Public Policy Brief

Making Work Pay

Wage Insurance for the Working Poor

Barry Bluestone and Teresa Ghilarducci

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Summary

In this *Public Policy Brief*, Barry Bluestone and Teresa Ghilarducci argue for the need to establish "wage insurance" in the current environment of stagnating wages, increasing income instability, and rising adult poverty. The War on Poverty has succeeded in reducing the poverty rate for elderly Americans from 30 percent to 10.5 percent over the past three decades. Nonelderly adults constitute an absolute majority (50.2 percent) of all poor persons in the nation, up from 40.1 percent twenty-five years ago. With the overall growth in the number of persons in poverty in the United States from 25.4 million in 1970 to 38.1 million in 1994, the number of poor nonelderly adults nearly doubled, from 10.4 million to 19.1 million.

Bluestone and Ghilarducci note that essential components of a wage insurance system already exist in the earned income tax credit (EITC) and the minimum wage. But the EITC and the federal wage floor must be seen as complements to one another, not substitutes for one another, in order to meet important criteria for any insurance program: high target efficiency and minimal adverse behavioral effects. Properly used, the EITC and the minimum wage fit together like finely cut jigsaw puzzle pieces; the considerable strengths of the EITC offset weaknesses in the minimum wage, while the minimum wage's greatest benefits offset some of the shortcomings of the EITC.

The authors show that low income is being "democratized" as job instability increases. Due in part to corporate downsizing, an increasing number of once-secure working-class and middle-class families are experiencing temporary or periodic poverty. Falling wages for at least the bottom 20 percent of the workforce and rising job and wage instability for much of the middle class portend a society in which work no longer serves as an effective guarantee against privation. Institutionalizing a form of wage insurance based on the EITC and a rising minimum wage can help protect a large segment of workers in this economic environment.

The modest minimum wage increase to $5.15 recently passed by Congress will raise the income of over 12 million workers who now earn from $4.25 up to $5.15 per hour. Moreover, findings suggest that nearly 9 million workers currently earning between $5.15 and $6.14 per hour will see their wages rise by an average of 10 percent when the $5.15 wage floor goes into effect. This means that more than 21 million workers—one out of six in the workforce—will see their wages improve as a result of enacting the higher minimum wage.

The EITC's greatest asset, from the perspective of battling poverty, is its target efficiency. More than 46 percent of the total tax credit goes to families who are living under the official poverty line, and more than two-thirds of the credit goes to families with income under $20,000. The EITC has still another advantage, one that is often overlooked by both its supporters and its detractors. It is a form of wage insurance for the temporary poor in a time of job instability and earnings insecurity. In any one year about one in six families is eligible for the tax credit, and over a period of a decade nearly 40 percent of families will have a year or more in which their wage income declines sufficiently for them to be eligible for the EITC.

Neither the minimum wage nor the EITC is by itself an ideal solution to the wage poverty problem. Yet when the two are combined, the sum is greater than its parts. On three criteria (income adequacy, target efficiency, and labor supply employment effects), the minimum wage is weak. These are precisely the strengths of the EITC. On four other criteria (labor demand, productivity enhancement, fiscal impact, and limited moral hazard), the minimum wage is clearly the preferred program. What makes the two fit together so well is that the existence of a higher minimum wage actually reduces the negative productivity, fiscal impact, and moral hazard effects of the EITC, while the EITC makes up for the weak target efficiency and income adequacy of the minimum wage.

Bluestone and Ghilarducci argue for a comprehensive and coherent strategy aimed at the working poor and those susceptible to highly fluctuating incomes. Changes in the food stamp program enacted as part of the recent welfare reform legislation and proposed cuts in the EITC work in precisely the opposite direction. A cut of $23 billion in food stamp benefits between 1997 and 2002 and the increased FICA tax liability accompanying the increase in the federal minimum wage reduce the effective hike in the wage floor from $0.90 to $0.73 per hour for nonimmigrants. For legal immigrants working full-time, who will now be denied food stamps, the lost benefit is more than double the earnings gain attributable to the increase in the minimum wage. In addition, the congressional resolution for balancing the federal budget by 2002 includes an $18.5 billion reduction in EITC benefits. These changes undermine the objective of assuring that families that work will not be mired in poverty and dependency.

Wage insurance becomes more necessary in a political climate of welfare overhauling and budget cutting that gives with one hand while taking with the other. Efforts to improve education and training programs, expand community development efforts, promote unionization, and narrow the gender pay gap can reduce the long-run cost of wage insurance.

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Preface

Although President Clinton recently signed into law an increase in the federal minimum wage, the debate over the virtues and vices of a minimum wage continues. The arduous political battle over the 90-cent-an-hour boost in the minimum wage was passionately fought on grounds of both efficiency and ethics, and economists are still arguing about the wage floor's target efficiency (e.g., do teenagers and the nonpoor benefit too much?) and employment effects (e.g., does an increase in the wage floor result in job displacement?).

Congress has also scrutinized the earned income tax credit (EITC). The EITC was at one time championed as the best antipoverty program, but it is now criticized (even by some former supporters) for waste, fraud, abuse, and error. Proponents of the EITC concede that it is an imperfect program, but still believe that the EITC's design and intent—to help the working poor escape poverty and dependency—make it a valuable program that must be preserved. Indeed, many observers argue for reinforcement of the EITC in light of the recent welfare reform legislation that will flood the low-wage labor market with millions of entrants.

Barry Bluestone and Teresa Ghilarducci recommend a comprehensive approach to help the working poor flee the scourge of poverty. Their approach is founded on the notion that an individual who works full-time and year-round should be assured an above-poverty standard of living. The main tenets of the wage insurance plan—modeled on the success of social insurance programs such as Social Security and the state unemployment insurance programs—are the minimum wage and the EITC. The authors demonstrate how the two mutually supportive programs work in tandem to help low-wage workers; the advantages of the

minimum wage offset and ameliorate the disadvantages of the EITC, and vice versa. Together, the two policies are effective tools in helping low-wage workers avoid poverty in the current period of employment and earnings instability and economic insecurity.

The present drive to "reform" welfare emphasizes work requirements and time limits on benefits for able-bodied adults. Bluestone and Ghilarducci's research lends some support for measures that will increase work incentives and facilitate the transition from welfare to work. However, the authors conclude that indexing the minimum wage (currently $5.15 per hour) and full funding of the EITC are the building blocks for a comprehensive wage insurance strategy to ensure that work pays in America.

This *Public Policy Brief* makes a valuable contribution to the ongoing debates over the minimum wage, welfare policy, and the nature of the public sector's role in providing a social safety net.

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Executive Director
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Wage Insurance for the Working Poor

Fifty years ago, passage of the Employment Act of 1946 committed the federal government to pursue economic policies that would assure maximum employment consistent with reasonable price stability. The framers of the act assumed that maintaining a low unemployment rate was the necessary and, for all practical purposes, sufficient condition for guaranteeing an adequate standard of living for any family in which one or more members were gainfully employed. They assumed that with full employment rising real wages would reduce, if not totally eradicate, poverty among working families.

Employed workers were distinguished from those out of work or unable to work. For the unemployed, the disabled, the elderly, and dependent children, "social insurance" was envisioned as a substitute for a family's "living wage." Since the 1930s many programs—state unemployment insurance; Old Age, Survivors, Disability and Health Insurance (OASD-HI, more commonly known as Social Security); Supplemental Security Income (SSI); Aid to Families with Dependent Children (AFDC); housing subsidies; and nutrition programs, such as Food Stamps and the Women, Infants, and Children food supplement (WIC)—have become important threads in the American tapestry of social insurance. The overall system is aptly named "social" because it provides universal coverage and "insurance" because it is constructed to protect individuals and families against the temporary or, for some, permanent risks of not working and being poor. The framers of the act assumed that the labor market would take care of those who can work; social insurance was to care for those who cannot.

Federal and state social insurance programs have played an important role in limiting the spread of poverty. Conservative rhetoric notwithstanding, the War on Poverty, begun in the mid 1960s, has had its share of major victories. None is more striking than the sharp decline in poverty among the elderly. In 1967 nearly 30 percent of older Americans were living on an income below the official poverty line. Today, only 10.5 percent are poor, thanks to the expansion of Social Security and Medicare. Danziger and Weinberg (1992) estimate that without these universal transfer programs an absolute majority (51 percent) of people in the nation over 65 would be living in poverty. Programs for the nonelderly have not been as successful. Nonetheless (and contrary to the widespread criticism of AFDC), Mishel and Bernstein (1994) estimate that without AFDC, Social Security, nutrition programs, and housing benefits the incidence of poverty among persons in female-headed families with related children under age 18 would be 51.7 percent instead of the 33.7 percent it is with those programs (Primus, Porter, Ditto, and Kent 1996).

The success of Social Security and other social insurance programs has dramatically changed poverty's demographic profile, as shown in Table 1. In 1970 children under 18 made up about 41 percent of the poor, and the elderly accounted for about 19 percent. In 1994 children made up 40.2 percent of the poor, but the elderly accounted for only 9.6 percent. Nonelderly adults constituted an absolute majority (50.2 percent) of all poor persons in the nation in 1994, up from 40.1 percent in 1970. While the total number of persons in poverty in the United States grew from

Table 1 **Demographics of American Poverty Status by Age**

| | Age | | | |
	Under 18	Age 18–64	65 and Over	Total
1970				
Number	10,440,000	10,187,000	4,793,000	25,420,000
Percent [a]	41.1	40.1	18.9	100
1994				
Number	15,289,000	19,107,000	3,663,000	38,059,000
Percent	40.2	50.2	9.6	100

[a] Percents do not add up to 100 because of rounding.
Source: U.S. Bureau of the Census, *Current Population Survey*.

25.4 million in 1970 to 38.1 million in 1994, the number of poor nonelderly adults nearly doubled, from 10.2 million to 19.1 million.[1]

Put another way, more than 70 percent of the net increase in poverty has been among those whom we normally think of as at work or available for work. This may be the first time in the history of any country—certainly the first time since the era of Charles Dickens—when a majority of the poor are not the young, the old, and the infirm, but people who are of working age and are able to work. In spite of the creation of 16.6 million jobs over the past decade, working poverty is hardly disappearing. The implicit standard-of-living promise of the 1946 Employment Act has not been realized for vast numbers of Americans who work.[2]

Burkhauser, Couch, and Glenn (1995) note that in 1989 three out of four poverty households had one or more workers. Nearly 70 percent of all poor individuals between the ages of 25 and 54 did some paid work during the year. Three out of every ten worked year-round, full-time. Nowhere among the poor is work more important than in families with both a mother and a father present. In 1989 in more than 55 percent of poor, married-couple households with children, at least one of the adults had a full-time job for some period. That percentage was up from 47 percent in 1975.[3]

This turn of events could not have been foreseen by the framers of the original Employment Act. Only with the advantage of hindsight and an avalanche of wage and income data can we recognize the economic trends that have undermined full employment as the means by which poverty would be eliminated among the "gainfully employed." These trends will not easily be reversed. For this reason, it now appears appropriate to consider "wage insurance" for workers who earn poverty wages. An existing program—the earned income tax credit (EITC)—is a strong candidate for this role. But, as we shall demonstrate, it must be tied to another existing program—the minimum wage—in order to deal with two serious problems that any insurance program must confront: target efficiency and unintended adverse behavioral effects, or "moral hazard." Properly used, the EITC and the minimum wage fit together like well-cut jigsaw puzzle pieces and have the potential to fill much of the wage gap of the working poor. Strengths of the EITC offset weaknesses of the minimum wage, and the minimum wage's greatest benefits offset some of

the EITC's shortcomings. Much of the machinery for such wage insurance is in place, but changes will be required. The newly passed minimum wage of $5.15 per hour by itself is too low to do much about wage poverty, and the EITC is expensive and will become even more costly to taxpayers over time, especially if the minimum wage is not indexed annually or at least biennially to reflect rising living costs.

The value of linking these two programs has not been obvious, at least within political circles. In 1995 the majority leadership in both the House and the Senate condemned the minimum wage as a job destruction program. Along with the usual arsenal of arguments against the federal wage floor, minimum wage opponents made the point that with the expansion of the EITC program the minimum wage was no longer necessary. As we shall demonstrate in this paper, the EITC requires a higher minimum wage if wage poverty is to be challenged effectively and if the EITC is to be prevented from becoming a subsidy to employers rather than to workers and an ever-larger burden on taxpayers. Without an adequate indexed minimum wage, the EITC tends to "socialize" wages. The minimum wage "privatizes" them.

Wage and Income Trends That Foster Working Poverty

The labor market trends that make a full-scale "wage insurance" plan necessary are now well established. Average wages have been falling, family incomes have stagnated, and distribution of both earnings and household incomes has become vastly more unequal over the past two decades. Between the end of World War II and 1973 inflation-adjusted average weekly wages for nonsupervisory employees rose by 60 percent, and real median family income, boosted by the growth in female labor force participation, doubled. Those at the bottom of the income distribution saw their incomes rise slightly more than those at the top. The Employment Act was well on its way to fulfilling its promise of adequate income for those at work.

Such a benign climate of rising income, more equally shared, came to an end in 1973. Since then, average weekly wages for production and nonsupervisory employees have fallen by nearly 20 percent.[4] Even with higher labor force participation, real median family income in 1994 was

no higher than in 1978. Over the same period inequality in the overall income distribution increased dramatically. The U.S. Bureau of the Census (1996) reported that mean real income for the top quintile of the income distribution rose by 24 percent, while income for the bottom quintile, where most of the poor are located, fell by 7 percent.

There are a host of reasons for the decline in the standard of living among those at the low end of the income distribution. Gary Burtless (1996) has parsed out the sources of income decline for the bottom quintile. Between 1973 and 1993 the average income per capita available to this low-income group fell by nearly 23 percent—from $5,867 to $4,532 (in 1993 dollars).[5] Cutbacks in AFDC and private pensions caused a small amount of the decline. However, no less than 60 percent of the total loss in income was due to the declining labor market earnings of household members as a consequence of falling wages or reduced employment or both. These results confirm earlier studies of the reasons families end up poor. After analyzing the impact of low skills, bad work habits, single parenthood, illness, and age, Rebecca Blank (1991) found that low earnings has been the most cogent explanation for the rise in poverty even during periods of healthy aggregate economic growth.

Families permanently trapped on the lowest rungs of the income ladder are not the only families in economic trouble. Low income is becoming "democratized" as job instability increases. Corporate downsizing at all levels of the firm is taking its toll, causing an increasing number of once secure working-class and middle-class families to experience temporary or periodic poverty as the result of job loss.

Stephen Rose (1995b) was one of the first to quantify this trend. His research shows a sharp decline in employment "stability" among prime-age workers. Rose found that the degree of occupational stability remained unchanged between the 1970s and the 1980s; the probability of a male worker's changing occupations during the 1980s was not much greater than during the 1970s. But *job* stability declined sharply. In the 1970s, 67 percent of men had a "strong attachment" to their firm. They worked full-time for the same company for at least 8 out of 10 years during the decade. The percentage of male workers with such strong company affiliation fell to only 52 percent in the 1980s. Weak attachment, on the other hand, defined as working for the same employer for no more

than 3 years in the decade, doubled from 12 percent of all prime-age male workers to 24 percent. Rose found that such employment turnover leads to disrupted career paths, in turn resulting in lower average earnings. Job loss plunges a not-insignificant number of families into the ranks of the poor or near poor, at least temporarily.

What these statistics suggest is that poverty has become part of the very fabric of the American labor market. Falling wages for at least the bottom 20 percent of the workforce and rising job and wage instability for much of the middle class portend a society in which work no longer serves as an effective guarantee against privation.

Combating Working Poverty by Raising the Minimum Wage

"Making work pay" has been the key objective of two federal policies. For more than half a century the federal government has attempted to prop up earnings by regulating minimum wages, and since the middle of the 1970s it has improved the incomes of working families with children by offering a wage subsidy, the EITC. The two policies combat low earnings in very different ways.

Well before the passage of the 1946 Employment Act, the government recognized the need for putting a floor under wages. In Franklin Roosevelt's second inaugural address, in 1937, he called on Congress to help the one-third of Americans who were "ill-housed, ill-clad, and ill-nourished." The Fair Labor Standards Act set a minimum wage in 1938. Its purpose, as stated in the legislation's preamble, was the "maintenance of the minimum standard of living necessary for the health, efficiency, and general well-being of workers." The original minimum wage of $0.25 per hour improved wages, but was sufficient to raise a worker's earnings only to the point at which the earnings would, using today's standards, support a family of three at 46 percent of the poverty line.

After World War II the federal government raised the minimum wage regularly. Between 1950 and 1991 Congress raised the wage floor 14 times. As shown in Table 2, the real value of the minimum reached its high point in 1968 when, at $1.60 per hour, it represented, on a full-year, full-time basis, 118 percent of the poverty wage for a family of three.

**Table 2 Full-Time, Full-Year Work at the Minimum Wage as a Percent of Poverty Income for a Family of Three**

Year	Percent
1938	46
1945	57
1950	80
1956	94
1961	98
1967	107
1968	118
1975	100
1980	96
1987	78
1991	74
1995	72

Source: Economic Policy Institute.

Since then, the minimum wage has slipped further and further behind the rising cost of living. By 1995 a full-time worker with a minimum-wage job was able to earn enough to supply only 72 percent of the income needs of a three-person family living at the poverty level. According to Levy Institute Research Associate Edward N. Wolff, if the minimum wage had kept up with inflation since 1965, the current wages earned by American workers would place 30 percent of them below that income level. As shown in Figure 1, the real value of the minimum wage has declined since 1968. Even if the new minimum wage of $5.15 per hour had been in place in 1994, it would have already been nearly $1.15 *less* than its 1968 real value. If a family of three were to rely on the minimum wage alone to keep from falling below the poverty line, the minimum would have to be $6.08 per hour. For a family of four, it would have to be $7.80.

Still, even the modest increase in the wage floor promoted by the Clinton administration and passed by the Congress will have a substantial impact, since real wages have fallen so far during the past 20 years. According to Mishel, Bernstein, and Rasell (1995), raising the minimum wage to $5.15 per hour from $4.25 will raise the income of over 12 million workers who now earn from $4.25 up to $5.15 per hour.

Figure 1   Real Value of Minimum Wage
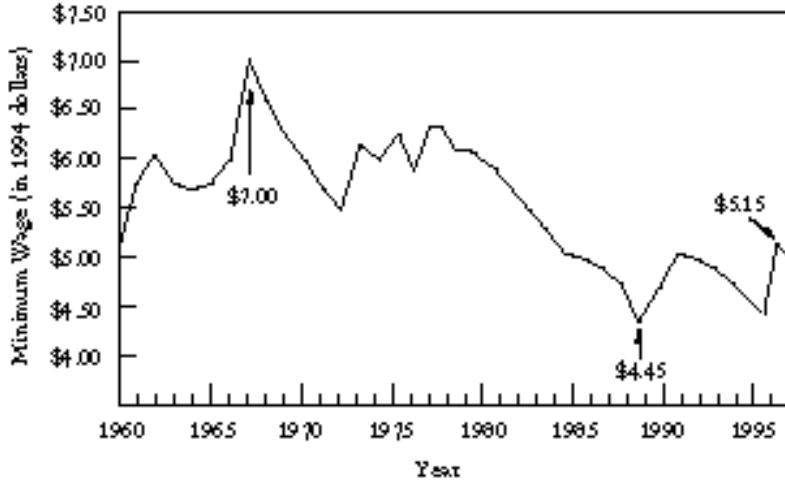
Source: Center on Budget and Policy Priorities.

In addition, as labor economist John Dunlop described in the 1950s, firms typically maintain wage differentials between groups of workers by establishing wage contours. William Spriggs and Bruce Klein (1994) estimated the nation's "low-wage contour" in order to measure how many people working just above the statutory minimum wage would benefit from a wage hike. They found that nearly 9 million workers currently earning between $5.15 and $6.14 per hour will see their wages rise by an average of 10 percent when the Clinton $5.15 wage floor goes into effect. Together, then, more than 21 million workers—one out of six in the U.S. workforce—will see their wages improve over the next two years as a result of enacting the $5.15 minimum wage.

We know who these minimum-wage workers are. Mishel, Bernstein, and Rasell (1995) show that three-fourths are adults; only about one-fourth are teenagers. Nearly three-fifths are women, whose families are dispro-portionately in poverty. Over half are found in the poorest 20 percent of all families. Well over two-thirds work in retail trade and services (a full 41 percent in food service alone). Only one-tenth work in manufactur-ing, where the threat of low-wage international competition may increase if the minimum is raised.

As public policy, the minimum wage has at least four things to recom-mend it. First and foremost, it increases workers' earnings without placing

a burden on the taxpayer. It adds nothing to the federal deficit. In fact, it likely decreases the deficit by boosting income tax revenue and reducing welfare payments.[6] Second, it provides increased income to workers who do not qualify for government transfer programs or tax credits. Third, it is an incentive to work in the "aboveground" economy rather than in the "underground" economy, where wages are often higher than the federal minimum. Fourth, and by no means least, it may lead to higher productivity in the economy. At current wage levels there is little incentive for low-wage employers to introduce new technology or find other ways to boost the output of their workforce. According to Robert Gordon (1996), if firms were required to pay a higher wage, they would have an incentive to find ways to use their workers more effectively.

Shortcomings of the Minimum Wage as a Strategy for Reducing Poverty

These advantages notwithstanding, the minimum wage is not a perfect remedy for low earnings. It has been criticized on two grounds. First, it is claimed that it induces unemployment, especially among younger workers with limited skills. Second, it is asserted that it has poor "target efficiency," that is, it helps many workers in nonpoor families and provides only limited earnings assistance to the truly needy. It turns out that the first of these criticisms—the traditional economic argument that raising the wage floor hurts the very workers it is supposed to help—can no longer be regarded as credible for modest increases. The second, however, is. The minimum wage may raise earnings, but its impact on pulling families out of poverty is quite limited.

Unemployment Effects

According to an article in *The New York Times* by David Rosenbaum (1996), only 22 percent of the public believe that an increase in the minimum wage will lead to job loss, yet a recent survey of the American Economic Association shows 77 percent of economists expect that such an increase will lead to higher unemployment. This is no surprise; their conclusion is based on the standard textbook model of wage equilibrium. If minimum wages do not cause unemployment, all

economics textbooks, including the most liberal ones, would have to be rewritten.

Brown, Gilroy, and Kohen (1982) suggest that the Minimum Wage Commission of 1981 provided the rule of thumb used by mainstream analysts today to calculate the likely negative employment impact of raising the national wage floor. The commission employed teams of economists to synthesize all the available minimum wage studies and simultaneously conducted its own research into the matter. Teenagers, the commission concluded, bear the brunt of minimum wage-induced job loss, being the least skilled and most expendable in the labor pool. The commission concluded that a 10.0 percent increase in the federal wage floor typically leads to a 1.0 to 3.0 percent cut in teenage employment. Among adults, the effect was found to be substantially weaker, but still statistically significant, in the range of 0.3 to 0.7 percent. Empirical research since 1981 has appeared to confirm the commission's concern, but generally finds a teenage effect no greater than 1.0 percent.

Neither the commission nor the economists who have found a negative employment effect have ever denied that many workers benefit from a hike in the legal minimum. But, taking a page from Dostoevsky's *The Brothers Karamazov*, they have argued that it is economically and ethically questionable to force some teenage workers out of their jobs in order to raise wages marginally for others. This is particularly true, argue opponents of the minimum wage, because early work history is vital for future labor market success. Michael Cox (1996) stated that sentencing teenagers to joblessness not only hurts them when they are young, but will continue to harm them the rest of their lives.

In recent years, however, a growing number of economists have taken issue both theoretically and empirically with the notion that a minimum wage necessarily reduces employment. In cases of imperfect competition—especially when workers are not fully mobile, as in cases of a monopsony—employment may remain the same or actually rise after the wage floor is raised.[7] If the firm has some oligopolistic power in the product market, the wage may rise with no change in prices or employment levels. And in pure monopoly cases, the firm can absorb the wage increases in lower profits without reducing employment at all.

The theory of the monopsony case was first rigorously laid out by Milton Friedman (1967), but Friedman concluded that in the real world it was unlikely that the monopsony case would ever be found in the low-wage labor market, which he saw as fully competitive in terms of both labor supply and labor demand. Empirical studies by David Card and Alan Krueger (1995) now suggest that the monopsony model may not be as irrelevant for the low-wage market as Friedman conjectured. In their micro studies, Card and Krueger demonstrate that in the real world of fast-food restaurants and other low-wage employers, modest increases in minimum wages have virtually no negative impact on employment levels. Their counterintuitive results have brought a storm of criticism from traditional economists, but none of Card and Krueger's detractors have fundamentally undermined their findings. Essentially, there is sufficient slack in the relationship between wages and employment levels, especially in industries not subject to international low-wage competition, so that employers absorb the higher minimum wage by lowering profits slightly rather than by laying off workers.

The Card and Krueger studies served well to weaken some initial congressional opposition to the new minimum wage. It turns out, however, that even if their results were ignored and the critics' estimates of an unemployment effect accepted, the purported job loss would not constitute a case for rejecting a higher minimum wage. The reason is that virtually *every* low-wage worker benefits from a higher minimum wage, *even if* there is an *aggregate* labor displacement effect. The "Dostoevsky" criticism is irrelevant because in the real labor market we do not sacrifice some workers' jobs to boost other workers' earnings. Instead, because of the high job turnover rate among teenagers in particular and low-wage workers in general, no single individual bears the full burden of unemployment.[8] Those who benefit from the higher federal wage floor share both the higher wages *and* a portion of any induced unemployment. In the case of the new minimum, the typical working teenager will see a 21 percent increase in wages and a 6 percent decline in annual hours worked, if there is job displacement as severe as early estimates make it out to be. One presumes few teenage beneficiaries would vote against a wage-job displacement deal that involves a 15 percent annual income increase. For adults affected by the new minimum, the same 21 percent wage increase is offset by a loss of no more than 1.5 percent in annual

hours worked, hardly a dent in their improved economic condition. This should vindicate the minimum wage, even for someone who does not buy the Card and Krueger results.

Target Efficiency

Still, there is another criticism that makes the minimum wage less than ideal as an antipoverty remedy. It concerns what economists call "target efficiency." Only a small proportion of the poor benefit directly from increasing the wage floor, despite the fact that nearly 75 percent of poor households have someone who works. According to estimates by Burkhauser, Couch, and Glenn (1995), only about 17 percent of the workers in poor households in 1991 were in jobs paying below what will now be the statutory minimum of $5.15 per hour. The other 83 percent of working-poor households will not be helped, since their working members already earn wages above this level. As noted earlier, the federal wage floor would have to be $7.80 per hour for a full-time worker to earn enough to raise a family of four above the poverty line ($15,600 for 2,000 hours). Hence, most workers in poor families fall into a "dead man's zone." The Clinton minimum wage is below what they are currently making, but their pay is not sufficient, even on a full-time, full-year basis, to catapult their families out of poverty.[9]

Combating Working Poverty with the EITC

To assist the most disadvantaged of the working poor, a program with better target efficiency is needed. Here is where the earned income tax credit comes in. First enacted in 1975, the EITC is a refundable tax credit aimed directly at helping poor working families with children. Its original intent was to offset a portion of the payroll tax liability of low-income families, thus reducing the regressivity of federal taxes at the bottom of the income distribution. Being refundable, it has aspects of a "negative income tax." If the credit due a family is greater than its federal tax liability, the IRS remits the balance to the family.

The way the EITC works in principle is quite simple (see Figure 2). Take a working family with one earner and two or more children. Under the

Figure 2 EITC Schedule, 1996 Values
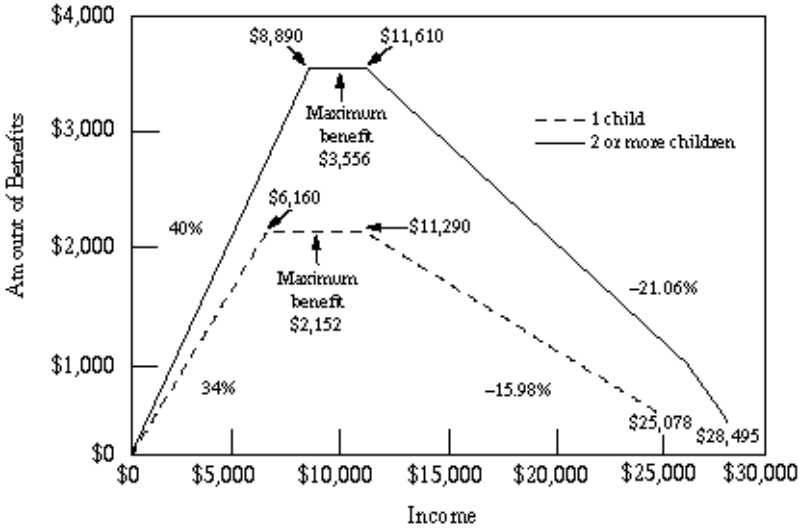
Source: U.S. Department of Treasury, "Earned Income Tax Credit: Rewarding Work for Working Families," June 5, 1995.

rules that went into effect this year, the family will receive a $0.40 credit for every dollar earned up to $8,890 (indicated as 40 percent in Figure 2). Hence, the EITC provides a maximum benefit of $3,556 (0.40 x $8,890). When that family files its Form 1040 and its total taxes are figured, the tax liability is reduced by this amount. A check is sent to the family for the difference between what it owes and the amount of the credit. The family is eligible for the maximum credit until its total earnings from work reach $11,610. After that, the credit declines by $0.21 (−21.06 percent) per dollar of earnings. The credit vanishes altogether when the family's earnings exceed $28,495. There is a separate, lower schedule for working families with one child. Under that schedule, the maximum credit is $2,152, and the credit "vanishes" at $25,078. The EITC's greatest advantage from the perspective of battling poverty is its target efficiency. According to Burkhauser, Couch, and Glenn (1995), more than 46 percent of the program's total tax credit goes to families who are living under the official poverty line, and 63 percent goes to poor and near-poor families, those with incomes no more than 1.5 times the poverty line.

Only about 15 percent goes to families with incomes 3 times the poverty line or greater (families who have relatively high incomes, but receive

only a portion of their income from wages). The U.S. Treasury Department estimates that in 1996 more than two-thirds of the credit will go to families with income under $20,000. Hence the credit directly affects millions of poor families, including the millions in the "dead man's zone" who are not helped by the minimum wage. For a family of four with one earner making $7.00 per hour and working 1,500 hours per year, the EITC fills nearly 80 percent of its "poverty gap," the difference between after-tax earnings and the poverty line.

The EITC has another great advantage, often overlooked by both its sup-porters and its detractors. It is a form of wage insurance for the temporary poor in an era of job instability and earnings insecurity. Stephen Rose (1995b), reprising the method he developed to study strong and weak job attachment, estimated how many families would be eligible for the EITC at least 1 year in 10. The answer is a striking 39 percent. In any single year about 1 in 6 families is eligible for the tax credit, but over a decade, nearly 2 out of 5 families will have a year or more in which their wage income declines sufficiently for them to be eligible for the EITC. Rose finds that 30 percent of all families with a male head of household and 46 percent of families with a female head are eligible in at least 1 year in 10.

The EITC proves particularly useful for younger families, those hardest hit by the falling average wage rates. More than half of families headed by individuals younger than age 36 can benefit from the credit at least some time in a 10-year period. The tax credit may not do anything to reduce the threat of corporate downsizing, but it does help many of its victims. The EITC is life support for the permanent low-wage worker and it is earnings insurance for the middle class.

Shortcomings of the EITC as a Strategy for Reducing Poverty

However good its target efficiency, the EITC does have pitfalls. For one thing, it is of no help to unrelated individuals and childless couples. The maximum benefit they can receive is $324 per year.

An even greater disadvantage, at least politically, is that the EITC is expensive from the perspective of the taxpayer. This year the EITC will

cost the federal treasury nearly $25 billion, and its annual cost is projected to rise with population growth to $30 billion by the year 2000. Its expense is one of the reasons the Republicans, in their zealous attempt to balance the budget by 2002, have targeted EITC for significant cuts despite their previous enthusiastic support for it.

A third problem—one that is plaguing all income support programs from agricultural subsidies to tax deductions—is that the EITC is subject to abuse. Until administrative changes were made in the program, first in 1991 and again in 1995, the "error rate" (which includes waste, fraud, abuse, and error) for the credit was found to be extremely high relative to other IRS provisions. Some families were receiving the credit when they were ineligible; others were receiving more credit than they were legally permitted; still others were receiving less. Some of the errors were due to arcane IRS rules regarding household filing status, a fault that has been repaired. The error rate was also reduced by instituting the practice of cross-checking tax returns with Social Security earnings records. Nonetheless, since there is benefit to be gained from overstating one's income at very low earnings to move up toward the maximum credit on the EITC schedule and there is benefit to be gained from understating income at higher earnings levels to retain the maximum tax credit, there will always be some enforcement issue needing attention—even if it presents the IRS with nowhere near the headache of policing tax compliance among the rich.

The most serious problem with the EITC, however, involves "moral hazard"—the possibility that merely offering insurance leads to adverse behavior on the part of the insured or other actors. For example, people with theft insurance may become less conscientious about locking their house. In the case of the EITC, the moral hazard is often referred to as the "Speenhamland" effect. The EITC not only subsidizes workers, which was its initial intent; it may subsidize low-wage employers, which was not its objective. It permits employers to keep wages low while relying on the federal government to help workers make up the difference between substandard earnings and something approaching a living wage. The British learned this lesson two centuries ago when they imposed an equivalent of the EITC in the form of the infamous Speenhamland provisions. Introduced during the first decades of the industrial revolution, the Speenhamland laws provided benefits to workers to keep them from

starving to death. Almost immediately, employers realized they could drive down wages and have the government pick up the tab for their employees. By the early 1800s the Speenhamland laws were bankrupting local treasuries, and they were repealed. Outdoor relief was also repealed and the workhouse was introduced.

Because the EITC is an implicit subsidy to employers, the credit has yet a fifth shortcoming: it may have an adverse effect on productivity. A wage subsidy tends to reduce the incentive for investment in new technology and capital. If an employer can obtain labor for $0.80 on the dollar, why invest in labor-saving technology?

Finally, because of the subsidy schedule in the EITC, there is an incentive for some workers to increase their work effort, but a disincentive for others. Those whose earnings place them under the maximum EITC benefit have a strong monetary incentive to increase their work effort as long as that effort does not place them on the downward-sloping section of the benefit schedule (see Figure 2). In 1996 a worker with two children employed in a minimum-wage job earned $4.25 per hour before counting the EITC credit. At a 40 percent subsidy rate, the value of an additional hour of work is effectively $5.95 (1.4 x $4.25). As such, on this upward-sloping part of the EITC schedule, there is an EITC-induced incentive to increase work effort. From a social policy perspective, this is good news.

However, as annual wages increase, workers reach the downward-sloping section of the schedule and face a stiff tax rate when they undertake additional work. Above the maximum benefit level, an additional hour of work reduces the subsidy by $0.21 for every additional dollar earned (for workers with two children or more). In this case, an additional hour of work at, say, $8.00 per hour is worth only $6.32 because of the consequent reduction in the EITC subsidy. Adding the income tax rate of 14.0 percent on the extra hour of work and the employee's share of Social Security taxes (7.65 percent), the effective marginal tax rate on that added hour of work is more than 42.0 percent—steeper than the top income tax rate on the very richest Americans and perhaps sufficiently high to dissuade such workers from taking on that additional employment.[10]

How large is the net aggregate impact on work effort of the EITC likely to be? A comprehensive General Accounting Office (GAO) report in 1993

provides such an estimate, based on extrapolations from negative income tax (NIT) experiments carried out in the 1970s in Seattle and Denver on the impact of various tax rates on welfare payments. Five thousand families in Denver and Seattle were split into two groups. Families in one group were given a guaranteed income (instead of welfare) of $4,800. As their income went up, they gradually lost the guarantee. The phase-out was 50 percent, so that a family with a $9,600 income received no grant. Families in the other group received no grant. As theory predicts, individuals who received the grant worked less than individuals who did not. Single mothers and wives reduced their hours of work by 23.0 and 20.7 percent respectively. Men reduced their hours of work, on average, by 12.5 percent.

The GAO argues that the NIT experiments help predict the effect of the EITC because both involve a phase-out range and both pertain to low-income people. But because of a substantially lower phase-out rate under the EITC than in the NIT experiments and because of the positive subsidy rate for the lowest wage earners, the estimated impact on labor supply is much lower for the EITC. The GAO's best estimate is that the EITC reduces work effort by as little as 1 percent, or an average of 24 hours a year, and by no more than 3 percent, or an average of 34 hours. Other research, including that of John Scholz (1995), suggests a small positive effect on labor market participation since the EITC induces some individuals to enter the labor force who would not otherwise do so. On net, then, at worst it is likely that the EITC has a small adverse effect on work effort.

Building an Adequate, Effective, and Efficient "Wage Insurance" Program

It should be clear by now that neither the minimum wage nor the EITC is an ideal solution to the wage poverty problem. Yet when the two are combined, the sum is greater than its parts. Table 3 summarizes the strengths and weaknesses of the two programs. Note the symmetry between them.

On three criteria—income adequacy, target efficiency, and labor demand employment effects—the minimum wage is weak. These are precisely the strengths of the EITC. On four other criteria—labor supply,

Table 3 Strengths and Weaknesses of the Minimum Wage and the EITC

Attributes of Good Social Insurance	Minimum Wage	EITC
Income adequacy	–	+
Target efficiency	–	+
Employment effects (labor demand)	–	+
Employment effects (labor supply)	+	–
Productivity enhancement	+	–
Fiscal impact	+	–
Limited moral hazard	+	–

productivity enhancement, fiscal impact, and limited moral hazard—the minimum wage is clearly the preferred program. What makes the two fit together so well is that the existence of a higher minimum wage actually reduces the negative productivity effect, fiscal impact, and moral hazard of the EITC, while the EITC makes up for the weak target efficiency and income adequacy of the minimum wage. Clearly, the combination of the two makes for good antipoverty policy, especially in an era in which the majority of poor people are working-age adults and job insecurity is on the rise. (See the appendix for estimates of how much the increase in the minimum wage to $5.15 per hour in tandem with the current EITC will help low-income families.)

In a recent paper Robert Greenstein (1996) included the value of food stamps in projecting the minimum wage that would be necessary to pull a family of four to the official poverty line in the year 1998, by which time the full Clinton increase in the minimum wage will have gone into effect. Table 4 shows his estimates for a family with one full-time earner (40 hours

Table 4 How the Minimum Wage, EITC, and Food Stamps Combined Bring a Family of Four Almost to the Poverty Line

Poverty line	$16,997
Minimum wage earnings (2,000 hr at $5.15/hr)	10,300
Payroll (FICA) tax	–788
EITC	3,696
Food stamps	3,760
Total	$16,968

Source: Adapted from Robert Greenstein, *Raising Families with a Full-Time Worker Out of Poverty: The Role of an Increase in the Minimum Wage* (Washington, D.C.: Center on Budget and Policy Priorities, 1996).

per week for 50 weeks) *assuming* no cuts in the food stamp program and an EITC credit adjusted for inflation. It turns out the Clinton minimum of $5.15 just does the trick, with a few cents to spare. This hypothetical family with earnings of $10,300 ends up just below the poverty line of $16,997 as a result of nearly equal amounts of EITC and food stamps. Note, again, that it is a combination of federal programs that elevates family income.

Putting Wage Insurance on a Permanent Footing

By assembling a variety of federal programs in a package of wage insurance benefits, it is possible to lift most families with working members above the poverty line. But over time families will slide down the income ladder again unless the dollar value of the components of the insurance scheme is maintained or enhanced. Under current law the minimum wage is raised only by explicit legislative action, and in recent years it has been a herculean task to get Congress to move on each minimum wage measure. Thus inflation erodes the value of the wage floor in between legislative efforts. Given that the EITC is indexed to inflation, over time the EITC is forced to take on a greater share of the wage insurance burden as the value of the wage floor declines.

To remedy this problem, the minimum wage should be indexed. This could be done by boosting the wage floor annually by the growth rate of nominal average hourly wages for production and nonsupervisory employees. If indexing had been instituted in 1991, when the minimum wage was raised to $4.25, the wage floor would have reached $4.84 today without the need for legislative action. Given expected increases in the nominal average hourly wage, the minimum wage would have reached $5.14 in 1998, just shortly after the full $5.15 Clinton minimum is scheduled to go into effect. If the minimum wage is indexed to average wages, the lowest-paid workers will at least keep pace with other workers, limiting the growth in earnings inequality. If the tax indexing of EITC is maintained, family incomes will continue to be at least partially insured against rising costs.

Such a long-run approach to wage insurance may require a major political effort, particularly because all of the elements of the scheme come under legislative attack periodically. The Welfare Reform Bill passed this year in

Congress and signed by the president includes $23 billion in food stamp reductions between 1997 and 2002, amounting to an 18 percent cut in recipient benefits. By far the hardest hit will be legal immigrants, most of whom will lose their eligibility for food stamps when the welfare reform bill goes into effect. For legal immigrant families whose income comes solely from the earnings of a full-time, minimum-wage worker, the loss in food stamp benefits amounts to $3,798. This loss is more than double the gain from the Clinton increase in the federal wage floor; the combination of the higher minimum wage and lower food stamps benefits leaves such families more than $2,100 poorer. For nonimmigrant families with a min-imum-wage income, the loss in food stamps benefits amounts to a little over $200. For these families the $0.90 increase in hourly wages promised by the hike in the wage floor ends up being closer to $0.73 after added FICA taxes and the lost food stamps benefits are deducted.[11]

On top of the food stamp cuts, the EITC program is slated to lose $18.5 billion between now and the year 2002 under the 1996 congressional budget resolution (Parrott, Super, and Steinmetz 1996). This will be particularly burdensome, for the stated objective of welfare reform is to move millions of AFDC families off the public assistance rolls. Forced to work, many former AFDC recipients will become even more dependent on food stamps and more families will be eligible for EITC, despite the legislated cut in the former and the current legislative attempt to reduce the latter. While wage insurance is an idea whose time has come, the current politics of welfare reform and budget cuts suggest that what is given with one hand (a higher minimum wage) is undercut by what is taken away with the other (food stamps, EITC).

As is true for any insurance scheme, the ultimate objective should be to improve conditions so that the insurance is less and less needed. Improvements in roads and the safety features on motor vehicles should reduce the cost of auto insurance, a reduction in crime should lower home insurance premiums, good preventive health care should reduce medical insurance premiums, and equitably distributed rising wages should reduce both the number of workers forced to rely on the mini-mum wage floor and the cost of the EITC program. Hence, fashioning a full employment macro policy should be thought of as part of the overall approach to wage insurance. Similarly, efforts to improve education and training programs, expand community economic development efforts,

increase unionization, and move toward comparable pay for men and women can reduce the long-run cost of wage insurance. In the meantime, in an era of stagnating wages, increasing income instability, and rising working-age adult poverty, legitimizing the concept of wage insurance seems to be the next logical step in dealing with important issues of social equity.

Appendix. How Raising the Minimum Wage and Keeping the EITC Intact Helps Working Families Put Food on the Table

Assume a family (Family 1) with two children and one adult earner working 1,500 hours per year at the old ($4.25) minimum wage (see Table 5). At this wage floor the family would have a total annual income of just $5,887 (after subtracting its share of FICA taxes), excluding its EITC. The EITC alone boosts this family's income to $8,437. Lifting the minimum wage to $5.15 per hour raises after-tax earnings to $7,027 and total income to $10,071, even if we take into account the highest possible hours displacement effect (1.5 percent) due to the boost in the minimum wage. Overall, the family's income is raised by 71 percent as a result of the higher minimum wage and the tax credit. Raising the minimum wage boosts family income by $1,140; the increase in EITC benefits due to higher earnings adds another $494.

Family 2 in Table 5 has two children and one adult earner working 1,500 hours per year at a job that pays $6.00 per hour, more than both the old and new minimum wages. However, passage of a higher federal wage floor is expected, using the wage contour estimate of Spriggs and Klein (1994), to raise this worker's pay to $6.60 per hour. The increase in the minimum wage increases family income by $831 net of FICA taxes. Because the worker's earnings fall within the flat part of the EITC schedule, there is no change in the size of the wage subsidy. Overall, the annual income of Family 2 is 53 percent higher than it would have been if there were no EITC and the minimum wage had remained $4.25 an hour.

Family 3, also with two children, has one adult earner working 1,500 hours per year, but at a job that pays $7.00 per hour. We assume no increase in this wage rate even after the federal minimum is increased. While the minimum wage has no impact on this family's income, the

Table 5 Simulations of Income for Four Families

Family 1. Two children; one adult earner working at minimum wage, 50 weeks per year, 30 hours per week

	Hourly Wage and Hours Worked	Earnings	Earnings after FICA	EITC	Total
Old minimum wage and no EITC	$4.25 x 1,500 hr	$6,375	$5,887	$0	$5,887
Old minimum wage and EITC	$4.25 x 1,500 hr	$6,375	$5,887	$2,550	$8,437
New minimum wage and EITC	$5.15 x 1,477.5 hr	$7,609	$7,027	$3,044	$10,071

Increased minimum wage and EITC raises family income by 71 percent after FICA taxes.
Increased minimum wage adds $1,140 (net of FICA taxes) to family income.
Increased EITC due to higher earnings adds $494 to family income.

Family 2. Two children; one adult earner working at just above minimum wage, 50 weeks per year, 30 hours per week

	Hourly Wage and Hours Worked	Earnings	Earnings after FICA	EITC	Total
Old minimum wage and no EITC	$6.00 x 1,500 hr	$9,000	$8,312	$0	$8,312
Old minimum wage and EITC	$6.00 x 1,500 hr	$9,000	$8,312	$3,560	$11,872
New minimum wage and EITC	$6.60 x 1,500 hr	$9,900	$9,143	$3,560	$12,703

Increased minimum wage and EITC raises family income by 53 percent after FICA taxes.
Increase in minimum wage adds $831 (net of FICA taxes) to family income.

Family 3. Two children; one adult earner working at $7.00 per hour, 50 weeks per year, 30 hours per week

	Hourly Wage and Hours Worked	Earnings	Earnings after FICA	EITC	Total
Old minimum wage and no EITC	$7.00 x 1,500 hr	$10,500	$9,697	$0	$9,697
Old minimum wage and EITC	$7.00 x 1,500 hr	$10,500	$9,697	$3,560	$13,257

Increased minimum wage adds no income, but EITC raises family income by 37 percent after FICA taxes.

(Continued)

Table 5—*Continued*

Family 4. Two children; two adult earners, each working at minimum wage, 50 weeks per year, 30 hours per week

	Hourly Wage and Hours Worked	Earnings	Earnings after FICA	EITC	Total
Old minimum wage and no EITC	$4.25 x 3,000 hr	$12,750	$11,775	$0	$11,775
Old minimum wage and EITC	$4.25 x 3,000 hr	$12,750	$11,775	$3,323	$15,098
New minimum wage and EITC	$5.15 x 2,955 hr	$15,218	$14,054	$2,805	$16,859

Increased minimum wage and EITC raises family income by 43 percent after FICA taxes.
Increase in minimum wage adds $2,279 (net of FICA taxes) to family income.
Increased minimum wage reduces federal government EITC liability by $518.

Note: These simulations assume a 1.5 percent reduction in hours worked for earners working at the minimum wage as a result of raising the minimum wage from $4.25 to 5.15 per hour. They also assume that workers who are presently earning no more than $1.00 over the new $5.15 minimum wage will receive a 10 percent wage increase as a result of employers' interest in maintaining wage differentials within the firm.

addition of the EITC does. Family 3 is eligible for the maximum EITC benefit so that its income after FICA taxes is 37 percent higher than it would be in the absence of the wage subsidy.

Finally, we have Family 4, also with two children, but with two adult earners, each working 1,500 hours per year at the old ($4.25) minimum wage. Boosting the minimum wage to $5.15 increases family income by nearly $2,300 net of FICA taxes. In this case, raising the minimum wage also benefits the federal treasury through savings on EITC. The higher minimum wage puts Family 4 on the downward-sloping section of the EITC schedule, resulting in a reduction of $518 in tax credits. The net increase in family income from raising the federal wage floor is 43 percent, despite the loss of some EITC income. It should be clear from Table 5 that all of these families have improved their incomes substantially because of the *combination* of an improved minimum wage and the present EITC program.

Notes

1. Weinberg (1995) noted that 1994 marked the first year since records have been kept when the proportion of people aged 18 to 64 who are poor (11.9 percent) exceeded the proportion of elderly who are poor (11.7 percent). As late as 1970, the elderly poor proportion was two and a half times the poverty rate for nonelderly adults.

2. In support of the promise of full employment as an antidote to low wages and poverty, one can argue that we have not really tried full employment yet. Millions of new jobs are created every year and the official national unemployment rate has been below 6 percent for more than two years. Nonetheless, the argument goes, there is still enormous slack in the labor market and therefore no real pressure to boost wages. The use of temporary, part-time, and other contingent workers increases the number of reported jobs, yet reduces upward pressure of wages. Aaron Bernstein reported in *Business Week* (1996) that according to the Conference Board, the national help-wanted index has risen from its low level during the 1990–1991 recession, but it is still nearly 25 percent below its 1988 level, when aggregate unemployment was about equal to today's 5.6 percent. Bernard Wysocki in *The Wall Street Journal* (1995) reports that about a million men aged 25 to 55 left the labor force during 1995 and 1996 and therefore do not show up in the unemployment statistics at all. Many of these left, often following layoff from a well-paying job, because they were discouraged by their employment opportunities. Lester Thurow (1996) has tried to estimate the "real" unemployment rate taking into account discouraged workers and part-timers who desire full-time jobs. His estimates suggest a current "real" unemployment rate of 14 percent. Hence, we do not know to what extent real full employment might lift wages. The problem is that no one, surely not the Federal Reserve Board, is going to promote policies to drive the official unemployment rate down much below present levels.

3. Current plans to revamp the welfare system will almost assuredly swell the ranks of the working poor even further. The bipartisan steamroller to "end welfare as we know it" has a single, overarching aim: to reduce welfare dependency by requiring welfare mothers to find work. Already states are being granted federal waivers to experiment with programs that require AFDC mothers to take jobs or lose benefits. In some states, such as Wisconsin and Massachusetts, the forced entrance of welfare recipients into the labor market is already under way. Few of these former recipients can expect to find jobs that pay enough to lift their families out of poverty.

4. Mishel and Bernstein (1994) show that production and nonsupervisory workers make up more than 80 percent of wage and salary workers. The remaining workers are primarily executives, managers, and the self-employed.

5. Note that although the real average income per capita for the bottom quintile fell by nearly 23 percent between 1973 and 1994, the average income for households in that quintile fell by "only" 7 percent over a roughly comparable period. What is responsible for this difference is the change in household composition in the bottom quintile since the 1970s. There are fewer one- and two-person elderly households in the quintile

and more larger families with children. Hence, per capita income has fallen much more than household income in the bottom quintile.

6. The gains from additional tax revenue and welfare payment reductions will more than likely offset any increase in state and federal unemployment benefits, even if the minimum wage has some negative employment effect.

7. Monopsony is a market situation in which there is one buyer, in contrast to a monopoly, in which there is one seller. Monopsony in a labor market may result from limited job search by workers and not simply from limited numbers of potential employers. In a pure monopsonistic labor market, workers have no power. A single employer—or a group of employers in a situation of limited employee job search—can force wages down below the workers' marginal product. The establishment of a minimum wage in this case will simply shift some of the excess profit from the employer to the workers.

8. A recent study of working welfare mothers by Spalter-Roth, Burr, Hartmann, and Shaw (1995) shows that low-wage workers change jobs on average every 14 months. The turnover rate among teenage workers is probably even higher.

9. While target efficiency is not one of the strengths of the minimum wage, one should not lose sight of the fact that raising the minimum wage still provides real help to low-income families. According to an Economic Policy Institute study, 40 percent of the gains from the proposed Clinton wage hike would go to the poorest 20 percent of working families—those with annual incomes less than $22,000 in 1993. These are clearly deserving families, even if only about half this number are below the official poverty line.

10. The high marginal "tax" rate on the EITC is necessitated by the need to phase out the EITC for families with two children earning more than $28,495. A lower benefit reduction rate would extend the EITC to families with much higher incomes and become prohibitively expensive to the federal treasury. For example, given the current parameters for the EITC schedule for a family with two children, a phase-out rate of only 15 percent rather than 21.06 percent would make a family with earnings of up to $35,317 eligible for the EITC. A 10 percent phase-out rate would extend the benefits of the EITC to families with as much as $47,170 in annual earnings.

11. The minimum wage boost increases the income of a family with a full-time earner by $1,662 net of increased FICA taxes. The food stamp cut reduces that family's net purchasing power by $204. Thus, the $1,800 gross increase in pay for a full-time worker is offset by $138 in added Social Security taxes and a legislated $204 cut in food stamps. The net gain is $1,458. The promise of the increased minimum wage is worth about 81 cents on the dollar! These calculations are based on unpublished statistics from the Center on Budget and Policy Priorities.

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