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The Child Tax Credit: 25 Years Later

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Chairman Bennet, Ranking Member Thune, and subcommittee members, thank you for the opportunity to testify. My name is Angela Rachidi and I am a Senior Fellow on poverty and opportunity at the American Enterprise Institute. Before I joined AEI, I was a Deputy Commissioner for the New York City Department of Social Services, where for more than a decade I oversaw the agency's policy research. My research focuses on the intersection of safety net policy and employment as a path out of poverty.

I want to make three key points in relation to the Child Tax Credit. First, Congress initially created the Child Tax Credit as a tax credit for working families with children, complementing the Earned Income Tax Credit or EITC, which is primarily a refundable tax credit for those who do not owe federal income taxes. Second, over the years, Congress increased benefits to low-income families by expanding the refundability of the CTC, meaning that it now substantially overlaps with the EITC. Finally, any efforts to turn the CTC into a child allowance would move it away from the positive design features that have made the EITC (and by extension the CTC) one of the most effective anti-poverty policies we have. Policymakers should consider the potential negative implications on employment of changing the CTC, which would make long-term poverty reduction in the US more challenging. This is especially true in light of the poorly targeted nature of proposals expanding the CTC into a child allowance.

First, it is important to acknowledge the history of the Child Tax Credit. The CTC started in 1997 as a modest $500 per child non-refundable tax credit for working families as a way to offset some of their federal income and payroll tax liability. Over the years and through different Congressional sessions and Presidential administrations, the CTC has expanded to the point that under current law it is partially refundable, meaning that families without federal income tax liability can still receive some of the credit as a transfer payment. Eligible families can receive a refundable credit of 15 percent of earnings above $2,500 per year, up to a maximum $1,500 per child in tax year 2022 (the maximum refundable amount increases for inflation each year until it reaches $2,000). The 15 percent phase-in reflects the employee and employer share of payroll taxes. Families with significant federal income tax liability receive $2,000 per child as a non-refundable credit on their federal income taxes.

The CTC works in conjunction with the fully refundable EITC, which primarily targets low-income working families without federal income tax liability. The EITC provided $67 billion to 31 million low-income working families in 2022, of which 86 percent was refundable, while the CTC provided $108 billion in 2022, of which 39 percent was refundable.[1] It remains true that the CTC provides less generous benefits to families with low earnings, but that is because the EITC targets these low-income working families.

Although some policymakers supported a child allowance throughout the 1980s and 1990s, because of concerns over the potential employment disincentives and the overall cost, it failed to garner broad support. However, Congress still believed a need existed for a child-related benefit, passing a non-refundable CTC through the tax code as a way to support working families and to address concerns over the personal exemption not keeping pace with inflation[2]. By the early 2000s, at the

[1] US Internal Revenue Service, "EITC Reports and Statistics," January 24, 2023, https://www.irs.gov/credits-deductions/individuals/earned-income-tax-credit/eitc-reports-and-statistics.

[2] Angela Rachidi, "America's Path Toward a Guaranteed Income for Families with Children: How Nixon's Family Assistance Plan Shaped Antipoverty Policy," American Enterprise Institute, October 27, 2021,

urging of President George W. Bush's administration, Congress expanded this modest CTC, making it partially refundable for families with income at or above the EITC plateau – that is, available to families without income tax liability who had reached the maximum EITC benefit. The policy recognized that these EITC-eligible families faced additional payroll tax liability but were not eligible yet for the full CTC.

The 2009 American Recovery and Reinvestment Act completely disconnected the CTC from the EITC by reducing the earnings floor from $10,000 to $3,000, essentially duplicating the EITC for low-income families. While President George W. Bush's administration had only made the CTC refundable for low-income families with income high enough to receive the maximum EITC amount, the 2009 ARRA reduced the income necessary to qualify for the CTC, essentially adding refundable benefits on top of the existing EITC. Congress made this change permanent in 2015 and increased the benefit level in the 2017 TCJA. These policy changes essentially expanded the CTC's role as a tax credit for working families, which was complementary to the EITC, to serve also as a transfer payment to low-income families in addition to the EITC.

This brings me to my second point about the often-overlooked aspects of the CTC's current design. By increasing the refundability of the CTC over the years, policymakers have expanded it into a transfer payment that targets low-income families who also receive several other safety net benefits. The typical working single mother with two children earning $12 per hour for full-time work, would receive the refundable EITC, refundable CTC, and SNAP benefits, totaling more than $12,000 in government benefits per year alone. Additionally, her children would likely receive free school lunches, health insurance through Medicaid, and they could receive housing assistance and childcare assistance that could total another several thousand dollars in assistance per year. Congress should consider any further reforms to the refundable portion of the CTC within this context.

Another crucial point is that even though Congress has expanded the refundability of the CTC over the years, Congress has always kept the key features of the EITC as part of the CTC– such as phasing-in the CTC with earnings and requiring some earnings to maintain eligibility. This changed, however, with the temporary 2021 CTC expansion, in which Congress eliminated the phase-in and the work requirement. Although supporters argued that this was necessary as pandemic-related relief, making these policy changes permanent would reduce the labor supply of the most disadvantaged groups, raising questions over its long-term effects on poverty reduction.

Studies of the EITC have found that it reduces poverty, improves child health and educational outcomes, and increases employment among single mothers.[3] The evidence suggests that any efforts to move the CTC away from the EITC's design – such as by removing the phase-in – could

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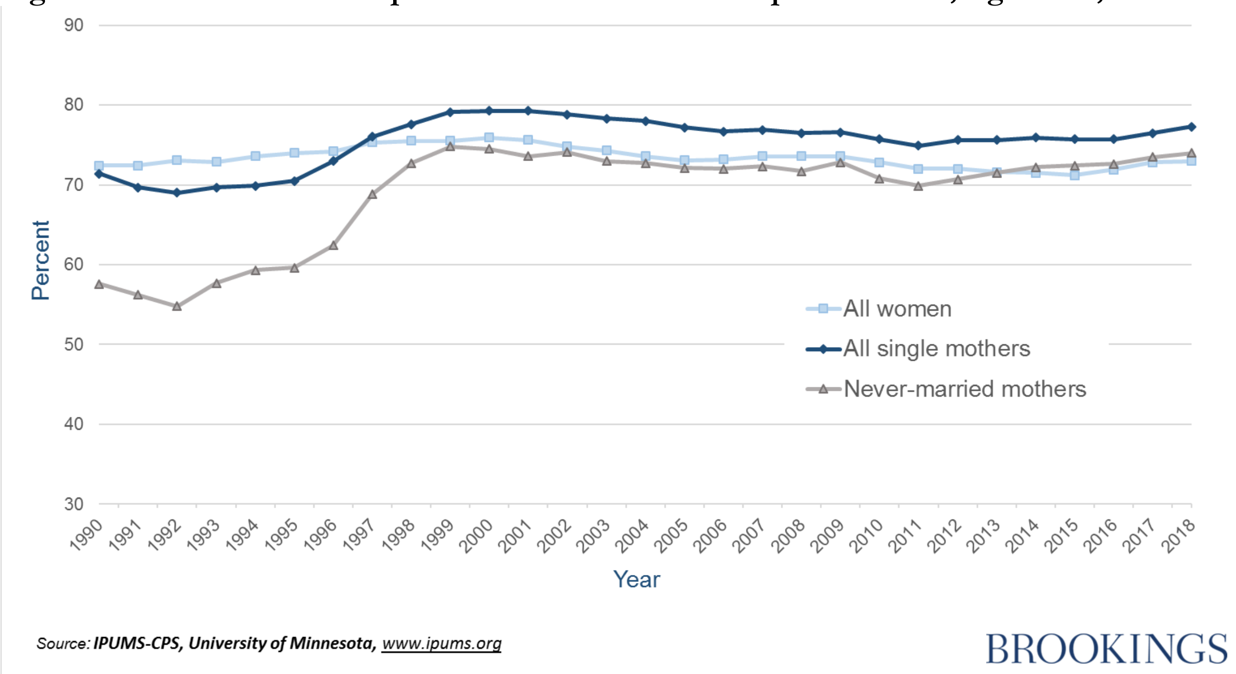
https://www.aei.org/research-products/report/americas-path-toward-a-guaranteed-income-for-families-with-children-how-nixons-family-assistance-plan-shaped-antipoverty-policy/; Scott Winship, "Reforming Tax Credits to Promote Child Opportunity and Aid Working Families," American Enterprise Institute, July 29, 2021, https://www.aei.org/research-products/report/reforming-tax-credits-to-promote-child-opportunity-and-aid-working-families/.

[3] Bastian, Jacob and Katharine Michelmore. 2018. The Long-Term Impact of the Earned Income Tax Credit on Children's Education and Employment Outcomes. *Journal of Labor Economics* 36, no. 4, https://www.journals.uchicago.edu/doi/epdf/10.1086/697477; Meyer, Bruce and Dan Rosenbaum, 1999. Welfare, the Earned Income Tax Credit, and the Labor Supply of Low-Income Mothers. National Bureau of Economic Research, https://www.nber.org/papers/w7363.

counteract these positive aspects and partially reverse decades of progress. Research suggests that labor supply would decline should Congress turn the CTC into a child allowance.[4] This would turn the clock back on three decades of social policy success in which single mother employment has increased and child poverty has declined dramatically.[5]

Figure 1: Labor Force Participation Rates for Select Groups of Women, Age 18-54, 1990-2018

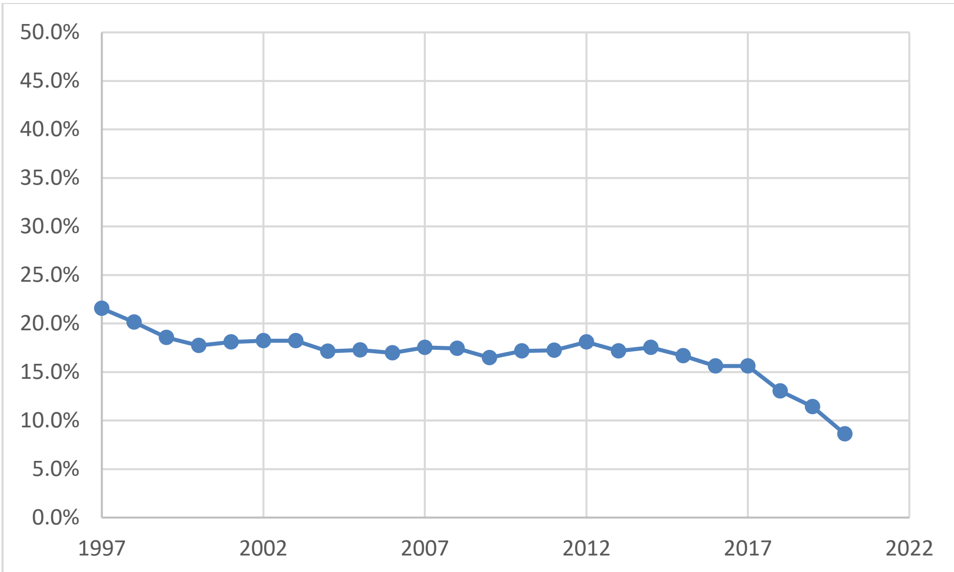


Adapted from Haskins, R., & Weidinger, M. (2019). The Temporary Assistance for Needy Families Program: Time for Improvements. The ANNALS of the American Academy of Political and Social Science, 686(1), 286–309.

[4] Corinth, Kevin, Bruce D. Meyer, Matthew Stadnicki, and Derek Wu, 2022, "The Anti-Poverty, Targeting, and Labor Supply Effects of Replacing a Child Tax Credit with a Child Allowance." NBER Working Paper 29366 (revised March 2022).

[5] Bruce Meyer, "Testimony on Anti-Poverty and Family Support Provisions in the Tax Code," Senate Committee on Finance, June 15, 2023, https://www.aei.org/research-products/testimony/testimony-on-anti-poverty-and-family-support-provisions-in-the-tax-code/.

Figure 2. Anchored Supplemental Poverty Measure (SPM) for Children



Source: Columbia University Center on Poverty and Social Policy.

Changing the CTC's design permanently would affect labor supply among those eligible to receive it, even though some analyses of the 2021 temporary CTC expansion suggested that there were no employment effects associated with the fully refundable benefit. The complex policy environment in 2021 during the time of the temporary expansion, severely limits our understanding of the effects of the temporary CTC, especially because researchers were unable to control for many confounding factors that made analyzing the impact of six months of payments to families almost impossible. Moreover, because the policy was only temporary, we would not expect any short-term behavioral effects to exist or to be as large as the long-term effects of a permanent policy.

For these reasons, we should look to other research to suggest how an expanded CTC might affect families over the long term. As already mentioned, the EITC includes a phase-in and work requirement and research shows that it has resulted in increased maternal employment and positive child outcomes over many years.[6] Rolling back these features in the CTC likely would have effects in the opposite direction. Furthermore, although not a direct comparison, we can look to a recent randomized controlled trial of a child allowance-type policy called Baby's First Years to provide evidence that unconditional payments influence employment behavior. Baby's First Years randomly assigned families with a new baby to a treatment group in which they received $333 per month for three years or to a control group in which they received a minimal $20. Researchers compared employment rates and hours worked between the two groups. While there was no statistical difference in employment rates on the extensive margin (whether a mother worked or not at the time of the survey), the payments reduced full-time employment by 11 percent across the three years

[6] Bastian, Jacob and Katharine Michelmore. 2018. The Long-Term Impact of the Earned Income Tax Credit on Children's Education and Employment Outcomes. *Journal of Labor Economics* 36, no. 4, https://www.journals.uchicago.edu/doi/epdf/10.1086/697477; Meyer, Bruce and Dan Rosenbaum, 1999. Welfare, the Earned Income Tax Credit, and the Labor Supply of Low-Income Mothers. National Bureau of Economic Research, https://www.nber.org/papers/w7363..

and hours worked by 12 percent.[7] Because the Baby's First Years payment was on top of the existing CTC, it did not eliminate the CTC's existing incentives, suggesting that replacing the CTC with a similar payment would have an even larger disemployment effect. Although we cannot extrapolate these results to a child allowance that covers all children, it demonstrates the importance of taking seriously concerns over how government payments affect employment. My main concern is that eliminating the phase-in of the CTC and the work requirement will reduce employment and make upward mobility more challenging for low-income families.

My final point is that there are better ways to reduce poverty that address concerns over employment and that better target those who are in need. Turning the CTC into a child allowance has implications beyond simply reducing short-term poverty rates. Nobel Laureate Dr. James Heckman from the University of Chicago made a relevant point when describing Denmark's welfare state, which includes generous universal child benefits. He noted that while Denmark experiences lower income inequality compared to the US because of their universal social policies, lower inequality has not translated into smaller education and skill formation gaps – gaps that still prevent people from progressing over the long term.[8] His point was that imposing income equality through redistribution fails to promote individual advancement.

This is how an expanded CTC would work. Not only would it discourage employment among those who need full employment the most, but an analysis by the Penn-Wharton budget model found that only 17.4 percent of new benefits in an expansion like 2021's would go to families in the bottom income quintile, and only 50 percent of benefits to those in the bottom two quintiles.[9] Unlike the EITC, where 86 percent of federal expenditures are refundable and therefore go to low-income families, only 56 percent of expanded CTC benefits in 2021 were refundable even though the policy extended to non-working families.

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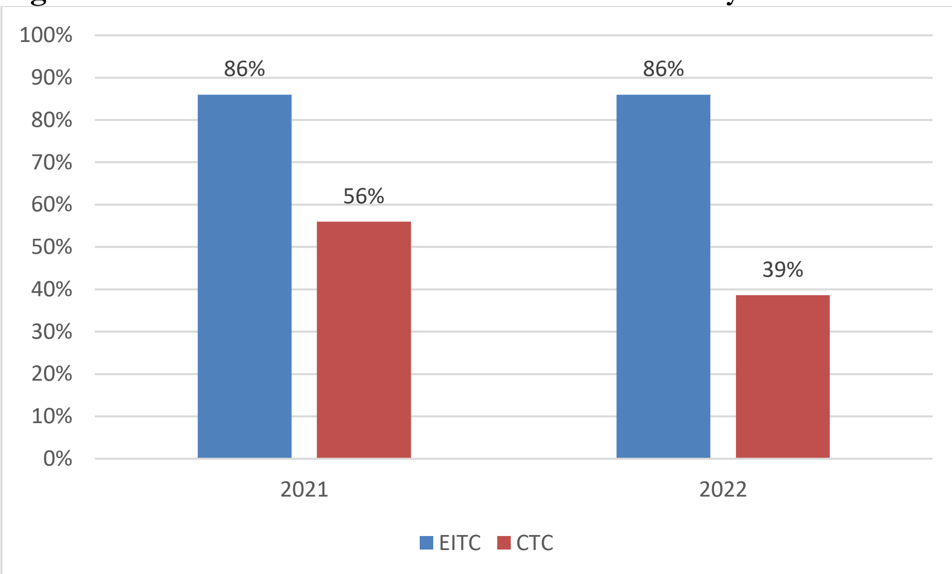
[7] Maria Sauval, Greg J. Duncan, Lisa A. Gennetian, Katherine A. Magnuson, Nathan A. Fox, Kimberly G. Noble, and Hirokazu Yoshikawa, "Unconditional Cash Transfers and Maternal Employment: Evidence from the Baby's First Years Study", November 2022.

[8] Heckman, James and Rasmus Landerso. 2021. Lessons from Denmark about Inequality and Social Mobility, National Bureau of Economic Research, https://www.nber.org/papers/w28543.

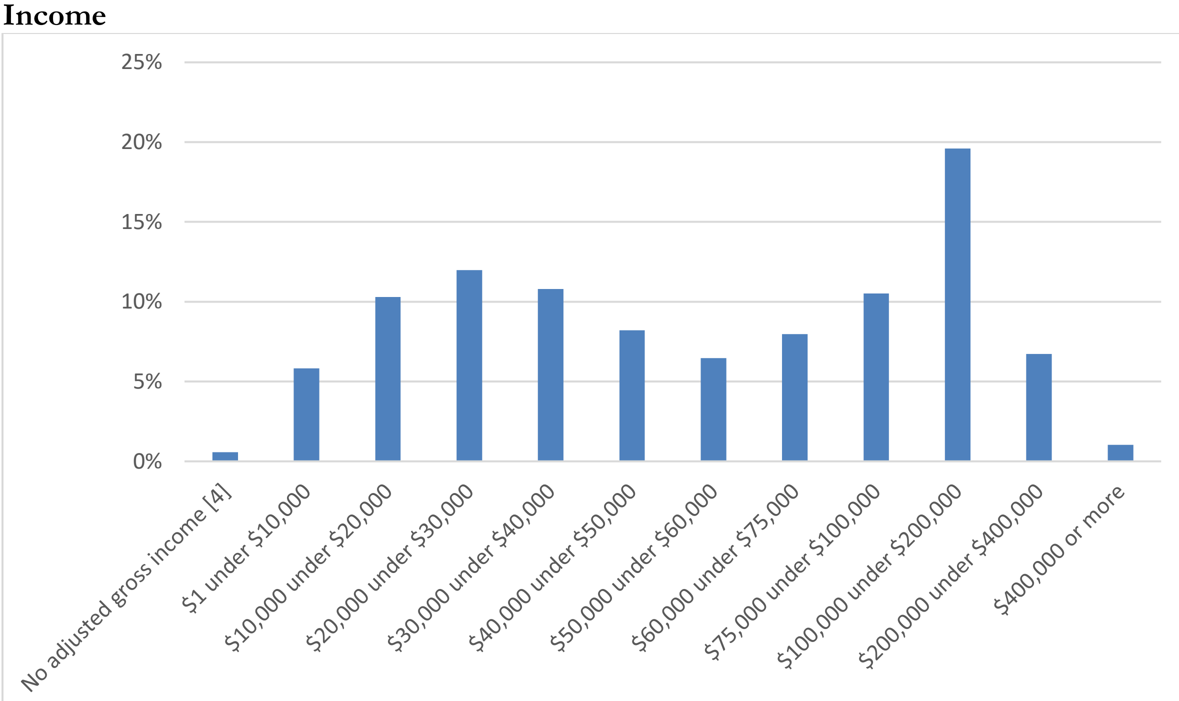
[9] Penn Wharton Budget Model, "Expanding the Child Tax Credit: Budgetary, Distributional, and Incentive Effects," October 25, 2021, https://budgetmodel.wharton.upenn.edu/issues/2021/10/25/expanding-the-child-tax-credit-effects

Figure 3: Refundable Portion of the EITC and CTC by Tax Year: 20021 and 2022



Source: Joint Committee on Taxation, Estimates Of Federal Tax Expenditures For Fiscal Years 2022-2026.

Figure 4: Distribution of Qualifying Children Receiving Advance Payments in 2021 by Income



Source: Internal Revenue Service, SOI Tax Stats – Advance Child Tax Credit Payments in 2021.

The Tax Foundation estimated that making the temporary expansion of the CTC permanent would have cost $1.6 trillion over 10 years, which translates into over one trillion federal dollars to support an expanded CTC presumably aimed at reducing child poverty that is not targeted toward low-income families. It would reduce employment for some low-income families making the likelihood of long-term upward mobility more challenging, while increasing benefits for middle- and upper income households. This is not a winning policy.

To conclude, the CTC has historically served an important tax relief purpose for working families, but expansions to its refundability over the years largely duplicates the EITC. Nonetheless, because it shares the same employment-related design features of the EITC, it contributes to similar positive outcomes such as higher employment levels among low-income families and lower poverty. Proposals to move the CTC away from its original goals of tax relief threaten this progress by discouraging employment and mistargeting important federal benefits.

Thank you and I look forward to answering your questions.