Laffer curve

- **Laffer was an economic advisor to U.S. president Ronald Reagan in the 1980's**
- **Laffer curve shows the relationship between tax rates and tax revenue arguing that cutting tax rates would have a double benefit of raising tax revenue and national output**
- **Laffer suggested that a reduction in U.S tax rates would lead to an increase in tax revenue and supply side economists supported the concept**

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Web note 241 Laffer Curve

- Syllabus items: take a look please!
- 118
- 119
- 131
- 132

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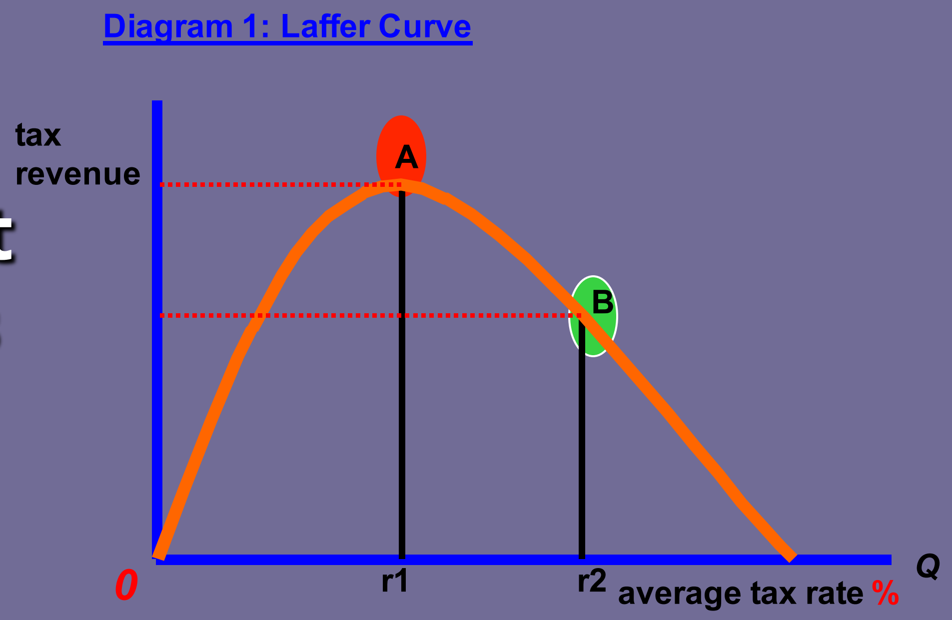
- **A tax rate of 0r1 maximises tax revenue because more people want to work and firms will be inclined to expand =**
- **INCENTIVE (see syllabus item 131)**



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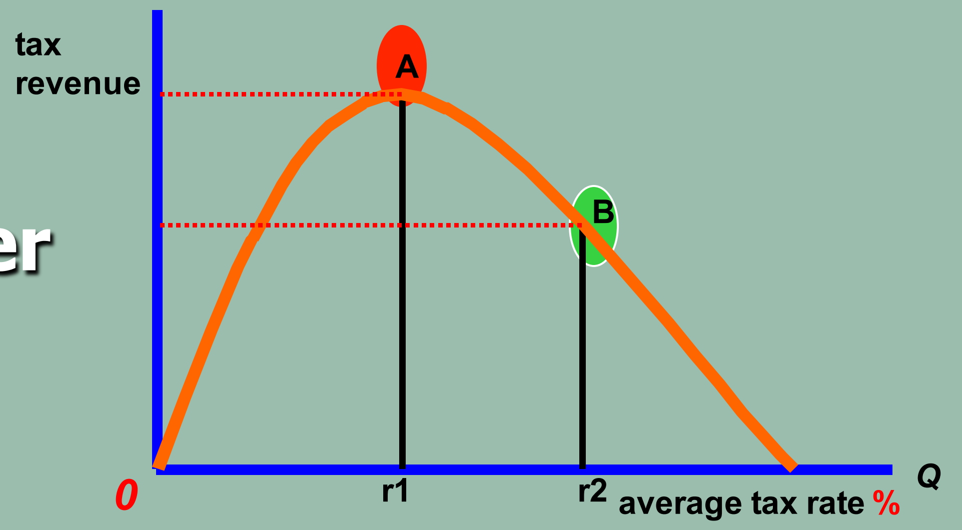
- **A tax rate of 0r2 would actually decrease tax revenue for government. In other words higher tax rates discourage work and output falls**
- **= dis INCENTIVE**

Diagram 1: Laffer Curve



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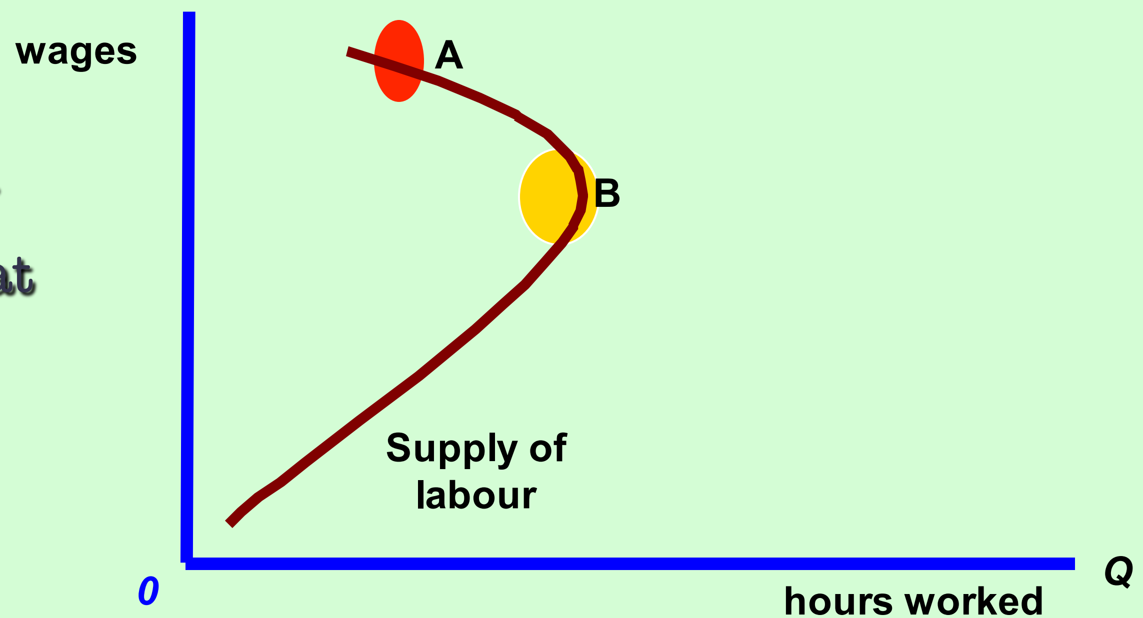
Web note 241: Backward Bending Supply Curve

- Critics of the Laffer curve argue that a cut in tax rates would in all probability lead to a fall in tax revenue.
- Idea here is based on backward bending supply curve whereby at higher wage rates workers may offer less hours of labour i.e. workers value leisure time more that additional hours at work subject of course to some minimum required standard of living
- = disINCENTIVE

Diagram 2: Backward bending supply curve for Labour



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Web note 241 Laffer Curve

- Reading:
- See Glanville p.334 and McGee 'The Good, the bad and the economist' p.455
- End