Trickle-Down Economics Has Always Been a Scam

Rae Deer

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On September 13, 1974, in the aftermath of Watergate, four men met at a restaurant in Washington, DC to discuss a new strategy for the Republican Party. One of them was Donald Rumsfeld. Another was Arthur Laffer.

Laffer had made a name for himself as chief economist in the Office of Management and Budget and was now working as a consultant to the secretary of the treasury. His ideas had been on the fringe of economic orthodoxy for most of his career. Unfortunately for the rest of us, that was about to change.

At that time, President Gerald Ford had just inherited an economy in the throes of a stagflationary crisis, unleashed by the 1973 OPEC oil embargo and a crashing dollar following the collapse of the Bretton Woods system. Rumsfeld had called upon Laffer to scrutinize Ford's plan: reducing inflation and raising revenue by introducing a temporary 5 percent tax surcharge on corporations and high income individuals. Laffer ridiculed the idea.

Instead, he argued that the "real" cause of stagflation was that the United States had been overtaxing work while over-subsidizing unemployment, decreasing the number of people willing to work and lowering the total possible amount of income-tax revenue collected. To illustrate his point, he whipped out a marker and started scribbling on a napkin. "If you tax a product: less results," he wrote. "If you subsidize a product: more results."

He then drew a parabolic curve on a graph, with axes for the tax rate and tax revenue. At 0 percent tax, there would be no revenue generated, with revenue steadily increasing in line with the tax rate up to a midpoint, where it fell, until reaching zero again as the tax rate reached 100 percent. Lowering the higher income-tax rate, rather than raising it, he suggested, was the answer.

Ford didn't go on to enact Laffer's policies, perhaps because Rumsfeld forgot to take the napkin with him when he left the restaurant. But Jude Wanniski, a financial journalist also present at the restaurant, kept it, and over the next few years wrote a series of articles to propagate Laffer's ideas. By the 1980s, Laffer had caught the attention of Ronald Reagan's campaign in the lead-up to the Republican primaries. He was brought on as an economic advisor alongside Chicago School professor Milton Friedman.

Friedman was a former president of the Mont Pelerin Society (MPS) — an organization formed by a group of economists dedicated to discrediting the postwar consensus of welfare states by appealing to a small but influential group of wealthy global elites. Through think tanks like the Cato Institute, it advocated for business and markets to have free rein over the economy, rolling back state support and any other form of government interference like financial regulation, protective legislation for workers, or progressive taxes on the wealthy and corporations.

Unlike Laffer, who ostensibly believed tax cuts would increase government revenue, Friedman saw tax cuts as a way to shrink the state by depriving the government of revenue. But Laffer's concept, deridingly referred to as "voodoo economics" by Reagan's Republican primary opponent George Bush Sr, provided the perfect cover to surreptitiously implement the MPS's long-term plan. Shortly after coming to power, as part of 1981's Economic Recovery Tax Act, Reagan slashed the top rate of income tax from 70 percent to 50 percent, while reducing the bottom rate by just 3 percent from 14 percent to 11 percent. He cut taxes again in 1986, reducing the top marginal rate from 50 percent to just 28 percent.

At a cursory glance, it appeared Laffer had been right: cutting taxes coincided with an increase in federal receipts from $599 billion to $991 billion between 1981 and 1989. But the tax cuts had also been accompanied by a huge increase in government spending. By 1990 the budget deficit had nearly tripled, and government debt as a proportion of GDP increased from 31 percent to 50 percent by the time Reagan left office.

During the same period, median real wages dropped by 0.6 percent and income inequality in the United States, measured by the Gini coefficient (where is 0 is complete equality and 1 complete inequality), increased from 0.37 to 0.43 — a trend that has continued ever since.

From Washington to London

On the other side of the Atlantic, a couple of years before Reagan's victory, Margaret Thatcher had come to power and embarked on her own mission against the welfare state. She was assisted by the MPS-affiliated Institute for Economic Affairs (IEA), whose contemporary alumni include Priti Patel, Dominic Raab, and Sajid Javid. The IEA had been biding its time, waiting for a crisis to hit so it could pounce on an unsuspecting electorate. The 1970s provided that crisis.

The postwar economic consensus was caught off guard by the hyperinflation of the '70s. The combination of rising oil prices and a weakening pound caused by the end of fixed exchange rates led the price of imports to rocket up. Keynesian economists were stuck trying to figure out how inflation and unemployment were rising simultaneously, in contradiction to the prevalent macroeconomic paradigm of the postwar years, the Phillips Curve. An embattled Labour government was forced into accepting a $3.9 billion loan from the International Monetary Fund (IMF) in the face of a loss of confidence in the pound.

Into this space stepped Thatcher and the IEA — pinning the blame for inflation on excessively high taxation for the rich and corporations, which had supposedly stifled investment, contributing to the UK's lagging productivity and currency crisis. Part of the remedy, therefore, was to slash taxes for the very richest in order to boost productivity, encourage investment, stimulate growth to correct the trade deficit, and shore up the pound.

In 1979, the top rate of income tax was 83 percent. By 1988 it had been more than halved to 40 percent. By comparison, the basic rate of income tax was only decreased from 33 percent to 25 percent. What was given to lower-income earners with one hand was taken away with the other, as the rate of VAT increased from 8 percent to 15 percent. The rate of corporation tax was cut too, from 52 percent to 35 percent.

As we now know, these policies didn't deliver. Tax cuts did not abate unemployment. Concurrent mass privatizations meant unemployment hit 12 percent during the '80s, with record numbers of people having to sign on for unemployment benefits. The Gini coefficient in the UK rose sharply, from 0.25 to 0.34.

The cut to corporation tax did coincide with a marked increase in corporate tax revenue as a proportion of GDP, but it had more to do with the increase in newly privatized monopolistic companies, as well as the deregulation of banks, which led to significant growth in financial services. The UK's financial services as a proportion of GDP are now the third highest in Europe; only notorious tax havens Luxembourg and Switzerland place higher. London and the South of England benefited from this mass influx of foreign capital at the expense of the deindustrializing North, creating stark regional inequalities that only worsened lagging productivity.

Today, the consequences are obvious. Wealth inequality in the UK has reached record levels. The top 1 percent have 230 times more wealth than the bottom 10 percent, the increase in corporate profits since the 1980s has outpaced the growth in nominal median wages by nearly 15 percent, and the average remuneration of a CEO has increased from twenty to sixty-three times that of the average employee. And rather than the rich investing the extra money productively, it has been channeled toward assets like housing, pushing up prices and creating an even more unequal society. The median earner now spends between a quarter and a third of their income on rent alone.

Recent Resurrection

A2020 paper published by researchers at the London School of Economics entitled "The Economic Consequences of Major Tax Cuts for the Rich" looked at UK and US data from the 1980s and found that tax cuts for the rich had no statistical effect on economic growth. Another report, from the IMF of all places, found that "a rising income share of the top 20 percent results in lower growth," and that a more effective strategy was to increase the income share of the bottom 20 percent (a "trickle-up" approach). The impact of tax cuts for the rich is clear.

But that is precisely what short-lived chancellor of the exchequer Kwasi Kwarteng called for in his catastrophic September "mini-budget": scrapping the 45 percent rate on earnings over £150,000, which would have seen the incomes of the richest 5 percent increase by 5.5 percent, with over half the total tax savings going to those with incomes of over £1 million; and scrapping the increase in corporation tax from 19 percent to 25 percent, which would have handed more than half of the tax cut to companies with profits over £1 million.

Gilt markets weren't convinced that the tax cuts would encourage the rich to work harder, increase productivity, stimulate growth, or encourage investment. Instead, the budget sent those markets into a death spiral and crashed the pound, forcing a slate of U-turns and a new chancellorship. Could that be a sign that "trickle down" has finally been called on its bluff? Don't count on it.

Today, Laffer's napkin is displayed at the National Museum of American History. Exactly what the "optimum" tax rate it indicates for the rich and corporations has never been made clear — the ideological power of the curve is in its conceptual ambiguity. Nonetheless, the scribblings it contains have gone on to shape the content of global economic discourse for decades. Its failures have been repeatedly and roundly documented. But trickle-down economics keeps limping forward, resurrected time and again by successive governments hoping to justify tax cuts for the rich with false promises of prosperity for all.