Problems on the supply side

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In a complex world, understanding the global economic system (and national economies) is not simple, particularly now that the era of cheap resources has disappeared. Basic commodities such as fuel and food are becoming more costly at the same time as pollution is increasing and global warming is becoming more obvious, with the result that people have fewer positive dreams about the future for themselves or their children. In an analysis that sounds very modern, Pierre-Joseph Proudhon [Proudhon(1847)] noted several basic contradictions in the working of economies,[1] including:

- the division of labour, without which production is almost nothing, is subject to a thousand inconveniences, of which the worst is the demoralization of workers;
- machines produce cheap goods, but also they produce congestion and unemployment;
- competition leads to oppression; and
- "taxation, society's material bond, is often a dreaded plague equivalent to fire and hail" – Proudhon then remarked that Joseph Garnier had said, accurately, that taxation is a "privation that should be reduced as much as possible, given the needs of society".

Proudhon's "demoralization" of workers is the workers' estrangement from work. Workers see little point in what they are doing, and work only to live – they are alienated.

Though probably not the result of estrangement or alienation, many working people in the USA are demoralized – many do not think their job is worthless, but they are exceedingly worried about their future and losing their worthwhile job. Perhaps as a result of their demoralization, these people often believe they pay too much tax, using perceived governmental waste and administrative incompetences to justify their desire to lower taxes. At the same time they feel patriotic, and support the US military – not realizing that a great part of government tax revenues goes to pay for the US military and associated activities (some of which are, of course, wasteful and inefficient). If government revenues are reduced then something has to give, but that which gives is probably not wasteful spending and administrative incompetences, nor the US military.

The general welfare

That others believed that taxation is "society's material bond", to be applied for the good of people in society, is reflected in the injunction in the US Constitution that taxation be used "to pay the Debts and provide for the common Defence and general Welfare of the United States"[2]. The meaning of "the good of the people" (or "general welfare") depends upon who your view of the world. Many a conservative/regressive diatribe indicates that the "timeless" constitution should have had an actual definition of what was meant by "general Welfare" because, for example, it can be claimed that welfare for individuals is not part of the general welfare.

Assistance with health care for the poor – known in the USA as Medicaid (Medicaid did not exist, of course, in 1787) – is thus not constitutional, according to a pseudonymous comment to an online article[3] "I think it is silly to keep spending money the government doesnt have. The government spends way too much money on too many social programs. The gov should only be in the public safety business (fire and police), roads, and possibly waste removal. That is it. ... No where in the Constitution of the United States or of the State of Michigan is spending money on medicaid authorized." Such arguments are based on shaky foundations: for example, there is no explicit constitutional authorization for spending on public safety business, roads, or waste removal; though such concerns might be considered part of the general welfare – as might Medicaid and many other programs. The writer thought that saving money by not spending on social programs would mean "more money in the hands of working people which in turn would be more tax money for the local/state and Federal government". It is worth mentioning that, in the 1700s, when politicians and of that era talked of "taxes" they did not mean income taxes (which were rare) but property taxes, sales taxes, excise taxes, and similar.[4]

Though there might be far more disagreement on funding the military in certain of its operations, national defence itself has almost unanimous support and, though there is disagreement on Medicaid spending, most people do not feel we should be cruel to the poor. A person whose political leanings were left of the mainstream had such a dislike of the military operations in Iraq that he wanted to pay less taxes, and certainly did not want to pay more, because he thought any extra revenue would go to the operations in Iraq. His partner worked for the federal government and, if tax revenues declined, my guess is that – unless administrations changed – funding for her department (and her job) was more likely to disappear than funding for the Iraq adventure. Funding for Medicaid would also be more at risk, though health care for older people (Medicare) was much safer from cutbacks, because of the voting power of the retired.

A more sanguine view, from the right of the mainstream, sees reducing taxation as being good because it gives the government less tax-payer money to spend, without caring very much about which spending is reduced – as long as government becomes smaller (sometimes known as "starving the beast"). However, as we saw with the Reagan administration, taxes can be reduced and the government have less tax-payer money to spend, but the result is that government debt is increased. Government spending is controlled by the executive and by legislatures, all of whom have many interested parties to satisfy, from constituents who want money for local projects (say, "a bridge to nowhere") to political donors who want tax breaks for their businesses (say, tax breaks for oil companies).

Most people might agree that disaster relief is part of the general welfare, but even then there are outliers with strange ideas about what should be done. After the devastation caused by hurricane Katrina, there were those thought that New Orleans's problems after the storm were created by government – the considerable poverty and people's inability to care for themselves revealed in the aftermath of the storm was the result of "a federal welfare system that offered perverse incentives when it comes to building families and stability. . . . And let's be clear, to the extent that government does help those affected by Katrina, *government* should be making the sacrifices. Not taxpayers. . . . every cabinet department within the federal government should be asked to trim 2 percent of its budget for relief efforts." (Rodney Balko, *FoxNews.com*, 21 September 2005).

Such simplicity. In 2005, 13.3% of individuals in the USA were living below the poverty level, and 19.8% of Louisianans lived in poverty: there are many poor people in the USA, and relatively more poor people in Louisiana (one fifth) – even before Katrina hit (US Census Bureau, *American Community Survey* data for 2005).

Do tax cuts increase revenues?

President George W Bush was answering press questions (24 August 2001) that moved to the topic of Bush's tax cutting package. Bush said he was proud of the congressional vote for tax cuts because he said it helped respond to adverse national economic circumstances (this was before the 11 September attack). However he warned the legislators "don't go hog wild. I mean, appropriators appropriate. Don't overspend. And one of my jobs as the President is to make sure we keep fiscal sanity in the budget." A reporter pointed out that, if the package was off by just a point or two in its projected impact, the budget would be billions and billions short – to which Bush replied "Well, if I'm off by a point or two, then Congress can adjust their sights." As should have been expected, the package was off by a point or two and Congress did not adjust their sights, with the result that deficits in both Bush's terms greatly increased – moving from a healthy surplus on coming to office to an unhealthy deficit on leaving.

In *The Wall Street Journal* (14 February 2005, prior to Katrina) Arthur Laffer[5] was clear about the presidency of George W Bush and the effect of Bush's tax cuts, saying that "George W. Bush could well turn out to be the best president in recent history" and that, because of the Clinton surplus, Bush's budget deficits could easily be absorbed by the U.S. economy. By the autumn of 2008, it had become clear that Laffer wrong on both counts, and so his further opinion "Supply-side pro-growth economics couldn't ask for a better champion" than Bush might also be wrong, or the supply-side pro-growth economics mantra had indeed the champion it deserved. Supply-side economics is sometimes known as "trickle-down" economics and, in a nutshell, supply-side economists claim that tax cuts (always popular, especially with conservatives/regressives) grow the economy and increase government revenues so that there is more money for government programs such as Medicare or Social Security (always popular with the populace) – you do not cut taxes to starve the beast, you cut taxes to feed the beast. In a debate with Peter Schiff on CNBC (*Kudlow & Company*, 28 August 2006) Laffer bet Schiff one cent that the US economy would not be in a recession in 2007 or 2008 because, Laffer said, the

US economy had never been in better shape, wealth had risen, and the Bush monetary policy was spectacular – Laffer had still to pay when interviewed by Bill Maher on HBO (*Real Time with Bill Maher*, 24 October 2008).[6]

The positive effects on revenues of tax cuts is a popular mantra with Republicans, in that they can cut taxes at the same time as claiming support for social programs or, as John McCain said in a *National Review Online* interview, "Tax cuts, starting with Kennedy, as we all know, increase revenues" (5 March 2007) – McCain knew this because he was "friendly with the godfather of supply-side economics, Arthur Laffer".[7] The success of tax cuts during John F Kennedy's presidency are often used by Republican ideologues so they seem to be less partisan, because Kennedy was a Democratic politician and a modern cultural icon. Actually, the tax-cut legislation was passed after Kennedy died, during the presidency of Lyndon Johnson. At the same time Johnson instigated a "war on poverty" injecting public monies in many areas – with an accompanying economic stimulus. A further stimulus was the war in Vietnam, but then it became a fiscal drag:

> I recommend to the Congress a surcharge of 6% on both corporate and individual income taxes – to last for 2 years or for so long as the unusual expenditures associated with our efforts in Vietnam continue. ... Now if Americans today still paid the income and excise tax rates in effect when I came into the Presidency, in the year 1964, their annual taxes would have been over $20 billion more than at present tax rates. So this proposal is that while we have this problem and this emergency in Vietnam, while we are trying to meet the needs of our people at home, your Government asks for slightly more than one-fourth of that tax cut each year in order to try to hold our budget deficit in fiscal 1968 within prudent limits and to give our country and to give our fighting men the help they need in this hour of trial — Lyndon B Johnson, *State of the Union* (10 January 1967)

A 10% surtax was passed in 1968 (not 6%) and President Nixon who took office in 1969 continued the surtax until 1970.

Grover Norquist is head of a group called Americans for Tax Reform (ATR) that worked with John McCain during the 2008 presidential campaign. Not long after the election, Norquist was more inclined to incite than to show insight in a CNBC discussion about tax cuts and the US president-to-be – he said "the economy is in the present state because when the Democrats took the House and Senate in 2006 you knew those tax increases were going to come in 2010. The stock market began to collapse as soon as you recognize that those old tax rates were coming back." ("The New Washington: Should Obama abandon his tax plan?", *CNBC: Call of the Wild*, 25 November 2008). It is either the case that expectations reign supreme, because the economy and the stock market collapsed on the basis of what might happen in two years, or the case that the failure of fragile loans to fragile people produced an economic and stock market collapse. Though the economist John Maynard Keynes stressed the importance of expectations on people's economic behaviour, he did not think they reigned supreme – nonpayment of debts, say, had more power to affect behaviour. When Norquist blamed Franklin D Roosevelt for the depression of the 1930s the rewriting of history climbed to new heights (he said FDR turned a recession into a depression because he increased taxes).

A former advisor to President GW Bush is more realistic about tax cuts and increased revenues: "Republican candidates are fond of saying we should cut tax rates because doing so would incentivize more rapid economic growth (true) and raise tax revenue (wishful thinking)" (N Gregory Mankiw, *New York Times*, 3 February 2008). Mankiw had been a chair of the Council of Economic Advisers (CEA) for the Bush administration and whilst at the CEA Mankiw estimated that reducing taxes on labour would, through economic growth, only increase government revenues by 17 cents for each dollar of reduced taxes. In the 2008 article Mankiw was also darker, noting that, unless benefits were cut for future retirees, taxes would have to rise: "The national debate will have to shift from which tax cuts do the most good to which tax increases do the least harm".

In an official government publication about the US economy in 2002, after the first Bush tax cuts, there is an interesting comment on the association between tax cuts and government revenue:

> Although the economy grows in response to tax deductions (because of higher consumption in the short run and improved incentives in the long run), it is unlikely to grow so much that lost tax revenue is completely recovered by the higher level of economic activity. — *Economic Report of the President* (Transmitted to the Congress, February 2003)

Three years later, Edward Lazear, another chair of Bush's CEA, said:

> Will the tax cuts pay for themselves? As a general rule, we do not think tax cuts pay for themselves. Certainly, the data presented above[8] do not support this claim. Tax revenues in 2006 appear to have recovered to the level seen at this point in previous business cycles, but this does not make up for the

> lost revenue during 2003, 2004, and 2005. — Edward P Lazear, Council of Economic Advisers, "State of the Economy and the Budget", *Testimony to Senate Budget Committee* (28 September 2006).

It seems clear that the support for tax cuts is ideological rather than factual.

Notes

1. Based on my translations of "Ainsi la division du travail, sans laquelle la production serait à peu près nulle, est sujette à mille inconvénients, dont le pire est la démoralisation de l'ouvrier ; les machines produisent, avec le bon marché, l'encombrement et le chômage; la concurrence aboutit à l'oppression; l'impôt, lien matériel de la société, n'est le plus souvent qu'un fléau redouté à l'égal de l'incendie et de la grêle" and Proudhon's quote from Joseph Garnier that "l'impôt est une «privation qu'il faut chercher à diminuer le plus possible, jusqu'à concurrence des besoins de la société»."
2. Article I. Section. 8. – The Congress shall have Power To lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defence and general Welfare of the United States; but all Duties, Imposts and Excises shall be uniform throughout the United States; — *US Constitution* (1787).
3. "Public dislikes tax hikes, spending cuts", *Michigan Political Report with Peter Luke* (17 August 2008) – All spelling as posted.
4. For example, there is the US Constitution's "... Taxes, Duties, Imposts and Excises", or Johnson's definition "To Tax — To load with imposts" [Johnson(1755)].
5. Laffer was a member of the Reagan administration's Economic Policy Advisory Board (1981-1989).
6. Interestingly, details of the bet were removed from the Wikipedia entry for Arthur Laffer by somebody who did not think it relevant.
7. Stephen Moore, "The Weekend Interview: John McCain", *Wall Street Journal*, 26 November 2005. Moore was a co-author with Laffer and Peter Tanous of a recent supply-side tirade [Laffer et al.(2008)].

8. For example, Figure 4 of the testimony: "Real Federal Revenues Around Business-Cycle Troughs".

References

[Johnson(1755)] Samuel Johnson. *A Dictionary of the English Language*. Various publishers, 1755.

[Laffer et al.(2008)] Arthur Laffer et al. *The End of Prosperity: How Higher Taxes Will Doom the Economy – If We Let It Happen*. Threshold Editions, 2008. Arthur B Laffer, Stephen Moore, and Peter Tanous.

[Proudhon(1847)] Pierre-Joseph Proudhon. *Système des contradictions économiques, ou philosophie de la misère*. Various publishers, 1847. "System of economical contradictions: or, the philosophy of misery." Sometimes known as "The philosophy of poverty".