

# ECONOMICS IN THE REAL WORLD

## STUDENT RESOURCES

A-LEVEL



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### The Laffer Curve

Begin the lesson by splitting class into 5 groups. Each group will be given the starter activity and will work together, assessing the two examples and will be asked to derive a relationship between the rate of tax and total tax revenue the government receives.

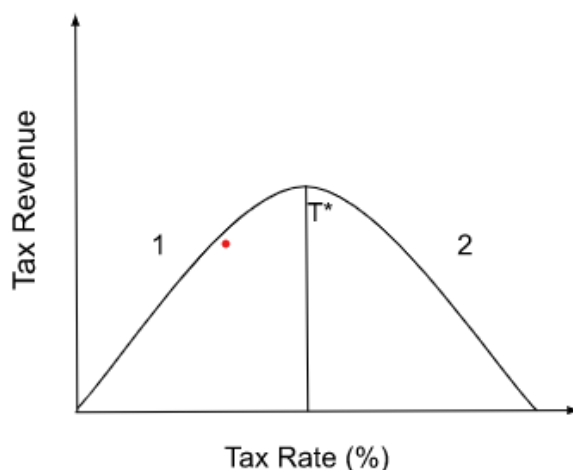
The groups will also be asked to draw a graph that establishes the relationship on a whiteboard. On the vertical axis will be total revenue and on the horizontal axis will be tax rate.

Ask one person from each group to hold up their whiteboards.

Show the students the Laffer curve. Have them compare their graphs to the Laffer curve. Why do you think the Laffer curve looks different from your own graph?

Main activity: Using the graph you have drawn on the whiteboard ask the students why they think the laffer curve looks as it does? Can they give reasons for its shape? Go through each section of the curve and annotate using class contributions.

At section 1 ask the students 'As we can see throughout section 1, as tax rate is increasing so is tax revenue, why do you think this is?' Once one student contributes, write down their explanation on the graph, ask the other students if they have anything to add.



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At section 2, once the tax rate passed  $T^*$ , tax revenue starts to decrease, ask students why they think this is. If students are struggling, guide them to the correct answer by asking questions such as if you had to work everyday and knew the government were taking 100% of your income as tax, would you continue to work? Do you think tax avoidance contributes to a decrease in revenue when the tax rate exceeds  $T^*$ ?

To ensure students have understood how the Laffer curve works, put example numbers on the graph (e.g. change  $T^*$  to 30%) and ask students, if they were a politician choosing the tax rate, what tax rate would they choose to charge their citizens? Ask them to write their answer on a whiteboard and hold it up. Their answers should be 30% (or whatever number you have chosen to replace  $T^*$  with). If some students have not written this, ask them why they think it would be best to charge  $T^*$  rather than their answer.  $T^*$  can therefore be called the optimal tax rate.

Go on to assess potential criticisms of the Laffer curve. Ask students if they can think of any and begin to form a list on the board, discussing each criticism with the class. These can include but should not be exclusive to criticisms such as: Vague ideal tax rate (An exact numerical value of  $T^*$  is not provided, the Laffer curve merely identifies it as being somewhere between 0% and 100%).

To end the lesson discuss the policy implications of the Laffer curve e.g. how increasing tax rates in countries with existing high rates of tax could slow economic growth and discourage work and investment. Similarly, how lowering tax rates could be used to stimulate economic growth.

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