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FACTS AT A GLANCE **March 20th, 2014**

Rewarding Work: The Minimum Wage and Tax Credits

Both the minimum wage and income enhancement programs like the Earned Income Tax Credit (EITC) are important tools for reducing poverty and boosting incomes among low-income working families. Because these two tools operate in different ways, however - and therefore, in part, have differing effects on different groups of low-income workers - it is important that each remains strong. EITC increases are most effective as a supplement to and not a substitute for a strong minimum wage.

The EITC and A Strong Minimum Wage Work Best Together

The Earned Income tax Credit (EITC) is an important and successful program, one that delivers meaningful support to millions of low-income working families nationwide; in 2012, for example, the EITC lifted some 6.5 million people out of poverty, half of them children.[i] Because the program is specifically designed to focus benefits on low-income households with children, however, many childless low-income workers receive little or no support from the EITC. Additionally, the EITC can create downward pressure on low-end wages. By increasing the after-tax incomes of many low-income households, the EITC allows these workers to accept lower wages than otherwise would be possible, potentially pushing down the hourly wage rate that low-wage employers must pay to attract and retain employees.[ii] The minimum wage pushes back against this potential wage decline. It sets a solid wage floor for all low-income workers and thus couples well with the many positive aspects of the EITC.

Another challenge arises when we rely too heavily on the EITC to lift incomes for low-wage working families: we have finite public resources and it would be costly to boost these families' incomes primarily through the tax code rather than primarily with wage increases. Doubling the state's EITC match rate to 30 percent of the federal credit, for example, would cost the Commonwealth about $130 million more a year, a significant increase in funding for this important program.[iii] Even still, this increase would provide, on average, only another $450 or so annually for families with children and a maximum increase of about $900 annually (for a married couple with three children earning less than $22,870 and more than $13,430). [iv] While very important for these low-wage working families, this increase doesn't substitute for adequate wages.

Because the minimum wage has not kept pace with inflation, a full time minimum wage worker now makes about $5,400 a year less than in 1968. (See MassBudget's report, "What's It Worth?") Each year that the minimum wage is not adjusted, the real annual wage for such a worker declines by about another $450 (assuming the wage has been restored to $10.50).[v] Importantly, the research shows that the cost of modest increases in the minimum wage can be and is absorbed in a variety of ways, including reduced staff turnover (which reduces recruitment and training costs), greater worker efficiency and small price increases, among other responses.[vi]

Special Business Tax Credits Do Not Improve Minimum Wage Increases

Other attempts to use tax credits to offset the costs of minimum wage increases can create their own set of problems, particularly when those tax credits are directed toward low-wage employers. One example is a tax credit in New York that refunds to businesses a portion of the wages they pay to teen workers earning the minimum wage. Specifically, a fixed portion of the hourly wage increase that is paid to a teen worker is refunded to the employer as long as the teen is paid no more than the minimum wage. This policy was initiated in response to an increase in New York's state minimum wage. The concern was that, with the wage increase, employers would be "over-paying" for less-skilled, less-productive teen employees - and in response, employers would reduce their hiring of teen workers.[vii]

The research consensus, however, is that modest minimum wage increases – of a couple of dollars - have little or no impact on the hiring levels of teens or other workers.[viii] Furthermore, the particular *structure* of the New York tax credit creates added problems for teen and adult low-wage workers. It creates strong incentives for businesses to cap their teen workers' hourly pay at the minimum wage – effectively creating a wage "ceiling" rather than a wage floor; creates incentives for business to hire teens in place of adult workers; and places downward pressure on the wages of non-teen workers. [ix]

Additionally, like other tax credits, the lost revenue is a cost to taxpayers, no different in its fiscal impact than direct spending on programs and services. New York's teen minimum wage credit costs the state's taxpayers millions of dollars annually in lost revenue. In summary, business tax credits like the one adopted in New York are an unproductive, problematic and costly accompaniment to minimum wage increases.

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[i] Center on Budget and Policy Priorities, "Policy Basics: The Earned Income Tax Credit," January 2014: http://www.cbpp.org/cms/?fa=view&id=2505

[ii] Political Economy Research Institute, "Combining Minimum Wage and Earned Income Tax Credit Policies to Guarantee a Decent Living Standard to All U.S. Workers", October 2010: http://www.peri.umass.edu/236/hash/9b8a787cfa16226190e4f96e582348cd/publication/428/

[iii] Massachusetts DOR, *Tax Expenditure Budget FY15* (TE item 1.605): http://www.mass.gov/dor/tax-professionals/news-and-reports/state-budget-documents/tax-expenditure-budget/

[iv] $450 estimate is about 15% of the average family credit in 2011 (see http://www.cbpp.org/cms/?fa=view&id=2505) Maximum credit increase ($907) is equal to 15 percent of federal maximum, which will be $6,044 for tax year 2013.

[v] At this wage a fulltime worker would earn $21,000 a year. CBO projects inflation in 2017 of 2.2 percent or $462 of this worker's annual earnings.

[vi] Center for Economic Policy Research, "Why Does the Minimum Wage Have No Discernible Effect on Employment?", February 2013: http://www.cepr.net/index.php/publications/reports/why-does-the-minimum-wage-have-no-discernible-effect-on-employment

[vii] Fiscal Policy Institute, blog post, March 25, 2013: http://fiscalpolicy.org/the-many-problems-with-new-york%E2%80%99s-proposed-minimum-wage-reimbursement-credit

[viii] Center for Economic Policy Research, "Why Does the Minimum Wage Have No Discernible Effect on Employment?", February 2013: http://www.cepr.net/index.php/publications/reports/why-does-the-minimum-wage-have-no-discernible-effect-on-employment

[ix] Fiscal Policy Institute, blog post, March 25, 2013: http://fiscalpolicy.org/the-many-problems-with-new-york%E2%80%99s-proposed-minimum-wage-reimbursement-credit
For more on the adverse effects of "Teen Training Wages", see the National Employment Law Project's factsheet, February 2014: http://www.nelp.org/page/-/rtmw/Fact-Sheet-Training-Wage-Loophole.pdf?nocdn=1