

## Don't tax sweat

Thomas Colignatus  
March 29 2010

With our intelligence and entrepreneurship we create micro chips and send crafts into space but the creation of jobs for the disadvantaged seems out of reach. The rich countries in the world still have a huge pool of unemployment and poverty at the bottom of society. A close analysis gives the insight that we actually create unemployment and poverty ourselves.

The following table gives the legal minimum wage in the US (dollars), in the UK (pounds) and in Holland (euro's) as key examples for the rich world. The table is best understood from the principle of "don't tax sweat". That is, workers at the minimum should be exempt from levies. The Dutch economist A.J. Cohen Stuart in 1889 (120 years ago) gave the perfect analogy: "A bridge must bear its own weight before it can carry a load." In the same way a worker at the minimum cannot pay taxes since he or she must first earn subsistence. When levies are included then the cost of labour rises above productivity and the worker becomes unemployed – and must be supported by family or the dole. As we can see in the table, the tax wedge at the minimum is 18.1% in the US, 23.7% in the UK and a huge 48.5% in Holland. This table disregards sales tax (VAT) so that the problem is actually bigger, e.g. in the US another 8%.

<i>Legal minimum wage US 2009, UK &amp; Holland 2010</i>	<i>US (dollar)</i>	<i>UK (pound)</i>	<i>Holland (euro)</i>
Gross minimum wage	11790	11341	18309
Net income, after deduction of income tax and premiums	10751	9751	14889
Gross labour costs: gross wage plus employer premiums	12692	12059	22106
Taxes and premiums (excl. VAT)	1941	2307	7217
Incidence as a percentage of gross labour costs	15.3%	19.1%	32.6 %
Incidence as a percentage of net income	18.1%	23.7%	48.5 %

The US estimate is from own calculation. The UK estimate is by courtesy of Mr Donald Hirsch and Mr Chris Goulden from the Joseph Rowntree Foundation. The Dutch data are from its Central Planning Bureau.

The legal minimum wage means that workers are not allowed to work below that wage. Hence, the taxes and premiums below the minimum wage are not collected either. Thus the tax wedge below the minimum wage is also a "tax void". Levies are imposed but entirely fictional. The beauty of the tax void is that these levies can also be abolished overnight. What is not collected can also be abolished for free. By a rather simply measure we can create employment opportunities for large sections of the labour force.

Historically the tax void has arisen in three ways. Firstly, social insurance was enacted but this had no exemption, which is a logical error. Secondly, tax exemption is internationally adjusted for inflation but subsistence rises with both inflation and the general rise in welfare. Thirdly, income tax has been replaced by sales tax (VAT) because our fellow economists entertain theories about the disincentive by marginal tax rates. We agree that the marginal approach is important for optimality but amend for dynamic effects of the "dynamic marginal tax rate". A discussion of this would lead to far. It suffices to say that we can now understand how unemployment and poverty have been so persistent in our societies that are so rich and creative in so many other ways.

Unemployment and poverty are not external events like earthquakes but internal results of our economic system. They are evidence of errors in policy making. Since these errors are structural we must look for structural solutions. Within the realm of national decision making Montesquieu's checks and balances of the executive, legislative and judiciary branches have

failed. We need a fourth branch, a scientifically based Economic Supreme Court, that checks the quality of the information used for decision making. The structural neglect of science in the political process has become too costly, not only for unemployment and poverty but for policy making in general.

*Thomas Colignatus is an econometrician in Scheveningen, <http://thomascool.eu>. More on the tax void can be found here <http://mpa.ub.uni-muenchen.de/14812>.*