Trickle-Down Economics Fails to Deliver as Promised

By Michael S. Derby | *June 30, 2009*
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Trickle-down economics, a centerpiece of conservative economic thinking for many decades, failed to deliver its promise of distributing wealth across the economy, a new paper from Harvard University's Kennedy School of Government says.

According to this theory, when government policies favor the wealthy — for example, via tax cuts for upper-income classes — the increase in wealth flows down to those with lower incomes. That's because the rich are more likely to spend the additional income, creating more economic activity, which in turn generates jobs and eventually, better paychecks for the less well-off.

It's a school of thought that is closely linked to former President Ronald Reagan, and is frequently referred to as "Reaganomics."

The idea has had enough power to be used as part of a long process to lower tax rates on the wealthiest Americans. According to the Tax Policy Center, the top marginal tax rate in the U.S. stood at 70% when Reagan was elected in 1980, falling steadily to 28% by 1989, before it began to rise modestly. The top marginal rate now stands at 35% against a peak of 94% in 1945.

Trickle-down economics prevailed in a period in which a smaller portion of the U.S. gained an increasing share of the most important measures of economic vigor. Be it total wealth or net income, the top gained a greater share of the pie at the expense of the less-well-off.

The paper does not argue that trickle-down economics is without merit. It's just that it doesn't appear to generate enough bang for the buck. It was written by Harvard's Dan Andrews and Christopher Jencks, and Australia National University's Andrew Leigh.

"Increases in inequality lead to more growth," the paper's authors wrote. "There appears to be some trickle-down effect in the long run, but since the impact of a change in inequality on economic growth is quite small, it is difficult to be sure from our estimates whether the bottom 90% will really be better off or not."

In an interview, Jencks said it's a real challenge to gather the information needed to determine whether trickle-down economics works as its advocates believe.

But he concludes the evidence shows "it certainly didn't deliver as much as many said" and to the degree it did work, "the effects are really small."

The paper's findings were based on data from 12 developed nations, observed over most of the last century into the current century.

Trickle-down economics' day is probably done, for now at least. The financial crisis will bring not just stricter regulation and tighter oversight for many markets. The massive budget deficits that the U.S. will be left with as a consequence of the bailouts and economic stimulus spending will require tax hikes that are likely to reach beyond the rich.

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Cold water poured on tax cuts trickling down

Clancy Yeates
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AS HIGH income earners enjoy the latest tax cuts, a new study says people missing out could be waiting until 2022 to benefit from knock-on effects.

The Government faced criticism this week over tax cuts skewed towards the wealthy.

Critics say they will add to the budget deficit with little economic benefit. A group of Australian and US economists question the so-called "trickle down effect", which claims society wins from the rich taking a bigger share of the pie because it fuels growth.

Looking at 12 countries over the last century, the study found it took 13 years for a rise in the incomes of the wealthiest 10 per cent to benefit the rest of the population. One of the authors, Andrew Leigh of the Australian National University, said high-end tax cuts were just one type of policy that bred inequality.

"When you cut taxes for the rich then their share of income goes up," Professor Leigh said.

In Australia, the share of national income going to the wealthiest 10 per cent has risen from 25 per cent in the early 1980s to 31 per cent earlier this decade.

Professor Leigh said this had added about 0.5 per cent to Australia's yearly growth rate.

"It's true that this makes the country grow faster, but it's not sufficiently good for growth that the bottom 90 per cent ought to keep voting for tax cuts for the top 10 per cent," he said. Over the same period, the share of income held by the wealthiest 1 per cent had almost doubled from 5 per cent to 9 per cent.

"The rich have got richer, but the super-duper rich have grown richer still," he said.

A similar change has occurred across the English-speaking world in recent decades.

This story was found at: ***http://business.smh.com.au/business/cold-water-poured-on-tax-cuts-trickling-down-20090702-d6kk.html***