Personal Income Inequality, Taxation and Financial Instability in the Supermultiplier Model*

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Abstract

The Supermultiplier Model has been a widely-used framework for analyzing the relationship between autonomous (non-capacity creating) demand and economic growth. However, previous versions of the model have not taken into account important issues such as personal income inequality, income taxes, and financial variables. This contribution seeks to fill this gap by developing an amended version of the model that incorporates these factors. Our findings as regards a possible tax reform suggest that: (i) a progressive tax shift can lead to temporary higher growth rates during the traverse and an overall positive level effect on the output level; (ii) the size of this impact is influenced by the product of the propensity to consume and the income share of each income bracket affected by the tax reform. By analyzing credit-financed consumption-led growth, this contribution has shown that the necessary condition to warrant sustainability is that the growth of debt-financed consumption is aligned with income distribution. Therefore, it is argued that indebtedness cannot systematically replace disposable income without leading to instability. Consequently, policies aimed at promoting sustainable economic growth must be designed while analyzing growth contributions with a particular focus on possible demand leakages, and on the income distribution engendered by the underlying income-generating process emerging from each demand component.

Keywords: Distribution, Credit, Instability, Effective Demand, Growth
JEL Codes: B51; D31; E11; E12; E62; O41.

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