This diagram illustrates the shocking truth about how the burden of taxation really falls on employers, despite appearances to the contrary.

Consider a fairly average wage of £25,000 paid to an employee under the PAYE system. This is subject to tax as follows:

Income tax at 22% above £5000
= £4400

Employees National Insurance at 11%
= £2200

Total deduction
= £6600

Net wage
= £18400

Employers NIC
= £2650

To provide someone with a net wage of £18,400 costs an employer £27,650, the nominal wage being £25,000.

But that is not all. Actual wages are the goods and services provided to the wage earner in exchange for the money spent. The difference between the money spent and the goods and services received is the amount paid in indirect taxes. It is about 15% for the top 20% of earners and 32% of disposable income in the case of the bottom 20% of earners.

In the case of the example given, the £27,560 in employer's cost of an employee's nominal wage of £25,000 produces an actual wage of £18,400, less a further 25%, which equals just
Gross labour costs = (Actual wages x 1.25) + PAYE Income Tax + Employer's NI + Employee's NI.

This gives rise to the seemingly impossible - a low wage/high labour-cost economy. The effect is that for every £1 of actual purchasing power received by an employee, the total labour cost to an employer is more than £1.80. There is a general principle that if something is taxed, less of it is consumed. The Window Tax is held up to ridicule because the result was bricked-up windows. But when governments raise most of their revenue from taxes on work, is it any wonder that employees try to minimise the size of their labour force? Between the end of the war and the mid-1970s the country got away with this but eventually the inevitable result was persistent unemployment. It has been unacceptably high for the past 30 years. We need tax reform and we need it now.

Governments around the world are thrashing around to try to get their economies re-started, whilst at the same time their finances are deteriorating due to declining tax revenues and increasing welfare bills. Fiscal stimulus is the favoured means. So far it has not worked but in any case it is a policy that would need to be precisely focused on projects that sustain and enhance the country's capacity to create real wealth. Worthwhile infrastructure projects are required, not make-work schemes. There is no harm in financing them from new money - provided that this new money is withdrawn from the system later on to avoid inflation. This will have to be done by taxation, which will also have to be raised if governments are to rebuild their finances. But if it is done under the present tax system, it will push the country back into recession for the reasons given above. This is another reason we need tax reform.