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Is the 'Earnings Credit' the Best Way to Cut the Dole Queues?

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EXECUTIVE SUMMARY

To combat joblessness and welfare dependency, the 'Five Economists' in October 1998 proposed a temporary minimum wage freeze and the introduction of 'in-work benefits'. The rationale is that, while a minimum wage freeze boosts employment opportunities for the jobless, in-work benefits—a tax break for low-income families of which one or more members are in paid work—provide the jobless with incentives to take those opportunities.

The proposed in-work benefit programme has since been developed into an 'earnings credit' scheme. This is supposed to encourage an increasing number of the jobless into employment, thereby reducing joblessness and welfare dependency significantly.

But evidence from the United States and Britain, where in-work benefit programmes have been in operation, shows that the employment effects of the earnings credit may not be necessarily positive.

First, responses to in-work benefits appear to differ from one demographic group to another. Employment among jobless lone parents has markedly improved. But married men have hardly changed their labour market behaviour, and furthermore, there has been a significant decline in labour supply from married women whose spouses are employed.

Second, in-work benefits are eventually phased out. Their claimants, in response, appear to stop making additional work effort. This is considered to be an important reason for the lack of response among married men and the negative response among married women whose spouses are employed.

The earnings credit may somewhat decrease joblessness insofar as it boosts employment among lone parents. But welfare dependency might as well increase. The earnings credit, though disguised as a tax credit, is just another welfare benefit. The growth in the number of its claimants at once means the growth in welfare dependency. The unavoidable phasing out of in-work benefits, furthermore, acts as a work disincentive and discourages personal initiative—a quality so desired of individuals in a free society.

There is a better way for Australia to tackle joblessness and welfare dependency: to raise the tax-free threshold. Under a higher tax threshold, individuals would end up with more of the money that they earn through their own effort. This way, personal initiative would be encouraged rather than eroded.

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Introduction: The challenge of joblessness and welfare dependency

The Invalid and Old-age Pensions Act 1908, the very first Commonwealth social security legislation, was intended to give assistance to 'people permanently excluded from the labour market'.[1] Government benefits were thus reserved for those who were deemed genuinely incapable of earning a living. Australia's income support programmes have since expanded both in variety and in generosity. Today, an increasing number of able-bodied individuals who might reasonably be expected to provide for themselves are in receipt of, and heavily dependent on, welfare. The proportion of working-age adults deriving most of their income from government benefits increased from 11.9% in 1986 to 14.1% in 1996-97.[2]

The rise of welfare dependency is symptomatic of growth in jobless households.

The rise of welfare dependency is symptomatic of growth in jobless households, that is, households in which no adult member is gainfully employed. In 1997-98, 16.3% of all Australian households were jobless. This represented a 3.6% increase from the 1982 figure. The incidence of dependent children in these households rose from 10.2% in 1982 to 15.0% in 1997-98.[3] This is particularly alarming, for children who grow up in jobless households are more likely to end up jobless themselves.[4]

To combat joblessness and thus welfare dependency, the 'Five Economists', in an open letter to Prime Minister Howard in October 1998, proposed a temporary

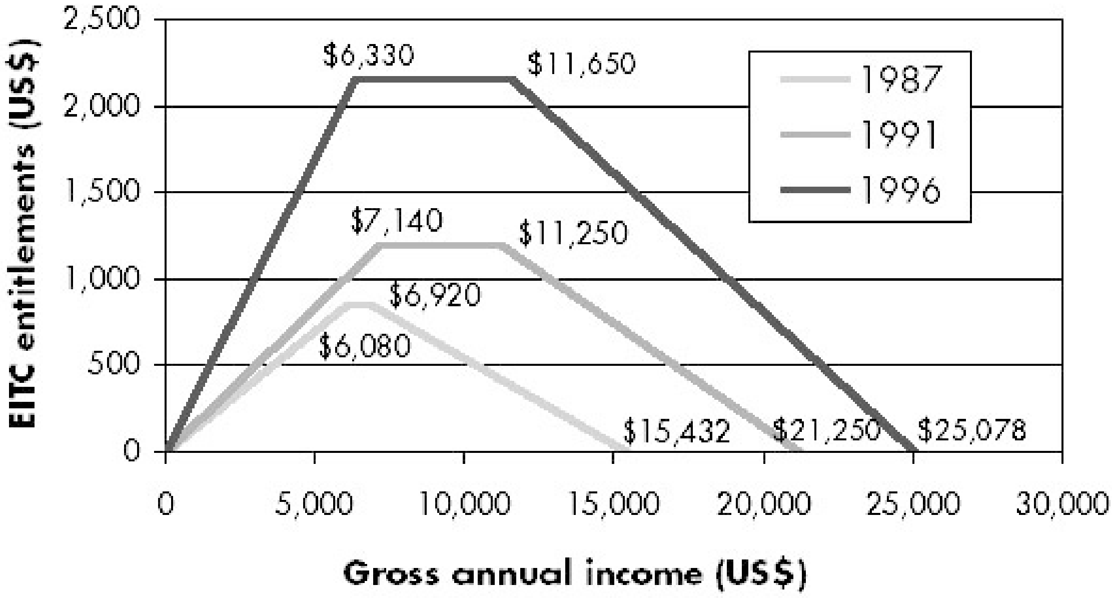
Increased generosity of the EITC

The schedules for 1991 and 1996 are applicable only to families with one 'qualifying' child (see Table 1). Separate credit rates for families with two or more children were first introduced in 1991.

The expansion in 1987 increased the phase-in rate from 11% to 14%. The level of annual income at which the phasing in ceased was raised from $5,000 to $6,080. As a result, the maximum credit increased from $550 to $851. The flat region now ended at an annual income of $6,920, $420 higher than in 1985-86. The phase-out rate was reduced from 12.2% to 10.0%, so that taxpayers with annual incomes of up to $15,432 were eligible for the credit. The indexation of the EITC to inflation began this year.

After 1991, the credit was phased in at 16.7% and phased out at 11.93%. The maximum credit was now $1,192.

The expansion in 1993, phased in between 1994 and 1996, was the largest-ever. The phase-in rate was gradually increased from 18.5% to 34.0%, and the maximum credit, from $1,434 to $2,152. Although the phase-out rate was slightly raised from 13.21% to 15.98%, the EITC overall became significantly more generous.



Source: Nada Eissa and Hilary Williamson Hoynes, *The Earned Income Tax Credit and the Labor Supply of Married Couples*, Discussion Paper No. 1194-99 (Madison: Institute for Research on Poverty, August 1999): Table 1.

minimum wage freeze and the introduction of 'in-work benefits'.[5] A minimum wage freeze would lower the cost of, and thereby increase the demand for, low-skilled labour. This would boost employment opportunities for adult members in jobless households, who are more likely than not to be low-skilled.[6] The consequent minimum wage, however, might be insufficient for some workers to make ends meet and so might give rise to a large working-poor population. In-work benefits aim to prevent this by providing a tax break for low-income families of which one or more members are in paid work.

Similar schemes operating in the United States and Britain are called the Earned Income Tax Credit (EITC) and the Working Families' Tax Credit (WFTC), respectively. The EITC, first introduced in 1975, was significantly expanded in 1987, 1991 and 1994 (see box). Britain's in-work benefit programme dates as far back as to 1971. The WFTC replaced its predecessor, the Family Credit, in October 1999, and the generosity of the programme was increased. The major features of the EITC and the WFTC are summarised in Table 1. As seen later, both programmes have, though to varying degrees, succeeded in boosting employment among lone parents, a population group generally prone to a low employment rate.

The proposal for a minimum wage freeze has been criticised by, for instance, the Australian Council of Trade Unions (ACTU), which claims that the level of the

In work benefits aim to provide a tax break for low-income families of which one of more members are in paid work.

Table 1. Comparing the main features of the EITC, the WFTC and the earnings credit

	EITC (2000)	*WFTC (after June 2000)*	*Earnings Credit (for a couple with two children aged 8 and 13)*
Eligibility	• Must have positive earnings in the previous year and annual investment income under $2,350 • 'Qualifying' children are those who are under 19, or are under 24 and a student, or are permanently and totally disabled.	• Must work more than 16 hours a week • Must have dependent children—that is, children under 16 or under 19 and in full-time education • Must have less than £8,000 in capital.	• May target families with children • There may be no requirement with regard to the number of hours worked.
Value of Basic Credit	• Credit is annual, and is a fraction of $353/$2,353/ $3,888 for families with 0/1/ 2+ children.	• Credit is weekly • The basic credit is £11.25, and an additional credit of £25.60 for each child, or £26.35 for each child aged 16 to 18.	• The maximum credit is $30 per week, or $1,560 per annum.
Programme Design	• Phased in at a rate of 7.65%/34%/40% for families with 0/1/2 children until the maximum credit is reached • Tapers off at a rate of 7.65%/15.98%/21.06% for families with 0/1/2 children once the annual income reaches $12,690, or $5,770 for families with no children.	• Tapers off at a rate of 55% once the weekly income reaches £91.45.	• Added on to Family Tax Benefit (FTB) Part A • Phased in at a rate of 5.5% • Reaches the maximum amount at the very moment when FTB Part A begins to be withdrawn—that is, when the couple's annual income reaches $28,200 • The maximum amount is maintained until the couple's annual income reaches $44,600.67, after which the credit is withdrawn at a rate of 30%.

Sources: Mike Brewer, 'Comparing In-work Benefits and the Reward to Work for Families with Children in the US and the UK', *Fiscal Studies* 22:1 (2001), Table A.4; Alan Duncan, *Work Incentives and Labour Supply of Lone Parents: Employment Credit in Australia*, paper presented at the Towards Opportunity and Prosperity conference, The University of Melbourne (4-5 April 2002), 18-19.

minimum wage has nothing to do with unemployment.[7] The idea of in-work benefits, in contrast, appears to have more general appeal. Labor advocated it as far back as in 1998.[8] The Coalition has also alluded to it on several occasions—although it has recently become a bit more cautious.[9] Perhaps because it makes perfect sense to help those who help themselves, few seem to consider what harm, not only what good, an in-work benefit programme might do to Australia. Based on findings from similar programmes in the UK and US, this paper attempts precisely that.

The 'earnings credit'

The Five Economists' plan, since its first appearance in Australia's social policy debate, has been further developed not only by the Five Economists themselves but also by other, like-minded economists. Simon Lambert, for example, has proposed an 'earnings credit'.[10] His idea, also called an 'employment credit', is the focus of most recent studies on the possibility of in-work benefits in Australia.

International evidence suggests that the recipients of the earnings credits would only modestly increase, or even decrease, their labour supply.

In Lambert's proposal, an earnings credit of up to $30 per week, or $1,560 per annum, is added on to the existing Family Tax Benefit (FTB) Part A. Figure 1, replicated from Alan Duncan's paper, illustrates how such a system would work for a couple with two children aged 8 and 13. The horizontal axis indicates household earnings, and the vertical axis, the amounts of FTB Part A and the earnings credit that correspond to various levels of household earnings. The implication is that eligibility for the earnings credit is assessed on a household, not an individual, basis. This is in line with the EITC and the WFTC.

The rates of FTB Part A are as of July 2000. This couple is entitled to the maximum amount of FTB Part A as long as their annual income is less than $28,200. After that, their payment is withdrawn at a rate of 30%. At an annual income of $49,800, they begin to receive the base rate of FTB Part A. Their entitlement is phased out again at a rate of 30% once their income exceeds $73,000 per annum.

Under Lambert's proposal, this couple is also eligible for an earnings credit as long as at least one of them is in paid work. The earnings credit schedule has three regions. In the first, 'phase-in' region, the credit accumulates from the first dollar of earned income. The rate of accumulation is, in the case of this couple, about 5.5%. The credit reaches the maximum amount at the same time that FTB Part A begins to taper off. In the second, 'flat' region, the credit remains at its maximum. At the very moment FTB Part A reaches the base rate, the final, 'phase-out' region kicks in. The credit is thereby withdrawn at a rate of 30%.

A boost for work incentives?

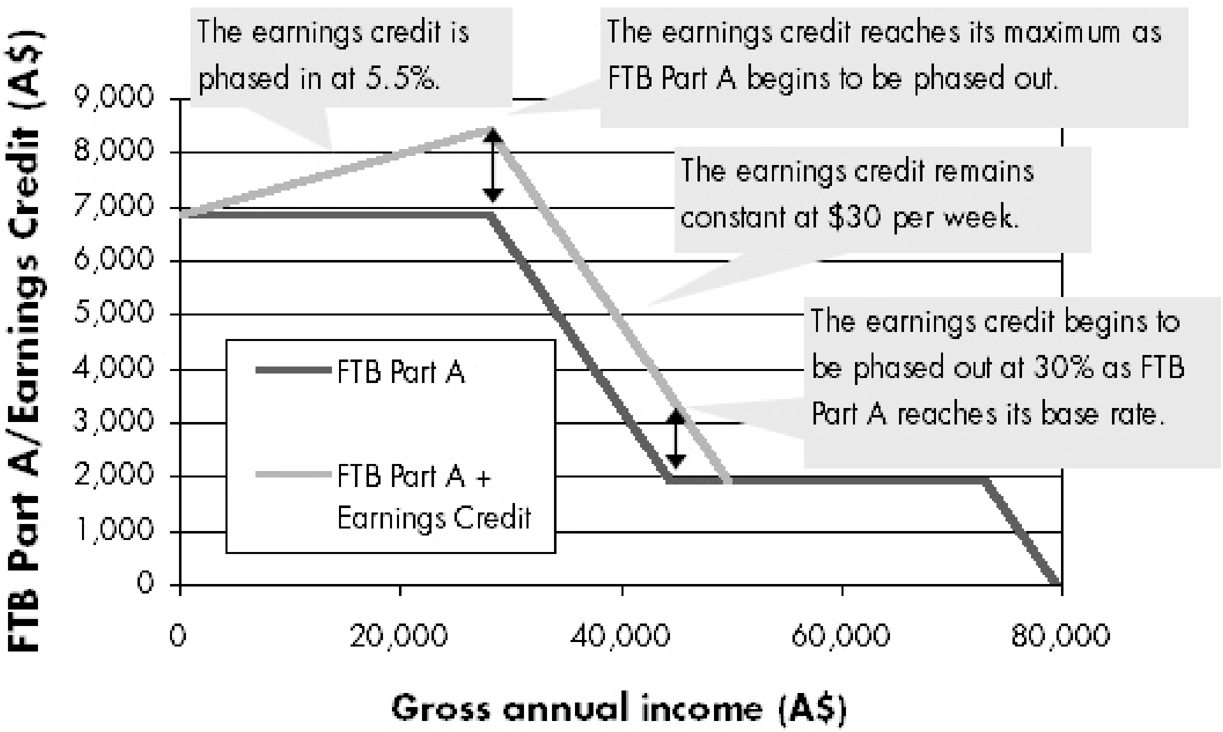
It is clear from Figure 1 why the earnings credit is supposed to boost labour supply from jobless households: increased work effort is, in the phase-in region, rewarded with a corresponding increase in the earnings credit. Yet in the flat region and further in the phase-out region, extra work effort is no longer as rewarding. As seen shortly, international evidence indeed suggests that the recipients of the earnings credit in these regions would only modestly increase, or even decrease, their labour supply.

Responses to the earnings credit are also expected to differ from one demographic group to another. Lone parents are likely to increase their labour supply significantly, but employment growth among married men would be far less significant. Married women whose spouses are employed, furthermore, may reduce their hours of work, or even withdraw from the labour market.

Lone parents

As described in the box, the EITC in the United States was made increasingly generous after 1986. This increased employment among unmarried mothers in general.[11] There was a particularly sizeable change in the labour market behaviour of unmarried mothers who were the least skilled and thus had the lowest earnings potential. Their employment rate, after remaining more or less constant before the early 1990s, skyrocketed from 30% in 1992 to 45% in 1996 and subsequently continued to

Figure 1. Family Tax Payment Part A and an Earnings Credit



Source: Alan Duncan, *Work Incentives and Labour Supply of Lone Parents: Employment Credits in Australia*, (Melbourne: Melbourne Institute of Applied Economic and Social Research, University of Melbourne, 4-5 April 2002), Figure 5.

rise.[12] Although this also coincided with the expansion of the welfare-to-work programme for lone parents, it is undeniable that 'the EITC played a major role'.[13]

Annual hours worked by unmarried mothers are also estimated to have risen on average by 37 after the expansion of the EITC in 1986. The increase was greater—84 hours—for those with less than high school education. Unmarried mothers who had already been in the labour force before 1986, on the other hand, increased their annual hours of work by 25 hours and by just 3 hours if they had less than high school education.[14] Thus, most of the gain in unmarried mothers' hours of work is considered to have occurred because those previously without jobs began to work some hours, not because those already in jobs began to work more hours. There is, furthermore, no evidence that unmarried mothers in the phase-out region reduced their hours worked in order to take advantage of the EITC.[15]

The effects of Britain's WFTC on employment among lone parents are summarised in Panel A of Table 2 (overleaf). The rightmost column and the bottom row show the employment status of all lone parents before and after the advent of the WFTC, respectively. The proportion of unemployed lone parents declined from 60.2% to 58.0% due to the WFTC. This is because, as row 1 indicates, 0.7% and 1.5% of all lone parents moved from unemployment to part-time and full-time employment, respectively. An additional 0.5% is estimated to have switched from part-time to full-time jobs. Although a very small minority of lone parents—0.2%—may have reduced their hours of work, the aggregate effect is still considered positive. The average hours worked, on the other hand, rose by a mere 0.22.[16]

Another issue to consider in the design of an in-work benefit programme is whether to attach an hours condition. In-work benefits can be more tightly targeted by requiring its claimants to work not just any number of hours but more than a certain number of hours. In theory, this provides an added incentive to work longer, and therefore, is considered to help boost employment. However, evidence does not support this conclusion.

In theory, an hours condition provides an added incentive to work longer and is considered to help boost employment. However, evidence does not support this conclusion.

As shown in Table 1, 16 hours per week of work is a minimum condition for the receipt of the WFTC in Britain. This has actually been in effect since the Family

Table 2. Employment effects of the WFTC

Panel A. Lone parents (%)

		Post-WFTC			*Pre-WFTC*
		Out of work	*Part-time*	*Full-time*	*Total*
Pre-WFTC	*Out of work*	58.0	0.7	1.5	60.2
	Part-time	0.0	18.6	0.5	19.1
	Full-time	0.0	0.2	20.6	20.7
Post-WFTC total		58.0	19.4	22.6	100.0

Panel B. Married men (%)

		Post-WFTC		*Pre-WFTC*
		Out of work	*In work*	*Total*
Pre-WFTC	*Out of work*	19.6	0.4	20.0
	In work	0.3	79.8	80.0
Post-WFTC total		19.9	80.1	100.0

Panel C. Married women whose spouses are employed (%)

		Post-WFTC			*Pre-WFTC*
		Out of work	*Part-time*	*Full-time*	*Total*
Pre-WFTC	*Out of work*	32.2	0.1	0.1	32.4
	Part-time	0.3	31.6	0.0	32.0
	Full-time	0.4	0.1	35.0	35.6
Post-WFTC total		33.0	31.8	35.2	100.0

Sources: Blundell, Duncan and Meghir, *Evaluating the Working Families Tax Credit*, Background Paper for 'Structural versus Non-structural Approaches to Evaluation' (London: Social Policy Network, Institute for Fiscal Studies, 20-21 November 2002), Tables 7 and 8; Blundell, Duncan, McCrae and Meghir, 'The Labour Market Impact of the Working Families' Tax Credit', *Fiscal Studies* 21:1 (2000), Table 10.

Credit reform in 1992. Evidence shows that, after the reform, labour market participation among less educated lone parents increased by 11.2% but that the proportion of those working more than 18 hours decreased by 15%.[17] So an hours condition in this case had not only the intended but also unintended consequences. In 1995, an additional bonus began to be offered to those working more than 30 hours per week, but the subsequent growth in hours worked was relatively insignificant. The proportion of less educated lone parents working more than 30 hours per week only rose by 2.9%.[18] On balance, the inclusion of an hours condition does not seem to have contributed much to employment growth in Britain.

An hours condition, in the case of Australia, would dampen rather than improve employment among lone parents.

The outcomes of the earnings credit for Australia's lone parents are expected to be positive. According to an estimate, employment among lone parents would increase by 5.1%, and the average hours worked, by 1.5.[19] As noted earlier, Lambert's proposal is intended to provide a tax credit of $30 per week regardless of hours worked. If the claimants of the earnings credit are required to work for more than 10, 20 and 30 hours a week, the employment growth would fall to 4.7%, 4.1% and 2.6%, respectively. So an hours condition, in the case of Australia, would also dampen rather than improve employment among lone parents. If, alternatively, the amount of the weekly credit is increased to $40, employment among lone parents, in the absence of an hours condition, would grow more significantly by 6.4%. The average hours worked would increase by 1.8. The introduction of an hours condition as above would again reduce the rate of employment growth respectively to 6.3%, 5.9% and 3.6%.

Married men
The behavioural response of married men to in-work benefits is ambiguous. The expansion of the EITC that occurred between 1984 and 1996 is considered to have increased labour force participation among married men by 0.2%. The lower their earnings potential, the higher the estimate: for example, labour force participation among those ranked lowest on a 10-point earnings potential scale grew by 0.6%.[20] The average annual hours worked, however, declined by 45 hours.[21]

British evidence is more or less similar. Panel B of Table 2 indicates that 0.4% of married men are considered to have become newly employed after the introduction of the WFTC. But because 0.3% may have moved from employment to unemployment, the aggregate effect is perhaps minuscule—0.1%. The average British married man, on the other hand, is estimated to be working just 0.03 hours longer each week.[22]

The reason why married men are so much less responsive to in-work benefits than lone parents lies with programme designs. Consider the EITC. It has three distinct regions: phase-in, flat and phase-out (see box). Generally speaking, the incentive to increase work effort tends to diminish as the recipients leave the phase-in region and lessen further as they approach the phase-out region. Thus, growth in labour supply following the expansion of the EITC would be smaller among those in the phase-out region than among those in the flat or the phase-in regions.

Evidence with regard to married men confirms this. The rates of labour market participation growth between 1984 and 1996 were 0.6%, 0.2% and 0.2% for married men in the phase-in, flat and phase-out regions, respectively.[23] Changes in hours worked show a more striking contrast. The average annual hours worked increased by 34 among married men in the phase-in region but decreased by one among those in the flat region and by 73 among those in the phase-out region.[24] An estimate indicates that 42.8% of married men were in the phase-out region in 1996, as opposed to 9.0% in the phase-in region and 5.8% in the flat region. It is now clear why the average annual hours of work fell so markedly among married men in general. Lone parents responded differently because the majority of them were jobless to begin with and therefore were able to take full advantage of the more generous EITC.

In-work benefit programmes are a waste of taxpayers' money as far as married men are concerned.

The insignificant labour supply growth observed among married men also suggests that in-work benefit programmes cause a 'deadweight loss', that is, they are a waste of taxpayers' money as far as married men are concerned. An overwhelming majority of married men would work even without in-work benefits. For them, in-work benefits are practically a publicly funded bonus.

Married women whose spouses are employed
Work disincentives inherent in in-work benefit programmes are even more evident among married women whose spouses are employed. Following the expansion of the EITC between 1984 and 1996, labour market participation among married women in the United States dropped on average by 2.4%. Somewhat surprisingly, husbands' earnings potential was negatively correlated with the chance of their wives opting out of the labour market. By way of example, the rate of the reduction in labour market participation among married women was 4.2% if husbands were at the bottom 10%, and 1.0% if husbands were at the top 10%, of the earnings potential scale.[25] Hours worked, on annual average, fell by 93. The size of the reduction was again larger for those whose husbands had lower earnings potential: 156 hours if husbands were at the bottom, and 21 hours if husbands were at the top, of the earnings potential scale.[26]

In Britain, 0.2% of married women whose spouses were employed are estimated to have obtained either part-time or full-time jobs as a result of the WFTC reform (see Panel C, Table 2). The aggregate outcome was, however, overwhelmingly negative: 0.1% moved from full-time to part-time employment, and furthermore, a total of 0.7% left the labour market altogether. The average hours worked declined by 0.18.[27]

There are three possible, closely related explanations why an in-work benefit programme might discourage labour force participation among married women whose spouses are employed. First, the majority of married women are second earners. There might be no financial necessity for them to go out to work. Second, entitlements for in-work benefits are determined on a household, as opposed to an individual, basis. Married women would qualify for in-work benefits as long as their spouses are in work. They might, moreover, consider too high the 'opportunity cost' of working outside home; the activities which they could afford by not working might be more valuable for them than the money which they could earn by working.

The third explanation has to do with a point made earlier with regard to married men: in-work benefits taper out. Consider again the US experience. An estimate shows that, in fact, married women who were in the phase-out region of the EITC schedule in 1996 had significantly increased their labour supply: 9.0% more had newly entered the labour market. Their annual average hours worked also had risen by 203.[28] This increase, however, was more than offset by a decrease in labour supply that had occurred elsewhere: married women in the flat and the phase-out regions were, respectively, 6.6% and 5.4% less likely to have been in the labour force after 1984, and those who did remain in the labour force were working, on annual average, just 24 hours more if in the flat region and 278 hours less if in the phase-out region.[29] The fact that 42.8% of married women with employed spouses were in the phase-out region, as opposed to 5.8% in the flat region and 9.0% in the phase-in region, rendered overwhelmingly negative the aggregate employment effect of the EITC on this demographic group.[30]

Though the incidence of jobless households may decline in response to the earnings credit, welfare dependency might well increase.

A hand up or a hand out?

Peter Dawkins, one of the Five Economists, admits that married women with employed spouses might reduce their labour supply in response to the earnings credit. He nevertheless does not seem very concerned—because, according to his own preliminary estimate, that negative effect would be small.[31] This claim, however, is contested by Patricia Apps, a leading critic of the Five Economists' plan.[32] The earnings credit, in her view, would simply raise 'effective marginal tax rates' (EMTR) for second earners. When an individual's private earnings increase in one way or another, some of the government benefit to which he or she has previously been entitled may be withdrawn due to an income test. His or her tax liabilities may also rise. An effective marginal tax rate refers to the percentage of an additional dollar of private earnings that gets lost this way. Apps takes an example of a couple both of whom are in full-time work. The primary earner is assumed to be earning $28,200 per annum, and the second earner, $23,100 per annum. In the absence of the earnings credit, the EMTR for the second earner, typically the mother, would be 31.5%. Put differently, 31.5 cents for each dollar that she earns would disappear as she pays income tax and loses some of her benefit entitlements. As though this is not already too high, if the earnings credit was introduced, her EMTR would rise further to 56%—well over half of her earnings. This is a clear work disincentive, and is assumed to have a significant negative effect on labour supply for second earners.

The primary objective of the earnings credit, Dawkins underlines, is to reduce the incidence of jobless households. After all, the withdrawal of married women from the labour market would not affect the incidence of jobless households as long as their husbands are in work.[33] There is, moreover, little doubt that the earnings credit would deliver a positive employment outcome for lone parents, over a third of whom were in 1999-2000 deriving 90% or more of their income from government benefits.[34] If that is the case, the earnings credit promises to tackle welfare dependency as well as joblessness.

However, though the incidence of jobless households may decline in response to the earnings credit, welfare dependency might well increase. The explanation for this is that the earnings credit, though disguised as a tax credit, is just another welfare benefit. It merely differs from existing income support programmes in that it is conditional on being in paid work. The employment growth induced by the earnings credit would certainly reduce the scales of income support programmes such as the Newstart Allowance and Parenting Payment. Those who have left these programmes would, however, switch to dependency on the earnings credit. Thus, the number of those dependent on 'welfare' as well as the size of 'welfare' spending would not change significantly. Indeed, it might even grow.

As Douglas Besharov notes, the EITC has 'already gone far beyond what would be needed to help families leave welfare'.[35] The number of US families on cash assistance declined by a staggering 53% between 1996 and 2001.[36] Yet federal spending on means-tested entitlements, including the EITC, in the meantime rose by nearly 30%, from $187.3 billion to $242.7 billion (in Fiscal Year 1996 constant dollars).[37] In Britain, too, the WFTC appears to be well on the way to become the biggest-ever welfare programme. The number of families in receipt of the Family Credit/WFTC increased remarkably from 965,300 in 1999 to 1,293,700 in 2001.[38] Spending on family benefit programmes indeed dropped by £1,630 million between the two years, but the growth of tax credit spending was even greater—by £3,676 million.[39]

Peter Dawkins claims that the earnings credit, because it reduces unemployment and thus welfare dependency, would have a positive effect on the federal budget in the long run.[40] But this is questionable. Those who have been self-sufficient prior to the introduction of the earnings credit—notably married men—may come to look up to the government as a source of additional income. The claimants of the earnings credit are also likely to adjust their labour market behaviour once their entitlements cease to increase or begin to be phased out. They may become trapped in welfare dependency.

The fact that in-work benefits unavoidably taper off acts as a work disincentive and discourages personal initiative—a quality so desired of individuals in a free society. Consider the following anecdotal evidence cited by Frank Field, the former Minister for Welfare Reform under the Blair government:

> Interviewed on the BBC's 6 o'clock news on the night of the 2001 Budget, a low-paid worker expressed thanks for the extra WFTC cash. He then added, unscripted and unprompted, that he realised that he would now never be able to improve his family's living standards by his own efforts. That would only come by politicians changing benefit rates.[41]

Neither are there incentives to work harder or longer or to upgrade skills, for '[a]ll such efforts are penalised by the withdrawal of tax credits'.[42]

Under a higher tax-free threshold, individuals would end up with more of the money that they earn through their own effort.

Conclusion

As Peter Saunders argues, all participants in Australia's welfare debate, while disagreeing on many issues, agree on at least three key objectives.[43] First, any policy aiming to alleviate poverty 'should encourage employers to create jobs and jobless people to take them' because the major cause of poverty is joblessness. Second, those in full-time work 'should take home enough money at the end of the week to keep their heads above water'. Third, it is important to create and maintain work incentives. A minimum wage increase would destroy jobs and so fail to achieve the first objective. The earnings credit, on the other hand, might have an adverse effect on work incentives.

There is a third option that meet all three criteria: to raise the personal tax-free threshold. The current tax-free threshold is set at $6,000 per annum. By raising it from such a low level, returns to paid work would be boosted. As a result, it would become less necessary to raise minimum wages or to supplement wages with the earnings credit. A higher tax-threshold would neither affect job creation nor perpetuate poverty. Most of all, it would not discourage personal initiative. Under a higher tax-free threshold, individuals would end up with more of the money that they earn through their own effort. As is the case with the earnings credit, some people might cut their hours of work in order to avoid moving up to a higher tax bracket. But they would receive nothing in return. The income support system would gradually begin to attain what it set out to do nearly a century ago—to provide assistance for those who are genuinely in need.

Endnotes

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