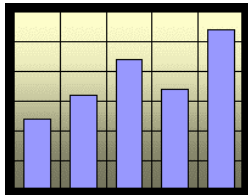


A Brief Summary of Economic Issues and Compliance Needs for Alabama's Child Support Guideline Review[©]

**Presented to
Alabama Child Support Review Panel
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Introduction

Alabama's presumptive child support guidelines (see *Alabama Rules of Judicial Administration, Rule 32*) were promulgated to conform to the Family Support Act of 1988 and to act as a legal presumption in child support determination. Accordingly, any economic review of the guidelines must be in light of federal requirements and constitutional principles regarding legal presumptions and child support determination. The following briefly: 1) summarizes federal requirements for child support guidelines and guideline reviews and summarizes constitutional principles of child support determination as expounded in *Legal Requirements for Review of Child Support Guidelines by the State of Alabama*, by John Remington Graham, 2) summarizes the economic assumptions of Alabama's child support guidelines, and 3) documents portions of the guidelines that are economically unsound and/or conflict with federal regulations and/or constitutional principles on legal presumptions on child support determination.

Part I.

Legal Requirements and Constraints in Establishing and Reviewing Presumptive Child Support Guidelines

Federal regulations are clear regarding a number of requirements for developing a State's presumptive child support guidelines. The key requirements include:

- Review and revise, if appropriate, the State's child support guidelines at least once every four years to ensure their application results in the determination of appropriate support award amounts.
- For the review of a State's guidelines, a State must consider economic data on the cost of raising children.
- For the review of a State's guidelines, a State must conduct a review of cases to determine if the guidelines are appropriate and if the guidelines are being applied appropriately.
- Guidelines must apply to all orders.
- Deviations or rebuttal award patterns must be incorporated into guideline formula.

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These federal requirements must be viewed as conforming to constitutional principles of child support determination. As discussed in the memorandum, *Legal Requirements for Review of Child Support Guidelines by the State of Alabama*, by John Remington Graham, legal requirements for presumptive child support award are dictated by constitutional principles on due process (regarding presumptions) and equal protection, among others. In addition to federal regulatory requirements stated above, constitutional principles mandate that child support guidelines:

- Must make a determination such that both father and mother have an equal duty to provide for the reasonable needs of their children on an ability-to-pay basis;
- Must be created as a legal presumption that must always be liberally rebuttable so that deviation from or setting aside the presumption is allowed whenever it is shown that the presumed facts of the guideline do not fairly approximate or conform to the proper legal objective;
- Must not be arbitrary;
- Must be founded upon use of not just any economic data but correct use of authentic economic data on the cost of raising children; and
- Must conform to principles of legal presumptions and not be treated as a mere policy choice.

These requirements based on federal regulatory requirements and on constitutional principles of child support determination establish the benchmarks for evaluating the economic features of Alabama's child support guidelines.

Part II.

Key Economic Features and Assumptions of Alabama's Child Support Guidelines

The economic background of Alabama's child support guidelines is a proper starting point for any economic critique of these guidelines.

The Income Shares child support guideline

There are two different Income Shares models—the original Income Shares based on the work of Thomas Espenshade and Ernst Engel (currently in use in about a dozen States, including Alabama) and the version based on the work of David Betson and Erwin Rothbarth, now advocated by Policy Studies, Inc. (PSI) and used in about two dozen States.¹ Each uses a different definition of child costs, but both are based on indirect income equivalence measures, rather than relying directly on parents' spending for their children.

¹ Jane Venohr and Robert G. Williams, David A. Price. *Economic Basis for Updated Child Support Schedule, Commonwealth of Kentucky*, Policy Studies, Incorporated, Denver, Colorado, September 1, 2000.

PSI's stated reason for using indirect estimation techniques relates to data issues involving the underlying database, the Consumer Expenditure Survey (CEX) of the U.S. Bureau of the Census. Notably, the CEX expenditure categories do not always separate household expenditures into spending on children's goods and on adult goods. For example, there are separate categories for spending on children's clothing and adult clothing. In contrast, data on spending for housing, food, and transportation are gathered only on a household basis. The issue then is one of how to allocate a portion of the food, housing, and transportation costs to the children.

In order to avoid these data problems, the developers of the Income Shares method turned to what economists call income equivalence measures. These measures were originally developed more than a century ago to answer a very specific type of question: how much income is needed for different family types (varying the number of adults and children) to have the same standard of living? For example, these studies would attempt to quantify how much income a two-parent-one-child family needed to have the same standard of living as a two-adult household. While these measures were never intended to estimate child costs, that is precisely the purpose for which they are now used.

The original version of Income Shares child support guidelines—the Espenshade-Engle methodology to estimate child costs—the methodology used in Alabama

The first economist to work on income equivalence measures was Ernst Engel.² His purpose was to measure consumption of different goods in families, and observe how outlays varied by the level of income and the number of household members. He found that the share of income allocated to food consumption declined as income rose. As income increased, spending was increasingly allocated to non-basic goods (luxury goods) and to savings. A family having children would boost its share of food consumption relative to a family without children. Engel then compared how much additional income would be needed to return the family to its earlier lower share of spending on food (boosting the non-food share).³

The Engel methodology was used by Thomas Espenshade to estimate child costs in a 1984 U.S. national study.⁴ He defined child costs as the difference in overall consumption between a family with and without children, but with the same share of the budget spent on food. Two families of different size were assumed to be equally well off when they spent the same share of their budgets on food. PSI used data from

² H. S. Houthakker. "An International Comparison of Household Expenditure Patterns, Commemorating the Centenary of Engel's Law," *Econometrica*, 25 (October 1957), pp. 532-551, p. 532.

³ Lewin/ICF, Washington D.C. "Estimates of Expenditures on Children and Child Support Guidelines," Submitted to Office of the Assistant Secretary for Planning and Evaluation, U.S. Department of Health and Human Services, October 1990, p. 2-13.

⁴ See Espenshade, Thomas J. *Investing in Children: New Estimates of Parental Expenditures*, The Urban Institute Press, Washington, D.C., 1984.

Espenshade's study to derive the original Income Shares guideline.⁵ States that adopted the Income Shares guideline in the late 1980s (and have not since adopted the newer Income Shares methodology) define child costs according to how food consumption changes between varying types of families according to family size.

PSI's original definition of child costs for Income Shares child support schedules:

Based on intact family data, the child cost is —when comparing two families (one with children and one without children)—the difference in expenditures between the two families when both consume equal proportions of their budget on food.

This is an "income equivalence" definition—not a measure of actual money spent on child cost items.

Reasons behind why the Income Shares model overstates child costs

There are several reasons why PSI's methodology leads to an overstatement of child costs: (1) the use of intact family data to estimate child costs, (2) the use of upwardly indirect estimating techniques with household food consumption as a target definition, (3) the failure to recognize that tax benefits associated with the children offset some of these costs, and (4) the failure to place child costs in the household where there actually occur—such as when the non-custodial parent exercises parenting time.

The first problem with the PSI methodology is that the Espenshade-Engle Income Shares guideline is based on studies of intact families. Yet when two households must be supported with the same income, there is clearly an increase in adult overhead such as mortgage and utilities. There is less income left for spending on all other things—including children. By using intact family data, the Income Shares guideline overestimates the ability of both parents to spend on the children and thereby the level of child costs to be shared.

The second problem with this PSI methodology for estimating child costs is that this statistical technique used is upwardly biased (tend to overestimate). It is widely recognized by economists that the Espenshade estimates of child costs using the Engel methodology are upwardly biased. See the following statement from a federally funded report on these issues.

The validity of the Engel estimator is critically dependent on the assumption that the percentage of the family's expenditures on non-food items that should be attributed to the family's children is the same as the

⁵ See Robert G. Williams, 'Child Support Guidelines: Economic Basis and Analysis of Alternative Approaches,' *Improving Child Support Practice, Volume One*, The American Bar Association, Section I., p. 8.

percentage of the family's food expenditures that is attributable to the family's children. There is reason to believe that this assumption is invalid; children are probably relatively "food-intensive." That is to say, the percentage of the family's food that is consumed by children is probably greater than the percentage of non-food items consumed by children. If this is the case, then the Engel estimator overestimates [emphasis original] the true expenditures on children. Unfortunately, Deaton and Muellbauer's analysis indicates that the degree of overestimation [of child costs] may be quite substantial. This leads Deaton and Muellbauer to conclude that, "We can construct no plausible defense for the belief that the food share correctly indicates welfare (well-being) between households of different size, and we do not believe that credence should be given to estimates based on that belief."⁶

A third problem with the Income Shares guideline is that it ignores the offset to child costs of child-related tax benefits. These tax benefits include being able to claim the children as deductions, child care tax credits, and the ability to file as head of household for a lower tax rate.

A fourth problem with the Income Shares guideline is that it fails to locate the child costs properly in the two parents' households. It treats all child costs as being in the custodial parent's household, even when the non-custodial parent spends considerable time caring for the children.

In summary, the Income Shares guideline makes the following economic assumptions:

- The household is intact. That is, parents can afford to spend as much on their children as before the divorce—there is no additional adult “overhead” from a second household.
- The custodial parent cares for the children 100 percent of the time and the non-custodial parent has no parenting time costs.
- Child costs are best estimated by indirect measures based on income equivalence scales, rather than direct reports of out-of-pocket spending.
- For Espenshade-Engel based Income Shares guidelines, the best method of estimating child costs is to compare household consumption percentages of food before and after having an additional child. It is assumed that children consume non-food household goods in the same proportion as food.
- Tax benefits attributable to the children are not cost offsets—they are not negative costs.

⁶ Lewin/ICF. *Estimates of Expenditures on Children and Child Support Guidelines*, submitted to Office of the Assistant Secretary for Planning and Evaluation, U.S. Department of Health and Human Services, October 1990, Section 2, pp. 28-29.

Constitutional and Congressional Limits on Child Support Guidelines

Alabama’s child support guidelines must conform to federal regulations and constitutional principles of child support determination (due process and equal protection) as discussed above. Accordingly, the guidelines:

- Must not be arbitrary,
- Must be based on valid empirical data,
- Must hold both parents to the same standard of equal duty of support,
- Must have underlying facts of the presumption that exist in application in typical cases,
- Must incorporate into the formula the deviation factors that are found to typically occur and hence over the years must include in the guideline formula all significant economic issues of support that occur with notable regularity.

Apparent Conflicts with Federal Regulations and Constitutional Principles of Child Support Determination

The following provisions of Rule 32 of Alabama Rules of Judicial Administration appear to conflict with federal law.

From Rule 32:

- Conflict issue: The assumption that the cost schedule already includes an adjustment for standard visitation is factually incorrect and arbitrary.

See Section (A)(1)(a):

“(1) Reasons for deviating from the guidelines. Reasons for deviating from the guidelines may include, but are not limited to, the following:
(a) Shared physical custody or visitation rights providing for periods of physical custody or care of children by the obligor parent substantially in excess of those customarily approved or ordered by the court;”

This section is factually incorrect in terms of the implication that the presumptive cost schedule already takes into account “typical” parenting time costs of the non-custodial parent.

The developer of Income Shares, Robert G. Williams, specifically states in the original manual issued by the federal government for developing child support guidelines that the Income Shares costs tables are based on intact family data and are allocated between the parents according to intact family costs. That is, all of the child costs in the cost tables are assumed to be in one household—there are no built-in parenting time adjustments.

The Income Shares model calculates child support as the share of each parent's income estimated to have been allocated to the child if the parents and child were living in an intact household. A basic child support obligation is computed based on the combined income of the parents (replicating total income in an intact household).⁷

Policy Studies, Inc. (PSI) continues to document that visitation costs of a non-custodial parent are not taken into account in Income Shares cost schedules. Examples are found in recent reports by PSI such as analysis for the State of Oregon.⁸

Visitation costs are not factored into the schedule. Since the Schedule is based on expenditures for children in intact households, there is no consideration given for visitation costs. Taking such costs into account would be further complicated by the variability in actual visitation patterns and the duplicative nature of many costs incurred for visitation (e.g. housing, home furnishings).

This section of Rule 32 is arbitrary.

- Conflict issue: The definition of income does not put self-employment income on the same basis as payroll income.

See Section (B)(3):

“(3) Self-employment income.”

This section does not make necessary adjustments to put parents that have self-employment income on the same ability to pay basis as parents on salary or hourly payroll earnings. Self-employment income must be adjusted to reflect that the self-employed pay not just the employee's portion of payroll taxes but also the employer's portion. This issue is not related to any particular type of guideline but is specifically related to how income is defined for child support purposes.

- Conflict issue: The assumption that the cost schedule already includes an adjustment for child-related tax benefits is factually incorrect and arbitrary.

See Section “Comment,” (1):

⁷ Robert G. Williams, *Development of Guidelines for Child Support Orders*, U.S. Department of Health and Human Services, Office of Child Support Enforcement, September 1987, p. II-68.

⁸ See *Economic Basis for Updated Child Support Schedule, State of Oregon, Salem, Oregon, December 31, 2001*, submitted to Oregon Department of Justice, Division of Child Support; submitted by Policy Studies Inc., Denver, Colorado, p. 40

“(1) Tax exemptions. The Schedule of Basic Child Support Obligations assumes that the custodial parent will take the federal and state income tax exemptions for the children in his or her custody;”

This section is factually incorrect and implies incorrectly that child-related tax benefits are automatically taken into account as cost offsets in the presumptive cost schedule. As is detailed in research and also in Income Shares methodology notes, the Income Shares methodology is based on intact family cost data and intact family net income. The conversion of child costs as a share of intact family income to gross income has no adjustment for child-related tax benefits as cost offsets.

Child costs are based on intact family data and include child-related tax benefits as part of net income of intact families. However, child costs in the presumptive cost tables are gross spending—not net of child-related tax benefits. Thus the net income portion of the matrix must then be converted to gross income. However, in this conversion process, no adjustments are made for child-related tax benefits as cost offsets. Specifically, “all income is assumed to be earned by a non-custodial parent with no dependents.”⁹ Assumptions for income tax withholdings reflect a standard deduction for a single tax payer and one personal exemption. In the conversion process, expenditures as a share of net income are calculated for intact families and then converted to gross income for a non-custodial parent. At no point in this process is there use of custodial, single-parent data for costs or tax calculations. There is no subtraction of child-related tax benefits from gross costs.

Essentially, the child support guidelines used by 33 States (plus pending in Tennessee) include child-related tax benefits as net income when deriving the child cost tables but then ignore child-related tax benefits as partial cost offsets to child costs. Income Shares guidelines require the two parents to share child costs in proportion to each parent’s share of gross income, but allow only the custodial parent to presumptively enjoy the cost offset from child-related tax benefits.

Additionally, child-related tax benefits vary by custodial parent income—not by combined income as shown in the cost schedule. It is economically impossible to include child-related tax benefits in the cost schedule since the cost schedule is based on combined income and one does not know what the custodial parent’s income is in advance. The custodial parent’s income could be as low as zero or as high as the combined income amount and the child-related tax benefits would likely be sharply different depending on what the custodial parent’s income is.

This commentary in Rule 32 on child-related tax benefits should be deleted as arbitrary and replaced with commentary that child-related tax benefits are part of intact family income in the calculation of the cost schedule but there is no discounting of the cost offset built in.

⁹ See Robert Williams, et al., *Economic Basis for Updated Child Support Schedule, State of North Carolina*, prepared for Administrative Office of the Courts, North Carolina Supreme Court, State of North Carolina, submitted by Policy Studies, Inc., November 19, 1993, page 28.

- Conflict issue: The assumption (separate section) that the cost schedule already includes an adjustment for standard visitation is factually incorrect and arbitrary.

See Section “Comment,” (3):

“(3) Visitation. The Schedule of Basic Child Support Obligations is premised on the assumption that the noncustodial parent will exercise customary visitation rights, including summer visitation. Any abatement of child support because of extraordinary visitation should be based on visitation in excess of customary visitation.”

This section is factually incorrect and implies incorrectly that “standard visitation” is already taken into account in the cost schedule. This section should be deleted as arbitrary and replaced with commentary that the presumptive child cost schedule assumes that all child costs are incurred by the custodial parent and that the non-custodial parent’s only child costs are the child support payments to the custodial parent. This section’s factual errors are discussed in more detail above.

- Conflict issue: The guidelines’ cost schedule is based on intact family child cost data and is based on the assumption that the family is intact. A key underlying fact does not exist in application.

See Section “Comment,” (early text and related external documentation of underlying facts):

“The Schedule of Basic Child Support Obligations was developed through research sponsored by the National Center for State Courts and is based on extensive economic research on the cost of supporting children at various income levels.”

Alabama’s Rule 32 guidelines are Income Shares guidelines based on the research cited immediately above as expounded upon in *Development of Guidelines for Child Support Orders: Advisory Panel Recommendations and Final Report*, September 1987, by Robert Williams, for Office of Child Support Enforcement, U.S. Department of Health and Human Services. Specifically, the guidelines’ cost schedule is based on intact family data, yet the guidelines are applied to non-intact family situations in which the parents have less available income for spending on children than if in an intact situation. The presumptive cost schedule is based on an underlying fact that does not exist in application. This is a due process violation to apply a presumption in which a key underlying economic fact does not exist in application and has a significant impact.

Part III.

What the Guideline Review Panel Needs to Do to Bring Alabama's Guidelines into Conformance with Constitutional Principles and Federal Law

- Review the latest professional studies on child costs and incorporate into the guidelines.
- Conduct a statistically valid case study of deviation awards and existence of deviation factors. Constitutional principles of child support determination and legal presumptions expand the regulatory requirement regarding deviation awards and indicate that not only must deviation awards be factored into the formula but also any significant economic factors that typically occur regardless of whether deviations were made on the basis of those factors.
- Incorporate any regularly occurring significant deviation factors into the presumptive formula.
- Recognize factual errors in the guidelines by:
 - Deleting requirements and commentary that the guidelines assume the custodial parent claims the child-related tax benefits and adding commentary that the cost schedule includes the child-related tax benefits as net income for intact households but makes no allocation of these benefits as cost offsets between the separated parents; and by
 - Deleting any requirements and commentary explicitly stating or implying that the cost schedule already takes into account “standard visitation” of the non-custodial parent and replace with commentary that the cost schedule assumes that the children are with the custodial parent 100 percent of the time.
- Incorporate into the guideline formula the following factors presumptively:
 - Parenting time of both parents so that the guidelines incorporate an equal duty of support standard,
 - Child-related tax benefits as cost offsets so that the guidelines incorporate an equal duty of support standard, and
 - Either adjust the defined available income in the cost schedule for the additional cost of a second household or replace the cost table with one based on two, single-parent households.