Box 1.

The Minimum Wage and the Earned Income Tax Credit

The earned income tax credit (EITC) provides cash assistance through the federal income tax system to low- and moderate-income families on the basis of their earnings, adjusted gross income, and family structure.[1] At first, as family earnings rise above zero (the "phase-in" range), EITC benefits increase; when earnings reach a certain point, the benefits stop increasing; when earnings reach a higher point (the beginning of the "phaseout" range), the benefits decline; and when earnings are high enough, the benefits end.[2] The maximum credit in 2014 is $5,460 for people with two qualifying children, for example. In 2016, the Congressional Budget Office (CBO) projects, the earnings level at which EITC benefits end will range from $15,100 for an unmarried worker without children to $54,300 for a married couple with three or more children.

Using the Minimum Wage or the EITC to Boost the Resources of Low-Income Families

To achieve any given increase in the resources of lower-income families would require a greater shift of resources in the economy if done by increasing the minimum wage than if done by increasing the EITC.[3] The reason is that a minimum-wage increase would add to the resources of most families of low-wage workers regardless of those families' income; for example, one-third of low-wage workers would be in families whose income was more than three times the federal poverty threshold in 2016, and many of those workers would see their earnings rise if the minimum wage rose. By contrast, an increase in the EITC would go almost entirely to lower-income families.

The Interaction of the Minimum Wage and the EITC

An increase in the minimum wage would affect EITC benefits in different ways for different families. Many families whose income was initially within the phase-in range of the EITC schedule would find that increased earnings led to additional EITC benefits. But families whose income was initially in the phaseout range of the schedule would find that income gains from a higher minimum wage were partly offset by a reduction in EITC benefits. And families whose income was initially between the phase-in and phaseout ranges (a range in which EITC benefits do not change as earnings rise) and remained in that range after the minimum-wage increase would see no change in their EITC benefits. As for higher-income families with low-wage workers, they would not have been eligible for the EITC in the first place.

The EITC encourages more people in low-income families to work—particularly unmarried custodial parents, often mothers, for whom the EITC is larger than it is for people without children.[4] That increase in the number of available workers tends to reduce workers' wages, allowing some of the benefit of the EITC to accrue to employers, rather than to the workers themselves.[5] An increase in the minimum wage would shift some of that benefit from employers to workers by requiring the former to pay the latter more.

1. Adjusted gross income is income from all sources not specifically excluded from the tax code, minus certain deductions.
2. For a more extensive description of the EITC, see Congressional Budget Office, *Refundable Tax Credits* (January 2013), www.cbo.gov/publication/43767.
3. In a 2007 analysis, CBO compared the cost to employers of a change in the minimum wage that increased the income of poor families by a given amount to the cost to the federal government of a change in the EITC that increased the income of poor families by roughly the same amount. The cost to employers of the change in the minimum wage was much larger than the cost to the federal government of the change in the EITC. See Congressional Budget Office, *Response to a Request by Senator Grassley About the Effects of Increasing the Federal Minimum Wage Versus Expanding the Earned Income Tax Credit* (attachment to a letter to the Honorable Charles E. Grassley, January 9, 2007), www.cbo.gov/publication/18281. Most of the budgetary effect of an increase in the EITC shows up as an increase in spending, rather than as a reduction in revenues, because the credit is refundable and most of the total benefits represent amounts that are paid out rather than amounts that are used to offset other tax liabilities.
4. See Bruce D. Meyer and Dan T. Rosenbaum. "Welfare, the Earned Income Tax Credit, and the Labor Supply of Single Mothers," *Quarterly Journal of Economics*, vol. 116, no. 3 (August 2001), pp. 1063–1114, http://www.jstor.org/stable/2696426; and Nada Eissa and Jeffrey B. Liebman, "Labor Supply Response to the Earned Income Tax Credit," *Quarterly Journal of Economics*, vol. 111, no. 2 (May 1996), pp. 605–637, http://www.jstor.org/stable/2946689.
5. See David Lee and Emmanuel Saez, "Optimal Minimum Wage Policy in Competitive Labor Markets," *Journal of Public Economics*, vol. 96, no. 9 (October 2012), pp. 739–749, http://dx.doi.org/10.1016/j.jpubeco.2012.06.001; and Jesse Rothstein, "Is the EITC as Good as an NIT? Conditional Cash Transfers and Tax Incidence," *American Economic Journal: Economic Policy*, vol. 2, no. 1 (February 2010), pp. 177–208, http://www.jstor.org/stable/25760056.