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THE NEW SENATE REPUBLICAN OFFER ON THE CHILD TAX CREDIT

Is it Preferable to No Action?

by Robert Greenstein

In a letter sent July 22 to House Majority Leader Tom DeLay and House Ways and Means Committee Chairman Bill Thomas, Senate Republican leaders offered a "compromise" on child tax credit legislation. The compromise appears, however, to be an offer largely to accept the child tax credit provisions of the House bill.

The offer essentially takes the House-passed bill and "sunsets" the two most costly provisions of that bill at the end of 2007 instead of at the end of 2010, ostensibly reducing the House bill's cost from $82 billion to $50 billion. Of particular note, the Senate offer includes no specific offsets. The Senate letter, sent by Senators Charles Grassley, Don Nickles, and Trent Lott (the three Senate Republican conferees on the bill), states "We also believe that we should discuss the issue of including offsets in a final agreement." House Republican leaders have consistently opposed inclusion of offsets in the legislation.

- If such a proposal is accepted by House conferees and offsets are not included, the resulting legislation would further enlarge skyrocketing budget deficits. Because of the pressure that such deficits eventually are likely to place on programs for low-income families and children, *these low-income families would likely lose more over time than they would gain under such legislation*.

- The principal "winners" under the Senate offer would be higher-income families, not low-income working families. Effective immediately, the income level up to which a family would receive a full child tax credit of $1,000 per child would be raised from $110,000 to $150,000 for married filers, and the level up to which a partial child tax credit would be provided would be raised close to, or above, $200,000 for many married families. (See table on page 4.)

The Senate Republican offer maintains the provision included in both the House and Senate bills to accelerate to 2003 the increase in the child tax credit for low-income working families that, under current law, is scheduled to take effect in 2005. This would mirror provisions in the tax-cut legislation enacted in May that accelerated to 2003 other scheduled increases in the child tax credit as well as reductions in tax rates, but failed to accelerate the child tax credit provision benefiting low-income families. The benefits of accelerating this provision for low-income families would be fairly modest.

- The 6.5 million low-income families[1] that would be affected would receive increases in their child tax credits averaging approximately $150 per child in both 2003 and 2004.

- This provision would affect these families' child tax credits only in 2003 and 2004 since, as noted, the increase in the credit for these families takes effect in 2005, anyway, under current law.

- In contrast, the Senate offer would provide a new tax cut of $1,000 per child for married filers with $150,000 in income. (See table on page 3.)

Senate Offer Effectively Discards $350 Billion Limit

The provision benefiting high-income families would sunset at the end of 2007, as would another provision of the House bill that is not part of the Senate-passed legislation but that the Senate offer would retain: the extension beyond 2004 of the general increase in the child credit to $1,000 per child. The tax-cut legislation enacted this May sunset the increase to $1,000 per child at the end of 2004, in order to hold the price tag of that legislation to $350 billion. This means

Child Tax Credit Provisions of House and Senate Bills and New Senate Offer

Senate Bill	House Bill	Senate Offer
1. Accelerate low-income provision from 2005 to 2003; cost of $3.5 billion.	Same as Senate (except payment not made until next spring); cost of $3.5 billion	Same provision as Senate; cost of $3.5 billion.
2. Expand child tax credit to higher-income families, by raising the income level at which the credit begins phasing down for married filers to $150,000; start to phase in expansion in 2008, provide full expansion in 2010 only. Sunset after 2010. Cost of $4.8 billion.	Same as Senate, except it would be fully effective starting in 2003. Sunset at end of 2010; cost of $20.4 billion.	Same as House, except sunset at end of 2007; cost of approximately $11 billion.
3. No provision.	Eliminate 12/31/04 sunset on increase of child tax credit to $1,000 per child. Affects tax years 2005-2009. (Credit rises to $1,000 in 2010, under current law.) Cost of $57.3 billion.	Same as House, but sunset at end of 2007, so child tax credit would drop to $700 in 2008 and $800 in 2009 before returning to $1,000 per child in 2010; cost of approximately $33.5 billion.
4. All costs offset.	No offsets.	No specific offsets; suggests offsets should be discussed.

[1] The estimate of 6.5 million low-income families comes from an analysis by Citizens for Tax Justice. Analysis by the Urban-Brookings Tax Policy Center finds a modestly larger number of low-income families — 7.1 million — would be affected.

Impact on Low-income and Higher-Income Families in 2003 (Married Family with Two Children)			
Income	**Current Child Credit**	**Credit Under Senate Offer**	**Increase**
$12,000	$150	$225	$75
15,000	450	675	250
20,000	950	1,425	475
135,000	750	2,000	1,250
150,000	0	2,000	2,000

that unless the Senate offer is accompanied by offsets, it would effectively discard the $350 billion limit.

Even with the sunset of the two aforementioned provisions at the end of 2007 (rather than the end of 2010, as under the House bill), the Senate offer would benefit higher-income families to a much greater degree than lower-income families. The Senate offer would provide nearly $11 billion in new tax cuts to families with incomes exceeding $110,000; it would provide $3.5 billion to low-income families. The Senate offer consequently would provide *three times as much* in increased child tax credits to higher-income families than to the low-income families that are supposed to be the reason for the legislation in the first place.

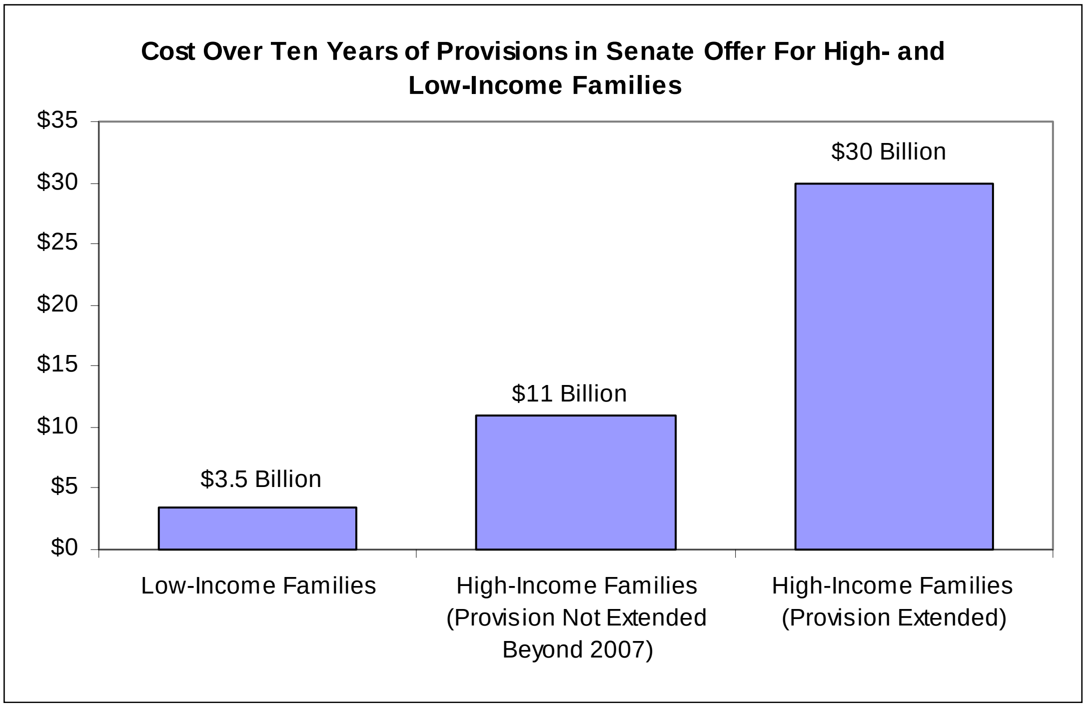
In addition, if the expansion of the child tax credit to higher-income families is subsequently extended beyond 2007, as almost certainly would be the case, the result of the legislation would be to confer *$30 billion* over ten years in new, presumably deficit-financed, tax cuts on higher-income families. The provision for low-income families would, as noted, have no effect after 2004.

Finally, the Senate offer would extend the child tax credit to many higher-income families not currently eligible for it because their incomes are *too high*, while failing to extend the child credit to any families left out of it because their earnings are *too low*. Working-poor families that earn $10,500 or less a year are ineligible for the child tax credit. A family with a full-time year-round minimum wage worker is, and would remain, ineligible for the credit — full-time minimum wage work pays $10,300 — while the credit was extended to many families in the $150,000 to $200,000 range.

The Long-term Consequences for Low-income Children

New budget estimates issued last week by the Office of Management and Budget project deficits of $455 billion in fiscal year 2003 and $475 billion in 2004. In addition, Peter Peterson (chairman of the New York Federal Reserve Bank and President of the Concord Coalition), the Center on Budget and Policy Priorities, and Goldman Sachs all project deficits of between $4.0 trillion and $4.5 trillion over the next ten years, assuming the tax cuts are extended. Moreover, the budget picture worsens further after that, as the baby boomers retire in large numbers and the costs of Social Security and Medicare rise.

OMB itself has projected, in a graph printed in the President's budget in February, that if the Administration's tax cut and other proposals are adopted but no other policy changes are



made, the budget will be in deficit every year for the next 50 years and deficits will eventually climb to levels dangerous for the economy. In a recent analysis for its clients, Goldman Sachs warns that the long-term budget outlook is "terrible, far worse than official projections suggest."[2]

The Senate-passed version of the child tax credit bill pays some acknowledgement to the grim fiscal realities the nation faces by limiting the bill's cost to $10 billion and offsetting all of that cost. The House ballooned the cost to $82 billion and offset none of it. It is difficult to see how conferees could reach agreement on $50 billion in offsets to cover the costs of the provisions in the Senate offer. This may be why the Senate offer is specific with regard to all of its tax-cut provisions but vague on offsets.

The revenue losses and increases in the deficit the Senate offer would engender (unless offsets are included) would come at a time when the nation's revenue base shows signs of hemorrhaging. The OMB budget data issued last week show that federal revenues will fall this year to their lowest level, measured as a share of the economy, since 1959, a time before Medicare, Medicaid, or most federal aid to education existed. In fiscal year 2004, the OMB estimates show, revenues will fall to their lowest level as a share of the economy since 1950. This revenue contraction will remain after the economy recovers. Federal revenues over the next ten years are now on track (assuming the tax cuts are extended) to be lower, as a share of the economy, than the average revenue levels of the 1960s, 1970s, 1980s, or 1990s.

What is at stake thus is more consequential than whether the low-income child tax credit provision that was dropped from the tax-cut legislation enacted in May is finally approved, and low-income working families receive modest tax benefits in 2003 and 2004 as a result. The most critical issue is whether expiring tax cuts are extended and new tax cuts are added *without* the

[2] Bill Dudley and Ed McKelvey, "Budget Blues: Play It Again, Uncle Sam," Goldman Sachs, March 14, 2003.

Child Tax Credit Phase-out for Married Couples

Number of children	Current law		Proposal	
	Credit begins to phase out at incomes of:*	Credit phases out completely at:	Credit begins to phase out at incomes of:*	Credit phases out completely at:
1	$110,000	$129,000	$150,000	$169,000
2	110,000	149,000	150,000	189,000
3	110,000	169,000	150,000	209,000

* Credit is reduced by $50 for each $1,000 of income above this threshold level.

costs of such actions being offset. Recent analysis by Brookings economists William Gale and Peter Orszag shows that if all provisions of the tax code set to expire in coming years are extended without these extensions being paid for, the cost of the extensions will reach $430 billion *a year*, or 2.4 percent of the Gross Domestic Product, by 2013. This is triple the average size of the Social Security shortfall that the Social Security Trustees project for the next 75 years. In short, if the tax-cut measures that are scheduled to expire are extended and further tax cuts are added on top without the costs being offset, the nation's already bleak long-term fiscal picture will become markedly worse.

Such a development could have profound consequences for children. If "sunsets" in the tax code are removed without the costs being offset and further tax cuts are added, the result will be to pass a greater mountain of debt to the nation's children and to create intense pressures for increasingly severe cuts in federal programs over time. With low-income children being one of the nation's weakest political constituencies, programs to assist them will likely suffer from the deep budget cuts that will become almost inevitable.

Conclusion: No Action Would be Preferable — and More Responsible — than the Senate Offer

If the choice comes down to one between adopting the Senate offer without its cost being offset and failing to accept such a measure — even if that means no action is taken on the child tax credit provision for low-income children — low-income children will be better served by no action. Of course, this is not the only course available to policymakers. They can still accept the bill the Senate passed in early June, which addresses the low-income child tax credit issue without adding to deficits.