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The Minimum Wage Ain't What It Used to Be

By DAVID NEUMARK



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TODAY'S ECONOMIST

Perspectives from expert contributors.

Proponents of raising the minimum wage often point out that the real minimum wage is lower now than it was decades ago. But the federal policy aimed at low-wage work and low-income families has shifted — wisely — away from reliance on the minimum wage and toward a generous earned-income tax credit, which is better focused on poor families. There is nothing wrong with reducing our reliance on a less effective policy when we have adopted a more effective one. In fact, we should hope that research on public policy leads to exactly this kind of outcome.

The decline in the real value of the minimum wage is indisputable. As shown in the chart below, the real value of the federal minimum declined sharply over the 1980s, and then further in the mid-2000s, before partly recovering with the fairly steep increases in the minimum wage in 2007-9. But despite those increases and low inflation in recent years, it still remains well below its real value in the 1970s.

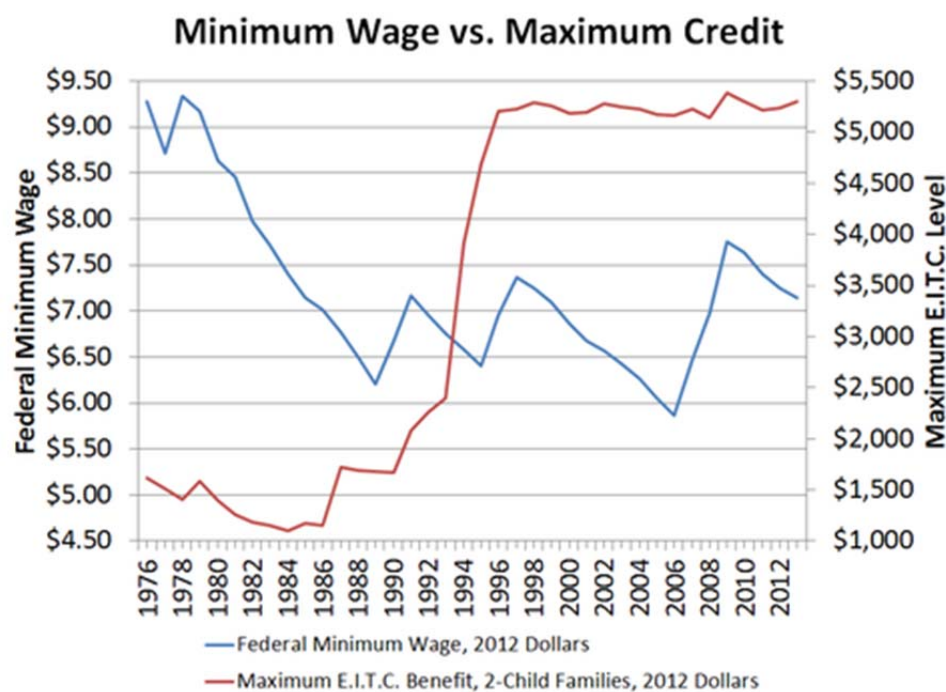


Source: Author's calculations.

There has been a significant policy shift, however, in how to guarantee a minimally acceptable income to families with low-wage workers. In particular, the earned-income tax credit was instituted in 1976, and its generosity has since been expanded considerably.

Through the tax system, the earned-income tax credit pays benefits to families with low income and employed workers. For example, in 2013 a low-income family with two children could receive a refundable tax credit of 40 percent of its income up to a maximum credit of \$5,372. This maximum applied to families with income of \$13,430, and it is phased out as their income rises. In addition, many states supplement this with their own earned-income tax credits. The benefits are a little higher for three-child families, a little lower for one-child families, and negligible for families with no children (a maximum of \$487, or a subsidy of only 7.6 percent). So like the minimum wage, the earned-income tax credit provides an income floor for working people that exceeds what they would earn in the absence of either policy.

Reflecting this change in how we support low-income families, federal government spending on the earned-income tax credit rose to \$55 billion in 2011, about twice the spending on welfare. The figure below shows the real minimum wage (as above), and the maximum credit for a household with two children. The policy shift is obvious. And indexing of the earned-income tax credit ensures that, unlike the minimum wage, it is not eroded by inflation.



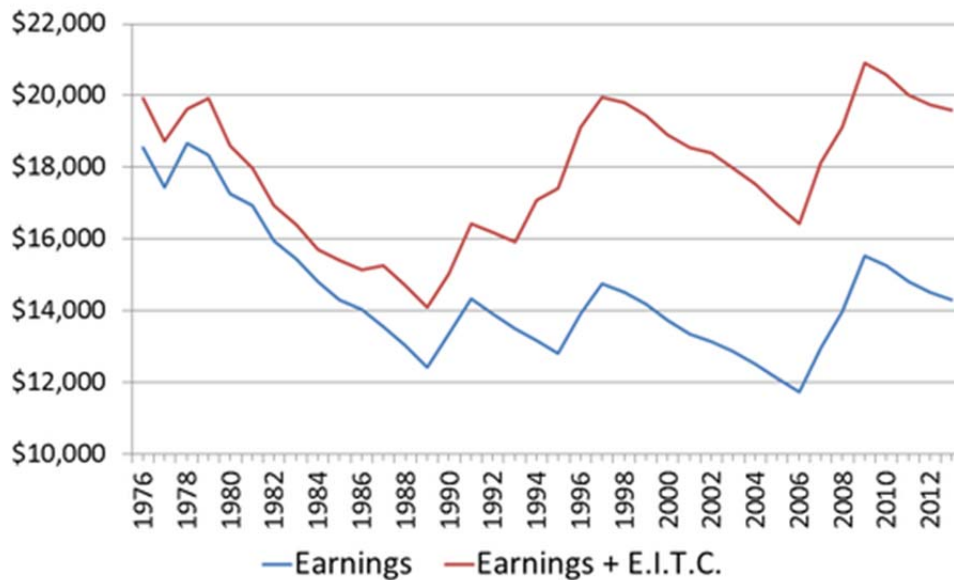
Source: [Tax Policy Center](#)

Center and author's calculations.

So suggesting that federal policy addressing low-wage work and low-income families has somehow failed because the minimum wage has not kept pace with inflation ignores the fact that we have moved away from a focus on the minimum wage — a policy with many flaws — and toward the earned-income tax credit. We shouldn't be asking simply how much the real minimum wage has changed, but rather how much the combined income floor generated by the two policies has changed.

To provide an example, the blue line in the figure below shows the wages received by a single adult worker earning the minimum wage and working full time throughout the year. This can be interpreted as the income floor established by the minimum wage. The red line shows the level of family income when the earned-income tax credit for a family with two children is added (all in 2012 dollars). The lower line illustrates the income consequences of the real decline in the minimum wage. But the upper line shows that, because of the sharp increase in the generosity of the earned-income tax credit, the combined effect of the two policies is that the real income of this family is as high or higher than it was in past decades — when the real minimum wage was relatively high — and much higher than it was in most of the intervening years.

Income With and Without the Earned-Income Tax Credit



Figures are for a one-

earner household working at minimum wage for 2,000 hours, in 2012 dollars. Source: [Tax Policy Center](#) and author's calculations.

Nonetheless, there are important differences between the earned-income tax credit and the minimum wage. The fundamental difference is that the earned-income tax credit aims benefits at low-income families with children, rather than simply low-wage workers. This is in large part its virtue, and it makes a lot more sense than the minimum wage's focus on low-wage workers. Do we really care if a low-wage teenager in a middle-class family makes an extra dollar an hour? Economists of all persuasions in the minimum-wage debate agree that mandated wage floors do a bad job of directing benefits to low-income families. This is confirmed in recent research by my graduate student Sam Lundstrom, calculating who would be affected by increasing the current federal minimum to \$8.25 from \$7.25. He finds that only 21.3 percent of the affected workers would be in poor families, while 30.9 percent would be in families with incomes more than three times the poverty line.

Making children a target of benefits is also very sensible. There are different views across the political spectrum as to why adults are poor and whether providing poor adults with assistance reduces work effort and encourages dependence on government support. But no one views children as actively taking part in decisions that make them poor, and we know that living in poverty is associated with adverse outcomes for children. Hence, many components of the safety net in the United States aim benefits at children, and this approach is not controversial. The earned-income tax credit does the same. It is a fair question, however, whether we are providing a sufficient income floor for childless low-wage adults, who have to a large extent been left out in the cold by our income-support and safety net programs.

Research also supports the notion that the earned-income tax credit provides greater support to low-income families than does the minimum wage. Most studies of the effects of the minimum wage on the income distribution in the United States suggest that a higher minimum wage does little to reduce poverty. How is this possible? When the minimum wage goes up, there are winners, to be sure — those whose wages increase and who retain their jobs and don't have their hours reduced. But some low-skilled workers lose their jobs and others fail to find work because of the higher wage floor. (This point is contested by some, but the [evidence that William Wascher and I have compiled](#) is fairly overwhelming.) [Research by Richard Burkhauser and Joseph Sabia](#) shows that the balance between winners and losers, coupled with the distribution of these winners and losers across low-income and higher-income families, results in no net change in poverty from a higher minimum wage.

In contrast, research shows that the earned-income tax credit has beneficial effects. There is overwhelming evidence of the credit's positive employment effects for female-headed households with children, which have a very high incidence of poverty. And [my work with Mr. Wascher](#) shows that the earned-income tax credit helps families to escape poverty — and not simply through the payment of the credit, but also through the incentives that the credit creates to work more. That is, even before we account for the credit payment, the pro-work incentives of the earned-income tax credit lead to more families *earning* their way out of poverty.

There is a more subtle argument — that the combination of an earned-income tax credit with a higher minimum wage can lead to better outcomes than the earned-income tax credit alone. The basic mechanism is twofold. On the one hand, a higher minimum wage, coupled with an earned-income tax credit, can induce more of those eligible for the credit to enter the labor market. On the other hand, those not eligible for the credit face greater competition from the increase in labor supply, which can amplify the disemployment effects for them.

[My work with Mr. Wascher](#) has explored the interactions of higher minimum wages and a more generous earned-income tax credit. We indeed find that a combination of these two policies leads to higher employment and income among single women with children who are eligible for the credit. At the same time, the combined policies lead to more adverse employment effects on specific groups — like teenagers and less-skilled minority men — who are not eligible for the earned-income tax credit and have to compete with the new labor market entrants who are eligible for it.

Thus, on distributional grounds there may be an argument for coupling the earned-income tax credit with a higher minimum wage. But to be clear, the higher minimum wage entails some job loss. We may simply be willing to accept this job loss in return for better distributional outcomes.

This doesn't change the fact that the earned-income tax credit's generosity has increased significantly and plays a predominant role in our efforts to help low-income families.

These factors are some of the reasons the earned-income tax credit has attracted widespread political support, and — as shown above — has to some extent supplanted the minimum wage as a means of helping low-income families. That the minimum wage has declined in real value is not necessarily an indication that we, as a society, have abandoned our obligations to low-income families. It may be more of an indication that we have found a better way to meet these obligations.

42COMMENTS

OPINION

Delay the Minimum-Wage Hike

A recession is the worst time to raise the cost of low-skilled employment.

By: **David Neumark**

Updated June 12, 2009 12:01 a.m. ET

Despite severe economic difficulties confronting businesses, and soaring unemployment among youths and minorities, the federal minimum wage is slated to increase to \$7.25 in July from \$6.55 today. This will be the final step of a three-step increase enacted in the spring 2007, when the unemployment rate was 4.5%.

Based on 20 years of research, I doubt there is ever a goodtime to raise the minimum wage. However, with the aggregate unemployment rate at 9.4%, the teen unemployment rate exceeding 22%, and the unemployment rate for black teens nearing 40%, next month's increase seems like the worst timing possible.

Despite a few exceptions that are tirelessly (and selectively) cited by advocates of a higher minimum wage, the bulk of the evidence -- from scores of studies, using data mainly from the U.S. but also from many other countries -- clearly shows that minimum wages reduce employment of young, low-skilled people. The best estimates from studies since the early 1990s suggest that the 11% minimum wage increase scheduled for this summer will lead to the loss of an additional 300,000 jobs among teens and young adults. This is on top of the continuing job losses the recession is likely to throw our way.

The reduction in jobs for youths might be an acceptable price to pay if a higher minimum wage delivered other important benefits. Many people believe, for instance, that it helps low-income families. Here, too, the evidence is discouraging. There is no research supporting the claim that minimum wages reduce the proportion of families living in poverty. Research I've done with William Wascher of the Federal Reserve Board and Mark Schweitzer of the Cleveland Fed indicates that minimum wages increase poverty.

How can this be? Because the relationship between being a low-wage worker and living in a poor family is remarkably weak. Many low-wage teenagers and young adults are in higher-income families, and many poor families have no workers.

According to recent data from a study by Richard Burkhauser and Joseph Sabia, 34% of minimum-wage workers were in families with incomes exceeding three times the poverty line (\$22,050 for a family of four) -- roughly the top half of the income distribution. Only 17% were in poor families.

In addition, when deciding which low-wage worker to retain following a minimum wage increase, employers may opt for a teenager, who may have high potential, over an adult who, because he still earns a low wage, likely has much lower potential. Thus, the job-destroying effects of minimum wages fall particularly hard on low-skilled adults in poor families.

There is also evidence that the short-term consequences of minimum wages have long-term effects. The principal sources of an individual's higher earnings are more schooling and the accumulation of experience and skills in the labor market. Unfortunately, increased minimum wages induce some teenagers to drop out of high school and take a job. Moreover, these dropouts take jobs away from the even lower-skilled teenagers who had dropped out earlier. With fewer opportunities to acquire labor-market experience and skills, these teenagers face lower wages as adults.

The accumulated evidence undermines the case for minimum wages even in the best of times. I recognize that there is continuing debate about some of the effects of minimum wages, and that strong public support for higher minimums -- regardless of the evidence -- will likely lead to future increases.

But let's put aside the broader debate and focus on the narrower question: Should we raise the minimum wage in the worst of times? When so many people -- especially the young -- are struggling to find a toe hold in the labor market, does it really make sense to make it harder for employers to hire them?

Minimum wages, like most public policies, confront us with trade-offs. An employed, low-skilled worker who keeps his job earns a slightly higher wage. But a worker who loses his job, or a labor-market entrant or unemployed worker who cannot find a new job, pays a much higher cost. Given present economic conditions, the imperative should be to create and enhance job opportunities.

I do not expect President Obama or congressional Democrats to give up their long-held support for a higher minimum wage. However, they should delay the increase in the minimum wage scheduled for this summer.

Mr. Neumark is professor of economics at the University of California, Irvine, and the author, with William Wascher, of "Minimum Wages" (MIT Press, 2008).

