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The Politics of Supporting Low-Wage Workers and Families

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Abstract and Keywords

This chapter highlights two policies that supplement the earnings of low-wage workers: the federal minimum wage and the earned income tax credit (EITC). The need for earnings supplements arises in part from the nature of the jobs held by less-skilled, low-wage workers. Such jobs are likely to be compensated on an hourly basis, not salaried, and are less likely to be full time. A focus on the minimum wage and the EITC contributes to—and expands our understanding of—the American welfare state in two ways. First, it looks beyond social insurance and public assistance, which have been considered the main tools of social policy, to explore the importance of alternative antipoverty policies. Second, it moves beyond income support to nonworkers to focus on efforts to support individuals who are *active* in the labor market.

Keywords: earned income tax credit (EITC), federal minimum wage, anti-poverty policies, low-wage workers, earnings supplements

1 Introduction

THIS chapter highlights two major policies that supplement the earnings of low-wage workers: the federal minimum wage and the earned income tax credit (EITC). These policies reflect a core belief: all able-bodied workers must participate in the labor market full time; if they do so, they should earn enough to keep their families out of poverty. However, declining demand has pulled down the wages of the less skilled, both men and women, so employment alone often does not lead to economic self-sufficiency. Thus, despite decades of efforts to help low-wage workers, the challenge of making work pay for *every* American remains.

The need for earnings supplementation arises in part from the nature of the jobs held by less-skilled, low-wage workers. Such jobs are likely to be compensated on an hourly basis, not salaried, and are less likely to be full time. Moreover, the wages that these jobs pay have declined in relative terms. Over the past several decades the real hourly wage rate grew faster at the top of the wage distribution than at the middle and grew faster at the middle than at the bottom. For the foreseeable future, many less-skilled workers will continue to face low and even falling real wages. This trend provides a backdrop to policy efforts to use the minimum wage and refundable tax credits to supplement the earnings of low-income workers and their children. Such policies move many workers and families out of poverty, but by no means all of them.

A legally binding minimum wage is in place in twenty-one Organisation for Economic Co-operation and Development (OECD) countries (Immervoll and Pearson 2009). Nevertheless, minimum wages remain controversial. In part this is because they are redistributive; they "do not increase the pay of workers by magic" (Freeman 1996, 640), but rather entail gains for some and losses for others. In many OECD countries (p. 374) persistent labor market difficulties experienced by individuals with limited earnings potential have led to an interest in policies aimed at assisting them. A motivation to promote self-sufficiency has prompted ongoing discussions of rebalancing social safety nets. The result has been a growing interest in, and use of, "make work pay" policies such as the EITC (Immervoll and Pearson 2009).

A scholarly focus on the minimum wage and the EITC contributes to—and expands our understanding of—the US welfare state in two ways. First, it looks beyond social insurance and public assistance programs (such as welfare), which have been considered the main tools of social policy, to explore the importance of alternative policies. Second, it moves beyond income support to nonworkers (the elderly, the disabled, nonworking mothers with dependent children) to focus on efforts to support individuals who are *active* in the labor market. In so doing, it contributes to a scholarship that has reshaped thinking about the welfare state by introducing such concepts as the "hidden welfare state" and the "shadow" or "divided" welfare state (Howard 1997; Gottschalk 2000; Hacker 2002). As Chris Howard (2003, 414) observes, the "American welfare state is exceptional not so much for its small size—in terms of spending—as for its reliance on a broad range of policy tools to achieve social welfare objectives."

The policies highlighted in this chapter are not the only ways in which the government can boost the pretax earnings or after-tax incomes of low-income earners. The government can invest in human capital through education and training programs that help less-skilled workers prepare for higher-wage jobs. A range of means-tested benefits continues to help working poor families with basic expenses such as health care (Medicaid, CHIP), food security (SNAP), and child care. One consequence of our fragmented set of employer mandates, means-tested benefits, and tax credits is that working poor households in different circumstances receive different levels of support.

2 Protecting Low-Wage Workers in the United States

The US Congress and President Franklin D. Roosevelt initially set the federal minimum wage at 25 cents per hour as part of the 1938 Fair Labor Standards Act (FLSA) (Grossman 1978). At the time most of the lowest-wage workers were employed in southern industries such as lumber textiles, and tobacco. Textiles and lumber were the two largest manufacturing employers; agriculture, the largest employer in the South, was originally exempted from coverage. Southern Democrats, responding to agricultural and other business groups, kept agricultural and domestic service occupations out of contributory social insurance and public assistance programs and out of federal labor standards (Linder 1987; Palmer 1995; Mettler 1998).

(p. 375) In recent decades the impact of the minimum wage has not been concentrated in one region. It largely affects teenagers and young adults; however, in recent decades an increasing number of adults have become its potential beneficiaries (Freeman 1996). Recent evidence suggests that the minimum wage reduces inequality in the lower end of the wage distribution (Autor, Manning, and Smith 2010). Congress has increased the minimum wage numerous times over the past seven decades, as shown in Figure 21.1. As of 2014 the minimum wage was $7.25 per hour. Nonetheless, because the minimum wage has not been indexed to inflation, it has not kept pace with the cost of living, and its real value has declined between each statutory increase. Currently all "covered nonexempt" workers are entitled to $7.25 per hour, and many states have minimum wages that exceed this amount. In cases where an employee is protected by both a state and federal minimum wage, the employee is entitled to the higher minimum wage. More than 130 million workers are protected by the minimum wage, which is enforced by the Wage and Hour Division of the Department of Labor (US DOL 2014).

Fig. 21.1 Federal Minimum Wage Rates Under the Fair Labor Standards Act.

Mimimum Hourly Wage of Workers First Covered by				
			1966 & Subsequent Amendments[3]	
Effective Date	1938 Act[1]	1961 Amendments[2]	Nonfarm	Farm
OCT. 24, 1938	$0.25			
OCT. 24, 1939	$0.30			

OCT. 24, 1945	$0.40			
JAN. 25, 1950	$0.75			
MAR. 1, 1956	$1.00			
SEPT. 3, 1961	$1.15	$1.00		
SEPT. 3, 1963	$1.25			
SEPT. 3, 1964		$1.15		
SEPT. 3, 1965		$1.25		
FEB. 1, 1967	$1.40	$1.40	$1.00	$1.00
FEB. 1, 1968	$1.60	$1.60	$1.15	$1.15
FEB. 1, 1969			$1.30	$1.30
FEB. 1, 1970			$1.45	
FEB. 1, 1971			$1.60	
MAY 1, 1974	$2.00	$2.00	$1.90	$1.60
JAN. 1, 1975	$2.10	$2.10	$2.00	$1.80
JAN. 1, 1976	$2.30	$2.30	$2.20	$2.00
JAN. 1, 1977			$2.30	$2.20
JAN. 1, 1978			$2.65 for all covered, nonexempt workers	
JAN. 1, 1979			$2.90 for all covered, nonexempt workers	
JAN. 1, 1980			$3.10 for all covered, nonexempt workers	
JAN. 1, 1981			$3.35 for all covered, nonexempt workers	
APR. 1, 1990[4]			$3.80 for all covered, nonexempt workers	
APR. 1, 1991			$4.25 for all covered, nonexempt workers	
OCT. 1, 1996[5]			$4.75 for all covered, nonexempt workers	
SEPT. 1, 1997			$5.15 for all covered, nonexempt workers	
JUL. 24, 2007			$5.85 for all covered, nonexempt workers	
JUL. 24, 2008			$6.55 for all covered, nonexempt workers	

JUL. 24, 2009	$7.25 for all covered, nonexempt workers

([1]) The 1938 act was applicable generally to employees engaged in interstate commerce or in the production of goods for interstate commerce.

([2]) The 1961 amendments extended coverage primarily to employees in large retail and service enterprises as well as to local transit, construction, and gasoline service station employees.

([3]) The 1966 amendments extended coverage to state and local government employees of hospitals, nursing homes, and schools, and to employees of laundries, dry cleaners, large hotels, motels, restaurants, and farms. Subsequent amendments extended coverage to the remaining federal, state, and local government employees who were not protected in 1966; to certain workers in retail and service trades previously exempted; and to certain domestic workers in private household employment.

([4]) Grandfather Clause: Employees who do not meet the tests for individual coverage, and whose employers were covered by the FLSA on March 31, 1990, and fail to meet the increased annual dollar volume (ADV) test for enterprise coverage, must continue to receive at least $3.35 an hour.

([5]) A subminimum wage—$4.25 an hour—is established for employees under twenty years of age during their first ninety consecutive calendar days of employment with an employer.

Currently there are two ways in which an employee is covered: "enterprise coverage" and "individual coverage." Enterprise coverage applies to businesses that have at least two employees and an annual volume of sales or business of at least $500,000, or are hospitals, businesses providing medical or nursing care for residents, schools and preschools, or government agencies. When there is no enterprise coverage, employees are protected as individuals if they are "engaged in commerce or in the production of goods for commerce." Domestic service workers, such as housekeepers, full-time babysitters, and cooks, are examples of workers who are individually covered (US DOL 2014). Minimum wage exceptions apply to some workers such as full-time students and tipped employees.[1]

For service workers, tips and commissions can supplement their hourly wage. Many service-oriented employees regularly receive more than $30 per month in tips, and their employers may elect to use a tip credit provision and demonstrate that tipped employees receive at least the minimum wage when direct (or cash) wages and the tip credit amount are combined. For example, if an employee's tips combined with the employer's direct (or cash) wages of at least $2.13 per hour do not equal the minimum wage of $7.25 per hour, the employer must make up the difference. Thus, the maximum tip credit that an employer can claim is $5.12 per hour (the minimum wage of $7.25 minus the minimum required cash wage of $2.13). Employers can also pay a youth minimum wage of $4.25 an hour (to employees who are under twenty years of age during the first ninety days after initial employment). This includes protections for adult workers and prohibits employers from displacing any employee in order to hire someone at the youth minimum wage (US DOL 2014).

In 2012, 75.3 million workers in the United States age sixteen and over were paid at hourly rates, representing 59.0 percent of all wage and salary workers. Among those paid by the hour, 1.6 million earned exactly the prevailing federal minimum wage of $7.25 per hour. About 2.0 million had wages below the federal minimum. Together, these 3.6 million workers with wages at or below the federal minimum made up 4.7 percent of all hourly paid workers. the highest proportion of hourly paid workers earning at or (p. 376) (p. 377) below the federal minimum wage was in service occupations, at about 12 percent. The industry with the highest proportion of workers with hourly wages at or below the federal minimum wage was leisure and hospitality (about 19 percent) (US DOL 2013).

(US DOL 2013). Thus the minimum wage affects primarily small businesses. The percentage of workers earning the minimum wage does not vary much by race or ethnicity (US DOL 2013).

Historically, proponents have viewed the minimum wage as an important antipoverty tool. Opponents have seen it as a burden on employers and an unwarranted interference with the labor market. The employment effects of the minimum wage have generated particular controversy. As early as the 1940s, George Stigler argued that "economists should be outspoken and singularly agreed" that the minimum wage does not reduce poverty (1946, 358). Opponents claim that the weight of the evidence supports the view that higher minimum wages reduce employment by forcing marginal businesses to lay off workers. However, empirical research suggests that the most recent increases have had little or no adverse effects on employment (Card and Krueger 1995; Freeman 1996). Moreover, some economists believe that the minimum wage offers benefits to firms, citing higher productivity, decreased turnover, lower recruiting and training costs, decreased absenteeism, and increased worker morale as gains that might offset some of the costs to employers of a wage increase (Fox 2006).

3 Taxing Low-Wage Working Families out of Poverty

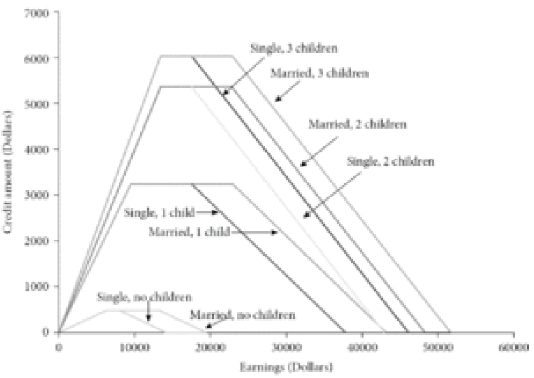
Before examining the origins of the EITC, a useful way to think about the impact of the income tax on low-wage working families is to compare the income tax entry threshold and the federal poverty threshold. The tax entry threshold is the maximum income a family can earn before owing federal income tax (Maag 2004). The federal poverty threshold represents "the minimum dollar amount needed for individuals, couples, or families to purchase food and meet other basic needs" (US Dept. of Health and Human Services 2011). The poverty threshold increases with family size and is updated for inflation annually, using the consumer price index (CPI) (Maag 2004). If total family income is less than the threshold appropriate for that family, the family is in poverty. For example, if the tax entry threshold for a family of four falls at or below the poverty threshold, tax liabilities can push such families below the poverty line.

Because the personal exemption and the minimum standard deduction remained constant in nominal terms between 1948 and 1963, while the poverty threshold rose with inflation, the level at which low-income families started paying income taxes fell below the poverty line during this period. In 1964 Congress began to adjust the tax entry threshold—the amount a family could earn before having to pay federal income taxes—back up toward the poverty threshold (Atrostic and Nunns 1991). For (p. 378) the first time the income tax came to be seen as an antipoverty tool. But the tax entry threshold again fell below the poverty threshold during the late 1970s, and ad hoc increases were adopted in 1970, 1972, and 1979 to address the problem (Bakija and Steuerle 1991).

The 1980s brought tax relief for low-income families in two forms. First, the 1981 Economic Recovery Tax Act (ERTA) indexed the personal exemption, standard deduction, and tax brackets to inflation beginning in 1985. Second, the 1986 Tax Reform Act (TRA) expanded the EITC, which had been introduced in more modest form as the earned income credit in 1975, and indexed it to inflation as well. These changes, followed by increases in the EITC in the 1990s under the Bush and Clinton administrations, reduced the tax burden faced by low-income earners with children. Since the 1990s the tax entry threshold for a family of four has exceeded the poverty threshold, due largely to the EITC and more recently to the child tax credit (CTC) (Maag 2004).

Besides income taxes, most workers owe payroll taxes. When the federal payroll tax was first collected in 1937, it was only 2 percent of wages and salaries, evenly divided between employer and employee. By 1960 the rate had tripled to 6 percent, which approached the upper range of what President Franklin D. Roosevelt's Treasury Department had anticipated that low-income workers could bear without needing income tax relief. In 2011 the payroll tax rate was 15.3 percent of earnings (12.4 percent for Social Security and Disability Insurance and 2.9 percent for Medicare) (Burman and Leiserson 2007). Historically, Democrats and Republicans have disagreed over how to finance expansion of the Social Security program. Liberal Democrats preferred to increase the income ceiling on the payroll tax base, which would increase the tax burden on higher-income workers, while their more conservative colleagues favored increasing the payroll tax rate (Reese 1980). However, by the mid-1970s Democrats and Republicans expressed growing concern about the regressive effects of the payroll tax, which when combined with the income tax imposed a higher effective tax rate on low-income earners than high-income earners. In fact, many low-income taxpayers owed more in payroll taxes than in federal income taxes. To help such families, in 1975 Congress adopted the earned income credit—later known as the EITC—which reduced their tax liability.

The EITC reduces poverty by supplementing the earnings of workers with low earnings. Beginning with the first dollar, a worker's EITC grows with each additional dollar of earnings until the credit reaches the maximum value. This creates an incentive for people to leave welfare for work and for low-wage workers to increase their work hours. In 2011 working families, with children who had annual incomes below about $36,000 to $49,000 (depending on marital status and children) may have been eligible for the EITC. Working poor individuals without children who had incomes below about $13,600 ($18,700 for a married couple) could receive a small EITC (Center for Budget and Policy Priorities [CBPP] 2011). Twenty-five states, including the District of Columbia, have established EITCs to supplement the federal credit.



Click to view larger

Fig. 21.2 Earned Income Credit by Number of Children and Filing Status, 2013

Source: Historical EITC Parameters, January 28, 2013, Tax Policy Center. http://www.taxpolicycenter.org/taxfacts/displayfact.cfm?Docid=36.

(p. 379) The amount of EITC depends on a recipient's income, marital status, and number of children (Figure 21.2). The amount rises with earned income until it reaches a maximum and then begins to phase out at higher income levels. In the 2009 tax year twenty-seven million working families and individuals received the EITC, which lifted about six million people out of poverty, including about three million children. The poverty rate among children would have been nearly one-third higher without the EITC. The EITC lifts more children out of poverty than any other social policy (CBPP 2011).

During the 2009 tax year the average EITC was $2,770 for a family with children and $259 for a household without children. Because of the credit, most low-wage working parents do not owe any federal taxes and often receive a tax rebate. There has been bipartisan agreement that a two-parent family with two children and at least one full-time, minimum-wage worker should not have to raise its children in poverty. At the minimum wage's current level, such a family can move above the poverty line only if it receives the EITC as well as SNAP (food stamp) benefits (CBPP 2011). The EITC for workers without children remains too small to fully offset federal taxes for workers at the poverty line. Currently, a childless adult or noncustodial parent who works full time at the minimum wage does not receive any EITC benefits. As a result, low-wage workers not raising children can still be taxed into poverty.

(p. 380) 4 Partisan Politics

Agreement that full-time workers and their families should not live in poverty does not mean agreement over how best to achieve that goal. Political conflict over the minimum wage and EITC has mirrored major ideological and distributional divisions within American politics over the past several decades. There has been significant partisan conflict over increases in the minimum wage (and expansion of coverage), driven by the perceived trade-off between increases in workers' income and in labor costs for small business. Broader debates over the progressivity of the tax code have been partisan and divisive. Tax credits for low- to moderate-income earners with children, such as the EITC and CTC, have been a partial exception to this rule, drawing support across partisan, ideological, and economic lines. Nonetheless, partisan conflict has emerged over the EITC's "refundability," the costs of which have grown substantially over the past decades.

Democrats and Republicans have preferred different policies not solely for technical or ideological reasons, but also based on their distributive consequences for core constituents and interest groups. In forging the coalitions needed to enact policy change, both parties have sought to distribute tax relief or minimum wage increases (or exemptions) to the groups perceived as crucial to their electoral success. Moderates have played a pivotal role in brokering and shaping these final bargains. Both policies have been marked by repeated trade-offs between the demands of effectiveness and political support, and smaller, bipartisan groups of centrists have been critical at every stage of their evolution (Gitterman 2009).

5 The Federal Minimum Wage, 1938–2013

The minimum wage emerged from the later New Deal as a mechanism to boost the pretax earnings of low-wage workers, regardless of their family size. The Great Depression had reached unprecedented depths by 1932–1933, with more than half of

Americans living below a minimum subsistence level. The challenge was to lift wages and prices at the same time. Roosevelt's initial response was the 1933 National Industrial Recovery Act (NIRA), through which Congress empowered the president to set minimum prices, wages, and competitive conditions in all industries. The minimum wage was intended to increase workers' purchasing power. However, there was widespread evasion of the NIRA labor codes, and the US Supreme Court declared the program unconstitutional (Bernstein 1987).

Led by Roosevelt, Congress adopted the 1935 National Labor Relations Act (NLRA), which authorized most private-sector employees to join unions, to bargain collectively (p. 381) with their employers, and to strike. Congress established an independent entity, the National Labor Relations Board (NLRB), with the power to investigate and decide allegations of unfair labor practices and to conduct elections in which workers could choose whether to be represented by a union. Under the NLRA unionization rates doubled to more than one in four workers by 1940. However, collective bargaining was not a realistic option for many low-wage workers (Tomlins 1985).

To help unorganized workers, Roosevelt proposed a federal minimum wage at 80 cents per hour. Under his plan, Congress would delegate authority to a Fair Labor Standards Board, analogous to the NLRB, to set a minimum wage on an industry-by-industry basis and adjust the minimum wage to keep pace with inflation. However, to win passage of his proposal, the president had to secure the support of rural conservative southerners, who dominated the Democratic Party. In the early 1930s they favored an assertive role for the government in economic affairs and supported many of Roosevelt's labor-related initiatives, albeit with reservations and only after securing protection for their regional interests. As economic historian Gavin Wright (1986) has observed, all the distinguishing differences between the South and the rest of the United States had their roots in the "separateness" of the southern labor market. This "separateness" was evident in the low average wages paid, low investment in education, and low average value added in manufacturing per worker (Brand 1988).

In crafting a final bargain—a 25 cents per hour federal minimum wage, with many industries excluded—a conservative coalition of Republicans and southern Democrats chose to retain direct legislative control over the minimum wage rather than delegate authority to an independent body. This choice ensured that a new coalition had to be built *each and every time* policy makers sought to increase the minimum wage or expand its coverage. From 1938 to 1994 an enacting coalition had to include key members of the congressional labor committees, the House Rules Committee, the leadership of the majority party, and the president. By retaining political control, Congress could claim credit for a minimum wage increase, which had strong public support across all regions, as well as minimize blame from groups that feared its impact on labor costs by limiting coverage and the amount of the increase (Gitterman 2012).

In ensuing decades, policy makers made the most of this ability by fine-tuning increases (and limiting coverage) in response to the dictates of electoral politics. Congress adopted increases in a series of incremental steps rather than one large expansion, often directly before an election—a logic similar to Social Security benefit increases. Rather than work for repeal of the minimum wage, which was not in its members' electoral self-interest, the conservative coalition opposed any expansion of coverage from 1938 until 1961, as well as efforts to index it to inflation. However, the coalition did agree to modest and periodic increases in the minimum wage. Throughout this period liberal Democrats and their labor allies were forced to scale back their ambitions to win any support for wage increases from conservative legislators and their agricultural and small business allies. In the 1960s, however, moderates began to replace conservatives among southern Democrats in Congress, leading in 1961 and 1966 to the first major expansion of coverage since the New Deal. Each increase was made (p. 382) possible by intraparty bargaining between conservative southern and liberal Democrats (Gitterman 2012).

By the early 1980s the minimum wage emerged as "political enemy number one" for President Ronald Reagan and Senate Republicans. When Reagan took control of the White House, he was calling it an injustice, the cause of "more misery and unemployment than anything since the Great Depression." After regaining control of the Senate in 1986, Democrats aimed to increase the minimum wage to roughly half of the average wage (Cohodas 1987). Republicans blocked Democratic efforts to do so during the latter part of Reagan's second term. In late 1989 the moderate President George H. W. Bush agreed to a two-step increase to $4.25 (by 1991) in exchange for a temporary training wage for teenagers and a larger exemption for small businesses (Pytte 1989).

An unlikely agreement was struck between President Bill Clinton and the Republican Congress in 1996. As a candidate for president, Clinton had positioned himself as a moderate Democrat who promised to “end welfare as we know it” and make work pay. Although Clinton had promised to increase the minimum wage during his first year, he delayed proposing an increase because of concerns about antagonizing moderate-to-conservative Democrats. After Republicans took control of Congress in the historic 1994 midterm elections, Clinton proposed an increase from $4.25 to $5.15 over two years (Gitterman 2009).

Congressional Republicans in the 1990s were more conservative than their counterparts in the 1960s. Predictably, Republican leaders opposed any increase. Moderate Republicans, in contrast, supported a modest increase. Thus a new intraparty conflict emerged between conservative House leaders, primarily from the South, and a smaller group of moderate Republicans from the Northeast and Midwest, who feared that a vote against an increase would hurt them in the 1996 elections. The Republican leadership responded to concerns about an increase in labor costs by packaging a modest minimum wage increase with a tax relief package for small business. Ultimately, as part of the 1996 Small Business Job Protection Act, Clinton and a Republican Congress approved a two-step increase (from $4.25 to $4.75 and then to $5.15 by September 1997) (Gitterman 2009).

The 1996 agreement represented the first increase ever adopted when Republicans controlled at least one chamber of Congress. It reflected a new bargain: conservative southern House Republicans allowed a coalition of centrist northeastern Republicans and liberal Democrats to enact an increase, but only if it was coupled with tax relief for small businesses. Later in the decade Republicans were ready to make a similar deal. Although many remained opposed to the minimum wage on ideological grounds, they recognized it was important to moderate Republicans’ electoral fortunes and thus to their control of Congress. Some supported a modest increase because they hoped to remove the issue from the Democrats’ political arsenal, especially before the 1998 and 2000 elections (Gitterman 2009).

Between 2001 and 2006 President George W. Bush, backed by Republican leaders in Congress, refused to increase the minimum wage. After regaining control of Congress in 2006, the Democrats secured an increase as part of a supplemental defense (p. 383) appropriations bill that provided emergency funds for the war in Iraq. The agreement—the 2007 Small Business and Work Opportunity Tax Act—combined an increase to $7.25 an hour by 2009 with $4.84 billion in small business tax relief. During the 2008 campaign Democratic presidential candidate Barack Obama pledged to increase the minimum wage to $9.50 and index it to inflation, but Congress was reluctant to support an increase during the recent economic downturn (Gitterman 2009).

6 The Earned Income Tax Credit, 1975–2013

The EITC is a refundable tax credit, enacted with bipartisan support in 1975. It encourages low-income workers with children to enter and remain in the labor market by supplementing their earnings. Initially a temporary measure, it was made a permanent part of the Internal Revenue Code (IRC) in 1978. Since then it has undergone expansions with bipartisan support. The credit was expanded in 1986 under President Reagan, in 1990 under President Bush, and again in 1993 under President Clinton, when the size of the credit was doubled and a small credit was added for workers without children (Holt 2006). The EITC’s initial popularity was based on its ability to provide both work incentives and tax relief for low-income workers and their families. One bipartisan goal, often espoused by President Reagan, was to eliminate income taxes on workers below the poverty line so they would not be taxed deeper into poverty.

The roots of the EITC can be traced back to the 1960s. President Lyndon B. Johnson charged several antipoverty task forces with investigating the impact of nonindexation of the personal exemption and standard deduction, as well as the effects of the payroll tax. The rising payroll tax burden also helped fuel interest among some Democrats in a proposal known as the negative income tax (NIT). The NIT would be a mirror image of the income tax. Instead of tax liabilities varying positively with income according to a tax rate schedule, benefits would vary inversely with income according to a negative tax rate (or benefit reduction) schedule. This approach would allow policy makers to increase the income of low-wage earners whose tax liability was already zero, but who faced increasingly burdensome payroll taxes. More broadly, it would provide an additional policy tool for pushing low-income working families above the poverty threshold and keeping them from turning to welfare or other cash assistance programs.

Although President Richard M. Nixon had not mentioned the NIT in the 1968 campaign, he included it as part of his Family Assistance Plan (FAP) in 1969. Under this proposal, a family of four with no income would receive $1,600—a guaranteed minimum income. The idea was blocked by conservative Democrats, who argued that it would undermine the incentive to work (Ventry 2000). Senator Russell Long (D-La.) proposed a plan to distribute tax relief only to those "willing to work." This proposal called for wage subsidies to low-income workers, known as a "work bonus," equal to 10 percent (p. 384) of the wages subject to payroll taxes. Long argued that his proposal would offset payroll taxes, act as an earnings subsidy, and "prevent the taxing of people onto the welfare rolls" (Ventry 2000, 986). An attraction of the earnings subsidy, which became known as the earned income credit, was that its benefits rose positively with earnings up to a plateau, increasing incentives for very low income earners to work. However, more liberal House Democrats rejected the proposal three years in a row in the hope of passing an NIT instead.

In the mid-1970s President Gerald Ford proposed an $80 tax rebate for the poorest taxpayers. House Democrats went further by proposing a refundable credit, worth 5 percent of earned income, up to a maximum of $200 for lower-income earners with little or no tax liability (Ford 1975). This EIC, which closely matched the payroll tax on the first $4,000 of earned income, was expected to stimulate the economy because low-wage earners generally spend much of their increases in after-tax income (H.R. Rep. 94-19 1975). House Democrats viewed a one-time EIC as a way of offsetting the regressivity of the payroll tax, a subject of concern within both parties. More conservative Senate Democrats, in contrast, portrayed the EIC as welfare reform and sought to restrict the credit to low-income married couples with children. Because many low-wage workers were from nonpoor families, Senate Democrats concluded that extending earning subsidies to all workers would be "expensive and inefficient in reaching the poor" (S. Rep. 94-36 1975). The Senate reduced the number of eligible earners from 28 to 6.4 million. Ultimately, the 1975 measure created a one-year refundable credit of up to $400 for earners with dependents (and incomes below $8,000). Nonetheless, the EIC emerged as a tool to boost the paychecks of low-wage workers with children.

Initially policy makers were divided over the credit's purpose: whether to provide payroll tax relief to all low-wage workers or to increase the labor force participation of less-skilled workers who might otherwise rely on public assistance to support their families, or both. Ultimately Congress structured the credit to do both, but only for families with children, thus placing more emphasis on its role in welfare reform. In this way the EITC fulfilled its original purpose as set forth by Congress, "an added bonus or incentive for low-income people to work," and as a way to reduce welfare dependency by "inducing individuals with families receiving federal assistance to support themselves" (S. Rep. 94-36 1975).

Both parties in the 1980s supported the EITC as a mechanism to boost the paychecks of working poor families (Toder 1998; Steuerle 2008). This development was important given the stalemate over the minimum wage, which remained at the same level from 1981 to 1990. Not surprisingly, many of the same business groups that opposed increases in the minimum wage supported the EITC; they preferred that taxpayers boost wages for their workers (Howard 1997). In the early 1990s Clinton pledged that full-time work at the minimum wage plus the EITC (and any Food Stamps for which a family was eligible) would be enough to raise a family's after-tax income above the poverty threshold. The emphasis on helping low-income earners with jobs, rather than those on welfare, reflected a conviction often repeated by Clinton: the government should "make work (p. 385) pay" for those at the bottom. To achieve this distributional goal, the EITC would need to be increased, particularly for families with two or more children. These changes, followed by increases in the EITC under Clinton, reduced the tax burden faced by low-income earners with children. Although part of the EITC's growth was due to rising demand, the reason for expansion has been sizable real benefit increases legislated in 1986, 1990, and 1993 (Myles and Pierson 1997).

By the mid-1990s, however, the bipartisan consensus had started to unravel. Some Republicans now wanted to roll back the EITC. Many conservatives had come to view the refundable EITC as a form of welfare. Arguing that the EITC was supposed to offset tax liability for low-income, full-time workers, Republicans claimed that the most recent Clinton expansion had transformed the EITC "into more of a welfare program than a tax refund" (Rubin 1995, 3057). In addition, many Republicans were concerned about fraud and abuse, as well as about the exponential growth of the refundable portion of the EITC. Republicans secured new rules to strengthen compliance and enforcement as part of the 1996 Personal Responsibility and Work Opportunities Act, the 1997 Taxpayer Relief Act, and the 1997 Balanced Budget Act (US Treasury 2003).

The opening decade of the twenty-first century brought modest gains to working poor families. The 2000 election gave the Republicans control of the White House and Congress for the first time since 1954. During the debates on President Bush's tax cuts in 2001, Senate centrists insisted on more tax relief for those at the lower end of the income distribution. For example, they won agreement on a *refundable* child tax credit for working poor households earning at least $10,000 and set the income threshold for eligibility to satisfy Republicans, who opposed earnings subsidies for nonworking poor families. With a typical minimum wage worker earning a little more than $10,500 in 2001, the eligibility threshold allowed Republicans to claim that only families with the equivalent of a full-time, working parent would benefit from the refundable CTC (Nitschke and Swindell 2001). Single parents who worked less than full time and two-parent families with very limited earnings would not qualify for the credit.

During the 2008 campaign Obama proposed a making work pay (MWP) credit, worth $500 for single workers and $1,000 for families, which would eliminate the tax liability of ten million low-income earners (Tax Policy Center 2008). Obama pledged to expand—but did not succeed in expanding—the EITC and making the child and dependent care tax credit refundable for the first time in its history. Under the 2009 American Recovery and Reinvestment Act (ARRA), President Obama and congressional Democrats approved the MWP credit and temporarily expanded the EITC in two ways. First, the act added a "third tier" of the EITC for families with three or more children, so that these families can receive up to $629 more than families with two children. Second, the ARRA expanded marriage penalty relief in the EITC, reducing the financial penalty some couples experience when they marry by allowing married couples to receive larger tax benefits. These changes were scheduled to expire at the end of 2010, but Congress extended them through 2012 (CBPP 2011). By 2011, the recession and high unemployment, the Republican takeover of the House, and budget deficits loomed as stumbling blocks for Obama.

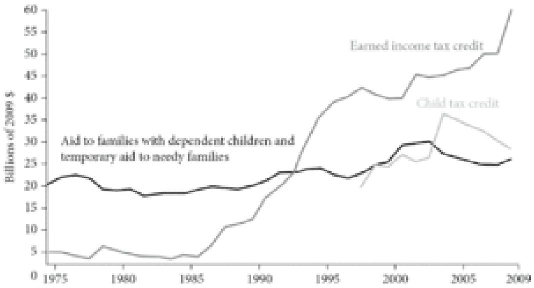
(p. 386) 7 Supporting Low-Wage Workers in the United States

The minimum wage and EITC have followed distinct historical trajectories. As a result, they do not add up to a coherent policy regime. An enduring, fragile consensus rests on a simple idea: if able-bodied parents participate in the labor market, their take-home pay should be sufficient to lift their families out of poverty. The effectiveness of the minimum wage in alleviating poverty clearly depends on the workings of the tax system and vice versa. In the case of the minimum wage, this has meant slow and piecemeal growth. In the five decades after its passage, liberal Democrats had to accept limitations on coverage to gain support for modest increases from southern Democrats and Republicans. In the mid-1990s the price they paid for increases became tax relief for small businesses. Such bargains have allowed the minimum wage to endure through both liberal and conservative periods.

On the income tax side of the agenda, refundable credits have emerged as the centerpiece of efforts to help working poor families. This development has been fostered by growing reliance on the budget reconciliation process. Through reconciliation—a process first used in 1981—Congress decides which changes in mandatory spending and revenue programs are necessary to reach the overall goals set by the budget resolution for that fiscal year (Lindblom 2008). The process is governed by expedited procedures and restrictions, such as a ban on filibustering in the Senate, and produces huge omnibus packages. Together, these rules ensure that a bill moves quickly through the legislature, "beset by few of the procedural veto-gates that lie in wait for the typical piece of legislation" (Garrett 2000, 720). In this environment, tax credits have become a popular way for legislators to fine-tune the distributional impact of tax and spending packages and to deliver benefits to favored constituencies.

Thus, throughout its history the EITC has helped legislators deliver benefits to low-income families, alter the distributional balance of omnibus tax packages, and thereby secure bipartisan agreement. The 1986 EITC expansion resulted from a bipartisan effort to deal with some of the distributional unfairness of Reagan's tax relief in 1981. In 1990 both Republicans and Democrats saw expansion as a straightforward way to alter the distributional characteristics of the deficit reduction package and head off charges that it essentially benefited high-income earners. The 1993 EITC expansion made it easier for Democrats to support Clinton's first budget, which included more spending cuts and deficit reduction than they preferred.

Equally important, the period since the early 1980s has seen the consolidation of a consensus on the idea that working families should be the primary beneficiaries of tax-based assistance. It drove and was strengthened by the passage of welfare reform in 1996. This reform—which replaced Aid to Families with Dependent Children (AFDC) with Temporary Assistance to Needy Families (TANF)—shifted the focus of efforts to (p. 387) support poor families from cash assistance programs, such as welfare, to strategies to supplement labor market earnings, such as refundable tax credits (Haveman 2003). As Figure 21.3 shows, shifts in budgetary outlays on these programs and credits are indicative of the changing policy orientation.



Click to view larger

Fig. 21.3 Real Federal Spending on EITC, CTC, and Welfare, 1975–2009.

Source: Budget of the U.S. Government, Fiscal Year 2012, for AFDC/TANF; Internal Revenue Statistics of Income, various years for EITC and CTC; Bureau of Labor Statistics for CPI Deflator.

In recent years the temporary refundable making work pay credit and recent (temporary) payroll tax reductions have offset Social Security and Medicare payroll taxes. Unlike the EITC, this tax relief is offered to moderate- and middle-income workers and families as well as lower-income families (up to their first $110,100 in wages). The payroll tax reduction was passed for one year when Obama and Republicans in Congress sought compromise on the Bush tax cuts. Moreover, unlike the CTC, it helps childless workers and married couples, as well as families with children, suggesting a turn toward universalism in policies to boost the after-tax income of working families. The MWP credit expired in 2010.

8 The Challenges Ahead

Self-sufficiency and hard work lie at the heart of the idea of the "American Dream." Full-time participation in the labor market remains central to economic well-being, and the primary source of support for most working-age adults is their employment and earnings (Blank 2000; 2009). Americans expect their fellow citizens to work hard to support themselves and their households (Sawhill and Morton 2007). This emphasis on work as the route to self-sufficiency has driven many of the welfare reforms in (p. 388) recent decades. Yet minimum wage work alone is still not enough to keep some workers and their families out of poverty or to move others into the ranks of moderate-income families.

The original 1938 minimum wage agreement established a logic that helps explain its subsequent development. Instead of delegating authority to a wage-setting board, Congress chose to retain control over the amount and timing of any increase and the industries and occupations covered. Legislators guarded this power over the following decades. By retaining statutory control over its parameters, reluctant converts to the minimum wage were able to maximize the electoral benefits of a popular policy while minimizing the negative effects by limiting the costs imposed on business and agricultural groups. Since the late 1960s the principal casualties of these dynamics have been the real value of the minimum wage and the earnings of minimum wage workers. In 1977 Congress refused to index the minimum wage to inflation, and in 1990 it declined to establish a minimum wage advisory board even to "recommend" cost-of-living adjustments. Obama pledged to increase the minimum and to index it to inflation. But every prior effort to index the minimum wage has been defeated, and moreover, Obama could emerge as the first Democrat since the New Deal not to sign an increase.

The prevailing wisdom among political analysts is that narrowly targeted income transfers, such as direct cash assistance to poor families, have enjoyed only sporadic political support. They tend to be enacted or expanded in periods of partisan imbalance and to be vulnerable to retrenchment when elections shift the balance of power. However, many suggest that the EITC is a notable counterexample. It has been expanded under both Democratic and Republican administrations, often with bipartisan support. According to Robert Greenstein (1991, 450), the EITC's design—"a middle ground of maintaining a targeted program structure while incorporating near-poor and moderate-income working families that are struggling themselves"—has helped broaden its appeal.

However, the EITC is not immune to opposition, and the attacks on the program suggest the many challenges that credits may face in the future. Notably, some Republicans remain opposed to the concept of refundable credits, while many centrists are concerned about the cost in terms of budget outlays. Many critics of refundability would agree with George Yin (1996) that "programs should not be hidden in the tax system and therefore be subject to a lower level of scrutiny. If as a transfer program the EITC would not garner a sufficient level of political support to remain viable, there is no reason that it should continue to exist in the tax system and in the process be administered inefficiently" (1996, 316). In addition, some believe that everyone should pay at least some taxes, even if just one dollar, as a duty of citizenship and so that they feel they have some stake in governmental decisions (Batchelder, Goldberg, and Orszag 2006). This last argument, which opposes the rise of the "zero-filers" or those with no federal tax liability, is perhaps the most daunting for proponents of refundable credits.

Some research concludes that the EITC is more effective than the minimum wage in providing support for low-wage workers. Critics argue, for example, that the EITC is better targeted because many of the beneficiaries of minimum wage increases are not (p. 389) members of low-income families (Hotz and Scholz 2000). However, others conclude that the effectiveness of the EITC in raising the incomes of working poor families above the poverty threshold depends, in part, on regular increases in the minimum wage. Richard Freeman (1996) concludes that an appropriately set minimum wage can be a modestly effective redistributive tool—a risky but potentially profitable investment—particularly if it is linked with other social policies, such as the EITC, that support low-income earners and their families.

In forecasting the future of the minimum wage and the EITC, it is important to highlight the role of partisan political control of the White House and Congress on the one hand and coalition politics within Congress on the other. The differences between the parties over these policies have increased in recent decades as partisan polarization has soared. According to Nolan McCarty (2007), by almost all measures the divide between Democratic and Republican members of Congress has widened over the past twenty-five years, reaching levels of partisan conflict not witnessed since the 1920s. Polarization contributes to gridlock and stalemate, making it more difficult for Congress to respond to economic shocks and adopt measures such as minimum wage increases and expansions of the EITC.

Since the early 1980s both Republicans and Democrats have found their way around partisan gridlock to reach bargains on issues as contentious as tax policy and the minimum wage. With rare exceptions, neither party has had a sufficient majority or sufficient internal unity to legislate on its own in the past three decades. Relatively little attention has been paid to the effects of polarization on policy outcomes. Some political scientists conclude that polarization is not ideologically neutral; it has had a conservative effect on policy. Others argue that the main effect of polarization has been to produce less policy (McCarty 2007). However, most agree that polarization leaves centrists in both parties with the ever more important and demanding role of brokering policy bargains. Without a new bargain that balances partisan distributional and electoral goals, low-wage workers' families and the policies to support them remain at risk.

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Notes:

(1) . For a complete list of minimum wage exemptions, see U.S. Dept. of Labor, “Fair Labor Standards Act Advisor: Exemptions,” http://www.dol.gov/elaws/esa/flsa/screen75.asp.

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