Then we moved away from supply-side principles and Depression-based theories came to dominate policy-making. Despite the poor record of the past 15 years, our experts cling to this now-obsolete thinking. Their stubbornness is understandable. A wholesale return to incentive economics would discredit most economists. Hell hath no fury like a priesthood scorned.

The basic mistake of supply-siders was putting too much emphasis on the efficacy of tax cuts, too little on the damaging potential of an unhinged, non-gold-based monetary policy. German, Japanese, and American tax cuts worked because Bretton Woods provided a modicum of international financial stability.

Nonetheless, it is astonishing that most of our political leaders haven't grasped supply-side policies. It's as if a businessman were ignoring a lucrative market. Politicos want votes and the public wants economic growth. As the elections of 1980 and 1982 have demonstrated, candidates who espouse the right principles do better than those who don't. The political opportunities are there.

Will Reagan be perspicacious enough to grab them again as he did in 1980?

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GEORGE GILDER

Remember the summer of 1981? It seemed the answer to a supply-sider's prayer. Not only did the triumph of the Reagan program exceed most expectations—thus assuring the fulfillment of the supply-side vision of the Roaring Eighties to come. Better still, the collapse of the stock market provided us with a once in a lifetime license to steal.

It offered an unparallelled buying opportunity for the investment of our rising royalties and lecture fees. And since many established economists continued to predict a new Great Depression, there was a continuing need to explain our ideas to still baffled audiences of financiers, market analysts, Keynesian economists, reporters, pundits, and others who stood obtusely aside while the market sunk, scores of dazzling new companies emerged, and business prospects, in general, soared.

It is literally true that all the models and resources of conventional economists could not enable them, in 1981 and 1982, to differentiate between the portents of depression and the promise of a supply-side boom. Virtually every prediction by the economic establishment in those years—runaway inflation, permanent stagnation, the death of productivity, tax giveaways to the rich—has proved radically and utterly wrong.

Now two years later in the summer of 1983—with the Roaring Eighties erupting on cue, inflation dying, and the rich paying their highest share of income taxes in 11 years after the drop in the top rate—I am asked to contemplate the possible death of supply-side economics. It is an impossible task. The "Keynesian" economics of aggregate demand and the balanced budget multiplier (higher taxes promote growth and progress) are as intellectually bankrupt and commercially profitable as Jane Fonda, astrology, or the Bermuda Triangle. But supply-side economics cannot die because it is the only economics of growth and progress.

From time to time, of course, the economics of ascetic egalitarianism, of Masoch, Sade, Marx, Galbraith, and Gandhi, will captivate Washington and induce the country to don leather and assemble in macroeconomic aggregates on the corner of Christopher and Gay, with whips, enemas, emetics, price controls, cattle prods, chains, shackles, surtaxes, and other instruments of economic fine-tuning and redistribution. But sooner or later it is noticed by the uninitiated that countries that allow people to get rich do far better by their poor than countries that don't, that redistribution of wealth invariably means its destruction, that technological progress is almost entirely a product of individual creativity, that investment is far better managed by investors than by demagogues, and that any marginal tax rate over 25 percent does not redistribute incomes; it redistributes taxpayers. They move from productive work and investment into real estate finagles, accounting pettifoggery, jurisprudence, yachts, politics, Mercedes, offshore resorts, and Aspen Institute seminars on the unfairness of capitalism.

Someday people will also notice that most of the aggregate numbers used by conventional economists are deeply misleading. Statistical measures of capital formation, for example, even when celebrated by professed supply-siders, comprise an almost meaningless aggregate, in that the quality of investment is vastly more significant than its quantity. The USSR, for example, leads the world in "capital formation." But sad to say for socialism, you can't form capital without capitalists. Even the usual methods of Marxist robbery, seizing the material means of production, are feckless in practice. For the means of production are impotent in creating wealth without the men of production, the entrepreneurs.

These principles are paramount in the economics of growth. All else is the economics of Masoch and Sade, Christopher and Gay, still popular, I hear, among consenting adults (and bamboozled children) in the Ivy League and on Capitol Hill. But please don't tell me it's economics, and above all don't bring it back to the White House.

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WILLIAM M.H. HAMMETT

Whether or not supply-side economic policies have died, supply-side economics—explorations of the effects of tax policy on revenue—is definitely alive and working.

In a Manhattan Institute book published this fall by Chatham House (*The Supply-Side Solution,* edited by Bruce Bartlett and Timothy Roth) Peter Gutmann supplements the Laffer Curve, dealing with the effect of taxation on the supply of labor and capital, with a "Gutmann Curve," dealing with the effect of taxation on the relative sizes of the legal and subterranean economies. He concludes by pointing out that even when we combine both effects, we cannot predict with certainty whether the U.S. tax system has reached the rate at which cutting taxes will increase tax revenue. What we *can* predict, Professor Gutmann says, is that

> lower tax rates would increase both the potential of the legal economy to produce gross national product and, as a result, the potential of the legal economy to move to higher productivity—something that is very urgently needed. Higher national productivity means in turn that the need for any given level of government expenditure, hence revenues, would diminish.

There is both hard and anecdotal evidence to support the Gutmann Curve. Correlated with bracket creep, the subterranean or underground economy has been growing at explosive rates. It is now estimated conservatively at between $100 billion and $200 billion a year—and an article in the July *International Currency Review* is not so conservative:

> In 1981, Simon and Witte gave a figure of $330 billion, which is the number taken as "correct" by the Senate Committee's staff study—implying that the current level of the underground economy would be of the order of $400 billion.

A growing tax haven "problem" is causing government agencies to consider policies such as forbidding direct air travel to designated tax havens, requiring exit visas from U.S. citizens planning to go there, and disallowing tax deductions for travel to such places, as well as discriminating against international banks that do business there. Since, depending on what list you read, countries as geographically accessible as Canada, Mexico, Austria, and Costa Rica are considered tax havens, and Great Britain and France have enacted commercial secrecy acts that may make them tax havens too, it has become clear that passing laws and regulations can no more stanch the flow of American capital overseas than it can stop the growth of the underground economy at home.

The Senate Committee staff study mentioned earlier was issued in February 1983 by the Permanent Subcommittee on Investigations of the Committee on Governmental Affairs, and the writer for the July *International Currency Review* had this to say about it:

> . . . there is a tendency to muddle justified disapproval of corruption and abuses, including wholesale laundering of narcotics proceeds through corrupt banking relationships, with the efforts of otherwise honest citizens to protect their wealth, and to keep it out of the clutches of the avaricious agents of an overspending and (many believe) increasingly arrogant state apparatus.

This of course is the point. To the extent that more and more hard-working citizens have lost confidence in the way the United States government seizes and disburses the money they have earned, more and more jobs are being done for cash, more and more items are being sold by peddlers on street corners who keep no records, there is more and more barter, and more and more businessmen and high-income earners, liberals and conservatives alike, are seeking domestic and overseas tax shelters, and refusing to consider that wanting to protect the money one has earned is a crime. That's the real message that supply-side economics has uncovered.

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JACK KEMP

One measure of an idea's vitality is the number of its imitators. On that ground alone, supply-side economics appears to be pretty lively. Two years ago, liberal Democrats pooh-poohed the notion that you can collect as much revenue at lower rates from a broader tax base as at higher rates from a narrower tax base. They squawked at the idea of cutting the top tax rate from 70 percent to 50 percent. But today, even Walter Mondale has embraced a bill designed to cut the top rate to 30 percent and preserve the distribution of President Reagan's tax cuts—the Bradley-Gephardt plan. Democratic Senator Bill Bradley says that "supply-side economics was right in its conclusion that lower rates do stimulate work, savings and investment." Perhaps this is why critics have to announce the death of supply-side economics so often—the idea simply refuses to die.

In one sense, we are all supply-siders now. No one any longer can seriously doubt that when you tax something you get less of it, and that when you subsidize something you get more of it. Instead of being *about* supply-side microeconomics, most of the important economic controversy today is *among* supply-siders, and it concerns the disorganized state of demand-side macroeconomics. Supply-side neo-Keynesians worry about the deficit, supply-side monetarists worry about the money supply, and "classical" supply-siders put forward the case for fixed exchange rates based on gold. This kind of intellectual ferment hardly typifies a moribund school of thought.

If the implementation of supply-side economics can be faulted, it is for reasons different from those President Reagan's critics usually cite. While they complain the program went too far, in many ways it didn't go far enough. The President's program involved tax incentives, spending restraint, deregulation, and a non-inflationary monetary policy. Almost all brands of supply-siders agreed that tax-rate cutting must be implemented at the same time as anti-inflationary policies, to cushion their effect. Yet the tax cuts were trimmed and delayed until after the monetary brakes were applied, causing a recession; even then, the tax cuts barely matched offsetting tax increases for most taxpayers. Meanwhile, federal spending continued to rise, in large part because of the recession.

Federal Reserve policy has been misguided, too. In my view, the failure to restore stable exchange rates remains a serious threat to long-run growth, which is evident in the squeeze on U.S. export industries caused by the rising exchange value of the dollar.

Nevertheless, the President's opponents can't argue with results. A strong economic recovery has begun, led by the housing and auto industries. The stock and bond market booms have contributed to a $1 trillion increase in the wealth of American families. New stock issues have set a record since the tax cut on capital gains. People are going back to work. And it's interesting that income-tax revenue collections from upper-bracket taxpayers increased when the top tax rate was cut from 70 percent to 50 percent. Those who claimed that the onset of the 1981-82 recession "proved" the failure of President Reagan's program, which had not yet begun, now go to outlandish lengths to "prove" that subsequent economic recovery has nothing to do with his policies. It would be foolish to claim that the original supply-siders were blessed with perfect foresight. But judged by results, we were miles closer to the truth than President Reagan's critics.

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MELVYN B. KRAUSS

Ronald Reagan came to office as the high priest of supply-side economics. Three years into his first term, however, the high priest has fallen from grace. Social spending and taxes have not been cut as promised; U.S. protectionism is on the rise; deregulation of American business has been short-circuited; and bailouts have become all too frequent for an Administration supposedly dedicated to the principle of market place discipline. Indeed, the Administration's support of the Third World bailout via the IMF may go down as the worst example of its backtracking from original principles.

But just because a high priest falls from grace doesn't mean God is dead. Just like Jacques Brel who turned up alive and well and living in Paris, supply-side economics is alive and well and living in several Third World countries. In particular, there is a great deal of evidence to suggest that in countries following supply-side policies the poor benefit substantially from them—indeed more than when the stated objective of government policy is to promote their cause and increase their incomes. In other words, "trickle-down" works, David Stockman notwithstanding.

One of the more important implications of the Laffer Curve for Third World countries is that a given level of tax revenues is consistent with two different rate levels—a low tax rate and a high one. This implies two strikingly different approaches to government finance: public expenditure financed by economic growth with low tax rates, or by a stagnant economy with high tax rates.

Singapore is an example of a low-tax-rate, capitalist-oriented economy. Its top marginal rate on personal income is 45 percent at $185,185, according to Price Waterhouse; investment income is minimally taxed. India is a high-tax-rate, socialist-oriented economy. Its top marginal rate is 60 percent at $12,000; investment income is severely taxed.

The World Bank reports that from 1960 to 1977 the average annual increase of *public consumption* in Singapore was 9.8 percent, more than twice that of Sweden (public consumption includes public education, hospitals, and health plus public housing—70 percent of Singapore's population lives in public housing); in India, for this same period, the comparable figure was *negative* 0.67 percent. The reason for the disparity was economic growth. Per capita gross national product increased at an average annual rate of 1.3 percent in India between 1960 and 1977. In Singapore the increase was 8.7 percent.

All of the low-tax, high-growth economies in the Pacific Rim had impressive public consumption growth from 1960 to 1977. After Singapore at 9.8 percent came Hong Kong at 8.6 percent (Hong Kong is the low-tax champion of the Third World with a top marginal rate of 15 percent at $20,000), Korea at 6.9, and Taiwan at 4.5. The benefits from low-tax, high-growth policies do