IDEAS ON LIBERTY
FEBRUARY 2000

A Much-Deserved Triumph in Supply-Side Economics

"After occupying center stage during the 1980s, the supply-side approach to economics disappeared when Ronald Reagan left office."

—PAUL SAMUELSON[1]

Until Robert Mundell won the Nobel Prize in 1999, supply-side economics had been a school without honor among professional economists. Established textbook writers such as Paul Samuelson (MIT), Greg Mankiw (Harvard), and Alan Blinder (Princeton) frequently condemned the supply-side idea that marginal tax cuts increase labor productivity, or that tax cuts stimulate the economy sufficiently to increase government revenues.

The Laffer Curve—the theory that when taxes are too high, reducing them would actually raise tax revenue—is dismissed. "When Reagan cut taxes after he was elected, the result was less revenue, not more," reports Mankiw in his popular textbook.[2] Never mind that tax revenues actually rose significantly every year of the Reagan administration; the perception is that supply-side economics has been discredited. Arthur Laffer isn't even listed in the 1999 edition of *Who's Who in Economics*, although the Laffer Curve is frequently discussed in college textbooks.[3]

Now that is all about to change with Columbia University economist Robert A. Mundell's Nobel Prize in economics. According to Jude Wanniski, Mundell, 67, is the theoretical founder of the Laffer Curve.[4] In the early 1970s he told Wanniski, "The level of U.S. taxes has become a drag on economic growth in the United States. The national economy is being choked by taxes—asphyxiated."[5]

Mundell offered a creative solution to stagflation (inflationary recession) of the 1970s: impose a tight-money, high-interest rate policy to curb inflation and strengthen the dollar, and slash marginal tax rates to fight recession. Mundell's prescription was adopted by Reagan and Fed chairman Paul Volcker in the early 1980s. "There's been no downside to tax cuts," he told reporters recently.

Yet, oddly enough, Mundell isn't accorded much attention compared to supply-siders Laffer, Paul Craig Roberts, and Martin Anderson. In their histories of Reaganomics, Roberts and Anderson mention Mundell only once.[6]

Two major studies of supply-side economics in 1982 don't cite his works at all.

Nevertheless, Mundell has accomplished a great deal worth lauding. In fact, he is considered the most professional scholar of the supply-siders.

Robert Mundell has had an amazing professional career. A Canadian by birth, he has attended, taught, or worked at over a dozen universities and organizations, including MIT,

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University of Washington, Chicago, Stanford, Johns Hopkins, the Brookings Institution, Graduate Institute of International Studies in Geneva, Remnin University of China (Beijing), and the IMF. Before going to Columbia in 1974, he was a professor at the University of Chicago and editor of *The Journal of Political Economy*. Thus the Chicago school can once again claim a Nobel, although Mundell differs markedly from the monetarist school.

Monetary vs. Fiscal Policy

Famed monetarist Milton Friedman says, "I have never believed that fiscal policy, given monetary policy, is an important influence on the ups and downs of the economy."[7] Supply-siders strongly disagree. Cutting marginal tax rates and slowing government spending can reduce the deficit, lower interest rates, and stimulate long-term economic growth. Mundell counters, "Monetary policy cannot be the engine of higher noninflationary growth. But fiscal policy—both levers of it—can be. . . . The U.S. tax-and-spend system reduces potential growth because it penalizes success and rewards failure."

Mundell favors spending on education, research and development, and infrastructure rather than government welfare programs. He advocates reducing top marginal income tax rates, slashing the capital gains tax, and cutting the corporate income tax. Such policies would sharply raise saving rates and economic growth—"an increase in the rate of saving by 5% of income (GDP), say from 10% of income to 15%, would increase the rate of [economic] growth by 50%, i.e., from 2.5% to 3.75%."[8]

Mundell as Gold Bug

Supply-siders also take a different approach to monetary policy. They go beyond the monetarist policy of controlling the growth of the money supply. Unlike the monetarists, supply-siders like Mundell resolutely favor increasing the role of gold in international monetary affairs. "Gold provides a stabilizing effect in a world of entirely flexible currencies," he told a group of reporters in New York in November 1999. According to Mundell, gold plays an essential role as a hedge against a return of inflation. He predicted that the price of gold could skyrocket in the next decade, to as high as $6,000 an ounce, if G7 central banks continue to expand the money supply at 6 percent a year. "I do not think this an outlandish figure. Gold is a good investment for central bankers." He did not foresee central banks selling any more gold. "Gold will stay at center stage in the world's central banking system," he said.

In awarding Mundell the prize, the Bank of Sweden recognized him as the chief intellectual proponent of the euro, the new currency of the European Community. He considers the euro a super-currency of continental dimensions that will challenge the dollar as the dominant currency. The benefits of a single currency include lower transaction costs, greater monetary stability, and a common monetary policy. Mundell advocates an open global economy, expanded foreign trade, and fewer national currencies. Ultimately, he envisions a universal currency backed by gold as the ideal world monetary system. Under a strict gold standard, "real liquidity balances are generated during recessions and constrained during inflations."[9]

Mundell is an optimist as we enter a new century. He's bullish on the global stock markets, the gold standard, globalization, and downsized government. He's my kind of economist. □

1. Paul Samuelson and William D. Nordhaus, *Economics*, 16th ed. (Boston: Irwin/McGraw-Hill, 1998), p. 640.
2. N. Gregory Mankiw, *Principles of Economics* (Fort Worth, Tex. Harcourt/Dryden Press, 1998), p. 166.
3. Mark Blaug, compiler of *Who's Who in Economics* (Northampton, Mass. Edward Elgar, 1999), determines the top 1,000 names in the book based on frequency of citation in scholarly journals. Among the famous economists missing the cut are Arthur Laffer, Paul Craig Roberts, and Murray N. Rothbard.
4. Jude Wanniski, *The Way the World Works*, rev. and updated (New York: Simon and Schuster, 1983), p. x.
5. Wanniski, "It's Time to Cut Taxes," *Wall Street Journal*, December 11, 1974.
6. Paul Craig Roberts, *The Supply-Side Revolution* (Cambridge, Mass.: Harvard University Press, 1984) and Martin Anderson, *Revolution* (Stanford, Calif.: Hoover Institution Press, 1990).
7. Milton Friedman, "Supply-Side Policies: Where Do We Go from Here?" Supply-Side Economics in the 1980s Conference Proceedings (Federal Reserve Bank of Atlanta, 1982), p. 53.
8. Robert A. Mundell, "A Progrowth Fiscal System," *The Rising Tide*, ed. Jerry J. Jasinowski (New York: Wiley, 1998), pp. 198, 203–204.
9. Mundell, *The New International Monetary System* (New York: Columbia University Press, 1977), p. 242.

CAPITAL LETTERS:

"States' Rights" and Freedom

To the Editor:

Gene Healy represents a disturbing trend among some libertarians to nostalgically recall the good old days when states were bastions of freedom. Those days never existed; and as James Madison depicts them in *Federalist No. 10*, even at the founding they were such bastions of tyranny that a stronger national government was called upon to restrain them.

The concept of states' rights libertarianism is oxymoronic. All libertarians know that states do not have rights. States have powers. The purpose of our federal system is to restrict the powers of both national and state governments.

The Fourteenth Amendment was the product of the most libertarian Congress in history. Properly construed, the amendment's scope is purely negative in the sense of restraining state and local violations of civil rights.

Let's see . . . John Calhoun versus Roger Pilon and Randy Barnett? Not exactly a tough choice for libertarians.

—CLINT BOLICK
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To the Editor:

The complete version of the quotation fragment attributed to me by Gene Healy (from my favorable review of Clint Bolick's *Grassroots Tyranny* in *Reason*, October 1993) is this: "Most of those who pass for 'conservatives' are proponents of 'states' rights federalism,' a hoary legacy of the days of human slavery."

There I joined Bolick in criticizing "conservatives" who view the states as a bulwark against federal power, but who have no concern about what the states themselves do to diminish the freedom of their citizens. Examples given are Robert Bork and Edwin Meese III, who champion the Tenth Amendment and dismiss the Ninth.

For libertarians, of which I am generally one, the important goal is not to preserve inviolate some magical balance of countervailing governmental powers, but to protect and enlarge liberty. "States' rights" in our time has meant unpunished lynchings, Jim Crow laws, denial of the right to vote, exclusion from occupations, and countless burdens and humiliations inflicted on black Americans by racist state governments. When libertarians invoke a higher (federal) power to protect liberty against slavery and its lingering incidents, I think they have a strong case. The principle of "states' rights" cuts both ways, as Healy shows. The principle of liberty works only to advance liberty.

Incidentally, states have no rights. States have powers. Only individuals have rights.

—JOHN MCCLAUGHRY
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To the Editor:

There he goes again. Last August, in a long article in the pages of *Liberty*, Gene Healy went after my views on the Fourteenth Amendment. My detailed, 7,000-word response appears in the February 2000 issue. Then in the December 1999 issue of *The Freeman: Ideas on Liberty*, Healy took on Clint Bolick, John McClaughry, Randy Barnett, and me—on the same subject, but with more attention to history than to theory. My response here will be brief.

Healy wants to resurrect "states' rights" as a brake on federal power. Properly understood, so do I. But in arguing against *federal* tyranny, he all but ignores state and local