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Reducing Child Poverty Requires Closing the Cash Benefit Gap

by Samuel Hammond[1]

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Introduction

The United States has one of the highest child poverty rates within the OECD. While child poverty has many causes and potential dimensions for intervention, the proximate cause for the United States' staggering rate of child poverty compared to other developed economies is a relative lack of direct cash expenditures on families and children. For example, the United States spends only 0.7 percent of GDP on family social expenditures, of which the share devoted to cash benefits, 0.1 percent of GDP, is the lowest of any OECD country. The United States would need to increase cash transfers to families by approximately $200 billion per year simply to match the cash benefit portion of the OECD average.

Increasing direct cash transfers to guardians of children in low income households would be the single most effective way to lower child poverty rates in the United States, and would have a sizable impact on secondary outcome variables, like child health and well-being, as well. Moreover, relative to other policy interventions, cash transfers are simple to administer, robust to political-economic constraints, and have an effect that is immediate and measurable.

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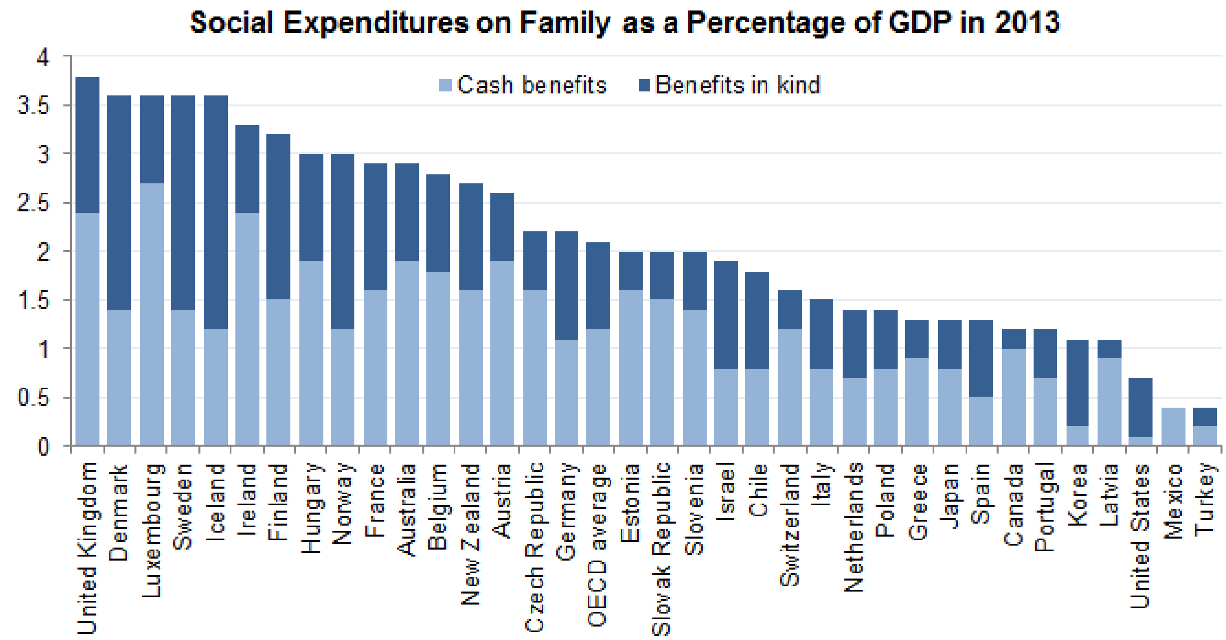

Based on latest available data from the OECD Social Expenditure Database. Data for Chile and Israel refer to 2015. Data for Australia, Canada, Korea and New Zealand refer to 2014. Data for Greece and Poland refer to 2012. Created by Samuel Hammond, July, 2017.

Effectiveness

The academic literature on the effectiveness of cash transfers for outcomes linked to children is voluminous, particularly in the context of low and middle income countries. For example, a 2016 systematic review of 75 reports and 35 studies on conditional cash transfer programs and unconditional cash transfer programs around the world found that cash transfer programs of both types improved school enrollment and attendance.[2] Yet insights about the effectiveness of cash transfers learned from studies in the developing world have substantial applicability to the developed world, as well.

Consider the Earned Income Tax Credit (EITC), which has been estimated to add a quality-adjusted life year (QALY) to recipients at an average cost of $7,686.[3] QALYs gained is an important measure of the effectiveness of health interventions. For comparison, Medicaid is considered cost effective at $66,000/QALY gained, which implies that expanding cash transfers through the EITC is more than eight times more cost effective *as a health intervention* than direct spending on low-income healthcare. While it is unlikely that expanding cash transfers has constant returns to transfer size, findings like this are strong evidence that cash benefit levels in the United States are currently well below the point of diminishing returns.

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[2] Baird, Sarah, Francisco H. G. Ferreira, Berk Özler, and Michael Woolcock. 2014. “Conditional, Unconditional and Everything in between: A Systematic Review of the Effects of Cash Transfer Programmes on Schooling Outcomes.” Journal of Development Effectiveness 6 (1): 1–43.
[3] Muennig, Peter A., Babak Mohit, Jinjing Wu, Haomiao Jia, and Zohn Rosen. 2016. “Cost Effectiveness of the Earned Income Tax Credit as a Health Policy Investment.” American Journal of Preventive Medicine, August. doi:10.1016/j.amepre.2016.07.001.

Researchers have exploited variability to tax credit generosity to estimate the net present value of expanding tax the EITC and the Child Tax Credit (CTC) — the two main child-oriented cash transfer programs in the United States.[4] Their central finding indicates that expanding tax credits by $1,000 raises student by at least 6% of a standard deviation, leading to higher earnings later in life that surpass the credit's budgetary cost. Under standard social cost benefit analysis, a finding like this is a strong indication that expanding tax credits is Pareto efficient.

What makes cash so effective? In essence, the fungibility of cash allows it to meet the complex and heterogeneous needs of low income households. While often held in stark contrast to in-kind benefit approaches, most often justified on the basis of paternalism, cash is simply a medium for converting between various forms of in-kind benefits (goods and services) with decision making decentralized to the recipient.[5] Indeed, the option-value of cash appears quite large. For instance, recipients of grocery benefits provided under the Supplemental Nutrition Assistance Program (SNAP) are estimated to value their total benefits at 80 percent of their face value on average.[6] This suggests the value of in-kind benefits is easily overstated by accounting cost.

Reforms to Existing Programs

Both the EITC and play an important role in reducing child poverty, however they currently suffer from two core limitations. First, both credits are only partially refundable, and therefore fail to reach the lowest income households. And second, both are delivered through the tax code as annual, lump-sum refunds, and therefore do not correspond to household consumption patterns. Increasing the refundability of both the EITC and CTC would help to reduce child poverty. However, the EITC has a distinct policy goal of promoting labor force participation which a move towards full refundability would undermine. In other words, conditionality is a key feature of the EITC. The CTC does not have that ulterior policy goal and is thus is a strong candidate for full refundability.

Some have argued against periodic payments by noting how the lump-sum nature of tax credits may be useful as a forced savings mechanism.[7] Yet expenditure surveys show as many as 84 percent of EITC recipients use some portion of their refund to pay down debts.[8] Further research reveals that credit card usage by EITC recipients increases in anticipation of the refund, indicating that debt-paying behavior is largely a byproduct of credit-based consumption smoothing. Periodic payments would allow households to smooth consumption without incurring

[4] While the EITC is often characterized simply as an in-work benefit, the maximum credit increases substantially with every child claimed by the tax filer, suggesting it is better thought of as a credit for low income working families. Indeed, the EITC and CTC have nearly identical trapezoidal phase-in structures. The key differences are the CTC's $3,000 minimum income threshold and higher phase-out thresholds, which tend to target the benefit to families farther up the income distribution.
[5] Cunha, Jesse M. 2014. "Testing Paternalism: Cash versus In-Kind Transfers." American Economic Journal. Applied Economics 6 (2): 195–230.
[6] Whitmore, D. 2002. "What are food stamps worth?" Princeton University, Industrial Relations Section. Mimeograph, January
[7] Holt, S. 2009. "Beyond Lump Sum: Periodic Payment of the Earned Income Tax Credit." Washington, DC: The Brookings Institution.
[8] Mendenhall, Ruby, Kathryn Edin, Susan Crowley, Jennifer Sykes, Laura Tach, Katrin Kriz, and Jeffrey R. Kling. 2012. "The Role of Earned Income Tax Credit in the Budgets of Low-Income Households." The Social Service Review 86 (3): 367–400.

interest costs, thus relaxing credit constraints more efficiently.[9]

Reforming the CTC to be fully refundable and paid-out over shorter periods (months or weeks) would effectively convert the CTC into a child allowance (CA). CAs are a periodic, unconditional cash transfer delivered to the parents or guardians of children, and may vary by age and income level. For instance, the Canada Child Benefit (CCB) provides an annual benefit of $6,400 CAD and $5,400 CAD to parents for every child under the age of 5, and 18 respectively, delivered in monthly payments, and phasing out for incomes in excess of $30,000. The CCB was introduced by the Government of Canada in 2016 as part of an explicit plan to cut child poverty rates in half, and is the most generous CA program of its kind.[10]

The CCB is administered by the Canada Revenue Agency (CRA), which has a long history of administering periodic, means-tested payments.[11] The Internal Revenue Service (IRS), in contrast, already struggles with proper payment to and verification of existing tax credit recipients. In lieu of IRS modernization, a national CA would therefore be ideally administered via the Social Security Administration, the federal agency with the most experience administering periodic cash transfers.

Proponents of "work-first" anti-poverty policy have pushed back against the proposal for American CA program.[12] Work is undoubtedly essential to any anti-poverty initiative. Nonetheless, the evidence that unconditional cash transfer programs reduce employment or labor force participation is weak, and implausible given standard estimates of the income effect on labor supply.[13] Evidence from Canada's Universal Child Care Benefit (UCCB), a predecessor to the CCB, suggests that the dis-employment effects of a CA are modest, and differential based on marital status and education.[14]

Conclusion

The proximate cause for child poverty in the United States is a dearth of cash transfers to low income households with children relative to other OECD nations. Expanding unconditional cash transfers to children through a child allowance or comparable Child Tax Credit expansion would therefore be the single most effective means of reducing child poverty in half within a short time frame.

[9] Jones, Lauren E., and Katherine Michelmore. 2016. "Timing Is Money: Does Lump-Sum Payment of Tax Credits Induce High-Cost Borrowing?" SSRN Electronic Journal. doi:10.2139/ssrn.2712849.

[10] Hammond, Samuel and Robert Orr. 2016. "Toward a Universal Child Benefit," Niskanen Center.

[11] For example, the CRA has been administering the GST-HST Credit for over two decades. A quarterly, means-tested cash transfer, the credit is designed to rebate the imputed sales tax paid by low income individuals.

[12] Hammond, Samuel. 2017. "Bad Arguments Against a Child Allowance." Retrieved from the Niskanen Center website: https://niskanencenter.org/blog/bad-arguments-child-allowance/

[13] Kumar, Anil, and Che-Yuan Liang, 2016. "Declining Female Labor Supply Elasticities in the United States and Implications for Tax Policy: Evidence from Panel Data." National Tax Journal 69 (3), 481–516.

[14] Koebel, Kourtney, and Tammy Schirle. 2016. "The Differential Impact of Universal Child Benefits on the Labour Supply of Married and Single Mothers." Canadian Public Policy. Analyse de Politiques 42 (1): 49–64.