Laffer Limits

If you study the Laffer Curve you know that there is a section of the curve where a reduction in the tax rate will increase the dollar revenues. It is a simple economic expression of increasing the demand (for income, profits or capital gains) by reducing the cost (taxes).

Yet there is a portion of the curve where additional reductions in taxes will not increase the tax revenue and will in fact reduce revenue. If taxes are 100% no one will produce and you will get no revenues; if taxes are zero percent, everyone will produce and you will get no tax revenues. The Laffer Curve explains what happens in between those extremes.

Personally I beleive we are close to an ideal point of maximizing tax revenue. If we increase rates (as Obama proposes) we will see revenues decline. But I would be less assured that a decrease would cause a substantial increase in revenues.

But there are two other perspectives. Our tax revenues are not just a factor of our changes in the tax rate but their change relative to competitive rates. If our rates stayed the same and other nations reduced their rates, we could lose revenues as investments sought a better investment climate.

Secondly a small repeated change (1% increase for ten consecutive years) may have less of an impact than a singler 10% increase in a single year (which Obama proposes). This second factor is simultaneously affected by competitive tax rates.

Bill Clinton and George W both cut capital gains and dividend tax RATEs and INCREASED the tax revenues from those sources. Obama seeks to reverse those tax policies.

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