"Trickle-Down" Poverty

Guest Commentary by Thomas E. Nugent* March 11, 2009

When Ronald Reagan began his presidency in 1981, his economic policies were "supply-side" focused on providing Americans with incentives to work, save, and invest. The key element in his plan was reducing marginal tax rates to "prime the pump" in order to turn the Carter miasma of double digit inflation and interest rates into a growth economy with rising standards of living for all. His left wing adversaries characterized these policies as "trickle-down economics." This interpretation ridiculed the idea that such policies could actually help the poor by helping the rich. Prevailing wisdom was that the wealthy benefited greatly from tax cuts but workers at the lower end of the spectrum experienced little, if any benefit.

In October of 2000, Arthur Laffer, the father of supply-side economics wrote: "I am sometimes in favor of tax rate reductions, but only for the purpose of incentivizing people to be more productive and to improve their livelihood. In no case should my recommendations be viewed as cutting taxes for rich people just because the rich are highly taxed…If tax cuts cost revenue on a dollar-for-dollar basis—i.e., if there were no incentive effects—then it would be the unconscionable scoundrel who would cut taxes on the rich. The truth is that tax cuts on the rich (and to a lesser extent on the poor) create jobs, output, employment, self esteem, happiness and, yes, sometimes even larger surpluses."

Many economists have never made the distinction between tax cuts and tax *rate* cuts. President Reagan's policy included the reduction in marginal tax rates to give the working wealthy even greater incentives to grow their income (and actually pay more in taxes) to enjoy a higher standard of living. Since the implementation of those tax rate cuts in the Eighties, the U.S. economy boomed as did the stock market. Even President Obama's economic advisors including Laura Tyson now admit that Reaganomics was successful in creating a growing economy and a rising stock market from 1982 through 1997. [i]

Recently the Obama Administration announced its budget for 2009. For the first time, the skin was put on the bones of Obama's presidential campaign promise to raise taxes on the rich. In addition to eliminating the tax rate cuts from the Bush years, Obama will be raising tax rates on individuals and families who earn over $250,000 per year. His budget also includes a tax cut for the rest of the people who don't fall into that income category. The purpose of this tax plan is to provide for lower income workers at the expense of higher income workers (*income* not wealth re-distribution) and to finance additional spending. This "trickle down poverty" is exactly the opposite of Reaganomics and will have serious repercussions for the economy.

Even before the Obama budget was announced, we began to see the signs of "trickle down poverty" emerging from attacks on the rich. The criticism of the Big Three executives flying on corporate jets to the Capitol was widely criticized by Washington elites. Once the word was out that any perceived excesses in corporate spending would be subject to accusations of corporate greed, the "trickle down poverty" theory became reality.

The outcry over such excesses expanded to corporate reward trips. This uproar caused many executives and their companies to cancel planned trips or parties due to the perception that rewarding success and making money was bad. Unfortunately, middle class workers who cater these parties and work for hotels found themselves out of a job and now those companies providing these leisure/entertainment services face potential bankruptcy. Airlines, car rental companies, taxi drivers, restaurants, entertainers and even Elvis impersonators have all been hurt by "trickle down poverty."

This situation reminds me of the early Nineties when Congress approved the implementation of a luxury tax on boats as a means to extract additional revenues from the wealthy. As the story goes, the wealthy went on strike and stopped buying. The outcome was that thousands of middle class workers in the boat building industry lost their jobs. The economic theory at work here is incidence vs. burden. The politicians placed the incidence of the tax increase on the wealthy while the burden of that tax fell on the middle class. One example of this phenomenon today is that Gulfstream Aerospace announced an initial layoff of 1,200 workers who produce corporate jets. Sales of these jets virtually collapsed hurting the company and their employees, not the wealthy.

Two years into the Reagan presidency, phased-in tax rate reductions began to take effect. The result was an economic boom of historical proportions. Trickle-down economics proved to be the best policy for increasing standards of living for the ensuing twenty-five years.

Two months into the Obama administration, we have seen accelerated equity market declines and a worsening economy. Since announcing his budget that increases tax rates in 2011 on the "rich" -- those defined as earning $200,000 for individuals and $250,000 for families – we are beginning to see the effects of a "trickle down poverty" policy. In two years the full force of Obamanomics can be juxtaposed with the principles of Reaganomics. Time will tell if these two diametrically opposed economic theories can produce a similar outcome.

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[1] Tyson, Laura D'Andrea, "In Defense of Obamanomics," Wall Street Journal editorial, March 9, 2009

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