M.A ECONOMICS –SEM 2 CC 8

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THE SUPPLY—SIDE ECONOMICs

The supply side economists include Arthur Laffer,Robert A Mundell, Jude Wanniski and others.

The concept of the supply- side economics refers to the view which states that cutting the tax rates will result in the enormous increase in the aggregate supply/output in the economy—so much that the total tax revenue will rise rather than fall. A sustained tax rate cut of the magnitude of 10 percent or more yearly will cause an explosion of incentive to work more, to save more ,to invest more and to higher capital formation in the economy leading to a substantially large increase in the aggregate supply/output thereby raising the base upon which taxes are levied, given enough time, say over a period of five years or so. Consequently, the additional tax collections raised on this higher output base will more than offset the resulting increase in deficit due to the cut in the tax rates.

The major tenet of the supply—side economists is that reduction in the tax rates is truly an effective method of increasing the growth rate/aggregate supply in the economy .Consequently total capital stock increases which combined with a greater labour input will result in the larger total output or supply. With the larger base of total output available for taxation, even a reduced tax rate would yield higher tax revenue.

The basic tenet of the supply side economics is opposed to the Keynesian tenet. According to the Keynesian view the aggregate income/output in the economy increases due to a tax cut through increasing the aggregate spending/demand. Keynesian view is called demand -side economics which is in sharp contrast to the supply side economics.

The supply side economists argue that economic growth, which is essentially a matter of greater work effort ,increase in saving and positive capital formation, can be achieved only through the policy involving appropriate cuts in the tax rates. For the supply-side economists ,a policy of appropriate tax cuts is almost the sine qua non of economic growth through increasing the aggregate supply in the economy. With the larger base of total output available for taxation even a reduced tax rate will boost tax revenue and consequently ,boost economic growth.

CRITICAL EVALUATION

1 The argument that reduction in tax rates will promote growth by increasing the aggregate supply/output, as this tenet forcefully assert, has nothing new in it as it has been debated ever since Adam Smith's time

2 The supply-side economists views remain the views of only a small number of professional economists.

3 The supply -side economics has as yet not become a massive force to dislodge demand-side economics from its position of general acceptance.

4 So far there is no conclusive evidence that a policy of tax cuts will certainly improve work effort in both quantitative as well as qualitative terms

5 There is no certainty that following a tax rate cut the work- leisure ratio, the saving-income ratio ,the investment-income ratio and the capital stock-income ratio will all for sure move unidirectionally in a positive manner.

6 The supply side economics is essentially of only pedagogic importance with little relevance in practical life.

7 In truth ,the tax rate cut cause relatively small increases in the aggregate supply and relatively large increases in the aggregate demand.

MERITS

1 The basic tenet of supply-side economics is very simple

2 The USA during the administration of President Ronald Reagan had successfully experimented with the supply-side economic policies in 1981-83 with substantial tax cuts.

3 In fact, it is only the supply-side policies which can permanently increase the aggregate output. The demand-side economic policies are useful only for short terms results

4 The supply-side economists have attracted a good deal of attention over the past two and a half decades.

QUESTION

1 Critically examine the concept of the Supply-side economics.-10 Marks

2 Write a short note on Supply-side economics.-5 Marks