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 over-spending 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 business-men 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

more than trickle down to the poor—they gush down upon them.

In Africa there is the case of two neighbors—Ghana and the Ivory Coast. Ghana is a socialist, high-tax-rate country, with a top marginal rate of 75 percent at $12,552; the Ivory Coast is capitalist, low-tax-rate, with a top marginal rate of 37.5 percent at $20,922. In Ghana, the average annual growth rate of gross domestic product during the 1960s was 2.1 percent, a figure that fell to 0.4 percent between 1970-1977. During the same periods the Ivory Coast had an annual growth rate of 8 and 6.5 percent. Public consumption in Ghana during these periods grew at an average annual rate of 6.1 and 1.5 percent, by 11.8 and 8.6 percent in the Ivory Coast.

Of course, public consumption is not the only way supply-side growth can help the poor. There is also the effect on private incomes. During the 1960s, Brazil achieved a high rate of economic growth compared to other Third World countries. By the late sixties and early seventies its growth rates approached 10 percent a year. This was the basis of Brazil's widely acclaimed "economic miracle." Who benefited? According to Gary Fields writing in the *American Economic Review,* every income group did, but especially those below the poverty line—their personal income increased at a rate perhaps twice as great as the rate of those above the poverty line. Consequently, the "poverty gap" in Brazil—the amount by which incomes of the poor would have to be raised to bring them to the poverty line—was reduced by 41 percent between 1960 and 1970.

To conclude, the moral justification for a free-market approach to global economic development is that economic growth is the best way to help poor people. The Reagan Administration lost the moral initiative when it let the Democrats outmaneuver it on trickle-down economics. David Stockman's remarks in the *Atlantic* and the Administration's inability to overcome them have reflected a basic lack of sympathy for what supply-side economics is supposed to be about. This is the main reason why Reaganomics has degenerated from a coherent set of policies geared to promote economic growth to a virtual tautology. Anything the Reagan Administration does—and shouldn't do—has become Reaganomics.

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ARTHUR B. LAFFER

Action and consequence and the ability to relate the two is the central factor of behavior modification. When attached to a series of rewards and penalties, the ability to relate emerges as incentives and disincentives. With children, the broad process is called "education" whereas, in later life, "political economy" is the appropriate name. A system's ability to gauge the dynamics of an action-reaction sequence in conjunction with incentives and, then, provide proaction determines the degree to which that system achieves success or, in some instances, literally survives.

This constellation of effort-and-reward association provides the underlying rationale for classical economics—now called supply-side economics. Attractive activities, because they furnish the provider with rewards, increase, while unpleasant actions are shunned. In its simplest form, taxes cum subsidies alter individual perceptions of natural attractiveness. When socially useful actions are taxed and socially undesirable activities are subsidized beyond what is natural, behavior will be altered so as to diminish the socially useful and expand the socially undesirable. The more adept the system is at comprehending, the more rapidly and more penetratingly it will accentuate the socially undesirable at the expense of the useful. A government that governs too much thus assures its own extinction, but only with an enormous toll of forfeited weal.

Incentives extend into every aspect of life, in addition to economics. While supply-side activists rightfully point to this, that, or the other distortion, their efforts must, of necessity, be squandered unless they fall on fertile political soil. Excellence must start at the top of the political hierarchy. If excellence is not the norm at the very top, political corruption will guarantee that natural incentives will not survive. These incentives will be altered virtually beyond recognition. A political system that fails to reward politicians in direct accordance with the beneficial aspects of their policies will ultimately become so misshapen as to deny the body politic the bulk of the prosperity that could have been.

Our political system has grown more and more complex. Elected representatives don't understand, let alone read, the legislation upon which they vote. This increasing complexity has caused representative democracy as we know it to collapse under the weight of its outmoded system of misplaced incentives. To reconstruct a viable system of properly placed incentives within the political arena will be the ultimate achievement of supply-siders. Only when political incentives are correctly constituted can one reasonably anticipate consistently good economic policies and a thriving society. Back-and-forth bickering over balanced budgets and the like obfuscates the profound agenda of reestablishing a society where people are held responsible for their own actions and are provided the full authority to alter their circumstances—where government in its most minute aspects is of the people, by the people, and for the people. People do deserve the governments they have, if only they secure the power to control.

People are the sole comprehensive perceivers of the total impact of governmental policies. Who cares more about taxes, the nation's defense, and busing than the people? Surely it's not Tip O'Neill, Ronald Reagan, or the Supreme Court. In a recent 6 to 1 decision, the California Supreme Court denied the California voters the right to vote on a legitimately qualified constitutional amendment. Such outright disregard for the legitimate authority of the people further perverts incentives. Such actions are fortunately a rarity in California and, even in this instance, will probably be dealt with deftly by the electorate at some later date. No person should be disenfranchised from the electorate; nor should the electorate be disenfranchised from governance.

The key to good government is to be found in the rights of the people to referend and amend without obstruction at all levels and in all branches of government. This, then, is the highest item on the supply-side agenda.

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ROBERT D. NOVAK

The decline of supply-side, both as a catchword and as a political movement, in little more than two years is illustrated by the metamorphosis of Dr. Martin Feldstein. In 1981, as a Harvard economics professor, he was a self-styled supply-sider and an ardent advocate of tax reduction. In 1983, as chairman of President Reagan's Council of Economic Advisers, he rails at supply-side "extremists" and lusts for tax increases.

He is not alone. Those who long ago stopped calling themselves supply-siders and started pressing for tax increases include Rep. James Jones, Dr. Charles Walker, and Lawrence Kudlow, to name only a few. The very words, "supply side," have all but disappeared from the public prints. Purists believe the only bona fide supply-sider inside the Reagan Administration is a middle-level White House aide named Wendell Willkie Gunn, though Dr. Manuel Johnson, an assistant secretary of the Treasury, would seem to pass all but the most stringent purity test. Other names in the Administration do not come easily to hand. The roll call of practicing politicians who not only carry the supply-side banner but flourish might well be exhausted by listing Rep. Jack Kemp and Lewis Lehrman.