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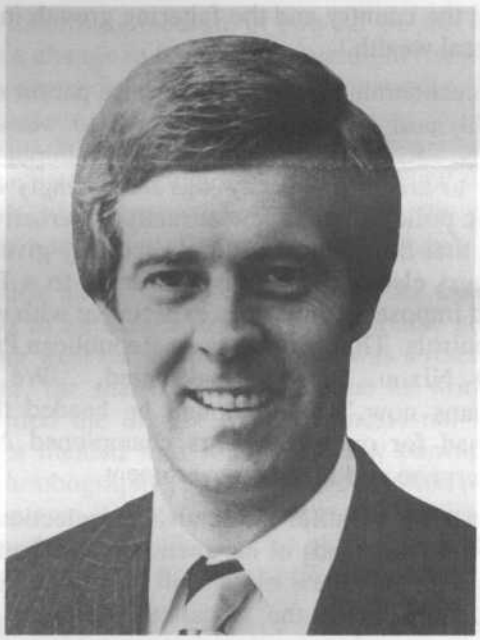
# BEYOND SUPPLY-SIDE ECONOMICS

**By John K. Andrews, Jr.**



**Prologue: On the evening of April 15, 1983, income tax day, the writer was among several hundred conservative and libertarian faithful crowding a hotel ballroom in Chicago. We were there to hear a speech by one of the newest and most fiery anti-tax crusaders, Lewis Lehrman of New York.**

**Lehrman argued for a flat-rate income tax, a gold standard, and a "federalism amendment" to the Constitution. Yet something obvious was missing from his impassioned prescription for America's economic ills: "supply-side economics."**

**So short a time ago, this trendy phrase had been inescapable in discussions of public policy. But this night we never heard the term uttered, in the speech or in the questions afterward, though speaker and audience were implicitly committed to the supply-side view.**

**Why has supply-side economics disappeared so quickly from the national dialogue? There may be more to the answer than the simple political fact that President Reagan's ill-wishers among the Democrats and the media no longer want to trumpet the term now that a vigorous recovery is underway for which supply-side policies deserve much credit.**

**Maybe the country's rapturous but short-lived honeymoon with supply-side ideas says something about an unhealthy American obsession with economic abstractions in general. Let's have a look.**

## I. Courtship and Consummation, 1975-1981

Americans who pay attention to fashions in ideas began hearing about supply-side economics sometime in the mid-1970s. Within half a dozen years, publicists and politicians had succeeded in making the term a household word, electing a new national administration pledged to its implementation, and then actually making some of its precepts the law of the land.

To make sense of this whirlwind courtship, we should begin by remembering the mood of frustration with prevalent doctrines, and of hunger for hopeful new ones, that blanketed the country in those Bicentennial years.

The America of Gerald Ford and Jimmy Carter—into which supply-side notions, the rediscovery of Say's Law, the famous (even if aprocryphal) scribbling of the Laffer Curve on a paper napkin, the charts and graphs of marginal tax rates under Andrew Mellon, blazed like a comet—that America was not a happy or self-confident land.

Its system of productive enterprise and markets was growing more and more sclerotic under repeated waves of interventionist and redistributionist legislation dating back to the early years of this century: the Progressive era, then the New Deal, then the Great Society. Measures like the Federal Reserve System and progressive income tax (1913) and the National Labor Relations

im•pri•mis (im-pry-mis) adv. In the first place, from Latin *in primis*, among the first things...

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Act (1935), enacted before most contemporary businessmen and public officials were even born, had worked their cumulative effects to slacken the pace of American economic growth from the miraculous toward the mediocre.

Of more recent date, but equally costly, were the legacies of the 1960s. One of these was the vast social welfare schemes that rapidly eroded productive incentives, the work ethic, and the infrastructure of family, church, and school. The other was a roaring inflation, triggered by political dishonesty in postponing payment for the Vietnam War, and maintained by increasing disassociation between the ballooning supply of money and credit in the country and the faltering growth in production of real wealth.[1]

Macroeconomic management, whose patron saint was John Maynard Keynes, only seemed to worsen these problems. Keynes's emphasis on manipulation of demand to create prosperity was increasingly bankrupt as public policy. Yet so few attractive alternatives were in sight that the country had only recently given one of the largest electoral margins in history to a President who had imposed a disastrous experiment with wage and price controls. That was the same Republican President, Richard Nixon, who had declared, "We are all Keynesians now," even though he headed the party which had for over 100 years championed American free enterprise and limited government.

Nixon went on after his landslide reelection to play directly into the hands of his enemies from the ideological left and the "new class" of knowledge wielders, helping them create the so-called Watergate scandal.

**About the Author**

John K. Andrews, Jr. is the editor of *Imprimis*, vice president for outreach at Hillsdale College, and chief of staff at the Shavano Institute for National Leadership.

He has previously been a press aide and speechwriter for President Richard Nixon, 1970-73; executive director of Adventure Unlimited, an international Christian youth organization; and a freelance writer and idea broker.

Mr. Andrews grew up in the Midwest and the Rockies, took his B.A. degree in politics and business from Principia College in 1966, and was a U.S. Navy submarine officer during the Vietnam War. In 1981 George Roche brought him to Hillsdale to direct the Center for Constructive Alternatives and help found the Shavano Institute.

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Watergate devastated national morale, nullified the conservative mandate of the 1972 elections, and paralyzed American will to enforce the Vietnam peace accords. The resulting fall of South Vietnam, widely perceived as America's first-ever lost war, sent shockwaves throughout the free world and visited untold human suffering upon Southeast Asia itself.

The America of the mid-1970s was also an America gripped with what the new class insisted was an energy crisis of apocalyptic proportions. Only a few were able to perceive the root cause of this painful dislocation in government-maintained, artificially low energy prices in the United States over the past generation. Only a few correctly foresaw resolution of this self-inflicted "crisis" by a combination of price discipline (the only efficient allocator of resources mankind has yet discovered) and technological breakthroughs like those that repeatedly throughout history have moved mankind through narrow passageways of discomfort into wider levels of mastery over our environment.[2]

Abroad, Soviet political and military adventurism was sharply on the rise, despite the paradox that the entire Communist bloc was more and more obviously an *economic* failure, sustained only by a growing mountain of Western credits and favorable trade in everything from food to technology.

The generation since the close of World War II had seen massive decolonization of most of the Southern hemisphere, with the majority of new nations embarking on a suicidal path of self-impoverishment through various forms of socialism and authoritarian statist economic policies. But that same period, 1945 through 1975, had seen an equally striking trend of economic success stories in the Far East, around the Asian rimland from South Korea to Singapore, each case having in common relatively non-intrusive government and relatively broad freedom of enterprise.

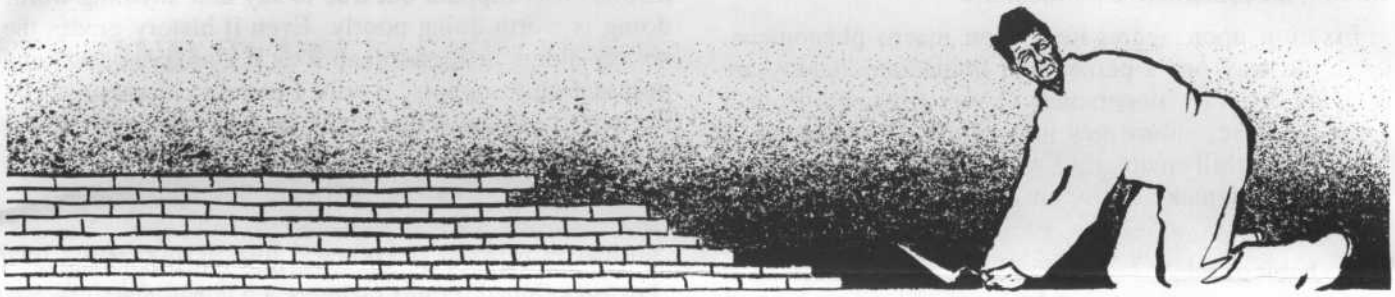
So Americans in those years saw a rich variety of examples, counter-examples, competitors, claimants, supplicants, and threats when they looked around an increasingly smaller and more interdependent world.

Enter supply-side economics. The leading names are familiar. In the United States Congress, Jack Kemp of New York, previously best known for his ability to throw a football. In academia, Professor Arthur Laffer of California (where else?), previously employed in the notorious Nixon economic stabilization bureaucracy. In the media, Jude Wanniski, the former *Wall Street Journal* writer who boasted of his minimal training in economics and modestly entitled his book on the supply-side gospel *The Way the World Works*.

Incarnated in the dramatic Kemp-Roth proposal to cut marginal federal income tax rates, and soon embraced by the lean and hungry Republican Party and its most attractive figure, Ronald Reagan, supply-side economics during the late '70s moved inexorably toward the

center of power.

To the average citizen, the supply-siders seemed to be saying a number of simple things. Simplest and most important of all, giving their school of thought its name, they restated Say's Law: supply creates its own demand. In other words, production of goods and services must precede their consumption, and overproduction in any particular area will be rapidly brought into line if market forces are free to operate.



One had only to invert this basic assertion of the supply-siders to obtain the Keynesian formula in its baldest terms, an embarrassment on its face. Why, to claim that *demand* creates its own supply, that wealth will be forthcoming if only enough people can be made to passively desire it and to offer paper money or bank credits in exchange for it, suddenly sounded patently absurd. How could the West have believed it all these years?

The supply-siders went on from there. Everyone responds to positive incentives and recoils from disincentives, they told us. Taxation in the form of money exactions as well as in the form of a regulatory "wedge" constitutes one of the most powerful disincentives to production in modern economies, they taught. "When you tax anything," Jack Kemp went up and down the land saying sensibly, "you get less of it." Was the answer, then, to cut aggregate taxation? No, no, aggregates are an illusion, came the reply. It is the individual, acting on the margin, that determines everything. Hence it is the *marginal rate* of taxation that must be reduced if productive economic activity is to be stimulated.

And the best part was yet to come. For a reduction of marginal tax *rates,* if gauged correctly, might actually yield increased tax *revenues* to the public treasury as well as increased private wealth for consumption and savings. This would occur, we were told, as the reduction of disincentives to work and invest enlarged the overall economic pie of a society, and as various forms of wealth, production, and exchange hitherto driven underground by high tax rates were brought back into the open (when it became less trouble to subject them to moderate taxation than to conceal them from the government).

Naturally, all of this sounded good. Why listen to the Club of Rome talk about limits to growth, to Lester Thurow talk about a zero-sum economy, to Jimmy Carter in his cardigan sweater talk about a national malaise, when one could listen to Kemp, and later Reagan himself, talk about this painless, all-win new approach to public policy?

The new approach would balance the federal budget while initiating a massive American rearmament to meet the Soviet threat and at the same time maintaining the social welfare safety net for the truly needy. Fiscal policy would stimulate economic growth while monetary policy halted inflation. There need be no tradeoff of higher unemployment for lower inflation. Traditional Republican emphasis on austerity and cutbacks was muted, at least for the moment.

Reagan's opponents scoffed. John Anderson said it would all have to be done with mirrors, and George Bush called it "voodoo economics." But other observers thought they saw the emergence of a new and formidable political species: the bleeding-heart conservative. It had worked in Kemp's Congressional district, where blue-collar union voters kept returning him by big majorities. Why couldn't it work for Reagan?

And work it did, at least in terms of contributing significantly to the thumping Republican victory in the American election of November 1980. Whether it also worked in terms of delivering the economic results it had promised is another question, however. Depends on whose promises you hold to account, whom you ask to evaluate the results, and when. (One popular benchmark for pronouncements of "dead on arrival" was just after the measures' enactment but well before they took effect in law.)

**II. Divorce and Second Thoughts, 1981-1983**

In a matter of months, Ronald Reagan had set in motion a package of measures to trim the growth in social spending, cut marginal tax rates, and reduce regulation in a number of industries. The Federal Reserve Board under Chairman Paul Volcker, a 1979 Carter appointee, did its part by holding down money growth to bring inflation down to low single-digit rates. The whole approach was dubbed, for better or worse, "Reaganomics." The public perception in America was that all this was the work of those supply-side wizards about whom they had been hearing so much for the past several years.

How different the *realities* of Administration personnel, practice, and philosophy were from this simplistic perception, and how disappointingly mixed were the short-run indicators of economic vitality in comparison to the glowing advertisements made in advance, is now of course a depressing matter of record.[3]

The fact is that supply-side economics has received only the feeblest trial in the United States to date. To the extent that some Reagan measures can accurately be attributed to supply-side thinking, other measures have tended to blunt or nullify their effects. Tax rate reductions were watered down and stretched out to the point where inflationary bracket creep, Social Security tax increases, and the 1982 tax-raising work of Bob Dole's Senate Finance Committee left many Americans no better off than before.

The adversary media, with their vested interest in steady growth of the public sector, wrote instant obituaries for Reaganomics, dealing jarring blows to the public confidence needed for long-range investment decisions. Political opportunism, cynicism, and cowardice in the U.S. Congress, not only among the opposition party but even among many members of Reagan's own party, further fostered public doubt.

The biggest successes were registered in moderating inflation, but even there many Americans flatly did not believe the improved numbers. The people, it seemed, knew their politicians all too well; they remained braced for Congressional Indian-giving on tax cuts and indexing, wary of the caprice of Fed monetary policy. Both the opinion polls and the persistently high interest rates suggested that most people expected an eventual return of roaring double-digit inflation.

So it can be said that in late 1983, even with the worst economic downturn in 40 years now over, the future of political economy both in the United States and around the world is exceptionally cloudy. The supply-side case studies abroad, ranging from Puerto Rico to Hong Kong, are no less persuasive and compelling than they were before the new school of thought saw its U.S. reputation tarnish so swiftly. But in other parts of the world, signals are mixed.

The Thatcher government in Britain, a bright hope for supply-siders when it first took office, has yet to produce the decisive economic triumphs that many hoped for. There, as in the United States, policies seem to have operated hesitantly and at cross purposes, and the pattern of labor union extortion upon the rest of British society (a disease not specifically addressed in supply-side theories as this writer understands them) remains a crippling factor.

Elsewhere in the West, the dominant problems likewise are ones not specifically treated by supply-side thinking. Japan's global trade offensive and its unrealistic sheltering from defense responsibilities, West Germany's mesmeric fascination with rapprochement toward its mortal enemies in the Kremlin (tempered but not broken by the election of Helmut Kohl), France's already souring experiment with socialism, Canada's and Mexico's persistent commitment to unsatisfactory statist economic paths—none of them are explained by supply-side precepts.

None of these situations constitutes a disproof of supply-side economics. Yet they suggest that the elegant rationality of Adam Smith and Ludwig von Mises cannot by itself account for the stubborn denial of his own long-range best interests by that creature whom Christian theologians have taught us to call fallen man.

Leading us to conclude—what? Perhaps that supply-side economics is at once *more* and *less* than either its proponents or its detractors have claimed it to be.

*More,* because when we probe beneath the jazzy new rhetoric of such supply-side popularizers as Jude Wanniski and George Gilder, we find the fundamental truths of all economic behavior—truths which no amount of political coercion or social engineering or moralistic exhortations can repeal, since they are rooted in human nature itself; truths that partake of the essence of what von Mises, in the title of his masterpiece, called *Human Action*.

But also *less,* because supply-side economics as placed on the table for intellectual debate, and on the agenda of nations for policy implementation during the past decade, is but one thin slice of the entirety of human action. It is by no means wrong *as far as it goes*. Yet it is decidedly incomplete, and it further suffers from its proponents' frequent failure to acknowledge that incompleteness.

Whether one sides with a libertarian purist like Richard Ebeling, who argues that supply-side ideas fundamentally contradict the great truths recognized by Mises, Hayek, and their fellow Austrian economists, or with the more worldly observers and practitioners like Tom Bethell, who maintains that the supply-siders are in full harmony with the Austrians on all matters of importance, one must ultimately recognize that this whole dispute is fatally beside the point.[4] For the point is this: supply-side economics is exactly what its name implies, an *economic* theory only. That is, it addresses but one of the three interrelated spheres of thought and action that make up human society. True as the doctrine is in relation to questions of production, exchange, wealth, and the supplying of material wants, it touches only glancingly, if at all, the domain of political organization and behavior, or the moral-cultural domain of human experience—the other two legs of what Michael Novak calls our "trinitarian" social order. How then could it have been other than the mild disappointment which it has proved to be?

In no way, for example, does supply-side economics alone come to grips with the temptation ever beckoning the majority in a democracy to bankrupt their society

through greedy and envious excesses of taxing and spending. In no way does it address dozens of other grave questions before the house, such as:

—Why do tragic episodes of political and ethical folly such as the Vietnam War and the Watergate scandal—so costly to so many millions of people who never met, let alone chose, the principal actors in those tragedies—recur in every age and every society?

—Why do socialism, collectivism, statism, and countless other forms of the one fatal utopian error continue mesmerically fascinating large portions of the human race even as a snake can hypnotize a bird and then destroy it?

—Why do free people seem to lack the staying power for resolute and sustained defense of their freedoms against an implacable enemy whose design of world domination spans generations?

It is not enough for the supply-siders to scramble around revising and expanding upon what they have earlier observed and prescribed. Wait a minute, we hear them saying, there was much more we meant to tell you about the gold standard, about enterprise zones, about the villainy of Volcker.[5]

Better specific policy prescriptions are needed, certainly. Someone has to hammer them out. But to repeat, this little stage is not all the world. Vastly broader endeavors to take stock of what we are and what we have, and hence to map a future for ourselves, endeavors impossible to classify as supply-side economics or as economics of any sort for that matter, are needed as well.

Works like George Gilder's *Wealth and Poverty*, Michael Novak's *The Spirit of Democratic Capitalism*, and *The Economy in Mind* by Warren Brookes push in this direction. And such works as these, bold as they are, are in turn dwarfed by such overarching contemporary phenomena as the witness borne by Alexander Solzhenitsyn, an authentic giant of the centuries, and the spiritual ferment evidenced in arenas as diverse as John Paul II's papacy, Jerry Falwell's Moral Majority, and Lech Walesa's Poland.

### III. Obsession Diagnosed: A.D. 1, 1776, 1492

Physical scientists have various yardsticks by which to interpret reality in past epochs prior to the advent of humankind. But only a moral and spiritual key can explain the Age of Man. Human history, in its unfoldment as we approach the third millennium after Christ, can *only* be understood in terms of the two seminal bodies of thought that have shaped those Western economies, polities, and cultures which today set the tone and agenda for all humanity. These bodies of thought are, of course, the Judeo-Christian Scriptures and the foundational documents of the United States of America.

For the West to begin focusing a more responsible, creative, sympathetic, and reverent attention upon these two great testaments—and to place far less faith in the proudly "value-free" science of economics, no matter whether in the Misesian or Marxian or Keynesian or Lafferite or Schumacherite version—would be of incalculable benefit to the renewal of a dangerously demoralized free world.

In neither document, significantly, does the word "economics" even appear. The concept, of course, does appear in different words; but what might we gain by trying, for a time at least, to explore the concept without the word?

A disturbing measure of how far we still may be from such a change in focus is the overnight rise of that vulgar and wrong-headed term, "Reaganomics." Here is a coinage as debased and corrupt as any "IOU nothing" Federal Reserve greenback. Its instant and virtually uncontested acceptance as semantic legal tender during the 1980 campaign shows just how far gone we are under a sort of intellectual Gresham's Law.

Think about it. When a Christopher Columbus proposed in an earlier time to revolutionize geography by sailing west on what he asserted was a round, not a flat planet, the man and the discipline he worked in were accorded the dignity of distinctness, not having their names melded into some silly new concept known as "Columbography." Sadly, the discipline of economics in our own time seems to possess rather less credibility as an objectively fixed body of patterns and truths than geography did in the days of Queen Isabella.

The supply-side thinkers who pinned their hopes on Ronald Reagan certainly cannot be held responsible for coining the term "Reaganomics." But given the realities of our media-saturated age, with its instant opinion polls and its simplistic scoreboards for everything, their cause was more than half lost the minute they conceded acceptance of this fatally flawed conceptual shorthand.

Wherever the idea came from that economics is an infinitely malleable set of propositions that can fit together any way enough people want it to (and be renamed accordingly), Americans must be disabused of this foolish obsession before it destroys us.

Irving Kristol got at part of the problem in a thoughtful *Wall Street Journal* piece a few years ago. He pointed out how our latter-day fondness for casting things in terms of an abstraction called "the economy," rather than in terms of a concrete process of individual exertions and choices called "business," bespeaks an entirely new and ominous mindset of the mid- and late twentieth century. Why ominous? Because the semantic identification of a thing we misname "the economy" leads in a direct line to the fatal hubris of assuming that there are mechanisms of political manipulation and control through which that neat but illusory entity can be

made to do almost any wonderful thing the mind of man can imagine.

The fascination with economic doctrines, economic statistics, and economic predictions, now so pervasive in the United States and throughout most of the world, is not a healthy condition. It fosters a passivity, a spectator mentality, which is the antithesis of those qualities of initiative, self-reliance, sacrifice, and hope that are essential to all individual mental health, all creation of wealth, all constructive political life.

Fixation upon aggregates, upon macro phenomena, upon the way one's person and immediate locality are affected by vast impersonal causes triggered from a great distance, submerges the individual and breeds a kind of anthill mentality which can suffocate free societies and make Marxism appear tolerable or even attractive.

No habit of mind, I submit, could be less American or less in the spirit of Moses and Jesus.

To the guild of professional economists, then—or at least to that clear-headed minority of it which still cherishes individual freedom and dignity—may the rest of us accord the due respect of the layman and the tentative gratitude of a sometime beneficiary. But might it not be well for some few of us, who are concerned about Western civilization's future and not encumbered with specialization to the extent that the economists are, to explore a less pretentiously scientific way of looking at man in society?

Suppose we tried to set aside any discrete, compartmentalized concept of "the economy," seeking instead to reason as clearly and common-sensibly as we can about one indivisible whole: *individuals applying God-given intelligence to their surroundings in order to live better*. Reasoning thus, perhaps we could formulate a modest body of observations, increasingly testable and predictive, about the whole spectrum of human behavior, individually and as a family.

If pursued with a genuine determination to see familiar things afresh, but also with a willingness to learn from the best scholarly and lay thinking that has already been done down through the centuries; and if skillfully injected into the all-important domain of popular perceptions that is now left to the conceptual trash epitomized by the word "Reaganomics," this line of thinking might have real promise. It could begin to clarify a comprehensive, new-old democratic capitalist theory of political economy, both empirical and moral, which appears so urgently needed if Western civilization is to regain its nerve and if freedom is to survive.

Supply-side economics by itself cannot reach these great goals. But even as imperfectly as it has been realized thus far, supply-side economics is surely a step in the right direction; and its role as a catalyst toward new developments in both thought and policy may yet prove to be even more important than its direct applied results. It is flippant but true to say that anything worth doing is worth doing poorly. Even if history grades the supply-siders no higher than B or B+ as economists and political philosophers, it will, I believe, increasingly be forced to acknowledge their genuine heriosm in the cause of freedom at this, its hour of great peril.

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[1] For background on this eight-decade downward slide, see George C. Roche III, "The American Collectivist Myth: Its Roots, Its Results, Its Downfall," *Imprimis*, Vol. 11, No. 2 (February 1982).

[2] A good short account is given by William Tucker, "The Energy Crisis is Over!", *Harper's*, Vol. 263 No. 1578 (November 1981), p. 25.

[3] Two noteworthy documents giving the flavor of the widespread disenchantment with Reagan and the supply-siders a year or so into his administration are William Greider, "The Education of David Stockman," *The Atlantic*, Vol. 248 No. 12 (December 1981), p. 27, and "Has Ronald Reagan's Presidency Been Captured by...Non-Reaganite Republicans?", *Conservative Digest*, Vol. 8, No. 2 (February 1982), pp. 2-40.

[4] Richard M. Ebeling, "Ludwig von Mises and Some Contemporary Economic Themes," in *Homage to Mises: The First Hundred Years*, (Hillsdale, MI: Hillsdale College Press, 1981), p. 38. Tom Bethell, "Would Von Mises Have Been a Supply-Sider?" in *Champions of Freedom*, Vol. 9, (Hillsdale, MI: Hillsdale College Press, 1982).

[5] For an example of the continuing clarifications, see Jude Wanniski, "Inflation, Deflation, and the Golden Constant," in *Champions of Freedom*, Vol. 9, (Hillsdale, MI: Hillsdale College Press, 1982).

[6] Irving Kristol, "'Business' vs. The Economy,'" *The Wall Street Journal*, June 29, 1979, editorial page.

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