HOW TRICKLE-DOWN ECONOMICS WORKS

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Tax policy has always remained a dubious question for the government of any country. History showed loads of approaches to taxation, but those introduced by trickle-down theory still remain highly controversial. Although economists agree that changing how a government taxes its citizens can have some dramatic effects on an economy, they disagree on which policy is best. Trickle-down theory represents one such idea that can supposedly spur economic growth.

"Trickle-down economics" and "the trickle-down theory" are terms used in United States politics to refer to the idea that tax breaks or other economic benefits provided by government to businesses and the wealthy will benefit poorer members of society by improving the economy as a whole. It is based on the premise that within an economy, giving tax breaks to the top earners makes them more likely to earn more. Proponents of these policies claim that if the top income earners are taxed less that they will invest more into the business infrastructure and equity markets, it will in turn lead to more goods at lower prices, and create more jobs for middle and lower class individuals. Proponents also argue that economic growth flows down from the top to the bottom, indirectly benefiting those who do not directly benefit from the policy changes. According to the theory, this boost in growth will ultimately help those in lower income brackets as well. Although trickle-down economics is often associated with the policies of Ronald Reagan in the 1980s, the theory dates back to the 1920s. The name also has roots in the '20s, when humorist Will Rogers coined the term, saying, "The money was all appropriated for the top in the hopes it would trickle down to the needy".

David Stockman, U.S. politician and businessman, placed supply-side economics in a long tradition in economics and claimed that laissez-faire, or trickle-down economics, will benefit not just "those well placed in the market" – the wealthiest people, but also "those poorly placed in the market" – the poorest people. A more general version argues that increases in real gross domestic product are beneficial for poor people – indirectly, marginally and eventually beneficial, of course – as a consequence, or side effect, of their being directly, significantly and immediately beneficial for the rich people.

Some argue that giving tax breaks to the wealthy can actually increase tax revenue for a government. This might seem difficult to believe, but Arthur Laffer, American economist, argued otherwise. He concluded that government tax rates and revenues don't have a directly positive correlation. In what became known as the Laffer curve, Laffer showed that the relationship between taxes and revenues looks like a curve rather than a straight line. In other words, tax revenues don't rise consistently like tax rates do. Laffer's curve shows that when tax rates are at zero, revenues are zero as well – the government makes no money when it taxes nothing. But it's the same result if the tax rate were 100 percent. The Laffer curve postulates that once the rates get too high, the steep taxes discourage work to an extent that the revenues themselves suffer. The range in which taxes are too high for maximum revenues is called the prohibitive range. When taxes are in the prohibitive range, a tax cut would produce an increase in tax revenues, according to Laffer. But the ideal tax isn't necessarily 50 percent; rather, it depends on the taxpayers. Through Laffer's Curve it is possible to visualize how tax rates could discourage people from producing, which results in fewer jobs and a hurting economy. If Laffer's Curve is correct, then cutting taxes for the wealthy can encourage investment and production to promote general economic health. Redubbed supply-side economics, trickle-down economics found new life in the United States in the 1980s.

Trickle-down economics received lots of critics. Economist Thomas Sowell has written that the actual path of money in a private enterprise economy is quite the opposite of that claimed by people who refer to the trickle-down theory. He noted that money invested in new business ventures is first paid out to employees, suppliers, and contractors. Only some time later, if the business is profitable, does money return to the business owners – but in the absence of a profit motive, which is reduced in the aggregate by a raise in marginal tax rates in the upper tiers, this activity does not occur. Sowell further has made the case that no economist has ever advocated a "trickle-down" theory of economics, which is rather a misnomer attributed to certain economic ideas by political critics. The economist John Kenneth Galbraith noted that "trickle-down economics" had been tried before in the United States in the 1890s under the name "horse and sparrow theory." He wrote, "Mr. David Stockman has said that supply-side economics was merely a cover for the trickle-down approach to economic policy – what an older and less elegant generation called the horse-and-sparrow theory: 'If you feed the horse enough oats, some will pass through to the road for the sparrows.

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