Labor Supply & Income Taxes


It is possible an individual will still work 8 hours regardless (i.e., have an inelastic supply curve) and thus choose “B.”

But the inelasticity arises not because there is no substitution effect, there is. It’s because the 2 effects pull in exactly offsetting directions.

A lump sum tax raising the same revenue (through pt. B) as the income tax ⇒ ↑welfare, ↑income, but the person works more.

Leisure (Hours)