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The Anti-Poverty, Targeting, and Labor Supply Effects of the Proposed Child Tax Credit Expansion

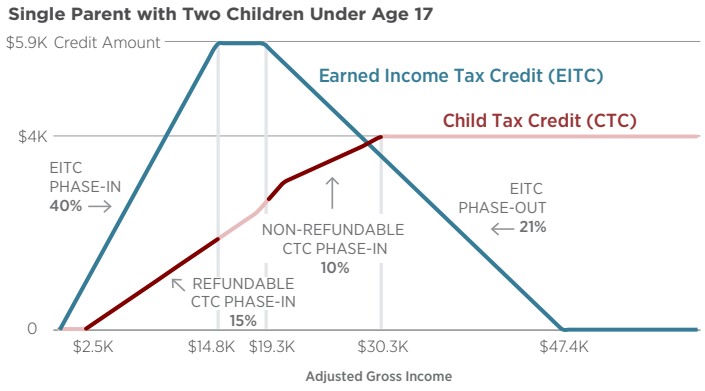
Based on BFI Working Paper 2021-115, "The Anti-Poverty, Targeting, and Labor Supply Effects of the Proposed Child Tax Credit Expansion" by Kevin Corinth, Executive Director, Comprehensive Income Dataset (CID) Project, Harris Public Policy at UChicago; Bruce D. Meyer, McCormick Foundation Professor, CID Founder, Harris Public Policy at UChicago; Matthew Stadnicki, Menard Family Pre-Doc, CID and Harris Public Policy at UChicago; and Derek Wu, Research Fellow, CID and Harris Public Policy at UChicago

Current proposals to expand the Child Tax Credit would reduce employment by 1.5 million people and, as a result, reduce child poverty by only 22%—more than a third lower than estimates that fail to account for employment reductions—and fail to reduce deep child poverty at all.

The American Families Plan under debate in Congress proposes to eliminate the existing Child Tax Credit (CTC), which is based on earned income, and replace it with a child allowance that would increase benefits to $3,000 or $3,600 per child (up from $2,000) and make the full credit available to all low- and middle-income families, regardless of earnings or income. In effect, the CTC would transition from a worker-based benefit to a form of guaranteed income. The authors estimate the labor supply and anti-poverty effects of this policy using the Comprehensive Income Dataset—which links survey data from the U.S. Census Bureau with an unprecedented set of administrative tax and government program data—thus producing more accurate estimates than previous studies.

Initially ignoring any behavioral response, the authors estimate that expansion of the CTC would reduce child poverty by 34% and deep child poverty by 39%. The cost for such a program would reach over $100 billion, which exceeds spending on food stamps and the Earned Income Tax Credit (EITC). Given its universal nature, the new CTC would expand beyond the low-income families targeted under current means-tested programs, including the EITC.

Figure 1 • Child Tax Credit and Earned Income Tax Credit by Adjusted Gross Income Using 2020 Rules



Source: Internal Revenue Service, Congressional Research Service.

Notes: Child Tax Credit (CTC) and Earned Income Tax Credit (EITC) parameters are based on 2020 tax law (all dollar values expressed in 2020 nominal terms). The refundable CTC phases in at a 15% rate because it is calculated as 15% of the difference between earnings and $2,500, up to a maximum of $1,400 per dependent child. The non-refundable CTC phases in at a 10% rate because it is a non-refundable credit and thus phases in at the federal marginal tax rate once Adjusted Gross Income is sufficiently high to generate a positive tax liability. The CTC as a whole phases in at a 25% rate when the refundable portion of the CTC and non-refundable portion of the CTC phase in simultaneously. All adjusted gross income is assumed to come from earned income, and the family is assumed to take the standard deduction and claim no other non-refundable tax credits.

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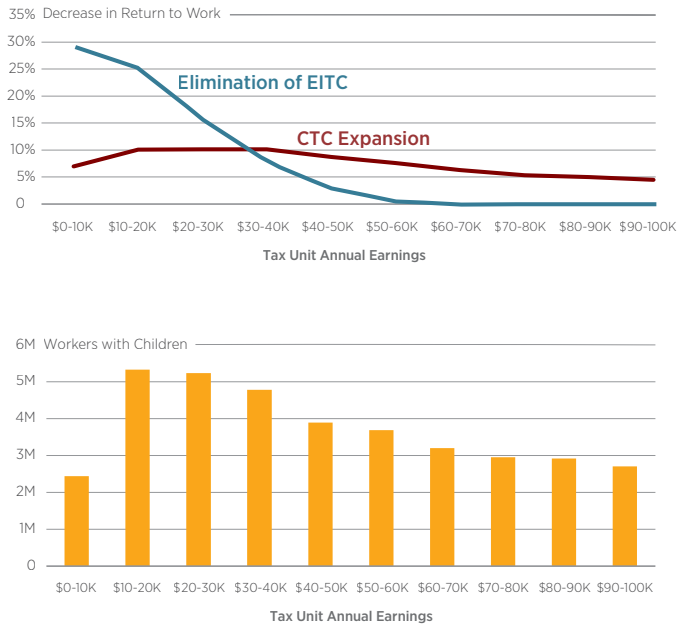
Figure 2 • Average Decrease in the Return to Work Due to Child Tax Credit Expansion and Elimination of the Earned Income Tax Credit and Number of Workers with Children, by Tax Unit Earnings



Source: 2017 CPS ASEC (adjusted to 2022 levels using changes in prices and benefits) linked to administrative IRS and program records, TAXSIM.

Notes: Estimates in the top panel are based on simulations of the proposed Child Tax Credit (CTC) expansion for 2022 and the elimination of the Earned Income Tax Credit (EITC) as it is defined by current law. Percent decrease in the return to work is the decrease in the return to work divided by the baseline return to work among currently working parents. The baseline return to work is earnings net of tax liability and the phaseout of transfer benefits. The decrease in the return to work due to the Child Tax Credit expansion is the change in the expanded CTC (between working and not working) minus the change in the existing CTC (between working and not working). The change in the return to work due to the elimination of the EITC is the EITC benefit itself. A working adult with children is any adult aged 18 or over who (i) is the primary or secondary filer in a tax unit that includes at least one dependent under the age of 18 and has strictly positive earnings, and (ii) either reported working in 2016 or is the primary filer in a tax unit in which no adult reported working in 2016. Tax unit earnings are reported in $10,000 bins. Our sample consists of all individuals in PIKed and non-whole imputed families, with survey weights adjusted for non-PIKing and whole imputes using inverse probability weighting. The Census Bureau has reviewed this data product for unauthorized disclosure of confidential information and has approved the disclosure avoidance practices applied to this release, authorization number: CBDRB-FY2021-CES005-028.

The estimated reductions in child poverty could be threatened due to weakened work incentives under the proposed CTC. For example, under the existing CTC, a working parent with two children receives $2,000 if she earns $16,000 and $4,000 if she earns over $30,000. Under the new plan, a parent with two children would receive between $6,000 and $7,200, regardless of whether she works. Pivoting from a work-based to a universal benefits program raises an important question: How many parents will leave the work force because of diminished work incentives?

To answer this key labor supply question, the authors rely on estimates of the responsiveness of employment decisions to changes in the return to work from the academic literature and mainstream simulation models. They find that replacing the existing Child Tax Credit with a child allowance would lead approximately 1.5 million working parents to exit the labor force. Most of this decrease derives from the elimination of work incentives; for example, the return to work is reduced by at least $2,000 per child for most workers with children. In this regard, the existing CTC provides work incentives on par with the EITC; eliminating the existing CTC would reduce employment by 1.3 million jobs on its own. Further, the new child allowance would reduce employment by an additional 0.14 million jobs because people work less when they have more income.

These findings contrast with a 2019 study by the National Academy of Sciences, which estimated that replacing the CTC with a child allowance would have little effect on employment. This study, though, did not account for the elimination of the existing CTC's work incentives, even though the study did account for similar incentives when studying an expansion of the EITC.

Ultimately, when accounting for the substantial exit from the labor force due to the proposed CTC, the positive impact on poverty reduction diminishes greatly: The replacement of the existing CTC with a child allowance program would reduce child poverty by just 22%, and deep child poverty would no longer fall.

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