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Chairman Beyer, Ranking Member Lee, and Members of the Committee:

My name is Wendy Edelberg and I am the director of The Hamilton Project and a senior fellow at the Brookings Institution. Before coming to Brookings, I was chief economist at the Congressional Budget Office. Thank you for this opportunity to discuss the effects of the tax provisions currently being considered in the reconciliation package.

Despite the headwinds created by the Delta COVID-19 variant, the economy is recovering. Economic growth during the pandemic has generally surpassed consensus expectations while households and businesses have maintained a surprising amount of activity and spending while social distancing. Much of that strength owes to the fiscal support enacted by Congress over the last 18 months. The current rapid economic recovery and expected slowing in the near term creates risks that policymakers should heed. Nonetheless, the policy proposals that Congress is currently considering would not notably add to those risks.

This is the moment to strengthen the social insurance system and to enact an ambitious federal investment package. Together, those policy changes would make the US economy more resilient and productive over the longer term. Additionally, they would broaden the degree to which prosperity in the United States is shared across workers and families.

Strengthening the social insurance system

The proposals that are currently included in the reconciliation package would strengthen the social insurance system, and empirical evidence shows that those changes would improve well-being and make our economy more resilient.

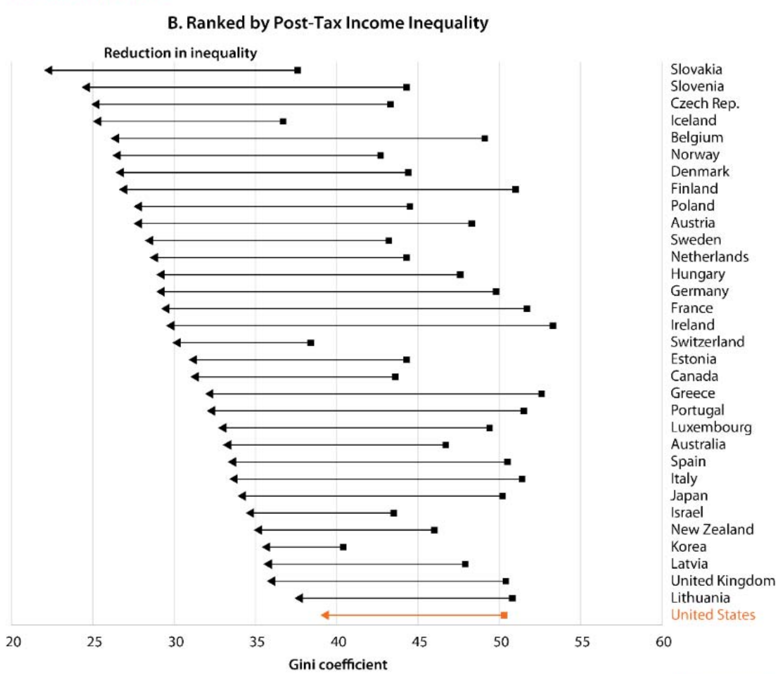
The social insurance system in the United States, implemented by federal, state, and local government agencies, provides protection against what President Franklin Delano Roosevelt called the vicissitudes of life: disability, the loss of earnings in old age, being laid off, and other setbacks. The social insurance system also provides support to help people meet their basic needs and gain the skills and services they need to enter and succeed in the workforce. It encompasses a wide range of government programs, from the Social Security system, to Unemployment Insurance, to early childhood education. Nearly everyone in the United States directly benefits from the social insurance system at some point in their lives. Moreover, everyone indirectly benefits from it—either from knowing the system would be there for them during some unexpected hardship or simply because it helps to support the overall economy.

How does the social insurance system reduce income inequality and poverty?

Although the social insurance system reduces income inequality, it could do more. The United States is among the advanced OECD countries with the greatest inequality before taxes and transfers; it also has the widest inequality after these policies are taken into account. This is a result both of pre-tax-and-transfer income inequality being high in the United States relative to the other advanced OECD countries and of the reduction in inequality from taxes and transfers being smaller in the United States than in most other OECD countries (figure 1).

Figure 1.

Gini Coefficients Before and After Tax and Transfers in Advanced OECD Countries



Source: OECD Income Distribution Database 2020.

Data from 2017 for all OECD countries, with the exception of: Australia and the Netherlands (2016); Japan (2015); New Zealand (2014); Belgium (2013); Colombia (N/A).

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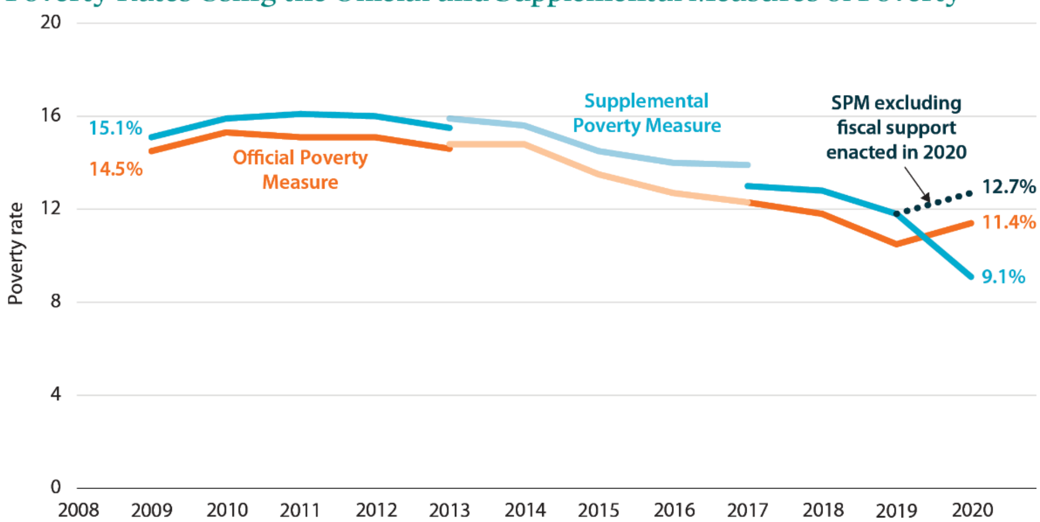
Using a measure of poverty that includes benefits from federal programs (the Supplemental Poverty Measure, or SPM) data show that in recent years social insurance programs had cut the SPM poverty rate in half after post-tax-and-transfer income is taken into account. As a result of the enormous fiscal support provided to households in 2020, the percentage of the US population in poverty, as measured by the SPM, fell from 12 percent to 9 percent; if Congress had not enacted relief for families, SPM poverty would have risen to 13 percent rather than falling to 9 percent. The two policies that had the most significant effects relative to earlier years, because they were the most changed from prior policy, were the expansion of unemployment compensation and checks to households.

Figure 2.

Poverty Rates Using the Official and Supplemental Measures of Poverty



Source: Census Bureau 2021a.

Note: The Supplemental Poverty Measurement (SPM) was revised in 2019 with the implementation of revised methodology, in 2017 with the implementation of an updated processing system, and in 2013 with redesigned income questions. Estimate for SPM excluding stimulus provided by Census Bureau removes the first two rounds of stimulus payments issued under CARES Act and CRRSA Act of 2020. For additional detail, refer to the Supplemental Poverty Measure: 2020 report appendix.

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With respect to children, in 2019 the child poverty rate before benefits and taxes was 20 percent. After benefits and taxes are taken into account, the child poverty rate was 13 percent. In 2020, owing to the robust fiscal support in the face of a massive economic shock, the SPM poverty rate for children fell to 10 percent. Nonetheless, for some groups of children, poverty rates after taxes and transfers remained very high. Data from 2015 highlights the disparities: the National Academy of Sciences found that in that year, child poverty rates for Black and Hispanic children were more than twice as high as non-Hispanic white children. The same report found that children of single parents endure double the poverty rate of a two-parent household (NAS, 2019).

In 2021, continued fiscal support—particularly the full refundability of and the increase in the child tax credit and increases to the Supplemental Nutrition Assistance Program (SNAP) maximum benefit—as well as the continued labor market recovery should help to lift households out of poverty. Another factor behind the decrease in poverty was the relatively strong wage growth for those at the bottom of the income distribution who remained employed. Notably, those wage gains came on the heels of strong wage growth in 2018 and 2019, when the tight labor market benefited lower-wage workers.

How would the proposed policies alleviate poverty, reduce inequality, improve well-being, and make the economy more resilient?

The successes in 2020 and 2021 of expanding and improving our social insurance system show some of the potential of making improvements in policy. Of course, the pandemic also exacerbated long-standing challenges and highlighted areas where better policies are needed. Making some policies permanent would make sustained progress in reducing post-tax-and-transfer poverty and provide more insurance protection to families.

In this section, I summarize evidence for the benefits of reforming and expanding the social insurance system in the following areas: the Child Tax Credit, child care, paid leave, the Earned Income Tax Credit, and health care. In an appendix, I offer additional detail on those areas of the social insurance system and evidence about the programs' efficacy. Although the changes discussed here are not the only improvements to the social insurance system included in the reconciliation package, I limit my discussion for tractability and because the changes I describe here are useful illustrative examples.

Child Tax Credit (CTC). Extending the changes that the American Rescue Plan (ARP) made to the CTC for 2021—most importantly, making permanent the full refundability of the tax credit—would lock in place the enormous good this policy is doing for child poverty rates. Those changes the ARP made to the CTC, along with the other measures in the ARP, are projected to reduce poverty among children in 2021 from 14 percent to 8 percent (CPSP 2021). Indeed, more than 400 economists signed onto a letter supporting this change, based on evidence that CTC reduces child poverty and improves academic and long-term outcomes for children without affecting parental labor supply (Hoynes and Schanzenbach 2021).

Child care. The current policy proposal would make permanent the recent expansion of the Child and Dependent Care Tax Credit (CCDTC) and grants and tax subsidies aimed at raising wages of child-care providers. Those changes would help families with earnings too low to owe federal income tax afford child care and would improve the quality of child care and early childhood education, the benefits of which are well-documented. Together, the changes would boost the labor supply of parents of young children.

Paid leave. Standing up a federal paid family and medical leave program would improve children's health, reduce worker turnover, and increase labor force participation with perhaps the largest effects for disadvantaged children and mothers.

Earned Income Tax Credit (EITC). The current proposal would make permanent the recent expansion of the EITC for adults without children. Doing so would reduce poverty and income inequality and increase labor force participation.

Health insurance. If Congress made permanent the expansions to health-insurance premium tax credits and cost-sharing subsidies included in the ARP, the uninsured rate would fall by 13.6 percent (4.2 million) and lower-income households would be more financially secure (Banthin et al. 2021). Further expansions in access to Medicaid would do more to extend access to health care, where we have ample evidence that access increases annual health-care use among child and adults and improves the quality of life.

The effect on the economy of the reconciliation package and the bipartisan infrastructure package

The ambitious policies included in the reconciliation package and the bipartisan infrastructure package would not create worrying inflation risk and their effect on the long-term fiscal trajectory would be modest. The revenue raising policies would have only muted negative effects on incentives to work and invest, while some other policies would increase those incentives.

Muted near-term economic effects on output and inflation

The policies Congress is currently considering would have only a modest effect on economic activity in the short term. We should not think of those policies as fiscal stimulus. Take for example expansion of tax credits and other tax policy changes being proposed by the House Ways and Means committee. The staff of the Joint Committee on Taxation estimates that those provisions, on net, would be nearly deficit neutral over the next two years. Other parts of the reconciliation package, such as the clean energy initiatives, would likely take over a year to fully implement.

Instead, the effective expansion of the social insurance system, some right-sizing in tax revenues, and investments in social and physical infrastructure would make the economy more productive and resilient over the longer term and lead to greater well-being and more equitably shared growth.

Moreover, the reconciliation package in combination with the bipartisan infrastructure package would not create notable inflation risk in the near term. The recent increase in inflation is largely attributable to the recent burst in consumer demand, which has outpaced supply, and also to various disruptions in global supply chains. Policymakers across many countries are rightfully paying attention.

There are two primary reasons why the rise in inflation is unlikely to persist. First, the significant shifts in demand and bottlenecks are a function of the recent, temporary pace of economic activity. For example, demand for automobiles recovered quickly during the pandemic to high levels even as production was curtailed, in part due to disruptions in the supply chain for critical semiconductors. The result has been a sharp increase in prices for new and used vehicles. Second, as production is increased (with normalization of global supply chains) and growth in demand abates, inflation should slow overall. Nonetheless, certain factors will continue to create inflationary pressure; even with the slowdown, economic activity over the next year or so will continue to exceed the sustainable level. We might also see price spikes in certain services as demand shifts. For example, from March 2021 through July sales at restaurants were up 14 percent while sales at building materials and garden stores were down 11 percent. Such changes could lead to price surges at restaurants that more than offset softer prices at stores selling building materials and garden supplies. In addition, the rapid rise we have seen in home prices will likely translate into significantly higher rental costs across the country.

Fiscal trajectory little changed

Policymakers have stated their goal is to include increases in tax revenues and decreases in spending that would fully offset the decreases in revenue and increases in spending. If something close to a full offset is achieved, the reconciliation package would do little to the projected debt trajectory.

To be sure, as has been true for a long time now, policymakers have long-term challenges with regards to the federal budget. However, that fiscal trajectory is not an urgent challenge that policymakers need to take on in this legislative effort. Over the next decade, under current law, debt as a share of GDP rises only modestly in CBO's baseline. And, notably, that baseline includes roughly a doubling of the 10-year rate over the next decade. So, an increase in interest rates is not, on the face of it, a risk to that debt trajectory; an increase in rates is already reflected in that trajectory.

Beyond the next decade, debt as a share of GDP is indeed projected to rise – with rising interest costs and rising spending on major health care programs coupled with relatively flat revenues as a share of GDP. However, this reconciliation package – even if the estimates end up showing it would modestly increase the cumulative deficit over the next decade – would not meaningfully worsen those challenges.

The long-term economic effects

An essential aspect of a federal budget is raising revenue, and it is virtually impossible to raise revenue without creating some negative incentives to work or to invest. But, good tax policy minimizes those negative effects. The tax provisions that raise revenue that are currently being considered in the reconciliation package would raise substantial revenue and have only modest negative effects on incentives.

Because the policies would undo some of the changes enacted as part of the 2017 tax act, it is instructive to consider how those prior changes were estimated to affect the economy. CBO, as well as a broad consensus of other groups, estimated that the 2017 tax act boosted the level of economic output in the longer term by less than 1 percent, with essentially no effect on the long-term growth rate. CBO estimated that positive incentive effects on spending on nonresidential fixed investment raised the level of GDP after several years by less than one-half percent (CBO 2018).

Economists are currently debating whether effects on investment following the enactment of the 2017 tax act were smaller than projected (Gale and Haldeman 2021; Gravelle and Marples 2019; Kopp et al. 2019). One reason for that debate – and why it won't ever be definitively settled – is that the projected effects were themselves small relative to the size of the US economy. As a result, it is difficult to disentangle what happened to investment from the tax act or from the many other effects and economic developments. In sum, the effect of the tax act on investment was small enough that it is getting lost in the noise.

Similarly, consider how the 2017 tax act cut effective marginal tax rates on labor income – averaged among all workers in the US – by a little over 2 percentage points at its peak. That was estimated to increase average hours supplied by the workforce by about a quarter of a percent. The reconciliation package currently includes a similarly sized increase in the effective marginal tax rates on labor income – but only for a small portion of the labor force comprised of the highest income people. If that increase in tax rates were enacted, the aggregate effect on labor supply would be small enough that we likely could not separately identify it.

Nonetheless, the increase in effective marginal tax rates for the highest income earners is not the only aspect of the reconciliation package that would dampen incentives to work. To some degree, people work as many hours as they do because they are financially desperate, or because they fear financial hardship owing to such events as losing a job or suffering from a health event. Although the vast majority of people who benefit from the social insurance system work for pay (for example, well over 90 percent of families receiving the Child Tax Credit [Goldin and Michelmore 2020]), a lessening of those factors could reduce hours worked per week. To put such effects in context, policymakers should focus on what a policy's primary goal is: providing insurance, improving well-being, increasing labor force participation and hours worked per week, or raising revenue.

While the revenue raisers in the reconciliation package would have muted negative effects on incentives to work and invest, other policies would increase the incentives to work and invest. For example, improving access to high-quality and affordable child care and ensuring that workers have access to paid family leave would lower the cost of working among parents of young children and thus increase their supply of labor. It would also, over the longer term, improve the earning potential of those children who benefit. As another example, expanding the EITC would increase labor force participation. In addition, with a larger and more productive workforce, firms would have greater incentives to invest in the US and expand the capital stock.

Conclusion

Although these remarks have focused on the fiscal effects and the aggregate economic effects of the policies under consideration, those should not be the only – and perhaps not even the primary – points of consideration. The tax provisions being proposed, and indeed many of the policies being proposed, would improve well-being and ensure that our prosperity is more widely shared. GDP estimates and net deficit effects attract attention because they are numbers with seemingly a lot of precision. And numbers have power. However, I urge policymakers to step back from those estimates and consider whether the policies they are debating would move us closer to the kind of society we want to live in.

Appendix. Further Discussion of Changes to the Social Insurance System

In this section, I offer additional detail on these areas of the social insurance system and evidence about the relevant programs' efficacy: the Child Tax Credit, child care, paid leave, the Earned Income Tax Credit, and health care.

Child Tax Credit (CTC)

The CTC is a per child tax credit, which prior to the ARP provided a credit of up to $2,000 per child to eligible tax filers with children under age 17. Most low-income children, however, and many modest-income children as well—about 27 million children in all—received either no credit or only a partial credit because families with earnings below $2,500 did not qualify, and the credit phased in very slowly as a family's earnings rose above that level.

For 2021, the ARP makes low- and modest-income children eligible for the full credit amount per child, removing the earnings requirement and slow phase-in. The ARP also raises the credit for 2021 to $3,600 per year per child under age 6 and $3,000 per child for those aged 6–17, thereby adding 17-year-olds to the eligible pool. It also changed the distribution of the tax credit to periodic rather than annual (unless a filer opts to receive the credit annually). Those changes, set to expire after 2021, along with the other measures in the ARP, are projected to reduce poverty among children in 2021 from 14 percent to 8 percent (CPSP 2021).

The CTC extends far up the income scale: with changes made by the 2017 tax act, married filers with incomes up to $400,000 can receive the full credit and married filers with two children and incomes between $400,000 and $480,000 can receive a partial credit. In fact, prior to changes made by the ARP (and after those changes, which are currently scheduled to be in effect for only one year, expire), the CTC was more valuable to higher-income families than to lower-income families. That was a consequence of families with no or very low earnings not qualifying, the size of the credit phasing in slowly for working-poor families as their earnings rise, and the imposition of a limit on the size of the credit for filers who did not earn enough to have federal income-tax liability.

Child care

The Child and Dependent Care Tax Credit (CCDTC) subsidizes a portion of child-care costs. Prior to 2021, that credit primarily helped middle-income families. The ARP enlarged the credit and made it fully refundable for 2021, so that families with earnings too low to owe federal income tax can receive the full benefit of the credit.

Improving access to the CCDTC helps to provide access to high-quality, affordable child care and early childhood education. Early childhood education, or ECE, is a term used to describe center-based care and other nonparental forms of supervised child care. ECE can refer to preschool or pre-kindergarten programs that support children's early social and academic development as well as day care. Programs that directly support access to child care for eligible families include Early Head Start, Head Start, the Child Care Development Fund (CCDF), and the Preschool Development Grant (PDG). As of 2019 there were 5.4 million children in a federal or state ECE program. Nonetheless, there is not sufficient capacity for all eligible families to be served by the public programs. As a result, many lower-income families do not have the resources to enroll their children in a preschool program (Workman and Jessen-Howard 2018; Malik 2019). Extending access to the CCDTC helps to shore up those resources.

However, improving the CCDTC is not enough. Our underinvestment in ECE is evident in the challenges faced by providers. As described in a Hamilton Project proposal by Elizabeth Davis and Aaron Sojourner:

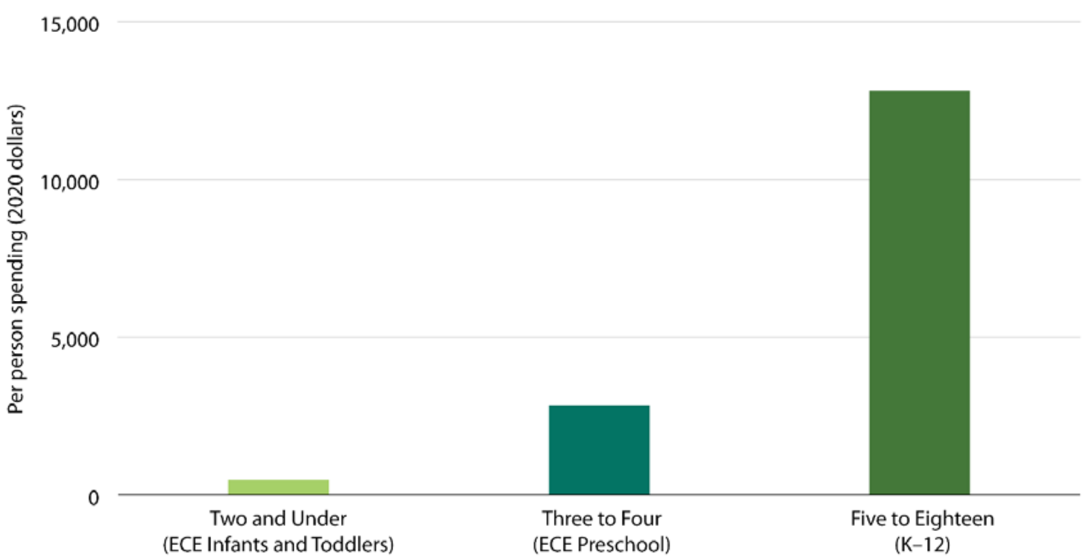
> For childcare providers public underinvestment means low wages, high turnover, and an inability to expand or improve services (Whitebook et al. 2014; Workman 2018). Those working in the child-care field earn among the lowest average wages of any occupation, and pay and benefits lag well below the earnings of workers with similar educational credentials (Vogtman 2017). Quality in ECE depends on the stability of nurturing relationships between adults and children, but high turnover of staff due to low pay disrupts those relationships (Caven et al. 2021). One study found that the average annual turnover rate of child-care staff was 30 percent, which imposes significant costs on child-care businesses and also impacts the quality of care by disrupting child-teacher relationships (Porter 2012).
>
> As a result of under-resourcing of ECE, the sector has been unable to pay workers anything close to their marginal social value. The system should provide resources so that ECE workers' earnings are at a level that recognizes the value

they create and permits ECE employers to attract, motivate, and retain talented caregivers.

Furthermore, our society underestimates the value of care work, connected to the fact that women, and especially Black and Latina women, disproportionately do this work. More than 93 percent of ECE workers are women. Non-Hispanic white Americans make up a 13 percent lower share of the child-care workforce than their share of the population, while Black Americans make up a 24 percent higher share. Furthermore, Black educators were more likely to work in low-wage child-care centers (Caven et al. 2021; Data USA 2020). Recognizing the full value this work creates in our community by directing more resources to the workforce would constitute concrete progress against racism and sexism in the labor market.

Sojourner and Davis also document the significant imbalance in public investment across ages. As those authors write and the figure shows, “In 2019 public spending amounted to less than $500 per child in care and education during the first three years of life, and about $2,800 per child for children ages three to four, compared to $12,800 per child for elementary-age children.”

Federal, State, and Local Government Spending on Child Care and Education in 2019, by Age Group



Source: Cascio and Schanzenbach (2013); Census (2020); Crandall-Hollick and Boyle (2021); Friedman-Krauss et al. (2020); Joughin (2019); NCES (2020); NSECE (2016); OCC (2019a; 2019b; 2021); Office of Head Start 2020; author's calculations.

Note: Expenditures include spending on the school-based prekindergarten programs, Child Care and Development Fund, (Early) Head Start, Child and Dependent Care Credit, and K-12 education. For additional details, see endnote four.

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The benefits of high-quality ECE programs are well-documented. Evidence on the short- and long-term effects of ECE typically relates to the outcomes of specific programs, whether the evidence comes from the landmark evaluations of Perry Preschool, Abecedarian, and Head Start, or from the rollout of state preschool programs (see Cascio 2021 for a review). A meta-analysis of research on ECE concludes that children who participate in ECE programs in their first five years have lower rates of repeating a grade and higher high school graduation rates (McCoy et al. 2017).

Paid leave

The United States does not have a national paid leave program. At the national level, we only have the Family and Medical Leave Act of 1993 (FMLA), which allows eligible employees to take up to 12 work weeks of unpaid leave during any 12-month period for caregiving or illness recovery purposes. Employers and employees must meet several criteria for employees to use the FMLA for leave. The firm must be relatively large (at least 50 employees within a 50-mile radius, though in eight jurisdictions the threshold is lower); the employee must have worked for the employer for at least 12 months; and the employee must have worked at least 1,250 hours in the past 12 months. Additionally, the FMLA applies only to immediate family members in all but 11 jurisdictions. Some states and localities have passed laws requiring employers to give eligible employees paid leave. As of early 2021, however, paid family leave—leave that can be used for post-birth/adoption care and caregiving for sick family members—is available in only six states. Two others have passed legislation and are in the process of implementing it.

We have evidence of the efficacy of paid leave from those states and from the effects of FMLA. FMLA reduces worker turnover (Appelbaum and Milkman 2011) and enhances children's health (Rossin 2011; Ruhm 2000). Economic benefits of FMLA for workers and employers include increased labor-force participation, increased lifetime earnings and retirement benefits, and increased use of leave (Boushey, O'Leary, and Mitukiewicz 2013). Research from states with paid leave programs find higher rates of maternal leave take-up and increased job return post-leave (Baum and Ruhun 2013; Byker 2016; Rossin-Slater, Ruhm, and Waldfogel 2011). The positive effects of leave are strongest among disadvantaged mothers (Byker 2016; Rossin-Slater 2013). However, some evidence shows negative wage effects from paid parental leave for women so the potential for paid leave policies to close the gender pay gap remain unclear (Bailey et al. 2019).

Earned Income Tax Credit (EITC)

The EITC is a refundable tax credit available to income-eligible households that work, which means that the IRS sends eligible claimants a refund check each year after they file their tax returns. The EITC phases in as a family's earnings rise up to a certain income level and then gradually phases down above a somewhat higher income level.

The ARP expanded the EITC in 2021 for workers not raising children at home; in 2020, its maximum benefit was $538; workers who are not married (most beneficiaries of the childless EITC are single) became ineligible at incomes of only $15,820. For tax year 2021, the ARP nearly triples the maximum benefit for the childless workers' EITC to about $1,500, raises to $21,427 the income at which the credit phases out entirely for single workers, and makes workers 65 and over and workers who are 19 to 24 years old eligible for the childless workers' EITC for the first time, excluding students under 24 who are in college at least half time.

While the point estimates vary, studies find that EITC raises labor force participation and annual income among lower income families (Eissa and Liebman 1996; Meyer and Rosenbaum 2001; Hoynes and Patel 2018; Bastian 2020; Schanzenbach and Strain 2020; see Hoynes and Rothstein 2016 for a review of the literature). Indeed, the EITC has a stronger effect in increasing labor force participation than it does in increasing the number of hours worked among those already employed (Saez 2010). Scholars have found that EITC improves many aspects of well-being, including economic (Baughman and Dickert-Conline 2009; Neumark, Asquith, and Bass 2019), health (Hoynes, Miller, and Simon 2015; Braga, Zblavin, and Gangopadhyaya 2020), and human capital (Chetty, Friedman, and Rockoff 2011; Bastian and Michelmore 2018).

Health insurance premium tax credits and cost-sharing subsidies

Despite the different programs aimed at increasing the availability of health coverage in the United States, millions of Americans are still uninsured. A report from the CBO suggests the high cost of health insurance premiums and deductibles and the complexities for enrolling for coverage create obstacles for some of the eligible to receive coverage. (CBO 2020b).

For those who are not eligible for public health insurance and who do not have access to affordable employer-based coverage, the Affordable Care Act established premium tax credits that people with incomes between 100 percent and 400 percent of the poverty line can use to subsidize the purchase of health insurance in the Affordable Care Act's marketplaces, along with a series or rules to ensure the marketplaces function effectively. A second set of subsidies, to reduce cost-sharing charges, is available to people enrolled in marketplace plans who have incomes between 100 and 250 percent of the poverty line. The tax credits generally are not paid directly to beneficiaries; rather, the US Department of the Treasury sends them directly to the insurance company in whose plan a beneficiary is enrolled.

The American Rescue Plan both increases the size of the subsidies and eliminates the 400 percent of poverty eligibility cut-off for 2021 and 2022. If this change were made permanent, the Urban Institute estimates that the uninsured rate would fall by 13.6 percent (4.2 million) and save enrolled households more than a thousand dollars (Banthin et al. 2021)

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