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The Belden Center for Private Enterprise Education
Harding University School of Business
Searcy, Arkansas

The entrepreneur

This issue courtesy of Mr. Ned Martin, Martin-Tomlinson Roofing Co., Inc., Dallas, Texas

Harding University Economics Team Wins National Competition In Dallas, Texas

The Harding University Economics Team defeated college and university teams from seven regions to win the 1981-82 National "Students In Free Enterprise" Championship at the Conquistador Ballroom of the Marriott Hotel in Dallas, Texas, July 25-27, 1982. This climaxed the competition which began a year ago with nearly 200 colleges and 6000 students from around the country. The Harding team received a first place trophy and a check for $1500 for the university's general fund.

Harding's 1981-82 "Capitalism Corps" was composed of members Paul Holliman (student co-chairperson) of Bartlesville, Oklahoma, Sally Florence (student co-chairperson) of Columbus, Ohio, Byron Carlock of Blytheville, Arkansas, Susan Collins Miller of Atlanta, Georgia, Debbie Garrett of Brookston, Indiana, Steve Haynes of Little Hocking, Ohio, Penny Hightower of Mt. Pleasant, Texas, Ellen Reid of Sugar Land, Texas and Jeff Tennyson of Harrison, Arkansas. The Team's faculty sponsor is Dr. Don Diffine, Professor of Economics and Director of the Belden Center for Private Enterprise Education.

Economics Team — Belden Center Move Into New Facilities

Harding University's Belden Center for Private Enterprise, the happy issue of an improbable marriage between business and higher education, has become a favorite *cause celebre* of our constituency since its inception in 1976.

In September, 1982 the Belden Center and the 1982-83 Economics Team moved into an expanded four-room suite at the main entrance of the Mabee Business Center on the Harding University campus.

The Belden Center is dedicated to an extraordinary entrepreneur, Clark David Belden, founder of Louver Manufacturing Company, now located in Jacksonville, Arkansas. Mr. Belden had a firm belief in free enterprise and the basic principles that have made America a great nation. Lomanco is currently owned and operated by his son, D. R. Belden and third generation Beldens — all dedicated enterprisers in their own right.

The Economic Policy Debate: 'Trickle Down' vs. 'Siphon Off'

by

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Associate Professor of Economics

At odds today are the neo-classical supply-side economics and the Keynesian demand-side economics, sometimes alluded to as "trickle down" and "siphon off" approaches respectively. Four decades of education based on demand-side economics understandably caused this approach to be deeply imbedded in the thinking of our elected leaders, scholars, and the media. Therefore, an understanding of supply-side economics is still beyond the grasp of many today, even though it is pure, vintage Adam Smith.

The ideas of John Maynard Keynes have dominated the last four decades, and his theories have been imposed on western democracies. What were his basic premises? He preached that prosperity would be the result of increased consumer demand and increased government spending through an inflated currency.

Keynesian "siphon off" policies have drained away the private sector's vitality and have caused scarey combinations of budget deficits, double-sigit inflation, and volatile interest rates. Stimulating demand through federal spending has spawned ever-growing numbers of special interest groups. And should it be a surprise that each of these groups has vigorously guarded "its" so-called share of the Federal government's budget?

Supply-side economics, in its simplest form, is the application of incentive-based price theory to the economy. It has its foundation in the belief that the free market is stable and, if the government keeps its hands off, the result will be an efficient allocation of goods, services, resources, and income. Far from being new and unsound, the basic principles of supply-side economics have been standard operating policy through most of America's history. Its legacy has been the phenominal development of American capitalism.

One needs only to contrast that early American record to the present Keynesian legacy of falling productivity, persistent inflation, relatively high tax burdens and the quantum leap in the size and scope of government and its debt in the past 40 years and ask which policy was the fluke, which one was unsound, and which one failed?

The notion that we could continually prod the economy into prosperity through force feeding it with annual budget deficits, that created a noxious mixture of stagnation and inflation that we call "stagflation," has clearly knocked Keynesian economics off its pedestal.

Here is supply-side economics in a nutshell. A reduction in tax rates is like a raise in pay which results in higher savings, lower interest rates and higher investment. Corporate tax rate cuts and-or increases in the investment tax credit, combined with accelerated depreciation allowances, improve business investment by increasing average after-tax rates of return.

Higher business investment results in productivity increases, which means more output is produced per unit of input. The transfer of resources from the government sector to the private sector increases productivity rates still further, since productivity gains in the government sector are usually nominal anyway.

The subsequent increased rates of economic growth provide the needed factory capacity to create additional goods and services demanded because of the tax cut. The result is balanced economic growth with neither shortages nor surpluses. Reduced tax rates result in lower demands for wage increases, because real income has risen as a result of the tax cut. With the wage-price spiral somewhat broken, lower inflation results in an increase in real income.

Consumer spending, output and employment, will subsequently be on the rise. Lower tax rates give individuals more incentive to work, and quite naturally the result is more and better work being performed. The private sector's productive capacity is further increased, and the underlying inflation rate is reduced further.

ENTER ARTHUR LAFFER

It was USC economist, Arthur Laffer, who said it was insufficient supply that resulted in inflation and economic stagnation. The prime cause was a governmental wedge that interfered with the free market's incentives to work, invest and produce, and produced ever-increasing taxation, government regulation and spending. The cure: cut tax rates frequently, irrespective of the size and scope of inflation, business fluctuations, and federal budget imbalances.

The "Laffer Curve" is basically a graph which compares the relationship between tax revenues and tax rates. The curve readily shows that when tax rates are low, tax revenues are low. As tax rates increase, revenues increase at a reduced rate. At some optimum point on the curve, tax revenues are maximum. If tax rates are increased above the optimum point, tax revenues actually fall. It's the law of diminishing returns in its purest form. Beyond some optimum point, if tax rates are raised further, the actual result is fewer tax dollars flowing into the government coffers.

The economy's position on the Laffer Curve — and the subsequent extent of the response of work effort, investment, and production to a tax cut — has become the key to the controversy in the policy debate over supply-side economics. If the reaction of the economy is so slight that a tax reduction generates even larger federal deficits, then the resulting jump in government borrowing could either crowd out private borrowers from credit markets or — if accomplished through additional money creation — accelerate the rate of inflation. Either result could weaken a tax cut's stimulus in a supply-side sense.

Supply-siders correctly say that inflation is caused by too much money chasing too few goods. By renewing the supply-side of our economy, a sizeable step could be taken to reduce inflation. Personal and business-tax cuts combined with deregulation are designed to restore conditions that would produce long-run growth. Cuts in Federal spending and stable money supply growth are both vital to their success.

So, one key to it all is Federal Reserve policy that restrains growth of the money supply. This, combined with the increase in goods available to buy, is supposed to wipe out the inflationary problem of too much money chasing too few goods. The Federal Reserve could, therefore, reduce its "taxes" on our banking system — by lowering the interest rates, reducing the discount rate, and reducing reserve requirements. The goal, of course, is to increase the demand for money and make it more attractive.

In large measure, the remarkable resurgence of Japan and West Germany to become the third and fourth largest economic powers can be attributed to tax policies which encouraged growth. Britain has slipped to eighth in GNP.

Japan and West Germany have fairly low rates of tax on earnings and profits. It is supply-side economics personified: a narrow tax base and low rates of direct taxation promote rapid economic growth which results in high and ever-increasing tax revenues.

It's the Laffer Curve in action — low tax rates bring about high rates of real economic growth, resulting in rising revenues which can be made available for public sector spending for well-run social programs. At the same time, welfare states like Sweden, rely on high tax rates, and continue to labor under serious economic difficulties. Critics of President Reagan's tax cut plan still say that it will be making 230 million Americans the guinea pigs for an untested economic theory. That hardly seems to be the case, in light of economic history.

THE KENNEDY-REAGAN CONNECTION

Prior to President Reagan, the last real growth-oriented politician in the United States was President Kennedy. Mr. Kennedy launched a very abrupt change in economic policies in the United States, cutting taxes the most on those who earned the most. Mr. Kennedy believed that no person has ever truly prospered by trying to pull down another. All Americans are therefore prospered whenever any one American prospers. His point was that we don't work just to pay taxes; we work to have what is left after taxes. Furthermore, entrepreneurs don't look at factories with humanitarian motives; they are looking for rate of return on investment. Nobody saves to go bankrupt; we save to augment our wealth.

President Reagan has told the nation that federal tax reductions will not be held hostage to spending reductions. In fact, Mr. Reagan clearly said that "government revenues will increase as the economy grows . . . because the economic base will have been expanded by reason of the reduced (tax) rates." Mr. Kennedy in his 1963 Economic Report of the President made the same point as follows: "Tax reduction thus sets off a process that can bring gains for everyone" . . . and explained why "reducing taxes is the best way open to us to increase revenues."

On the issue of helping the poor to cope with the hardships of life, Reagan and Kennedy share sharply different views from the Keynesian redistributionists. Time and again, Kennedy remarked that the best form of welfare was still a good, high-paying job. This notion was characterized by the phrase that "A rising tide raises all boats" and that a growing economy elevates the standard of living of the poor, along with the more affluent.

Redistributionists turn the Kennedy "rising tide" phrase on its head and refer to the same policies as "trickle down" economics. Reagan, remaking Kennedy's point stated: "Our aim is to increase our national wealth so all will have more, not just redistribute what we already have which is just a sharing of scarcity."

So-called "trickle down economics," is a sound economic concept. In a profit-oriented market economy, taxable revenues are created by the deployment of captial. If we don't penalize those who have the capital by high tax rates, the benefits do "flow through" the economy. Such has been the very positive heritage of our American Industrial Revolution.

In the 1963 Economic Report of the President, Mr. Kennedy put it this way:

Tax reduction thus sets off a process that can bring gains for everyone, gains won by marshalling resources that would otherwise stand idle — workers without jobs and farm and factory capacity without markets. Yet many taxpayers seem prepared to deny the nation the fruits of tax reduction because they question the financial soundness of reducing tax when the federal budget is already in deficit. Let me make clear why, in today's economy, fiscal prudence and responsibility call for tax reduction even if it temporarily enlarged the federal deficit — why reducing taxes is the best way open to us to increase revenues.

SUMMARY AND POLICY IMPLICATIONS

Mr. Reagan, one could say, understands the true message of John F. Kennedy. President Reagan is currently wrestling with many bad economic projections. He inherited bigger deficits than he expected, plus a deeper recession.

So, here we stand, with a legacy of high interest rates and large deficits causing each other. An administrative attack on stagflation will likely succeed if the following seven requisites are accomplished simultaneously: (1) There should be a reduction in federal spending as a percentage of national income and the subsequent elimination of the budget deficit; (2) Strict limitations should be placed on the heretofore erratic growth of the money supply; (3) The public must be convinced that inflation is truly being beaten; (4) The supply-side strategy must show real progress before the 1984 Federal elections, or it will lose its key proponents (faster than a speeding ballot); (5) It also must avoid too sharp an economic shock, lest a wave of business and personal bankruptcies wash away large sectors of the economy; (6) Major special interest groups, many of which have conflicting desires, must not be alienated; and (7) All of this must be accomplished while the nation rearms itself and the business community is revitalized because we bargain best from a position of strength. It's a mighty tall order.

Supply-side economics just might work. What we do know is that Keynesian economics is no longer working. Neither are a great many Americans. If there were any one prescription that would do the American economy an enormous amount of good, it would be a health dose of the 6-D's: De-Tax — De-Spend — De-Regulate — De-Control — Disinflate — and Downsize government. It is indeed regrettable that this approach was not fried a decade ago, before the numbers got so downright scarey. This is open-heart surgery we're talking about. But after all, capitalism, as we know it, is the oxygen tent.

Arthur Laffer at Harding

Nationally-acclaimed and presidential economics advisor Arthur B. Laffer highlighted the spring program of Harding University's American Lecture Series, with a presentation on April 5. Dr. Laffer, who is professor of economics at the University of Southern California and a member of President Reagan's Economic Policy Advisory Board, has gained national prominence in recent months as an expert on supply-side economics, because his theories are at the heart of President Reagan's economic program.

Dr. Laffer first proposed the now-famous "Laffer Curve" of economics theory in 1974, and later presented his ideas on taxation and acononics to the Ford administration, with a partial result being the introduction of the Kemp-Roth Tax Reduction Act of 1977, which later became law. Laffer's curve shows that as tax rates rise from zero, revenues increase — but only until an optimum point is reached. If taxes are increased further, he says, they discourage consumer spending and business investment, reducing government revenues.

Laffer believes the United States has already rounded the curve, and that even President Reagan's plan to slash taxes is woefully inadequate. He also advocates eliminating the tax on windfall profits and eventually replacing the income tax with a value-added tax, which would be levied on a product at each stage of its manufacture and sale.

Incentive-Based Economic Policy

By Arthur Laffer

Democratic President John F. Kennedy, just as Republican President Ronald Reagan, understood that if our federal government keeps on raising taxes, taking a bigger and bigger percentage of everybody's income — it will not automatically generate bigger revenues, more and more tax payments.

Kennedy realized, as does Reagan, that tax rates can get so high that they discourage work, saving, and investment, and encourage tax avoidance; that when that happens, tax revenues decline, and the only policy is to reduce tax rates across the board, giving everybody the same percentage cut on their taxes.

In his **1963 Economic Report of the President,** Jack Kennedy said: "Our need today, then is (1) to provide markets to bring back into production underutilized plants and equipment; (2) to provide incentives to invest, in the form of both wider markets and larger profits — investments that will expand and modernize, innovate, cut costs; (3) most important, by means of stronger markets and enlarged investment, to provide jobs for the unemployed and for new workers streaming into the labor force during the sixties — and, closing the circle, the new jobholders will generate still larger markets and further investment.

Another similarity between Kennedy and Reagan is their belief that if it is adequate, military power won't have to be used. Whenever a country has to use its military powers, it's a sign that it has not spent enough. The notion is that spending money to put locks on the front door is not wasted.

Kennedy campaigned on the conviction that there as a "missile gap," and the United States needed more defense spending. By the same token, Reagan maintains that America is unduly exposed by "a window of vulnerability," and that defense spending should increase.

Jack Kennedy promised a concerted effort to revitalize America's decaying inner cities. So has Ronald Reagan, through his Enterprise Zones program. Businesses that locate within the inner city would pay lower tax rates on their income earned there. Likewise, businesses locating within the inner city that employ individuals residing in the inner city would face lower payroll tax rates for both the employer and employee. Such measurers provide the incentives to create inner city jobs, which, as Kennedy observed, are the best form of welfare.

Add up the similarities and you see there is good reason to conclude that there is a remarkable kinship between the economic policies of Ronald Reagan and John F. Kennedy.

— Text courtesy of **Enterprise America Report**

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