Taxing wages: How taxes affect the disposable income of workers and wage costs of employers in OECD countries

Written by: Dominique Paturot, OECD Centre for Tax Policy and Administration

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Every worker and employer is directly affected by taxes on wages. Taxation is one of the principal ways we finance public services. It also helps us achieve important social objectives, such as redistributing wealth to address inequalities. But as the OECD's annual Taxing Wages points out, tax policies on labour income may have an impact on individuals' behaviour with respect to the labour market or their consumption habits.

Comparing the labour income taxes people actually pay among OECD countries, in particular, net personal average tax rates for single individuals and families with children, shows how taxes impact household disposable income. This can help policymakers adjust policy incentives, for instance, for people to enter the workforce or work more hours.

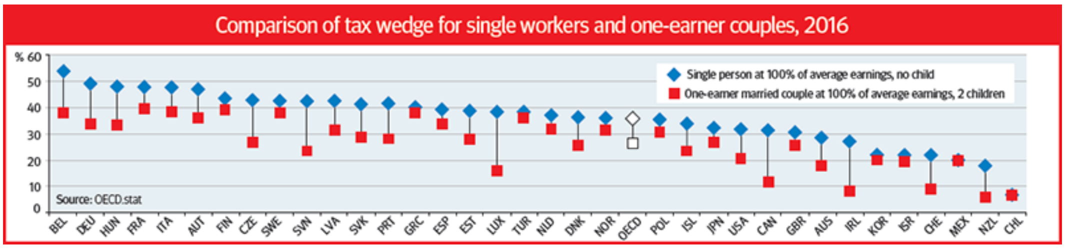
A worker's gross wage is reduced by personal income taxes as well as social security contributions paid to the government to finance the likes of healthcare, unemployment benefits, pensions and other social insurance schemes. The amount of deductions differs depending on such factors as family composition, working situation and income level. A worker's net disposable income comprises the remainder of their wage plus any cash transfers the state pays out.

In *Taxing Wages*, we calculate the disposable incomes of eight household types across OECD countries, including the combined impact of personal income taxes, social security contributions, and family benefits. The report places most emphasis on a single worker with average earnings and a one-earner couple at the same level of earnings with two children. Among OECD countries, Belgium has the highest net personal average tax rate for a single worker with average earnings: 40.7%, in 2016. This means that the disposable income of the average worker in Belgium is the remaining 59.3% of their gross wage. At the other extreme, Chile has the lowest net personal average tax rate, at 7%. Thus, a single average worker in Chile takes home 93% of their gross wage.

For a one-earner couple with average earnings and two children, the net personal average tax rate is highest in Denmark (25.5%). There, the disposable household income after tax, including family benefits, comes to 74.5% of the gross wage. The lowest is in Ireland (-1.6%), where the rate is negative due to the total amount of family benefits exceeding total personal income tax and employee social security payments. As a result, the disposable income of Irish one-earner couples with two children earning an average wage is higher than their gross wage.

Tax wedge

One important question, not least from a competitiveness viewpoint, is how taxes affect the overall cost of hiring a worker. This means looking not just at taxes paid by workers, but the additional deductions employers have to pay as well, usually as social security contributions and payroll taxes. The sum of all this is the tax wedge, which is the difference between the employer's cost of hiring a worker and the worker's net disposable income. It includes personal income tax and social security contributions paid by the employee and the employer (including payroll taxes) net of family benefits. The tax wedge can be quite a high percentage of labour costs, and therefore clearly has a bearing on the hiring decisions of firms.



Comparison of tax wedge for single workers and one-earner couples, 2016

The OECD's average tax wedge was 36% of labour costs in 2016 for a single average worker. The tax wedge is 26.6% for a one-earner couple with average earnings with two children. In almost every OECD country, the tax wedge is lower for one-earner couples than for single workers (see chart). The highest tax wedge for a single worker with average earnings is in Belgium, with 54%. The lowest is in Chile, with just 7%. For one-earner couples with average earnings and two children the highest is France (40%) and the lowest is New Zealand (6.2%).

Taxing Wages provides a comprehensive overview of the effects of tax policies on the incentives on employees and employers with respect to the labour market. However, these indicators, which focus on the structure of income tax systems, do not provide a complete picture of the overall impact of the government sector on people's welfare. For this, other factors such as indirect taxes (eg. VAT) would have to be taken into account, as would other forms of income, such as from self-employment or capital income, and other tax allowances and cash transfers not considered in *Taxing Wages*. The effect on welfare of services provided by the state, access to education and health facilities, and the incidence of corporate and other direct taxes on earnings and prices would also have to be considered.

Readers can find more data on these aspects by visiting the OECD Tax Database (http://www.oecd.org/tax/tax-policy/tax-database.htm).

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