



Problems with the Payroll Tax

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Payroll Tax = Income Tax

There are only two basic paths money takes in an economy. One is from households to businesses in payment for goods and services. Economists call this the expenditure flow. The other is from businesses to households in compensation for resources. Economists call this the income flow.

Payments to households take the form of wages, interest, rent, or profit. A tax on payroll or compensation is a tax on the income flow in the economy. It is a tax on providing resources for use in production.

Payroll (Income) Taxes Penalize Work and Production

Income is a result of productive activity. A basic, immutable *law* of economics is that when the price of something goes up (in relative terms) less of it is purchased. A tax on labor increases the price of labor. Therefore, less labor will be purchased. This directly creates unemployment.

Another basic, immutable *law* of economics is that when the net price for a producer goes down, less is supplied by the producer. Wage earners are labor producers. The effect of a payroll tax is to lower wages since it limits wage increases to keep up with inflation. Lowering the net wage reduces how much people will be willing to work and produce. A payroll tax directly discourages productive effort.

The bottom line is that payroll taxes discourage job creation in a very direct way.

A Payroll Tax Is Regressive

The first jobs eliminated are the least productive ones when labor costs increase. These might be relatively menial jobs, but they are not menial to those who have and need them. What this means for low-income individuals is that their jobs are the first eliminated.

Many criticize other taxes for their regressive nature, but analyses that claim other taxes are more regressive ignore the fact that such regressivity measures are meaningless when the option is: 1) a job where taxes must be paid, or 2) no job due to a payroll tax.

Who Gets Hurt by a Payroll Tax?

This is obvious. A payroll tax hits the service sector hardest, where the cost of the product is mostly in the labor provided. Particularly hard hit will be those businesses and jobs in:

- ⊗ Private education services
- ⊗ Nursing services
- ⊗ Health care and legal services
- ⊗ Janitorial and lawn services
- ⊗ Grocery stores
- ⊗ Retail sales
- ⊗ Repair services
- ⊗ Business services
- ⊗ Any new business, or business where the margins are low