

What really causes the 'Laffer effect'?

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There has been some recent discussion of the Laffer curve on the blog as a result of reaction to a blog [by Jolyon Maugham](#). As is, I think, quite well known, I am dubious about the existence of a Laffer effect at any of the current headline rates of tax in the UK, and the vast majority of those proposed. I think it may just appear if the Greens have a top rate of income tax of 60% with uncapped national insurance contributions.

In response to these comments Howard Reed, an occasional co-author of mine and a man whose work I much admire, [posted some comments](#) I thought worth sharing more widely. He said:

Most of the Laffer effect (I feel bad calling it the “Laffer effect” as Laffer is a total far-right crank and charlatan... for example, do a search on “[Krugman New York Times Laffer](#)” on Google and you’ll find several examples of why Laffer is a nutjob...) is NOT due to reduced hours or effort by high earners because the tax rate is so high. It’s due to increased avoidance activity and (e.g.) shifting remuneration from income to capital gains. A General Anti Avoidance Rule (as proposed by Richard) would put paid to most of the Laffer effect. Personally I think we would be fine up to at least 65-70% top rate but I appreciate this is a matter about which there can be intelligent disagreement. Some commentators (e.g. Saez/Piketty) have suggested that 80% is the revenue maximising top rate.

More fundamentally, it's not clear to me that Laffer is right even on its own terms. Would the revenue yield from a 100% tax rate be zero? If we had (e.g.) a very high Citizens Income, so that no-one *needed* to work, I'm sure some people would go on working because they enjoyed their work even if tax rates were 100%. This might well be a minority of people and so I wouldn't suggest 100% tax rates as a serious proposal, but Laffer's argument (that the yield of a 100% marginal rate is zero) seems to me to be flawed if work conveys any positive utility, at least for some of the population. And there are certainly people around who like their jobs — for example there is evidence of people who win the Lottery and carry on in their job.

I well recall several of my staff in some of the companies I have run in my time for

whom pay (and by implication, therefore, tax) was not the key or even, in all likelihood, a significant motivation for their coming to work. Various other factors were at least as big a motivational effect. In other words, I think Howard may be right with his second suggestion.

That tax avoidance is the main reason for the Laffer effect is beyond dispute. And as Howard notes, we could beat that if we wanted to.