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Harnessing the Child Tax Credit as a Tool to Invest in the Next Generation

By Rachel West, Melissa Boteach, and Rebecca Vallas August 2015

Center for American Progress



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Introduction and summary

The price tag of middle-class economic security has risen dramatically in recent years. Costs associated with the pillars of joining or staying in the middle class—health care, retirement savings, child care, college savings, and housing—increased by \$10,600 between 2000 and 2012 for the typical married family with two children, even as incomes remained flat.¹ This has squeezed American families, leaving millions of people on the financial brink. The combination of flat incomes and rising costs has hit families with children especially hard: Child-related costs account for nearly 70 percent of the rising costs associated with the middle-class squeeze for families with children and have increased at a much faster rate than other costs in recent years.²

The problem is particularly acute for families with young children. Families face significantly higher rates of poverty and economic insecurity during the first three years of their child's life—years that are the most critical for a child's brain development. The birth of a child is one of the leading triggers of poverty spells in the United States—and in 2013, nearly 23 percent of infants and toddlers lived in households with incomes below the federal poverty line.³ Ongoing economic instability and poverty are enormously detrimental to children's long-term health, educational, and employment outcomes. In fact, child poverty costs the U.S. economy an estimated \$672 billion each year, or 3.8 percent of gross domestic product, or GDP.⁴ Yet the United States spends just 1.2 percent of GDP on family benefits, less than half of the Organisation for Economic Co-operation and Development, or OECD, average of 2.6 percent.⁵

The Child Tax Credit, or CTC, is an important policy tool to address these challenges, providing families with up to \$1,000 per child under age 17.⁶ However, in its current form, the CTC has several key limitations:

- The credit is not fully refundable, preventing it from reaching the lowest-income children, and its minimum earnings requirement excludes many families who experience job loss.
- The credit is not tied to inflation, and its value erodes each year that Congress does not act.
- Parents must wait until tax time to claim the CTC, preventing them from using the credit to meet the continuous costs of childrearing.
- The CTC's modest benefit does not increase during the stage when a family's needs are greatest—when children are young and earnings are relatively low.

This report offers proposals to strengthen the CTC by addressing these shortcomings and leveraging the credit as a tool to better invest in the next generation by:

- Eliminating the minimum earnings requirement and making the credit fully refundable to ensure that it reaches all low- and moderate-income families with children.
- Indexing the value of the credit to inflation so that it does not continue to lose value over time even as the costs of reaching or staying in the middle class are rising.
- Enhancing the CTC with a supplemental Young Child Tax Credit of \$125 per month for children under age 3. The Young Child Tax Credit would be made available to families on a monthly basis through direct deposit or the Direct Express card, in recognition of the fact that child-related costs do not wait until tax time.

These enhancements to the CTC would not only help parents cope with the rising costs of basic pillars of middle-class security, but they also would help them afford the unique costs associated with raising young children, such as diapers, car seats, cribs, and infant hygiene products.

As a first step, policymakers should make permanent key provisions of the CTC and the Earned Income Tax Credit, or EITC, which will otherwise expire at the end of 2017. If lawmakers fail to save these key provisions, more than 50 million Americans would lose some or all of these important tax credits, and more than 16 million people in working families—including 8 million children—would be pushed into poverty—or deeper into it—in 2018.⁷ As Congress considers tax packages in the near term, it must be a top priority to make permanent these crucial investments in family economic security and upward mobility.

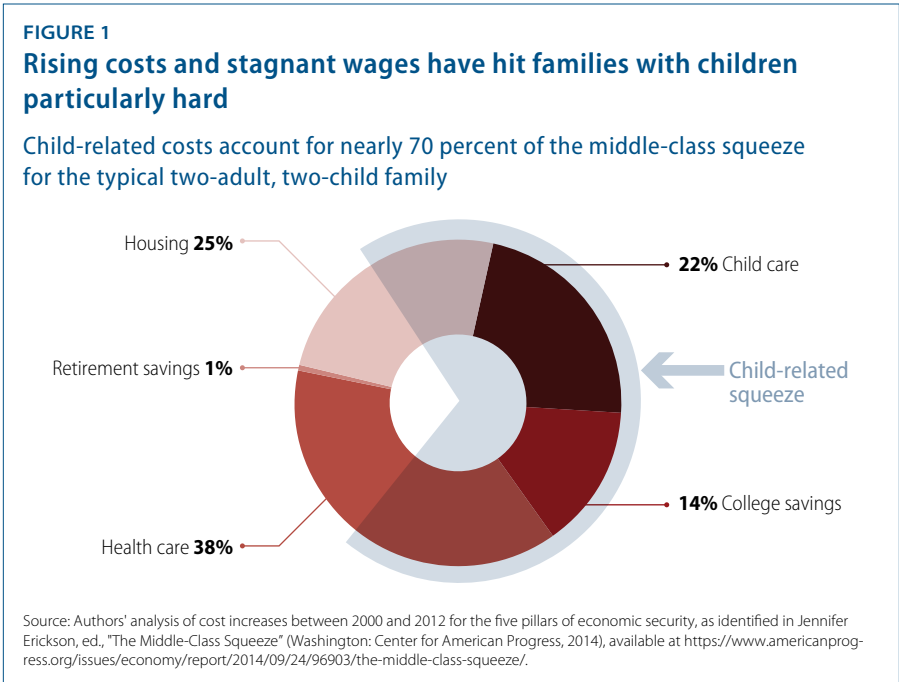
Assuming that key provisions of the EITC and the CTC are made permanent, the total package proposed herein would increase the overall anti-poverty power of the CTC, with especially strong effects for young children. With these reforms enacted, the CTC would now reduce overall poverty for children under age 17 by 13.2 percent and lift 18.1 percent of poor children under 3 out of poverty.⁸ This would nearly double the number of children under 17 lifted out of poverty by the CTC—and would protect more than two-and-a-half times as many children under age 3 from poverty than are protected under current law.⁹

The proposed reforms also would close more than one-quarter—26.1 percent—of the poverty gap—the amount by which family income falls short of the poverty threshold—for those children under age 3 who remain below the federal poverty line, significantly lessening the depth and severity of poverty among young children. The additional proposed improvements would cost \$29.2 billion in 2015.¹⁰ Given that research has shown that boosting poor children’s family income early in life has long-term effects on education, health, and earnings,¹¹ this investment also would likely have positive effects on children’s long-term economic mobility.

Families with children are more likely to be on the financial brink

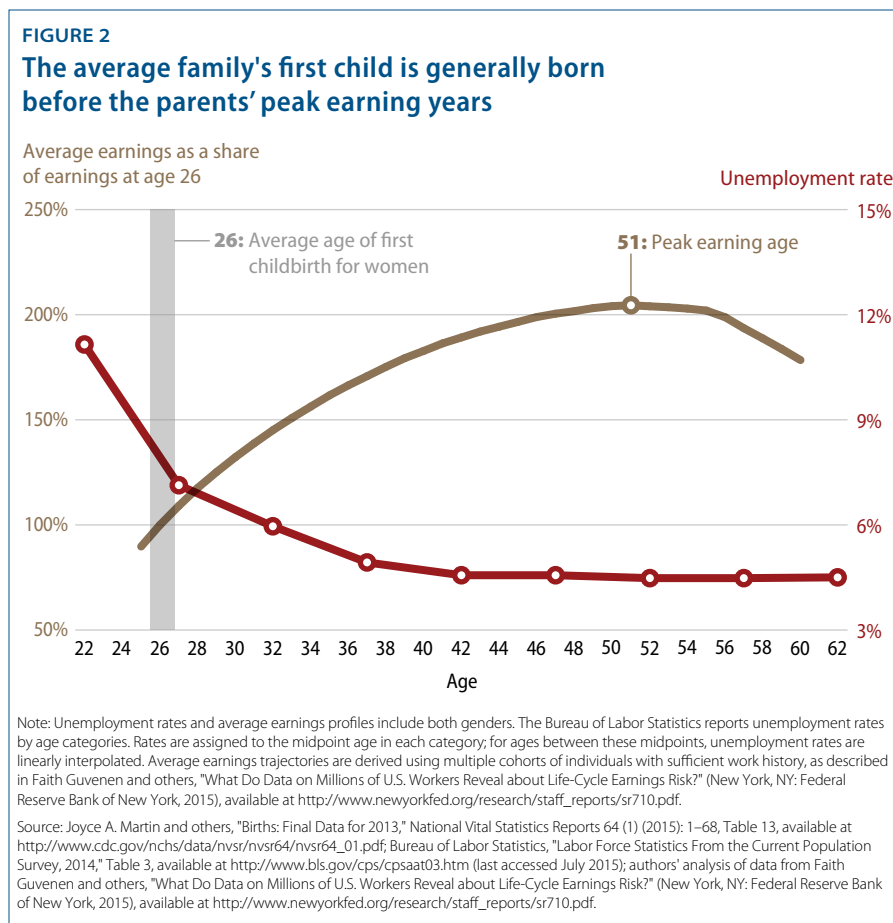
The cost to American families of raising children has risen dramatically in recent years. In a recent report titled “The Middle-Class Squeeze,” the Center for American Progress found that the yearly cost of traditional pillars of middle-class economic security increased by \$10,600 between 2000 and 2012 for a married family with two children, even as incomes remained flat.¹² The combination of rising costs and stagnant incomes has squeezed families, locking millions of struggling Americans out of the middle class altogether.

Families with children have been especially hard hit by this devastating combination of rising costs and flat incomes. Child-related costs grew by \$7,200 over this time period for the typical married family with two children, accounting for nearly 70 percent of the rise in costs and growing far faster than the overall rate of 32 percent.¹³



Families with children are not only confronting more rapidly rising costs compared with other families but also face elevated rates of poverty and economic insecurity. The official poverty rate for families with one or more children under age 17 stood at 17.7 percent in 2013, 3.2 percentage points above the national poverty rate.¹⁴

The birth of a child can be financially destabilizing for families across the income spectrum, ushering in new expenses and time constraints. This means that families with very young children are particularly vulnerable to poverty and income instability. What’s more, parents of infants and toddlers are often young adults who are still in the process of establishing their careers and building savings. They are more likely to be paying student loans and to have high mortgage payments relative to their incomes. As Figure 2 below shows, the average age of first childbirth comes a quarter of a century before a woman’s peak earning years.¹⁵ Additionally, parents at the age of first childbirth are more likely to experience spells of unemployment than their older, more economically secure counterparts. For these reasons, it comes as little surprise that families with very young children are more likely to struggle financially.



Indeed, very young children are the nation's poorest residents. Children under age 3 are more likely to live in poverty than older children: In 2013, 23 percent of children younger than 3 were poor, with family incomes below \$19,530 for a family of three; nearly half—46 percent—of children under 3 were in low-income families, defined as below twice the federal poverty line.¹⁶ This is compared with about 19 percent and 42 percent, respectively, of children from 3 to 17 in 2013.

The case for investing in children

Alleviating the hardship, stress, and suffering that accompany child poverty is reason enough to invest in children. However, in addition to this moral argument, the positive effects of investments in children go far beyond mitigating near-term deprivation and strain. Extensive research by Hilary Hoynes, a professor at the University of California, Berkeley, and her colleagues—among many others—quantifies the powerful long-term benefits of childhood access to social assistance programs.¹⁷

A growing body of research finds that boosting a child’s family income, specifically, improves a host of long-term outcomes, expanding opportunity and increasing economic mobility in adulthood. Studying the effects of the Earned Income Tax Credit, for example, research finds that children whose families receive a larger credit—holding other factors constant—have higher rates of high school completion and greater adult earnings.¹⁸ In Canada, where the income received from child benefits has varied across provinces and over time, researchers have demonstrated that additional income has had substantial positive effects on test scores, maternal health, and children’s mental health.¹⁹ A host of additional research—both in the United States and around the world—finds long-term positive effects that span the areas of academic achievement, higher education enrollment, health, and adult employment.²⁰

Research indicates that the earliest years of life are when family income is most important and that these years wield the most powerful influence on children’s long-term outcomes. Moreover, even modest increases in young children’s family income have significant positive effects. Professor Greg Duncan of the University of California, Irvine, and his colleagues found that a \$3,000 increase in annual family income for low-income children from the prenatal period to age 5 led to a 17 percent earnings increase in adulthood.²¹ And a recent study by Kimberly Noble, a neuroscience professor at Columbia University, and her colleagues found that for children raised in low-income families, small differences in income led to substantial differences in brain surface area, a key indicator of cognitive ability.²² Further research shows that poverty has similarly large detrimental effects on gray matter, depressing brain development, school readiness, and academic achievement.²³

Policies that deliver additional income in the early years of life can thus be expected not only to reduce child poverty but also to pave the way for a healthier, more productive next generation.

Child poverty costs the U.S. economy an estimated \$672 billion each year.

Child poverty: A bill we cannot afford

On the flip side, a host of literature also has traced the far-reaching negative consequences and costs that childhood poverty and family income instability impose. Children who grow up without adequate resources are less likely to find stable and productive employment and are more likely to experience poor health and incarceration as adults.

In a seminal 2007 paper, Professor Harry Holzer of Georgetown University and his colleagues quantified the costs that child poverty imposes on the U.S. economy.²⁴ They estimated that child poverty costs the United States the equivalent of 3.8 percent of GDP each year. Today, that translates into an annual cost of more than \$672 billion.²⁵

Enhancing our nation's future wealth, health, and growth

Just as much of the high cost of child poverty is shouldered by our nation as a whole, the long-term benefits of investing in children are not limited to children and their parents but are instead broadly shared across our society and economy. Today's children are tomorrow's workforce; an investment that improves academic achievement and attainment will enhance the productivity of the labor force, the basis for the nation's continued growth and wealth. Greater adult earnings and employment will yield increased tax revenues for federal, state, and local governments.²⁶

Public spending to boost children's family incomes also has strong economic stimulus effects. Under key provisions enacted under the American Recovery and Reinvestment Act, or ARRA, during the Great Recession, every \$1 spent on the Child Tax Credit generated \$1.38 in economic activity, according to testimony before Congress in 2012 by Mark Zandi, chief economist at Moody's Analytics.²⁷ This was the strongest effect of any of the 16 tax provisions that Zandi examined. Through the well-studied economic multiplier process, this additional activity leads to the creation of new jobs in the economy.²⁸

As noted above, boosting children's family incomes also leads to reductions in crime, ill health, and later-life poverty. This produces substantial social savings, including decreased expenditures on incarceration and the criminal justice system and reduced public health care and other public assistance spending.

When a wealth of research suggests that investing in children could be our country's greatest opportunity, allowing America's children to grow up in poverty is penny wise and pound foolish. The nation's underinvestment in its children stands in stark contrast to its upside-down tax code, which significantly favors the wealthy and large corporations. In 2015, for example, an estimated \$49.7 billion will fund just one of the many tax expenditures for the wealthy—the step-up in basis for capital gains, which protects large sums of wealth from taxation when it is passed down to inheritors.²⁹ Spending on this single item that benefits primarily adult children of the wealthy exceeds by nearly \$3 billion per year all current spending on our nation's 74 million children through the CTC.³⁰

Given that policies that boost income during childhood—particularly during the critical first years of life—pay both short- and long-term dividends, the opportunity to invest in children is one that we cannot afford to pass up.

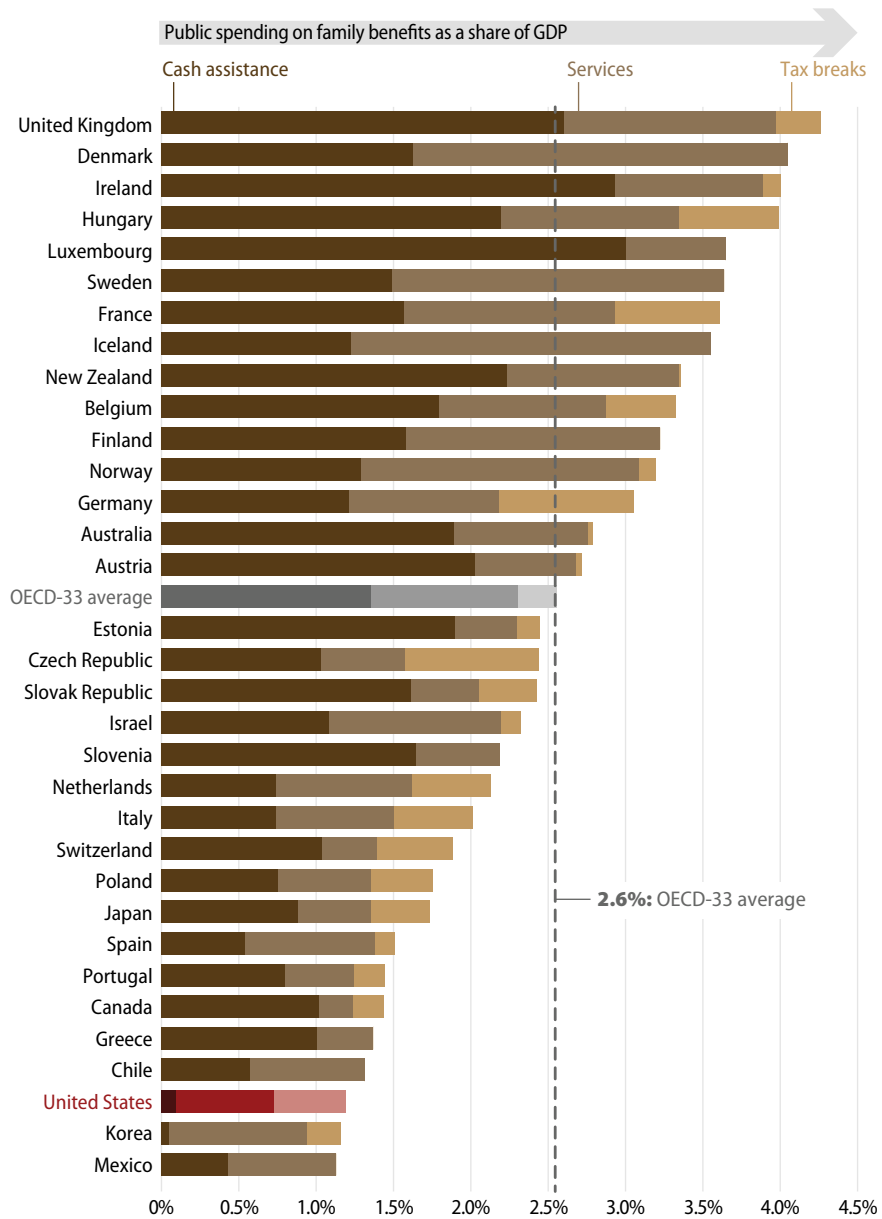
How the United States measures up

Despite the nation's great wealth, child poverty in the United States is far higher than in other developed nations. Of the 34 high-income countries in the Organisation for Economic Co-operation and Development in 2010, the United States ranked 30th in terms of the share of children with family income below half of the median income.³¹ By that measure, 21.2 percent of American children lived in poverty, compared with the OECD average of 13.3 percent.

It is thus hardly surprising, or coincidental, that the United States is severely underinvesting in children relative to its developed peers. The United States spent just 1.2 percent of GDP on family benefits in 2011, less than half of the OECD average of 2.6 percent.³²

Indeed, nearly all wealthy countries—as well as many less wealthy ones—have monthly or weekly child benefits to help families meet the costs of raising children. In many nations, these child benefits are universal; in others, they are means tested such that low- and moderate-income families receive somewhat greater benefits.³³ Some nations, such as Canada, provide an enhanced benefit for young children.³⁴ The reforms proposed in this report emulate several features of other nations' successful family policies within the structure of the existing CTC.

FIGURE 3
The United States invests very little in families
compared with other OECD countries



Note: Family benefits data are from 2011 and include child payments and allowances, parental leave, and child care support.
 Source: Authors' analysis of the 2013 March Current Population Survey. See Minnesota Population Center, "Integrated Public Use Microdata Series," available at <http://cps.ipums.org/cps/> (last accessed July 2015).

Current policy can be strengthened

The Child Tax Credit

The CTC provides families with a tax credit of up to \$1,000 per eligible child under age 17.³⁵ Through the CTC, American families with children received an estimated \$46.4 billion in benefits in 2014.³⁶

As currently structured, the CTC is partially refundable and subject to a minimum earnings requirement of \$3,000 per year. This means that families with no federal income tax liability and annual earnings below \$3,000 are not eligible for the credit under current law.³⁷ This earnings threshold is set to rise if Congress fails to act by 2017, leaving millions of working families without access to the CTC.

For low-income families with annual earnings slightly above \$3,000 per year—and who have little or no federal income tax liability—the refundable portion of the credit, called the Additional Child Tax Credit, or ACTC, phases in at a rate of 15 percent for every \$1 earned. This means, for example, that a single parent who earned \$8,000 and had one child would receive a CTC of \$750 rather than \$1,000. The credit then phases out at a rate of 5 percent beginning at an adjusted gross income, or AGI, of \$75,000 for single filers and \$110,000 for married couples filing jointly. Thus, for example, the credit is not available to a married couple with one child if their AGI exceeds \$130,000.

Limitations of the current CTC

As important as the CTC is for families with children, several features limit its ability to serve the lowest-income and youngest children.

Minimum earnings requirement

The CTC's minimum earnings requirement has been set at \$3,000 per year since 2009, when the American Recovery and Reinvestment Act reduced it from \$12,050, making the credit available to many more working families with children.³⁸ While the current earnings requirement is far preferable to the higher requirement that preceded it, having a minimum earnings requirement at all penalizes those who experience job loss, taking away further resources at a time when they have already lost wages and security. It also penalizes parents who stay at home with their child, whether by choice or because they face barriers to steady work.

In 2011, more than 8 percent of children received no CTC at all because parental earnings were below the minimum earnings threshold.³⁹

Partial refundability

Like the minimum earnings requirement, the fact that the CTC is not fully refundable hinders its capacity to reach the children most in need. For example, under current law, a single parent with two children working full time, year round at the minimum wage in many states would not be eligible for the full refundable CTC.⁴⁰ If key provisions created under the ARRA are allowed to expire, this family with a full-time worker would receive almost no CTC.⁴¹

Unlike the Earned Income Tax Credit, which has a steeper phase-in rate for families with multiple children, the CTC effectively phases in for one child at a time. Thus, for example, a mother with two children and earnings of \$10,000 would receive just \$1,050 instead of \$2,000, or \$1,000 for each child.⁴² For a mother of one child, however, the CTC of \$1,000 would be fully phased in by \$10,000 in earnings. This occurs in spite of the fact that the average family with two children faces greater costs than a family with one child.

These two features of the CTC—partial refundability and the minimum earnings requirement—lead the United States to underinvest in those who should be foremost in policymakers' eyes: very young children. Paradoxically, because families with very young children are more likely to be poor, they are less likely than families with older children to receive the full CTC, as currently structured.

In total, an estimated 20.5 percent of children lived in families that received less than the full CTC in 2011 because earnings were too low. Among children younger than age 3, the share is greater—close to 30 percent.⁴³

Shrinking value

Since the \$1,000 value was first introduced in 2001, inflation has eroded more than one-third—34 percent—of the credit’s purchasing power. Even if child-related costs were not rising, this would still mean that the credit’s power as an anti-poverty tool has diminished over time. But with costs increasing, the CTC’s shrinking real value further diminishes its role in addressing the middle-class squeeze.

Once-per-year delivery

Under current policy, families must wait until tax time to receive their full CTC. While there are advantages to delivering the CTC as a lump sum, such as offering families a clear opportunity to build savings,⁴⁴ this means that the CTC is not available throughout the year to meet the unique costs of childrearing, many of which—such as diapers, cribs, car seats, and infant hygiene products—cannot easily be addressed with other assistance programs. Diapers alone cost an average of \$936 per child each year.⁴⁵ In a 2013 study, which found that diaper need was associated with higher levels of maternal stress, 30 percent of pregnant and parenting women reported that they lacked sufficient diapers.⁴⁶ New parents in particular also face a host of substantial one-time expenses at the time of childbirth. The purchase of a crib and car seat for a new baby cannot easily be put off until next year’s tax time.

Investing in America's children through an enhanced CTC

Several simple but powerful changes could greatly enhance the Child Tax Credit as a tool for investment in our nation's children.

Boosting the CTC's anti-poverty power

As a first step, Congress must act to make permanent key provisions of the CTC and the EITC that are set to expire at the end of 2017. (See text box) Building on that progress, two important reforms would ensure that the credit reaches children in low-income families, who stand to gain the most from the additional income that the CTC provides. Policymakers should eliminate the minimum earnings requirement and should make the credit fully refundable, so that all qualifying families are able to access the full credit. These changes alone would lift an additional 1.5 million children out of poverty relative to current policy.⁵¹

First, do no harm: Making key provisions of the EITC and the CTC permanent

Importantly, as policymakers consider the reforms proposed in this report, they must ensure that they preserve the progress made to date. Key provisions of the Earned Income Tax Credit and the CTC must be made permanent before they expire at the end of 2017.⁴⁷ These provisions strengthen the refundable portion of the CTC, enabling many more low-income working families with children to benefit from the credit, and strengthen the EITC by reducing the marriage penalty and boosting assistance for families with more than two children.

If Congress does not act, the refundable portion of the CTC will become much more limited. The minimum earnings requirement will rise from \$3,000 to \$14,700 per year, shutting out children whose parents earn at or close to the minimum wage.⁴⁸ This means that in order

to qualify for the full CTC, a family with two children would need to earn more than \$28,000 per year. Families with three children would also see a substantial drop in the amount of the credit they receive. Inaction would reduce or eliminate these critical tax credits for 50 million people and would cause 16 million people—including 8 million children—to be pushed into or deeper into poverty in 2018.⁴⁹

The fact that these critical provisions for working families are in jeopardy contrasts sharply with the constancy that wealthier Americans can expect from Congress. Advantages that disproportionately benefit the upper middle class and the rich—such as the low tax rate on capital gains—have long been permanent fixtures of the tax code.⁵⁰ America's low- and middle-income families deserve the same stability in their expectations as wealthier taxpayers.

In addition to the anti-poverty power of these two changes, these steps would have the sensible result of decoupling the CTC—a credit that Congress created to “better recognize the financial responsibilities of raising dependent children”⁵²—from parents’ employment patterns. Children themselves cannot work, nor can they control their parents’ employment. These measures would insulate the assistance that the credit provides from the hazards of today’s labor market, in which workers’ schedules, job tenure—and even hourly earnings, in professions that rely on tips—are often unpredictable, uncontrollable, and unstable.

Increasing investment in America’s greatest asset—young children

The Center for American Progress proposes enhancing the CTC with a supplemental Young Child Tax Credit for each child under age 3. This supplemental credit would be in the amount of \$125 per month, for a total of \$1,500 per year, and would phase out at a rate of 5 percent, starting at the existing CTC income threshold of \$75,000 for a single-earner household and \$110,000 for a dual-earner household.

Unlike the existing CTC and EITC, which are delivered as single lump sums at tax time, families would have the option to claim the Young Child Tax Credit in monthly installments, enabling parents to use the funds to meet the continuous costs of childrearing.⁵³ The base CTC would remain a year-end, lump-sum credit. Families’ monthly payments could be directly deposited into their bank account or deposited on the Direct Express card provided by the Department of the Treasury, which is widely used to deliver federal payments, including Social Security benefits and federal tax refunds.⁵⁴

Preventing further erosion of the CTC’s value

The value of the CTC should rise with inflation. The common-sense practice of inflation indexing—already in place for other tax credits such as the EITC—will halt the erosion of the CTC’s value each year. The credit was last increased in 2001; had it kept pace with inflation since that time, it would be worth one-third more today—\$1,340 instead of \$1,000.⁵⁵ Linking the CTC’s value to inflation will ensure that, at a minimum, the value will not continue to shrink in real terms while the cost of raising children continues to rise.

Automatic inflation adjustment also would ensure that the credit remains meaningful for American families' budgets, without the need for repeated congressional action.

Total cost

The total cost of these proposed enhancements to the CTC would be \$29.2 billion dollars in 2015.⁵⁶ Because the value of the credit would be linked to inflation, the cost would increase slightly each year relative to current policy.⁵⁷

Benefits of the CTC enhancements

A previous section of this report surveyed the research on the long-term benefits of additional income to families with children, which include increased educational attainment, higher employment and earnings, improved health outcomes, and reduced poverty and criminal justice-related costs. The following section discusses the additional positive effects of the policy proposals in this report, along with the immediate benefits for children, families, and the economy.

Mitigating the middle-class squeeze

For families with young children—who are among those hardest hit by the combination of rising costs and stagnant incomes—enhancing the Child Tax Credit would mitigate some of the financial stress created by the middle-class squeeze. The Young Child Tax Credit of \$1,500 proposed herein would address a considerable portion of the \$7,200 increase in child-related costs that the typical married-parent family with two children faced between 2000 and 2012.

Making the CTC more transparent

In addition to reaching many more families, making the credit fully refundable and eliminating the earnings requirement would make the credit more understandable and predictable to parents as they plan their budgets and file their taxes. For most families, no consideration of income data would be necessary.

Reducing poverty and hardship

In 2013, about 23 percent of infants and toddlers under age 3 lived in households with incomes below the federal poverty line, which stood at \$19,530 per year for a family of three, and nearly half of these children, or 11.1 percent of all children under 3, lived in deep poverty—half of the federal poverty line, or \$9,765 per

year for a family of three.⁵⁸ Assuming that key provisions of the Earned Income Tax Credit and the CTC are made permanent, the enhancements to the CTC proposed herein would significantly increase the credit's anti-poverty power, with particularly strong effects for young children. With these reforms enacted, the CTC would protect 18.1 percent of poor children under age 3 from poverty—more than two-and-a-half times as many young children as the current policy. It would reduce overall childhood poverty in the United States by 13.2 percent, nearly doubling the number of children under 17 lifted out of poverty relative to current law.⁵⁹

The proposed reforms also would close more than one-quarter—26.1 percent—of the poverty gap—the amount by which family income falls short of the poverty threshold—for those children under age 3 who remain below the poverty line, significantly lessening the depth and severity of poverty for young children.⁶⁰

Reducing racial and ethnic disparities

In the next few years, more than half of all infants born in the United States will be infants of color, but racial and ethnic disparities persist.⁶¹ These disparities represent not only a violation of America's promise that no matter his or her skin color, a child will have an equal shot at the American Dream, but they are also a threat to our long-term economic competitiveness: Today's children are tomorrow's workers, and child poverty can undermine the long-term productivity of our workforce.

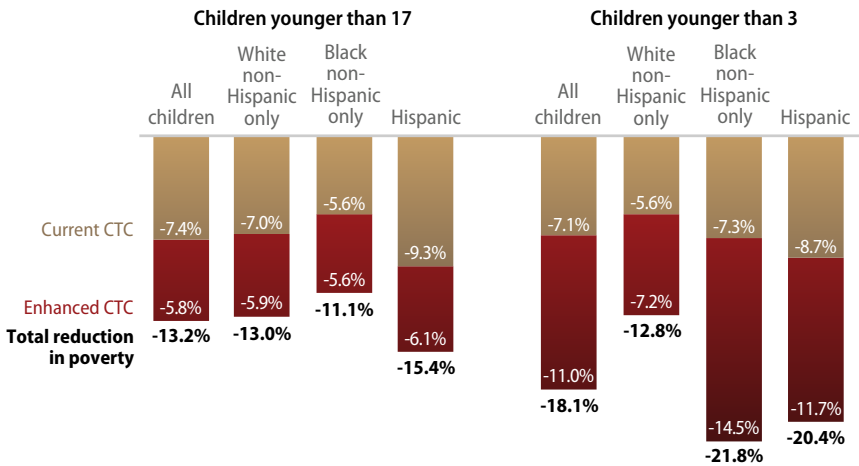
Our proposal would reduce poverty for all children, but—as Figure 4 illustrates—it would have a disproportionate effect on children of color, closing some of the persistent racial and ethnic disparities that belie our values and undermine our economy. By reducing the incidence and depth of poverty for millions of people, this proposal would tackle inequality where it starts—with our nation's children.

With the proposed enhancements, the CTC would protect two-and-a-half times more children under 3 from poverty.

FIGURE 4

Enhancing the Child Tax Credit would reduce child poverty —particularly among children of color

Percent reduction in official poverty, by children's race and ethnicity



Note: The chart shows children identified solely with the listed race or ethnicities; children identified as other or multiple races are not included above. The chart shows the percent reduction in official poverty that would be achieved if the Child Tax Credit were counted as income against the U.S. Census Bureau's official poverty threshold. This is a hypothetical exercise, because unlike some alternative measures of poverty—such as the U.S. Census Bureau's Supplemental Poverty Measure—the federal government's official poverty measure does not take into account income from tax and transfer programs. Estimates for subpopulation groups of children under 3 should be interpreted with caution, as margins of error may be wide due to relatively small sample size.

Source: Authors' analysis of the 2013 March Current Population Survey. See Minnesota Population Center, "Integrated Public Use Microdata Series," available at <http://cps.ipums.org/cps/>.

Stabilizing family income

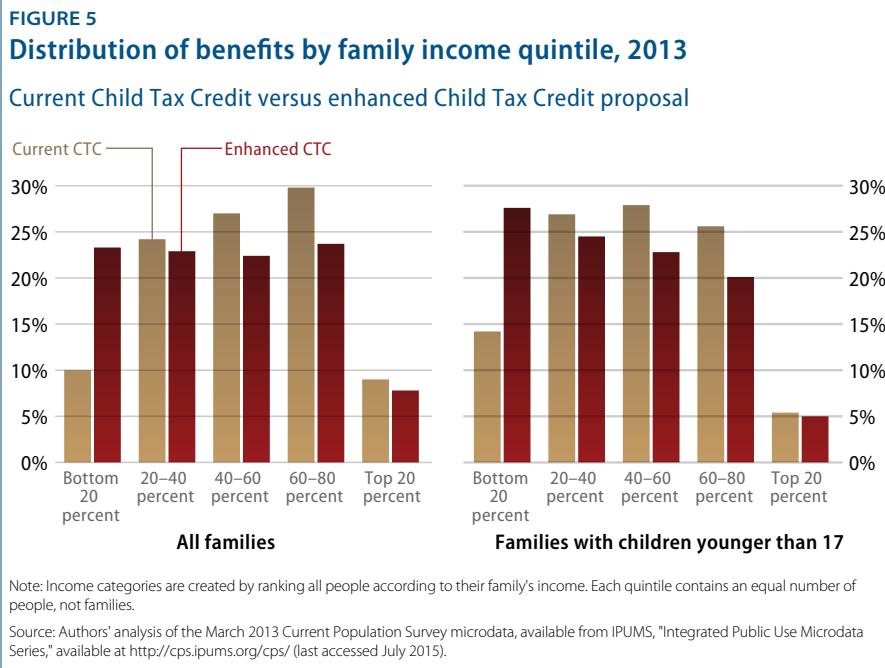
In addition to boosting family income—and thereby enabling parents to better protect themselves and their children from poverty and hardship—enhancing the CTC would also have important stabilizing effects on family income. Researchers such as Bradley Hardy of American University have found that income volatility has harmful consequences for families that extend above and beyond the detriment caused by low income alone.⁶²

Making the credit fully refundable and eliminating the minimum earnings requirement would ensure that low-income households can be certain of the size of the credit they would receive at tax time. This guaranteed security would allow families to better plan and budget for the future. It would help smooth the incomes of the many working- and middle-class families who struggle with volatile wages or hours or unstable employment—conditions that are all too common in today's labor market.

The fully refundable supplemental Young Child Tax Credit would have even more powerful stabilizing effects for families with young children. The monthly delivery would allow families to meet the continuous costs of childrearing in a timely fashion, help fill the spending gaps created by emergencies and hard times, and prevent small crises from turning into a downward spiral of debt for families with young children. Additionally, by reducing financial instability, the supplemental credit would promote family stability: Research suggests that financial stress is a risk factor for marital conflict, violence, and divorce.⁶³

Making tax policy more progressive

The CTC is an important anti-poverty tool, and key provisions established in the 2009 American Recovery and Reinvestment Act enabled the credit to reach many more low- and moderate-income families. As discussed above, however, the minimum earnings threshold and partial refundability mean that, even with the changes under ARRA, the distributional effects of the policy leave out many low-income households.⁶⁴ As Figure 5 below illustrates, the largest share of the CTC's benefits accrue to middle-income and upper-middle-income families. The reforms we propose would make the CTC significantly more progressive.



Reaching disadvantaged groups

The supplemental Young Child Tax Credit would deliver relatively greater benefits to children in low-income families. Moreover, its benefits would reach several disadvantaged groups of children who are underserved by the current CTC because their caregivers tend to have disproportionately lower earnings. These groups include:

- **Families with young children.** The parents of young children tend to have lower earnings than those of older children. This happens for several reasons: because parents of infants and toddlers tend to be, themselves, younger in age and thus still in their lower-earning years; because they are more likely to require reductions in their work schedules in order to care for a young child, reducing their take-home pay; and because they face greater child care costs, since child care for young children is more costly than for older children.⁶⁵ An analysis of 2011 data estimated that 3 in 10 children younger than age 3 lived in families that did not receive the full CTC because their parents earned too little, compared with less than 20 percent of older children.⁶⁶ Furthermore, nearly 13 percent of young children lived in families that received no CTC at all, compared with 8 percent of older children.⁶⁷
- **Families of color.** Just more than one-fifth of all children under age 17 lived in families who earned too little to receive the full CTC in 2011.⁶⁸ However, given that families of color face higher poverty rates, this masks significant disparities by race and ethnicity: Nearly 30 percent of Hispanic children and 38 percent of African American children lived in families that did not receive the full credit.⁶⁹
- **Families with nonparental caregivers.** Children whose primary caregiver is not a parent—such as the 2.2 percent of children being raised by a grandparent—may have a caregiver who is less likely to be in the workforce and therefore less likely to meet the current CTC’s earning requirements.⁷⁰ This proposal would give nonparental caregivers greater access to much-needed additional resources to support their care.

Greater parity for stay-at-home parents

Parents who do not work outside the home or who only work part time—either because they choose to stay at home with their child in the early years of life or because they face barriers to work associated with caregiving—forego critical income in order to do so. By decoupling the child benefit from employment status, this proposal would increase parity for families with a stay-at-home parent.

Conclusion

The price tag of middle-class American economic security has been rising particularly rapidly for families with children, leaving these families increasingly hard-pressed to meet the costs of childrearing. At the same time, a large and growing body of research suggests that children are our nation's greatest investment opportunity because the benefits of a healthier, better educated, more productive future workforce accrue to our entire society.

Yet despite the push of the middle-class squeeze and the pull of untapped opportunity, the United States continues to substantially underinvest in children relative to peer nations. As a consequence, the heavy costs of high child poverty rob the nation of \$672 billion in GDP annually, or nearly 4 percent of economic output each year.

The Child Tax Credit offers a powerful tool for making much-needed investments in the country's next generation. As a first step, Congress must act to make permanent key provisions of the existing CTC and Earned Income Tax Credit set to expire at the end of 2017. But lawmakers should also look ahead to ways that they can further harness the CTC to ensure that all children have the opportunity to succeed.

By making the credit fully refundable and eliminating the minimum earnings requirement, lawmakers can ensure that the CTC reaches all low- and moderate-income children. By indexing the credit to inflation, policymakers can ensure that it keeps pace with the rising cost of raising a child. Finally, by creating a monthly supplemental credit for children under age 3, policymakers can boost the outcomes of some of our nation's most vulnerable—but also most promising—members, its young children, and help young families meet the unique and heightened needs of children at this sensitive age.

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Acknowledgments

The authors wish to thank Brendan Duke, Indivar Dutta-Gupta, Shawn Fremstad, Sarah Jane Glynn, Kali Grant, Katie Hamm, Rob Hanna, Harry Stein, Alex Thornton, and colleagues at the Center on Budget and Policy Priorities for their helpful comments on an earlier draft.

Endnotes

- 1 Jennifer Erickson, ed., “The Middle-Class Squeeze” (Washington: Center for American Progress, 2014), available at <https://www.americanprogress.org/issues/economy/report/2014/09/24/96903/the-middle-class-squeeze/>.
- 2 Authors’ calculations are based on *ibid.* Of the five pillars of economic security identified in the report, two—child care and college savings—are fully child related. We assume that in a family of two parents and two children, half of the cost increase in two other categories—health care and housing—is also related to the family’s children. For purposes of calculating the change in costs over time, we allocate 50 percent of the cost of health care to the child-related cost category and the remaining 50 percent to the non-child-related cost category. We allocate housing costs to each category in the same manner. We then calculate the rate of growth in total spending in each category between 2000 and 2012.
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- 8 Authors’ calculations based on the 2013 March Current Population Survey. See Minnesota Population Center, “Integrated Public Use Microdata Series.” Throughout this report, poverty status and depth are assessed relative to the official federal poverty line, or FPL, which does not account for income from taxes or transfer payments. For the purposes of demonstrating how the Child Tax Credit would affect children’s family income, the analysis in this report treats income from the current and proposed CTC as though it were countable against the FPL. For information on how the Census Bureau measures official poverty, see Bureau of the Census, “How the Census Bureau Measures Poverty,” available at <http://www.census.gov/hhes/www/poverty/about/overview/measure.html> (last accessed July 2015). In recent years, several alternative measures of poverty have been developed—including, notably, the Census Bureau’s Supplemental Poverty Measure, or SPM, which assesses a family’s resources after taxes and transfer payments. See Kathleen Short, “The Research Supplemental Poverty Measure: 2010” (Suitland, MD: Bureau of the Census, 2011), available at <https://cps.ipums.org/cps/resources/spm/p60-241.pdf>. This report focuses on the FPL rather than the SPM because the FPL is close to pretax cash income. For a family with limited access to cash in the near term, the FPL is thus closely tied to the ability to make purchases for a child—particularly purchases for a young child, such as diapers and infant hygiene products, which cannot be delayed until tax time. Prior research has explored how some elements of this proposal would affect poverty as measured instead by the SPM. For example, an Urban Institute study found that in 2010, making the CTC fully refundable and eliminating the minimum earnings requirement would have decreased supplemental poverty among children by 11.6 percent. While the data used in the study coincided with the height of the Great Recession, the results suggest that the anti-poverty power of the reforms proposed herein may be even greater when assessed using the SPM rather than the FPL. See Linda Giannarelli and others, “Reducing Child Poverty in the US: Costs and Impacts of Policies Proposed by the Children’s Defense Fund” (Washington: Urban Institute, 2015), available at <http://www.childrensdefense.org/library/PovertyReport/assets/ReducingChildPovertyintheUSCostsandImpactsofPoliciesProposedbytheChildrensDefenseFund.pdf>.
- 9 Authors’ calculations are based on the 2013 March Current Population Survey. See Minnesota Population Center, “Integrated Public Use Microdata Series.” Under current policy, the CTC reduces poverty among children under age 3 by an estimated 7.1 percent. This proposal would more than double that figure, reducing young child poverty by an additional 11.8 percent relative to current policy. Among children under 17, for whom the existing CTC reduces poverty by 7.4 percent, poverty would be reduced by an additional 6.3 percent.
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- 14 Authors' calculations are based on the 2013 March Current Population Survey. See Minnesota Population Center, "Integrated Public Use Microdata Series"; Bureau of the Census, "Table 3. Poverty Status of People, by Age, Race, and Hispanic Origin: 1959 to 2013," available at <http://www.census.gov/hhes/www/poverty/data/historical/people.html> (last accessed July 2015).
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- 43 Harris, “The Child Tax Credit: How the United States Underinvests in Its Youngest Children in Cash Assistance and How Changes to the Child Tax Credit Could Help.”
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