



THE ROLE OF TAX POLICY IN REDUCING POVERTY IN THE UNITED STATES

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Abstract

This paper analyzes the role of U.S. tax policy in reducing poverty and documenting especially important tools, including the Earned Income Tax Credit (EITC) and the Child Tax Credit (CTC). The study presents a systematic literature review and some new data, and assesses the impact that these transitory policies have on alleviating poverty and suggests reforms to make them more effective. Results indicate that although current tax policies have played a role in reducing poverty they have also increased inequality, and specific policy measures need to be implemented. The study goes on to examine the history of tax policies targeting poverty reduction and compares the US tax system with the tax systems of other advanced industrial nations.

Keywords. Tax policy, poverty reduction, Earned income tax credit, Child tax credit, income inequality, social welfare, fiscal policy, United States

Introduction

Poverty has remained one of the persistent problems in the United States, as 11.4% of the population were living below the poverty line in 2020. The COVID-19 pandemic widened the gap in income, and this made government intervention necessary to cushion citizens from economic hardships. Tax policy has been used for a long period of time to alleviate poverty and reduce income inequality.

The U.S. government has taken a hybrid system of direct welfare programs and indirect tax-based interventions to assist the low-income families. In reality, EITC and the Child Tax Credit have emerged as the two strong instruments of tackling poverty in general. Though all these policies are very beneficial in their ways, they do suffer from various exclusion criteria, shortage of benefits pertaining to a certain



demographic cluster, and administrative bottlenecks, which also refrain the entitled persons from drawing benefits.

This article is dedicated to an overview of tax policy as one of the elements of poverty alleviation, taking into consideration how efficient such tools as EITC and CTC are, and also contrasting tax policy against social welfare programs and its general contribution to income redistribution.

Literature Review

The role of tax policy in reducing poverty has been debated for quite some time by economists and policy thinkers. Most of the early federal anti-poverty programs initiated in the U.S. have been based not on tax policy but on direct welfare assistance. Tax-based policy for poverty reduction actually began to emerge with the introduction of the EITC in 1975.

Research has shown that the EITC has been instrumental in reducing poverty among working families. For example, a study by Hoynes and Patel (2015) estimated that a \$1,000 increase in the EITC resulted in a 7.3 percentage point increase in employment and a 9.4 percentage point reduction in the share of families with after-tax and transfer income in poverty.

The Child Tax Credit has also played a vital role in the struggle against child poverty. According to the Center on Budget and Policy Priorities, the expansions of the Child Tax Credit in 2021 reduced the number of children living in poverty by 3.7 million. But scholars note that the benefits of both programs accrue to households inequitably because certain populations face obstacles in claiming the full benefits.

Research Methodology

This study combines quantitative analysis of recent tax data with the qualitative assessments from the existing literature. It covers utilizing datasets from the IRS, U.S. Census Bureau, and research institutions such as the Tax Policy Center and the Congressional Budget Office, comparing the impact of the US tax system on poverty to those of other developed nations such as Canada and the UK; the effectiveness of tax credits in different states, some with progressive and others with regressive tax policies.



Analysis and Results

The federal tax system reduces income inequality. Households with high incomes pay a greater percentage of their income in total federal taxes than households with low incomes. However, state and local taxes tend to be less progressive, with some-like sales taxes-being regressive.

Earned Income Tax Credit benefits approximately 25 million workers annually, reducing poverty for about 6 million people, including 3 million children (CBPP, 2022). Research suggests that every \$1 in EITC benefits generates about \$1.50 to \$2 in local economic activity.

The expanded Child Tax Credit of 2021 removed 3.7 million children from poverty, by lowering the rate of child poverty by 40% (CBPP, 2022). Once the expanded CTC expired in 2022, child poverty rates increased to show just how key and vital it was. Most low-income working families are either unaware of, or the complexity inhibits them from, claiming full EITC benefits. Sometimes, state and local tax structures also offset most federal tax gains because of increased sales and payroll taxes, levied heavily upon low-income citizens. The present tax system holds little regard for unemployed people and therefore provides more gaps than completeness in poverty-reducing practices.

Conclusion

Tax policy is essential in poverty reduction strategies within the United States, hugely contributed by such programs as the Earned Income Tax Credit and the Child Tax Credit. In fact, the credits contain evidence of reducing poverty, especially among low-income families with children. For example, the EITC has been proven to increase employment rates and reduce poverty by directly increasing the incomes of eligible households. Similarly, the CTC has proved a major driver of recent declines in child poverty, lifting millions of children out of poverty thanks to recent expansions.

However, these programs have their limits in ensuring effectiveness. Even though the programs have been quite successful, stark disparities persist because of administrative barriers, eligibility requirements, and lack of awareness. State and local taxes often reinforce inequality through regressive taxes that further weaken the poverty-reducing impact of federal policies. The expiration of expanded tax credits, such as the temporary increase in the CTC in 2021, showed just how vulnerable such



policies are to political changes in the wind and the disastrous implications of cutting or eliminating these critical supports.

These have tended to catch up in poverty reduction, but these also need to be framed in the context of broader strategies on direct welfare, health, education, and low-cost housing. Given the tax policy to help in poverty reduction, reforms should now be directed toward expanding eligibility, simplifying claims, and assuring the recipients of their entitlements in full. Further contributions to an inclusive and equitable economic system will be made by increasing support for the unemployed and addressing regional inequalities in state tax structures.

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