Research

Primer: Earned Income Tax Credit and the Minimum Wage

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President Lyndon B. Johnson declared a War on Poverty in his 1964 State of the Union address. For the last fifty years, fighting poverty has been a top national priority. Recently, as the economy fails to fully recover in the wake of the financial crises and ensuing recession, lawmakers have called for an increase in the minimum wage. In the last 12 months five states and the District of Columbia passed minimum wage hikes. Meanwhile, President Obama in his 2014 State of the Union address announced his intention to issue an executive order requiring federal contractors to pay their employees at least $10.10 per hour. President Obama also called on Congress to increase the federal minimum wage for all employees to $10.10.

Would a hike in the minimum wage help those in poverty? This remains highly contested, especially in academia. Several argue that increasing the minimum wage would do little to combat poverty and that further improving the earned income tax credit (EITC) would be much more effective. The EITC better targets families in poverty and incentivizes people to work, the key to moving out of poverty. Those without jobs are four times more likely to be in poverty than those who are employed.

How much more effective is the EITC than minimum wage? To answer this question, this paper closely examines the design and history of the EITC and employs recent Current Population Survey data to compare its antipoverty capabilities to those of the minimum wage. We find that not only does the EITC help more people, those it does help are in much greater need than those who earn the minimum wage.

HISTORY OF EITC AND MINIMUM WAGE

The Earned Income Tax Credit

The EITC, first enacted under the Ford Administration in 1975, is an income subsidy provided through the tax code specifically targeted to low-income working families.[1] The value of the credit received is a fixed percentage of family earnings; as earnings increase, so does the credit at a constant rate determined by the number of children. The credit hits a maximum value also determined by the number of children. The credit is then flat at the maximum value for a certain earnings range and when earnings rise above that range, the credit reduces at a constant rate until the family phases out and no longer qualifies for the EITC. The phase out begins sooner for single filers than it does for married ones. In addition, the EITC is fully refundable, meaning that if the credit exceeds a family's tax liability, the family still receives the full credit. As a result, they receive the excess credit as a tax refund.[2]

Table 1 details the EITC's maximum earnings to qualify and maximum credits by number of children and marital status.

Table 1: 2014 Earned Income Tax Credit[3]			
Children	**Maximum Credit ($)**	**Maximum Earnings ($)**	
		Single	**Married**
Childless	469	14,590	20,020
One Child	3,305	38,511	43,941
Two Children	5,460	43,756	49,186
Three or More Children	6,143	46,997	52,427

In the years following President Johnson's 1964 State of the Union address, the idea of the EITC came out of a public debate over the use of the Negative Income Tax (NIT). The basic premise of the NIT was that instead of paying taxes, low-income families would receive money from the government through the tax code. The proposal was very appealing to those implementing the War on Poverty as it did not require the huge bureaucratic investment that other antipoverty programs needed. In 1966, an NIT was the primary focus of the Office of Economic Opportunity's plan to defeat poverty. President Johnson, however, did not support the policy because he believed a promised income without work restrictions would incentivize people to not work. As a result, the government did not implement an NIT.[4]

In 1969, President Richard Nixon renewed debate over the NIT by introducing his own version of it called the Family Assistance Plan (FAP). Opponents attacked FAP for being too generous and also having insufficient work requirements. Senator Russell Long, then chair of the Senate Finance Committee, introduced an alternative to FAP, called the Work Bonus Plan, which delivered an income subsidy through the tax code specifically to working families. Senator Long kept the plan alive over the next few years and successfully enacted a version of it, the EITC, in 1975 on a temporary basis.[5]

By 1978 the EITC was made permanent and it has been periodically expanded ever since. Given that the EITC was specifically designed to alleviate poverty, it was likely easier for policymakers to reform it in ways to further improve its capabilities. Lawmakers expanded the maximum credit available in 1984, 1986, 1990, 1993, and 2009. In addition, policymakers indexed the EITC for inflation in 1986, increased the maximum credit for taxpayers with two or more children in 1990, extended the EITC for childless adults in 1993, allowed military personnel to be covered in 1994, reduced the marriage penalty in 2001, used the EITC to provide hurricane relief in 2005, and raised the earnings level for when the credit begins to phase out in 2009.[6], [7]

The Minimum Wage

Unlike the EITC, the minimum wage was not designed to pull families out of poverty. As discussed in a recent AAF primer, the minimum wage was first introduced by the Fair Labor Standards Act of 1938 (FLSA) and was primarily intended to protect factory workers and children from harsh working conditions and low pay. The Labor Department's Children's Bureau found that almost 25 percent of children were working at least 60 hours per week, with a median weekly wage of only $4.[8] FLSA imposed harsher restrictions on child labor, mandated a minimum wage, and imposed a maximum work week of 44 hours for production employees.

While FLSA mandated a minimum wage to prevent such dangerous child labor conditions, the initial design of the policy suggests it was never intended to be completely livable or support an entire family on its own. FLSA originally imposed a minimum wage of 25 cents per hour in 1938, which today is equal to $4.15.[9] In addition, FLSA's minimum wage mandate of 25 cents per hour was also only for production workers in manufacturing. The law only applied to half of those production workers and largely excluded all other sectors.[10] As a result, only about 20 percent of the U.S. labor force was covered by the minimum wage law.[11]

However, in his 1964 State of the Union address, President Johnson advocated for expanding the minimum wage to protect the working poor: "We must extend the coverage of our minimum wage laws to more than 2 million workers now lacking this basic protection of purchasing power."[12] The president successfully increased the value of federal minimum wage over the course of the next few years until it reached $1.60 in 1968.[13] In addition, throughout the 1960s and 1970s, lawmakers extended minimum wage coverage to agricultural, retail trade, and services industries. By 1975, more than 90 percent of the U.S. workforce was covered by the federal minimum wage.[14] Although the minimum wage was not initially designed to be an anti-poverty tool, President Johnson's War on Poverty reframed it.

EITC AND MINIMUM WAGE TODAY

Despite both the EITC and minimum wage laws undergoing significant expansions in the years following President Johnson's 1964 State of the Union address, the initial designs of these policies may have deeply affected their ability to combat poverty. In particular, the EITC assists vastly more people in poverty than does the minimum wage.

The EITC Targets Those in Poverty More Effectively

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An analysis of the 2013 Current Population Survey (CPS) March Annual Social and Economic (ASEC) Supplement, which reports information from 2012, reveals that far more people receive the EITC than earn the minimum wage.[15] In 2012, 11.6 percent of all wage and salary workers received the EITC and a mere 1.6 percent earned at or below the federal minimum wage of $7.25 per hour. Simply put, the EITC has far greater reach than the minimum wage.

Table 2: EITC and Minimum Wage Among all Workers		
Worker Type	**Receive EITC (%)**	**Earn Federal Minimum Wage or Less (%)**
Hourly	15.5	2.7
Salary	6.2	0.0
All Hourly and Salary	11.6	1.6

While the EITC helps far more workers than the minimum wage, it also more effectively targets those who are most in need. Average family earnings (income before taxes and social assistance transfers) for those who received the EITC were $24,017.04 in 2012. The minimum wage workers were in families with average earnings of $48,860.86, double that of EITC recipients.

Table 3: Average Family Earnings Comparison		
Earnings Category	**EITC Recipients**	**Minimum Wage Earners**
Average Family Earnings ($)	24,017.04	48,860.86
Average Family Income ($)	28,485.55	55,726.09

Expanding the EITC would not only help more workers than a minimum wage increase, it would also help workers who need the most assistance.

Looking specifically at how the EITC relates to poverty, 16.7 percent of all people in families with incomes below the relevant 2012 federal poverty lines received the EITC.[16] Meanwhile only 0.2 percent of people in poverty worked an hourly job and made at or below the minimum wage. The EITC is also much more effective at assisting the working poor than the minimum wage. In 2012, while 58.1 percent of all workers in poverty received the EITC, only 5.3 percent earned at or below the minimum wage.

Table 4: EITC and Minimum Wage Poverty Comparison		
Poverty Category	**Receives EITC (%)**	**Earns Minimum Wage (%)**
All in Poverty	16.7	0.2
Working Poor	58.1	5.3

The Brookings Institution's Benjamin Harris and Melissa Kearney (2014) point out that the beneficiaries of a minimum wage increase would not exclusively benefit people who earn today's federal minimum wage. Rather, it would bump up wages for all "near-minimum wage workers" who are paid hourly-rates between the current federal minimum and the proposed hike.[17] However, even if one assumes no negative employment effects, the number of people falling in this category that are in poverty remains very limited. In 2012, only 1.0 percent of all people in families with incomes below the federal poverty threshold earned at or below $9 per hour, 1.3 percent earned at or below $10.10 per hour, and 1.8 percent earned at or below $15 per hour. These figures suggest that increasing the minimum wage to $9, $10.10, or $15 in 2012 would have failed to directly assist over 98 percent of all people in poverty.

Even among those who work and are in poverty, the minimum wage stacks up poorly against the EITC. In 2012, 24.4 percent of the working poor earned $9 per hour or less, 31.7 percent earned $10.10 per hour or less, and 43.5 percent earned $15 per hour or less. While these increases in the minimum wage would affect good chunks of the working poor population, none would help nearly as many people in poverty as the EITC, which already helped 58.1 percent of the working poor in 2012.

Moreover, when looking specifically at the population of people who earn the minimum wage, it is clear that the vast majority are not in poverty. Consequently, an increase in the wage floor would disproportionately help people not in poverty. The larger the minimum wage bump, the more people not in poverty benefit. In 2012, 36.5 percent of those who received the EITC were in poverty. Meanwhile, 21.9 percent of minimum wage workers were in poverty and 78.1 percent were not. The data also reveal that people in poverty made up 20.1 percent of those who earned $9 per hour or less, 17.7 percent of those who earn $10.10 or less, and 12.3 percent of those who earn $15 or less. Clearly, the larger the minimum wage increase, the more imprecise it is as an anti-poverty tool.

EITC, Minimum Wage, and the Labor Market

While the EITC more effectively targets those in poverty than the minimum wage, it also does a better job of promoting employment.

According to CPS data, in 2012 only 6.9 percent of people who had a job in the past year were in poverty, while 28.6 percent who experienced unemployment were in poverty. If the person was unemployed, he or she was over four times more likely to be in poverty than those who were employed. This does not account for people who stopped looking for work and dropped out of the labor force entirely.

Table 5: Employment, Poverty, and Income in 2012		
Employment Status	**In Poverty (%)**	**Average Family Income ($)**
Employed	6.9	90,223.37
Unemployed	28.6	52,076.95
United States	15.9	76,965.60

Table 5 reveals that the income gains from employment were substantial. In 2012, the average family income of the employed was well above the national average of $76,965.60 at $90,223.37. Meanwhile the average family income of the unemployed was $52,076.95, well below the national average.

The success of the EITC getting its recipients to work is evident in their average work hours. While minimum wage workers averaged 24.2 hours per week in 2012, EITC recipients averaged 35.0 hours per week. Not only does 10 plus additional working hours provide those most in need with additional pay, but it also helps workers gain skills necessary for the higher paying jobs that will lift their families out of poverty.

Table 6: Weekly Work Hours		
	EITC	**Minimum Wage**
Average Hours Working Per Week	35.0	24.2

Raising the minimum wage, on the other hand, raises the hourly benefit of those who are working, but does so at the cost of the private market. While an increase in the minimum wage could have a similar effect as the EITC by incentivizing work, the ultimate effect on employment is uncertain as the extra costs to businesses reduces demand for workers.

To make matters worse, there is mounting evidence in academia that the minimum wage ultimately negatively affects employment. Despite the ongoing debate over the effect of minimum wage on the level of employment, new research by Meer and West (2013) suggests that a negative impact of the minimum wage can be isolated by focusing on employment dynamics. Specifically, they find that a 10 percent increase in the real minimum wage is associated with a 0.53 percentage point decrease in the net job growth rate.[18] In earlier analyses, AAF applied Meer and West's work to current proposals to raise the minimum wage to $9 per hour and $10 per hour, finding that these policies would cost 1.4 million and 2.3 million jobs nationwide respectively.[19], [20]

HOW THE EITC CAN IMPROVE

The evidence presented so far demonstrates that raising the maximum value of the EITC would benefit far more people in poverty than an increase in the federal minimum wage. Even though the EITC outperforms the minimum wage in every statistic cited in this analysis, there are other key ways the tax credit could improve. In particular, low-income workers without dependent children only marginally benefit from the EITC.

Table 7 contains the average EITC received by various marital and family demographics.

Table 7: Average EITC of Working Poor Individuals by Family Type

Family Demographic	Average EITC ($)
All Working Poor	2729.46
Married	4033.45
Married with Children	4326.36
Married without Children	520.64
Single	2325.36
Single with Children	3379.12
Single without Children	408.69

Table 7 reveals that the main beneficiaries of the EITC are married couples in poverty who work and have children. While the EITC is purposely designed to benefit families and children, single and married childless filers could certainly benefit from larger EITC payments. In 2012, the average working poor EITC recipient received $2,729.46; married couples with children received an average $4,326.36. Meanwhile, childless workers were left behind, especially when single. Married couples in poverty who did not have children received $520.64 in EITC and single workers in the same situation received $408.69 on average. In addition to expanding the maximum credit available, policymakers could reform the EITC to increase the average credit received by childless workers. This would increase the relative value of working and increase incomes for a population that tends to be the most in need.

CONCLUSION

President Johnson's War on Poverty provided a unique opportunity to compare two policies whose goals have become one: to improve the welfare of low-wage labor. The EITC was conceived out of President Johnson's war and was designed specifically to fight poverty in the United States. The minimum wage, on the other hand, was significantly expanded during the war and over time has become a tool to combat poverty. However, from its inception in 1938, the minimum wage was never intended as such. In the end, the EITC helps far more people and better targets those in poverty than does the minimum wage.

While the EITC is precise and targeted in its ability to combat poverty, the minimum wage is inexact and mainly benefits non-poor families. Meanwhile, the EITC also more effectively promotes employment by increasing the relative value of working without forcing employers to pay the cost. In order to help those in poverty, policymakers should zero in on improving and expanding the EITC, which already has a great track record of success.

[1] "Taxation and the Family: What is the Earned Income Tax Credit?" Tax Policy Center, available at http://www.taxpolicycenter.org/briefing-book/key-elements/family/eitc.cfm