1 Boosting Paychecks in America

Self-sufficiency and hard work are core American values. Normatively, Americans expect their fellow citizens to work to support their families. Empirically, full-time participation in the labor market remains central to family economic well-being. Yet most Americans realize that work alone is not enough to keep all workers and their families out of poverty. Many of the 20 million working-age individuals in poverty are working, but even full-time work at the federal minimum wage does not provide enough income for a family of three to escape poverty. Therefore, in addition to programs to help individuals join the workforce, the federal government has devised a range of policies to boost the paychecks of low-income earners and their families. In a major Brookings report and the book *Government's Greatest Achievements: From Civil Rights to Homeland Security*, Paul Light identifies this effort as one of the greatest accomplishments of the twentieth century.[1]

This book analyzes the political origins and development of two critical pillars of the policy regime that supports low-income earners and their families in the United States: federal taxes on individual income and the minimum wage. My purpose is twofold: to explore the partisan and coalition politics that yield these policies and to highlight their economic and

1. Light (2000).

distributive consequences for low-income earners and their families. Ultimately, I seek to explain how American politics has shaped these policy bargains and to what degree they have succeeded in lifting poor and near-poor workers with and without families up and out of poverty.

Although disparities in the distribution of after-tax income have widened over the past quarter century, this book does not address America's political success or failure in reducing income inequality, measured as the size of the gap between those with the highest and lowest incomes. Rather, my focus is on policies that improve the economic well-being of low-wage workers and their families. By illuminating the politics of this issue and the consequences of the resulting bargains, I hope to bridge the perspectives of political analysts, who often account only for politics, and policy analysts, who focus on the distributional effects of alternative social policy choices.

The story told in this book shows that partisan distributional goals have been central to the politics of boosting paychecks for low-income working families. Democrats and Republicans have selected different policy tools not solely for technical or ideological reasons, but also based on their distributive consequences for core constituents and key interest groups. In forging the political coalitions needed to enact policy changes, Democrats and Republicans have sought to distribute tax relief or minimum wage increases to the earners or families who are perceived as crucial to their party's electoral success. Moderates or centrists in both parties have played a pivotal role in brokering and shaping these final policy bargains.

The resulting policy regime to support low-income working families reflects a core American belief: all able-bodied workers must participate in the labor market full time, and, if they do so, they should earn enough to keep a one- or two-parent family out of poverty. However, this consensus excludes low-wage single earners and married couples without children. For those without children, there is no guarantee that full-time work will generate enough income to escape poverty. Thus, despite nearly a century of efforts to help those at the bottom of the income distribution, we continue to face the challenge of making work pay for every American.

Rethinking the American Welfare State

This book expands our understanding of social policy in the United States in two ways. First, it looks beyond traditional social insurance and assistance programs (such as welfare) that have been considered the main tools of antipoverty policy to explore the importance of alternative policy instruments. Second, it moves beyond income support to nonworkers (the elderly, the disabled, nonworking mothers with dependent children, and others) to focus on efforts to support individuals who are active in the labor market. In so doing, it contributes to a recent wave of scholarship that has reshaped thinking about the welfare state in the United States by introducing such concepts as the "hidden welfare state" (which highlights the role of tax expenditures in social policy) and the "shadow" or "divided" welfare state (which focuses on the role of regulatory and tax policies in shaping employer-provided health and pension benefits).[2]

Scholars of the politics of U.S. social policy traditionally have focused on the income transfer programs that intervene when individuals—because of age, disability, or a sluggish economy—are unable to work.[3] Such social insurance and assistance programs typically redistribute cash and in-kind benefits. These benefits often appear meager when compared to their analogues in other advanced industrialized countries. Accordingly, many historical studies of U.S. social policy emphasize the political coalitions that did not come together to support large-scale social policy reform.[4] Seen in this light, the development of the American welfare state is often characterized as a long series of missed opportunities. However, as Christopher Howard observes, American social policy is exceptional not so much for its small size—in terms of spending—as for its reliance on an unusually broad range of policy tools to achieve social welfare objectives.[5]

Social insurance and assistance programs remain critical elements of American social policy. However, by focusing on these programs, analysts tend to overlook the broader set of tools that policymakers have used to assist low-wage workers and their families. These alternative policy instruments have recently moved to the forefront, as bipartisan consensus has shifted away from cash assistance for individuals outside the labor market and toward work-related income support for workers who are active in the labor market. Since 1980 federal income tax credits, such as the Earned Income Tax Credit (EITC), the Child Tax Credit, and, most recently, the Making Work Pay tax credit, have emerged as central elements of an ongoing political strategy to boost the paychecks of low-income working families

2. Howard (1997); Gottschalk (2000); Hacker (2002); Klein (2003).
3. Skocpol (1995); Amenta (1998); Marmor and others (1990); Graetz and Mashaw (1999).
4. Weir, Orloff, and Skocpol (1988); Katznelson (1989); Pierson (1995).
5. Howard (2007).

as well as moderate- and middle-income families.[6] However, their effectiveness in raising the incomes of the working poor can depend in part on regular increases in the federal minimum wage. Hence, the dual focus of this book.

Boosting Paychecks explores the political origins and development of taxes on individual income and the minimum wage as forms of earnings subsidies. Political conflict over these issues has largely mirrored major ideological and distributional divisions within American politics over the past century. Debates over the overall progressivity of the federal income tax code—tax rates, brackets, exemptions, and deductions—have been partisan and divisive. Tax credits for low- to middle-income earners with children have been a partial exception to this rule, drawing support across traditional partisan, ideological, and economic lines. Nonetheless, partisan conflict has recently emerged over the refundability of some tax credits, the budget costs of which have grown substantially over the past several decades. Similarly, there has been significant partisan conflict over increases in the minimum wage, driven by the trade-off between potential increases in workers' income and in labor costs for small business.

These policies are not the only ways in which the federal government can help low-wage workers and their families. The single factor that most benefits such workers and their families, experts agree, is a healthy macroeconomy with strong job growth.[7] In addition, government can invest in human capital through education and training programs that help workers prepare for higher-wage jobs. A range of "in-kind" supports also helps lower-income families with basic living expenses such as health care, food, and child care.[8] However, these means-tested benefit policies have been widely studied. In contrast, the politics of supplementing earnings through the income tax and the minimum wage remains largely unexplored.

The Nuts and Bolts of Supporting Low-Income Working Families

The federal government does not have official definitions of such terms as "low income," "moderate income," or "middle class," but it provides data that can help delineate these categories. According to the U.S. Department

6. Gitterman and Howard (2003); Steuerle (1990); Sammartino, Toder, and Maag (2002); Sawhill and Thomas (2001). See also William G. Gale, "Tax Credits: Social Policy in Bad Disguise," *Christian Science Monitor*, February 16, 1999.

7. Blank, Danziger, and Schoeni (2005); Blank (2000); Haveman and Schwabish (2000); Blank (2007).

8. Wilson and Stoker (2006).

of Commerce, real median income for all households in the United States was $50,303 in 2008.[9] Median income is the amount that divides the income distribution into two equal groups, half having incomes above the median, half having incomes below the median. Starting from this baseline, many analysts define *low income* as below 50 percent of the median income (roughly $25,000) and moderate income as 50 percent to 80 percent of the same figure ($25,000 to $40,000). Another approach starts with the federal poverty threshold, which was $21,834 for a two-parent family of four and $17,346 for a one-parent family of three in 2008, and defines *low income* as earnings at or below this level.[10] Moderate income can then be defined as earnings between 100 percent and 200 percent of the federal poverty threshold, or $43,688 for a family of four in 2008. Obviously, any such definitions are arbitrary, but they provide a sense of the economic challenges facing low- and moderate-income families.

The need for earnings supplements arises in large part from the nature of the jobs held by less-skilled, low-income workers. Such jobs are likely to be compensated on an hourly basis, as opposed to a salaried basis, and are less likely to be based on a full-time work schedule. Moreover, the wages that these jobs pay have declined significantly in relative terms. Over the past several decades, the real hourly wage rate in the United States grew substantially faster at the top of the wage distribution than at the middle, and grew faster at the middle than at the bottom.[11] This trend provides an important backdrop to efforts to use the tax system and federal minimum wage to help low-income earners and their families.

Role of the Federal Individual Income Tax

The tax system's effectiveness at supporting low-income earners and families depends largely on its progressivity. In a progressive tax system, the

9. U.S. Department of Commerce, "Income, Poverty and Health Insurance Coverage in the United States: 2008," press release, September 10, 2009 (www.census.gov/Press-Release/www/releases/archives/income_wealth/014227.html). The U.S. Census Bureau reported that real median household income in the United States fell 3.6 percent between 2007 and 2008, from $52,163 to $50,303. This broke a string of three years of annual income increases and coincides with the recession that started in December 2007.

10. For a single earner under sixty-five or a married couple under sixty-five with no children, the 2008 federal poverty thresholds were $11,201 and $14,417, respectively. U.S. Census Bureau, "Poverty Thresholds for 2008 by Size of Family and Number of Related Children under 18 Years" (www.census.gov/hhes/www/poverty/threshld/thresh08.html).

11. Congressional Budget Office, "Historical Effective Tax Rates: 1979 to 2004," Table 1C, December, 2006 (www.cbo.gov/ftpdocs/77xx/doc7718/EffectiveTaxRates.pdf).

share of earned income paid in tax rises with income, and after-tax income is more equally distributed than before-tax income. Over the course of the twentieth century, the federal individual income tax emerged as a relatively progressive tax that essentially exempts the poor, exempts some income from taxation at all income levels, taxes higher incomes at higher rates, and has no upper limit. Many provisions of the tax code have contributed to this outcome, including the tax rate structure and the definition of the tax base (defined as the portion of personal income subject to federal income tax at a positive rate).

INCOME TAX RATES AND BRACKETS. Tax rates are applied by brackets. For example, imagine there are three tax brackets: 10 percent (for earned income under \$10,000), 20 percent (for earned income between \$10,000 and \$19,999), and 30 percent (for income \$20,000 and above). Under this system, a worker with \$15,000 in taxable income would pay 10 percent on the first \$9,999 and 20 percent on the rest, for a total of \$2,000 and an average tax rate of 13.3 percent. In sum, a taxpayer's bracket defines her marginal rate—the rate paid on the "last dollar" earned—but, as a percentage of income, her tax liability is generally less than the marginal rate. The percentage of income that a household pays in income taxes is referred to as its average tax rate or tax burden.

The distribution of the overall tax burden can be reshaped dramatically by changing tax rates, the number and boundaries of tax brackets, or both. Broadly speaking, tax reforms that have reduced income tax rates by equal percentages have tended to redistribute income toward higher-income earners. To illustrate this effect, consider the situation of two families, one earning \$15,000 and the other earning \$50,000. Under the rate structure presented above, the low-income family would owe \$2,000 in tax, and the middle-income family would owe \$12,000 (an average tax rate of 24 percent). Now suppose that rates in all three brackets are cut in half to 5 percent, 10 percent, and 15 percent. The low-income family would then owe \$1,000 (an average rate of 6.7 percent), and the middle-income family would owe \$6,000 (an average rate of 12 percent). While both families have seen their tax liability cut in half, the low-income family's after-tax income has increased by only \$1,000, or 7.7 percent, while the middle-income family's after-tax income has grown by \$6,000, or 15.8 percent.

TAXABLE INCOME, EXEMPTIONS, DEDUCTIONS, AND CREDITS. Tax rates are not the only determinant of a household's tax burden; an equally important factor is the way in which the household's taxable income is defined. For most low-income families, their taxable income is equal to their adjusted gross income less personal and dependent exemptions and a standard deduction. Since 1985 the U.S. Department of the Treasury has annually adjusted the personal exemption, standard deduction, and income tax tables to account for the prior year's change in the consumer price index.

The personal and dependent exemptions reduce the amount of earned income subject to federal income tax to account for differences in ability to pay based on family size. The tax benefits resulting from these exemptions depend on a family's marginal tax rate. As a result, an exemption is more valuable for high-income families than for low-income families.[12]

The standard deduction reduces taxable income for most workers by a fixed dollar amount that depends on their marital status, filing status, and age.[13] Many middle- and upper-income taxpayers choose to itemize deductions instead of taking a standard deduction. Itemized deductions, including for pension contributions and earnings, employer-paid health insurance premiums, mortgage interest on owner-occupied homes, and state and local income taxes, account for the majority of federal income tax relief.[14] However, most low- to moderate-wage workers and their families claim a standard deduction. The actual tax relief of a standard deduction equals the amount by which it exceeds deductions that would be itemized multiplied by the average tax rate on such deductions.

During the 1970s the standard deduction—known as the "zero bracket amount" from 1977 to 1986—became the preferred policy tool of federal policymakers who hoped to lessen the tax burden on low-income workers and their families. More recently, tax credits have taken over this role. While exemptions and deductions reduce taxable income, tax credits reduce income tax liability dollar for dollar. There are two types of credits: nonrefundable and refundable. Nonrefundable tax credits can reduce tax owed to zero but do not give rise to a refund. A refundable credit can reduce taxes below zero and generate a cash refund. Income tax credits can be structured in a number of ways, each with different distributional implications. They can be set at a fixed amount that does not vary by income; they can be structured to be more generous for some income groups than

12. Sammartino, Toder, and Maag (2002).

13. Blind taxpayers and taxpayers with blind spouses also qualify for a slightly higher standard deduction.

14. Sammartino, Toder, and Maag (2002).

for others; or like the EITC, which is designed primarily to help low-income and moderate-income working families, they can exclude some income groups altogether.

MARRIAGE PENALTIES AND BONUSES. Many of the factors just described—tax brackets and marginal rates, standard deductions, and the structure of tax credits, notably the EITC—interact to impose a marriage penalty on two-earner families. Under the current system, single individuals, heads of households, and married couples are subject to different standard deductions and tax rate schedules. Therefore, changes of marital and filing status can have important tax consequences. A married couple is generally required to file a joint tax return based on the combined income of husband and wife. When workers with similar earnings marry, their combined income often pushes them into a higher tax bracket than they would face as singles because most brackets for married couples are less than twice as wide as those for single filers. In contrast, when earners with dissimilar incomes marry, the individual with a higher income moves into a lower marginal tax bracket as a result of the change in marital and tax filing status, reducing the household's combined tax burden and increasing its after-tax income.[15]

In 2001 Congress alleviated the marriage penalty for lower-income families by redefining the two bottom brackets so that they would be twice as wide for married couples as for single filers. At the same time, it eliminated a second aspect of the marriage penalty by making the standard deduction for married couples twice the amount for single filers. (Like many provisions of the 2001 tax law, these measures were scheduled to sunset in 2010.) However, the marriage penalty remains a significant problem for low-income families who qualify for income-related tax credits such as the EITC. If a single working parent qualifies for the full EITC, marriage to another worker will usually result in a reduction in her credit or even its elimination because of the increase in her household income.[16] As this example suggests, low-income earners face some of the highest marginal tax rates because additional earned income not only increases the percentage paid on each dollar but also can cause them to forfeit tax credits.[17] On the other hand, the EITC offers a marriage bonus for couples consisting of a nonworking mother and a working man without children. In this case, her

15. Alm and Whittington (1999).
16. Ellwood and Sawhill (2000). See also McIntyre and McIntyre (1999).
17. Sammartino (2001).

children and his earnings allow them to receive the EITC when neither would qualify otherwise.

Compared to their lower- and higher-earning counterparts, moderate-to middle-income parents face what has been called a "middle-class parent penalty." Low-income workers with children receive tax benefits from the EITC, while higher-income earners with children benefit more from dependent exemptions. Parents in the middle receive substantially smaller child-related tax benefits. Middle-income families are increasingly likely to face marginal tax rates that are often as high as or higher than those that more affluent families face, due in large part to payroll taxes to finance Social Security and Medicare, as well as to marriage penalties.[18]

Role of the Federal Payroll Tax

Payroll taxes are mandated by the Federal Insurance Contributions Act, which finances Social Security and Medicare. Social Security provides benefits under the Old-Age, Survivors, and Disability Insurance trust fund. Medicare provides benefits under the Hospital Insurance trust fund. In contrast to the individual income tax, payroll taxes are levied on gross wages without exemptions or deductions. They are imposed on earnings, not investment income, and they apply at a single marginal tax rate. In the case of the Social Security tax, it also only applies up to an earned income ceiling ($106,800 in 2009). Thus payroll taxes have many regressive characteristics. However, the Social Security system as a whole is progressive. Social Security benefits are paid according to a formula that gives low-income earners a better rate of return on their contributions than high-income earners. It thus redistributes income from middle- and high-income earners to low-income households.

Role of the Federal Minimum Wage

While income and payroll taxes affect earners' after-tax income, the federal minimum wage is intended to boost the pretax earnings of workers in the lower tiers of the wage distribution.[19] It affects the earnings of all low-wage workers by establishing a floor for hourly wage compensation in covered sectors. It has taken on greater significance as the proportion of the U.S. workforce that has its wages set by collective bargaining has declined.

18. Ellwood and Leibman (2000); Davig and Garner (2006). See also U.S. Department of Commerce (2007).

19. Freeman (1994, 1996).

In 1983, 20.1 percent of U.S. workers were unionized. By 2008 the number had fallen to 12.4 percent.[20]

Proponents of the minimum wage view it as an important antipoverty tool. Opponents see it as a burden on employers and as unwarranted interference with the labor market. In particular, the employment effects of the minimum wage have generated considerable controversy. As early as 1941, economist George Stigler argued that "economists should be outspoken and singularly agreed" that the minimum wage does not reduce poverty.[21] Opponents continue to claim that the weight of the evidence over the past twenty-five years supports the traditional view that higher minimum wages reduce employment by forcing marginal businesses to lay off workers. However, research suggests that the most recent minimum wage increases have had little or no adverse effect.[22] Moreover, some economists believe that the minimum wage offers substantial benefits. They cite higher productivity, decreased turnover, lower recruiting and training costs, decreased absenteeism, and increased worker morale as gains that might offset some of the costs employers experience from a wage increase.[23]

Centrists in both parties have tried to minimize the negative economic (and political) consequences of the minimum wage by exempting various types of employers. The original 1938 minimum wage extended only to "businesses that were actually engaged in and substantially and materially affecting interstate commerce." Although the primary goal of this clause was to ensure the constitutionality of the legislation, it also made it politically more appealing by limiting its cost. Even after the Supreme Court upheld the federal minimum wage in 1941, agricultural and domestic service workers were exempt until 1966. These occupations—together with employees in the retail trade, who were similarly excluded until the 1960s—made up a large proportion of low-wage workers in the 1960s. By 2008, the highest proportion of workers earning at or below the federal minimum wage was in service occupations, about 9 percent. About 7 in 10 workers earning the minimum wage or less in 2008 were employed in service occupations, mostly in food preparation and serving related jobs.[24]

20. U.S. Department of Labor, Bureau of Labor Statistics, "Union Members in 2008," Economic News Release, January 28, 2009 (www.bls.gov/news.release/union2.nr0.htm).

21. Stigler (1946).

22. Card and Krueger (1995); Freeman (1996).

23. Fox (2006).

24. U.S. Department of Labor (2009); U.S. Department of Labor, Bureau of Labor Statistics, "B-2. Average Hours and Earnings of Production and Nonsupervisory Workers (1) On Private Nonfarm Pay-

More recently policymakers have sought to cushion the effects of the minimum wage on employers by packaging increases with small business tax relief. The Targeted Jobs Tax Credit (TJTC) that was enacted in 1978 provided employer tax credits to firms that hired workers in a number of categories, including low-income youth, low-income Vietnam veterans, low-income ex-convicts, and welfare recipients. In 1996 the Small Business Job Protection Act authorized the Work Opportunity Tax Credit (WOTC) to replace the TJTC. In 2007 Congress extended the WOTC until 2011 by passing the Small Business and Work Opportunity Tax Act. Currently, the WOTC provides a tax credit of up to 40 percent of the first $6,000 in wages paid during the first twelve months for each new qualified hire.[25] However, participation rates in WOTC are low, and its impact on employment is questionable.

Some recent research concludes that the EITC is more effective than the minimum wage in providing support for low-wage workers. Minimum wage critics argue, for example, that the EITC is better targeted than the minimum wage because many of the beneficiaries of minimum wage increases are not members of low-income families.[26] However, others conclude that the effectiveness of the EITC in raising the incomes of working poor families above the federal poverty threshold depends, in part, on regular increases in the minimum wage. Richard Freeman 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 that support low-income earners and their families.[27]

Measuring the Distributional Impact

To understand how these policies affect the economic well-being of low-income earners and families, we must identify some appropriate metrics. In this book, I will focus primarily on how the federal income tax code and the

rolls by Major Industry Sector, 1964 to Date," 2009 (ftp://ftp.bls.gov/pub/suppl/empsit.ceseeb2.txt); U.S. Department of Labor, Bureau of Labor Statistics, "Characteristics of Minimum Wage Workers," table 4 (Employed Wage and Salary Workers Paid Hourly Rates . . .), 2008 (www.bls.gov/cps/minwage2008.htm).

25. Hamersma (2005).

26. Hotz and Scholz (2000, pp. 25–42).

27. Freeman (1996).

minimum wage affect a family's economic status relative to the federal poverty threshold. The federal poverty threshold represents "the minimum dollar amount needed for individuals, couples, or families to purchase food and meet other basic needs."[28] It increases with family size and is updated for inflation annually, using the consumer price index.[29] If total family income is less than the threshold appropriate for that family, the family is in poverty. Although the thresholds in some sense reflect families' needs, they are intended for use as a statistical yardstick, not as a complete description of what people and families need to live.

A useful way to think about the impact of the federal income tax on low-income working families is to compare the income tax entry threshold and the poverty threshold. The tax entry threshold is the maximum income a family can earn before owing federal income tax. If the income tax entry threshold for, say, a family of four, falls at or below the federal poverty threshold, tax liabilities will push such families below the poverty level. In recent decades policymakers have sought to avoid this outcome.

Another way to evaluate the impact of federal taxes is to examine the burden of the income and payroll tax.[30] The combination of income and payroll taxes can result in much higher effective tax rates and a higher total tax burden for lower-income households. (The effective tax rate measures the average rate at which an individual is taxed on his or her earned income.) It also shows that a higher portion of the total tax burden is being borne by labor income (as opposed to capital income, which is concentrated in higher-income households).

Like the tax system, the minimum wage can be evaluated relative to federal poverty thresholds. A key measure of the minimum wage's effectiveness is the annual income that a full-time, full-year worker who earns the minimum wage would earn relative to the poverty threshold for a family of three or four people. The ratio of the minimum wage relative to the average wage (which reflects the earnings of both skilled and unskilled workers) is another important metric, as is the real value of the minimum wage. In addition, many analysts focus on the number and percentage of workers who would be affected by a minimum wage increase.

28. U.S. Department of Labor (2005).
29. Maag (2004).
30. Center on Budget and Policy Priorities (1997).

A Brief History of the Federal Income Tax, Payroll Taxes, and the Minimum Wage

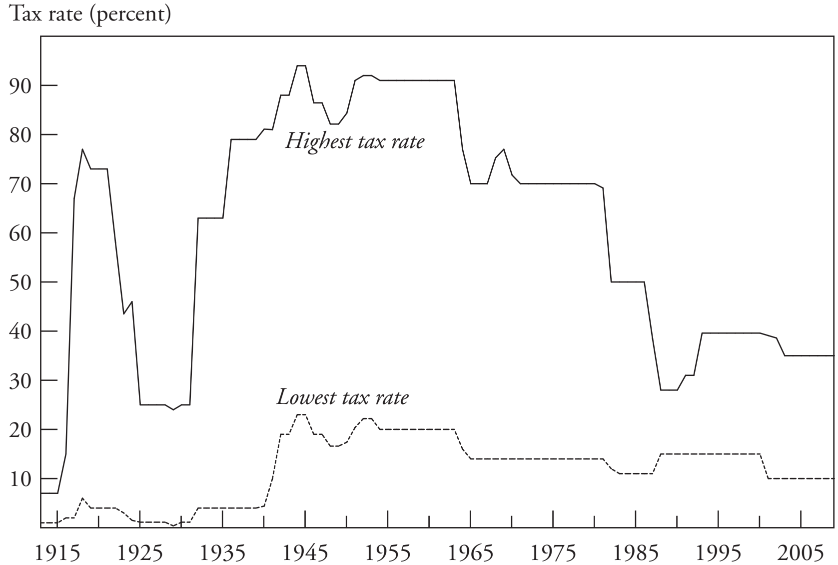
Federal income tax rates have varied widely since 1913, when the Sixteenth Amendment authorized Congress to levy an income tax, and now range from 10 to 35 percent of taxable income. (See figure 1-1.) From 1913 until World War II, high-income earners were the only group with any federal tax liability. This situation began to change in the early 1940s, when federal policymakers for the first time had to persuade low- and moderate-income earners to accept an individual income tax to help finance the nation's defense. With the emergence of inflation after World War II, these low- and moderate-income earners saw their tax rates increase through a phenomenon known as bracket creep: growth in their nominal incomes pushed them into higher tax brackets even when their real incomes remained the same or fell. High inflation rates played havoc on the after-tax income of low- to moderate-income earners because tax rate brackets, fixed exemptions, deductions, and credits were not indexed for inflation.

Because the personal exemption and the minimum standard deduction remained constant in nominal terms between 1948 and 1963, while the federal 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 tax entry thresholds—the amount a family could earn before having to pay federal income taxes—back up toward the federal poverty thresholds. But tax entry thresholds again fell below federal poverty lines during the late 1970s, and ad hoc increases were adopted in 1970, 1972, and 1979 to address the problem.[31]

The 1980s brought relief for low-income families in two forms. First, legislation passed in 1981 indexed the personal exemption, standard deduction, and tax brackets to inflation beginning in 1985. Second, the 1986 tax reform expanded the EITC, which had been introduced in more modest form in 1975, and indexed it to inflation as well. These changes, followed by further increases in the EITC in the 1990s under the Clinton administration, significantly 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 federal poverty threshold, due largely to the EITC and more recently to the Child Tax Credit.[32]

31. Bakija and Steuerle (1991).
32. U.S. House of Representatives (2000); Maag (2004).

Figure 1-1. *U.S. Individual Income Tax Rates, 1913–2009*



Source: Tax Policy Center, Tax Facts Online. Adapted from Tax Policy Center, "Historical Individual Income Tax Parameters," November 6, 2008 (www.taxpolicycenter.org/taxfacts/displayafact.cfm?Docid=543).

Payroll Taxes

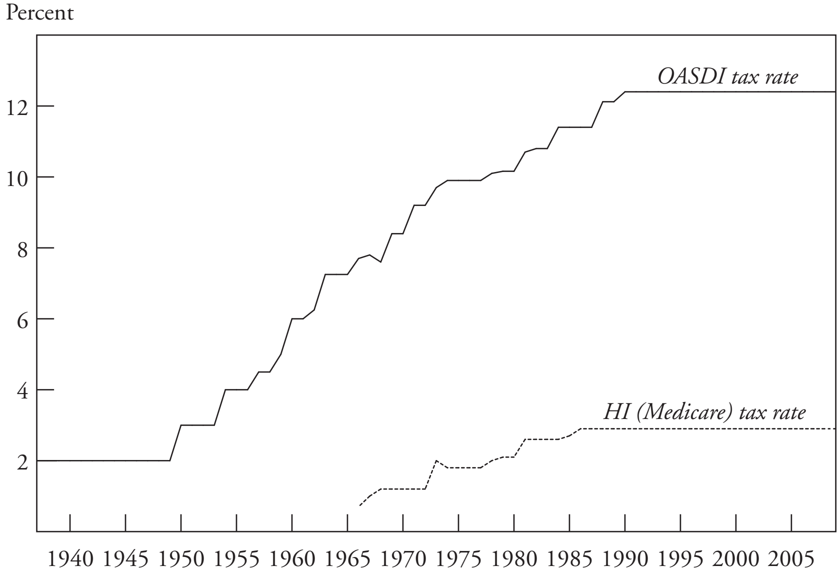
When the federal payroll tax was first collected in 1937, it was only 2 percent of wages and salaries, evenly divided between employer and employee. (See figure 1-2.) By 1960 the rate had tripled to 6 percent, which approached the upper range of what President Franklin D. Roosevelt's Treasury Department had anticipated that low-income workers could bear without needing income tax relief. In 2009 the federal payroll tax rate was 15.3 percent of earnings (12.4 percent for Social Security and 2.9 percent for Medicare).[33]

Historically, the parties have disagreed over how to finance expansion of the Social Security program. Liberal legislators typically 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, which would increase the tax burden on lower-income earners.[34] However, by the mid-1970s, both

33. Burman and Leiserson (2007).

34. Reese (1980, pp. 140, 169).

Figure 1-2. *Historical Payroll Tax Rates (OASDI and HI), 1937–2009*[a]



Sources: Social Security Administration, "Contribution and Benefit Base," January 15, 2009 (www.ssa.gov/OACT/COLA/cbb.html), and "Social Security and Medicare Tax Rates" (www.ssa.gov/OACT/ProgData/taxRates.html [January 8, 2009]).

a. OASDI, Old-Age, Survivors, and Disability Insurance trust fund; HI, Hospital Insurance trust fund. Amounts for 1937–74 and for 1979–81 were set by statute; all other amounts were determined under automatic adjustment provisions of the Social Security Act. Before 1989 the tax rate on self-employed persons was less than the combined tax rate on employers and employees. For 1991, 1992, and 1993, the upper limits on earnings subject to HI taxes were $125,000, $130,200, and $135,000 respectively. The upper limit was repealed by the Omnibus Budget Reconciliation Act of 1993.

Democrats and Republicans expressed growing concern about the regressive effects of the federal payroll tax, which when combined with the individual income tax, imposed a much 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 significantly reduced their tax liability. Because of such programs, most low-wage workers now have net negative tax liabilities throughout their lifetimes.[35]

35. U.S. Congress (1997).

The Minimum Wage

Congress initially set the federal minimum wage at twenty-five cents per hour as part of the 1938 Fair Labor Standards Act.[36] At the time, most low-wage workers worked in sawmills and the apparel industry in the South. Today the impact of the minimum wage is not concentrated in one region. It largely affects teenagers and young adults; however, as the earnings distribution has widened in recent decades, an increasing number of adults have become its potential beneficiaries.[37]

Beyond its initial three-step increase to 40 cents per hour in 1945, Congress has increased the minimum wage numerous times over the past seven decades. (See figure 1-3.) Nonetheless, because the minimum wage has not been indexed to increase with the cost of living, it has not kept pace with inflation, and its real value has declined. The inflation-adjusted value of the minimum wage was 19 percent lower in 2008 than it was in 1979.[38]

The minimum wage was most effective as an antipoverty tool in 1968, when it allowed a full-time, full-year worker to earn an income equivalent to 118.7 percent of the poverty threshold for a three-person family. Since 1980 it has been below the poverty level for a full-time, full-year worker in a three-person family.[39] Today a worker who is employed full-time at the minimum wage of $7.25 per hour earns about $15,000 a year—more than $2,000 below the federal poverty threshold for a family of three and more than $6,000 below the poverty threshold for a family of four.

Similarly, the proportion of hourly workers earning the federal minimum wage or less has trended downward since 1979, when the government began to collect data on a regular basis.[40] In 1981, 15.1 percent of hourly paid workers were making less than the new minimum wage; in 2007, 2.3 percent of hourly paid workers were making less than the new minimum wage. Among those workers paid by the hour in 2007, 267,000 were reported as earning exactly the prevailing federal minimum wage.

36. Grossman (1978). For more historical background, see Storrs (2000); Hart (1994); Mettler (1998); Steinberg (1982); O'Brien (1998); Robertson (2000).

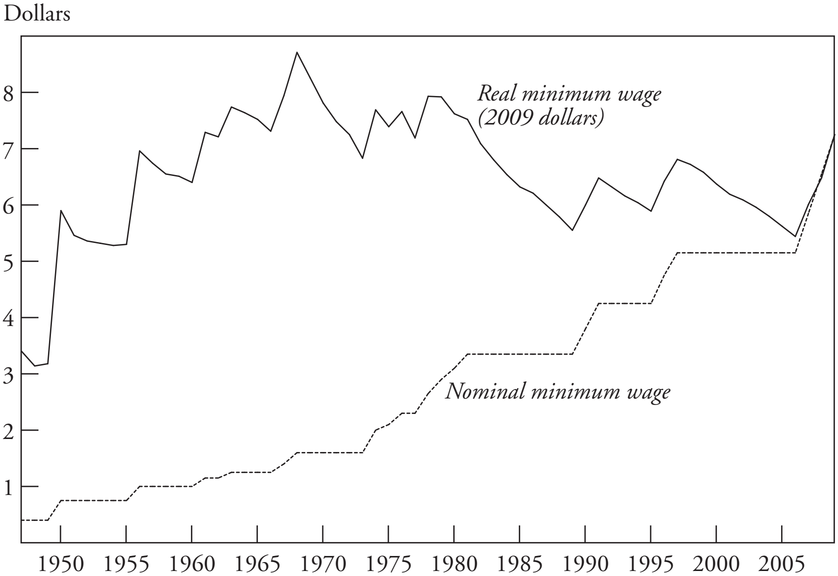
37. Freeman (1996).

38. Economic Policy Institute, "EPI Issue Guide: Minimum Wage," August 2008, p. 1 (www.epi.org/issueguides/minwage/epi_minimum_wage_issue_guide.pdf).

39. Tom Gabe, "Historical Relationship between the Minimum Wage and Poverty, 1959 to 2005," Congressional Research Service memorandum, July 5, 2005 (www.chn.org/pdf/crsminimumwage.pdf).

40. U.S. Department of Labor (2005).

Figure 1-3. *Nominal and Real Value of the Minimum Wage, 1947–2009*[a]



Source: Economic Policy Institute analysis of Department of Labor and Bureau of Labor Statistics data (www.epi.org/publications/entry/tables_figures_data).

a. In May 2009 dollars, based on the Consumer Price Index Research Series Using Current Methods (CPI-U-RS).

Nearly 1.5 million were reported as earning wages below the minimum wage. Together, these 1.7 million workers with wages at or below the minimum made up 2.3 percent of all hourly workers.[41]

Boosting Paychecks: The Role of Partisan Preferences and Coalition Politics

In analyzing these policy approaches, I highlight the importance of partisan political control of the White House and Congress on the one hand and coalition politics within Congress on the other. Partisan control of the White House has already been shown to have a significant effect on the distribution of income nationwide. For example, as Larry Bartels concludes, "The striking differences in the economic fortunes of rich and poor under Democratic and Republican administrations evident in the historical record

41. Ibid., table 10.

do not seem to be an artifact of the different conditions under which Democrats and Republicans have happened to hold the reins of government, but a reflection of the fundamental significance of partisan politics in the political economy of the post-war U.S."[42] The average rates of real, after-tax income growth since 1980 for households at the 20th, 40th, 60th, and 80th percentiles of the income distribution scale show that households at every income level did about equally well under Democrats Jimmy Carter and Bill Clinton, while Republicans Ronald Reagan and George H. W. Bush produced weaker income growth at the top of the income distribution and little or none at the bottom.

Partisan political control is also important for understanding the federal minimum wage. Keith Poole and Howard Rosenthal report that changes to the nominal value of the minimum wage since World War II have depended largely on which party controls Congress and the White House.[43] The federal minimum wage increased at an average annual rate of 7.1 percent when Democrats controlled both the House and the Senate. When Democrats had political control of the White House as well, the federal minimum wage grew 9.3 percent a year. Under a Republican president and a Democratic Congress, its annual growth rate was only 4.6 percent.

The differences between the parties over key issues have increased in recent decades as partisan polarization has soared. According to Nolan McCarty, 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.[44] Polarization contributes to gridlock and stalemate, making it more difficult for Congress to respond to economic shocks and to pass contested measures such as increases in the minimum wage.

Nonetheless, bipartisan coalitions have continued to form around important policy issues. In the case of the income tax, centrists in both parties have embraced the goal of progressivity and worked together through the House Ways and Means and Senate Finance Committees to incorporate such policies as the EITC and other tax credits into omnibus budget packages. Moderates have also joined coalitions in support of minimum wage increases by crafting agreements that allowed them to secure the elec-

42. Bartels (2004, p. 13).
43. Poole and Rosenthal (1991).
44. McCarty (2007).

toral benefits of a modest minimum wage increase without imposing industry-, group-, or geography-specific costs.[45]

In examining each of these bargains, the major analytical challenge is to identify the coalition that made the political agreement possible. Thus, rather than examine only the preferences of the ardent supporters and opponents of each policy approach, I attempt to identify the centrist members of the enacting coalition whose preferences had to be taken into account in order to reach a bargain.[46]

Plan of the Book

In the chapters that follow, I offer an analytically grounded narrative that abstracts from the historical details and identifies broad partisan and coalitional patterns in the politics of supporting low-income earners and their families since the early twentieth century. Chapters 2 and 3 explain the political development of the federal income and payroll tax and the minimum wage, with a particular focus on the period between the New Deal and 1980. Chapters 4–6 focus on the political evolution of the federal income and payroll tax and the minimum wage (and their potential interactions or lack thereof) from 1981 to the 2008 election. Chapter 7 focuses on initial efforts by Obama and Democrats in Congress to extend additional income tax relief to working families. Chapter 8 assesses the distributive implications of the federal government's policy regime to support low-income working families and concludes by moving from the retrospective to the prospective: the immediate political future of boosting the paychecks of low-wage workers and their families in America.

Why is boosting paychecks so important? It is simply because, for the foreseeable future, many less-skilled workers will continue to face low and even falling real wages. Declining demand has pulled down the wages of the less skilled, both men and women, so employment often does not lead to economic self-sufficiency. Consequently, the construction of a new policy regime that balances the flexibility of the labor market with economic security for low-wage workers and their families remains a key political challenge in the twenty-first century.

45. Arnold (1990).

46. McCubbins, Noll, and Weingast (1992, 1994).