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# Why taking the poor out of tax makes economic and moral sense [1]

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Today is the start of 'Living Wage Week', the promotional week run by the Living Wage Foundation to plug their campaign to get firms to pay staff no less than £7.20/hour (£8.30/hour in London). I'm broadly supportive of this sort of thing -- consumer pressure is a much better way to get things done than government fiat, and I respect the fact that the Living Wage Foundation has largely avoided lobbying government and calling for a mandatory Living Wage.

Sadly, not everyone has been so self-restrained. It looks as if [3] Labour is going to call for a massive hike in the National Minimum Wage (NMW) to meet the Living Wage rate. To contradict this sort of thinking, we've released a short paper today [4] outlining some of the empirical evidence surrounding rises in the minimum wage, which show a strong correlation between rises in the minimum wage and drops in employment. It stands to reason -- if you impose a price floor on the price of labour, there will be a shortfall of demand for labour. In other words, there will be unemployment. While it's true that this relationship isn't fool-proof -- there are many factors at play in any economic phenomenon, and it would be silly to claim that any one policy will certainly have a particular effect in a complex world -- no responsible legislator should risk raising unemployment.

Nevertheless, the problem of people working on such low pay that they can barely afford to live is a very real one. In the paper, I point out (as Tim Worstall has, many times before) that the pre-tax minimum wage is actually greater than the post-tax Living Wage. In short, the thing that's holding people on the minimum wage below the basic living standard that Living Wage campaigners want is tax. Lift the tax-free personal allowance threshold to the minimum wage rate and you stop them paying tax, effectively giving them a Living Wage without any of the problems associated with raising the minimum wage rate. People earning less than £100,000 would get a bump in their take-home pay, too.

This would cost about £14bn above the government's commitment to raise the threshold to £10,000, but it would probably cost less than that given the reduced welfare bill and increased economic activity associated with tax cuts. The Keynesian left should support this, too -- this targets the wallets of low- and middle-income earners, and so (in the Keynesian worldview) it should have a stimulatory effect in the same way that government spending is supposed to.

It's a simple policy, but one that makes a lot of sense. Stop taxing the people at the bottom of the earnings ladder, and you'll have gone a long way to solving the low pay problem.

**Read the full paper.** [4]

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