23 Things We're Telling You About Capitalism XIII [1]

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Thing 13 is simply that trickle down economics doesn't work. Making the rich richer doesn't make everyone richer therefore we shouldn't be planning to make the rich richer. The whole thing is based upon the marginal propensity to invest: investment is good for the future of the economy, the rich invest more of their incomes than the poor do thus if the rich get more of the money then there will be more investment and that's good for the future. Chang insists that this idea is wrong, based as it is upon the classical economists. The rich don't necessarily invest more therefore allowing them to have more of the pie won't increase investment and so no glorious future.

There's a very serious problem with this argument of Chang's. For the flip side of this marginal propensity to invest is the marginal propensity to consume. And it's an absolutely standard part of Keynesian economics (most definitely not classical economics then!) that the poor have a greater marginal propensity to consume than the rich do. Indeed, we do get people telling us that in economic hard times we should be taking money of the rich to give to the poor. Precisely because the rich will just save and invest it while the poor will spend it thus boosting aggregate demand.

Here is such an argument in fact:

> ?For example, in an economic downturn like today's, the best way to boost the economy is to redistribute wealth downward, as poorer people tend to spend a higher proportion of their incomes.?

The greater marginal propensity to consume is exactly the same thing as the lower marginal propensity to save and invest: if the poor are more likely to spend then this is the same statement as the rich are more likely to save. The really unfortunate thing for Chang's rejection of the idea that the rich invest more is that this sentence comes from Chang. In this very same chapter where he urges us a to reject the greater marginal propensity to invest of the rich. Oh dear, eh?

It's also probably true that Chang should be deprived of his economists' secret decoder ring or confusing wealth and income as he does in that sentence. Wealth is a stock, income a flow, and never should the two be confused.

There's a common rhetorical flourish throughout the chapter that should have been avoided as well. He veers between talking about a redistribution of income upwards in recent decades and the way in which the growth in incomes has gone disproportionately to the already rich. The two are very much not the same statement: the first is that extant incomes have been snatched, like a humble crust from a Dickensian waif's lips, to be awarded to the rich. The second is that of the new incomes that are being created the upper part of the income distribution is getting most of that new income: the crusts are still safe in the waif's hands. The truth is that there has not been a redistribution of incomes upwards: the last few decades have seen average (both mean and median) incomes rise therefore nothing has been taken away from anyone. It is true that a large portion of the new income created has gone preferentially to those already gaining high incomes.

You may be happy about that or not but that is what has been happening, not the first but the second.

And now we should look at the proof that Chang uses to show that allowing the rich those higher incomes doesn't improve the growth of the economy. It is, fairly simply, that in more equal times like the 50s and 60s then economic growth was higher than it has been since the 80s, when inequality started to rise. What more proof could we require that the rich getting more of the pie doesn't grow said pie?

At which point we'd probably recommend that Chang read his own chapter 9. In which he tells us, entirely correctly, that as economies mature growth will become more difficult and thus, presumably, slower. Chang's (and, interestingly, the correct, which is an amusing coincidence) argument is that in the long term economic growth comes from improvements in total factor productivity (tfp). This tfp is easier to increase in manufacturing than it is in services. Chang uses this to argue that therefore economies should have lots of manufacturing so that tfp can be improved: an argument we rejected as there's only so much manufacturing that we actually want.

But look at what that does to Chang's subsequent argument about economic growth. We know very well that manufacturing has fallen as a portion of western world economies in recent decades. Indeed Chang tells us that manufacturing as a percentage of total production fell, in Britain, from 37% in 1950 to 13% today. That's the manufacturing where tfp growth is easier than in the services which have grown faster (for yes, manufacturing output has still grown, just not as fast as services) which has shrunk as a portion of the economy. And it's Chang himself who tells us that this makes future economic growth more difficult as a result of that difficulty in increasing tfp in services.

Yet when it comes to comparing growth rates in manufacturing heavy and services heavy economies the lack of growth is all about how the rich have all the money. Go figure. Consistency isn't just the hobgoblin of little minds you know.

One final point about why we don't want to be taxing those high incomes too much. It isn't, as Chang purports, because only the rich can make everyone else rich by investing. Rather, it's because the process of people getting rich is what makes us all richer. Assuming no rent seeking (which we free marketeers do indeed abhor) and the lucky sperm club then the only way you can get rich, become rich, is by satisfying the desires of others. You need to be producing something that others are willing to purchase. That they are willing to purchase it shows that they value it more than it costs them: by definition this makes them richer. As the influx of cash makes you richer.

It's not the static state of being rich that makes everyone better off: it's the activity of producing what others value that makes both the producer and consumer richer. And that's why we don't want to take huge bites out of the incomes of people who are doing this: because we'd like them to be seen to be well rewarded so that others are willing to take the risks of similarly producing value that all can enjoy. After all, we know that taxing something produces less of it: thus taxing the creation of wealth will produce less wealth.

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