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THE WAGE SUBSIDY
A Better Way to Help the Poor

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EXECUTIVE SUMMARY

As contentious debate proceeds about the extent and causes of wage stagnation on the lower rungs of America's economy, efforts have increased across the political spectrum to improve the economic fortunes of low-wage workers. In particular, policymakers have focused on making work more attractive. This approach, unlike most expansions of the welfare state, holds the promise of increasing the immediate well-being of the working poor, as well as the incentive of the nonworking poor to find jobs.

Two wage-support tools typically receive consideration: the minimum wage and the Earned Income Tax Credit (EITC). Both have the potential to significantly increase disposable income for at least some low-income workers. But their mechanisms—and impact—differ dramatically. The minimum wage, a price floor under wages, performs well vis-à-vis an individual worker but poorly in its labor-market and distributional effects. The EITC, a subsidy for income earned, has strengths and weaknesses roughly the opposite. The drawbacks of both tools prevent them from delivering fully on their antipoverty goals.

Any discussion of wage-support options should include a third policy tool with the potential to deliver the best of both worlds: a wage subsidy delivered directly to low-wage workers, via their

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paychecks, as additional dollars per hour for every hour worked. (The EITC, while commonly called a "wage subsidy," is not one. It is a tax credit paid after the fact on total income earned; a wage subsidy is paid in real time for each hour worked.)

Through its effect on wages paid, the wage subsidy would deliver to workers much the same benefit as a minimum wage. Through its effect on the economics of the low-wage employment relationship, it would influence the labor market in much the same way as the EITC. Its structure is thus preferable for the unemployed, for workers, for employers, and for society.

Variations of the wage subsidy have been proposed previously and have appeared prohibitively expensive.[1] Nobel laureate Edmund Phelps's 1997 book, *Rewarding Work: How to Restore Participation and Self-Support to Free Enterprise*, offers a detailed wage-subsidy proposal with an annual cost of $185 billion.[2] In fact, the money needed for a large wage-subsidy program is available because the U.S. government already spends it—on a growing EITC and on various other safety-net programs that provide in-kind benefits to the working poor. A recent University of California at Berkeley study, for instance, found that federal and state governments spend more than $150 billion annually on benefits for low-wage workers,[3] funds that could be rerouted to a more effective wage-subsidy program. Indeed, when Phelps redirected funds from existing programs to pay for his wage subsidy and accounted for the dynamic effects of the ensuing increased employment, his proposal had a net cost of zero.[4]

This paper explains why a wage subsidy would help policymakers better achieve their antipoverty and economic-mobility goals than substantially increasing the minimum wage or expanding the EITC. **Section I** reviews the economic and social factors motivating the increased focus on wage supports. **Section II** outlines the components of the three aforementioned wage-support tools. **Section III** evaluates the merits of each tool.

I. WHY SUBSIDIZE WAGES?

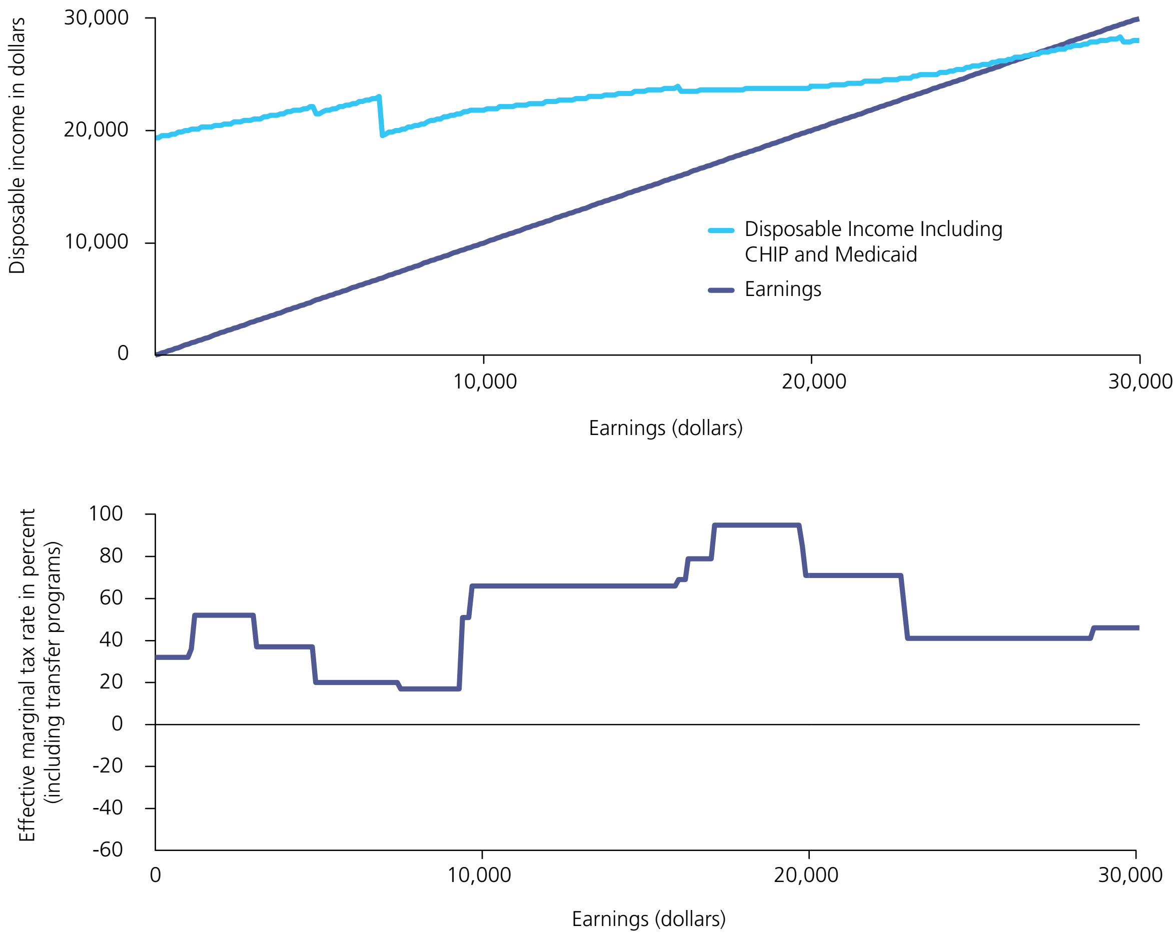
A job should offer a path out of poverty. But for those lacking the skills that America's labor market demands, it does not. This reality is often obscured by debates over "inequality" and "mobility." Much valuable research has focused on how inequality and mobility change over time—and the economic and social implications of such change[5]—yet neither the length of the economic ladder nor the frequency with which people ascend or descend it determine conditions on the ladder's lowest rungs. At present, those conditions are not good. The inadequacy of market wages low on the ladder is apparent from three angles.

Relative to the Safety Net

The value of the goods and services that society commits to providing all citizens—food, shelter, health care, education, and, more recently, even technology[6]—is an important consideration. Because the government phases out benefits as income rises, a prospective worker chooses not between zero income and a market wage but between current benefits and the prospective wage. Even the potential marginal value that a worker receives in return for his hour of work is further diluted by new costs, such as transportation and child care, that might accompany employment.

As America's safety net has expanded, it has overtaken what some households can earn in the market. For these households, a low-income job demands many sacrifices and offers little return. In 2012, the Congressional Budget Office calculated that a single parent with one child would lose 65–95 cents in benefits for every dollar earned, for an income of $10,000–$20,000 (**Figure 1**).[7] For instance, that household would receive approximately $20,000 in benefits if it earned no income; with earnings of $20,000, the total value of benefits and income would rise to only $25,000. A labor market operating under such conditions will struggle to attract low-wage workers, especially those with short-term horizons.

Figure I. What the Government Giveth . . .



Source: Congressional Budget Office

Relative to Poverty

The poverty line serves as an official proxy for what society deems a minimally adequate income. Consider the median income of working men over age 25, with only a high school diploma, in relation to the poverty line for a family of four. In 1973, that median income would bring a family to more than 200 percent of the poverty line; but in 2013, to only 131 percent. For high school drop-outs, the figures are 171 percent in 1973 and 90 percent in 2013 (**Figure 2**).

In other words, a working high school graduate in 2013 was in worse position to support his family than was a high school drop-out in the 1970s. And a working high school drop-out in 2013 was likely mired in poverty despite his employment. The story is different for women but no better: incomes for females with little education have, on average, never been sufficient to support a family and have not made progress. Median income for women with only a high school diploma declined from 79 percent of the poverty line in 1973 to 77 percent in 2013. For high school dropouts, the figure fell from 56 percent to 50 percent.[8]

In theory, the inadequacy of one wage earner's income might incentivize the formation of more two-parent households. Yet the presence of two-parent families continues to decline sharply: in 1970, 13 percent of families with children under 18 were headed by a single parent; and in 2014, 31 percent.[9] For households where the parent holds a high school diploma or less, more than 65 percent of children under the age of seven lived with a single parent in 2012, compared with just over 20 percent in 1970.[10] If policy is to improve on current conditions of family collapse and poverty, it must work from America's current family-structure realities.

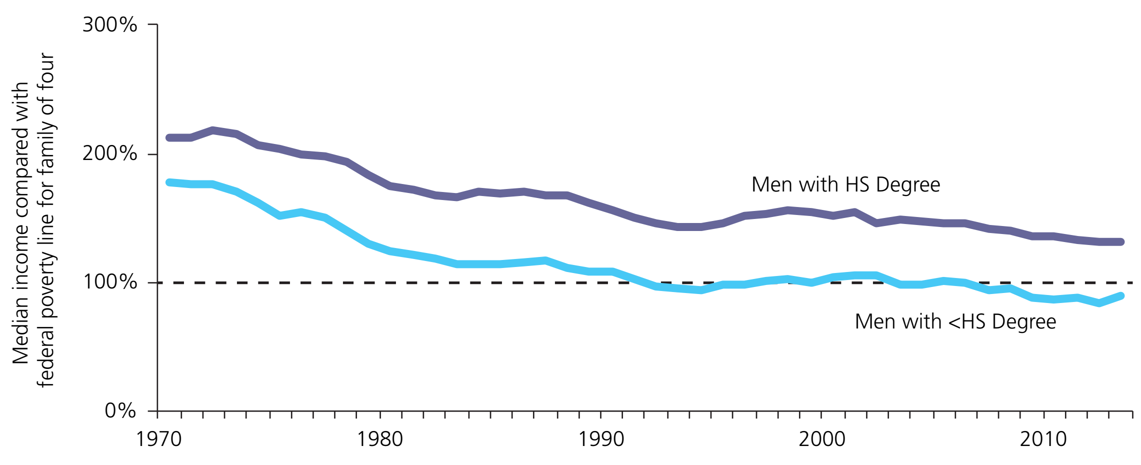
Marginal Behavior

The labor-force participation rate measures the share of civilian adults who work or seek work. Rate fluctuations indicate whether people are becoming more or less willing to exchange an hour of their time for the wage that an hour worked can earn. Since 2000, U.S. labor-force participation has suffered an unprecedented decline.[11]

The standard explanation for the decline emphasizes demographic changes driven by retiring baby boomers. However, labor-force participation has been declining rapidly within key demographic cohorts of *non*-retirees. That decline has accelerated during the economy's cyclical upswing after the last recession ended in 2009. Participation among men aged 25–54 declined from 89.8 percent in 2009 to 88.2 percent in 2014—three times faster than the rate of decline in 2004–09. Participation among women aged 25–54 fell from 75.7 percent to 74.0 percent—a reversal of the 2004–09 *increase* from 75.3 percent to 75.7 percent.

American labor-force participation is declining across all education levels (used in this paper as a proxy for earning power). But before the 2007–09 recession, workers without high school diplomas had seen their participation steadily *increase* for decades, peaking during the 2007–09 recession. Since 2009, however, their participation has declined, too. Whatever forces were pulling America's lowest-wage workers into the labor market have been replaced by forces pushing them out.[12]

Figure 2. Harder to Stay Out of Poverty



Source: U.S. Census Bureau

One response to these challenges is simply to accept them: Living standards have improved across the income distribution. Efforts to distort the market wage are inherently inefficient. Social programs exist precisely to help those unable to earn a sufficient income. And investment in education will improve skill levels and productivity over time.

Such acceptance is a mistake because it leaves unused the most effective weapon in the antipoverty arsenal. Low wages do not only—or even primarily—produce poverty through the obvious and static mechanism that earning less money leads one to have less money. Of greater concern are the dynamic ways in which low wages grease the flywheel of long-term and intergenerational poverty. Low wages leave individuals who work with insufficient resources to invest in their future and that of their children. Low wages discourage entry into the workforce and the formation of stable families.[13] In theory, wage supports thus offer a unique opportunity to break America's negative cycle of poverty, family and community breakdown, and low human-capital development.

Transferring resources directly to the working poor, thereby encouraging more poor people to work, is an intervention that better leverages what government can do effectively. Social programs ask government to build strong families and communities in destitute neighborhoods. Education reform asks government to imbue young people with forms of human capital that their families and communities do not impart. These efforts—however well-intentioned—are interventions for which government is ill-suited and its track record poor.

Delivering support to the working poor, via wages, has advantages over doing the same via government benefits. It gives the recipient flexibility to put resources to their best use, rather than those dictated by federal programs. It confers a dignity that benefits do not. Even when society wishes to provide resources to the worker and nonworker, work still offers a reward when it produces dollars to replace a benefit card or voucher. The effect is to expand labor-force participation, set workers on a path toward self-sufficiency, and provide them with resources that will strengthen family formation and community.

In 2013, more than one-third of poor adults worked.[14] Raising their wages will not eliminate poverty but would be a powerful advance for them, as well as for those who would be newly incentivized to work.

II. WAGE-SUPPORT OPTIONS

U.S. policymakers typically focus on two potential mechanisms for increasing the take-home pay of low-wage workers: the minimum wage and the EITC. In his 2014 State of the Union Address, President Obama called for increasing each in consecutive paragraphs.[15] Politicians and pundits, particularly on the right, often tout the advantages that an EITC can offer over the minimum wage—or use EITC support to soften their opposition to a higher minimum wage.[16] But they rarely acknowledge the EITC's own shortcomings, relative to a minimum wage, or consider an alternative wage-support option.

Minimum Wage

The federal minimum wage, established in 1938,[17] is the best-known wage-support tool. It defines the minimum amount that an employer may pay an employee per hour worked. In 2015, the federal minimum wage stood at $7.25/hour,[18] though 29 states,[19] as well as some cities,[20] mandated higher minimums. Economists who favor the minimum wage often support variation across markets to reflect differences in economic conditions and living costs,[21] potentially as a fixed ratio between a market's median wage and its minimum wage.[22] Seattle, San Francisco, and Los Angeles have adopted a $15 minimum wage with support from prominent progressive politicians, including Democratic presidential candidate Hillary Clinton.[23]

Minimum-wage policies can vary in application across classes of employees. Federal law allows employers to pay a lower hourly wage of $2.13 to employees who receive tips, though some jurisdictions set a higher "tipped" minimum or even the same minimum as non-tip workers.[24] In 2014, President Obama issued an executive order requiring employers to pay a minimum wage of $10.10 for workers participating in federal contracts.[25] Labor unions in Los Angeles followed their successful campaign for a $15 minimum with a campaign to exempt their own union members from that minimum.[26] In a more promising direction, Michael Strain of the American Enterprise Institute has proposed lowering the minimum wage for the long-term unemployed to make them more attractive to employers (pairing it with an offsetting wage subsidy to boost the employee's take-home pay).[27]

Despite such variation, the minimum wage is, at its core, a price floor under the hourly wage.

Earned Income Tax Credit

Established as a temporary program in 1975 and made permanent in 1978, the EITC has become a major component of federal antipoverty policy by targeting cash assistance to the working poor, particularly low-income households with children.[28]

In the 2013 tax year, the federal government dispensed $66 billion to 28 million low-income households.[29] In 2015, a single parent with one child received a $0.34 credit for every dollar earned, up to a maximum credit of $3,359 (when earnings reached $9,880). The household remained eligible for the $3,359 credit until earned income exceeded $18,110, when the credit declined by $0.16 for every dollar earned. Once the household reached earnings of $39,131, it was no longer eligible for any credit.[30]

The structure of EITC payments is similar for all household types, but the slopes and maximums vary significantly (**Figure 3**). A household with no children receives a credit of less than $0.08 for each dollar earned, with the maximum credit capped at $503; for a household with three or more children, the numbers are $0.45 and $6,242, respectively.[31]

The EITC is refundable: it not only reduces a tax filer's liability but can entitle the filer to a net payment from the government. The household must file a tax return to claim the credit. Numerous nonprofits provide free tax-preparation services,[32] and the IRS makes intensive efforts to inform workers of their options and to provide support to community organizations.[33]

For many years, the IRS offered an "advance" option that allowed workers to receive a small portion of the credit in regular installments throughout the year. Workers were generally unaware of it, however, and users risked tax bills at year's end if they initially misestimated their eligibility.[34] President Obama eliminated the program as part of 2010 legislation focused on supplementing state education and Medicaid funds.[35]

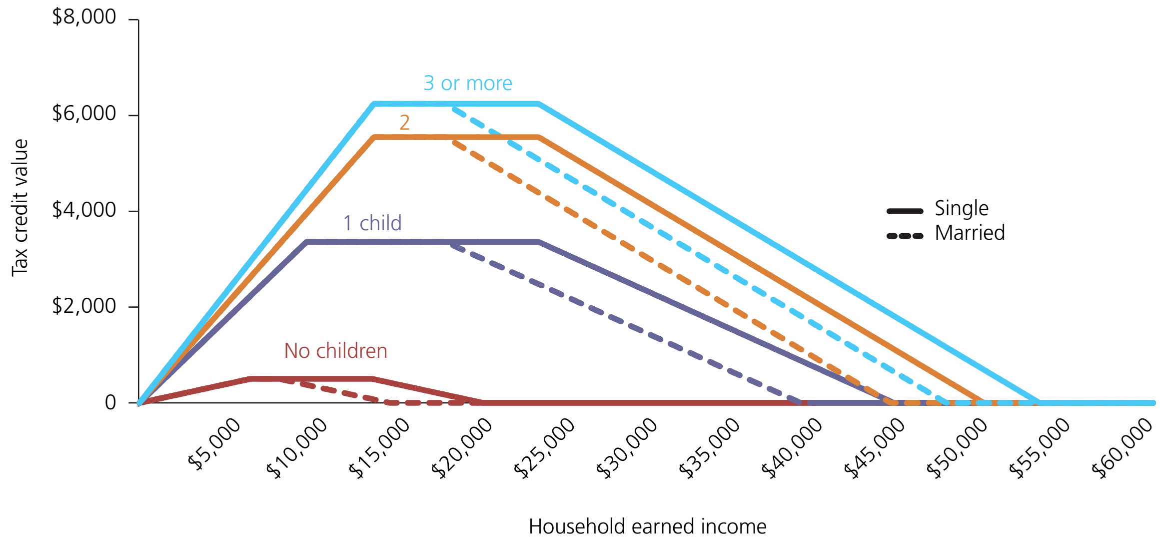
Most recent proposals to expand the EITC have focused on increasing support to households with no children. President Obama and Congressman Paul Ryan have both proposed doubling the maximum credit for childless workers to approximately $1,000 (still a small fraction of what households with children can receive), though they disagree on how to fund the expansion.[36]

Proposals have looked in other directions, too. Robert Cherry of the Institute for Family Studies has suggested a New Mothers' Tax Relief credit to further intensify support for mothers with children under six, as well as to prevent couples from facing a marriage penalty.[37] As the political debate over allocation of the credit continues, the EITC will remain a tax-season payment to low-income households to subsidize their earnings.

Wage Subsidy

Not part of current U.S. wage-support policy, the wage subsidy could take many forms. It could go to the employer or employee; it could vary in how and when it is delivered; it could vary in amount relative

Figure 3. . . . Where Credit Is Due



Source: Internal Revenue Service

to a particular wage level; and its beneficiaries could vary. Regardless, its essential component would involve an additional dollar amount paid by the government to support an hourly wage of a given level, decreasing as the wage increases. The wage subsidy described herein operates as follows:

Payee. The employee receives the subsidy directly in his paycheck. This approach may pose administrative challenges but offers two significant benefits. First, it would provide the greatest transparency on the payment and receipt of the subsidy. This transparency would allow statisticians to accurately track the flow of government benefits and makes possible a clawback, via the tax code, of subsidy payments made to high-income households (discussed later). Second, as a matter of political appeal, a subsidy to the low-wage worker would likely garner far greater support than a subsidy to the low-wage employer, even if the economic effect were identical.

The wage subsidy and EITC both go to the employee rather than the employer, but they differ in delivery. The wage subsidy arrives in each paycheck, and an employer could even advertise it in offering the job. The EITC arrives as a lump sum after the year ends and the employee files a tax return.

Calculation and phaseout. The subsidy calculation uses a "target wage" for reference, such that the subsidy closes half the gap between the market wage and the target wage.[38] The latter could be set nationally or, in keeping with proposals for minimum-wage reform, depend on local market conditions—equal, for instance, to 60 percent of the median wage in the local market.[39] In a market with, say, a median wage of $20/hour, the target wage would be $12/hour. A worker earning $8/hour has a wage $4/hour below the target and would thus receive a subsidy of $2/hour (approximately $4,000/year, if working full time).

Crucially, the wage subsidy's phase-in and phaseout behavior differs significantly from the EITC's. The wage subsidy's phase-in would occur as the worker's hours increase. Using the previous example, the worker receives an additional $2 of subsidy for every additional hour worked. There is no legislated cap but only the implicit limit on hours available for work. A full-time worker's 2,000 annual hours would produce a $4,000 subsidy over the course of the year. If that worker chose to take a second, part-time job at $10/hour that added an additional 1,000 hours, those hours would produce an additional $1,000 subsidy. If another member of the household took a part-time job at $8/hour that added an additional 500 hours, those hours would produce an additional $1,000 subsidy. For a given hourly wage, the subsidy does not phase out.

The phaseout occurs as wages increase—half the value of any wage increase up to the target wage would be offset by a decline in subsidy. If the full-time worker receives a raise from $8/hour to $10/hour, earned income increases by $4,000 but the subsidy declines by $2,000 (from $4,000 to $2,000). A raise to $12/hour adds another $4,000 of earned income but eliminates the subsidy altogether. (This phaseout has no effect on the subsidy received for work by the other household member, or even for the worker's own second job.) With the wage subsidy, no implicit tax weakens the incentive to take a job or work an additional hour.

Recipient eligibility. Workers would be automatically eligible on the basis of their hourly wage (for salaried employees, on a per-hour equivalent). If overtime hours are paid at a higher wage, those hours receive less or no subsidy. This broad eligibility again differs from that of the EITC, which targets specific households based on family structure and total income.

In theory, a wage subsidy could limit eligibility in much the way the EITC does. As argued below, however, a wage support should be generally applicable to minimize distortions in the labor market. If policymakers want to direct further resources toward certain households, they should do so through a mechanism specific to that purpose (e.g., a child tax credit targeting parents). If policymakers want to reverse the subsidy's benefit for low-income workers in high-income households, they could do so through the tax code as well. (Indeed, this would happen automatically to some degree: a wage subsidy would be taxable income, subject to the marginal rate for high-income households.)

Flow of funds. Delivery of government benefits in each paycheck is a novel process that would pose administrative challenges different from those created by the EITC's use of the income-tax filing system. Fortunately, the existing payroll-tax system illustrates the mechanism and would provide much of the necessary infrastructure for a wage subsidy. Just as an employer must calculate a payroll-tax deduction from each paycheck and send those funds to the government, so, too, can it calculate any necessary subsidy and increase the employee's pay accordingly.

For most businesses, the total subsidy paid to all employees will be lower than the payroll tax collected from them for each pay period. These two values can be offset, with the lower net-dollar amount sent to the U.S. Treasury. General revenues, not payroll taxes, would be funding the wage subsidy, so the Treasury would need to debit the general account and credit the Social Security Trust Fund accordingly. For the subset of employers—fast-food franchises, perhaps—whose subsidy payments to employees exceed payroll taxes owed, the government would need to establish a system that provides funds to promptly meet payroll without constraining the business's working capital.

III. THE WAGE-SUBSIDY ADVANTAGE

Wage-support tools vary in performance across six dimensions. Two are based on distribution: Who receives the benefit, and who bears the cost? Two are based on incentives: What is the impact on individuals' willingness to work, and what is the impact on employers' willingness to hire? And two are based on experience: How is the benefit received, and how is the benefit delivered?

Evaluated across these dimensions, the wage subsidy wins by a wide margin. The wage subsidy performs most like the minimum wage in the ways that the minimum wage is attractive: a transparent, immediate effect on the recipient; and continued support, no matter how many hours are worked. It performs most like the EITC in the ways that the EITC is attractive: use of a well-distributed source of funding and promotion of low-wage employment.

Importantly, this conclusion does not depend on the leading critique that the minimum wage leads to significant job losses.[40] Even a minimum wage that eliminates no jobs is inferior to a wage subsidy because the former allocates its burden unfairly. Nor does this conclusion depend on the leading critique that the EITC is underutilized[41] and susceptible to fraud.[42] Even an EITC that reached every eligible participant and no others is inferior to a wage subsidy because its positive incentives are weaker and its negative incentives are stronger. The EITC is superior to a wage subsidy in one way: it can better target benefits toward specific classes of workers. But that superiority counts only if targeting is desirable. In practice, it is not.

Distribution

Wage-support tools aim to meet their antipoverty objectives by increasing take-home pay for low-wage workers. Because each additional dollar placed into a paycheck must come from somewhere, a tool's attractiveness also depends on whose money is being dispensed.

Who receives the benefit? The preliminary question is who *should* receive the benefit? Policymakers can choose a wage support that discriminates among recipients and targets greater resources toward particular households. Or they may choose one that behaves neutrally, with any rebalancing of resources performed through separate programs. The EITC is best suited to deliver a targeted benefit. Because payment calculation occurs through the income-tax system, all of a household's characteristics can play a role. In practice, household structure and income both help to determine payment. The wage subsidy can approximate this behavior, but not as cleanly. It can easily discriminate on characteristics known at the moment of employment (e.g., household structure) and adjust the subsidy level accordingly. It can even take into account information such as total household income, which is known only at year's end, through a clawback in the tax code that targets the subsidy component of reported income. (The subsidy must go directly to the employee to make this possible.) The minimum wage can perform only half the trick. It can be calibrated to factors like household structure; but because a worker's market wage absent a minimum wage is unknown, there is no way to claw back the difference at tax time.

Should the benefit be targeted? Greater targeting reduces cost. It also produces substantial labor-market distortions. Such distortions are most obvious, and most undesirable, in the case of the minimum wage. Setting the minimum wage higher for, say, single parents of young children would make such parents the least desirable low-wage workers. Employers would avoid hiring the very people whom the policy is supposed to help.

The EITC and wage subsidy create subtler, parallel distortions. An EITC- or wage subsidy–eligible worker can accept an \$8/hour wage and expect ultimately to receive the equivalent of \$10/hour. An ineligible worker must ask for \$10/hour to earn \$10/hour and thus finds himself at a disadvantage. Further, the EITC or wage subsidy will, by design, draw more low-wage workers into the labor force, thereby competing with the ineligible worker and driving down his wages.[43] He ends up worse than if there were no program at all. This is not speculation. The current EITC's intensive focus on providing resources to households with children has this precise effect on the young, single men whom policymakers should be desperate to encourage into the workforce.

For this reason, a wage support should be neutral across potential recipients at a given wage level.

Other policies can channel resources to, or away from, people. For instance, any of the wage supports paid at a lower level but paired with a refundable child tax credit can achieve the welfare objectives of the present EITC without tilting the market against young people seeking a first job. If necessary, higher marginal tax rates can reduce the after-tax income of high-income households.[44]

Figure 4 shows how the EITC, minimum wage, and wage subsidy can all target particular groups while creating varying labor-market distortions in the process. The EITC targets best, a wage subsidy can target well, and a minimum wage targets poorly. If the goal is not to target, the wage subsidy and the minimum wage perform comparably while the EITC suffers from its tax-time focus on a household's income, rather than the work of individuals.[45]

Still, workers are not the only interested parties. Employers may benefit from a wage support (though not with the minimum wage, where employers directly bear the cost). Where the government subsidizes the employment relationship through the EITC or wage subsidy, some portion of the subsidy's incidence will fall on the employer. By drawing additional workers into the market who are willing to accept a lower wage than they otherwise might have, the subsidy allows the employer to lower its wages and still secure necessary labor.

Fortunately, the reality of labor-market dynamics ensures that the benefit does not entirely, or even primarily, accrue to the employer. If the worker's market wage approximates the value of that worker to the employer (and to other employers), employers will bid the wage up toward the market level, regardless of what additional payments the worker might receive. If one employer tried to offer $4/hour to a worker worth $7/hour, the former would presumably be outbid by other employers offering closer to $7/hour. As a result, the worker is likely to still secure close to the $7/hour market wage and benefit from the subsidy.

Jesse Rothstein of the University of California at Berkeley found that approximately three-quarters of the EITC benefit accrues to the worker and one-quarter to the employer.[46] Britain's National Institute of Economic and Social Research found that a similar 72 percent–79 percent of Britain's low-wage tax credit accrues to the worker.[47] Some critics of the

Figure 4. To Target or Not to Target

	EITC	Wage Subsidy	Minimum Wage
Can target to particular household types?	Yes	Yes	Yes, but will likely harm the targeted individuals
Can target to particular household earnings level?	Yes	Yes, but only by imposing additional taxes on high-income households with workers that receive the subsidy	No, because cannot know at tax filing how much an individual's wage was propped up by the minimum
Can treat all people at a given wage level equally?	No, because earnings are not decomposed into hourly rate for tax filing	Yes	Yes

EITC—often advocates of the minimum wage—see this as a perverse outcome: it is bad enough that a low-wage employer pays its employees so little that they need government assistance; surely, the critics assert, the government should not reward the employer for doing so.[48]

Yet for workers with low productivity, the alternative to a low-wage job is not a high-wage job but no job. If bringing low-wage workers into the labor force has value for society through its long-run potential to reduce poverty, employers contribute a valuable service by providing more of those jobs. Further, *any* policy that pushes more low-wage workers into the labor force will, as a consequence, reduce the market wage that employers must pay. This is an inevitable side effect of increasing labor-force participation—employers benefit, as well as employees.

Objections to low-wage employers benefiting from taxpayer dollars also misunderstand how social safety nets operate.[49] The very presence of the net, particularly the benefits offered to those who do not work, pushes up the cost that employers must offer to attract workers. (Recall, in Section II, the discussion of how little marginal benefit a low-wage worker receives for moving into the workforce.) From the employer's perspective, the phaseout of benefits that accompanies payment of wages represents an enormous tax. Slowing that phaseout, by extending government benefits to workers, is therefore not a positive subsidy to the employer but a partial mitigation of the burdensome effective tax that the employer and employee face.

Who bears the cost? Every additional dollar paid to a low-wage worker must come from somewhere. The source for the EITC or wage subsidy is clear. The tax base that funds the subsidy—presumably, general federal revenues—bears the full cost; the progressive distribution of the federal tax code dictates who pays.[50]

Contentious debate surrounds the source of funds for the minimum wage. On the surface, it would appear that employers—and therefore the owners of capital—pay for it. Empirical evidence suggests that employers pass on much of the higher cost as higher prices.[51] Though consumers throughout the economy face the inflated prices, the burden relative to income will—as with any consumption-like tax—fall more heavily on lower-income households than will the federal income tax.[52] To the extent that lower-income households rely disproportionately on establishments that employ minimum-wage workers (i.e., fast-food and mass-market retail chains),[53] the burden falls still more heavily on their shoulders.[54]

Some economists argue that employers can recover a portion of the cost through improved operational efficiency—such as in lower employee turnover—that accompanies higher wages.[55] If this is true, it is not unique to the minimum wage but applies to other wage-support tools as well. Further, accounting for "dynamic scoring" that credits economic gains against the program's overall cost actually extends the advantages of a wage subsidy or the EITC. Unlike the minimum wage, a wage subsidy or the EITC generates additional economic activity and tax revenue that can offset part of the program's cost by expanding the labor force and, thus, total aggregate income.[56]

Even without establishing the minimum wage's exact burden across capital, labor, and customers, it plainly lands more heavily on the poor than does the EITC or wage subsidy. A minimum wage cannot help but be more regressive than the federal tax code, and it also imposes a disproportionate burden on the low-wage segment of the economy that is already doing the most for low-wage workers. If society wants to increase the incomes of low-wage workers, it should do so collectively, through its tax base, not through off-budget mandates on employers offering jobs.[57]

Incentives

By intervening in the terms of employment, a wage support affects the willingness of parties to offer and accept work. For the worker, each wage-support tool offers the prospect of more compensation for the same work and so should increase his willingness to work. Yet differences in how the benefit phases out as income rises create an important distinction. For the employer, the effect will vary, depending on the situation in which it receives a portion of the benefit or bears a portion of the cost.

What is the impact on individuals' willingness to work? Assuming that they offer equal income, each wage-support tool should offer the same draw to a prospective worker. While the minimum wage and the wage subsidy have the same effect on the worker's paycheck and should therefore create the same work incentive, the EITC has two drawbacks that dilute its effectiveness.

The first is that the EITC is paid after the fact. As a formal matter, the future lump-sum payment must be discounted back, for an apples-to-apples comparison with the immediate boost to each paycheck offered by the other wage-support tools. (If the interest rates accepted by low-income households on short-term loans are any indication, that discount rate is exceptionally high.) In other words, the prospect of earning a lump-sum payment more than a year after taking the job cannot produce an incentive comparable with the offer of a higher wage, particularly for a low-income household in dire financial straits for whom entry into the labor force is most critical.

Delayed delivery also creates an awareness problem: many eligible recipients do not realize that they are eligible when deciding whether to accept a job; and even those generally aware are unlikely to understand precisely how much their wage will be supplemented. One study found that only 10 percent of participants were fully aware of the EITC and could explain which part of their tax refund came from it.[58] To the extent that the EITC is not understood by the prospective recipient, it cannot influence his behavior.

The second EITC drawback receives less attention but is more important: the EITC operates like the minimum wage or the wage subsidy in its encouragement to take a job but not in its encouragement to work more hours. EITC payments decline as an increase in hours worked produces an increase in household income. The result: a steep marginal tax rate on the decision to work extra hours, take a second job, or send another member of the household into the workforce. Studies consistently confirm that the EITC encourages labor-market entry; research on the EITC's effect on hours worked offers more mixed results.[59] (The same EITC awareness problem that might dilute the positive incentive to join the labor force would, however, also dilute any disincentive.)

As discussed in Section II, neither the wage subsidy nor the minimum wage creates a disincentive to work longer hours. Both are paid on each hour worked and are available no matter how many hours worked. Their effect phases out only if a worker receives a raise. For the minimum wage, a worker receives a subsidy from his market wage up to the minimum wage for any subminimum market wage; and no subsidy, once he receives a wage above the floor. For the wage subsidy, a worker sees his subsidy decline gradually as his market wage increases. With both wage-support tools, the incentive to work another hour remains constant.[60]

A phaseout tied to a wage increase is of less concern than one tied to an hours increase because reducing the value of a raise does not make the worker less likely to accept it. A raise usually represents an unmitigated good and may even come with other nonmonetary perks.[61] By contrast, earning an extra hour's wage comes with the trade-off of having to work an extra hour. All three wage-support tools provide valuable incentives to work, but the wage subsidy and the minimum wage encourage additional work more effectively at the margin.

What is the impact on employers' willingness to hire? As noted, wage supports affect employers' incentives to hire. Because a portion of the wage subsidy and EITC subsidy go to the employer, these wage-support tools provide an incentive to hire. Each worker comes at lower cost than otherwise; higher-paid employees may deliver greater operational efficiency as well. Any efficiency should be greater with a wage subsidy that replicates the effect of a minimum wage than with an EITC that compensates the worker only after the fact.

The minimum wage, by contrast, should suppress the hiring of low-wage workers. The magnitude of this effect is contested, but the debate tends to assume small changes to the minimum wage; there is little dispute that a substantial increase would reduce employment.[62] There should also be no dispute that the impact is *less* positive than for the other wage-support tools.

To see why, reframe the minimum wage in the same tax/subsidy terms as the wage subsidy and EITC. Employee and employer experience the minimum wage as if the employee receives a subsidy equal to the difference between the market wage and the minimum wage, funded by a tax on the employer equal to the value of the subsidy. If employers pass on the cost of the higher minimum wage or otherwise mitigate its effects on their business, this represents a shifting of the tax's incidence but does not affect the presence of the tax.

Now envision a change in policy from minimum wage to wage subsidy. The tax leaves the employer and moves elsewhere. That shift must increase the employer's willingness to hire an employee who would previously have brought a tax but now will not. The employer can offer the same wage and presumably get the same worker under the same operating conditions, but the new hire is tax-free. This difference makes the EITC and the wage subsidy superior to the minimum wage for encouraging the employment of low-wage workers.

Experience

Such distribution and incentive effects largely reflect wage-support tools' projected performance in economic theory. Challenges to their practical implementation are equally important. An effective wage support should respond to the everyday needs of low-income workers and take a form that governments can reliably execute.

How is the benefit received? In theory, the EITC may perform every bit as well as a wage subsidy. If the worker knows that the subsidy will arrive, does it matter whether it arrives in each paycheck or at tax season? In practice, a delayed, lump-sum payment is not responsive to the needs of many low-income households. It does nothing to alleviate short-term cash-flow challenges at the time the worker chooses to accept the job. It requires the filing, often with assistance, of a tax return. It leaves the recipient with a sudden windfall that may be difficult to manage effectively without the saving and budget planning that low-income households frequently struggle with.

Some researchers studying the impact on individual families have depicted this after-the-fact windfall as a benefit of the EITC, arguing that filing taxes and receiving a refund instills a sense of belonging in the American workforce and establishes the benefit as a "just reward for work."[63] This may be true when compared with receiving in-kind benefits from programs such as SNAP; but when compared with receiving higher wages via the minimum wage or a wage subsidy, it is surely not the case.

The pro-EITC argument also frames the policy as a forced-saving tool.[64] However, in the most in-depth sociological study to date of EITC recipients, researchers found that "the first thing participants usually mentioned was the palpable relief they felt when they could finally make progress paying down debts and catching up on bills," with financial relief mentioned, without prompting, by 82 of 115 households. "The impulse to meet their financial obligations was so strong that 61 percent of those who filed at H&R Block took advantage of a rapid refund loan—a high-interest advance against the credit provided by the for-profit tax preparer—usually for the expressed purpose of paying off bills and debts or making a badly needed purchase just a few days sooner."[65]

Under such conditions, withholding the benefit for a full year and then paying it all at once serves no one. Any number of policies could do a better job than the EITC of supporting the saving efforts of low-income households while still giving them the flexibility to meet immediate obligations. These policies could be paired with a wage subsidy or minimum wage. By delivering resources to workers quickly and seamlessly, a wage subsidy or minimum wage offers significant advantages. (The former would make transparent the share of a paycheck attributable to the government; the latter would obscure it.)

How is the benefit delivered? Each wage-support tool offers distinct administrative challenges. The wage subsidy's obstacles appear most imposing because its implementation lies in uncharted territory. But if choosing a structure to embrace and invest in for the long term, it would likely perform at least as well as the others.

The minimum wage is a straightforward edict but can be difficult to enforce because its target (the employer) has a clear incentive to resist. Employers may coerce workers into working uncompensated hours as a condition of employment or, more subtly, take required tasks such as travel time or equipment donning off the clock.[66] The minimum wage drives many employment relationships into the black market, encouraging under-the-table payments and the hiring and exploitation of illegal immigrants. Cities, states, and the federal government all have labor-standards bureaus dedicated to preventing and addressing such practices.[67]

The EITC and the wage subsidy suffer from the opposite problem. Rather than avoid compliance, participants are eager to receive a payment and may do so fraudulently. EITC fraud is so prevalent that one prominent study of local awareness used plainly fraudulent tax filings as a proxy for the share of the population that likely knew of the credit.[68] The U.S. Treasury's inspector general estimates that 22 percent–26 percent of EITC payments go to ineligible recipients, at a cost of $14 billion–$16 billion annually.[69]

The EITC also suffers from the unique problem of limited public awareness. The government and nonprofits have responded with aggressive public-service campaigns—including EITC Awareness Day (which is January 30, in case you were unaware)[70]—and free tax-filing services. The need for filing creates additional vulnerability for low-income households that are aggressively targeted by for-profit filers.[71]

A wage subsidy would likely suffer from similar fraud problems but to a lesser degree. Whereas every individual tax filer requires awareness and is a potential source of EITC fraud, the flow of wage-subsidy funds through employers creates a far smaller, more knowledgeable, more manageable, and more deterrable group of actors.

A bigger challenge would involve managing the flow of wage-subsidy funds. Fortunately, the existing payroll-tax infrastructure would provide a workable mechanism. Implementation would, no doubt, be challenging—requiring a variety of changes and accommodations for existing technology systems—but is a task that the government has proved it can execute. A U.S. Government Accountability Office study of EITC advance payments found that the majority of employers reported little or no burden from the process; problems that did arise were associated with system configuration, not with ongoing management of funds.[72]

Delivering higher wages to low-income workers means picking an administrative poison. For reducing fraud, the EITC and the wage subsidy are superior because the fraud that does occur tends to benefit low-income workers, not harm them. The wage subsidy is superior to the EITC in consolidating the number of actors to monitor. The minimum wage, by simply mandating a higher wage, is easier to execute than policies requiring government payments.

On a continuum depicting the government's capability to competently execute a wide variety of antipoverty polices—including public education, job training, and even the promotion of values and lifestyles—all three wage-support tools lie firmly at the achievable end. As a policy that extracts the right resources and provides them effectively to the working poor, while creating the best incentives and least distortion in the labor market, a wage subsidy would likely perform best (**Figure 5**).

IV. CONCLUSION

A major wage-subsidy program runs afoul of both the Left's and the Right's current political posture. For the Left, embracing a wage subsidy would mean moving beyond the view that low-wage employers are the problem and instead recognizing them as critical to the solution. For the Right, it would mean accepting the fact that spending public funds is not bad policy per se and that progress will require spending money more wisely. The following principles might find substantial support on both sides and form a common ground on which a successful antipoverty policy—the wage subsidy—could be built:

1. **Make work pay.** Helping the poor is important, and getting them into jobs that can move them out of poverty is the best way to do so.
2. **Spend the money we have.** Accomplishing this will cost a lot of money, but there is already a budget of $1 trillion[73] in annual antipoverty spending that delivers inadequate results today and could, in part, be repurposed.
3. **Treat employers as part of the solution.** By serving as the economic ladder's lowest rungs, low-wage employers play a difficult and invaluable role without which low-wage workers would not have an opportunity to climb higher. Increasing low-wage employment and its rewards can and should benefit both parties.
4. **Design a broad, flexible program.** Antipoverty reforms should not narrowly target specific goods to the most politically salient populations; they should establish a broad-based infrastructure for making work pay that will strengthen a culture of work, transfer resources to anyone who does work, and remain flexible for a rapidly evolving economy.

Figure 5. Summary

	EITC	Wage Subsidy	Minimum Wage
Distribution: Benefit	✓	✓+	✓
Distribution: Cost	✓	✓	✗
Incentive: Worker	✓	✓+	✓+
Incentive: Employer	✓	✓+	✗
Experience: Worker	✗	✓	✓
Experience: Administration	✓	✓	✓

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