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Evidence-based policy making

# The minimum wage versus the earned income tax credit for reducing poverty

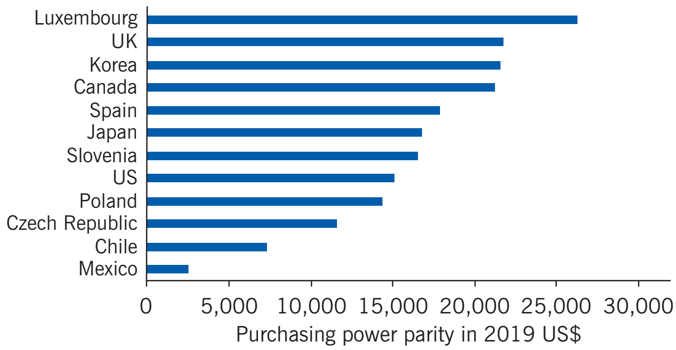
## Enhancing the earned income tax credit would do more to reduce poverty, at less cost, than increasing the minimum wage

Keywords: minimum wage, earned income tax credit, working poor

## ELEVATOR PITCH

Minimum wage increases are not an effective mechanism for reducing poverty. And there is little causal evidence that they do so. Most workers who gain from minimum wage increases do not live in poor (or near-poor) families, while some who do live in poor families lose their job as a result of such increases. The earned income tax credit is an effective way to reduce poverty. It raises only the after-tax wage rates of workers in low- and moderate-income families, the tax credit increases with the number of dependent children, and evidence shows that it increases labor force participation and employment in these families.

Annual real minimum wages in selected OECD countries




*Source*: Authors' own based on data extracted on May 21, 2021 from OECD.Stat. Online at: https://stats.oecd.org/

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## KEY FINDINGS

### Pros

- There is little causal evidence that minimum wage increases will reduce poverty rates overall or for workers.
- Minimum wage increases go primarily to workers in non-poor families.
- Some workers lose their jobs when minimum wages rise, pushing their families into poverty.
- Most working-age poor people do not work, work part-time, or have wages above proposed increases in the minimum wage.
- Earned income tax credits more efficiently provide benefits to workers in poor families and increase employment in them.

### Cons

- Modest minimum wage increases at most only have a small negative effect on employment.
- Minimum wage increases circumvent the budget process: they are funded neither by government expenditures nor by tax liabilities.
- The macroeconomic effects of a higher propensity to spend by those whose wages rise because of a minimum wage hike reduce its direct negative microeconomic effects on employment, at least in the short term.
- Minimum wage increases during the expansion phase of a business cycle, when labor demand is growing, can reduce poverty if the employment effects are small.

## AUTHOR'S MAIN MESSAGE

Introducing or increasing a minimum wage is a common policy measure aimed at reducing poverty. But doing so is unlikely to achieve this goal. While a minimum wage hike will increase the wage earnings of some poor families and lift them out of poverty, some workers will lose their jobs, pushing their families into poverty. In contrast, improving the earned income tax credit can provide the same income transfers to the working poor at far lower cost. Earned income tax credits effectively raise the hourly wages only of workers in low- and moderate-income families, while increasing labor force participation and employment in those families.


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