or whatever and say, “Okay, this means we need to compete more,” or “The United States has these specific new initiatives that we need to address.” Or was it simply dollars being spent? And do you see there’s a distinction there? Because there was this sense in the discourse that, well, the Soviet Union is simply looking at the number of dollars the United States is spending.
Anderson: With weapons systems.

Meeker: Okay. So it was specific initiatives you think?

Anderson: It was weapons systems, readiness, and military pay and morale. And so Reagan was very concerned about morale in the military. He was concerned about the MX missile, and about the upgrade to the Trident. The Soviet Union was going more and more in the direction of MIRVs, multiple warheads, and the Stealth bomber. I don’t think the word stealth was around at the time but that’s what we were talking about. And Reagan thought we should proceed with all these things that Carter had postponed or canceled. Okay.

Meeker: Okay. So it wasn’t merely a question of sort of trying to read what the Politburo was thinking, it was more we need the specific systems to remain competitive.

Anderson: Reagan felt very strongly that we needed to build up the military in order to bring the Soviets to the bargaining table so that he could negotiate a reduction in overall level of weapons, especially nuclear. And he is completely open about that with The Washington Post in an interview before he takes office. I think it’s June or July of 1980. He’s open about that in an interview with Cronkite in 1981. Cronkite said, “They think you want to build up the military, that you’re not going to negotiate until you’ve built up the military so you have a better position with the Soviets.” And Reagan says, “Well, Walter, I just don’t think it’s very reasonable to sit down at the table without good cards in your hand.” And he’s admitting this, right. He’s saying that. He’s open about that.

And Dick Allen tells a funny story about negotiating one national defense budget. He, and I guess Cap Weinberger—he’s the National Security Advisor so it’s got to be 1981—go to Reagan and say, “Here are the things that we possibly could do.” And Reagan looks it over and he says, “Well, let’s do all of them. Looks good to me.” So they’re expecting him to pick. He doesn’t. He says, “Let’s do it all.” And so he really wants to do that. Now, at the time when he starts negotiating with Gorbachev, he has written letters to other Soviet leaders. He writes to Brezhnev, he writes to Andropov, he writes to Chernenko. He talks about inviting Chernenko to come to the United States. He really wants to meet with him. Thinks they could do the Olympics in Los Angeles in ’84. But Chernenko is so sick by that time he couldn’t possibly go. So Reagan clearly doesn’t know how sick Chernenko really is. But he starts negotiating with Gorbachev. And at that time most of this hardware hasn’t been delivered. Almost none of it. The military pay has been increased and
we’re getting good people into the military. Reagan’s very pleased with that. But basically the hardware’s on order.

Sharma: That’s interesting stuff. We’re asking you to jump around a lot but maybe we can go back to your initial period at OMB.

Anderson: Well, I just wanted to say the defense buildup from five to something like 6.25 percent at its peak in ’85 or ’86 is really not that great. What is it? A twenty percent increase. There are several programs that increased by greater percentages over the entire period of the Reagan Administration than defense. So we think of defense as just huge. And basically one percent of the gross domestic product is a lot but there are other big programs, too.

Sharma: That’s interesting because I think it transitions into—there’s an image about the Reagan Administration’s budget priorities and then there’s more or less a reality. And one of the things that Stockman points out in his book is that this image of the Reagan Administration producing huge cuts in domestic discretionary spending in its first years is actually an illusion, that domestic spending increased pretty significantly under Reagan.

Anderson: Domestic spending did not increase under Reagan in terms of gross domestic product from the time he took office until the time he left, neither of which was a deep recession period. So when you look at GDP, you sort of have to allow for where the economy is. He cut domestic spending by a couple of percentage points. Now, that’s domestic spending. Everything the government spends exclusive of defense and interest. He cut that by a couple of percentage points. Bush increased it. Bush One. Clinton decreased it by a little over one percentage point. Bush Two increased it again. Okay? So Reagan’s record on domestic spending is really very good. One of the things that Reagan did not accomplish in domestic spending was reversing the great society programs. He didn’t do that. He had a proposal to control Social Security. We’d be in much better shape if that had passed at the time. To look at how much people get paid if they retire early, and that seemed to be excessive, and to look at retirement. I think retirement age. I’m not sure. The Congress was so upset over that proposal and the Republicans did not support the proposal. Their constituents were so upset that Reagan withdrew Social Security, let the Greenspan Commission come in and take care of it and accepted what they said, which included the tax increase, and just took it off the table for the rest of his administration a hundred percent. David Stockman, had some proposals in the areas of Medicare and Medicaid that I think largely failed. I don’t remember. They weren’t specifically in my area. But overall the Reagan Administration did a good job of controlling domestic spending. People may think otherwise, but that’s what the numbers show.
Sharma: I see. Maybe a lot of this feeling comes from Stockman’s own?

Anderson: Well, I think Stockman’s frustration was that he wanted to be the budget director who balanced the budget. Now, Reagan accepted some tax increases later on. And there was the ‘86 revision of the tax code. But basically, a lot of these increases later on were not such that they obviated the reductions that he had imposed. There was still reduction overall. So Stockman was frustrated. Yes. So if you look at the current deficit and the resulting debt, national debt, which is presumably the focus of this project, the problem starts with the major entitlement programs like Medicare and the growth in Social Security, which has increased all along. Those are the big problems. Those are the big programs. Health and retirement is the huge increase in the domestic budget. And so the problem begins with Johnson’s Great Society, which is basically passed out of a response to the assassination of John Fitzgerald Kennedy. So domestic spending is the fundamental problem with the national debt. National defense is easily controlled in response to the problems in the world. Congress is always eager to cut national defense if it possibly can. It always wants to cut—

Sharma: That seems sort of counterintuitive. It at least seems that military spending has grown. Maybe percentage of GDP has declined.

Anderson: Percentage of GDP. Because otherwise how can you compare these numbers? Under Clinton it got down to three percent. That was a cut from the Reagan peak, although it was declining at the end of the Reagan Administration and declined during the Bush Administration from six to close to three. That’s three percentage points of GDP. That’s the entire—everything you need to know about how Clinton balanced the budget. That’s the answer. Then it gets down—

Sharma: Or is it accelerating GDP?

Anderson: Well, economic growth is occurring, sure. And Clinton raised taxes a little bit, and actually, he did all right controlling domestic spending.

Sharma: So the sense that Stockman has about frustration with Congress. Others in the Reagan Administration, did you feel that your policies were successful at the time? Did you share Stockman’s frustration?
You see, I left in early ’83 and 1981 was pretty good. The Omnibus Budget Reconciliation Act, which was one of the things that Stockman did that was really good, is to put all this into reconciliation. There was a huge amount of legislation that was passed in addition to the budget. So there was budget legislation that related—it was not only the tax bill but the Budget Reconciliation Bill. And the Budget Reconciliation did a huge number of things. For example, one of the things it did was it changed the rules for running Conrail. There had also already been some deregulation, the Staggers Rail Act, which was passed in the Carter Administration. But the Omnibus Budget and Reconciliation Act made some new rules for Conrail that enabled it to become profitable. It was sold for a couple of billion dollars in 1986. Without that legislation in 1981 you could not have made that profitable enough to sell to the private sector. That was huge. We were running the freight railroads. So that was in 1981.

And did that come of this process of going through the budget line by line and looking for savings? That piece of legislation?

That was what legislation do you need to pass in order to enable Conrail to become profitable so that it is not constantly a demand on the federal budget. And so that was done. And that was done partly through the Office of Management and Budget. But also, Drew Lewis was Secretary of Transportation and he said to me, before he was appointed Secretary of Transportation—he knew he was going to be—he said, “The one thing we’re going to accomplish in this administration is to get Conrail back in the private sector. No reason why the federal government ought to be running a railroad.”

And were there other success stories?

Oh, there were a lot of things in terms of deregulation. The suit against IBM, the antitrust suit, was dismissed. AT&T was broken up into the Baby Bells. Transportation and communications were substantially deregulated and the financial sector was deregulated.

So I guess if one’s thinking about Stockman, I guess it’s always how one looks at experiences. Whether you consider things a success or a failure depends on a lot of different things. And so from your point of view, the Reagan Revolution actually succeeded in doing a lot of what it set out to do, whereas from his point of view—
Anderson: Yes. Look, we had ninety-two months of positive economic growth from the low, the trough in November of ’82. The growth rate during the Reagan Administration is almost four and three-quarters percent a year. That’s booming, right. On average, cumulative year on year. And then there’s a brief recession and then there’s another 102 months of economic growth. The stock market more than doubles under Reagan, and keeps going up. This is the longest peacetime expansion in US history. This is phenomenal. This is successful. Amazingly successful. It does not eliminate, in terms of what I think Stockman and maybe Reagan hoped to do, the Great Society programs of Lyndon Johnson and the substantial huge increase in entitlements that occurred.

Sharma: And to what do you attribute that success, the economic growth of the eighties?

Anderson: Well, I think to control of government spending, to reduced regulation, to lower taxes and stable monetary policy. The end of inflation and the support for Volcker and later for Greenspan in terms of controlling inflation. All of those things. And the stability is enormous. And not having to deal and always wondering if you were going to have inflation at a rate of this or that or whatever. To have it fairly low and stable is enormously attractive.

The other thing, of course, that happens as the result of Reagan’s successful negotiation with the Soviets and the end of the Cold War is not only do you get a reduction in defense but you have an opening of international markets worldwide. And China begins reforming in ’78 and then the Soviet Union comes apart in December of 1991. The Berlin Wall falls in ’89, November of ’89 and so you have Eastern Europe open. You’ve got Czechoslovakia, Poland, East Germany and so forth. And then you have all the Russian republics. So you’ve got an opening of world markets and international trade that is extraordinary. And you’ve got enormous increases in the living standards in some of these countries that have been behind the Iron Curtain for a long time. And so you’ve got one of the greatest increases in democracy and individual well-being that you’ve had. It’s an extraordinary period of time.

Sharma: Right, right. In some countries. Not in others. I’d like to get a sense of what—

Anderson: China, India.
Sharma: Right. Yes. No, that’s definitely true. The economic growth of the Reagan years was arguably purchased at the expense of continuing and unprecedented budget deficits and an unprecedented explosion of the national debt. And I want to get your opinions, your thoughts, about within the Reagan Administration at the time, was there a concern about the inability of the government to balance its books? There’s no escaping the fact that the debt exploded under Reagan. Reagan increased the national debt more than all previous Presidents combined.

Anderson: Well, you’re looking at absolute numbers and so you’re comparing numbers that are vastly different at different periods in time. Certainly the Reagan debt increased less than the current President has increased the debt in the Obama Administration. So that makes Reagan look like chicken feed. The debt increased under Reagan as a percentage of the GDP, the debt held by the public, which is the number that you want to use, from about twenty-six to something like forty. And now it’s above that and going towards seventy. And so I think that what you want to look at as the true problem of government is not the deficit spending and not the debt, but spending. What are they spending?

Sharma: And why is that?

Anderson: It’s the real cost of government. That’s the amount that it is taking out of the economy. That it is removing from the uses of the private sector whether through borrowing or taxing.

The solution to government debt is inflation. This is what they turn to. Now, the dramatic thing about the Reagan Administration was not just the tax cuts but the indexing of the tax code. And this was fully in effect not until 1985, but I think by ’85 or so it was fully in effect. That is so accepted today that if somebody said, “Well, we’re going to get rid of that,” there would be outrage. It’s like a Constitutional right, that you index the tax code. You don’t let inflation put people into higher tax brackets. But the government debt, and this is how we dealt with it before, is dealt with through inflation. That reduces the value of the outstanding debt and increases the GDP and so you get a lower debt to GDP ratio.

Sharma: But that that wasn’t the Reagan Administration’s policy to engage this sort of—?
Oh, absolutely not. Absolutely not. Just the opposite. But I’m saying that this much debt encourages the government to look at inflation as a solution. And if you really want to extract resources from the public, you can give up on your indexing of your tax code or your indexing of your benefits, Social Security, for instance.

Now, in the eighties, there is certainly this concern, though, especially among Republicans, about unbalanced budgets. So you get in ’82 this move towards a tax increase.

Yes. There has been a view that inflation is the result of deficits. And Reagan expresses that view at different times during the seventies. Milton Friedman’s view, of course, is that inflation is a monetary phenomenon and that you can have a deficit and control inflation at the same time if you have a monetary policy as was followed under Volcker and Greenspan. And that turned out to be the case.

I see. But I want to get your opinions on, and your understanding of how certain things like the tax increase in ’82 came about. I know you weren’t there but how the Gramm-Rudman-Hollings legislation came about.

That was the ’83 budget. We had planned that.

There was a strong concern about deficits.

Yes, there was. And Reagan felt bad about not being able to balance the budget. He wanted to be able to balance the budget and he clearly said that in terms of cutting taxes, spending on defense and balancing the budget, that balancing the budget was the third priority. If one of the three had to go, that was it. He would not give up on his economic program in order to balance the budget. He would not take the money out of defense and that’s what we’d been doing all through the late sixties and seventies. And he wasn’t going to do that. So five percent is not unreasonable, although you might not like what we’re spending it on. But five percent for defense is not an unreasonable amount. We increased it to six and brought it back down. So he clearly regretted not being able to balance the budget. He attributed that to Congressional desire to spend and that there were enormous pressures to spend and that without a Presidential line item veto or a balanced budget tax limitation amendment, that you could not manage the federal budget. Or a state budget, for that matter.
Sharma: And can you describe a little bit more your role in pushing for the Balanced Budget Amendment? You mentioned earlier that you were a chief liaison.

Anderson: Yes. The Senate passed SJ Res 58. It was a joint resolution. Senate Joint Resolution number 58 and the House did not want it to come to a vote. It was not my decision. It must have occurred in the legislative strategy group in the White House or with Reagan’s pressure. We had a Cabinet council meeting on it at one point. But the decision was to work on what was called the discharge petition and the people at OMB, the legislative liaison at OMB, were in charge of the discharge petition. The discharge petition is something you get Congressmen to sign that says we want to bring this to a vote on the floor of the House, whether the committee chairman wants to bring it to the floor or not. We get it to the floor through this petition. And that was passed. David Stockman was asked to testify. He was going to be the person who testified on behalf of the Balanced Budget Tax Limitation Amendment. I was assigned to write his testimony. I think I volunteered. And he said, “You have to write it to explain that it’s not going to work.” So I followed my orders and I wrote it that way and he said, “Annelise, this is not enthusiastic. You have to rewrite this.” So I rewrote it the way I really felt about it and the way I’m sure Reagan felt about it and other people in the Administration, that we really needed this and so forth.

And then when it came up for debate, when it was up for debate, there were a great many amendments that were introduced. I can’t actually remember whether this was the Senate or the House that was debating it. It must have been the House. These amendments would come up and every morning at seven o’clock at OMB I had to take positions on all of these amendments. I would think if you’re amending the Constitution, the Department of Justice would be the main player but apparently they didn’t want to. OMB, of course, coordinates legislative positions for the entire government, for the executive branch. So it was a very busy time. The basic philosophy was that we weren’t going to accept amendments. We wanted to have a straight vote. So generally I would find different ways to say no to these amendments.

Sharma: But the basic Reagan policy towards a balanced budget amendment was in support of it? And that there was a feeling that the government needed its hands tied?

Anderson: Absolutely. And Reagan very definitely. As I say, he had done this in California in ’73 with Proposition 1. And that was a way to limit both taxes and spending. That was the idea, to limit what the government spent and taxed to a certain percentage of gross domestic product or gross national product or whatever measure you used, except in times of national defense emergency.
And so you have that out, that you can get out of that if you need to. And then you have whatever conditions for declaring a national emergency you want to build into your amendment or none or whatever. And so SJ Res 58 was pretty good.

Sharma: I want to get your opinions on Stockman and your memories of when the William Greider article hit, how that played out within OMB and within the Reagan Administration. There was frustration?

Anderson: Yeah. It was November of ’81. It was very, very discouraging. And one of the worst things that happened was that Stockman had been an important voice within the Administration in dealing with the Cabinet to say we all have to participate in cutting the budget because you’ve all got your interests and your programs, keeping your constituents happy and so forth but overall we need to cut what the government is spending or control its increase, which was really all we were doing. And Stockman lost his effectiveness after that and became just a numbers cruncher. Since Baker, Meese and Deaver were advising the President—Meese and Deaver thought Stockman ought to be fired. Baker said let him stay. Stockman persuaded the President that Greider had gone against their agreement and published things that he wasn’t going to publish, at least not then, and felt very bad. So Baker thought he could stay. Stockman was technical, of course. He was terrific and knew all kinds of details and everything else. So he was useful. But he wasn’t nearly as useful in persuading either the Administration, the Cabinet secretaries with whom OMB negotiated the budget every year, or the Congress that we should pursue this course of action. And so he lost a huge amount of effectiveness. Damaged himself greatly I thought.

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Meeker: My question really focuses on the piece of legislation that allows for the indexing of tax rates to inflation rates. This is something, of course, that we’ve come across before in our research. But in your description of it today, there’s sort of a light bulb going on about how it is profoundly important. The implications of it are quite broad. Just as we look at debates in Congress today about taxation and also the fact that when it wasn’t indexed there was no need to raise taxes, and after indexing the question of revenues becomes much more politicized. So if there’s no need to raise taxes, then, of course—

Anderson: Taxes go up automatically. That’s the point.
Meeker: Well, you’re right.

Anderson: And so Congress does not have to legislate a tax increase. It’s built into the code. What they legislate are cuts.

Meeker: Yes, okay. But it’s a lot easier politically, right, to legislate cuts than it is to legislate increases.

Anderson: That’s right.

Meeker: And so I see that as a sea change, right, that is caused by this piece of legislation.

Anderson: It is. It is. It is.

Meeker: So I wonder if you can tell me from your vantage point how the indexing of tax rates to inflation came about legislatively.

Anderson: It was part of the bill that we sent to the Congress, as far as I recall.

Meeker: Which bill was it?

Sharma: Was it the Kemp-Roth Bill?

Anderson: No. Well, the Kemp-Roth is part of it. It’s ERTA. The Economic Recovery and Tax Act of 1981 and the Omnibus Reconciliation and Budget Act of 1981 are passed in May and June and July of ’81 and signed by Reagan at the ranch on August 13, 1981. The two of them. That’s the basic legislation. Once you’ve got those two things, you’ve done an enormous amount.

Meeker: How did that come about? I wonder when you were involved in drafting this legislation, were you involved in—
The Treasury drafts this legislation. Norm Ture was the Undersecretary of the Treasury for Economic Policy. Paul Craig Roberts, who was a real supply sider, one of the people in the Administration who really believed this stuff, was Assistant Secretary of the Treasury for Economic Policy. And Buck Chapoton, who was from Texas, was Assistant Secretary of the Treasury for Tax Policy. He and his staff wrote the tax bill. And he was a tax lawyer who was interested in public policy and he was one of the people who agreed with Reagan that all of this should be done. He did the technical details, writing the code.

And the ERTA was passed with fairly broad bipartisan support if memory serves. Probably mostly southern Democrats with a majority of Republicans.

Right.

Do you recall if there was ever any concern within the White House about getting this provision of indexing taxation to inflation passed? Did it seem like there was ever any concern about it being stricken from the legislation? Or was it a no-brainer, as one might say today?

I’m not sure. I know that Reagan really wanted to do it. That during the late seventies, between the time of governorship and the time when he announced for the Presidency, he wrote a huge number of commentaries, radio commentaries, some of which are in this book, *Reagan In His Own Hand*.

And he wrote seventy-seven on the economy, on one aspect or another. These are short essays, so they’re like six, 800 words. And he wrote about the problem of inflation, and pushing people into higher tax brackets was one of the frequent things he wrote about. Bracket creep is what it was called. Bracket creep. And he wrote another forty, forty-five essays on regulation and bureaucracies. So he was writing an enormous amount about the economy in the seventies. So it was part of his program.

So let’s say that this indexing was in fact a sea change when it comes to taxation in the United States. Was there an understanding at that point in time of how consequential the introduction of indexing would be?

No. I don’t think so. In August of 1980 when the Senate Budget Committee was making its projections, taxes were expected to increase to twenty-three percent of GDP. They were always expected to increase to levels that are unsustainable historically. This is why Congress was always cutting the taxes,
right, because otherwise they were going to go up and increase the tax burden repeatedly. Indexing would deny Congress this future surplus indefinitely, not allow them to decide what of it to spend and what of it to offer in tax reduction. I don’t think we realized how dramatic that would be.

Meeker: Looking back on it as an economist, do you think that it was a good and necessary piece of legislation?

Anderson: Oh, I think it was a terrific thing to do. Yes. The tax code changes all the time. This was something that was accepted as morally fundamentally right. Like due process. Fair. And requiring that Congress be explicit in what it was doing in terms of taxing and spending so that it didn’t automatically get programs covered.

Meeker: Fair enough. Do you want to ask any final questions to wrap-up?

Sharma: Sure. Well, I think we’ve covered most of it. I’ll just ask you if you have any concluding thoughts or anything you want to get out there.

Anderson: No, I don’t think so.

Meeker: Maybe anything that we should be covering that we haven’t asked about.

Anderson: No, I think you’ve done a pretty good job. I think so.

Meeker: So nothing that you want to add?

Anderson: I did want to tell you that as you look at these numbers, that we’re talking in relation to gross domestic product. The earlier numbers are in relation to GNP and there’s a switch to GDP. Whatever you look at, you’ve got to get a consistent series. And the other thing that you want to keep in mind when you’re looking at budget numbers is there are outlays and there’s budget authority. And when Congress appropriates funds, it gives the agencies authority. No funds may be drawn from the Treasury except in consequence of appropriations made by law. That’s what the Constitution says. So you have to have an appropriation. Now, what we’ve done with things like Social Security is this: if you’re taxed and money goes into the fund, that is deemed to be an appropriation. You can also appropriate “such funds as may be
necessary” or you can say people are entitled to certain medical, Medicare or whatever, and if they qualify, the amount for which they qualify is deemed to be an appropriation. And so there are all kinds of different ways to do this. I’ve been talking about federal outlays; somebody else may talk to you in terms of budget authority, which spins out over a period of years.

The other thing that I forgot to say, and Jimmy Miller must have dealt with this in terms of federal credit, is that there a lot of obligations that the government makes in terms of loans and loan guarantees that only partially and incompletely show up on its books as outlays. And so in addition to the federal debt, there are federal obligations. Look at the Pension Benefit Guarantee Corporation. Fannie and Freddie. Fannie Mae and Freddie Mac. The Reagan Administration worked on controlling Fannie Mae and Freddie Mac. The President’s Commission on privatization that I was a member of that reported in March of ’88 recommended that Freddie Mac and Fannie Mae be controlled and Ginnie Mae, and that these were expenditures that were getting out of control because there was no market competition. That’s basically what happens with something like Medicare, where you do not have individuals making a decision about money to spend and so you get obligations that make the federal debt that we’re acquiring look like potentially a small part of the problem. And so I think Jimmy Miller, and later in 1990, there was a federal credit act that tried to rationalize some of the use of federal credit so that Congress doesn’t turn toward, say, a loan guarantee, which is what it’s doing with all the housing stuff that has gotten us into some of the difficulties we’re in today. And that’s the other challenge in the federal budget, is dealing with all the other obligations of the government that are not part of direct outlays.

[End of Interview]