Expanding Child Care Choices

Reforming the Child and Dependent Care Tax Credit to Improve Family Affordability

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jec.senate.gov | G-01 Dirksen Senate Office Building Washington, DC 20510 | (202) 224-5171

Strong families are the backbone of a healthy society, which is why the Social Capital Project (SCP) has a stated goal of "making it more affordable to raise a family."[1] Many parents or would-be parents cite child care as a key component of family affordability: a 2018 poll found the most commonly given rationale among respondents who said they had or expected to have fewer children than they considered ideal was their belief that "child care is too expensive."[2]

The issue of child care intersects with other SCP goals of connecting people to work and increasing the effectiveness of investments in youth. For married parents, child care may be seen as necessary, optional, or irrelevant, depending on the parents' occupations and other objectives. For single parents, child care is virtually a necessity if they are to participate in the labor force. For children, high-quality child care has the potential to boost outcomes, but facilities that are not top-tier may not elicit the same results – and could even harm development.[3]

Preferences for work and family life vary widely across American families. Some parents rely on formal care, which for the purposes of this paper is a regular child care arrangement, most often in a center, which can be operated by a for-profit or not-for-profit entity subject to certain state regulations. Others rely on informal care, often provided by friends, family members, or neighbors, which may or may not be a commercial transaction, but is not run as a business. Still others rely on a stay-at-home parent. However families care for their children, government policy should be neutral toward the choices families make about balancing the competing demands of work and home life.

But our current tax code strays from that neutrality, and the Child and Dependent Care Tax Credit (CDCTC) is biased towards the needs of dual-earner families that use formal care. The credit could be reformed to ensure that families with a stay-at-home parent, families that do not utilize formal child care arrangements like center-based day care, and families that prefer to allocate income toward other aspects of care (including diapers, formula, educational resources, etc.) are not disadvantaged.

Policymakers could repurpose the CDCTC as a young child supplement for the Child Tax Credit (CTC) and offer up to $1,500 to parents of children ages 0-5 to spend on the expenses associated with the care and raising of young children. This would provide families with more of the flexibility they need, keep more of parents' hard-earned money in their pockets, and improve affordability for many families that are ignored by existing policy.

This paper will briefly examine the evidence on child care affordability and the evolving need for child care, and conclude with a discussion of how a young child supplement could more flexibly and fairly address the affordability needs of parents with young children.

UNPACKING THE RISE IN OBSERVED CHILD CARE COSTS

Improving the tax code's treatment of child care expenses first requires understanding some of the cost pressures on parents. It is common to hear concerns about an "affordability crisis" in child care, with some observers even concluding that "the whole system is broken."[4] One influential report estimated that "in 33 states and the District of Columbia, infant care costs exceed the average cost of in-state college tuition at public 4-year institutions."[5] But the story is more complicated than the reported figures suggest.

To start, roughly half of all working mothers with young children do not pay for child care, whether due to a flexible work schedule, care provided by a family member or friend, school-based programming, or other arrangements.[6] Beyond that, the data on prices for child care are far from perfect. A national survey of state-based child care resource and referral agencies relies on self-reporting of prices by the hour, week, month, or year, converted to the cost of full-time care.[7] Thus the sticker price, while eye-popping, does not always reflect the actual costs incurred by families.

The fraction of households spending a high fraction of their household income on child care has also been cited as heralding "relentless" child care costs.[8] But that figure also requires some explanation. In late 2016, the Administration for Children and Families (ACF) defined "affordable" co-payments in child care as costing families no more than seven percent of a family's income, down from the previous benchmark of ten percent.[9]

ACF based the affordability threshold on the monthly average share of income spent on care by families with children under age 15, which has hovered around seven percent since the mid-1980s. But young children will always be more expensive to care for than older ones, with the average share of income spent on care for children below age five standing at 10.5 percent.[10] Taken at face value, this would suggest the average family with young children is already spending "unaffordable" amounts of income on child care based on the fact that the constructed seven percent threshold includes older, and cheaper to care for, children. And, like many affordability thresholds, the ACF benchmark is somewhat arbitrary. For instance, it does not consider that for higher income families with more discretionary income, spending more than seven percent of household income on child care may be a reasonable and affordable choice.

When child care cost averages are reported, they can be skewed by outliers in this high-income group and thus paint a misleading picture. For example, the Census Bureau reports that families' average weekly child care expenditures rose by 71 percent between 1985 and 2011 (from roughly $205 to $350 per week, in constant 2019 dollars).[11] A 2015 paper by Chris Herbst re-evaluated the Survey of Income and Program Participation (SIPP) with an eye towards understanding how child care cost pressures impact different families in different ways.

Using the median, or statistical midpoint, rather than the simple average, Herbst found that the weekly child care expenditure rose by only 16 percent from 1990 to 2011, with the bulk of the increase coming from parents who were married, college-educated, and in upper income brackets.[12]

Still, it is possible that parents are paying more for more hours of care, and this is behind rising expenditures. To test this, Herbst estimates the median expenditure per hour and finds an increase of 14 percent, similarly concentrated in the same subgroups. This evidence suggests wealthy families that spend a lot of money on high-quality care may skew the reported average cost of child care.

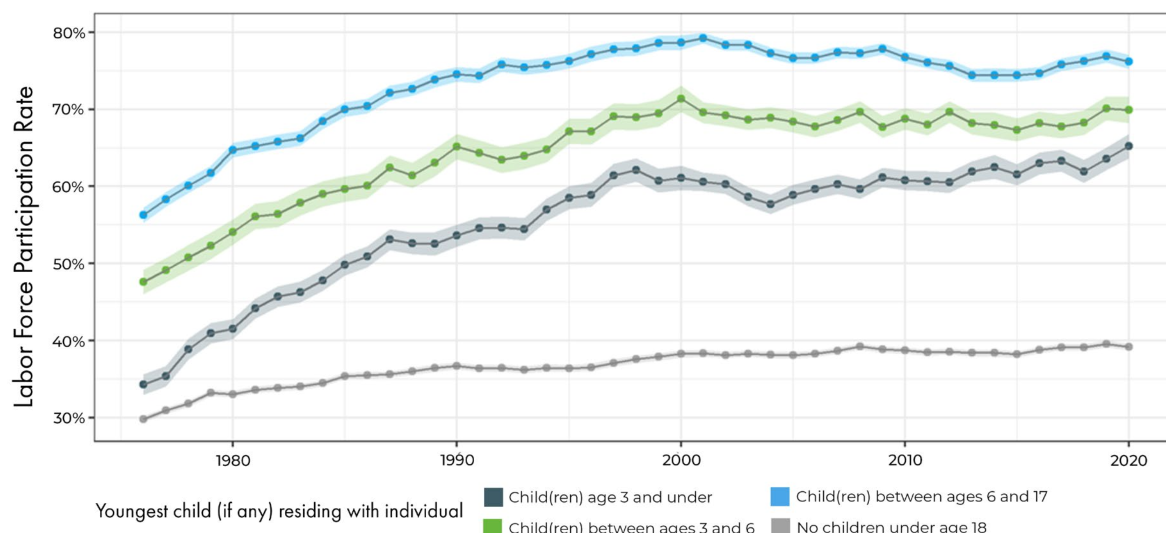
This is not to downplay the very real cost pressures facing families. But understanding the technical construction of the headline figures reminds us some figures can obscure just as much as they illuminate. Child care is a labor-intensive good, and it occupies a greater share of household income in urban areas, particularly among the college-educated and the very poor. But these families should arguably not be favored or advantaged by public policy simply because of their location or child care choices. And large-scale approaches to solving the child care "affordability crisis," such as universal child care proposals, operate from a set of assumptions about the demand for child care, and its cost, that ignore the varying attitudes and needs of parents.

DIVERSE CHILD CARE PREFERENCES ARE ILL-SERVED BY CDCTC

While the market for child care operates differently in different parts of the country, the need for child care has become increasingly prevalent as female labor force participation increased in the post-World War II era. As women's educational attainment increased and career options expanded, American families became more likely to have both parents in the workplace. As late as the early 1970s, about one-third of families operated on a male-breadwinner model, but by 1994 the share of families with that structure had fallen to 16.2 percent.[13]

The expansion of female labor force participation included mothers with children of all ages, though those with children under six worked less than those with school-aged children.[14] In 1975, 39 percent of women with children under 6 were in the labor force; by 1998, their participation rate had reached 65 percent, where it has remained mostly unchanged since.[15] Mothers with children of all ages have seen their participation rate largely stabilize over the past two decades, though the recent impact of the coronavirus has negatively affected women's employment.[16]

Figure 1: Labor Force Participation Among Women, 1976-2020
By presence and age of youngest child

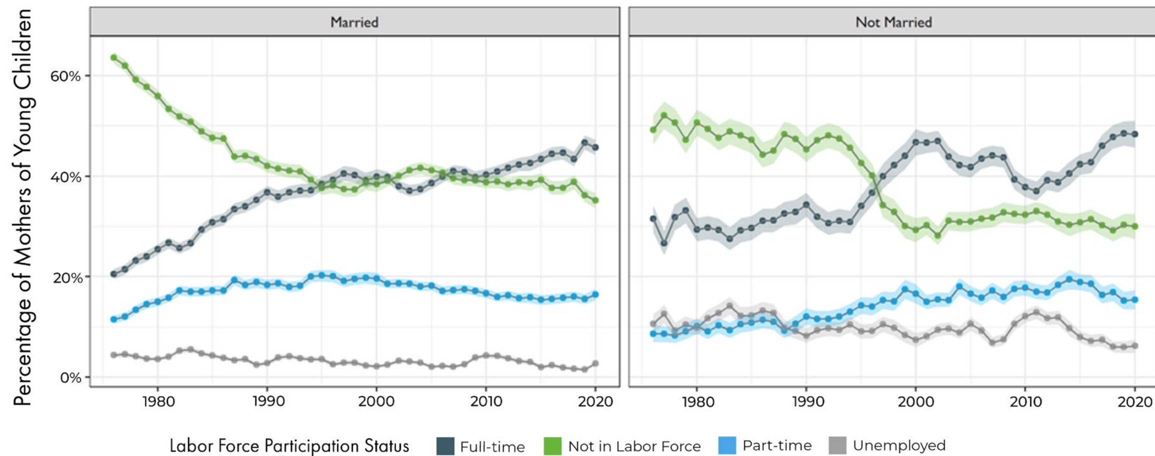


Shaded areas represent 95% confidence interval.
Data: Annual Social and Economic Supplement of the Current Population Survey, via IPUMS-CPS, University of Minnesota.

In addition to varying over time, child care needs can vary by family structure. Single mothers, who make up about a quarter of households with children, need formal or informal child care in order to earn income.[17] Poor families, which are disproportionately headed by single mothers, spend roughly four times the share of their income on child care compared to higher-income families.[18] Meanwhile, married-couple families sometimes have the option of a spouse providing care at home – in 2017, almost 30 percent of married mothers of children under 18 with a working husband did not work.[19]

Some parents choose to spend those early years in part-time or flexible working arrangements, some rely exclusively on center- or home-based child care, and some stay out of the labor force altogether.[20] In polls, a plurality of mothers express a desire for flexibility rather than full-time careers relying on full-time child care: A 2015 Gallup poll found that 56 percent of women with a child at home said they would prefer to stay home and care for their family, including 54 percent of mothers currently working.[21] A 2013 Pew study reported that "only 23 percent of married mothers today say their ideal situation would be to work full time."[22] And while the percentage of married mothers with children at home who work full-time has risen since the 1970s, a majority of that demographic still either work part-time or not at all.

Figure 2: Labor Force Status Among Mothers of Young Children, by Marital Status
Among women with children under 5, 1976-2020



Shaded areas represent 95% confidence interval.
Data: Annual Social and Economic Supplement of the Current Population Survey, via IPUMS-CPS, University of Minnesota.

Taken together, this evidence emphasizes the need for considering a wide degree of heterogeneity in families' needs and preferences in any child care policy, while also acknowledging that these needs may continue to change, and policies should be flexible as a result.

REFORMING THE CDCTC

Although the needs of families vary, the current treatment of child care in the tax code tends to assume a one-size-fits-all approach and leaves much to be desired. The CDCTC, the primary child care-related benefit in the tax code, "provides a credit worth between 20 percent and 35 percent of child care costs up to $3,000 for a child under 13, or up to $6,000 per household. Higher credit [reimbursement] rates apply to families with lower adjusted gross income."[23] To claim the credit, all parents in the household must be working (head of household for a single parent or both filers for married couples).[24]

One issue with the CDCTC is that a significant portion of the benefit may be passed through to child care providers rather than parents. Economic theory suggests, and empirical work with other tax credits supports, that much of the generosity of the credit could be passed from the consumer to firms through higher prices, depending on the relative elasticities of supply and demand in the child care market. Theoretically, the subsidy will benefit the more inelastic market actor, or the market actor less able to change their behavior.

While parents may seem to be more inelastic, and thus would stand to benefit, they also have the option of pursuing informal care, changing their work schedules, or not working at all. Firms, on the other hand, are often highly regulated, facing licensing requirements, staff ratios, and other regulatory constraints that make their supply less elastic, as evidenced by the waiting lists that characterize many child care facilities, particularly in urban areas.[25] A recent paper finds that "child care tax credits are passed through to the child care provider in the form of higher prices and wages," at about sixty cents on the dollar, with larger pass-throughs observed in urban areas and among higher-income populations.[26]

Another issue with the CDCTC is that the current structure results in a benefit that is highly skewed towards higher earners. Currently only 4.2 percent of all filers (or 12.7 percent of families with children) receive a benefit from the credit, according to the Tax Policy Center.[27] While households making $100,000 or more comprised 18 percent of tax filers in 2017, they made up 42 percent of returns claiming the CDCTC, and received 43 percent of the total dollar amount.[28]
In addition to requiring that all parents be working, the CDCTC requires the taxpayer provide a social security or employer identification number for the caretaker, which increases the administrative burden on parents who wish to claim the credit for spending on less formal care arrangements.

To address many of these issues, Congress could consider eliminating the CDCTC and repurposing the funds for an up-to $1,500 young child supplement as part of the Child Tax Credit to parents of children age 0-5. The credit could be made refundable against income and payroll taxes, along similar lines as was proposed by JEC Chairman Sen. Mike Lee during negotiations over the Tax Cuts and Jobs Act in 2017.[29] The current maximum amount per child, $1,050, was set by statute in 2001 and has not been adjusted for inflation since then. A credit of $1,500 would approximately update the figure for inflation and ensure that no parents, regardless of child care status, are left worse off.

In proposing a similar age-targeted credit, the Urban Institute notes the design would "target additional public resources where they seem to make the most difference: early childhood... [and] provide families with the flexibility to nurture their children as they think best."[30] Reforming the credit in this way also ameliorates some of the potential problem of pass-through identified above. If parents are able to spend their CTC young child supplement on a wide variety of expenses related to the care of young children, economic theory suggests, child care facilities will not capture as much of the value of the credit through higher prices.

A simple estimate suggests that a supplemental CTC for children age 0-5 would result in an additional net tax expenditure of $24.1 billion. This accounts for the existing $4.7 billion in tax expenditures on child care that currently exist.[31] This static analysis assumes that families do not change their work behavior to respond to how the expanded credit may phase in or out.[32] A more sophisticated model from the Urban Institute, using a more generous phase-in rate, estimates a FY20 tax expenditure of $27.3 billion.[33] The estimated cost of a supplemental

CTC could be offset by reducing other budget items and capping other tax expenditures. Congress will have to weigh the benefits of the reform, including its potential to stabilize working- and middle-class families and equalize treatment across work-life situations, against its budgetary costs.

Far more working- and middle-class families would see a tangible benefit under this proposal than under the current CDCTC. Using Herbst's estimate for the median weekly expenditure of $118 (in 2019 dollars), a back-of-the-envelope calculation estimates that 50 weeks of child care costs the median family with a young child and an employed mother $5,950. Holding all else equal, families who receive the full $1,500 and choose to spend it all on child care would see their out-of-pocket spending drop by one-fourth.

In addition to mitigating some of the other CDCTC-specific issues, reforming the CDCTC this way would remove the implicit penalty against single-breadwinner households or those who seek flexible and informal child care arrangements. This would be a substantial improvement over proposals that would simply increase the amount of the CDCTC, which requires all parents to be working and requires the child care provider to list a taxpayer or employer identification number, limiting parents' flexibility.

One drawback from transforming the CDCTC into a young child supplement would be that dependents of other ages would no longer benefit. Currently, the CDCTC can be used to reimburse spending on dependent children under 13 years of age or a spouse or dependent incapable of caring for himself or herself. However, less than four percent of CDCTC benefits are used on care for those over 13,[34] and only 22.8 percent of families with children age 6 to 14 pay for any type of child care.[35] Employer FSAs could still be permitted to cover those expenses, and universal savings accounts – proposed elsewhere by the Social Capital Project – could also be helpful.[36]

CONCLUSION

The issue of child care touches a bundle of related issues that reflect how we value family life and work. All parents face different trade-offs in making decisions that intersect with this Project's goals of making it more affordable to raise a family, connecting people to work, and investing in youth. As such, it seems important for Congress to keep in mind the principle of equal treatment – both across the income spectrum and between families who make different work-life decisions – in child care policy. Making it easier for families to raise children in the manner they deem best, especially in the important years of early childhood, strongly recommends a federal approach that disentangles tax benefit provision from a given family's choice of how to prioritize home and work.

There is no one-size-fits-all answer to questions about increasing labor force attachment, investing in children, and making it more affordable to raise a family. As such, there should be no one-size-fits-all preference in direct spending or the tax code. Government cannot guarantee peace of mind or the satisfaction of every parent's preferences about work-life balance. Nor can it invest in large-scale programs, like universal child care, without putting an unavoidable finger on the scale towards certain scripts about family and work.

Instead, public policy should empower families to achieve their desired preferences about work and family without favoring any one choice over another. In this respect, reforming the CDCTC could make existing policy more even-handed, make child care more affordable for more families, and better support parents of young children in pursuing the work-life situation they desire.

Patrick T. Brown

ENDNOTES

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families make too little or too much to receive any CTC, respectively, are aged 0-5. Scaling their average CTC payment for each segment of the population by the proposed young child supplement produces a naïve estimate of about $28.8 billion. Jacob Goldin & Katherine Michelmore, "Who Benefits From the Child Tax Credit?" NBER Working Paper No. 27940 (Oct. 2020), https://www.nber.org/papers/w27940. Making the young child supplement fully universal for children age 0-5, regardless of earnings or refundability, would cost $36.2 billion ($1,500 for each of the 24.2 million children under 6 in the U.S.)

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