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Supply-Side Economics

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Supply-side economics is the policy of inducing a greater supply of goods by reducing the costs that government has imposed on labor and industry. "Supply" means the quantity of goods provided at various prices. Taxes and arbitrary restrictions on labor, capital goods, and enterprise, all add to the cost paid by the purchaser, and with higher costs, fewer goods are purchased and produced.

The other basic economic policy is demand-side. There, government either increases its spending or pumps up the money supply to get more demand for goods. But unless the resources come in free from abroad, demand-side policy just transfers spending from the private sector to government, and inflating the money supply can lead to an inflation of prices, without any sustainable output gains.

The key policy variable is the marginal tax rate, the taxes paid on the extra amount of money earned. High marginal tax rates discourage investment and employment by making the extra amount too expensive and taking away the extra gains. The ultimate in supply-side policy is a marginal tax rate of zero.

There are two main ways of achieving a zero tax on extra income and output. One is with a lump-sum tax. That means a fixed amount of money is collected, regardless of income or output. For example, if you are a carpenter earning $50,000 per year, a lump-sum tax of $10,000 would require you to pay that amount regardless of how much income you earned.

Suppose you had just enough savings to enable you to take a year of vacation. You can't, because you also have to pay the $10,000 in tax. You have to work enough to pay that tax before taking the vacation. A lump-sum tax on labor does indeed not reduce labor; it can even increase labor, but it amounts to forced labor. And labor that is forced, is slave labor.

The other and better way to achieve a zero marginal tax rate is to tap a source of revenue unrelated to work and enterprise effort. One could tax antiques, but that would be silly. The main item that does not affect current human action is natural resources, or economic land. Land has no cost of production, and it cannot be imported or expanded.

The rent of land is a surplus that can be tapped for public finance with zero impact on work and enterprise exertion and effort. Using the economic rent for public finances is even beneficial, because it induces a more efficient and productive use of land. The rent assessment should be based on the typical market rent of a plot. Then land is not withheld from current production awaiting higher rent if its economic rent is used for public and community revenue.

Adam Smith (1723-90) is popularly regarded as a supply-side economist. His Wealth of Nations showed how reducing taxes and trade barriers leads to more growth and prosperity. The great

Arab economist Abu Said ibn Khaldun (1332-1406) earlier theorized that a reduction of tax rates could generate larger tax revenues by generating much more output.

François Quesnay (1694-1774) and the other French economists calling their policy "physiocracy" developed more fully the economic supply-side principle of using land rent for public finance rather than taxing labor and enterprise. They proposed the laissez faire policy of unhampered markets with free trade.

The American economist Henry George (1839-1897) discovered that not only does rent provide public revenue without reducing supply, but that not tapping the rent can reduce supply and cause recessions because the margin of production can be shifted to less productive areas when land is priced for future rather than current uses. Taxes on labor pay for civic goods that then pump up land prices, inducing speculation that can create distortions in land use that eventually lead to bad investments and depressions.

So what George said was that not only does supply-side policy avoid reductions in growth and wealth, but the failure to have a complete supply-side policy of tapping the rent itself leads to economic trouble. The lesson is clear: to maximize growth and wealth and avoid economic turbulence, we must use most of the land rent for community and public revenue, and we must not hamper, tax, or restrict labor and enterprise.

That is real supply-side economics.