

The Laffer Hypothesis and
the Starve the Beast Hypothesis:
Two rationales for tax cuts
that are not only unsupported,
but also at odds with each other

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March 2008

Is Laffer a straw man?

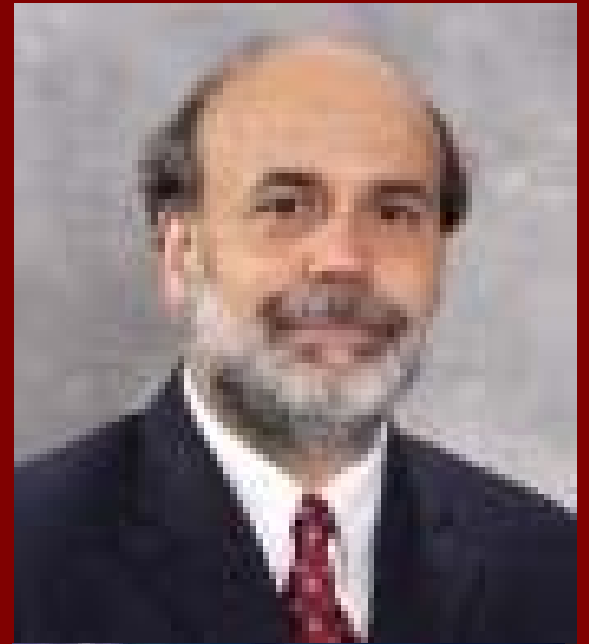
- As pointed out by Feldstein, some Reagan supporters claimed after the fact that nobody who held an important office in that administration ever asserted the Laffer hypothesis ^{1/}
 - E.g., Martin Anderson, *Revolution*, 1988.
- Among counterexamples to this claim was Reagan's Secretary of the Treasury, who, even after events had falsified the proposition to the satisfaction of most observers wrote,
 - of his “very strong opinion that a tax cut would produce more revenue than a tax increase” -- Don Regan, *For the Record* (St. Martin's Press: New York) 1988, (p.214).
 - Also: “The increase in revenues should be financed not by new and higher taxes, but by *lower* tax rates that would produce more money for the government by stimulating higher earnings by corporations and workers...” (p.173).

^{1/} *American Economic Policy in the 1980s*, Univ. of Chicago Press, 1994; p. 25.

Is Laffer a straw man?

High officials in the Bush Administration have been quoted saying that tax cuts, via faster growth, lead to higher tax revenues:

- President George W. Bush, July 24, 2003
- OMB Director Joshua Bolten, press conference July 2003; & *WSJ*, Dec. 10, 2003
- Treasury Secretary John Snow, Congr. testimony, Feb. 7, 2006: “Lower tax rates are good for the economy and a growing economy is good for Treasury receipts.”
- CEA Chair Ed Lazear, press conference 2/12/07, “revenues have come in...higher than we predicted...because the economy has grown at a rate higher than we predicted...[T]he tax cuts...[were] at least in part responsible for making the economy grow.”



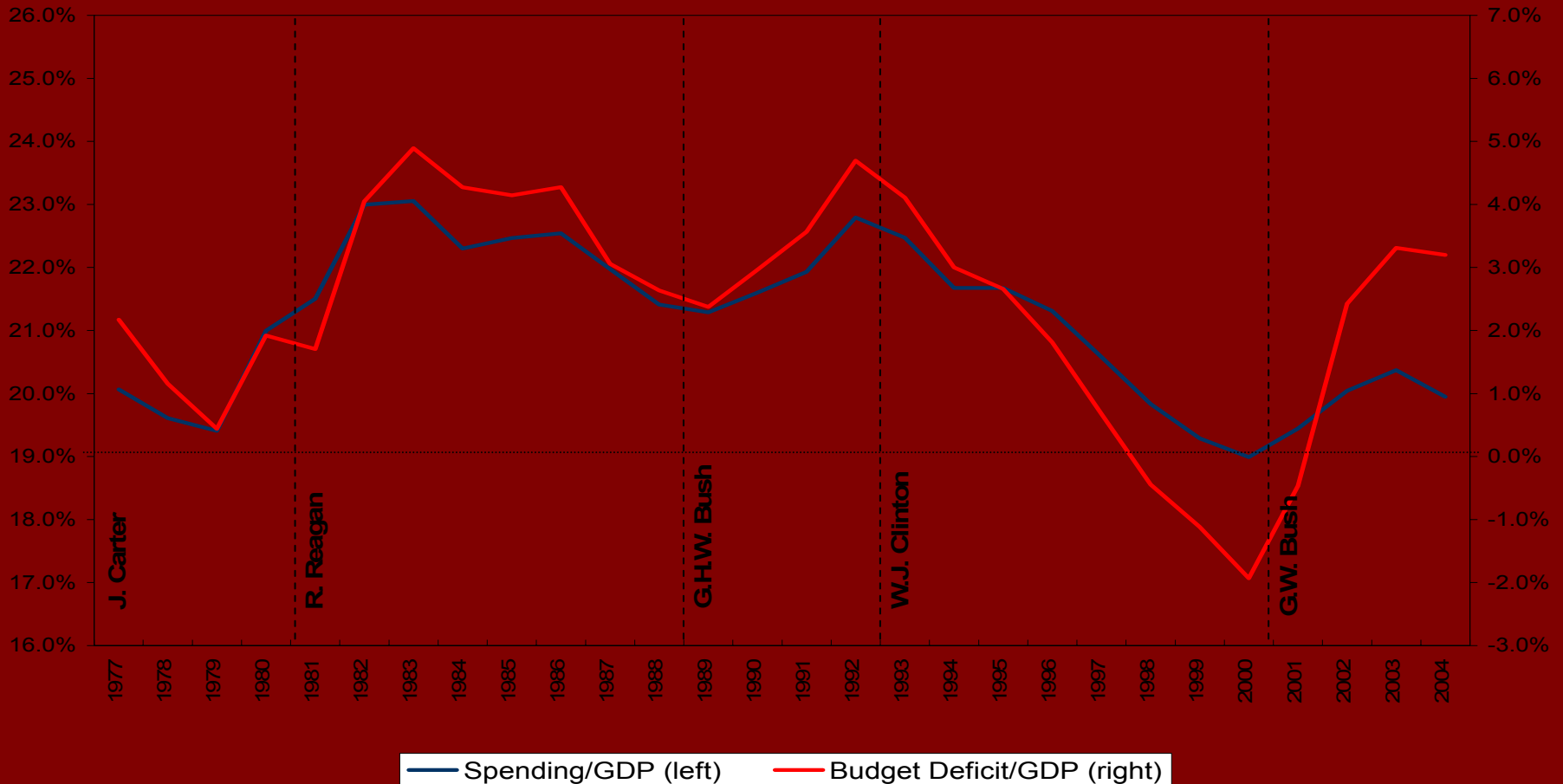
Alternative rationale for tax cuts: The “starve the beast” hypothesis

- Definition of starve the best hypothesis: the claim that if you deprive the government of tax revenue, it will reduce government spending.
 - E.g., Milton Friedman;
 - Gary Becker, Ed Lazear & Kevin Murphy (*WSJ*, 2003);
 - Greg Mankiw <http://gregmankiw.blogspot.com/2006/06/starving-beast.html>...

History is one of several ways of showing that the Starve the Beast claim does not describe actual spending behavior.

- See Figure 2.
- Spending is only cut under a regime of “shared sacrifice” that simultaneously raises tax revenue (the regime of caps & PAYGO in effect throughout the 1990s)
- Spending is not cut under a tax-cutting regime (1980s & current decade).

Fig. 2: US Federal Budget Deficit and Spending as % of GDP.



What if the Starve the Beast proposition were true

- and the Laffer hypothesis were also true?
- It would lead to the nonsensical proposition that Republican presidents should *raise* tax rates in order to reduce tax revenue (Laffer) and thereby reduce government spending (Starve the Beast).
- I challenge some candidate to run on that platform !