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Revival of the tax hikers

By Richard W. Rahn
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In recent years, the old "let's tax them more" crowd was on the defensive. But now, with a politically weakened president, the tax increase lobby is out in full force. All the Democrats running for president have promised to increase taxes. Almost every week, some senator or representative advocates more taxes to impose upon the American people.

The tax increasing Democrats are betting the new generation of voters does not remember how the old, high tax rates affected the economy. The U.S. has only suffered three "down" quarters of economic growth since 1982 — a record never before enjoyed. To pull off the "new taxes will not hurt" charade, the Democrats need to convince people the Reagan and Bush tax cuts had nothing to do with the unmatched economic growth and job creation. But the record is very clear about how the economy improved once the Reagan and, subsequently, the Bush tax rate reductions were enacted. Thus, the new line of attack is that the economy would somehow magically have improved without the tax cuts, and that the people behind the Reagan tax cuts were "crackpots."

Jonathan Chait, a self-proclaimed Bush-hater and a senior editor of the New Republic, is now trying to rescue his Democrat friends by writing a new book, "The Big Con: The True Story of How Washington Got Hoodwinked and Hijacked by Crackpot Economics." I just read a lengthy excerpt from the book in the New Republic, which quickly demonstrates Mr. Chait neither understands basic economics, nor wishes to present the true story of the "supply-side" revolution, in which I was a bit player.

The U.S. and most other developed countries followed Keynesian economic prescriptions in the 1950s, 1960s and 1970s. However, it was increasingly apparent by the 1970s that the Keynesian model was not working in that "stagflation" had developed (i.e., a stagnant economy and high inflation). Two giants of the economics profession, Nobel Laureates Milton Friedman and F.A. Hayek, and their followers had long been critics of Keynesian economics, and their forecasts had come true. Professor Robert Mundell of Columbia University, who also won the Nobel prize, and his associate Professor Arthur Laffer of Chicago (following in Friedman's and Hayek's footsteps) argued that the solution was to reduce high marginal tax rates on work, saving and investment to revive economic growth and, at the same time, reduce the growth of the money supply to reduce inflation.

This was precisely what was done in the early 1980s, and it worked better than expected. Mr. Reagan brought in a world-class team of economists, including the late Norman Ture as undersecretary of the Treasury for tax. Paul Volcker (originally appointed by Jimmy Carter) and, subsequently, Alan Greenspan at the Fed carried out the new monetary policy.

Mr. Chait's fictional version of these events is totally different. The central players in his drama are two very talented writers, George Gilder, who wrote "Wealth and Poverty," and Jude Wanniski, who wrote "The Way the World Works." Both books were hugely influential because Messrs. Gilder and Wanniski skillfully explained the arguments of the economists to noneconomists. However, they were not the theoreticians, policy advisers or implementers of the Reagan program.

In the few years before Mr. Wanniski passed away in 2005, he came to hold rather bizarre views on a number of issues, so it is easier for Mr. Chait to portray Mr. Wanniski as a "crackpot" than to deal with the real Reagan policymakers.

Mr. Chait spends considerable time trying to discredit Arthur Laffer and his famous curve. The Laffer Curve is merely a graphical presentation of a fact known for centuries that every tax rate has a revenue maximizing rate. If a tax rate is considered too high, people will not buy the product — they will pick substitutes, go to the black market, or do without — and the government will lose, rather than gain, revenue. (Some states now find they have jacked up cigarette taxes so high that revenues from the tax are falling.)

The same concept applies to taxes on labor and saving. If the tax on labor is too high, people will work less, as we have seen in France. If the tax on saving is too high, people will consume rather than save. The capital gains tax is a good example of a tax rate that was too high to maximize revenue, and when the rate was cut under the Reagan, Clinton and Bush administrations, the revenue increased each time.

However, neither Art Laffer nor the Reagan economic team ever claimed all tax rate reductions would result in greater revenue (as the critics often and falsely charge).

In fact, if Mr. Chait and his high tax allies in Congress told the truth about what was proposed and done by whom during the Reagan years, they would have no story; hence, no books to sell, and no excuse for proposing destructive tax increases.

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