Debunking “Trickle-Down” Economics
by David Johnson

A surprisingly large number of people believe (or at least claim to believe; perhaps they know it is wrong but continue to push the view out of self-interest) in so called “supply side” economics, or alternatively known as “trickle down” economics. The gist of the argument is that the economy is most efficient when the government has few regulations on businesses, and keeps tax rates low on business owners and corporations. I will not address the regulation issue here, but will instead focus on the tax question. The argument for lowering tax rates, or keeping them very low, is that business owners are the job creators, and if the job creators do not have to pay as much in taxes and are allowed to keep more of their money, then they will reinvest that money by hiring more people and expanding the business. This, in turn, provides jobs and economic growth, and thus, all boats are lifted by the rising tide. Because of this extra economic growth, the government ends up collecting just as much, if not more, in taxes than it would have if it would have simply taxed the business owners and corporations at a higher rate initially. This strategy would then be the best for creating jobs and prosperity for all.

I hope to pop the bubble on this silly right-wing fairy tale. I will not do so through statistics or studies, as these can often be manipulated to say whatever those funding the study want it to say. Instead, I will simply reason through the argument with a simple example and hopefully show the gigantic flaw in the argument. Anticipating an objection I know is coming from some who may have strong feelings on this issue, I acknowledge that I am a philosopher rather than an economist, but then again, so was Adam Smith, so I hope you won’t make too much out of that. I will also acknowledge that there may be other arguments, such as those based upon fairness (for example, Robert Nozick’s entitlement theory), which may work better in arguing against a progressive tax system. I am not addressing any of these arguments here. I am only attacking the “supply-side” theory.

I will use as my example a fictional restaurant owner. Let’s call him Leo, and say that he owns three Italian restaurants, all named *Leo’s Place.* Currently, there are thirty two people on his payroll, all told. Now, according to the supply-side argument, if the government cuts Leo’s taxes from 32% to 28%, the result should be that he will have a larger profit and because of greed (which is good, according to them, because it motivates him) he will reinvest that money in his business and hire more staff. He may even eventually expand and open a new restaurant. If he did expand, this could even provide new construction jobs so that economic growth could be stimulated even outside of Leo’s actual business. So, by lowering the tax rate on Leo, and those like him, more jobs are created for everybody else, and now several more people are paying taxes and enjoying good jobs.

Here is the huge flaw in this logic. Leo is a good, efficient businessman; he has to be in order to remain competitive in his industry. What if Leo doesn’t *need* more staff to effectively run his restaurants? It is likely that Leo has already cut his expenses as

much as he can, and it is also likely he will continue to do so in the future. Leo's decision to hire more staff is not any different than how he sets prices for his menu items. Basically, he will charge for his menu items as much as people are willing to pay and still come back. Well, when it comes to hiring, he is going to have the fewest employees that he can while still doing a sufficient job of running the restaurant. A business owner gets to keep whatever is left of the profits after all of the expenses are taken out, so Leo has a strong motivation to maximize profits and to minimize expenses as much as he can. He is not going to have four waiters working one night when three could easily handle the work load, as that would be bad business. It is, therefore, quite unrealistic to think that if Leo has extra money from lower taxes that he will automatically reinvest it in his businesses. What is more likely to happen if Leo's tax rate is cut is that he will simply consider the tax cut as extra profit and hoard it in his bank account. As long as the taxes are bearable to begin with, meaning low enough that he feels he can make enough of a profit to make it worthwhile to work, then what determines how many people Leo hires and how fast his business grows is simply supply and demand. If people really like his *product*, in this case the food, and the atmosphere of the restaurant enough to continue patronizing it, then Leo's business is profitable and he sees opportunities to expand. I want to really stress this point, so I will repeat it: *demand of the product is the only thing that determines how big and how fast a business can grow.* Do we really think that the growth of Cisco Systems, Apple, General Motors, or Microsoft were determined by tax rates? As though if only we dropped tax rates by five percent on those businesses they would suddenly each experience an equivalent five percent growth in demand for their products? It just isn't so. These companies were ultra successful because they were selling a great, really innovative product that customers believed was worth spending their money on. That has nothing to do with tax rates on the businesses themselves.

Now, I suppose some will try to object that Leo's business will grow, because his customer base would have more money in their pockets from the lower taxes and they would want to eat out more frequently. However, this would only happen if there was an across the board tax cut for everyone, and supply side economics only wants to cut tax rates for the "job creators." Unless he runs five star restaurants, it is unlikely that most of Leo's customers are business owners because there just aren't nearly as many business owners as there are employees. So, if Leo's customer base is representative of the general population, then that means that few of them would get the same tax cut that he enjoys. So, he is unlikely to have any increase in business because of a tax cut that only benefits business owners, and if he does not have an increase in business, then he will not have any reason to hire more people.

What is happening now to the Colorado River makes for a good analogy as to how trickle-down economics really works. Because of dams, irrigation, and various desert cities siphoning off their "cut" of the water, this once mighty river eventually dribbles down into a trickle, and now, runs completely dry before reaching the ocean. The very same occurs when the wealthiest among us dam up and siphon off the wealth in society so that by the time it gets to those who are furthest downstream on the economic ladder, there is barely a trickle left; and, for some, even the trickle has now run dry. I am

convinced that supply side economics is the reason that the gap between rich and poor has never been greater. It is a terrible, inefficient theory.

Ironically, if one really wanted to stimulate the economy in the short term, a boost in income for the poor would probably do the most good. This is because if the poor get extra money, they will almost immediately spend it. While the wealthy tend to sit on their money, and take it out of circulation, the poor don't have any extra, so they immediately put that money to work and thereby spur economic growth. To paraphrase an old economic adage, "whenever money changes hands money is made."[1] This means that trickle-down economics is not only wrong, but in fact exactly opposite of what would be the most effective stimulus. Giving more money the customers who buy the products of a business is a far better way to stimulate growth than giving it directly to the business owner. To return to our previous example, if Leo's customers now have more money, then maybe they would be more likely to eat out, assuming that it was only the lack of extra money that was holding them back from doing so before. It is not a guarantee that Leo's customers will spend that extra money, of course, or that they will spend it at Leo's, but there is a much greater chance that Leo's business will grow more from giving his customers a tax cut rather than giving one to him directly.

In all honesty, though, I would not even be in favor of attempting to stimulate the economy by giving money to the poor. The effects are likely to be so short lived that I just don't think it would be worth it. I would favor simply finding a reasonable tax rate for everyone and sticking with it. I feel that all of this meddling in the economy by both the federal reserve constantly fiddling with interest rates, and the government constantly wrangling over tax rates does more harm than good. Just keep rates consistent so that people know what to plan on, and leave it alone. Things would be far better that way in the long run.

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[1] I don't know if this is a direct quote or not, and if so, who said it. Otherwise I would cite the source. I have read it in multiple places and assume that no one really knows who first came up with it, and it is probably just collective knowledge. The idea certainly does seem to be true, however.