Taxes, revenues, and the "Laffer curve"

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As Arthur Laffer has noted, "There are always two tax rates that yield the same revenues." When an aide to President Gerald Ford asked him once to elaborate, Laffer (who is Professor of Business Economics at the University of Southern California) drew a simple curve, shown on the next page, to illustrate his point. The point, too, is simple enough—though, like so many simple points, it is also powerful in its implications.

When the tax rate is 100 percent, all production ceases in the money economy (as distinct from the barter economy, which exists largely to escape taxation). People will not work in the money economy if all the fruits of their labors are confiscated by the government. And because production ceases, there is nothing for the 100-percent rate to confiscate, so government revenues are zero.

On the other hand, if the tax rate is zero, people can keep 100 percent of what they produce in the money economy. There is no governmental "wedge" between earnings and after-tax income, and thus no governmental barrier to production. Production is therefore

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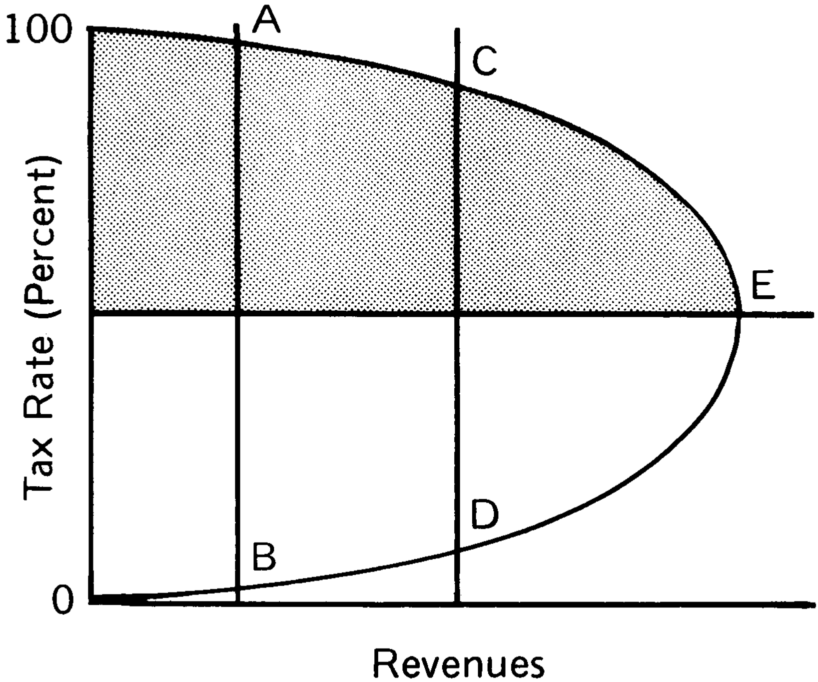
The Laffer Curve



maximized, and the output of the money economy is limited only by the desire of workers for leisure. But because the tax rate is zero, government revenues are again zero, and there can be no government. So at a 0-percent tax rate the economy is in a state of anarchy, and at a 100-percent tax rate the economy is functioning entirely through barter.

In between lies the curve. If the government reduces its rate to something less than 100 percent, say to point A, some segment of the barter economy will be able to gain so many efficiencies by being in the money economy that, even with near-confiscatory tax rates, after-tax production would still exceed that of the barter economy. Production will start up, and revenues will flow into the government treasury. By lowering the tax rate, we find an increase in revenues.

On the bottom end of the curve, the same thing is happening. If people feel that they need a minimal government and thus institute a low tax rate, some segment of the economy, finding that the marginal loss of income exceeds the efficiencies gained in the money economy, is shifted into either barter or leisure. But with that tax rate, revenues do flow into the government treasury. This is the situation at point B. Point A represents a very high tax rate and very low production. Point B represents a very low tax rate and very high production. Yet they both yield the same revenue to the government.

The same is true of points C and D. The government finds that by a further lowering of the tax rate, say from point A to point C, revenues increase with the further expansion of output. And by raising the tax rate, say from point B to point D, revenues also increase, by the same amount.

Revenues and production are maximized at point E. If, at point E, the government lowers the tax rate again, output will increase, but revenues will fall. And if, at point E, the tax rate is raised, both output and revenue will decline. The shaded area is *the prohibitive range for government,* where rates are unnecessarily high and can be reduced with gains in *both* output and revenue.

Tax rates and tax revenues

The next important thing to observe is that, except for the 0-percent and 100-percent rates, there are no numbers along the "Laffer curve." Point E is not 50 percent, although it may be, but rather a variable number: *It is the point at which the electorate desires to be taxed.* At points B and D, the electorate desires more government goods and services and is willing—without reducing its productivity—to pay the higher rates consistent with the revenues at point E. And at points A and C, the electorate desires more private goods and services in the money economy, and wishes to pay the lower rates consistent with the revenues at point E. It is the task of the statesman to determine the location of point E, and follow its variations as closely as possible.

This is true whether the political leader heads a nation or a family. The father who disciplines his son at point A, imposing harsh penalties for violating both major and minor rules, only invites sullen rebellion, stealth, and lying (tax evasion, on the national level). The permissive father who disciplines casually at point B invites open, reckless rebellion: His son's independence and relatively unfettered growth comes at the expense of the rest of the family. The wise parent seeks point E, which will probably vary from one child to another, from son to daughter.

For the political leader on the national level, point E can represent a very low or a very high number. When the nation is at war, point E can approach 100 percent. At the siege of Leningrad in World War II, for example, the people of the city produced for

900 days at tax rates approaching 100 percent. Russian soldiers and civilians worked to their physical limits, receiving as "pay" only the barest of rations. Had the citizens of Leningrad not wished to be taxed at that high rate, which was required to hold off the Nazi army, the city would have fallen.

The number represented by point E will change abruptly if the nation is at war one day and at peace the next. The electorate's demand for military goods and services from the government will fall sharply; the electorate will therefore desire to be taxed at a lower rate. If rates are not lowered consistent with this new lower level of demand, output will fall to some level consistent with a point along the prohibitive side of the "Laffer curve." Following World War I, for example, the wartime tax rates were left in place and greatly contributed to the recession of 1919-20. Warren G. Harding ran for President in 1920 on a slogan promising a "return to normalcy" regarding tax rates; he was elected in a landslide. The subsequent rolling back of the rates ushered in the economic expansion of the "Roaring Twenties." After World War II, wartime tax rates were quickly reduced, and the American economy enjoyed a smooth transition to peacetime. In Japan and West Germany, however, there was no adjustment of the rates; as a result, postwar economic recovery was delayed. Germany's recovery began in 1948, when personal income-tax rates were reduced under Finance Minister Ludwig Erhard, and much of the government regulation of commerce came to an end. Japan's recovery did not begin until 1950, when wartime tax rates were finally rolled back. In each case, reduced *rates* produced increased *revenues* for the government. The political leader must fully appreciate the distinction between tax rates and tax revenues to discern the desires of the electorate.

The easiest way for a political leader to determine whether an increase in rates will produce more rather than less revenues is to put the proposition to the electorate. It is not enough for the politician to propose an increase from, say, point B to point D on the curve. He must also specify how the anticipated revenues will be spent. When voters approve a bond issue for schools, highways, or bridges, they are explicitly telling the politician that they are willing to pay the high tax rates required to finance the bonds. In rejecting a bond issue, however, the electorate is not necessarily telling the politician that taxes are already high enough, or that point E (or beyond) has been reached. The only message is that the proposed tax rates are too high a price to pay for the specific goods and services offered by the government.

Only a tiny fraction of all government expenditures are determined in this fashion, to be sure. Most judgments regarding tax rates and expenditures are made by individual politicians. Andrew Mellon became a national hero for engineering the rate reductions of the 1920's, and was called "the greatest Treasury Secretary since Alexander Hamilton." The financial policies of Ludwig Erhard were responsible for what was hailed as "an economic miracle"—the postwar recovery of Germany. Throughout history, however, it has been the exception rather than the rule that politicians, by accident or design, have sought to increase revenues by lowering rates.

Work vs. productivity

The idea behind the "Laffer curve" is no doubt as old as civilization, but unfortunately politicians have always had trouble grasping it. In his essay, *Of Taxes,* written in 1756, David Hume pondered the problem:

> Exorbitant taxes, like extreme necessity, destroy industry by producing despair; and even before they reach this pitch, they raise the wages of the labourer and manufacturer, and heighten the price of all commodities. An attentive disinterested legislature will observe the point when the emolument ceases, and the prejudice begins. But as the contrary character is much more common, 'tis to be feared that taxes all over Europe are multiplying to such a degree as will entirely crush all art and industry; tho' perhaps, their first increase, together with other circumstances, might have contributed to the growth of these advantages.

The chief reason politicians and economists throughout history have failed to grasp the idea behind the "Laffer curve" is their confusion of work and productivity. Through both introspection and observation, the politician understands that when tax rates are raised, there is a tendency to work harder and longer to maintain after-tax income. What is not so apparent, because it requires analysis *at the margin,* is this: As taxes are raised, individuals in the system may indeed work harder, but their productivity declines. Hume himself had some trouble with this point:

> There is a prevailing maxim, among some reasoners, that every new tax creates a new ability in the subject to bear it, and that each increase of public burdens increases proportionably the industry of the people. This maxim is of such a nature as is most likely to be abused; and is so much the more dangerous as its truth cannot be altogether denied: But it must be owned, when kept within certain bounds, to have some foundation in reason and experience.

Twenty years later, in *The Wealth of Nations,* Adam Smith had no such problem: In his hypothetical pin factory, what is important to a nation is not the effort of individuals but the productivity of *individuals working together.* When the tax rates are raised, the workers themselves may work harder in an effort to maintain their income level. But if the pin-making entrepreneur is a marginal manufacturer, the increased tax rate will cause him to shift into the leisure sphere or into a lower level of economic activity, and the *system* will lose *all* the production of the pin factory. The politician who stands in the midst of this situation may correctly conclude that the increase in tax rates causes people to work harder. But it is not so easy for him to realize that they are now less efficient in their work and are producing less.

To see this in another way, imagine that there are three men who are skilled at building houses. If they work together, one works on the foundation, one on the frame, and the third on the roof. Together they can build three houses in three months. If they work separately, each building his own home, they need six months to build the three houses. If the tax rate on homebuilding is 49 percent, they will work together, since the government leaves them a small gain from their division of labor. But if the tax rate goes to 51 percent, they suffer a net loss because of their teamwork, and so they will work separately. When they were pooling their efforts, since they could produce six houses in the same time it would take them to build three houses working alone, the government was collecting revenues almost equivalent to the value of three completed homes. At the 51-percent tax rate, however, the government loses all the revenue, and the economy loses the production of the three extra homes that could have been built by their joint effort.

The worst mistakes in history are made by political leaders who, instead of realizing that revenues could be gained by lowering tax rates, become alarmed at the fall in revenues that results when citizens seek to escape high tax rates through barter and do-it-yourself labor. Their impulse is to impose taxes that cannot be escaped, the most onerous of which is a poll tax or head tax, which must be paid annually for the mere privilege of living. Hume had no difficulty in pointing out the fallacy of that line of thinking:

> Historians inform us that one of the chief causes of the destruction of the Roman state was the alteration which Constantine introduced into the finances, by substituting a universal poll tax in lieu of almost all the tithes, customs, and excises which formerly composed the revenue of the empire. The people, in all the provinces, were so grinded and op-

> pressed by the publicans [tax collectors] that they were glad to take refuge under the conquering arms of the barbarians, whose dominion, as they had fewer necessities and less art, was found preferable to the refined tyranny of the Romans.

The trouble with a poll tax, as Hume noted, is that it *can* be escaped—one method being not to defend your country against an aggressor who promises to remove the tax as soon as he has gained power. Montesquieu made a similar observation in Book XIII of *The Spirit of the Laws:*

> Because a moderate government has been productive of admirable effects, this moderation has been laid aside; because great taxes have been raised, they wanted to carry them to excess; and ungrateful to the hand of liberty, of whom they received this present, they addressed themselves to slavery, who never grants the least favor.
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> Liberty produces excessive taxes; the effect of excessive taxes is slavery; and slavery produces diminution of tribute. . . .
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> It was this excess of taxes that occasioned the prodigious facility with which the Mahommedans carried on their conquests. Instead of a continual series of extortions devised by the subtle avarices of the Greek emperors, the people were subjected to a simple tribute which was paid and collected with ease. Thus they were far happier in obeying a barbarous nation than a corrupt government, in which they suffered every inconvenience of lost liberty, with all the horror of present slavery.

Modern governments have at least abandoned the notion of using a poll tax to generate revenues. Instead, they often go directly to the barter economy in search of revenues. Activities previously not admitted to the money economy and public marketplace because of public disapproval—e.g., gambling and pornography—are welcomed because of the promise of revenues. But this process tends to lower the quality of the marketplace itself, hastening the exodus or discouraging the entry of enterprises that have earned public approbation.

"Cracking down"

Another timeless remedy of governments that find revenues falling in the face of rising tax rates is to increase the numbers and powers of the tax collectors. Invariably, this method further reduces the flow of revenues to the treasury. Yet even with a thousand-year history of failure, the policy of "cracking down" on tax evasion remains a favorite of modern governments. Here is Adam Smith, in *The Wealth of Nations,* on why such policies are doomed from the start:

Every tax ought to be so contrived as both to take out and to keep out of the pockets of the people as little as possible, over and above what it brings into the public treasury of the state. A tax may either take out or keep out of the pockets of the people a great deal more than it brings into the public treasury in the four following ways.

First, the levying of it may require a great number of officers, whose salaries may eat up the greater part of the produce of the tax, and whose perquisites may impose another additional tax upon the people.

Secondly, it may obstruct the industry of the people, and discourage them from applying to certain branches of business which might give maintenance and employment to great multitudes. While it obliges the people to pay, it may thus diminish, or perhaps destroy, some of the funds which might enable them to do so.

Thirdly, by the forfeitures and other penalties which these unfortunate individuals incur who attempt unsuccessfully to evade the tax, it may frequently ruin them, and thereby put an end to the benefit which the community might have received from the employment of their capitals. An injudicious tax offers a great temptation to smuggling. But the penalties of smuggling must rise in proportion to the temptation. The law, contrary to all the ordinary principles of justice, first creates the temptation, and then punishes those who yield to it; and it commonly enhances the punishment too in proportion to the very circumstances which ought certainly to alleviate it, the temptation to commit the crime.

Fourthly, by subjecting the people to the frequent visits and odious examination of the tax-gatherers, it may expose them to much unnecessary trouble, vexation, and oppression; and though vexation is not, strictly speaking, expense, it is certainly equivalent to the expense at which every man would be willing to redeem himself from it.

Adam Smith's point about smuggling may now seem obscure. After all, smuggling was something that went on in the 18th century, wasn't it? Consider the following excerpts from a recent editorial in *The Wall Street Journal,* which urged New York State and New York City to reduce their combined cigarette tax from 26¢ to 10¢ a pack:

Through our browsings in the *United States Tobacco Journal* we have learned of estimates that half the cigarettes smoked in New York City are smuggled in from North Carolina, where the tax is 2¢ a pack. State Senator Roy M. Goodman, a Manhattan Republican, says the state and city are losing $93 million a year in this fashion. The smugglers load 40-foot trailers with 60,000 cartons purchased legally at $2.40 each and peddle them in the city via the organized crime network for $3.75, which is $1.25 or more below legitimate retail.

Mr. Goodman recommends a one-year suspension of the city's 8¢-a-pack tax in order to break up the smuggling, plus an increase in the state enforcement field staff to 250 from the current 50, plus five years in jail for anyone caught smuggling 20,000 cartons or more. Last year only nine smugglers were jailed, each for a few months, with the common penalty $10 or $15.

If Mr. Goodman's solution were adopted, at the end of the year the smugglers would be back, and the state would have a bigger bureaucracy. More smugglers would be caught, more judges and bailiffs and clerks would have to be hired, more jails would have to be built and more jailers hired. The wives and children of the jailed smugglers would go on welfare.

Cutting the tax to 10¢ avoids all that. It immediately becomes uneconomic to smuggle. The enforcement staff of 50 can be assigned to more useful work, the state saving $1 million on that count alone. The courts would be less clogged with agents and smugglers, and the taxpayers would save court costs, as well as the costs of confining convicted smugglers and caring for their families.

The state and city would *appear* to face a loss of $50 million or $60 million in revenues, but of course smokers would now buy their cigarettes through legitimate channels and the 10¢ a pack would yield about as much in revenues as 26¢ a pack yields now. But that's not all. Legitimate dealers would double their cigarette sales, earning higher business profits and personal income that the city and state then taxes.

And don't forget the impact on the millions of cigarette smokers who would save 16¢ a pack. At a pack a day, that's $58.40 per year. At average marginal tax rates, a smoker has to earn more than $80 before Federal, state, and city taxes are deducted to get that amount. He can thus maintain his or her standard of living on $80 less in gross wage demands per year, which means it becomes economic for the marginal employer to do business in New York, increasing the number of jobs of all varieties and reducing cost and tax pressure on social services.

Among other benefits, the industrious smugglers would have to find legitimate employment. It might be argued that they would be thrown on the welfare rolls. But if we know New York City, they are already on the welfare rolls, and would be forced to get off once they have visible jobs.

The Finance Office of New York City, unwilling to take the advice of either Adam Smith or *The Wall Street Journal,* simply rejected the idea that lowering rates would produce expanded revenues. But Adam Smith's advice was not even taken in England at the time he tendered it. The theory was not tested until 1827, and then only by accident, by an Act of Parliament. Oddly enough, the incident in question involved tobacco smuggling. Stephen Dowell gives the following account in *A History of Taxation and Taxes in England:*

The consumption of tobacco had failed to increase in proportion to the increase in the population. A curious circumstance had happened as regards the duty on tobacco. In effecting the statutory rearrangement of the duties in the previous year, the draughtsman of the Bill,

> in error, allowed one fourth of the duty to lapse in July. Unconsciously he had accomplished a master stroke, for his reduction in the duty was followed by a decrease in smuggling so considerable as to induce [Chancellor of the Exchequer] Robinson to allow his [budget] surplus, estimated at about £700,000, to go to continue the reduction thus unconsciously effected.

The Politburo of the Soviet Union has the same problem as the Finance Office of New York City: It also rejects the idea behind the "Laffer curve." The greatest burden to Soviet economic development is Soviet agriculture. Roughly 34.3 million Soviet citizens, out of a total population of 250 million, are engaged in producing food for the nation—and there is never enough. The United States, by contrast, employs only 4.3 million workers in food production, out of a total population of 200 million, generating an annual surplus for export equivalent to one-fourth the entire Soviet output. The drain on the Soviet economy is not only the low productivity of the farm sector. Because there are always shortages, and the state puts farm goods on the market at regulated prices rather than using the market system to allocate what is available, Soviet citizens spend billions of hours annually waiting on lines. If food were produced in plentiful quantities, it could still be allocated through regulated prices in conformance with Soviet ideology, but most of the lines would disappear, and the talents and energies of the urban work force would not be wasted in long lines.

The real source of this problem is the high marginal tax rates exacted on the state's collective farms. The state provides land, capital, housing, and other necessities on its collectives. It also permits the workers to keep 10 percent of the value of their production. The marginal tax rate is thus 90 percent. In agriculture, a small expenditure of effort might yield, say, 100 units of production; but twice the effort might be required for 150 units, and four times the effort for 200 units. The worker on the collective thus faces a progressive tax schedule so withering that any incentive to expend anything beyond a minimal effort is lost. With minimum work, he gets land, capital, housing, and other necessities, as well as 10 units of output. By quadrupling his effort (not necessarily physical effort, but perhaps increased attentiveness to details), he gets the same services and only 10 more units of output.

Meanwhile, however, the peasants on the collective farms are also permitted to tend private plots, the entire output of which is theirs to keep. The tax rate on these private plots is zero. Here is the result, as detailed by Hedrick Smith in *The Russians*:

> Twenty-seven percent of the total value of Soviet farm output—about $32.5 billion worth a year—comes from private plots that occupy less than 1 percent of the nation's agricultural lands (about 26 million acres). At that rate, private plots are roughly 40 times as efficient as the land worked collectively. . . . Peasants farm their own plots much more intensively than they do collective land.
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> Ultimately, the Communist ideal is to have this last embarrassing but necessary vestige of private enterprise wither away as industrialized state farming grows in scale and output. Nikita Khrushchev, in spite of rural roots, pursued that end vigorously and earned the enmity of the peasantry. He cut the size of private plots to a maximum of half an acre and made life difficult for the farm market trade. I was told by Russian friends that Ukrainian peasants became so irate that they stopped selling eggs as food and made paint out of them.
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> Under Brezhnev things have improved. The maximum plot went back up to an acre and measures were taken to improve farm market operations. Soviet figures show the private farm output grew nearly 15 percent from 1966 to 1973.

In terms of the "Laffer curve," what Khrushchev did by reducing the size of the private plots from one acre to one-half acre was to increase the marginal tax rate of the *system* from point C to point A. This was undoubtedly a major cause of his political downfall. On the other hand, Brezhnev moved the marginal tax rate of the system back to point C, increasing output and revenues to the previous levels. This was an "economic miracle" of minor dimensions, but it has undoubtedly contributed heavily to Brezhnev's durability as a political leader.

The politics of the "Laffer curve"

The "Laffer curve" is a simple but exceedingly powerful analytical tool. In one way or another, all transactions, even the simplest, take place along it. The homely adage, "You can catch more flies with molasses than with vinegar," expresses the essence of the curve. But empires are built on the bottom of this simple curve and crushed against the top of it. The Caesars understood this, and so did Napoleon (up to a point) and the greatest of the Chinese emperors. The Founding Fathers of the United States knew it well; the arguments for union (in *The Federalist Papers*) made by Hamilton, Madison, and Jay reveal an understanding of the notion. Until World War I—when progressive taxation was sharply increased to help finance it—the United States successfully remained out of the "prohibitive range."

In the 20th century, especially since World War I, there has been a constant struggle by all the nations of the world to get down the curve. The United States managed to do so in the 1920's, because Andrew Mellon understood the lessons of the "Laffer curve" for the domestic economy. Mellon argued that there are always two prices in the private market that will produce the same revenues. Henry Ford, for example, could get the same revenue by selling a few cars for $100,000 each, or a great number for $1,000 each. (Of course, Ford was forced by the threat of competition to sell at the low price.) The tax rate, said Mellon, is the "price of government." But the nature of government is monopolistic; government itself must find the lowest rate that yields the desired revenue.

Because Mellon was successful in persuading Republican Presidents—first Warren G. Harding and then Calvin Coolidge—of the truth of his ideas the high wartime tax rates were steadily cut back. The excess-profits tax on industry was repealed, and the 77-percent rate on the highest bracket of personal income was rolled back in stages, so that by 1925 it stood at 25 percent. As a result, the period 1921-29 was one of phenomenal economic expansion: G.N.P. grew from $69.6 billion to $103.1 billion. And because prices fell during this period, G.N.P. grew even faster in real terms, by 54 percent. At the lower rates, revenues grew sufficiently to enable Mellon to reduce the national debt from $24.3 billion to $16.9 billion.

The stock market crash of 1929 and the subsequent global depression occurred because Herbert Hoover unwittingly contracted the world economy with his high-tariff policies, which pushed the West, as an economic unit, up the "Laffer curve." Hoover compounded the problem in 1932 by raising personal tax rates almost up to the levels of 1920.

The most important economic event following World War II was also the work of a finance minister who implicitly understood the importance of the "Laffer curve." Germany had been pinned to the uppermost ranges of the curve since World War I. It took a financial panic in the spring of 1948 to shake Germany loose. At that point, German citizens were still paying a 50-percent marginal tax rate on incomes of $600 and a 95-percent rate on incomes above $15,000. On June 22, 1948, Finance Minister Ludwig Erhard announced cuts that raised the 50-percent bracket to $2,200 and the 95-percent bracket to $63,000. The financial panic ended, and economic expansion began. It was Erhard, not the Marshall Plan, who saved Europe from Communist encroachment. In the decade that followed, Erhard again and again slashed the tax rates, bringing the German economy farther down the curve and into a higher level of prosperity. In 1951 the 50-percent bracket was pushed up to $5,000 and in 1953 to $9,000, while at the same time the rate for the top bracket was reduced to 82 percent. In 1954, the rate for the top bracket was reduced again, to 80 percent, and in 1955 it was pulled down sharply, to 63 percent on incomes above $250,000; the 50-percent bracket was pushed up to $42,000. Yet another tax reform took place in 1958: The government exempted the first $400 of income and brought the rate for the top bracket down to 53 percent. It was this systematic lowering of unnecessarily high tax rates that produced the German "economic miracle." As national income rose in Germany throughout the 1950's, so did revenues, enabling the government to construct its "welfare state" as well as its powerful national defense system.

The British empire was built on the lower end of the "Laffer curve" and dismantled on the upper end. The high wartime rates imposed to finance the Napoleonic wars were cut back sharply in 1816, despite warnings from "fiscal experts" that the high rates were needed to reduce the enormous public debt of £900 million. For the following 60 years, the British economy grew at an unprecedented pace, as a series of finance ministers used ever-expanding revenues to lower steadily the tax rates and tariffs.

In Britain, though, unlike the United States, there was no Mellon to risk lowering the extremely high tax rates imposed to finance World War I. As a result, the British economy struggled through the 1920's and 1930's. After World War II, the British government again made the mistake of not sufficiently lowering tax rates to spur individual initiative. Instead, the postwar Labour government concentrated on using tax policy for Keynesian objectives—i.e., increasing consumer demand to expand output. On October 23, 1945, tax rates were cut on lower-income brackets and surtaxes were added to the already high rates on the upper-income brackets. Taxes on higher incomes were increased, according to Chancellor of the Exchequer Hugh Dalton, in order to "continue that steady advance toward economic and social equality which we have made during the war and which the Government firmly intends to continue in peace."

From that day in 1945, there has been no concerted political voice in Britain arguing for a reduction of the high tax rates. Conservatives have supported and won tax reductions for business, especially investment-tax income credits. But while arguing for a reduction of the 83-percent rate on incomes above £20,000 (roughly $35,000 at current exchange rates) of earned income and the

98-percent rate on "unearned income" from investments, they have insisted that government *first* lower its spending, in order to permit the rate reductions. Somehow, the spending levels never can be cut. Only in the last several months of 1977 has Margaret Thatcher, the leader of the opposition Conservative Party, spoken of reducing the high tax rates as a way of expanding revenues.

In the United States, in September 1977, the Republican National Committee unanimously endorsed the plan of Representative Jack Kemp of New York for cutting tax rates as a way of expanding revenues through increased business activity. This was the first time since 1953 that the GOP had embraced the concept of tax cuts! In contrast, the Democrats under President Kennedy sharply cut tax rates in 1962-64 (though making their case in Keynesian terms). The reductions successfully moved the United States economy down the "Laffer curve," expanding the economy and revenues.

It is crucial to Western economic expansion, peace, and prosperity that "conservative" parties move in this direction. They are, after all, traditionally in favor of income growth, with "liberals" providing the necessary political push for income redistribution. A welfare state is perfectly consistent with the "Laffer curve," and can function successfully along its lower range. But there must be income before there can be income redistribution. Most of the economic failures of this century can rightly be charged to the failure of conservatives to press for tax rates along the lower range of the "Laffer curve." Presidents Eisenhower, Nixon and Ford were timid in this crucial area of public policy. The Goldwater Republicans of 1963-64, in fact, emphatically opposed the Kennedy tax-rate cuts!

If, during the remainder of this decade, the United States and Great Britain demonstrate the power of the "Laffer curve" as an analytical tool, its use will spread, in the developing countries as well as the developed world. Politicians who understand the curve will find that they can defeat politicians who do not, other things being equal. Electorates all over the world always know when they are unnecessarily perched along the upper edge of the "Laffer curve," and will support political leaders who can bring them back down.