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

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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.

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