Boosting the poverty-fighting effects of the minimum wage

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In the past five years, there has been a large increase in the number of states, counties, and cities that have established minimum wage laws that exceed the federal minimum wage of $7.25 per hour. Although many of these minimum wage laws explicitly state an intention to reduce poverty, the effects of minimum wage increases to date on poverty rates appear to be small at best. In order to make the minimum wage a more effective poverty-reduction tool, we recommend raising the federal minimum wage to $12.00 per hour, and using employer tax credits to offset any disemployment effects of the higher wage. Since this plan would increase tax revenue without increasing administrative costs, we recommend using the additional funds to allow minimum wage workers to continue to benefit from public income supports at higher income levels in order to "make work pay," and remove barriers to upward mobility.

Minimum wage trends

The first federal minimum wage was established in 1938 as part of the New Deal. The most recent increase to the federal minimum wage was in 2010, when it was raised from $6.55 to $7.25 per hour. However, the real value of the minimum wage has been on the decline since 1968, the last time it was increased to match the inflation rate. States, counties, and cities are permitted to set their own minimum wage rates at a level above the federal rate; a growing number are doing so at an increasingly high level compared to the federal minimum. For example, in 2011, 13 states had minimum wages above the federal minimum; on average, these state minimum wages were about 8 percent higher than the federal rate of $7.25. By 2016, 30 states and the District of Columbia had established minimum wages that ranged from $7.50 to $10.50, and averaged about 20 percent higher than the federal minimum. In addition, since 2012 at least 46 cities and counties have passed minimum wage laws that are higher than their state minimum; these range as high as $15.00 per hour. Overall, we calculate that around 60 percent of the U.S. population now lives in a state or locality with a minimum wage of more than $7.25.

Effects of the minimum wage on poverty

Research on the poverty-reducing effects of minimum wage laws has produced mixed results, but at best minimum wage increases have been associated with small decreases in poverty.[1] While measurement issues may explain some of these results, we believe that there are three primary reasons that the minimum wage is not associated with larger poverty decreases: (1) imperfect targeting of the minimum wage to the poor or near poor; (2) job loss or reductions in hours as a result of wage increases; and (3) interactions with income support programs that base eligibility and benefit levels on earnings and income.

Minimum wage laws do not target poor and near-poor individuals as effectively as many means-tested benefit programs; nonetheless, our research finds that they do disproportionately benefit disadvantaged workers, including women and persons of color (groups that have higher rates of poverty than the general population). In addition, our analysis of how poverty rates vary with wages indicates that increasing the minimum wage to at least $12.00 per hour would improve the targeting of this policy to reduce poverty even more.

A second mechanism that could restrict the poverty-reducing effects of the minimum wage is its disemployment effects. There is some evidence that decreases in poverty associated with an increase in the minimum wage could be partially or completely offset by concurrent increases in poverty resulting from reductions in employment and hours.[2]

The third, and we argue, most important reason why the minimum wage may not significantly decrease poverty has to do with the interaction between earnings and public assistance receipt. Low-income workers and their children can access a variety of in-kind and cash income supports to supplement their earnings. Eligibility and benefit levels for these income support programs are based on earnings and other income, and may phase out as income levels rise above a certain level. This interaction between earnings and income supports is known as an "implicit marginal tax rate." At low income levels, where work-related tax credits are phased in as earnings rise, the marginal tax rate is negative, meaning that an increase of one dollar in earnings results in more than one additional dollar of income, including in-kind and cash income supports. As income levels rise, the marginal tax rate becomes positive, so that an additional dollar of earnings raises income by less than one dollar, due to a loss of in-kind and cash income supports. Very high marginal tax rates can create a disincentive to work more or at a higher wage, which could restrict upward mobility.[3]

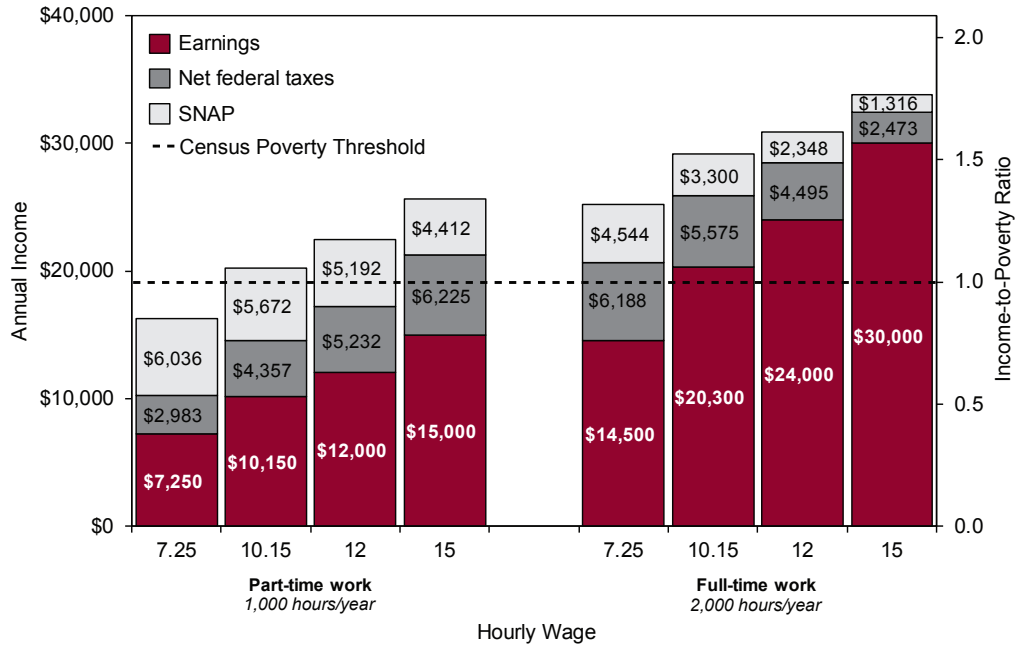

Figure 1. Annual income-to-poverty ratios for a household of one adult and two children.

Source: Authors' calculations.

Notes: Figure reflects 2016 tax and benefit amounts. Net federal taxes include Earned Income Tax Credit, Child Tax Credit, income tax liability, and worker's nominal portion of FICA payroll tax. Supplemental Nutrition Assistance Program (SNAP) benefits calculated based on average of calculators for three states. The poverty threshold is calculated by the Census and published each year.

The effects of marginal tax rates are illustrated in Figure 1, which shows income-to-poverty ratios for a one-adult-and-two-child household at various wage levels, for both half- and full-time work, using income from earnings plus the income support programs most commonly used by low-income working families: the Earned Income Tax Credit (EITC), the Child Tax Credit (CTC), and the Supplemental Nutrition Assistance Program (SNAP).[4] An increase from $7.25 to $10.15 for a half-time worker raises his or her annual earnings by $2,900, and annual income (including net taxes and the value of SNAP benefits) by $3,910, reflecting a marginal tax rate of about 35 percent. In contrast, if a full-time worker's wage rises from $12.00 to $15.00, his or her annual earnings rise by $6,000, but annual income rises by only $2,946, a marginal tax rate of over 50 percent.

Rising marginal tax rates are even more dramatic for families who receive housing and childcare assistance in addition to the benefits reflected in Figure 1. For families who receive these two benefits, full- or part-time work at the current federal minimum wage level puts them above the poverty line, but they also experience very steep marginal tax rates. For example, a full-time worker moving from a $12.00 to $15.00 wage would be subject to a marginal tax rate of 95 percent, with nearly every dollar of additional earnings offset by a dollar lost in other income, so that even with a $6,000 increase in annual earnings, their total annual income would increase by only $306.

Figure 1 also shows that it is the combination of a higher wage with the tax credits and SNAP that successfully raises total family resources above the poverty line. When the value of the tax credits and SNAP is added to earnings, families with one half-time worker can rise above the poverty line with a wage of $10.15 or higher, while families with a full-time worker are above the poverty line at any wage.[5]

What can be done to increase the poverty-fighting effects of the minimum wage?

We believe that individuals and families should be able to achieve an income above the poverty line with full-time work, or with half-time work combined with income supports such as tax credits and SNAP.[6] Further, low-income families should see their income rise as their wages rise, rather than having gains nearly entirely offset by decreases in income supports.

We propose that these goals be achieved by raising the federal minimum wage to $12.00 per hour, phased in over a period of two years, and keeping the rate indexed for inflation over time. This wage level would allow a family of two adults and two children to earn enough with full-time minimum wage earnings to be above the poverty line. In combination with SNAP and net federal tax credits, a half-time single worker with three or fewer children would also have an income

above the poverty line. The two-year phase-in period would allow employers flexibility in deciding when and by how much to raise wages in order to best absorb higher personnel costs. Indexing the minimum wage for inflation is crucial, as it would preclude the need for such large increases in the future.

Evidence from past state and federal minimum wage increases suggests that an increase from $7.25 to $12.00 could lead to reductions in employment. In order to avoid this, we propose offering temporary subsidies to employers of low-wage workers who hire and retain workers at a higher wage during the two-year transition period. This could be done by expanding the Work Opportunity Tax Credit program, which currently provides tax credits to employers who hire from particular target groups such as veterans, SNAP recipients, and released felons.

Our cost estimates indicate that a $12.00 minimum wage would increase net federal tax revenues, resulting in a net savings of $19.3 billion for the federal government. We propose that these additional funds be used to lower marginal tax rates below 50 percent for low-income workers, in order to make work pay as earnings increase. There are a number of different ways that this could be done. For example, the EITC phase-out rate could be reduced. The CTC could also be increased to offset high marginal tax rates in other safety net programs. Alternatively, in-kind supports such as housing and childcare could be expanded to benefit more families.

Evidence suggests that a $12.00 federal minimum wage, accompanied by temporary, targeted public investments would better target poverty than the current $7.25 rate, and would lead to net savings that could be used to make work pay for low-income families.■

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[1]A. Dube, "Minimum Wages and the Distribution of Family Incomes," IZA Institute of Labor Economics discussion paper, No. 10572, February 2017.

[2]D. Neumark and W. L. Wascher, "Minimum Wages and Employment," *Foundations and Trends in Microeconomics* 3, No. 1–2 (2007): 1–182.

[3]J. L. Romich, "Difficult Calculations: Low-Income Workers and Marginal Tax Rates," *Social Service Review* 80, No. 1 (2006): 27–66.

[4]Figure 1 assumes no change in employment as a result of wage changes, it illustrates only the mechanical effect of different minimum wages given a specific number of hours worked.

[5]While the figure shows results only for a household of one adult and two children, this is also true for households with two adults and up to three children.

[6]Because low-wage workers are disproportionately likely to have variable and unpredictable hours, and parents need to balance employment and parenting, we believe that half-time work is an appropriate expectation.

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