

# EPI Policy Brief

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## The Minimum Wage and the Earned Income Tax Credit: A Decade of Progress

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Working poor families are already earning federal subsidies of almost \$2.00 per hour, in addition to their hourly wage, but you would not know it from the debate over hiking the minimum wage. The reason is that acknowledging the success of the wage subsidy highlights the failure of the wage mandate.

The minimum wage and the Earned Income Tax Credit are both federal legislative attempts to alleviate poverty in America. The minimum wage, targeted at those with low wages, has failed badly and the EITC, targeted at families with low earnings, has been a qualified success.

A recent study by Richard Vedder and Lowell Gallaway concludes that both federal and state minimum wages have failed as anti-poverty devices.<sup>1</sup> This is because of unintended consequences such as:

- employment loss;
- substitution of higher-skilled workers for lower-skilled workers; and
- ineffective targeting of workers in poverty families.<sup>2</sup>

Instead of targeting those most in need, the minimum wage floor applies to all classes of workers—the single mother in need, the teenager working for extra money, and the retiree filling his days. On the other hand, a number of studies have shown that the

EITC, which expressly targets families in need, has increased the labor force participation among families with poverty incomes.<sup>3</sup>

**Congress greatly expanded the EITC during the mid-1990s and it is now a major factor keeping working families out of poverty.** Even prominent policymakers who in the past have advocated small increases in the minimum wage also acknowledge that the

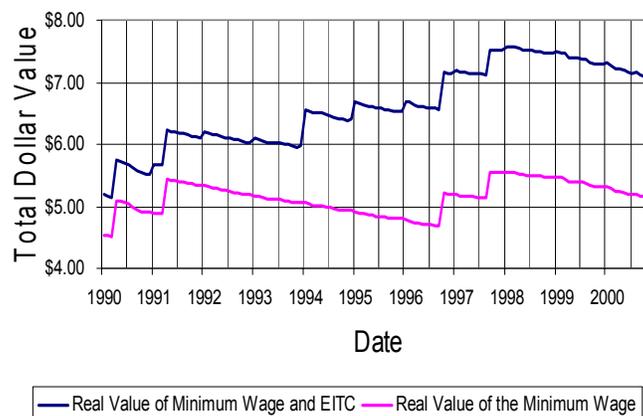
EITC has certain advantages over the minimum wage. For example, Robert Reich, former U.S. Secretary of Labor, stated in a 1993 memorandum to President Clinton:

*To be sure, [compared with a minimum wage hike] the EITC poses no threat to employment opportunities and can be better targeted to families in need.<sup>4</sup>*

Moreover, Dr. Rebecca Blank, a former member of President Clinton's Council of Economic Advisors has recently written:

*Without the EITC, there would be greater pressure to increase the minimum wage, which has growing disemployment effects as it rises, since it induces employers to substitute away from less-skilled labor toward other technologies.<sup>5</sup>*

Figure 1. Comparison of Real Value of Minimum Wage and Minimum Wage Plus EITC



Those who advocate raising the minimum wage to \$6.65 per hour point to a decline in the real (i.e., inflation-adjusted) value of the national minimum wage. However, such an analysis must also consider the real value of the EITC because Congress intended the two policies to alleviate poverty among the same low-income working population. In 2000, a single earner with two children qualified for a refundable tax credit of \$3,888 if she worked full-time, full-year at the national minimum wage. This amounted to an hourly wage supplement of nearly \$2.00 an hour. The family's earnings plus the credit equaled \$14,188, an income above the federal poverty threshold.

As an anti-poverty device, the EITC has many undisputed advantages. For example, unlike cash wages, the refundable EITC is not subject to payroll taxes and does not reduce income based-eligibility for other needed government benefits such as food stamps, Medicaid and Supplemental Security Income. It thus does more to increase family disposable income than the minimum wage.

Figure 1 shows the trend in the real value of the minimum wage and the EITC for a minimum wage worker who has two children and works 2000 hours a year.

The current policy debate over increasing the national minimum wage has largely ignored these uncontested policy-relevant facts about the minimum wage and the EITC.

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<sup>1</sup> Richard Vedder and Lowell Gallaway, "Does the Minimum Wage Reduce Poverty?" Employment Policies Institute, June 2001.

<sup>2</sup> Ibid.; see also David Neumark and William Wascher, "Do Minimum Wages Fight Poverty?" NBER Working Paper 6127, August 1997.

<sup>3</sup> See, e.g., Nada Essa and Jeffrey B. Liebman, "Labor Supply Response to the Earned Income Tax Credit." *Quarterly Journal of Economics* 111(2): 605-37, 1996; Bruce D. Meyer and Dan T. Rosenbaum, "Welfare, the Earned Income Tax Credit, and the Labor Supply of Single Mothers." NBER Working Paper 7363, September 1999.

<sup>4</sup> Robert B. Reich, Memorandum to the President of the United States, July 20, 1993, at page 5.

<sup>5</sup> Rebecca M. Blank and Lucie Schmidt, "Wages and Work," December 2000, paper prepared for the conference "The New World of Welfare: Shaping a Post-TANF Agenda for Policy," at page 17.