The wealth that failed to trickle down: The rich do get richer while poor stay poor, report suggests

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Trickle-down can be (very loosely) characterised as the idea that reducing the tax burden on the well-off is, in the end, good for everyone. A wealthy person's taxes are reduced and his disposable income increases. The wealthy person spends the extra income on a new mansion, or luxury goods, or lavish holidays. The estate agent, the luxury manufacturer and the tourist resort's profits increase. Those firms then invest the profits, expanding their capacity, creating new jobs in the process. That additional investment boosts income and employment (...) and general prosperity is enlarged.

Can it be true? Not according to Larry Summers and Ed Balls, the former American Treasury Secretary and Labour's shadow Chancellor.

To Summers and Balls, tax cuts for the rich do not inexorably result in more economic activity, but create a growing income gap between those at the top and those at the bottom. The rich tend to save more of their disposable income and growth slows down. Ha-Joon Chang, the popular economics writer from Cambridge University, is another veteran critic of the idea. “The trickle-down argument crucially depends on the assumption that, when given a bigger slice of national output, the rich will use it to increase investments”, he has written. He describes this as “an assumption that has not been borne out by reality”.

The remedy that Summers and Balls – and Chang – propose is: higher wages for ordinary workers, higher rates of tax on the super-rich and corporations, as well as a co-ordinated international closure of tax loopholes, with the money used to finance more public infrastructure investment.

But there is a growing sense that income inequality has reached excessive levels and is now holding back growth in many rich economies, rather than stimulating entrepreneurship (…).

There is also evidence that inequality can help create financial instability. (Some argue) that rising inequality in the US created tremendous pressures on politicians to make cheap credit available to the low paid.

What of the bigger picture? The right often point out that income inequality on a global level is falling, as emerging markets such as China and India plug themselves into the international economy. But in a report released today, the International Labour Organisation makes the point that inequality is also growing within many emerging economies, and that this is (…) reducing the potential for incomes in these states to catch up.

Many are also pondering whether rising inequality is a natural result of free-market capitalism. Thomas Piketty's best-selling Capital in the Twenty-First Century set the recent rise in Western income inequality in the developed world in historical context.

Crude trickle-down theory might well be a myth. But the idea that cutting tax for the rich is a sure-fire way to boost aggregate economic growth and living standards remains an article of faith among the Transatlantic right. And it is that proposition that Summers and Balls are setting out to challenge.

 (520 words)