

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

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Written by [Sam Bowman](#) [2] | Monday 5 November 2012

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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