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State Earned Income Tax Credits and Minimum Wages Work Best Together

By Erica Williams

As state legislative sessions begin, policymakers can help build an economy that works for everyone by adopting or strengthening two policy tools at their disposal: state earned income tax credits (EITCs) and state minimum wages. These are the twin pillars of making work pay for families that earn low wages. They boost income, widen the path to the middle class, and reduce the gap between high- and low-income households. They help women and communities of color — two groups that disproportionately work in low-wage jobs — see the fruits of their labor and share more fully in economic growth. And they help build a stronger future economy by putting children on a better path in life. The increased income helps working parents better meet the needs of their children, and as a result those children do better in school and earn more in adulthood.[1]

Strengthening *either* a state's minimum wage *or* a state EITC will boost incomes for low-wage working families, but these improvements are particularly effective in combination:

- **State minimum wages and EITCs reach overlapping but different populations.** Each supports families and individuals that the other doesn't reach. For example, EITCs primarily target low-income families with children and are available to working families earning up to more than three times a full-time minimum wage worker's annual salary of $14,500. The minimum wage, in contrast, targets the very lowest-wage workers, regardless of factors like total family income, family status, or age.
- **Increasing both at the same time provides added support to the working families who need it most.** Together, a minimum wage boost and a robust state EITC can move families beyond poverty and further down the road to economic security. A minimum wage increase provides the added benefit of increasing the EITC for some families.

[1] See discussion of the research in Chuck Marr, Chye-Ching Huang, and Arloc Sherman, "Earned Income Tax Credit Promotes Work, Encourages Children's Success at School, Research Finds," Center on Budget and Policy Priorities, updated October 1, 2015, http://www.cbpp.org/cms/index.cfm?fa=view&id=3793.

- **Workers receive the benefits of the two policies on different schedules.** An expanded minimum wage increases every paycheck, which helps workers cover routine expenses like food, monthly bills, and rent. State EITCs are paid at tax time and can be used for larger, one-time expenses, like car repairs or a security deposit.
- **A combination allows the public and private sectors to share the cost of boosting workers' incomes.** The EITC's cost is largely borne by state government, and by extension state taxpayers. The state minimum wage is borne principally by the private sector, especially employers and consumers. Improving both policies spreads the cost of making work pay more broadly than does either policy alone.

Recent improvements to the federal EITC and the federal Child Tax Credit (CTC), as well as less recent increases in the federal minimum wage, have helped many low-income working families across the country move closer to or above the poverty line. But we need to do more to get working families and individuals on a path to financial stability and self-sufficiency. State lawmakers can use their own policy tools to help keep people working, increase incomes, and reduce financial hardship.

Many states have raised their minimum wage in the past couple of years, and a few states have strengthened their EITCs. In 2014, three states — **Maryland, Minnesota,** and **Rhode Island** — and the **District of Columbia** did both; **Rhode Island** expanded both in 2015 as well. Other states also should look to advance the two policies in tandem for the biggest impact.

Wages Have Stalled for Low-Wage Workers

Low wages make it hard for working families to afford basics like decent housing in safe neighborhoods, nutritious food, reliable transportation, and quality child care, as well as educational opportunities that can move working families toward the middle class. But the wages of workers paid the least are no higher than they were 40 years ago, after adjusting for inflation.

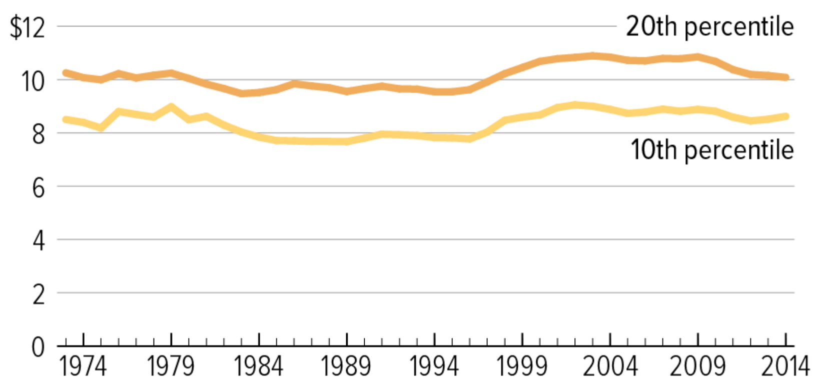
For the most part, wages have stagnated or declined over this period, with the only period of sustained growth coming from the late 1990s to the early 2000s.[2] In 2014, for example, the 20th percentile wage (that is, the wage that exceeds the bottom 20 percent of wages) was 1.7 percent lower than in 1973 and about 6.5 percent lower than in 2007. (See Figure 1.) Wages at the bottom have fallen back to their early 1970s levels even as productivity has grown; in other words, many workers are not sharing in the benefits of economic growth.

[2] Josh Bivens, Elise Gould, Lawrence Mishel, and Heidi Shierholz, "Raising America's Pay: Why It's Our Central Economic Policy Challenge," Economic Policy Institute, June 4, 2014, http://www.epi.org/publication/raising-americas-pay.

FIGURE 1

Wages for Low-Paid Workers Same as 40 Years Ago

Hourly wages at the 10th and 20th percentiles of the wage scale, adjusted for inflation



Note: At the 10th percentile of the wage scale, 90 percent of American workers earn more in wages. At the 20th percentile, 80 percent of American workers earn more in wages

Source: Based on data from the Economic Policy Institute's "Raising America's Pay"

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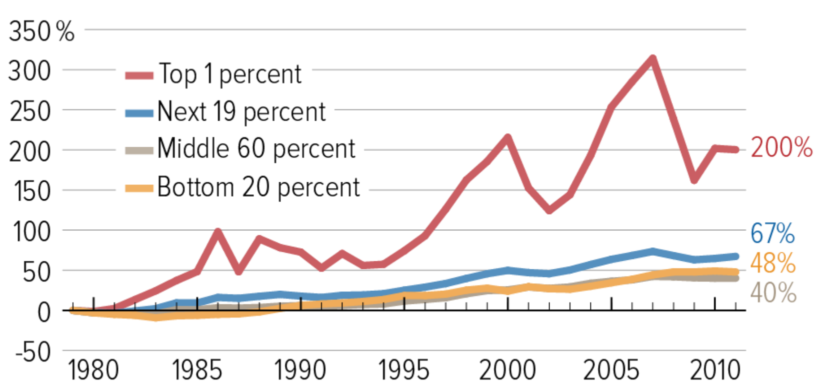
Instead, those benefits have been concentrated at the top. Looking at income from all sources, after taxes and adjusted for inflation, the richest 1 percent of households have seen extraordinary income growth since 1979, peaking at 314 percent in 2007. The Great Recession substantially reduced these gains, but incomes still grew four times faster for the top 1 percent of households than for the poorest households between 1979 and 2011. (See Figure 2.)

FIGURE 2

Income Gains at the Top Dwarf Those of Low- and Middle-Income Households

Percent change in real after-tax income since 1979



Source: Congressional Budget Office

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This glaring disparity has major consequences. If the incomes of all households had grown at the *same* rate between 1979 and 2013, roughly 22 million fewer people would have been below the poverty line in 2013 (about 23 million, as opposed to the actual figure of 45 million) and the 2013 poverty rate would have been 7.4 percent (as opposed to the actual figure of 14.5 percent).[3] The disparity in income growth has had a much bigger impact on the poverty rate than other commonly cited factors like demographic changes and increases in the number of families headed by single mothers.

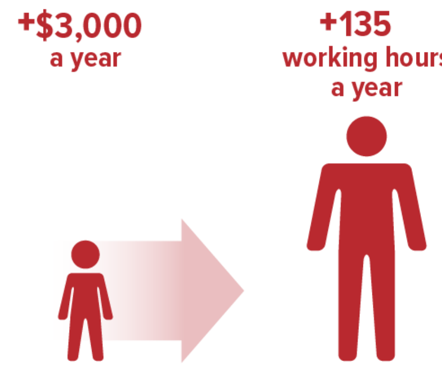
The failure of economic growth to reach low-wage workers particularly affects women and people of color. Women, for example, comprise less than half of the total workforce but roughly two-thirds of the low-wage workforce. African American and Latino women comprise about twice as big a share of the low-wage workforce as they do of the workforce as a whole.[4] And African American and Latino workers in general are far more likely than white workers to earn poverty-level wages.[5]

These trends also have long-term implications. The effects of low pay and poverty can last a lifetime for children. Relative to their better-off peers, poor children do less well in school, complete fewer years of education, and work less (and earn less) as adults. One reason appears to be that poor children are more likely to be in poor

FIGURE 3

Higher Earned Income Tax Credit or Other Income for Poor Children Expected to Boost Work and Earnings Later in Life

$3,000 annual increase in income to poor children before age 6 associated with increase in work hours when they become adults



For each $3,000 a year in added income that children in a poor family receive before age 6...

...their working hours rise by 135 hours a year between ages 25 and 37, and their annual earnings rise by 17%.*

*Note: The published paper uses a 19% figure, but the authors have indicated that this is a typographical error and 17 percent is correct.

Source: Greg J. Duncan, Kathleen M. Ziol-Guest, and Ariel Kalil, "Early-Childhood Poverty and Adult Attainment, Behavior, and Health," *Child Development*, January/February 2010, pp. 306-325

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[3] Elise Gould, Alyssa Davis, and Will Kimball, "Broad Based Wage Growth Key Tool in Fight Against Poverty," Economic Policy Institute, May 20, 2015, http://www.epi.org/publication/broad-based-wage-growth-is-a-key-tool-in-the-fight-against-poverty/. CBPP calculated the number of people who would have been above the poverty line using Census data on the rate of poverty and number of poor in 2013.

[4] Low-wage worker is defined here as earning $10.50 or less per hour. See National Women's Law Center, "Chartbook: Women's Overrepresentation in Low-Wage Jobs," http://nwlc.org/resources/chartbook-womens-overrepresentation-low-wage-jobs/.

[5] Poverty-level wages are defined here as $11.45 per hour. See "Share of workers earning poverty-level wages, by race and ethnicity, 1973-2013," *The State of Working America,* Economic Policy Institute,

health, which can affect their ability to learn and sometimes carries into adulthood.[6] Another reason is the stress associated with poverty. Unsafe neighborhoods, unstable housing, hunger, and other hardships associated with poverty can affect children's still-developing brains, impeding their social and emotional development and ability to learn.[7]

States Have Tools to Foster Broadly Shared Prosperity

State policymakers can partially address stagnant wages, hardship, and extreme income inequality by enacting or expanding a state EITC and by raising their state's minimum wage and maintaining its real value over time by indexing it to inflation. Both policies would buoy workers and their families and help them meet basic needs. These policies should also support local businesses and economies, since low- and moderate-income households spend (rather than save) most of what they earn to cover living costs.

Enacting or Expanding State EITCs

Federal and state EITCs go to low-income working families and individuals. Together with the federal credit, state EITCs:

- **Help working families make ends meet.** "Refundable" EITCs, which give working households the full value of the credit they earn even if it exceeds their income tax liability, provide low-income workers with a needed income boost.
- **Keep families working.** EITCs help low-wage working families pay for things that allow them to work, like child care and transportation. They are also structured to encourage the lowest-earning families to work more hours. That extra time and experience in the working world can translate into better opportunities and higher pay over time. Three of every five recipients of the federal credit use it just temporarily — for just one or two years at a time — while they get on their feet.
- **Reduce poverty, especially among children.** The federal EITC is one of the nation's most effective tools to reduce the struggles of low-income working families and children. It kept 6.2 million people — over half of them children — out of poverty in 2013, and helped many with slightly higher incomes make ends meet. State EITCs build on that record.
- **Have a lasting effect.** Young children in low-income families that get an income boost like the EITC provides tend to do better and go farther in school because the additional resources help parents better meet their needs. (See Figure 3.) And because these children attain more skills and education, they tend to work more and earn more as adults. This helps communities and the economy because it means more people and families are on solid ground and fewer need help over the long haul.

State EITCs also help to address skewed state tax systems that require low- and moderate-

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http://stateofworkingamerica.org/chart/swa-wages-figure-4f-share-workers-earning/.

[6] Marr, Huang, and Sherman, 2014, and Arloc Sherman, Danilo Trisi, and Sharon Parrott, "Various Supports for Low-Income Families Reduce Poverty and Have Long-Term Positive Effects On Families and Children," Center on Budget and Policy Priorities, July 30, 2013, http://www.cbpp.org/cms/index.cfm?fa=view&id=3997.

[7] Sherman, Trisi, and Parrott, 2013.

income families to pay a larger share of their income in taxes than high-income families.

Twenty-six states and the District of Columbia have EITCs (See Table 1.) Several states strengthened their EITCs during the 2014 legislative session, including the **District of Columbia, Maryland, Minnesota, Rhode Island,** and **Ohio**. In 2015, **California** adopted an EITC and **Maine, Massachusetts, New Jersey,** and **Rhode Island** expanded their credits.

Increasing State Minimum Wages and Indexing Them for Inflation

Like the EITC, higher minimum wages can boost income and set children on a better path in life. They also boost working households' purchasing power, which is good for the economy.

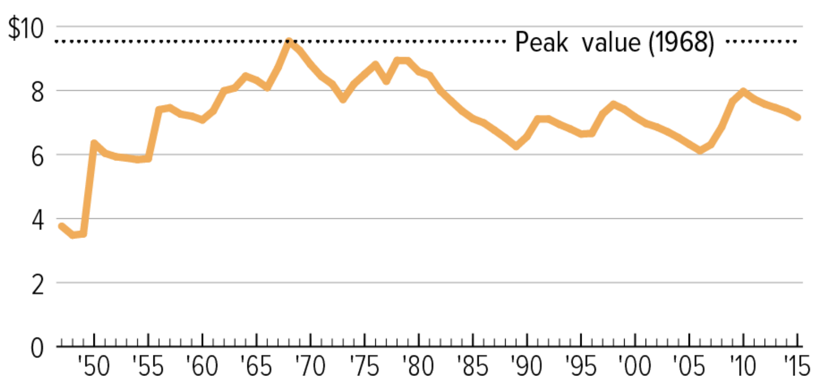
The federal minimum wage is the nation's wage floor. Many states set their minimum wage equal to the federal minimum wage; other states have a lower minimum wage or no minimum wage at all, in which case the federal minimum wage becomes the default for most workers.[8]

Yet the federal minimum wage hasn't kept pace with the cost of living. It is currently 24 percent below its peak value in 1968, after adjusting for inflation. (See Figure 4.) Today, a full-time worker earning the federal minimum wage and supporting two children lives below the poverty line.

FIGURE 4

Purchasing Power of Minimum Wage Has Not Kept Pace With Inflation

Minimum wage value, 2015 dollars



Source: Congressional Budget Office and Bureau of Labor Statistics

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Raising the minimum wage would greatly improve the outlook for the nation's lowest-wage workers in sectors of the economy that have seen little to no wage growth. A 2014 proposal to raise

[8] Some workers are not covered by the Fair Labor Standards Act and are therefore are not covered by the minimum wage or other provisions of the Act. For a listing of workers exempt from the minimum wage, see: http://www.dol.gov/elaws/esa/flsa/screen75.asp.

the federal minimum wage to $10.10 by 2016 and index it to inflation would have boosted wages directly for 16.5 million workers, the Congressional Budget Office (CBO) estimated, the vast majority of them adults and over half of them women and full-time workers. The raise would have lifted 900,000 people above the poverty line.[9]

CBO also estimated that the wages of another 8 million workers earning slightly more than the proposed $10.10 per hour would have gone up, since employers typically increase the wages of workers slightly above the new minimum. All told, the raise would have resulted in a net income gain for households with incomes up to three times the poverty line (about $72,300 for a family of four), or about half of the American population.[10]

States shouldn't wait for the federal government to raise the minimum wage when they can improve the lives of their state's workers now. In 2014, 14 states plus the District of Columbia adopted a minimum wage increase — **Alaska, Arkansas, Connecticut, Delaware, Hawaii, Maryland, Massachusetts, Michigan, Minnesota, Nebraska, Rhode Island, South Dakota, Vermont,** and **West Virginia,** and many other states considered doing so.[11] **Rhode Island** raised its minimum wage again in 2015. A number of major cities, including Los Angeles, Kansas City, and Washington, D.C., as well as smaller cities like Lexington and Louisville in Kentucky, also raised their minimum wages in the last couple of years.[12]

As of January 2016, 29 states and the District of Columbia have a minimum wage higher than the federal wage, although 12 of them don't index their minimum wage to inflation. These 12 states **— Arkansas, California, Connecticut, Delaware, Illinois, Maine, Massachusetts, Nebraska, New Mexico, New York, Rhode Island,** and **West Virginia —** should take that additional step to ensure that their minimum wage keeps pace with the cost of living. And the 21 states that have no minimum wage or have set their minimum wages at or below the federal minimum should improve their minimum wage to help working families meet basic needs and get ahead.

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[9] "The Effects of a Minimum-Wage Increase on Employment and Family Income," Congressional Budget Office, February 2014, http://www.cbo.gov/sites/default/files/cbofiles/attachments/44995-MinimumWage.pdf. CBO also estimated that the proposal (the Fair Minimum Wage Act of 2014) would result in the loss of 500,000 jobs, representing about 0.3 percent of workers (with a range of uncertainty of plus or minus 500,000 jobs around that estimate). However, CBO derives its job-loss estimate from an extensive economic literature on the minimum wage in which some of the best studies find negligible job losses or certainly job losses in the lower half of CBO's range. A subsequent prize-winning book examining the minimum wage literature concludes: "[I]ncreases in the minimum wage raise the hourly wage and earnings of workers in the lower part of the wage distribution and have very modest or no effects on employment, hours, and other labor market outcomes." See http://www.cbpp.org/blog/award-winning-study-minimum-wage-solid-benefits-small-costs.

[10] Arloc Sherman, "Why a Higher Minimum Wage Is a Net Win for Most Income Groups," Center on Budget and Policy Priorities, February 20, 2014, http://www.cbpp.org/blog/why-a-higher-minimum-wage-is-a-net-win-for-most-income-groups.

[11] According to the National Conference of State Legislatures, 34 states considered minimum wage increases in 2014. For more detail on state minimum wage bills in 2014, see: http://www.ncsl.org/research/labor-and-employment/state-minimum-wage-chart.aspx.

[12] National Employment Law Project, "City Minimum Wage Laws: Recent Trends and Economic Evidence," http://www.nelp.org/content/uploads/City-Minimum-Wage-Laws-Recent-Trends-Economic-Evidence.pdf.

TABLE 1

State EITCs and Minimum Wage as of January 2016

State	EITC as Share of Federal EITC	Minimum Wage	Minimum Wage Indexed to Inflation?
Alabama	None	None	No
Alaska	None	$9.75	As of Jan. 2017
Arizona	None	$8.05	Yes
Arkansas	None	$8.00	No
California	85% up to 50% of federal phase-in range**	$10.00	No
Colorado	10.0%	$8.31	Yes
Connecticut	27.5%	$9.60	No
Delaware	20.0% (non-refundable)	$8.25	No
District of Columbia	40% 100% (some childless adults)	$11.50*	As of Jul. 2017
Florida	None	$8.05	Yes
Georgia	None	$5.15	No
Hawaii	None	$8.50	No
Idaho	None	$7.25	No
Illinois	10.0%	$8.25	No
Indiana	9.0%	$7.25	No
Iowa	15.0%	$7.25	No
Kansas	17.0%	$7.25	No
Kentucky	None	$7.25	No
Louisiana	3.5%	None	No
Maine	5.0%	$7.50	No
Maryland	25.5%	$8.75*	No
Massachusetts	23.0%	$10.00	No
Michigan	6.0%	$8.50	As of Jan. 2019
Minnesota	Avg. 34%	$9.50 (large businesses) $7.75 (small businesses)*	As of Jan. 2018
Mississippi	None	None	No
Missouri	None	$7.65	Yes
Montana	None	$8.05 (large businesses) $4.00 (small businesses)	Yes
Nebraska	10.0%	$9.00	No
Nevada	None	$8.25 (without healthcare coverage) $7.25 (with healthcare coverage)	Yes
New Hampshire	None	None	No
New Jersey	30.0%	$8.38	Yes
New Mexico	10.0%	$7.50	No
New York	30.0%	$9.00	No
North Carolina	None	$7.25	No
North Dakota	None	$7.25	No
Ohio	10.0% (non-refundable)	$8.10 (large businesses) $7.25 (small businesses)	Yes

TABLE 1

State EITCs and Minimum Wage as of January 2016

State	EITC as Share of Federal EITC	Minimum Wage	Minimum Wage Indexed to Inflation?
Oklahoma	5.0%	$7.25 (large businesses) $2.00 (small businesses)	No
Oregon	8.0%	$9.25	Yes
Pennsylvania	None	$7.25	No
Rhode Island	12.5%	$9.60	No
South Carolina	None	None	No
South Dakota	None	$8.55	Yes
Tennessee	None	None	No
Texas	None	$7.25	No
Utah	None	$7.25	No
Vermont	32.0%	$9.60	Yes
Virginia	20% (non-refundable)	$7.25	No
Washington	10% (when implemented)	$9.47	Yes
West Virginia	None	$8.75	No
Wisconsin	4% - one child 11% - two children 34% - three children No credit - childless workers	$7.25	No
Wyoming	None	$5.15	No

* In July 2016, DC's minimum wage will rise to $11.50 from $10.50 and Maryland's will rise to $8.75 from $8.25. In August 2016, Minnesota's minimum wage will rise to $9.50/$7.75 from $9.00/$7.25.

** California's credit is available to working families and individuals with wage income below $7,000 to $14,000, depending on family size. The credit is worth 85 percent of household's federal EITC until household income reaches half of the level at which the federal credit is fully phased in; it then begins phasing out at varying rates, depending on family size. The value of the credit will be set each year by the legislature.

Source: CBPP and National Conference of State Legislatures

State EITC and Minimum Wage Improvements Go Hand in Hand

Three states — **Maryland, Minnesota,** and **Rhode Island** — and the **District of Columbia** increased both their state EITC and minimum wage in 2014. **Rhode Island** expanded both again in 2015. While improving either policy helps low-wage workers, improving both in combination produces complementary benefits and goes much further to make work pay.

- **State minimum wages and EITCs reach overlapping but different populations.** The EITC and minimum wage are targeted differently, so enacting or improving both policies in tandem will reach more workers than either on its own. For example, the EITC targets low-income working families with children. Workers *without* children working full-time, year-round at the minimum wage are eligible only for a federal EITC worth about $23 and are ineligible for the credit if they are younger than 25 or older than 64. Higher minimum wages, in contrast, benefit low-wage workers regardless of age, presence of children in the household, or total family income.

Similarly, while the minimum wage is focused on workers with the very lowest wages, the EITC remains available (albeit at gradually declining levels) to families as their income rises. (Of course, some minimum wage workers are also in families with higher incomes.) The EITC also reaches some workers not covered by minimum wage laws, such as domestic workers and farm workers.

- **Increasing both at the same time provides added support to the working families who need it most.** Families modestly above the poverty line often can't meet basic needs. Improving state EITCs and minimum wages together not only helps more families climb out of poverty, but also helps working families get further down the road to economic security.[13]

  For example, a two-parent, two-child family with one full-time, year-round minimum wage worker claiming the federal EITC and Child Tax Credit has after-tax income below the poverty line (about $24,000 for a family of four). Adding in a state EITC set at 30 percent of the federal credit leaves this family just shy (at 92 percent) of the poverty line. Alternatively, boosting the family's hourly wage to $10.10 through a minimum wage increase would raise its income to slightly above (108 percent of) poverty. But a working family that benefits from *both* policies takes a bigger step forward, seeing its income rise by almost one-fifth, to 114 percent of the poverty line. (See Figure 5.)

  In addition, for families with very low earnings, a higher state minimum wage boosts their federal and state EITCs, which rise with every additional dollar earned until reaching the maximum credit.[14] For example, even a small minimum wage increase from $7.25 to $7.75 for a single mother with two children working 35 hours per week would raise her federal EITC by $360.

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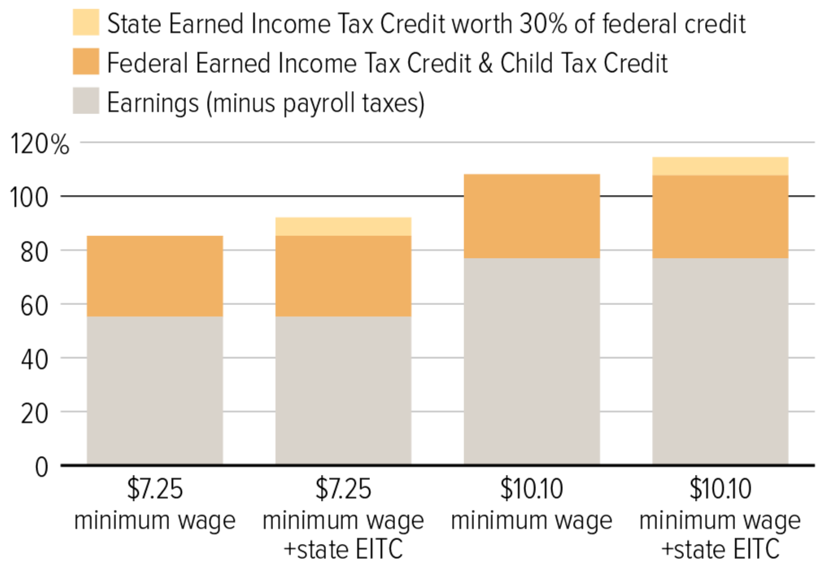
[13] A 2011 study by David Neumark and William Wascher finds that a higher minimum wage enhances the employment and earnings boost that single mothers aged 21-44 get from the EITC. It also finds that for some childless workers (primarily those who are poorly educated and aged 21-34), the two policies may combine to *reduce* employment and earnings, for two reasons. First, because the EITC encourages single mothers to enter the workforce, raising it can increase job competition and reduce wages for childless workers, who don't benefit much from the EITC. This could be remedied by expanding the EITC for childless workers, as President Obama and House Speaker Paul Ryan have proposed. (The District of Columbia recently expanded its EITC for childless workers.) Second, a higher minimum wage can result in job losses for the same general group of individuals. Other studies, however, have shown minimal negative employment effects of raising the minimum wage, and on net, an income *boost* for low-wage workers. See David Card, "Using Regional Variation in Wages to Measure the Effects of the Federal Minimum Wage," *Industrial and Labor Relations Review*, vol. 46, no. 1, 1992; and David Card and Alan Kreuger, *Myth and Measurement: The New Economics of the Minimum Wage*, Princeton University Press, 1995. Also see Dale Belman and Paul J. Wolfson, *What Does the Minimum Wage Do?,* Upjohn Institute Press, 2014. For a discussion of a range of studies, see John Schmitt, "Why Does the Minimum Wage Have No Discernible Effect on Employment?" Center for Economic and Policy Research, 2013, http://www.cepr.net/documents/publications/min-wage-2013-02.pdf.

[14] For some EITC families with relatively higher overall family income from multiple workers, an earnings bump from a higher minimum wage could result in a smaller EITC if their income enters the range at which the credit begins to phase out (about $24,000 for a married-couple family with two kids).

FIGURE 5

States Can Make Work Pay by Boosting EITC and Minimum Wage

Earnings compared to the federal poverty line for a family of four ($24,250) with one full-time worker



Note: Only some working adults are eligible for the Earned Income Tax Credit
Source: CBPP calculations

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- **Workers receive the benefits of the two policies on different schedules.** The EITC offers an annual, lump-sum payment when a family files income taxes. This payment helps many families afford major expenses like car repairs or a security deposit that facilitates a move to a better neighborhood, or it can provide them with funds to build a savings account.[15] An increase to the minimum wage, on the other hand, provides a boost year-round with every paycheck, helping working families afford monthly expenses like rent, utilities, and child care.
- **A combination approach allows the public and private sectors to share the cost of boosting workers' incomes.** Strengthening both the EITC and the minimum wage in the same general timeframe ensures that the cost of "making work pay" is more broadly shared. The EITC's cost is largely borne by state government, and by extension state taxpayers, while

[15] See Ruby Mendenhall *et al.,* 2010, "The Role of Earned Income Tax Credit in the Budgets of Low-income Families," National Poverty Center Working Paper Series, http://npc.umich.edu/publications/u/working_paper10-05.pdf; Andrew Goodman-Bacon and Leslie McGranahan, "How Do EITC Recipients Spend their Refunds?" *Economic Perspectives,* vol. 32 no. 2, 2008, Federal Reserve Bank of Chicago, https://www.chicagofed.org/digital_assets/publications/economic_perspectives/2008/ep_2qtr2008_part2_goodman_etal.pdf; Smeeding *et al.,* "The EITC: Expectation, Knowledge, Use, and Economic and Social Mobility," *National Tax Journal*, 2000, http://www.ntanet.org/NTJ/53/4/ntj-v53n04p1187-210-eitc-expectation-knowledge-use.pdf.

the cost of a state minimum wage is borne primarily by the private sector, especially employers and consumers.[16] (Where costs ultimately fall is not as straightforward as it might seem, given the interplay of the two policies and other programs for low-income workers. For example, a minimum wage increase will boost some workers' federal and state EITCs, thereby raising the cost of providing a state EITC but also adding EITC dollars into workers' pockets and the state economy, which in turn would raise state tax collections.)

A higher state EITC and a higher state minimum wage individually offer significant support to many low-income workers. States are right to consider strengthening these policies, which help make work pay and struggling families make ends meet. But a strong state EITC and an increased minimum wage are even more powerful, and support more working people, when combined.

[16] While the costs of both an EITC and a higher minimum wage ultimately are borne by individuals, a combined approach assures that precisely *which* individuals pay will be more varied than it otherwise would be.