NATIONAL CENTER FOR POLICY ANALYSIS

Lifting Workers Out of Poverty: The Minimum Wage versus the Earned Income Tax Credit

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San Francisco, Los Angeles, Seattle and New York State have all taken steps to establish a $15 an hour minimum wage. However, a $15 minimum wage will do far less to raise people out of poverty than the Earned Income Tax Credit (EITC) does currently.

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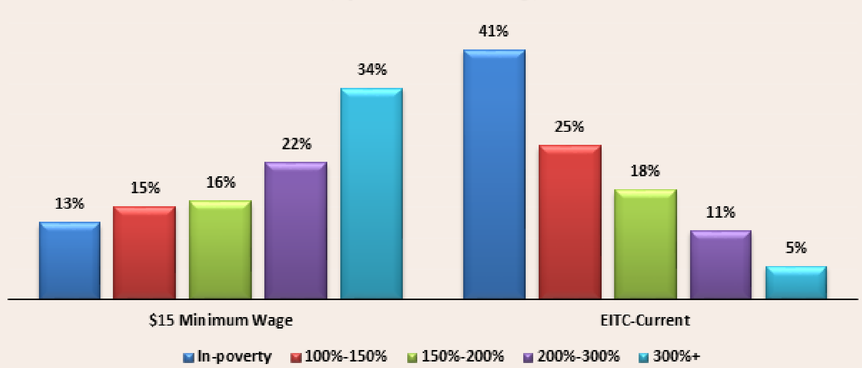
That is because the EITC efficiently targets those in poverty and does not distort the labor market. An individual is eligible for the EITC, either as a lump sum or advanced periodically by check, if he or she has an earned income below the ceiling set for their family size. Couples and families with children are eligible for a larger credit than single individuals.

Distribution of Beneficiaries. The purported goal of a large increase in the minimum wage is to raise the incomes of the poor and lift them into the middle class. Estimates from the Current Population Survey (CPS) show that about a quarter of workers earn less than $15 per hour. But the workers who would benefit are largely not poor [see Figure I]:

- Thirty-four percent of the workers who would earn the $15 minimum wage live in a household making three times the poverty level, which translates to $72,750 a year for a family of four.
- Almost 60 percent of the new minimum wage workers live in households with incomes twice the poverty level or higher, or $48,500 for a family of four.

Figure I
Percentage of Households Who Benefit
(by Income Group)



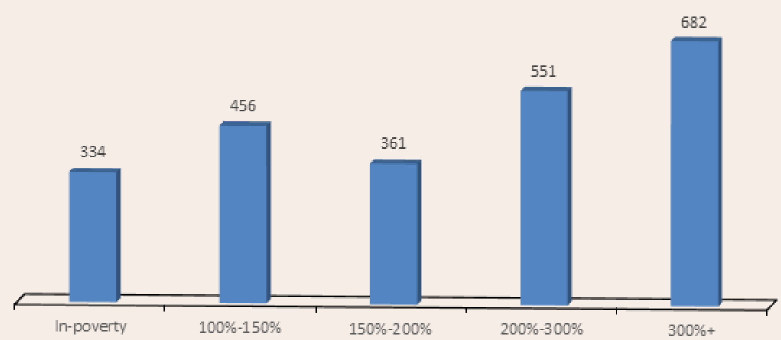
Source: Author's calculations based on the Current Population Survey, March 2014 supplement.

In contrast, the EITC supports the working poor in a much more targeted way:

- Two-thirds of those benefiting from the earned income tax credit (EITC) earn less than 1.5 times the poverty level.
- This includes a single parent earning less than $24,000 a year or a single person earning $17,000 or less.

Minimum Wage Employment Effects. According to economists David Neumark and William Wascher, a 10 percent increase in the minimum wage, say from $7.50 to $8.25, will result in a 1 percent to 3 percent decrease in employment among the affected workers.

Figure II
Job Losses by Percentage of Federal Poverty Level (Thousands of Jobs)



Source: Author's calculations based on the Current Population Survey, March 2014 supplement.

Using the March supplement of the 2014 CPS and restricting the sample to workers who would be affected (those earning under $15 per hour), it can be estimated that:

- The average hourly wage increase for the affected group of workers would be 39 percent.
- Under conservative assumptions, employment among affected workers would fall 5 percent.

Many supporters of the minimum wage hike would point to the average wage increase of 39 percent as a positive result that outweighs the 5 percent decrease in employment. However [see Figure II]:

- A 5 percent decrease in employment amounts to 2.4 million jobs lost.
- Taking into account household size, 7.5 million people would be affected.
- Further, a loss of 2.4 million jobs would increase the current (5.3 percent) U.S. unemployment rate to 7 percent.

The negative employment effects should be concentrated in areas with lower wage rates and lower costs of living. Thus, if the federal minimum wage is hiked to $15 an hour:

- Workers living in non-metropolitan areas would be 21 percent more likely to lose their jobs than those living in metropolitan areas.
- They would be 33 percent more likely to lose their jobs than those living in the New York City and Los Angeles metropolitan areas.

EITC Employment Effects. The EITC increases the income of those who work and increases employment for those who, without the increased returns to working, would otherwise choose not to work. Economists Austin Nichols and Jesse Rothstein found that, for example, a $1,000 increase in the EITC would lead to a 4 percent to 15 percent increase in employment.

Poverty Effects. The President's Council of Economic Advisers and the U.S. Census Bureau estimated that in 2013 alone the EITC was responsible for lifting 9.1 million Americans out of poverty.

Applying a $15 per hour wage to the number of hours worked last year by those below the poverty threshold shows that an increase in the minimum wage could be expected to lift 4.1 million Americans out of poverty. However, randomly assigning job losses with a probability equal to the employment elasticity associated with each worker's wage increase, the estimated flow of workers and families into poverty range from 600,000 to 1.1 million workers, and a total of 1.9 million to 3.75 million individuals.

Conclusion. Because negative employment effects offset wage increases, the minimum wage is projected to alleviate poverty for only 0.1 percent to 0.5 percent of the population, whereas the EITC currently alleviates poverty for 3 percent of the population. Thus, the EITC is a preferable tool for fighting poverty because it encourages individuals to earn income and develop employable skills.

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