



LECTURE ONE - PART SIX

The Supply Side Promise

Cut Taxes

Increase
Government
Tax Revenues

Accelerate the
Rate of Economic
Growth



WITHOUT

**Inducing
Inflation**

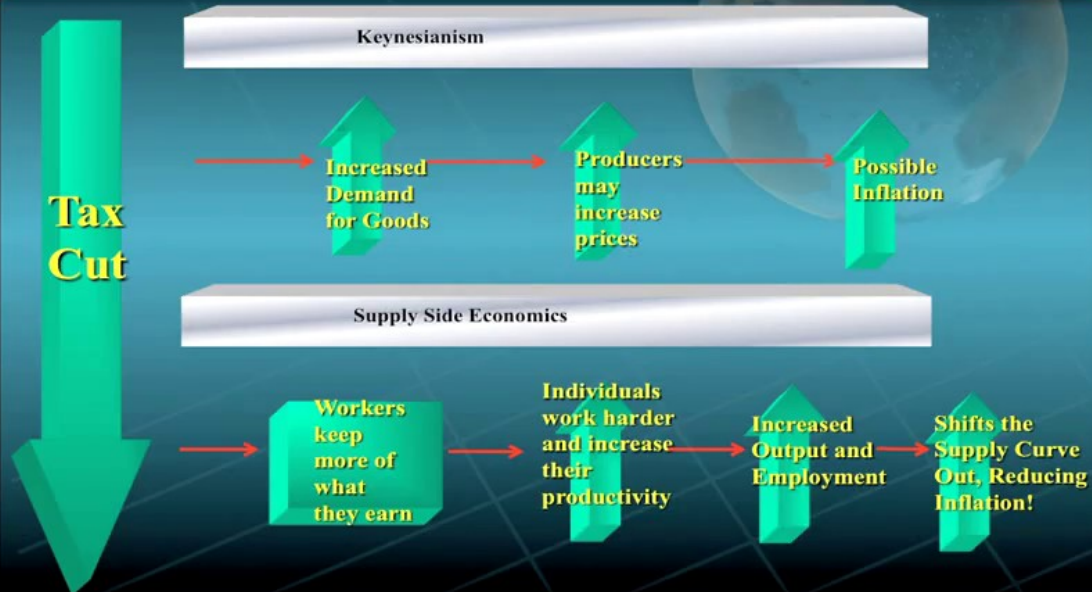
The Supply Side Philosophy

- A Supply Side tax cut looks very similar to a Keynesian tax cut.
 - Example: The Kennedy tax cut of the 1960s.
- However, the Supply Siders viewed such tax cuts from a very different behavioral perspective.



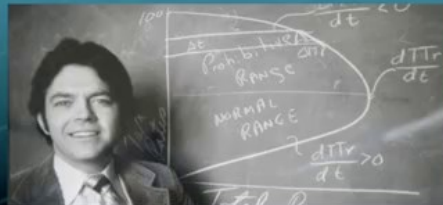
Arthur Laffer: The father of Supply Side economics.

The Behavioral Difference



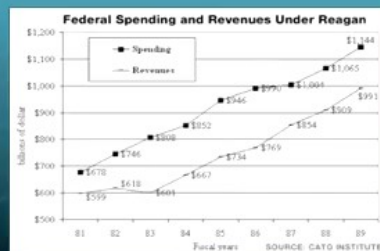
Supply Siders Predicted Lower Budget Deficits!

- The loss in tax revenues from a Supply Side tax cut would be more than offset by the increase in tax revenues from increased economic growth.
- Thus, under supply side economics, the budget deficit would actually be reduced!!!!



End Result of the Reagan Tax Cuts?

- The Supply Side prediction didn't come true
- The economy boomed but so did America's budget deficit.
- America's trade deficit also soared.



George Bush's "New Classical" Approach

- The budget and trade "twin deficits" deeply concerned Reagan's successor George Bush.
- After the budget deficit jumped over \$200 billion in 1990, the economy slid into recession.
- The Keynesian solution would have been more fiscal or monetary stimulus.
- Bush refused more stimulus based on the advice of his "New Classical" advisors.



New Classical Economics

- Based on the theory of "rational expectations."
- If you form your expectations "rationally," you will take into account the future effects of activist fiscal and monetary policies.



Robert Lucas: Won the Nobel Prize in Economics for his work on rational expectations

Central Idea of Rational Expectations

- Activist Keynesian policies might be able to fool people for a while.
- People eventually learn from their experiences.
- Then you can't fool people at all.

A Profound Policy Implication

Rational expectations render Keynesian policies ineffective so they should be abandoned!!!!

Good Economics Makes Bad Politics?

- Refusing to engage in Keynesian stimulus was bad politics for President Bush.
- Bush's advisors rejected a Keynesian "quick fix" even as the recession deepened.
- Instead, these advisors called for more "stable and systematic" policies based on long term goals.
- The deepening recession likely cost Bush the election!!!

It's The Economy Stupid!

- President Bush took his advisors' advice and refused any Keynesian stimulus.
- The economy limped into the 1992 election
- Democrat Bill Clinton ran on a platform that highlighted the failure of Bush's economic policies.
- Clinton beat Bush in 1992 just like Kennedy beat Nixon in 1960 -- because of a weak economy.



Clinton Restored Confidence

- President Clinton actually did very little to stimulate the economy upon taking office.
- The mere fact, however, that Clinton promised a more activist approach helped restore business and consumer confidence.



An Easy Re-election

- Clinton's 1993 deficit reduction legislation signaled Wall Street Clinton was serious about budget balance.
- These factors helped accelerate a recovery already begun towards the end of the Bush presidency.
- The booming economy also set the stage for Clinton's easy re-election in 1996.
- The 1990s marked the longest economic recovery in peacetime history.

The 2000s: A Decade Not So Kind Or Prosperous

- After President Bush took office in 2001:
 - A recession
 - The 9/11 terrorist attack
 - Two wars in Iraq and Afghanistan



China Joins the WTO

- China joins World Trade Organization in 2001
- Begins flooding American markets with illegally subsidized exports
 - Over 50,000 American factories disappear.
 - More than 5 million manufacturing jobs lost.
 - American GDP growth rate falls by 2/3rds.



The Great Recession of 2007

- A massive housing bubble bursts.
- The U.S. enters its worst recession since the Great Depression of the 1930s.



Keynesian Economics on Steroids?

- White House and Congress orchestrate biggest fiscal stimulus in history.
- Federal Reserve engineers an equally massive monetary stimulus.
 - Fed Chairman Ben Bernanke Inaugurates tools like “Quantitative Easing”



A New Failure of Keynesianism?

- Fiscal and monetary stimulus packages have been less successful this century than last.
- Economies around the globe seem to face structural problems increasingly resistant to Keynesian solutions.



Purpose of This Course

- Help you better understand the complex global economic forces affecting both your personal and professional life!!!!

In The Meantime

- Economics is not something to be memorized but rather something to conceptualize.
- So as you study it, think about it too.
- Your job and your business might just depend upon it.



THE POWER OF MACROECONOMICS

Professor Peter Navarro
University of California-Irvine

END OF LESSON ONE