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U.S. DEPARTMENT OF LABOR

SECRETARY OF LABOR
WASHINGTON, D.C.

July 20, 1993

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MEMORANDUM TO THE PRESIDENT

VIA: Robert Rubin

FROM: Robert B. Reich RM

SUBJECT: Reconciliation, the EITC, and the Minimum Wage: How much progress towards the make work pay goal?

cc: Lloyd Bentsen, Leon Panetta, Donna Shalala, Laura Tyson, Carol Rasco

An assessment of the EITC proposals in the reconciliation bills and the objective of "making work pay" leads to two recommendations. First, we should work to ensure that the House EITC reforms -- which reflect the Administration's proposal -- are retained. The Administration/House reforms make it easier to achieve the goal of lifting families with full-time workers out of poverty and provide overdue tax relief to poor childless workers.

Second, such an assessment underscores how the minimum wage and the EITC are complementary policies, and that it is time to begin to investigate what minimum wage reforms may be appropriate. To achieve the goal of making work pay, the minimum wage should be raised and then indexed. Even the substantial Administration/House EITC expansion cannot achieve the goal alone. And just as certain features of the EITC make up for shortcomings with the minimum wage, certain features of the minimum wage address shortcomings with the EITC. For example, in contrast to the EITC which is nearly always received through one lump sum payment at tax time, the effects of a change in the minimum wage are felt with every paycheck.

This assessment has led me to step up Labor Department efforts to review the minimum wage. I will report back to you in 90 days with my initial recommendations, via the NEC and/or the Domestic Policy Council.

House vs. Senate EITC

In designing the parameters of your EITC expansion, the combined value of full-time minimum wage earnings, plus EITC benefits, plus food stamps, and minus payroll taxes, was compared to the poverty line. The proposed EITC increase for families

with two or more children was set at a level that would lift a family of four with a full-time minimum wage worker out of poverty.

The Administration's EITC proposal, incorporated in the House bill, would attain this objective virtually precisely. But two of the assumptions made in the calculation should be highlighted. First, to reach the objective, the calculation assumed that the value of the minimum wage would equal $4.50 an hour in 1994 dollars.[1] Second, the assumption of the receipt of food stamps -- valued at more than $3,000 for a family of four with minimum wage earnings -- is often unwarranted. Substantially less than half of working poor families receive food stamps.

All this suggests there is virtually no room to maneuver in terms of cutting back our proposed expansions in the EITC. Nevertheless, the Senate reduced the proposed increases in a variety of ways. For example, the Senate provisions make it somewhat less likely that families with full-time workers will be lifted out of poverty. A family of four with two children would receive a maximum EITC benefit that would be $56 lower than under the House bill. Such a family with a full-time minimum wage worker would therefore fall $56 further below the poverty line.

The Senate's elimination of the new, small EITC for childless workers also is very troubling. Poor childless workers would no longer receive an offset for the new energy taxes they may have to pay. In addition, more than any other group of taxpayers, poor childless workers have been hit hardest by tax increases since 1980. Several of these increases contained regressive tax provisions that included an EITC offset for working poor families with children, but did <u>not</u> include an offset for poor workers without children. As a result, <u>the overall federal tax burden of the poorest fifth of households without children has risen a dramatic 38 percent since 1980.</u> Single workers also are the one group that still pays federal income taxes even when they are in poverty. The new EITC for childless workers would help address these problems.

The Role of the Minimum Wage

<u>The minimum wage and the goal.</u> Even if the Administration/House EITC reforms are fully adopted, indexing the minimum wage at $4.50 an hour is a <u>minimum</u> prerequisite to reaching the goal of lifting families of four with full-time

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[1] A minimum wage level of $4.50 an hour in 1994 is consistent with indexing the wage floor at its 1992 level of $4.25 an hour.

workers out of poverty. If the minimum wage is not indexed, or if it is indexed at a lower level, the goal will not be achieved.

- If the minimum wage remains unchanged at a given, nominal level year after year, it will take a continuously expanding EITC just to maintain minimum wage families at the same real income level. Otherwise, the fall in the purchasing power of the minimum wage will drop families further into poverty.

- A small difference in hourly wage levels can have substantial effects on total income. If the minimum wage is indexed at $4.25 an hour instead of at $4.50, the effect on the annual earnings of a full-time worker (employed 2,080 hours a year) would be a reduction of $520.[2] For a minimum-wage worker employed half-time, the reduction would be $260.

- Since the large majority of the working poor are employed for part of the year or for less than 40 hours a week, since most of the working poor do not receive food stamps, and since many of the working poor live in families of five or more, most of the working poor will remain in poverty even under the Administration/House EITC expansion and a $4.50-an-hour minimum wage. A larger minimum wage increase could narrow the poverty gap for these working poor households.

Historic Comparisons. From 1981 to 1990, the minimum wage remained at $3.35 an hour, despite the jump in the cost of living. President Bush agreed to raise the wage floor to $4.25 an hour, after vetoing a bill mandating a higher level. But this increase made up less than half of the ground that had been lost to inflation.

Consequently, increasing the minimum wage by just 25 cents to $4.50 an hour, and then indexing it, would yield a minimum wage well below its traditional value.

- A minimum wage of $4.50 an hour in 1994 would be more than $1 -- or about 19 percent -- below its average value in the 1970s, after adjusting for inflation. (See Figure 1.)

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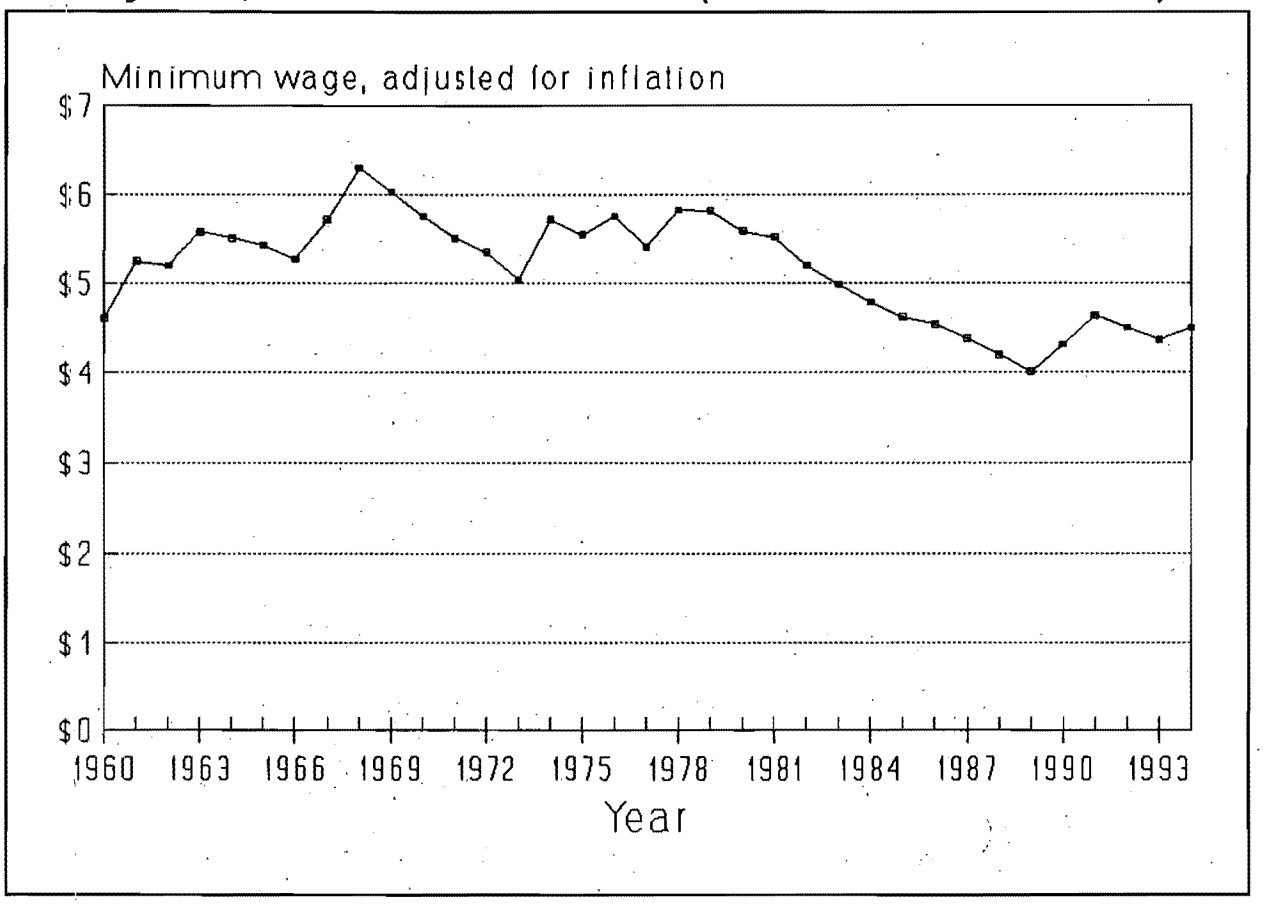
[2]The net effect on income would be less because the family would owe less in payroll taxes. If the family receives food stamp benefits, which are higher for families with lower incomes, the net effect would also be diminished somewhat.

Figure 1. Historic value of the minimum wage, assuming a minimum wage of $4.50 an hour in 1994. (Values in 1994 dollars.)



- In fact, setting the minimum wage at $4.50 an hour in 1994 would establish a lower real level than what was agreed to by President Bush. He supported a level of $4.25 an hour as of April 1, 1991; in 1994 dollars, that would equal an estimated $4.67 an hour.

For full-time minimum wage earners living in families with two or more children, the net income of a full-time worker receiving $4.50 an hour and the Administration/House EITC would be significantly higher than the net income of a full-time minimum wage worker during the Bush years. The larger EITC would more than offset the somewhat lower value of the minimum wage.

Taking a longer view, under the Administration/House EITC and a $4.50 an hour minimum wage, the combined value of minimum wage earnings and the EITC, minus payroll taxes, would be about the same for families with two children as the average combined

value in the 1970s.[3] In other words, for these families, the establishment and expansion of the EITC over time will have essentially offset the fall in the value of the minimum wage over time.

Since, however, workers with less than two children qualify for a smaller EITC than workers with two or more children, minimum wage earners with less than two children would have less net income than in the 1970s. The increase in their EITC will not have offset the fall in the minimum wage.

Delivery issues. On the one hand, it can be argued that the substitution of a higher minimum wage with a higher EITC would be a positive accomplishment. To be sure, the EITC poses no threat to employment opportunities and can be better targeted to families in need.

On the other hand, there are several reasons why the minimum wage and the EITC are best viewed as policies that complement -- rather than substitute for -- each other. One is the timing of payments:

- More than 99 percent of EITC recipients receive their benefits in one lump sum payment when they file their taxes. A partial redress to this delivery problem may be included in the reconciliation bill, and stronger remedies are being examined in the context of welfare reform, but it is likely to prove very difficult to change this proportion substantially.

- By contrast, the minimum wage is delivered in a more timely manner for struggling families; the effects of the minimum wage are felt with each paycheck.

A second factor to consider is public perception. Your pledge to make work pay has been well-received, but despite the EITC's many merits, I believe a larger lump sum payment delivered through the tax code will not demonstrate our commitment to supporting those who play by the rules as much as a minimum wage increase would.

Finally, there is the issue of striking the right balance between a private and public sector approach. The costs of making work pay are too large to be borne entirely by either the public or private sectors. Relying on both a stronger EITC and a stronger minimum wage involves the appropriate sharing of the

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[3]Because changes in the value of food stamps are difficult to compare over time, these calculations did not consider food stamp benefits.

burden between the two sectors.

Next Steps

The complementary effects of the EITC and the minimum wage on the working poor are important. For this reason, it is important to consider the value of the minimum wage in the context of developing our welfare reform proposal.

At the same time, however, a full assessment of where to set the minimum wage should consider a wide range of factors beyond its income effects on the working poor. After all, most minimum wage workers are not poor. And the potential effects of a minimum wage increase on employment should of course be weighed, particularly in combination with the effects of the health reform proposal.

Unless you prefer a different schedule or approach, the Labor Department intends to fully assess all these factors over the next 90 days. I will then forward my initial recommendations to you, via Carol Rasco and Bob Rubin.

Carol: This is some draft Waiver language that we are going to send to Sens. Lieberman & Glenn as part of their response to Senator Hutchinson's unfunded mandate bill. - PGW

Draft Language For Waivers For Distressed Communities

(a) **IN GENERAL.** -- At the request of a governmental entity that (1) has applied for designation as an enterprise community or an empowerment zone pursuant to Subchapter C of Title XIII of the Omnibus Budget Reconciliation Act of 1993 and (2) has developed a strategic plan for the purpose of (i) revitalizing a community with pervasive poverty, unemployment, and general distress or (ii) revitalizing a community experiencing out-migration equal to a decrease in the population of an area (as determined by the most recent census data available) by 10 percent or more between 1980 and 1990, the Community Enterprise Board ("Board") may waive any provision of Federal law or regulation administered by any member of the Board (the Secretary of Housing and Urban Development, the Secretary of Agriculture, the Secretary of Health and Human Services, the Secretary of Labor, the Secretary of Education, the Secretary of the Interior, the Secretary of Commerce, the Secretary of Transportation, the Secretary of Treasury, the Administrator of the Environmental Protection Agency, the Director of the Office on National Drug Control Policy, the Administrtor of the Small Business Administration, or the Attorney General) where:

(1) the Secretary charged with administering that provision of Federal law or regulation consents to the waiver;

(2) the Board determines that the public interest that would be served by granting the proposed waiver outweighs the public interest that would be served in adhering to the applicable statute or regulation if the proposed waiver is denied; and

(3) where the program involves the expenditure of Federal funds only, the Board finds that, if the waiver is granted, the funds will be spent solely in accordance with a plan that advances the purposes of that program.

(b) **LIMITATIONS ON WAIVERS.**

The following limitations shall apply to the Board's waiver authority:

(1) The Board has no authority to waive any provision of Federal law or regulation that governs programs that would have the effect of directing Federal funds to enterprise communities or empowerment zones that could not have received the funds absent the waiver.

(2) The Board has no authority to waive (i) any provision of the Social Security Act or the Food Stamp Act that pertains to eligibility and benefits; (ii) any Federal law or regulation that pertains to public or individual health or safety, civil rights and non-discrimination, environmental protection, labor

relations, labor standards, occupational health or safety, pensions, taxation, banking standards; or (ii) any Federal law or regulation deemed non-waivable by the Attorney General.

(3) The Board has no authority to grant a request for a waiver where such waiver would have the effect of increasing direct Federal spending above levels that would have occurred in the absence of the waiver.

(c) **PROCEDURE.** -- Any Secretary who receives a request for a waivers under Section (a) shall forward the request to the Board and to the Secretary charged with administering the program for which the waiver is sought. The appropriate Secretary shall inform the requesting party of the disposition of the request for waiver.

(d) **REVOCATION.** -- The appropriate Secretary, in consultation with the Community Enterprise Board, may revoke a waiver where the governmental entity fails to comply with the authorized strategic plan, fails to achieve the the benchmarks set forth in a strategic plan, and fails to spend the funds in accordance with the authorized plan.

(e) **IMPLEMENTATION.** -- In consultation with the Community Enterprise Board, the Attorney General shall, by notice jointly published in the **Federal Register**, establish such requirements as may be necessary to carry out the provisions of this Act. Such notice shall describe the criteria and procedures to be used by the Board in considering the waivers authorized by Section (a) of this Act.

(f) **SUNSET.** -- This section shall expire on September 30 of the first fiscal year that begins 4 years after the date of enactment.