The GOP's supply-side economists: their strengths and weaknesses

by Richard Freeman

Economic consultant Jude Wanniski, the leading publicist for what has come to be known as "supply-side economics," has argued that the person most sympathetic to his (and Rep. Jack Kemp and Prof. Arthur Laffer's) viewpoint in the Reagan camp is Ronald Reagan himself. In a sense that is true, although not because Reagan agrees with the exotic academic arguments associated with the "Laffer curve," i.e., the argument that a cut in marginal tax rates will automatically stimulate the economy sufficiently to generate enough tax revenue to compensate for the tax loss.

Kemp, Wanniski, and Laffer are old-fashioned American boosters, and their underlying philosophy appeals to President-elect Reagan more than the tired pessimism of the former Nixon and Ford advisers who currently dominate the Reagan economics team. However, shared sentiment is a long way from a governing program. The Western states' senators who stood by Reagan during the primaries, men like Paul Laxalt of Nevada, Orrin Hatch and Jake Garn of Utah, and Peter Domenici of New Mexico, share the booster sentiment. On many policy questions, e.g. whether Fed Chairman Paul Volcker's monetary policy should be retained for another four years, both they and the "supply-side" Easterners will agree.

But all the leading individuals in the "anti-austerity, progrowth" side of the Reagan transition apparatus are merely exemplary of why Reagan won by a landslide in the first place. Kemp and his advisers staked out their claim as the Republican Party's boldly progrowth group during the primaries, and when the voters rejected the Carter recession, achieved sudden prominence.

Reagan's victory owed as much to what the candidate perceived from the national mood as it did to the specific advice of the "supply-siders." Reagan adopted a modified version of the Laffer tax-cut plan. But he also adopted, on the advice of Ohio Republican Gov. John Rhodes and others, Democrat Lyndon LaRouche's line of attack against Carter's depression economics. What impressed Reagan was not the "supply-siders'" pat tax-cut theories but the fact that they stood out among his advisers in offering the new administration an alternative to what Kemp calls "root-canal economics."

At the moment, Kemp, Laffer, and Wanniski are a highly effective ginger group, operating "outside the tent," in Lyndon Johnson's phrase. In the Nov. 11 *Wall Street Journal*, former *Journal* editorialist Wanniski delivered a stinging rebuke to the Milton Friedman wing of the Reagan camp, whom Wanniski identified as former treasury secretaries George Shultz and William Simon, former Council of Economic Advisers Chairman Alan Greenspan, and former Fed Chairman Arthur Burns. "Will Reagan Be Thatcherized?" was the title of Wanniski's op-ed sally, which warned that the same disasters which befall Friedman-advised leaders like Joe Clark of Canada and Margaret Thatcher of Great Britain would befall Reagan if he followed Friedman's advice.

"We are the progrowth forces, against the austerity crowd," Wanniski told *EIR* in a recent discussion. In his op-ed in the *Journal*, Wanniski warned that some of Reagan's advisers were telling the current Fed chairman to induce a bout of "mind-blowing interest-rate austerity" before Reagan took office, in order to leave the blame for the worst consequences of Fed policy on the lame-duck administration.

Rep. Jack Kemp, Wanniski's close collaborator, similarly blasted "root-canal economics" in a Nov. 9 interview with the *Buffalo Courier-Express*. If the Republican Party does not repudiate the principle that the worse an economic policy feels, "the better it is for you," Kemp said, "the voters will turn on us."

Stone soup economics

The theoretician of supply-side economics, University of Southern California Professor of Business Arthur Laffer is a renegade Chicagoan. Trained by one of Milton Friedman's best-known protégés, Robert Mundell (now at Columbia University), Laffer absorbed Friedman's outlook on economic method, but could not stomach the implicit zero-growth conclusions of Friedman's monetarism. "You want to prove that Milton Friedman's a fascist? It's easy. Quote him," Laffer said in a recent interview.

Laffer's core argument, embodied in the Kemp-Roth tax reduction bill, is simple: individuals are motivated to produce by the pecuniary awards they receive by producing. High marginal tax rates (high progressive rates of taxation) eliminate the producer's incentive to produce, because after a certain point, the producer gives most of his additional income to the tax man. Therefore, the way to stimulate productivity and production is to lower tax rates on the upper end of the progressive income scale, and the economy will expand.

On the monetary side, the Laffer group favors gold-standard discipline on currency expansion. A Laffer-authored plan circulated prior to the Republican convention proposes that the Federal Reserve fix a price for gold against the American dollar, and defend the gold parity by reducing money supply if the parity comes under attack.

Laffer and Wanniski maintain that it is not important whether individuals use the proceeds of the proposed tax cuts to build condominiums in Florida and gambling casinos in Atlantic City, or if they create new mills and ports.

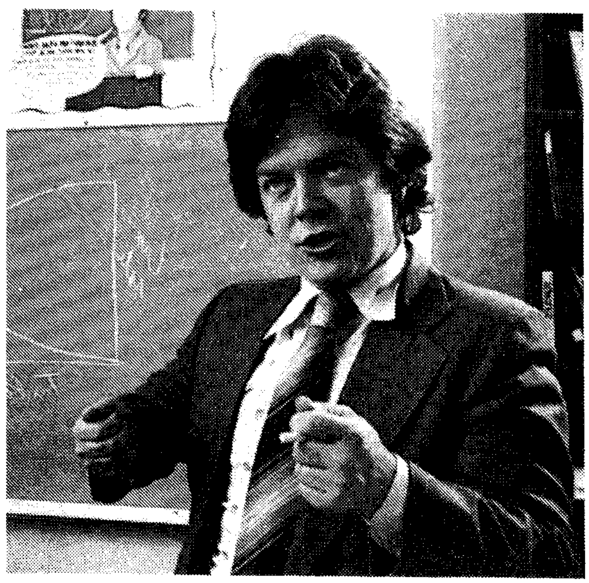
In their view, the productivity of a football team, measured by its audience drawing power, is not different from the productivity of a machinist (an analogy suggested by Jack Kemp's earlier career as star quarterback for the Buffalo Bills.) Laffer's unwillingness to distinguish between investment that enhances the productivity of basic industry and investment in, say, stock and real estate secondary markets, is a prejudice inherited from Milton Friedman and the Chicago "utilitarians," who try to reduce all economic quanta to a "pleasure-pain" principle.

Although Laffer has tried to put up econometric models that will forecast the rise in tax revenues due to lower marginal tax schedules, the approach is still considered exotic by most of the business community, let alone the economics profession, which is openly hostile. It speaks well for Reagan's admiration for the supply-side boosters that he has already incorporated part of their program into the few measures he has thus far proposed. But Reagan clearly does not trust the approach sufficiently to offer administration jobs to Kemp or his colleagues.

At best, the Laffer plan could work effectively the same way that the legendary stone soup tasted delicious: in combination with other programs that steered investment into enhanced industrial productivity, the reduction of tax rates could become the apparent centerpiece of a viable economic program.

But it is unlikely that events will proceed in this fashion. Reagan's progrowth sentiments will receive

Rep. Jack Kemp (above) and economist Arthur Laffer, two "supply-side" spokesmen. Their booster spirit is an asset; their lack of rigor on credit policy gives their monetarist opponents an opening. "We are the progrowth forces, against the austerity crowd," said Jude Wanniski, Kemp and Laffer's colleague.



support from a wider base than the tax-cut theorists in his own camp, including conservative Democrats and foreign leaders like German Chancellor Schmidt and French President Giscard. The supply-siders will continue to provide an aggressive counterpoint to the "austerity crowd" that has most of the leading positions in Reagan's transition team at the moment, but will probably not see the insides of the offices from which policy is made.

Alternative Treasury policies

The supply-siders' candidate for treasury secretary, or at least undersecretary for monetary affairs, is drugstore entrepreneur Lewis Lehrman. A friend of the late French economist Jacques Rueff, Lehrman created something of an "under 40" version of the Council on Foreign Relations a few doors down from the CFR's New York headquarters, modestly titled the Lehrman Institute. Lehrman gained public prominence last May when Morgan, Stanley, a leading investment bank, published a proposal he authored for revising Federal Reserve monetary policy.

The plan notes that the Fed has had no success in controlling monetary aggregates, and is incapable of doing so, contrary to the pretensions of Fed Chairman Paul Volcker. The Federal Reserve should give up and permit banks and their customers to determine the rate of credit growth, Lehrman argues, through the discount window rather than through open-market operations. The Fed should simply ensure that the discount rate hovers above market interest rates so that banks will only use it when other sources of funds are not available, that is, when there is a legitimate need.

Lehrman's plan has great merit compared to the botch-job the Federal Reserve has done over the past year, but it suffers from the same potentially inflationary defect that the Laffer tax plan reveals. If banks lend for secondary real-estate market or stock speculation, rather than for improving the productivity of the nation's industrial base, inflation will still result under this program. A similar plan with a crucial difference was published last week by the National Democratic Policy Committee, insisting that the Fed should make discount window facilities available only for loans made to further production and transportation of tangible goods (industry, agriculture, utilities, mining).

What will be the outcome of the fight inside the Reagan camp? "It's murky," Jude Wanniski says. "No decisions have really been made. People talk about so-and-so being sure for this or that cabinet post, but nothing is pinned down." The point, evidently, is that President-elect Reagan needs people in his administration who can put the economy on a growth track, but will turn to the proven losers of the Nixon-Ford period if he has to.

III. THE ADVISORY QUESTION

Appointments and a new kind of structure

by Kathleen Murphy

Photo: AP