

## Minimum Wage and Working Families

March 2007  
Poverty Policy Brief #7



*Darryl and Evelyn Greer are hardworking parents of two preschoolers. Darryl has a disability that limits him from many jobs but has found a stable position as janitor at the local shopping mall. Evelyn is a home health aide. Both work full-time at minimum wage, bringing home \$21,424 together on an annual basis. Their children are in subsidized child care and the federal tax refunds they receive (the refundable earned income tax credit and the refundable child tax credit), totaling \$5,083, really help out. The increase in the state minimum wage – to \$7.25 an hour – will greatly increase the Greers' paychecks, but it will not make them self-sufficient. In fact, it points to the need for other state policy actions to be put into place that will complement the minimum wage increase.*

*While the Greers' overall income will increase from \$21,424 to \$31,160, the Greers themselves will not actually benefit from over one-third of that increase. They will be paying nearly \$900 more in payroll taxes; their federal tax refund will be reduced by \$2,000; and their state income taxes will go up by nearly \$600. (This is a very high effective tax on their increased earnings – actually higher than the top federal tax rate paid by multi-million dollar income wage earners). More problematic, they now will be above the income eligibility level to qualify for Iowa's state child care subsidy. Rather than paying \$20 per week for child care through the state subsidy program, they will be responsible for the full cost of that care, which could eat up most of any gains they received from the minimum wage increase.*

This illustration shows the benefits of the General Assembly's action to increase the minimum wage on low-income families and also shows that it is only one important component of an overall strategy to alleviate poverty and improve economic self-sufficiency in Iowa. For many working families, other policies also need to be addressed if families are to be able both to get by and get ahead.

In particular, there are two policy strategies that Iowa could adopt to ensure families like the Greers see a fuller benefit from the minimum wage increase they received. First, an increase in Iowa's earned income tax credit (EITC) is almost as overdue as the

increase in the state minimum wage. Iowa's EITC has not been raised as a share of the federal EITC since 1990. At 6 ½ % of the federal EITC, Iowa's rate is one of the lower state EITC's in the country. Prior to the minimum wage increase, the Greers paid \$112 in state income taxes; after the increase they will pay \$678. Raising the Iowa EITC to 20% of the federal credit would reduce that tax burden by over \$225, which would keep significantly more of their earnings in their pocket and within their community. Iowa's income tax burden on low and moderate income working families with children is too high; Iowa starts taxing a working family of four when the family earns \$18,338, while

the federal government provides actual tax refunds to working families up to \$41,000 in income. Expanding the state EITC is recognized as one of the most efficient and effective ways state government can provide help to those working families with children and is an important complement to raising the minimum wage.

Second, raising the eligibility level for the child care subsidy from 145% of poverty up to 200% of poverty is needed to eliminate the cliff effect that currently exists in Iowa's child care subsidy program. Iowa has one of the lowest eligibility cut-off levels for its child care subsidy program in the country and produces a large cliff effect for a family needing the subsidy whose income goes from below 145% of poverty to above 145% of poverty, as happened with the Greers. A family receiving a wage increase of even twenty-five cents per hour can end up losing the child care subsidy entirely and be more than \$3,000 in the hole for child care costs, as a result.

Clearly, many individuals and families will benefit substantially from the increase in the minimum wage. Still, raising the minimum wage also requires attention to increasing the EITC and raising the child care subsidy level, if working families with children truly are to be in an economic position to raise their children well.

Table: Impact of the Minimum Wage Increase on State and Federal Taxes and After-Tax Disposable Income and the benefit of raising the EITC

|   | The Greers<br>2 full-time<br>incomes at<br>minimum<br>wage | The Greers<br>with Iowa EITC<br>raised to 20% |
|---|--|---|
| <b>\$5.15/Hour Minimum Wage</b>   |  |   |
| Income  | \$21,424   |   |
| FICA/Medicare Taxes   | (\$1,639)  |   |
| Federal Refund<br>(EITC + Child Credit)   | \$5,083  |   |
| Iowa Income Tax   | (\$112)  |   |
| Total Disposable Income   | \$24,548   |   |
| <b>\$7.25/Hour Minimum Wage</b>   |  |   |
| Income  | \$30,160   | \$30,160                                      |
| FICA/Medicare Taxes   | (\$2,307)  | (\$2,307)                                     |
| Federal Refund<br>(EITC + Child Credit +<br>Add. Child Credit)  | \$3,053  | \$3,053                                       |
| Iowa Income Tax   | (\$678)  | (\$446)                                       |
| Total Disposable Income   | \$30,228   | \$30,460                                      |
| <b>Source:</b> TurboTax 2006 calculations, based upon claiming standard deduction and personal exemption. |  |   |