

REAGANOMICS: THE SUPPLY-SIDE APPROACH

BACKGROUND INFORMATION

The objective of this assignment is to understand the rationale and consequences of President Reagan's supply-side economic program.

Supply-side economics, an alternative to the more traditional Keynesian, demand-side economics of the New Deal, formed the foundation of President Reagan's early economic planning. Both supply-siders and demand-siders aim at promoting full employment, price stability, and economic growth to provide for increased job opportunities and a rising standard of living. However, one focuses on increasing supply while the other stimulates demand to restore an ailing economy to health. Each takes the other side of the supply and demand equation largely for granted.

John Maynard Keynes (1883-1946), an English economist, considered increasing demand the key to reviving a sagging economy and expanding employment. He argued that unemployment and inflation result from an inappropriate rate of spending. The government, therefore, must stimulate demand in order to drive production up, and unemployment down, and put the economy on the path to recovery. In a recession, Keynes advocated tax cuts, increased government spending, and lower interest rates. On the other hand, to lower the rate of inflation requires tax increases, reduced government spending, and higher interest rates. Keynes argued that such strategies would stabilize the economy and balance the budget over the course of the business cycle.

Reagan's supply-side economics begins with the assumption that economic health depends on maintaining and enhancing incentives for private production. According to supply-siders, production capacity increases as a result of increased private investment. Tax cuts, relaxation of restrictions and regulations on business, and reduced welfare spending encourage work, investment, and saving. Work incentives increase the labor base; investment incentives increase the capital base necessary for economic expansion, and saving increases the pool of loanable funds for business investment and tends to drive interest rates down and provides entrepreneurial and investment incentives.

Supply-side economics is largely a "top-down" approach to economic health. Incentives are given to business and the wealthy to encourage investment and business expansion, thereby eventually providing jobs to those below. Critics often refer to this as the "trickle-down" theory, as benefits supposedly will eventually trickle down to those below. Demand-side economics is largely a "bottom-up" approach. Government and the less wealthy are incentivized to spend more money, thus creating a demand for more goods, and ultimately greater business production to meet the increased demand.

Two Economic Philosophies

- The Key to a healthy growing economy is to have the supply of goods in balance with the demand for goods. This results in full employment, stable prices, and a high standard of living.
- When the supply of goods exceeds the demand. The result is decreased production of goods and rising unemployment.
- When the demand for goods exceeds the supply the result is rising inflation
- When an economy becomes unbalanced and begins to falter. There are two philosophies on how to bring the economy back to health.

Supply-Side Economics	Demand-Side Economics
<p>Also known as:</p> <ul style="list-style-type: none"> • “Reaganomics” • “Trickle-Down” Economics <p>Maintaining and increasing production is the key to economic health.</p> <p>To fix a weak economy:</p> <ul style="list-style-type: none"> • Government provides incentives for private production • This expands production capacity • Increased production capacity leads to higher employment <p>Ways to increase production:</p> <ul style="list-style-type: none"> • Tax cuts to wealthy and corporations (this gives them more \$ to invest in production) • Reduced government regulations (means less restrictions on production). • Reduced welfare spending (encourages people to work, increasing employment) • Incentives to save \$ (increases amount of \$ available for loans to expand production) <p>Will get political support from the wealthy, big business, the banking industry and conservatives.</p>	<p>Also known as:</p> <ul style="list-style-type: none"> • Keynesian Economics <p>FDR’s New Deal used this approach to fight the Great Depression</p> <p>Spending is the key to economic health.</p> <p>To fix a weak economy:</p> <ul style="list-style-type: none"> • Government stimulates demand • This drives production up • Increased production leads to higher employment <p>Ways to stimulate demand:</p> <ul style="list-style-type: none"> • Tax cuts to consumers (this gives them more \$ to spend) • Increased government spending (creates demand for goods) • Lower interest rates (consumers can borrow more \$ with which to buy goods) <p>Will get political support from labor, the poor and liberals.</p>