

## [Yes, Virginia, there really is a laffer curve](#) [1]

Written by [Tim Worstall](#) [2] | Friday 18 January 2008



One of the hugely annoying things about the "debate" over the Laffer Curve is that there are still those who deny the very existence of the concept. Something which is absurd, for at the extremes it's a simple mathematical truism. At times (say, a 100% tax rate) reducing taxes will increase revenues collected. The strongest Laffer Curve argument, that reducing tax rates always increases total revenues collected (reducing a tax rate from 50% to zero say) is as similarly incorrect as the denial that reductions ever do.

The true argument is always about at which tax rate do we increase revenues, at which reduce? This argument being complicated by the fact that we have several different effects going on, depending on which tax we're talking about (effects on capital and labour taxation will be different, given different mobilities) and so on. Perhaps the most important point to make though is that cuts (or rises) in tax rates will not work in a linear manner. Amounts raised will vary dynamically.

But what is surprising in this latest working paper from the IMF is quite how low a tax rate can go and still show Laffer effects: not just a dynamic response to the lower rate, but more revenue collected both in total and as a percentage [of GDP](#) [3]:

*To illustrate the potential effects of tax rate cuts on tax revenues consider the example of Russia. Russia introduced a flat 13 percent personal income tax rate, replacing the three tiered, 12, 20 and 30 percent previous rates (as detailed in Ivanova, Keen and Klemm, 2005). The tax exempt income was also increased, further decreasing the tax burden. Considering social tax reforms enacted at the same time, tax rates were cut substantially for most taxpayers. However, personal income tax (PIT) revenues have increased significantly: 46 percent in nominal and 26 percent real terms during the next year. Even more interesting PIT revenues have increased from 2.4 percent to 2.9 percent of GDP? a more than 20 percent increase relative to GDP. PIT revenues continued to increase to 3.3 percent during the next year, representing a further 14 percent gain relative to GDP.*

Yes, there really is a Laffer Curve, and its effects can be seen at much lower tax rates than those we currently tend to think they can be. It might also be worth noting that, as with the ASI's own proposals for a flat tax, the heavily increased personal allowance raised (yes, raised, not lowered) the progressivity of the tax system as a whole.

More revenue, greater progressivity and lower tax rates. Well, why does anyone oppose such a system?

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