

## [The Laffer Curve doesn't depend upon what you think is a fair tax rate](#) [1]

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While [scribbling elsewhere](#) [3] on Gerard Depardieu and his fleeing of the extortionate tax rates in France it occurred to me that there's something rarely mentioned in this whole thing about where the peak of the Laffer Curve is. It's that that peak isn't determined by what you think is a fair rate of tax that they should pay is. Nor what the community in general, or democracy, politicians, think is a fair rate. It's determined by what those who have to pay the tax rate think is a fair rate.

And there's a lot of very interesting economics been done on what people do think is fair: take the [ultimatum game](#) [4] for example. Two people, \$100. One of them gets to decide how the two will split it. The other one can accept the split or reject it: on rejection neither of them get anything.

The logical policy is to accept any split at all from 1:99 on up. Hey, at least you'll get a whole dollar! But as it turns out people just don't react that way. As soon as the split starts getting worse than \$40:\$60 the rejection rate goes way up. The conclusion is that we're so tied up, we weird humans, about fairness that we will even punish ourselves in order to punish someone else we think is acting unfairly. There have also been experiments with both monkeys and apes (although with lovely pieces of fruit rather than useless pieces of paper) that lead to the same conclusion. All of us higher primates seem to be wired pretty much the same way: you try and rip me off and I'll take you down with me fella.

I've not seen this point explicitly made anywhere: although I assume that's to do with my lack of reading more than anything else. But if that sense of fairness is hard wired, then obviously it's also going to apply to those we're trying to tax. Which will mean that that peak of the Laffer Curve, that rate at which people bunk off, leave the country, reduce their work loads, lie or cheat the taxman, isn't determined by what we think is a fair rate to tax them. It's a result of what they think is a fair rate to tax them. Which, of course, could be a very different rate indeed from what we think is a fair rate.

Indeed, when we look at the family fortunes and incomes of those who advocate much higher tax rates we do indeed see all sorts of shenanigans going on to avoid those higher rates. The list of wills altered, trusts to hide from inheritance tax, personal service companies, dividend splitting and all the rest: even those who propose those higher taxes rates wriggle as if they think they are unfair when applied to themselves. That revealed preferences thing again: those who face those rates don't think they're fair.

And as I say, adding that ultimatum game into the mix does tell us something very interesting. It's not what we, or the left, think is a fair tax rate that matters. It's what the people paying the tax think is a fair rate that does. And as that game tells us, people start getting very unhappy with anything less than a 40:60 split. To the point where they will indeed give up income themselves in order to punish those offering such a measly share.

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