Supply side model of economics

Literature, Russian Literature

Supply Side Model of Economics Proponents of supply side economics have d that reducing taxes will fuel the economy by increasing consumer spending. Through a period of time, the improved growth in the economy will create a larger tax base that will compensate revenue that was lost through the tax cut. Also referred to as trickle-down economics, it is based on the theory that income tax cuts mean workers get higher pay that they can spend and provides entrepreneurs and investors an incentive to invest and save (Case & Fair 21). Supporting the idea that supply (or production) of goods and services is significant for economic growth, supply side economics attempts to explain macroeconomic phenomena as well as offer policies for steady growth. This paper will discuss the assumptions of the supply side model of economics, highlighting on its features, assumed benefits and the role the government plays in it. It will further highlight the reasons and when the model was introduced, whether it is a viable modey in current economics and its downfalls. Supply side economics argues for three key policies which are tax, regulatory and monetary (Case & Fair 38). The supply curve of the model bends backwards, with the assumption that tax cuts can unlock significant growth in the supplied quantity of productive resources to the economy, in terms of capital and labor and increasing Gross Domestic Product (GDP). To create a better understanding of the supply side model, many literatures have discussed it in comparison to the Keynesian theory, which suggests that the most significant economic drivers are the demand for services and goods, and also the consumers (Gwartney 48). This is in contrast to the supply side theory that believes producers, as well as their enthusiasm to produce services and goods, are the ones that determine the rate of economic growth. The supply side model assumes that less regulation will allow greater supply levels services and goods for the benefit of consumers at lower prices. Introduced in the 1970s, supply side economics was developed in response to the Keynesian policy when the demand management did not stabilize economies of the West, especially in consideration of the 1973 oil crisis (Gwartney 60). Its genesis can be traced to the inflation and high taxes that characterized the 1970s. The Laffer curve idea influenced the development of supply side economics by stating that distinction between tax revenues and tax rates. Laffer’s opinion was that tax revenues would not be maximized by either too low or too high tax rates, and was supported by proponents of supply side. They believed that the right level of reduced taxes within an environment of high taxes could raise revenue through facilitating rapid economic growth. Supply side economics is a viable model in today’s environment. This is manifested in Laffer’s curve that assumes all motivation to invest or work ceases when taxation is at 100 percent, and at zero percent no revenue is collected. With the constancy of tax proceeds being a percentage of GDP, marginal rates are surpassed by growth as tax revenue drivers. Therefore, supply side economics have the ability to invoke self interest as the stakeholders in the economy work towards improving their material circumstances. The less they are burdened by taxes, the more motivated they are to produce and consequently igniting a vigorous economy. However, the supply side economics model also has underlying disadvantages. First, there is the assumption that tax cuts on high incomes increase savings. However, it should also be noted that the government pays for the cuts using borrowed money (Gwartney 63).

Effectively, the rate of net saving for a country can decline to insignificant levels as compared to the effort. In another example, by reducing capital-gains and income taxes, the key beneficiaries would be citizens who earn the highest incomes hence, the benefits of the economic growth are distributed unequally. The wealthy would exploit tax cuts and expand their enterprises, meaning larger portions of the money would still remain at the top. Another downside is caused by reduced regulation in the creation of growth. It is worth noting that reduced regulation actually leads to higher profits and GDP, but is also laden with hidden costs (Blinder 69). If, for example, governments were to reduce regulations imposed on emissions in the coal industry, electricity costs would reduce and the industry owners would make higher profits. However, such benefits fail to take into account the costs incurred in medical treatment because of sicknesses caused by increased emissions from burning coal. Hence, while the economy is seemingly growing, it is still being eaten into by the reduced standards of living of an unhealthy population. Works Cited Blinder, A. Can fiscal policy improve macro-stabilization? Cambridge: MIT Press, 2006. Print. Case, K., & Fair, R. Principles of Economics. New Jersey: Prentice, 2007. Print. Gwartney, James. Concise Encyclopedia of Economics. Indianapolis: Library of Economics and Liberty, 2008. Print.