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Evaluating the Aces and Frauds of Supply Side Economics

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Abstract
Supply side economics is that branch of economics that deals with production of goods and services by providing incentives to the producers to produce more and hence ensure a steady stream of goods to the marketplace. This paradigm of economic growth assumes that lowering the tax rates provides incentives for the producers to produce more leading to a situation where there is an increase in incomes and hence the increase in tax revenues to the point where the shortfall due to the lower tax rates is more than made up due to the increase in the tax collections. Supply side economics came into prominence with the Reagan administration in the US and the Thatcher stint in the UK. This lead to an unprecedented boom in the economies of these countries that was touted as the example of "trickle down" economics that posited that wealth generated at the top of the pyramid trickles down to the members at the bottom.

A. Alternative Approaches to Supply Side Economics

The alternative approaches to supply side economics is the one that has been espoused in the US after Ronald Reagan demitted office. This is the method of stimulating demand by cutting interest rates. The other methods that are often touted as alternatives is the Keynesian method that holds that only increased governmental spending can stimulate demand make the economy grow. This dichotomy between encouraging the producers as opposed to encouraging the consumers lies at the heart of the debate between supply side economics and other approaches. While proponents of supply side economics argue that increasing governmental spending leads to higher inflation, the Keynesians point to the growing income disparities between the rich and the poor as a sign of failure of supply side economics.

B. Effectiveness of Supply Side Economics

In this section, we look at the ways in which supply side economics work and the perceived benefits of the same. The pillars on which supply side economics rests are privatization, deregulation, and reduction of taxes. As we shall discuss later, some of these foundations of supply side economics have been called into question in the wake of the current economic crisis. In the succeeding paragraphs, we look at each of the components of the supply side policies and the ways in which they bring about the desired benefits to the economy.

There has been much speculation on the role of supply side economics in stimulating demand and causing overall economic activity to pick up. The main criticism against supply side economics is that merely cutting taxes alone would not do the trick and other measures like controlling the money supply and lowering interest rates are the necessary conditions for economic growth.

The point about lowering interest rates and stimulating demand became more relevant in the 1990's when the manufacturing base of the US had shrunk and what the US economy was being driven was by growth in services. Thus, as opposed to growth in real manufacturing and production of goods and services, the economy was clocking impressive growth due to the rise in the growth of services. This growth in services was brought upon by the other pillar of supply side economics i.e. monetary policy.

C. Some Questions about the Effectiveness of Supply Side Economics

In the aftermath of the current economic meltdown, there are many who are questioning the viability of supply side economics and the lower interest rates paradigm as an alternative for the Keynesian paradigm. Considering the fact that the economy now had to be revived using massive stimulus packages in a throwback to the years of the great depression, it is worthwhile to note the return of classical economic paradigm in the US.

As pointed out in a previous section, the method of reducing taxes would lead to a situation where the people who benefit from this would be in a minority as opposed to the people who have lost out. This is the main criticism against supply side economics, namely that of the widening income gap between the rich and the poor. This approach has been criticized by many as contributing to increased alienation of the poor who have not benefited from the trickledown theory propounded by the proponents of the supply side economics.

Supply side economics grew in response to the Oil crises and shocks of the 1970's when it was apparent that higher oil prices would have deflationary effects on the US economy. Hence, the government resorted to cutting down taxes and making products more affordable to the people by practicing the supply side equation of the curve. However, this did not lead to an overall increase in prosperity and has been called by many as "making magic" and "peddling prosperity". It is to the credit of the paradigm that many developing countries hitched themselves to this model of economic growth as well.

D. Conclusion

The inescapable conclusion that stems from the current global economic meltdown is that supply side economics has outlived its purpose and it is now time to go in for a new paradigm of growth that revolves around making everyone wealthy instead of a select few.

In conclusion, it is apparent that massive governmental spending is the only way out of the current crisis. Contrary to the claims of the supply side economists, a small government may not be the best possible solution particularly when deregulation breeds excesses of profit taking and speculation way beyond the acceptable levels and results in a systemic failure that threatens the entire global economy.

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