how distinct from individual human beings and their relationships.

When economists forget this, mischief is afoot. For the economist who deals in the abstractions called "aggregates" is ever in danger of losing from his sight the thinking, valuing, choosing and acting individual. He is thus in danger of departing from reality.

As a case in point, consider the seemingly self-evident proposition that an increase in the marginal tax rate will be followed by an increase in tax revenues. The assertion seems perfectly obvious—*but only if individual people and their possible responses to an increased marginal tax rate are ignored.*

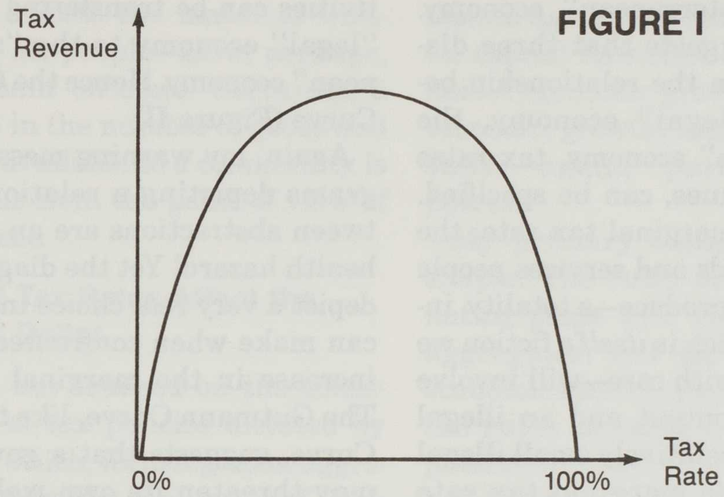
Tax Models

To make this point, I shall refer to two "tax rate-tax revenue" models elaborated by Professors A. Laffer[11] and P. Gutmann.[12] I do so with some hesitation, for the models—the so-called Laffer Curve and Gutmann Curve—*themselves* can lure us into committing the fallacy of misplaced concreteness. The models are *not* photographs of reality or even portraits of reality; at best they are like cartoons featuring characters such as Uncle Sam and John Bull. Unlike a diagrammatic representation of, say, Boyle's Law, which enables us to make specific predictions about the behavior of gases, the diagrams we shall consider *cannot* be used as a basis for precise prediction. Yet, *given that we exercise due caution*, the Laffer and Gutmann Curves can assist us in understanding a vital truth.

The Laffer Curve purportedly shows that increases in the tax rate cannot generate a rise in government receipts indefinitely. A zero tax rate means no government revenue. A 1% tax rate results in some government revenue. A 2% tax rate almost certainly leads to greater government revenue than does a 1% tax rate. Yet a 100% tax rate produces tax revenue approaching that resulting from a zero tax rate—namely, zero revenue. At some point, an increase in the marginal tax rate results in an individual choosing leisure rather than paid employment, and if sufficient individuals do this, tax revenue drops.

Put it this way. A person earns $100 a day. On Monday he is taxed at the rate of 20%, retaining $80 from his original $100. The cost of leisure—the cost of not engaging in paid employment and instead walking in the park, visiting friends, listening to the music of Mozart, and so on—is a forgone $80. On Tuesday a 40% tax rate applies, the individual retaining only $60 from his earnings. The cost of leisure has thus dropped, the individual forgoing only $60 if he chooses not to go to work. On Wednesday and Thursday the tax he pays rises to 60% and 80% respectively of his earnings. By Thursday the cost of leisure is temptingly low, being merely $20 forgone. On Friday a 100% tax rate applies. The cost of leisure is now zero—save, perhaps, for whatever pleasure an individual derives from his work and the company of his working companions. Simply, at some point an increase in the marginal tax rate will so decrease the cost of leisure, that many people will choose leisure rather than paid employment. Tax revenues thus drop. Hence the Laffer Curve (Figure I).

FIGURE I



I repeat that this tidy diagram ridiculously oversimplifies complex reality. It might suggest that if governments were smart enough, they could discover a tax rate which, at all times and places, maximizes government revenue. Clearly, this is nonsense. The point at which the cost of engaging in paid employment—that is, forgone leisure—becomes so high that what is forgone by not working is less valuable to an individual than the joys of his leisure activities, varies from person to person and, in the case of a specific individual, from time to time. What the Laffer Curve dramatically displays is that an increase in the marginal tax rate can so reduce the cost of leisure that an individual may rationally change his pattern of behavior in a way that reduces tax revenue. A consideration of the relationship between the marginal tax rate and tax revenue that ignores the thinking, valuing, choosing and acting individual is absurdly simplistic and misleading.

The Gutmann Curve depicts another possible human response to increasing marginal tax rates. Instead of choosing leisure rather than paid employment, individuals may choose to transfer their productive activities from the "legal" economy to the