Supply side economic theory and keynesian economic theories argumentative essay

Countries, United States

Generally, during recession period, there are theories that are implemented to try and remedy the situation. The two major theories that have been utilized during the United States of America to try and save big businesses are: supply side economics and Keynesian theory. Arguments have been put across regarding the best theory that is capable of rescuing big businesses during the recession. According to Boskin, many have been in favor of Keynesian while others have been in favor of Supply-side. In this paper therefore, is going to investigate both theories arguing in favor of supply-side. This paper will also reveal all advantages that are coupled with the implementation of this theory. This paper does acknowledge both theories to be useful even though in some areas, supply-side economics seems to have an added advantage over Keynesian theory side economics (Boskin Michael, 1-5)

Keynesian theory – This is a short term policy that is applied usually on dire situations. Keynes recommends that the government of United States takes consumers position during the time of recession and invest enough money to revive the economy. This theory focuses much on the demand section of economics. It is also popularly known as spend out of the recession (Blinder Alan, 1-4)

Supply side economy – Focuses general supply of services and goods that are produced. This theory makes it possible by increasing the available capital technology and labor. The main difference between these two theories is the duration in which they pertain and the equation of supply and demand which each one of them focus on.

The 2000s recession mainly in developed countries declined in economic activity. These recession mostly affected the EU during the years 2000 and 2001 and in the United States, it occurred in 2002 and 2003. The countries that avoided recession are Australia, UK and Canada. The world economists had at first predicted the early recession for many years. The reasons that made them to be suspicious are because of the boom that had been noticed in the 1990s that was followed by both low unemployment and low inflation during the Asian financial crisis in 1997. Many economists predicted that the early 2000s recession could be worse but luckily it was not as bad as they predicted.

July Beans asserts that National Bureau of Economic Research’s Business Cycle Dating Committee in the United States has determined how a peak in business activity happened in the U. S economy in the late 2000. The peak marked the end of expansion and paved way for the beginning of recession. A peak date determination in March is a determination that shows how the expansion began in 1991 and ended in 2001 which later led to the beginning of a recession. This expansion lasted for ten years and it is the longest in the National Bureau of Economic Research chronology. According to NBER which determines economic recessions, the United States economy was in recession in the year 2001 from March to November. This was a period of 8 months when President George W Bush was in the office. The economic conditions in the US however, didn’t satisfy the definition of recession which means a fall of real gross domestic product in a country in 2 or more respective quarters. This led to confusion about a procedure of determining the end and start dates of recession (Beams July, 1-6)

Supply-Side Economics

This is a macroeconomic school thought which argues that growth of the economy can be created effectively by lowering trade barriers for the public to supply or produce goods and services. Things that can be lowered include, capital gains tax and income tax and also by reducing flexibility regulation. According to Supply-side economic theory, consumers will benefit from lower prices resulting from increase in supply of goods and services from big companies. Recommendations policy of the supply-side economics is lower in the marginal tax rates. The current supply economics is concerned primarily with economic growth and it doesn't explain whether decreasing taxes raises government revenue. Economists argue that economic growth size can be of significance if the government revenue is increased from faster growing economy. This economic growth would be adequate to compensate short-term costs of the tax-cut and this tax-cut will cause revenue to increase. In 2003, the Wall Street Journal wrote a report about a Congressional Budget Office which stated that, taxes can't be deducted without losing revenue. Supply-side economics today is viewed as a trickle-down economics form.

Supply-side developed in early 1970s because of the Keynesian economics policy which had developed earlier. It also developed because of failure of Keynesian economics to stabilize demand management to Western economies during 1970s stagflation, in the wake of 1973 oil crisis. Supply-side economics drew on a series of non-Keynesian economic thought, mostly Austrian school on entrepreneurship and classical microeconomics. Supply-side economics was invented by intellectual thinkers like Alexander

Hamilton, David Hume, Ibn Khaldun, Adam Smith and Jonathan Swift.

Unlike Keysian economics, supply-side proposed that supply or production is a key to economic prosperity and demand or consumption is just a secondary consequence. This idea had been early summarized in the Says Law of economics. The law stated that any product is either created from that instance, or affords products market for full extent of its value. The Founder of Keynesianism John Maynard Keynes summarized this law as supply creates its demand. Mr. Keynes changed Say's Law in 1930s by declaring that a demand creates its value. Supply-side economics explains better the Say's Law by stating that supply of a commodity constitutes demand for other goods. Jude Wanniski published a book in 1978 called The Way the World Works whereby, he laid thesis pertaining supply-side economics and also detailed some of the failure of progressive high-tax rate income tax in the United States. He advocated for lower tax rates to be paid by big companies. Economist, Victor Canto, published a book in 1983 called The Foundations of Supply-Side Economics. The book focused on effects of the marginal tax rates to incentive save and work which affected supply-side growth. Keynesian theory focuses only on the changes growth rate of supply-side in the long run.

The supply-siders were strongly influenced by Laffer curve which states that tax revenues and rates were distinct meaning that, tax rates are either too low or high, something that may not maximize tax revenues. They felt that lowering taxes in high environment rate tax can raise revenues because of the faster economic growth. This led to advocate reductions in capital gains tax and marginal income to promote allocation of assets to businesses, which in return would produce additional supply of goods. This theory has been criticized politically as conservative. Advocates of Supply-side claim that they reinstating classical economists but not following an ideology. Supply-siders like Jude Wanniski and others have argued for reduction in tax rates to high tax revenues compared to those of the Keynesian economics. Some of the economists see similarities between Keynesian economics and supply-sided proposals. If there is a fiscal deficit change to the tax structure, then supply-side policy will be stimulating demand effectively through Keynesian multiplier effect. Proponents of supply-side would point out that the level of spending and taxation is important for the economic incentives and not only size of the deficit.

There has been trouble concerning which of the two is the real engine of economic growth in production or consumption of goods and services. Supply side economics have always believed that the growth in supply is imperative in creating demand from consumers. Given the fact that Schumpeter, Max and Ricardo are known to be the pioneer precursors of the theories of economic growth, the initial formal of economic growth models were implemented towards the end of 20th century.

Supply-side economics asserts that the increased taxation gradually reduces economic trade among the economic participants, that are within the nation and it also discourages investments. Income taxes acts as a form of trade tariff or barrier that causes participants of the economy to revert to proficient means of satisfying the needs of businesses. Unlike Keynesian economics which states that lower taxation leads to high levels of specialization and economic efficiency, Supply-side economics states that high taxation may lead to low levels of specialization and economic efficiency. Supply-side theory is referred by big businesses as the expansion of free movement of capital and free trade. Economists argue that free movement of capital allows frequent economic expansion.

According to Tutor2u. net, Supply-side economics is a policy that was espoused by former United States President Mr. Reagan Ronald. He popularized controversial idea which explains that greater tax cuts for entrepreneurs and investors provide incentives to investors and also produce the economic benefits that affects the economy. Supply-side theory in general has three pillars: monetary policy, tax policy and regulatory policy. However, the reason behind these pillars is that production is one of the most determinants of growth of the economy. Supply-side theory is held typically in stark while Keynesian economic theory which is among other facets involves the idea demand may falter if lagging demand of consumer drags an economy into recession. Keynesian also argues that the government should interfere with monetary and fiscal stimuli. Keynesian believes that all business consumers and their demand for services and goods are key economic drivers, whereas supply-side believes that the willingness of producers to create services and goods may lead to economic growth (Tutor2u. net, 1-10)

Supply-side holds that big businesses stimulate economic activities by increasing net wealth that is possessed by top echelons society. Wealth owners invest their wealth in marginal wealth gain that at the end increases supply to new companies, factories and innovative goods and services.

Under Keynesian theory, the government of the United States should spend heavily even if it has debts when the country is in recession. This will increase high-velocity of the economic activity. Both Supply-side economics and Keynesian economics claim that the use of deficits and the state-largesse will result to incur debt of the revenues. There are three major differences between Supply-side economics and Keynesian economics. These are:

Keynesian economic deficit spending explains that every dollar will have a highly velocity impact to all citizens while Supply-side economics largesse benefits only big businesses and companies will continue to benefit leaving poor people in poverty

The beneficiaries of Keynesian economics largesse are the middle class and the poor who may have actual direct need. This need may result in creating more small businesses and more-skilled workers. In contrast, Supply-side economics sends money to big businesses where a direct need values government intervention.

Supply-side is a monotone since it benefits only the rich and big businesses under all circumstances at any given time or condition. Whereas, Keynesians economics have proved that its policies is valuable and adaptable. Keynesians spend plentifully to get out of recession.

Supply-side economics today is associated with obsession of cutting down taxes under any circumstances. These cut-down taxes will benefit more than 500 hundred companies in the United States unlike Keynesian which only benefits people. The advocates in Congress confine themselves in cutting marginal tax rates as the supply-siders do. They also support the most economical, gimmicky dubious tax with intensity which is the same as that of Supply-side. Welfe explains that Tax cutters today claim that all tax cuts raises revenue. In 2008 Campaign for President, Senator John McCain in a National Review Magazine claimed that tax cuts increases revenue and also Steve Forbes said that supply-side economics have been given a firsthand whereby, there is higher revenue from low taxes in the US (Welfe Wladyslaw, 48-89)

People should understand that when Supply-side was created, there existed Keynesian economics which dominated economic policy and macroeconomic thinking in Washington. Keynesians held beliefs that: budget deficits stimulated economic growth; the way by which the government of the U. S raises its revenues is irrelevant economically; inflation is caused by unemployment; monetary policy is important; government tax cuts and spending affects the economy among other things. Most economists today do not believe what Keynesians believed in 1970s and they accept basic ideas from Supply-side economics (Davidson Paul, 1-4)

Advantages of Supply-Side Policies over Keynesian Policies

Lower Unemployment- This will increase sustainable rate of growth of the economy by increasing AS.

Lower Inflation- Shift of the AS to the right will reduce price level. In order for the economy to be efficient, supply-side policies will reduce the cost of inflation.

Improved Balance and Trade of Payments- Big companies will be able to export their products due to productive and competition from other firms.

Expansion of Investment- Advocates of supply side claim that the high marginal tax rate encourages big businesses to protect their business money from taxes and other measures in order to avoid paying additional taxes. In contrast, Keynesian does not have productive measures which may prevent people from paying additional taxes. Lower taxes allow people to keep their additional money which they earn. According to Supply-sider low taxes means greater freedom where businesses have freedom to invest more, earn more and also prosper.

Economic Growth- According to economists of Supply-side, lower marginal rates represents a policy for long run of economic growth. Marginal rates provide businesses and people incentives to work longer, earning additional income which is taxed at a lowly rate (Hall Shane, 2-4)

Some of the economists view that supply-side is an ill-conceived economic theory. They point out that supply-side economics lacks academic economics. Mr. David Harper and other people dismiss this theory because it offers controversial classical economics. This is not true because the theory offers new classical economics to big businesses and companies and it does not lack academic credentials of economics. According to Economicshelp. org, in the year 2006, Mellaby Sebastian of Washington Post quoted Dick Cheney, George W. Bush, Rick Santorum, Chuck Grassley and Bill Frist misstating effects of Bush Administration’s tax cuts. The Congressional Budget Office has anticipated that if the 2001-2003 Bush tax cuts are extended beyond 2010, deficits would increase by $1. 8 trillion over the preceding decade. Stronger critics dismiss supply-side economics as a complete failure because it reduces marginal tax cuts which eventually benefits big companies (Economicshelp. org, 3-5)

Krugman Paul of Princeton referred Supply-Side as a peddling Prosperity and also dismissed the theory as being unworthy in a book written to audience. The very same theory which Paul Krugman criticized in his early work, made Mundell to receive a Nobel Price. This means that Supply-side theory was talking about the truth and not what Keynesian economics was talking about. Supply-side economics has been critiqued and discussed in songs, films and books. The cartoonist and social activist Dan Parkins has supported this theory in his Modern World weekly cartoon (Bartlett B, 3-8)

In Supply-side theory, the government plays a minimal role to the economy of the United States. The macro-economic is a self adjusting meaning that businesses and consumers will correct any problem that may occur automatically in the economy over time. This theory mostly focuses on the long-term goals. Whereas in Keynesian theory, the government plays big role in improving the economy of the United States and it only focuses mostly on short-term goals. This theory is mostly used in times of recession where the government spending is a better way of putting money back into GDP and this will increase unemployment.

Vitez states that Supply-side economic theory allows for businesses and companies to act according to their interests regarding the economic decisions. These decisions ensure that the economic resources are billed according to desires of companies and businesses in the market place. It also uses theory value to determine prices in economic market. In contrast, Keynesian economics relies mostly on spending and demand aggregate in defining economic marketplace. They also believe that aggregate demand is influenced by private or public decisions. Private decisions may include businesses and individuals in the economic marketplace while public decisions represent government municipalities and agencies. Keynesian theory also relies heavily on the national monetary policy that affects a company's economy (Vitez O, 1-4)

Conclusion:

The two theories are very imperative when it comes to saving business and enabling them to recover quickly. Their differences are quite evident through the outcome after implementation. Generally, the differences between two theories during application are as following: like it has been believed, Supply-side economics theory is much better. However, there are advantages that are found Keynesian but not in supply side given the fact that Supply-side mostly works as short-term remedy as compared to Keynesian theory. The bottom line is that, they are all fruitful.

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