Excerpt from *The Commanding Heights* by Daniel Yergin and Joseph Stanislaw, 1998 ed., pp. 341-342.

It took three years. By the summer of 1982, the conquest of inflation was in sight. In fact, inflation that year would fall below 4 percent. [The] singular achievement [of Federal Reserve Chairman, Paul Volcker] was to conquer inflation at a time when defeatism was rampant. He set the United States on a new economic course. The risks of not succeeding were often on his mind. So was history. Once confronted with the accusation that he was behaving like a German central banker, he replied, "I don't take that as criticism. That's a compliment. I'm in pretty good company there."

Thanks to Volcker's efforts, monetary restraint was obtained quite early in the course of the Reagan administration. And Reagan's unwavering stance in the air traffic controllers' strike of 1981 helped change the tone of labor relations, indirectly contributing to the muting of inflationary psychology. But there was still fiscal policy to be dealt with—the ways that government raised its revenues and the ways that it chose to spend them. The rise of welfare demands, entitlements, and obligations toward the middle class, the poor, and especially the elderly made spending politically necessary as a source of votes. The problem, of course, was how to finance the outlays.

Ronald Reagan's advisors came to office with the intention of cutting both taxes and spending. But they soon found out that it was easier to achieve the first of these objectives than the second. The reason was simple: politics. It was popular to cut taxes. And taxes did come down substantially. The top marginal rate was reduced from 70 percent to 28 percent; the tax base was broadened; and many deductions and loopholes were eliminated. But it was unpopular to cut spending, and the Democratic Congress bridled at the extent of the cuts that the president proposed. Reagan did not take on middle-class entitlements. He also spared the Defense Department from the ax, and indeed initiated, over the course of his two terms, major increases in defense expenditures, including the "Star Wars" space defense program.

Some in the Reagan camp were optimistic, despite the failure to cut total government spending. They were the advocates of what traditional Republican economist Herbert Stein—echoing the music of the day—called "punk" supply-side economics, which made sweeping assertions that reductions in tax revenues resulting from tax cuts would be more than made Up for by higher tax revenues generated by economic growth. It did not turn out that way. Because spending did not come down with taxes—and indeed defense spending went up sharply—and because the tax cuts did not feed back into the economy to the extent hoped, both the federal debt and the annual deficit ballooned; and in 1981-82, the economy was in a deep recession.

In September 1982, in its first effort to repair the damage, the Reagan administration followed the "largest tax cut in history" with the "largest tax increase in history." But there was no catching up. By the end of Reagan's first term, the supply-side logic was discredited in the eyes of many, and the inability to bring taxes and spending down together stood in marked contrast to Volcker's victory over inflation. David Stockman, Reagan's first director of the Office of Management and Budget, left the administration dejected, disillusioned with supply-side economics, and chastened by the realities of the political process. Failure to achieve fiscal-policy change, he argued, was a clear vindication of the "triumph of politics"—of entitlements over austerity, and of the enduring pork-barrel tradition of American legislation over any cold economic logic. "I joined the Reagan Revolution as a radical ideologue," he wrote. "I learned the traumatic lesson that no such revolution is possible."

The triumph of politics and what Stockman called the "fiscal error" that went with it spawned a new monster, which would come to occupy center stage in policy debate: the deficit and the federal debt. Between the beginning and the end of the Reagan presidency, the annual deficit almost tripled. So did the gross national debt—from $995 billion to $2.9 trillion. Or, as Reagan and Bush administration official Richard Darman put it, "In the Reagan years, more federal debt was added than in the entire prior history of the United States."

There simply was no quick cure to the scale of spending. In the minds of some, however, there was another logic to tax cuts: Reduce taxes and government revenue, and eventually the pain and scale of deficits—and the threat of national bankruptcy—would force a retrenchment of government spending. That thought was not restricted to fervent supplysiders, and ultimately it would end up true. But not for some years, and certainly not during the Reagan years.

When George Bush took office in 1989, the annual deficit stood at $152 billion. Taxes could not be raised substantially for devastatingly powerful political reasons—as Bush found out when his retreat from his solemn "read my lips" campaign promise of "no new taxes" became his most damaging political liability. There was no choice but to contain spending. And luckily, international events afforded a good opportunity to start tackling the problem. The fall of the Berlin Wall and the crumbling of the Soviet empire made possible a tapering-off in defense spending. Still, this was not enough. Owing to the recession of the early 1990s, tax revenues fell, and in 1992, as Bush was ending his term, the deficit peaked at $290 billion.