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Minimum Wage, the Earned Income Tax Credit, and Inflation

By Troy Kravitz

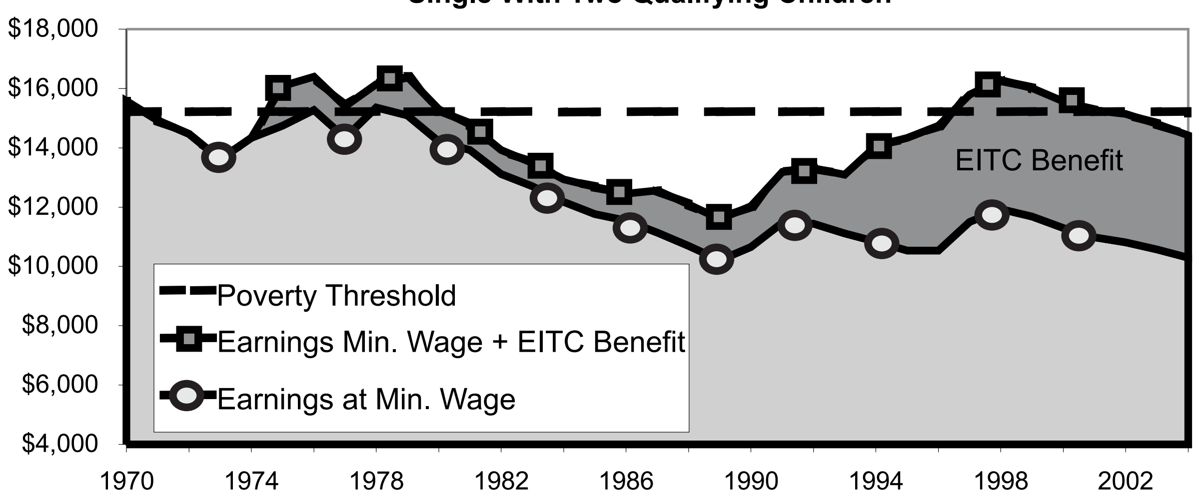
The earned income tax credit was enacted in 1975 to help provide subsidies to low-income working families. It was viewed variously as a pro-work alternative to welfare and as an offset to the Social Security payroll tax. The federal minimum wage, enacted in 1938, has a similar purpose but, unlike the EITC, is not indexed for inflation and thus declines in real value except when Congress increases it.

The minimum wage was increased several times in the 1970s, with the consequence that a single parent of two children working full-time at the federal minimum had annual earnings near the poverty threshold. Since then, the nominal minimum wage remained unchanged for long periods, and, as a result, incomes of families earning only at minimum wage declined relative to the poverty threshold. Major expansions in the EITC in 1986, 1990, and 1993, however, offset part of this decline. In 2004, for example, a single parent with two qualifying children working full-time (2,000 hours) at the federal minimum hourly wage of $5.15 earned $10,300 and received $4,120 from the EITC.[1] Without the EITC, this family would need to earn $7.21 per hour (140 percent of the federal minimum) to have the same income (more if payroll taxes are considered).

The decline in the real value of the federal minimum wage since 1997 has, perversely, also cut some low-income families' real EITC. The EITC is equal to a percentage of earnings up to a maximum amount; at higher earning levels, the EITC plateaus and eventually phases out. For families with earnings in the phase-in range of the credit, a declining real wage yields a smaller real EITC. Since 2001 the earnings of a single parent of two qualifying children working full-time at the federal minimum wage have been in the EITC phase-in region. For those workers, an unchanged nominal wage rate yields lower real earned income, and accordingly, lower real EITC benefit.

[1]Note that most low-income workers receive less than the maximum EITC.

Income for Full-Time Worker at Minimum Wage, Single With Two Qualifying Children



Notes: Real dollars (2004). Potential credits other than the EITC are not shown, nor are liabilities such as payroll taxes. The official poverty definition uses cash income before taxes (and the EITC) and does not include capital gains or noncash benefits.
Sources: House Committee on Ways and Means; Census Bureau; Department of Labor.

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