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OPINIONCOMMENTARY

The Child Tax Credit Is a Failed Experiment

I introduced the idea in a 1993 Heritage Foundation paper. It was a lot better in theory than in practice.

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Advocates are pushing Congress to extend and make permanent the temporary expansion of the child tax credit included in the American Rescue Plan of 2021, claiming this would reduce childhood poverty. I was one of the inventors of the child tax credit, nearly 25 years ago—and I think it's a bad idea.

Since the child tax credit was enacted in 1997, it has become one of the largest federal income transfer programs. It is one of the leading reasons that more than 40% of all filers pay no income tax. The beleaguered Internal Revenue Service isn't the right agency to play such a big role in addressing poverty.

The child tax credit made its debut in my February 1993 Heritage Foundation paper titled "Putting Families First: A Deficit Reduction and Tax Relief Strategy." The strategy called for a cap on the growth of federal spending, which would not only reduce the deficit but also fund pro-growth and pro-family tax relief. The pro-growth elements were faster expensing for capital purchases and a reduction in the tax rate on capital gains.

The pro-family component was a $500-a-child tax credit. The tax code wasn't sheltering as much income of families with children as it did during the 1950s, and the credit was a simple way of remedying that problem. A credit reduces a family's tax bill dollar for dollar, while a deduction does so indirectly by reducing taxable income.

Key elements of this plan made their way into the 1994 House Republicans' Contract with America. Congress enacted the $500 child tax credit as part of the Taxpayer Relief Act of 1997, and it grew from there.

The Bush tax cuts in 2001 temporarily doubled the credit to $1,000 and made it partly refundable for some families whose tax liability was less than the credit. That provision was extended in 2010 and made permanent in 2012. The 2017 Tax Cuts and Jobs Act doubled the credit again, to $2,000, and eased the limits on refundability. Each expansion meant fewer households on the tax rolls.

Last year the American Rescue Plan included another temporary expansion, to $3,000 a child and $3,600 for children under 6. It also required the IRS to distribute half these benefits to taxpayers monthly instead of waiting until tax season the following year.

The expanded credit was one of many relief programs available to families in 2021, and it contributed significantly to increasing the number of households with little or no income-tax liability. According to a Tax Policy Center estimate, some 74 million tax filers—or nearly half (48.3%) of all filers in 2021—had no income tax liability.

A study by the Paris-based World Inequality Lab titled "Why is Europe More Equal Than the U.S.?" determined that the U.S. tax system is more progressive than European systems and redistributes more to the bottom 50% of taxpayers than European systems. The child tax credit is one reason why. Even post-pandemic, the Tax Policy Center estimates that 44 million tax filers will have no income tax liability in 2022.

Can we have a sustainable tax system if the number of nonpayers continues to grow? Expanding the child tax credit would take our redistributionist tax code to a new level. Although 2021 was a pandemic year, it gives us a picture of what that world would look like.

Handing a family $3,000, $6,000 or even $9,000 in cash is certainly palliative, but does it truly improve long-term living standards? No. On the contrary, recent studies estimating the economic effects of the proposed expansion suggest that it would cause people to leave the workforce, reduce work effort, and lower capital investment, ultimately shrinking economic output.

A recent study by economists at the University of Chicago determined that without any changes in behavior, expanding the credit would reduce child poverty by 34% and "deep" child poverty—families whose income is less than half the poverty level—by 39%. But those gains would come at a cost: the diminution of the workforce by 1.5 million people. Consequently, fewer working parents would diminish the child tax credit's impact on reducing child poverty by more than a third, to 22% from the initial estimate of 34%.

A new study by Congress's Joint Committee on Taxation assesses both the budgetary and economic impact of expanding the child tax credit. First, JCT determined that it would be a budget-buster, reducing revenue by more than $1.3 trillion over the next decade. By contrast, all provisions of the 2017 Tax Cuts and Jobs Act combined reduced revenues by roughly $1.5 trillion over a decade.

The child tax credit is a drain not only on the federal budget but on the nation's economy. JCT's economic models predict that over a decade the policy would reduce the labor supply by 0.2% and reduce the amount of capital by 0.4%. As a result of the reduced supply of labor and capital investment, gross domestic product would shrink by 0.2%.

Aside from the effect on redistribution, nonpayers and the economy, the policy did something worse to the way we think about taxes—it conditioned conservative and liberal lawmakers alike to use the tax code for all manner of social policy.

In the 25 years since the child tax credit was enacted, the number of tax credits has proliferated. There are now tax credits for adoption, daycare expenses, college costs, electric vehicles, solar panels, housing and energy-efficient refrigerators. The Inflation Reduction Act alone created or renewed 26 credits for climate and energy industries. No wonder the IRS is dysfunctional—it's not equipped to be a social-service agency.

The "put money in people's pockets" approach of the child tax credit might have been good politics, but 25 years' experience shows it was bad policy. The country needs a tax agenda that promotes growth and opportunity, not handouts and redistribution.

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