In this memo, I will argue that the renewed version of the Child Tax Credit, as proposed under the American Families Plan, is a viable and necessary policy to help poor, no-income or low-income families raise children. I will outline the already existing programs, how the proposal differs from them, and what the expected economic consequences of enacting this policy are. Finally, I will propose potential adjustments to better target the policy.

The United States has two main ways of supporting families with children: the Earned Income Tax Credit, or EITC, and the Child Tax Credit, or CTC. Both programs are linked to earnings, meaning the received benefits increase as income increases until a cap is reached on the amount of the benefit. For example, for a single parent with two children, the maximum EITC benefit is reached at an income level of $14.8 ths. The EITC also phases out: using the same example, benefits would be reduced to 0 at an income level of $47.4 ths.[1] Thus, the EITC is a relatively well-targeted program; it is linked to income and the benefits are only received by a well-defined segment of society. The CTC is less targeted: it also phases in as income increases and is capped at $2,000 per child, but there is no reduction of the benefits thereafter.

The newly proposed, renewed version of the CTC would raise the maximum benefit to $3,600 per child, and would not link it to income, meaning no phasing in: no-income or low-income families, who currently cannot receive the guarantee (i.e., the maximum benefit), would also be eligible to receive it. This proposal will be evaluated alongside two criteria:

1. What are the economic and social benefits of the program, and do they justify the costs?
2. What are the potential adverse effects of this policy, namely, at what rate will it disincentivize work?

First, the program offers a larger guarantee for all parents, and makes the full amount available to all, regardless of income. As both the EITC and the CTC currently phase in as income increases, this would significantly expand the benefits received by no-income or low-income households. The cumulative effect of this policy (ranging from conservative to expansive estimates) is a 22%[2] to 34%[3] reduction in child poverty. Even a 22% impact could be regarded as significant – while the cost side will also need to be considered, the effect is clearly not nominal. Social science studies provide a further argument why, beyond monetary figures, such a change could have benefits: as the Brooking Institute[4] summarizes, potential social benefits might include better food security, better educational outcomes, and higher earnings expectations for children.

The program would also cost more than $100 billion. This cost, in the long term, might be partially or fully offset by the advantages provided by the program, most notably through increased tax earnings due to better educational and earnings outcomes. This offset would take decades to materialize, and it is also challenging to quantify upfront. To provide an estimate, I assessed the Medicaid expansion for children in the U.S., which was also a costly program aimed to better the outcomes of children: in this specific case, 58 cents on a dollar was estimated to be earned back in future tax revenues.[5] While there is no definite answer on how much state spending is justified for specific levels of provided benefits, I would conclude that even a 22% reduction in child poverty is justified by a program that can potentially earn back a significant part of its cost from future generations. Furthermore, considering international examples, universal cash benefits, especially if conditioned, are the best practice in poverty alleviation.[6] While the program could be fine-tuned, it is unlikely that a much cheaper alternative exists.

Second, the most notable adverse effect of the proposal is that it will provide work disincentives. As it is a universal child allowance not linked to work, with no benefit reductions, based on the underlying microeconomic effects, it is likely that some job loss will occur. Compared to the current model (where benefits are increased as earnings increase thus providing an incentive), by one estimate, the renewed CTC would lead to the loss of 1.4 million jobs due to the income effect (meaning, as people earn more, they tend to choose to work less) and due to the substitution effect (the benefit can substitute earnings).[7]

Another question is, however, if there are indirect work incentives also included in the program. This seem plausible, as during the pilot of the renewed CTC program, which ran for six months in 2021, studies generally did not find a change in employment.[8] In fact, employment decreased after the expanded benefits were no longer provided.[9] This might be due to two reasons, also mentioned by the Brookings Institute's analysis. One, a segment of low-income families might not be able to afford daycare or have access to other means of childcare such as extended family. Thus, parents in these low-income families might not have the option to return to the workforce. Two, for the same reason, parents might choose to work in a reduced capacity, or forgo additional employment. This claim is substantiated by a study that estimates that in 2021, 34% of families struggled to find affordable daycare.[10] A child allowance program such as this could provide the necessary funds for daycare, and this would allow some parents to either return to the workforce or increase their working hours. This could explain why employment did not decrease during 2021 when families received the CTC: while it did provide work disincentives for some, it provided additional work incentives for others, and these two effects cancelled each other out.

In conclusion, based on adverse effect analysis, I would recommend adopting the modified measure. To add to this, I would also like to link back to the previously mentioned social benefits. Even if earning a similar amount of money, a parent staying home with children could provide their time and attention to them which can potentially result in better school performance and overall better life outcomes. The monetary value of such a social benefit is hard to quantify but nevertheless cannot be ignored. Especially for families who cannot afford daycare but also cannot afford not to work, the renewed CTC could at the minimum provide a set of options.

There is one main disadvantage of the program that I must also mention: it is not targeted towards no-, low- or middle-income families. Regardless of income, all parents will receive the increased benefit. When looking at this effect from the combined perspective including the EITC, it could be argued that the two measures together reach an equilibrium: one incentivizes work and is targeted towards low-income families, while the other is a benefit for all, making even the poorest eligible but providing incentives and aid for high-income parents as well. Still, I would argue that it is unnecessary to increase the benefits for all households regardless of income, and that the benefit should be reduced at a certain income level to the original measure, $2,000 per child. While this would make the measure more targeted, it might also disincentivize work further – to counteract this, a mild benefit reduction rate is recommended. Another potential modification could be adding conditions to the program, building on international examples such as the Bolsa Familia, where, for example, benefits are conditional upon the child being vaccinated and attending at least 12 years of school.[11]

To summarize, the proposed renewed CTC has the potential to provide benefits to a currently underserved segment of the population, the no- or low-income households. Receiving cash handouts like this has been proven to better the child's future outcomes, which is the main policy outcome we should be looking at, but the program has the potential to earn back some of the costs over the long run as well. Some modifications might be beneficial, but overall, the measure should be adopted.

End notes and references

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