A letter to the Archbishop of York [1]

Written by **Tim Worstall** [2] | Monday 22 July 2013

The Most Reverend & Right Honourable Dr. John Sentamu, Archbishop of York

The Office of the Archbishop of York

Bishopthorpe Palace Bishopthorpe, York YO23 2GE

21 July 2013

Your Grace,

I note from today's Observer that you are concerned about the Living Wage. I write to make a point that I suspect the usual suspects will not make to you. The importance of understanding that the living wage is calculated as a pre-tax number.

We here at the Adam Smith Institute agree that the Joseph Rowntree Foundation is indeed measuring poverty in the correct manner. We derive this from Adam Smith's comments on a linen shirt: it is not a necessity. However, if one lives in a society where being unable to afford a linen shirt means that you are regarded as poor, then in that society, if you cannot afford a linen shirt you are indeed regarded as poor. The JRF numbers are gathered in a similar manner: what do focus groups think people should be able to do in order to be regarded as not poor in this time and place? Add up the costs of those things and we reach that living wage. This is a much better definition of poverty than the more usual reference to some percentage of median income.

However, it is absolutely vital to understand that those numbers are pre-tax. The importance of this is as follows: if it were not for the amount that government takes from such meagre wages then the minimum wage would indeed be, to an acceptable level of accuracy, that living wage.

An example to make this clear. Assume 37.5 hours a week of work for 52 weeks of the year. At that living wage of £7.45 an hour this is a gross weekly income of £279.40 (I round slightly) or £14,527.50 a year. We are all agreed that this is not a large sum.

From this sum the recipient will have to pay employees' national insurance. This starts [3] at £109 per week and is charged at 12%. £20.50 per week in such charges, or £1,063.30 per year.

There is also income tax to pay. This starts [4] at £9,440 this year and is charged at 20%. £1,017.5 in such taxation.

We can see therefore that the net income from the living wage is some £12,446.70 a year. This is not greatly different from the gross income on the minimum wage: £6.19 an hour for 37.5 hours for 52 weeks is £12,070.50. Or if we wish to bring that back to a rate per hour, the difference between the post-tax living wage and the pre-tax minimum wage is some 19 pence per hour.

Unfortunately it does not stop there. There is also employers' national insurance to pay. Some insist that it is actually the employer who carries the burden of this tax. Almost all economists disagree, insisting that it is the employee who does in the form of lower wages. Indeed, we have it on the word of an expert of great eminence, Richard Murphy of Tax Research (who is funded in part of the Joseph Rowntree organisations, just to show his impartiality on this point), that it is indeed the employees who carry the burden of this tax. The calculation is slightly complex, but it's reasonable enough to claim that it is a further 13.8 % of those wages (it isn't, it's 13.8% of the total wages including the employers' NI but let us keep the maths simple) meaning a further £20 to £23 a week deducted from those wages. Or a further £1,196 a year.

If we add all of this together we find that the living wage of £7.45 an hour actually provides a lower post-tax standard of living than the minimum wage of £6.19 an hour free of taxation would provide. That latter would provide £12,070.50 a year to live on. By no means a great sum but still larger than the £11,250.7 that is available from the living wage after the politicians have taken their very much more than tithe.

It is indeed possible to play with these calculations, to make them more accurate. But the same end result will always come out. The current minimum wage, free of income tax and national insurance, would provide a higher standard of living than the proposed living wage under the current taxation system.

It is for this reason that I have been proposing for some years now, in fact ever since the first JRF calculations on the living wage were published, that the personal allowance for both income tax and national insurance be raised to the full time full year minimum wage. This would, at a stroke, raise that minimum wage to a higher standard of living than the proposed living wage. With the advantage that we only have to convince the Chancellor of the Exchequer of the righteousness of this path, not millions of employers across the country.

I look forward to the results of your investigation into low wages and am convinced that you will come to the same conclusion that we have. The shockingly low disposable incomes of the working poor in this country are not the result of any meanness or avarice on the part of employers: it is simply that the government taxes the working poor too much. Given this, that we can convert the minimum wage into something better than the living wage simply by ceasing the political depredations upon the pockets of the populace, I assume that your conclusion will be that the personal allowance, including that for national insurance, should be substantially raised.

After all, it's not really a particularly complex point. If you want people to have more money then tax them less.

yours sincerely,

Tim Worstall

Senior Fellow

Adam Smith Institute

London SW1

Source URL: http://www.adamsmith.org/blog/economics/a-letter-to-the-archbishop-of-york

Links:

[1] http://www.adamsmith.org/blog/economics/a-letter-to-the-archbishop-of-york
[2] http://www.adamsmith.org/taxonomy/term/5778
[3] http://www.hmrc.gov.uk/rates/nic.htm
[4] http://www.hmrc.gov.uk/rates/it.htm
[5] http://disqus.com/?ref_noscript
[6] http://disqus.com