THE POLITICS OF PUBLIC VERSUS PRIVATE SOCIAL WELFARE

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ABSTRACT

Christopher George Faricy: The Politics of Public versus Private Social Welfare
(under the direction of Virginia Gray)

The United States has a divided social system in that both the public and private sectors provide citizens with benefits and services. The effects of political party control on public social policy are widely known. An area of study less understood is how partisanship influences private social benefits. I develop and test a theoretical argument that political parties' choice between indirect and direct social expenditures is primarily motivated by a desire to alter the balance between public and private power in society. The two major political parties have divergent philosophies on the role of government in society due to their significant differences in core democratic values and electoral coalitions. First, I properly conceptualize social policy as a choice between direct and indirect spending, using a new data set of federal tax expenditures. Next, I find no statistically significant difference between the Democratic and Republican parties in annual changes to total social expenditures. Additionally, my results show that Republican influence in the legislature results in a higher ratio of indirect to direct social spending, more private-sector spending, and increases to income inequality. These results have implications for determining the providers and beneficiaries of social benefits, the balance of power in society, and economic inequality.

To my first teachers: my mother and father

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CHAPTER I

THE POLITICS OF PUBLIC VERSUS PRIVATE SOCIAL WELFARE

My dissertation attempts to recast our understanding of the relationship between political parties and social policy through offering a new theoretical argument that builds on research from political institutions, public policy, and comparative politics. Common wisdom argues that the Democratic Party advocates for the creation and expansion of social programs while the Republican Party supports cuts to social benefits and spending. This traditional narrative misrepresents the reality of government activity in modern politics. The important difference between the two major political parties is not in the total amount of resources allocated to social policy but in the modality of social financing mechanisms. The United States has a divided social state in that both the public and private sectors provide citizens with social benefits and services. Public policy finances both these sectors and a deeper understanding of partisan politics is achieved by operationalizing social policy as a choice of policy tools. I develop and test a theoretical argument that political parties' choice between tax incentives, also known as indirect spending, and direct expenditures in funding social programs is primarily motivated by core democratic values and electoral goals. This dissertation demonstrates that partisan policy choices over social policy alter the balance of power between the public and private sectors in ways that influence economic inequality in America.

Politics is the authoritative allocation of values (Easton 1965). In the United States, the interplay of liberty and equality determines political culture and conflict. Although U.S. citizens recognize both values as being distinctly “American,” domestic political conflict is organized along the dividing line between equality and liberty. There is a clear relationship between these two core values and the political ideological spectrum. The belief that government should construct policy to encourage societal equality is a cornerstone of liberal ideology. According to progressive theorists, the root cause of economic and social inequality is the maldistribution of resources that occurs as a result of growing capitalist and unregulated capitalist economies. Liberal ideologues promote the use of government to correct for market failures or abnormalities that disrupt the equality necessary for a functioning republican democracy. Conversely, conservatives view the potential abuse of government power and the growth of the state as the major threat to individual liberty. Therefore, conservative advocates promote government activity that shrinks the influence of the public sector and grows the private sector.

In this dissertation, I examine the role of political parties in both the legislative and executive branches in bringing about different ratios of indirect to direct social spending and the resulting implications these changes have on private markets and economic inequality. The government allocates financial resources to social programs using multiple methods such as appropriations, grants, loans, and tax expenditures. In this project, I present a new conceptualization of social policy as a choice between direct and indirect social expenditures. This representation of social policy more accurately reflects the reality of the policy process and therefore can better capture the true differences between the two political parties over how best to provide economic security. The use of indirect and direct social spending allows for two new measurements of social policy: an aggregated measure that includes both expenditure types and a ratio measure, demonstrating how the two spending types move together. I expect that the new aggregated measure of social spending, when regressed on party control, to challenge existing theories of political party control and changing levels of social expenditures. In addition, I expect the Republican Party to support the use of indirect spending that subsidizes businesses in social provision and redistributes income to wealthier citizens. Next, I present a theoretical argument on the divergent partisan motivations for social spending. The Democratic Party values producing more societal equality and uses public policy to shift monetary resources to the public sector as a means to assuage market inequities and direct public monies to their constituencies. Conversely, Republicans are primarily motivated in maximizing individual freedom from the perceived encroachment of government and, therefore, use public policy to move economic resources to the private market and their constituencies. Subsequently, I offer a second unique data set on pure private-sector social spending. I predict that Republican Party control of government results in more indirect social spending (and less direct social spending), thereby stimulating business spending on social benefits and services. Finally, I theorize and test the relationship among political party control of government, the social expenditure ratio (indirect versus direct), and income inequality. I expect that Republican Party control increases the ratio of indirect to direct social spending, resulting in changes to the direction of income redistribution and greater income inequality. Understanding these relationships is critical to properly representing the size, scope, and scale of political party influences on the American social welfare state.

American politics is a battle over the proper balance between democracy and capitalism. The concept of individual liberty is the most important feature of theoretical capitalism. Capitalism presupposes the freedom of labor, the freedom of competition, and the free exchange between buyers and sellers. Democracy rests on the postulate that all individuals are essentially equal since no one person possesses greater inherent worth than another person. The equality of common humanity is the undergirding of democratic standards such as popular sovereignty, the universality of human rights, and the guarantee of minority rights. Within the American political system, however, economic individualism and egalitarianism do not easily coexist. The two major political parties represent contrasting philosophies over the role of government in the economy. The Democratic Party has both ideological and electoral incentives to use public policy to check the growth of capitalist markets while promoting the "American" ideals of equality and fairness. Republicans view capitalism as the fairest and freest system for organizing human behavior and use public policy to assist businesses and reduce the scope of the public sector. As a result, political party control of government results in changes to public policy that shifts power, resources, and jurisdiction between the public and private sectors.

CHAPTER II

A THEORY OF POLITICAL PARTIES AND SOCIAL POLICY

Since the New Deal, the fundamental dividing line between the Democratic and Republican political parties has been over the size of the federal government. Extant research reveals a consistent relationship across time between Democratic Party control of government and higher levels of domestic spending (Cooper and Bombardier 1968; Mayhew 1991; Cox and McCubbins 1993). Many of these same studies demonstrate that increased Republican influence correlates with less government spending. While these relationships are undoubtedly true, most empirical research does not take into account many of the fiscal tools used to finance public policy such as tax expenditures, grants, and loans. These policy tools have all grown more popular in recent decades and constitute an increasing percentage of public financing efforts. The unnecessary exclusion of these financing instruments both restricts our ability to build robust theory and empirically misrepresents the full effect of political institutions on public policy. The focus on the size of government, represented by changes to spending through the appropriations process, misses much of the important political action at the federal level. In this dissertation, I argue that transformations to social policy occur not only in adjustments to the annual level of appropriations spending but also in the modality of expenditures used to finance social benefits and services. The policy choice that political parties' encounter in choosing between tax expenditures and direct expenditures involves more than the deliberate selection of a mechanism to finance public policy. The choice between indirect and direct spending is essentially about altering the balance between public and private power in society.

Why would political parties in government use public policy, in general, and government spending, in particular, to move resources from one sector of society to another? A political party's decision to finance the public or private sector is primarily a function of their members' policy and election goals. The Democratic Party values societal equality and therefore uses public policy to allocate monetary resources to the public sector as a means to assuage economic inequities and progressively redistribute income to their constituents. Republican Party members are interested in maximizing individual economic freedom from the perceived advancement of government power and therefore use policy to shift public funds to the private market. This theoretical argument challenges the idea that only the Democratic Party actively supports social policy through increases to government spending. In recognizing America's bifurcated social system, the analysis of party conflict can move away from debates over the size of government to the study of political parties' perceptions of social benefits as either a right of citizenship provided by the state or a commodity sold in market. The difference between direct and indirect spending not only tilts the balance of power between the public and private sectors but also has tremendous implications for who provides social benefits, who receives social benefits, and the direction of national income distribution.

This chapter is organized into the following sections: literature review, political and policy contexts, the theoretical problem, and a theory of political parties and social policy. In the literature review, I situate this project among research on political institutions, comparative politics, and public policy. Second, I present modern political and policy environments for this study from 1967 – 2007, which are salient to understanding the causal mechanisms behind party influences on the changing social welfare state. Next, I lay out the theoretical problem in existing studies' failure to properly conceptualize the dual nature of public policy. Finally, I present a two-pronged theoretical argument of political parties and social policy that argues political parties' policy and electoral goals are primary in determining changing levels of social expenditures in the United States.

Previous literature on political parties and social spending

Political institutions influence public policy outcomes. Specifically, political party control of government has been found to affect policy, whether measured as important legislation, regulations, or government spending (Cooper and Bombardier 1968; Ripley 1969; Sundquist 1973; Clausen 1973; McCarty, Poole, and Rosenthal 2006). As applied to social policy, the Democratic (or leftist) Party continually expands social welfare through increases to government spending while the Republican (or rightist) Party contracts social programs through spending cuts. This resilient relationship has been found across time (Erikson, Mackuen, and Stimson 2002), across levels of government (Fellowes and Rowe 2004), and across countries (Blais, Blake, and Dion 1993, 1996; Huber and Stephens 2001).

The relationship between political parties and changes to the social welfare state is central to the study of comparative politics. Esping-Andersen (1990) in *The Three Worlds of Welfare Capitalism* argues that three entities provide social welfare: the state, the market, and the family and that understanding the role of public policy in social provision has to account for political parties influence on all three units. Esping-Anderson presents three typologies for social policy in advanced capitalist countries based upon worker decommodification:

liberal, conservative and social democratic. The United States is qualified as a liberal state, given the dominance of the private market in social policy and the unique ratio of public to private social welfare spending as compared to other Western industrialized nations. The vast majority of comparative research on social welfare policy focuses strictly on public programs and spending. Cross-national comparisons of social welfare that include only public spending demonstrate that U.S. expenditures are lower than those of all other European countries (Weir et al. 1988). Yet, to ignore tax subsidies for the private sector social spending disregards over one-third of total social spending in the United States (JCT 2008). Recent studies from the Organization for Economic Cooperation and Development (OECD) show that if tax incentives for private social welfare benefits and public sector spending are accounted for in total expenditure measurements, American social spending as a percentage of Gross Domestic Product (GDP) rises to the international average (Adema et al. 2005). In table 2.1., thirteen OECD countries are compared across three different types of social spending categories in 2003: direct, indirect, and total expenditures. In ordering the countries' social policy effort using the traditional metric of direct public spending as a percentage of Gross Domestic Product (GDP), the United States ranks last of the thirteen nations. However, America's social welfare effort ranks first in the category of indirect social spending or tax subsidies. The final column displays total social spending, a combination of the direct and indirect. The United States rises to ninth, just below Norway, in the total social spending rankings, demonstrating the importance of including all expenditure methods when calculating comparative social welfare efforts.

Public policy studies evaluate the role of government in the creation and maintenance of America's divided social system. Jacob Hacker's T*he Divided Welfare State*

(2002) demonstrates how public policy influenced the trajectory of private social benefits and in turn how the private social system colored policy decisions about public social programs. Hacker argues that what is unique about the American system, from a comparative perspective, is not the low percentage of social spending but the extent to which the private market is responsible for the provision of social benefits and services. He proposes a theory of policy path dependence and feedback that demonstrates why the private side is so heavily represented in the health care insurance industry but less so in the provision of old-age pensions. Other scholars argue that the growth of the private sector is the most significant change in modern social policy and is driven in large part by the increased political popularity of the policy tool of tax expenditures, or indirect spending (Howard 1997). Typically, research on political parties and spending does not recognize the historical use of subsidies and tax expenditures, which represent a significant portion of government efforts to address social needs in the United States (Howard 1997, 2007). Tax expenditures for social policy are not part of the appropriations process and therefore not captured by most studies of political parties and spending. Tax expenditures are segments of the tax code that provide for deductions, special exclusions, and credits for privileged individuals, organizations and activities. Christopher Howard argues that "most finance experts consider tax expenditures to be conceptually equivalent to direct spending" (1997, p.3). Therefore, a more accurate depiction of the relationship between parties and social policy should consider indirect spending side by side with direct social expenditures.

This dissertation offers a new theoretical argument on the motivations of the two major political parties in selecting specific modalities of public policy. The two major political parties each increase annual public spending in ways that align with their distinct election and policy goals. This line of argument is similar to the idea of interest-group liberalism offered by Theodore Lowi (1969). Lowi argued that the American style of pluralism was liberal in that it offered a positive view of the power and ability of government to shape societal outcomes and the public good was determined by the majority party's special interest coalition. I agree with Lowi that both political party elites, despite the limited government rhetoric from the Republican Party, have activist views of the federal government and use government power to distribute benefits and services to their constituents. In addition, Lowi was correct in implying that conservative and liberal ideologies should not be thought of as a disagreement over the size of government. I depart from Lowi in the specific motivations behind why political parties support different forms of social policy. First, I argue that political parties allocate benefits and services mainly to electoral constituencies, not necessarily special interests. Now, this is an imperfect division given that many electorally important social-economic groups have organized interests representing their concerns in social policy debates. In addition, I argue that political parties have incentive to select policy instruments that align with the party's ideological leanings. Elected officials are interested in adhering to their party's dominant ideology for both personal and political reasons. Often times, private citizens who decide to run for office are ideological outliers and are willing to undertake the sacrifices that come with public life for a chance to produce policy outcomes that align with their ideology. Finally, strict ideologically policy positions have a political payoff given that ideologically extreme voters are more likely to vote, donate money, and volunteer for campaigns.

The full theoretical model of how political party control relates to social policy and economic inequality is in presented in figure 2.1. Specifically, the Republican Party motivated by the core value of economic individualism and election goals use public policy to shift public resources and federal jurisdiction to the private-sector thereby taking away resources and jurisdiction from the public sector. Not only do businesses and wealthy individuals hold a privileged position in the private-market, their activities are subsidized by Republic social spending patterns and policy. These social policy changes represent a tradeoff, in that government revenue is distributed towards the wealthy by subtracting funds and diminishing the scope of programs aimed at assisting the working classes. This shift in social policy results in redirection of national income towards the wealthy both through direct policy changes and the indirect effects policy has on the interaction of the public and private markets. In conclusion, Republican control of government correlates with an increase in indirect social spending at the expense of direct spending resulting in an overall growth of income inequality.

The Political and Policy Contexts of the Study

The political and policy contexts of this study are salient to understanding the postulates and theoretical argument of the dissertation. Specifically, the rise of political party polarization and the end of the Great Society era are important elements for both the theory and research design of this study. The time period of this study runs from 1967 – 2007 due to the restricted availability of the data for indirect spending. Therefore, the theoretical argument and scope of this project is situated in the recent forty year period and not designed to be ahistorical. Over this period, the most important political trend was the polarization of the two major political parties at both the elite and mass levels. Political polarization is the increased intraparty preference homogenization as evidenced by the ideological position of each party's members moving closer together in space and time (Poole and Rosenthal 1984;

McCarty, Poole, and Rosenthal 1997). For example, roll call votes in Congress are more frequently divided between liberals and conservatives in the last forty years than at any other time since 1947 (Poole and Rosenthal 1997; McCarty, Poole, and Rosenthal 2006). Political polarization in Congress has resulted in more ideologically extreme members replacing previous legislators who were more moderate and therefore willing to cross the aisle and work with the other party. As polarization increased, political parties acted more as unitary actors in the policy process resulting in the emerging trend of "conditional party government" (Aldrich and Rohde 1999). Aldrich and Rohde argue that as members' policy preferences homogenize, they have greater incentive to provide party leadership with the power and resources to force ideological discipline, resulting in final policy being decided at the majority's mean – not the chamber's mean.

During the period of party polarization, political parties gained more institutional power in government. The majority party served as an important organizing mechanism in Congress, as party and caucus leaders became more willing to use their powers in the composition of committees and legislation. Kiewiet and McCubbins (1991) and Cox and McCubbins (1993) demonstrate majority party influence on committee assignments, committee transfers, aggregate expenditure levels, and roll-call voting. The dual trends of conditional party government and increased institutional power gave the majority political party greater power in distributive politics. In this study, I assume that the Democratic Party and its leadership have sincere preferences for liberal policy. Conversely, the Republican Party and leadership have sincere preferences for more conservative public policy outcomes. The second postulate that stems from these trends is that a political party in the majority has the institutional power to act as a unitary actor in the execution of trading off one type of spending for another.

In addition to elite-level polarization, the mass electorate polarized politically as well as along economic and racial lines. As the political parties polarized, their messages and contrasting preferences for public policy became more clearly communicated to the voting public. As a result, party identification became more important to voters as people realized there were significant differences between the two parties on policy preferences across issues areas (Carmines and Stimson 1989; Hetherington 2001: Layman and Carsey 2002). In addition, mass partisanship has become increasingly correlated with income over the past century. As the two political parties polarized over economic issues, the electorate has followed their lead. The wealthiest Americans increasingly identify with the Republican Party while working-class citizens are more reliably aligned with the Democratic Party. For example, the top income quartile was only marginally more likely to identify with the Republican Party in 1956, but in 2000, those in the top quartile were more than two and half times as likely to identify with the Republican Party as the lowest quartile (McCarty, Poole, and Rosenthal 2007). Political parties have separated not only along class lines but racial lines as well. The Civil Rights legislation of the 1960s sparked an exodus of white Southern voters from the Democratic to the Republican Party. As of the 1960s, the Democratic Party became more likely than the Republican Party to support aid to racial minorities, and therefore racial policy developed as an important characteristic dividing the two parties (Carmines and Stimson 1989). The high correlation of race and income class has only served to reinforce the electoral and policy differences between the two major parties. The Democratic Party increasingly represents working class and minority voters while wealthier whites identify with the Republican Party. The bifurcation of the electorate has made it easier for political parties in government to target their constituencies through changes to social policy.

The Social Policy Context: The End of the "Big Bangs" and the Rise of the Shadow State

Both the public and private provision of social benefits and services drastically changed from 1967 – 2007. A basic responsibility of any government and the core of domestic policy is the provision of social benefits and services to citizens. Social policy is commonly defined as any government effort to provide economic security to citizens through protection against income loss and guaranteeing a minimum standard of living. This definition allows and even invites us to examine all the ways through which government activity determines policy outcomes. I incorporate two basic facts that are missing from most analyses of the relationship between political parties and social policy: first, social policy is divided between the public and private sectors and second, public policy decisions finance and regulate the private social system in the United States.

The public social system was created largely during the two "big bang" periods of social policy: the New Deal and Great Society eras. These periods of policy punctuation occurred when the Democratic Party controlled the executive branch and enjoyed large majorities in Congress. This study starts after the Great Society, the second of the big bangs, and is generally referred to in public policy as an era of social policy retrenchment. During this period of retrenchment, supporters of public social programs were forced to justify the existence and current level of social benefits rather than focus on social policy expansion. On the public side, means-tested programs aimed at assisting the poorest citizens were scaled back or devolved to the state level (Fellowes and Rowe 2004). In addition, many federal social programs experienced policy drift. Policy drift occurs when social services and benefits remain stagnant while inflation and changing labor markets erode the extent and generosity of social insurance (Hacker 2004). There were only a smattering of new social programs created during this time such as the Supplemental Security Income Program, Pell grants, Adoption Assistance and Foster Care, Child Care Block Grant, the State Children's Health Insurance Program and Medicare Part D. Medicare Part D subsidizes prescription drugs by allowing citizens to obtain benefits through two private plans: Prescription Drug Plan (PDP) or Medicare Advantage (MA). Conversely, popular non-means tested programs, such as Social Security and Medicare, added some supplementary programs, increased in generosity or had their payments tied to inflation. Recently, scholars have recognized the different path trajectories of means versus non-means public social programs and relabeled this period as selective retrenchment (Mettler 2007). Medicare and Medicaid spending increased dramatically mainly due to cost increases in the health care industry. In conclusion, the public social system experienced mixed results with programs for the poor and unemployed usually being scaled back while benefits for senior citizens and the disabled were maintained or expanded.

The private social system in America grew in large part due to changes in public policy. The use of alternative policy tools to fund private, mainly employer-based social benefits and services is often referred to as the "hidden," "shadow," or "subterranean" social system. Just in the last forty years, the proportion of total American social spending in constant dollars that came from the private sector increased by more than 25%, even though the United States already spent the most on private social welfare in the industrialized world

(SSA)[1]. Some of the most important tax expenditure programs for social welfare originated in the period of this study. Two of the largest tax expenditure programs were expanded under Employment Retirement Income Security Act of 1974 (ERISA), which created new tax incentives for employer-based retirement and health care insurance. Under ERISA, employer plans must allow worker pensions after a determined minimum number of years of service, and it also created the Pension Benefit Guaranty Corporation (PBGC) to insure companies' benefits plans. ERISA created new government tax subsidies, which provided companies incentive to shift from defined benefit to defined contribution pension plans. Surprisingly, ERISA had even more of an impact on employer health insurance than it did on employer pensions. Although the act did not require employers to provide health insurance, it heavily regulated employers who volunteer to establish an employee plan along with creating the accompanying tax deductions and exclusions. There have been a number of amendments to ERISA's health insurance component including the establishment of the Consolidated Budget Reconciliation Act (COBRA) in 1985, which is insurance for the unemployed, and the Health Insurance Portability and Accountability Act (HIPAA) in 1996 that prohibits various forms of discrimination. The Earned Income Tax Credit (EITC), the largest and most expensive federal program to ameliorate poverty in America, was passed in 1975. The EITC was expanded in eligibility and generosity in 1990, 1993, and 2001. Finally, a number of tax credits for higher education were passed in the late 1990s along with the Child Tax Credit. In this period without significant Democratic majorities, important indirect social programs were passed and expanded. The previous growth in direct social spending during the Great Society era created political incentive to scale back public programs in the 1980s and 1990s, while it created positive incentives for the extension of private social welfare. Republican

[1] Social Security Administration

leadership interested in dismantling the public social welfare state followed a two-pronged strategy of not only decreasing, devolving, or drifting public benefits but creating an alternative social policy infrastructure through increases to tax subsidies for the private sector.

The Problem: The Divided American Social Welfare State

The United States has a divided social system, one public and the other private. In ignoring private-sector social benefits and the government subsidies that finance them, scholars have unnecessarily excluded a significant amount of government activity from their research and the means through which most American citizens receive social benefits and services. This dissertation, working from scholarship in public policy and comparative politics, treats social spending as having two elements – a direct and indirect path and a social system with both a public and private side. In 2008, there were 44,831,390 beneficiaries of Medicare and 50,898,396 citizens that received assistance in the form of Social Security on the public side of the divided welfare state.[2] During the same year, over 158 million citizens received health insurance through their employer or their partner's employer-sponsored health care plans and over 101 million people were enrolled in pension plans through their employer.[3] Jacob Hacker (2002) in *The Divided Welfare State* traces the historical development of public and private pensions and health care. Hacker argues that the differing characteristics of public versus private social welfare benefits presented alternative policy approaches and costs to political parties. In his analysis, the current mix of social benefits and services is a function of the particular dual path development for each policy.

[2] These data are presented by the Social Security Administration in their annual report for 2009.

[3] The data on private health care coverage are from the Kaiser Family Foundation's report on Employer Health Benefits for 2008 and the pension data are available from the Bureau of Labor and Statistics database (BLS).

Hacker demonstrates that the decision to finance public versus private social benefits has consequences for social policy administration, beneficiaries of social policy, and the political incentives for groups to lobby for changes to public policy.

Public policy tools can be used to finance either the public or private social systems. The last forty years has witnessed a tremendous growth in the diversity of policy tools, which are simply defined as ``a method through which government seeks policy objectives" (Salamon, 2002, pg.29). Numerous and varied government tools are used to finance private social benefits including: tax expenditures, grants, regulations, loan guarantees, government corporations, and loans (Hacker 2002; Howard 1997; Kettl 1997; Salamon 2002). I focus on tax expenditures, or indirect spending, since this has become an increasingly common method used by the federal government to finance social programs. Direct and indirect spending are the two largest categories of public expenditures for social policy that together summed to over $1.5 trillion dollars in 2006. In order to place this number in context, total U.S. budget expenditures in 2006 are listed at $2.6 trillion dollars (Jones, True and Baumgartner 2007).

The Policy Effects of Indirect and Direct Spending in Social Policy Analysis

Tax expenditures represent a method of counting in real dollar terms the cost to the U.S. Treasury of tax exclusions, deductions, and credits. Economists argue that tax breaks should be considered ``expenditures" since these instruments target money to specific populations or activities and have the same effect as direct spending on beneficiaries, the market, and the budget (Howard 1997; Burman, Geissler, and Toder 2008). Tax expenditures for social welfare have grown as a percentage of all tax expenditures and now represent close to 60% of total tax expenditures in the United States. Tax expenditures are the primary means of indirect public spending used to subsidize employer and private social benefits. Christopher Howard (1997) presents an analysis of how tax expenditures for social policy differ from public social programs in that most tax breaks for social benefits were initially passed without much organized debate and spread out over decades as opposed to originating in the ``big bang'' periods as public social programs did.

The majority of tax expenditures -all but refundable tax credits- have regressive effects on income redistribution. Since the income tax has a progressive structure, tax expenditures formulated as deductions or exclusions generally reduce the progressivity of the tax system. Tax expenditures regressively redistribute income by reducing average tax rates more for higher marginal rate taxpayers than for lower marginal rate taxpayers. For example, if a worker in the 40% bracket is allowed to exclude $10,000 from personal income, that worker receives a tax expenditure of $4,000. If a similar worker in the 20% bracket is allowed to exclude the same $10,000, the tax break is only $2,000.

Table 2.2. presents the redistribution of national income by income class from selected tax expenditures for social welfare. The relationship between income class and tax subsidies is clear. For the child care tax credit and student loan interest deduction, there is a positive relationship between class and benefits with increases to income correlating with more generous tax payments. The lone exception to the regressive nature of social tax expenditure programs is the refundable Earned Income Tax Credit (EITC). A refundable tax credit, as opposed to a nonrefundable, allows a taxpayer to reduce her income below zero and thereby qualify for a tax refund. Only those taxpayers who itemize their personal deductions receive benefits from tax expenditures. As of the mid-1990s, only one in three taxpayers even

itemized their taxes beyond the standard deduction. Since home ownership along with its accompanying deductions for interest and property taxes is almost essential for an individual to itemize, it is fair to say that the majority of tax expenditures for social benefits are government subsidies for wealthy homeowners. According to data from the I.R.S., taxpayers in higher income brackets are much more likely to itemize their deductions than those in lower brackets. In addition, the use of deductions, exclusions, and exemptions excludes nontaxpayers, the poorest Americans, from tax benefits for social purposes. The implications are that when social spending shifts from direct to indirect methods, the income redistribution effects associated with social policy become much more regressive.

In contrast to the private social welfare state, the public social system is funded through direct spending measures and progressively distributes financial benefits. Public social programs are often organized into two broad categories: means and nonmeans tested. Means-tested programs are aimed at reducing poverty through assisting working class citizens with aid, assistance, and training. These programs by design are progressive since they draw on the general tax base and redistribute income and benefits exclusively down the income ladder to poorer citizens in the form of cash or services. Nonmeans tested social programs are universal and therefore not designed to be explicitly progressive but have progressive financial effects nonetheless. Research shows that the income redistribution of Social Security and Medicare disproportionately benefit citizens down the income ladder (Jacobs and Skocpol 2005).

A Partisan Theory of Social Policy

A political party's decision to finance the public or private sector is primarily a function of its values and election goals. The Democratic Party values societal equality and uses public policy to allocate monetary resources to the public as a means to assuage economic inequities and progressively redistribute income to its constituents. On the other hand, Republican Party members are interested in maximizing economic freedom from the perceived advancement of government power and use policy to regressively shift public funds to the private market and conservative constituencies. In the following sections, I explore the values and electoral motivations for the two major parties' positions on modern social policy in America.

Core Values, Ideology, and Social Spending

Core values determine citizens' ideological disposition in American politics by constraining individual attitudes and preferences for public policy. Social psychological literature shows the importance of core democratic values in structuring people's attitudes and opinions about preferences for policy outcomes across issue areas (Converse 1964; Lipset 1979; Feldman 1984; Maio and Olson 1998; Peffley, Kniggie, and Hurwitz 2001; Keele and Wolak 2006). Ideology and core values are closely related. Self-identified liberals consistently rank egalitarianism as their highest personal value while conservatives select individual freedom as their most important core value (Feldman 1988; Jacoby 2006). When survey respondents are asked to decide between preserving a free-market economy and enacting measures that promote greater social and economic equality, conservatives emphasize capitalistic values while liberals emphasize democratic values. Jacoby (2006) finds that ``people who believe that liberty is more important than equality are also more likely to favor reductions in government spending. Conversely, those who value an egalitarian society apparently recognize the relevance of governmental spending and services for achieving this objective" (718). Feldman (1988) argues that "support for equalitarianism leads to support for a broad range of government social service spending and aid to minorities, while economic individualism is associated with preferences for a more limited federal government and limits on welfare spending" (p.123). In addition, this same study also demonstrates that party identification had a very limited impact on individual's issue preferences once controlling for core beliefs.

Research demonstrates that there are two prominent core beliefs that are directly applicable to the formation of American political culture: support for economic individualism and belief in equality of opportunity (Lipset 1979; McClosky and Zaller 1984; Feldman 1984). Economic individualism is based on the idea that people should advance through their own hard work in the marketplace. Equality of opportunity is the belief that formal equality is a right regardless of a citizen's socioeconomic status. These divergent partisan value hierarchies create hard and fast party preferences for one sector over another and by extension specific types of spending tools. The result is that Democrats use social policy to move economic resources and legal jurisdiction to the public sector, and conversely, Republicans use policy to allocate resources and jurisdiction to private markets. Each political party, once in the majority, has a choice between two types of social spending: direct expenditures administered by government bureaucracies that promote equal opportunity and indirect expenditures administered by the private-sector which advances economic individualism. Therefore, Democratic majorities will increase direct social spending at the expense of indirect spending and the Republican Party will support increases for indirect social spending and not direct expenditures.[4]

One reason for political conflict is that these dueling values cannot be easily dismissed by elite ideologues. Conservatives cannot ignore equality and democracy as core values in the U.S. while liberals cannot dismiss the values of economic individualism and limited government. McClosky and Zaller (1984) argue that “ideological conflict as exists in America is confined within a broad framework and of almost universal public support for the basic values of capitalism and democracy” (p.276). Recognized liberal and conservative opinion leaders use identifiable rhetoric and support different public policies, thereby effectively creating a set of ideological conventions for organizing conflict between the two prominent values of political culture. Core American values are communicated over time by politicians and maintained through stable political institutions (McClosky and Zaller 1984). Additionally, the mass electorate learns of core values from the set of widely held beliefs and norms about the relationship between citizens and their government represented in the political ethos. Members of the mass electorate who pay close attention to politics become aware of these organizing conventions and internalize the partisan value that is most central to their own predispositions. Political sophisticates place more emphasis on core values in constructing their opinions and demonstrate an ability to rank order values into attitudinal hierarchies (Jacoby 2006).

Distributive Politics, Political Parties, and Social Policy

[4] There is some evidence that conservatives have a larger gap between their first value of individual freedom and equal opportunity while liberals have more conflict between their preferred value of equal opportunity and individual freedom (Feldman and Zaller 1992).

Political parties use distributive politics to the electoral advantage of their members. Kiewiet and McCubbins (1991) argue that "it is in their spending priorities that parties tell the electorate most clearly what policies they favor and what groups they represent." Distributive politics is an institutional commitment by political parties to aid incumbents in delivering tangible and traceable benefits to their constituencies or congressional districts. Political party members have become increasingly convinced that legislative pork, skillfully targeted, produces votes from their constituencies (Alvarez and Saving 1997; Levitt and Snyder 1997). Research demonstrates that political parties are especially adept at targeting fiscal benefits to specific voting groups through the appropriations process. The appropriations process allows political party members in the majority to narrowly direct public projects, funds, or services back to their district or loyal party supporters.

A political party in the legislative majority uses its institutional position to disproportionately benefit its members, often at the expense of the minority party. Numerous studies demonstrate that districts of majority party members have been disproportionately favored in the distribution of defense dollars (Carsey and Rundquist 1999), transportation funding (Lee 2000), and federal grants (Levitt and Snyder 1995). Legislators value being in the majority party since they can form intraparty minimum winning coalitions (MWC) and thereby maximize their personal electoral and legislative benefits (Riker 1962). The clear benefit of majority status is the power of institutional discrimination that allows for the targeting of legislative pork to supporters and enhancing the ruling political party's electoral prospects. The majority party protects itself against charges of wasteful spending from the minority party by including some minority members in the distribution of benefits.

In addition to targeting pork back to their home districts, political parties use the appropriations process to target benefits towards loyal voting groups. Levitt and Synder (1995) conclude that parties in the United States target types of voters and not individual member districts. Specifically, Levitt, and Snyder (1995) find “that Democratic control of both the House and Senate over most of the post-war period has allowed Democrats to fashion a portfolio of spending programs that disproportionately benefit their constituents. It appears that parties in the United States can, given enough time, target types of voters, but they cannot easily target individual districts” (p.961). In this same study, political parties were most effective in directing spending types that are allocated using formulas and program funding that was created under the majority party’s control. In this study, I argue that the bifurcation of voting groups by ideology and class allows both political parties to design social legislation that redirects resources towards their supporters and away from the opposing parties’ constituents.

Political parties use “off-budget” policy tools to distribute government benefits to loyal party supporters. In contrast to direct spending, indirect spending passes through a smaller number of legislative committees and is not subject to an annual review. The private social system is subsidized by alternative public policy tools and distributes financial benefits to wealthier citizens. Assistant Secretary to the Treasury Stanley Surrey invented the concept of tax expenditures in 1967. Secretary Surrey wanted members of Congress and White House administrators to compare in real dollars the money spent in one category, such as health care, through the appropriations process and the tax code. Therefore, majority parties can and do use the tax code to direct resources in the same way they use the appropriations process.

The public and private social systems serve different populations. The two political parties select different social spending types due to the divergent policy effects of direct versus indirect expenditures. Indirect spending directs most financial gains towards two important Republican voting blocs: wealthier citizens and businesses. A recent study finds that the Republican Party uses alternative spending tools to distribute government goods and services to their constituencies. Bickers and Stein (1996, 2000) demonstrate in periods of Republican control of government, there are increases in contingent liabilities which include direct loans, guaranteed loans, and federal insurance programs. These types of spending programs underwrite risks for individuals and groups by guaranteeing that the federal treasury repays any loss. Contingent liabilities benefit core Republican constituencies including small businesses, farmers, and entrepreneurial businesses. Indirect spending initiatives are worth more per unit to taxpayers in higher tax rate brackets. Higher-income citizens identify more with the Republican Party, especially in recent decades. Not only do wealthier citizens benefit from increases to indirect spending but so do financial firms, private health insurance companies, and general business interests. Indirect spending subsidizes private social benefits which in turn help the bottom line of financial firms that offer 401ks and 403bs as well as private health insurance companies that work with corporations in offering employer-sponsored health care through the private market.

Indirect social spending methods that finance private social benefits and services disproportionately benefit groups that identify with the Republican Party. The distribution of private social benefits is biased towards people who are white, work full-time for large companies, and earn high wages. According to a recent study from the Congressional Research Service (CRS), in 2005 the percentage of 25- to 64-year-old workers in the private sector who participated in an employer-sponsored retirement plan was 45%. Black, Hispanic, and other non-white workers were less likely to have participated in an employer-sponsored retirement plan than white workers. In 2005, 57% of white workers participated in an employer-sponsored retirement plan, compared to 46.5% of black workers, 29% of Hispanic workers, and 48.8% of other non-white workers. The percentage of part-year or part-time workers in the private sector whose employer sponsored a retirement plan was 39.9% compared to 69.5% of full time workers in 2005. Only 25.3% of workers at firms with fewer than 25 employees participated in an employer-sponsored retirement plan, compared to 45.2% of workers at firms with 25 to 99 employees and 65.4% of workers at firms with 100 or more employees. There is also a great deal of variance by income class; only 27.5% of workers whose earnings were in the lowest quartile (under $25,000) participated in a retirement plan at work compared to 70.3% of workers whose earnings were in the top quartile (above $60,000). When social spending moves from direct to indirect, government subsidization shifts from more vulnerable to more privileged constituencies who are likely to identify with the Republican Party.

The beneficiaries of federal government social programs are the elderly, the disabled, the unemployed, and the poor. In addition to these target groups, federal social programs disproportionately serve racial minorities, ethnic minorities and single female-headed households. The major public social programs in the United States were created under periods of unified Democratic control of government. Therefore, the constituencies that benefit from public programs expect the Democratic Party to protect and expand social benefits and services. The first set of federal social programs centered on Social Security and created a generation of loyal "New Deal" Democrats that benefited from public works programs and have continually identified with the party for decades. Voting groups that benefit the most from public social programs such as the elderly, Blacks, Latinos, women, and the working class consistently identify more with the Democratic Party and are more likely to trust the Democrats in dealing with the issues of Social Security, Medicare, and general welfare services. Additionally, high-income liberals who value their political identity and are primarily concerned with government support of underrepresented populations and the creation of a more egalitarian society often identify with the Democrats. The Democratic Party gains an electoral advantage through increases to public social spending since the financial and social benefits accrue disproportionately to voting groups that identify with the party.

Conclusion

American politics is a constant push and pull between principles of pure capitalism and pure democracy, and nowhere is this more evident than in partisan debates surrounding social policy. In fact, the tensions between the two systems organize and animate political conflict in the United States. Capitalism is primarily concerned with maximizing economic individualism and private profit while democracy aims at fostering equality and public goods. Capitalism holds that the private market is not only the most efficient but the fairest method for distributing goods and services, including social goods and services. Democracies support the rights of democratic majorities to override economic market mechanisms to assuage economic and social distress resulting from the uneven distribution of resources by capitalist economies.

The important difference between the two major political parties is not in the total amount of financial resources allocated to social policy but in the modality of social financing mechanisms. This dissertation addresses political party motivations and strategies in financing public versus private social welfare benefits, as well as the resulting policy effects. Political parties can alter the delicate balance of power in society by favoring one over the other in ways that reflect the party's ideological and electoral interests. I include empirical work focusing on the role of political party control in determining the direction of the social welfare expenditure ratio, the effectiveness of tax incentives in stimulating private-sector social expenditures, and how changes to direct versus indirect social spending influences economic inequality.

An Addendum: Public Opinion and the Divided Social System in America

The American public is attentive and dynamically responsive to actions of the federal government and the federal government responds to movements of the mass electorate (Erikson, MacKuen, and Stimson 2002). This work generally speaks well for conceptions of democratic representation and democratic accountability in the United States. Contrary to this prevailing view of the American political system as open and dynamic is the idea that policymaking is restricted to a small group of political actors in "policy monopolies," "subgovernments," or "iron triangles" (Lowi 1955; Schattschneider 1961). According to these theories, there are specific types of policy areas, such as tax expenditures for private social programs, which are so narrow in scope as to diminish the saliency of public opinion and invite the influence of special interests. Therefore, dependent upon the policy arena, the American political system is either open and responsive to public opinion or closed and vulnerable to the demands of special interests. These two different conceptions of the policy process perhaps best describe the state of research with respect to American social policy. The public is generally attentive and responsive to changes in *direct* federal social appropriations—the amount that the federal government spends in particular social domains (Wlezien 1995, 2000). Conversely, *indirect* social spending is thought to be "hidden" from public view (Hacker 2002, 2004; Howard 2007) and much less subject to public influence. Models of indirect social policy imply that these types of policies have causes and consequences so obscure that they diminish the saliency of public opinion and invite the influence of special interests. In this section, I present the beginnings of a theory of public opinion and the divided social system. I theorize that voters have preferences over the role, and not the size, of government in society. These preferences are normally distributed in society and provide negative feedback when policy moves too far in one direction or the other. Therefore, changes to mass public opinion produce divergent patterns of social spending and distribution of benefits. I expect a public that is attuned not only to the role of government in the social policy arena, but also the redistributive effects of different types of social policy.

A micro theory of voters and preferences for social policy

The dominant view of mass responsiveness is that the public behaves as a political "thermostat" (Wlezien 1995), adjusting its preferences for the size and scope of the federal government in response to changes in public policy. In this model, the public is a collection of individuals distributed along a dimension of preference for "more" or "less" social policy. For example, if policy starts at the social policy median, which divides the public's preferences in half, then as direct social spending rises or falls opinion will move in the opposite direction. Wlezien (1995) argues that voters don't have specific preferences for an exact amount of social policy in mind but rather reveal relative preferences for "more" or "less" policy. There are two necessary conditions for this model. One is that the policy area must be large enough so changes can be observed or experienced by the mass public. Second, it must be important enough to warrant attention from political elites, the media, and the public.

In applying the thermostatic model to a broader conceptualization social policy, presented in this project, it becomes difficult to argue that citizens' central preferences are about more or less policy. First, the way social policy is framed by political and media elites convey information about disputes concerning the role of government in society. The two major political parties disagree as to whether social services such as health insurance and pensions are a right of citizenship, as believed by most liberals, or a consumer good, as believed by most conservatives. This fundamental disagreement has nothing to do with the magnitude of social benefits but rather which sector of society should have the jurisdiction to provide and regulate social services. Second, core democratic values structure individual's positions across social policy issues. Citizens who value more equality in society will translate this view into the government taking a more active role in funding and providing basic social services. In contrast, individuals that value more economic freedom will support a role in government that assists the private market. These differences are the underpinnings of the liberal-conservative ideology spectrum in American politics. Therefore, I would tweak the thermostatic model by arguing that the mass public is a collection of individuals that have relative preferences for the role of government in society. These preferences are normally distributed and provide negative feedback as the social expenditure ratio moves in one direction. For example, as indirect social spending is traded off for direct social spending, moving policy in a conservative direction, the mass public will respond by calling for a more direct role of government in society through increases to direct spending.

It has been argued that survey questions tap into a voter's perceived desires for more or less government or more or less policy (Wlezien 1995). In fact, there are many survey questions from both the GSS and NES that could be interpreted as tapping people's preferences for the role of government offering either a more public or market-based solution to the problem of economic security. For instance, take the following two examples from the GSS and NES respectively:

Here are several things that the government in Washington might do to deal with the problems of poverty and unemployment. I would like you to tell me if you favor or oppose them. - Would you say that you strongly favor it, favor it, neither favor nor oppose it, oppose it, or strongly oppose it?

A. Giving businesses and industry special tax breaks for locating in poor and high unemployment areas.

B. Spending more money on the schools in poor neighborhoods especially for pre-school and early education programs.

C. Provide special college scholarships for children from economically disadvantaged backgrounds who maintain good grades.

Some people feel there should be a government insurance plan which would cover all medical and hospital expenses for everyone...others feel that all medical expenses should be paid by individuals, and through private insurance plans like Blue Cross or company paid plans. Where would you place yourself on this scale, or haven't you thought much about this? (7 point scale)

1= Government Insurance Plan

7= Private Insurance Plan

The first question from the GSS presents two direct government options and one in which the government works through the private market. The second question from NES does not present an option of government subsidization of the private market but might pick up an individual's preference for whether she views health care as a right of citizenship and therefore under the jurisdiction of the government or as a good that can be provided by the market. In conclusion, questions that have traditionally been interpreted as tapping into preferences for the size of the government might be reinterpreted or rewritten to better evaluate the ideological differences between public support for more public intervention versus private subsidization.

How changes to social policy influence mass opinion

The clandestine nature of the policy process for tax expenditures has resulted in the idea that changes to indirect spending should not influence public opinion. The use of indirect spending to finance social programs has been referred to as "hidden," "a shadow state," and "subterranean" (Howard 1997; Gottschalk 2000; Hacker 2004). The limited number of congressional committees involved in policy process of indirect spending, along with the lack of annual review, provides institutional barriers and disincentive for the mass electorate to learn, understand, and react to spending changes. Indirect spending provisions are created or expanded in revenue or tax reform bills and not through the annual appropriations process. In addition, the Senate Finance and House Ways and Means committees have exclusive jurisdiction over indirect spending bills and serve as both approving and "appropriating" committees. Since indirect expenditures do not pass through the appropriations process, the provisions are not subject to any annual review process. In contrast, direct spending measures must pass through standing committees with jurisdiction over a specialized policy area as well as the Budget and Appropriations committees that fix discretionary spending levels for each budget category. Indirect spending programs for private social benefits are administered by the Internal Revenue Service (I.R.S.).[5] The reduced scope of conflict for indirect spending measures privileges the role of special interests groups and could diminish the importance of public opinion (Schattschneider 1960).

The public, at least in the aggregate, is attentive and responsive to both the policy actions of the federal government and the consequences of those actions. This thermostatic model provides a straightforward conception, rooted in classic systems theories of politics (e.g., Easton 1965), of how the public reacts to changes in the policy environment. In essence, this is a model of negative feedback to policymakers, as the public adjusts its *relative* preferences for public policy opposite the dominant ideological direction of policymaking activity. For example, when public policy moves in a conservative direction, citizens notice these changes and respond by demanding comparably more liberal policy. Advocates for this model posit that if levels of federal social spending increase, public demand for additional spending decreases (and vice-versa). This type of responsiveness bodes well for representative democracy, as it implies a public that is broadly attentive to the actions of federal policymakers, and that provides strong incentives for elected officials to consider the wishes of citizens when crafting policy (Erikson et al 2002).

[5] The I.R.S. rarely investigates the individual deductions that citizens claim for social purposes and do not monitor or evaluate employer or private social spending (Toder, Wasow, and Ettlinger 2002).

E.E. Schattschneider (1935) rightly observed that “new policies create a new politics”. Public policies, once enacted, reshape the political environment, especially for the mass public. Pierson (1993) theorizes that there are two “policy feedback” types that apply to the policy-mass public relationship: resource effects that determine how policies shape the distribution of incentives, and interpretive effects which influence how policy conveys information about the political environment to citizens. First, social policy provides resources to citizens in two ways: through social and financial benefits. The two types of social spending, direct and indirect, allocate social benefits to different populations and redistribute national income in opposing directions. Second, direct and indirect social spending are communicated by elites and therefore interpreted by the electorate as divergent ideological policy prescriptions to the problem of economic insecurity.

The two modalities of social policy tools, direct and indirect, have distributive effects that should produce distinct patterns of public response. An increase in direct social spending targets vulnerable populations such as the elderly, the working poor, and the unemployed by distributing social and financial benefits down the income ladder. It also increases the role of the federal government in directly providing benefits and social services. Indirect spending accrues social insurance to wealthier, professional workers in the private market through the upward distribution of social and financial benefits. It does so by enhancing the position of private and market-based actors in the provision of benefits by the use of targeted tax expenditure programs. The public, in other words, generally treats direct federal appropriations in social welfare domains as “liberal” public policy since it redistributes wealth downward. Conversely, indirect social expenditures allocate public resource to businesses and private organizations while redistributing wealth upward and therefore should be perceived as "conservative" policy. Following the thermostatic logic, citizens should thus respond to increases in direct social spending by increasing their demand for "conservative" public policy solutions and respond to increases in indirect spending by increasing their demand for public policy liberalism.

Political and media elites publicize changes in policy in ways that allow citizens to learn and understand the current ideological direction of public policy. Party leaders have substantial incentives to communicate policy changes in digestible and meaningful frames (Sniderman and Theriault 2004). In this project, I theorize and find evidence for differences in political parties' preferences for direct versus indirect social spending. For example, if an election produces new majorities for the Republican Party, the resulting policy action will be to increase indirect social spending at the expense of direct spending. The majority party, often using the bully pulpit of the presidency, will communicate through all available sources the benefits of recently passed legislation, using typical partisan language (Lakoff 2002). In my example, the media will cover the general rise in tax breaks and, due to the tradition of 'balanced' presentation, will communicate the policy as both needed tax relief desired by Republicans and Democratic criticism of tax breaks for the rich. The net effect will be that a sufficient swath of the electorate will read, hear, and learn about the change to public policy and update their preferences accordingly.

I expect that public opinion influences subgovernments because while the policy process of tax expenditures may be hidden, policy effects are not. I agree with past scholars that the process of tax expenditures is subterranean and highly influenced by special interests, yet the effects of tax expenditures are felt by the public. First, tax expenditures for social programs represent a substantial part of federal expenditures, totaling close to $700 billion in

2008. Next, changes to tax expenditures are communicated to citizens by the media as stories about the general direction of tax breaks by employers, tax specialists, unions, and accountants concerning employer-provided social programs, and through friends and family who itemize their returns. Finally, most of these tax expenditure programs are highly regressive and redistribute enormous sums of money to the wealthiest Americans. Increases in tax expenditure programs are often accompanied by cuts or stagnant direct spending trends, so the upward movement of financial resources would be noticeable to some portion of the population.

CHAPTER III

TAX EXPENDITURES: THE OTHER SIDE OF SOCIAL SPENDING

In a radio address on October 18th, 2008, Senator John McCain, the Republican candidate for President, opened a new line of attack against his Democratic opponent Senator Barack Obama. Senator McCain charged that, "Barack Obama's tax plan would *convert the IRS into a giant welfare agency,* redistributing massive amounts of wealth at the direction of politicians in Washington. I suppose when you've voted against lowering taxes 94 times, as Senator Obama has done, a new definition of the term "tax credit" comes in handy. At least in Europe, the Socialist leaders who so admire my opponent are up front about their objectives. They use real numbers and honest language. And we should demand equal candor from Senator Obama. Raising taxes on some in order to give checks to others is not a tax cut, it's just another government giveaway" (McCain 2008). Tax breaks, formally known as tax expenditures, have been used to fund social welfare benefits and services through the tax code since the passage of the progressive income tax in 1913 (Howard 1997). According to the Joint Committee on Taxation, tax expenditures amounted to $945 billion worth of government spending in 2007, or 10% of Gross Domestic Product (60% of total tax spending went towards social programs). In 1967, the Joint Committee on Taxation (hereafter the JCT) first identified 50 items as tax expenditures; forty years later using similar methodology in

2007, the JCT listed 170 tax expenditures.[6] The growth of tax expenditures has fundamentally changed the government's role in financing, providing, and administering social benefits and services in the United States of America.

The goals of this chapter are to present an introduction to the tax expenditure concept and to analyze the growth of tax expenditures during the modern era. Tax expenditures are used by governments primarily to subsidize private-market activities but also can be utilized to provide tax-free public benefits and services. Once a policy area is designated to receive funding, political actors can choose between direct spending and tax expenditures otherwise known as indirect spending. The political choice of tax expenditures to fund policy objectives results in a less visible policy path, more regressive income distributional effects, and an altering of the balance of power in society towards the private sector and away from the public sector. This chapter is organized into the following sections: the concept of tax expenditures, the methodology of tax expenditures, the policy process of tax expenditures, the policy effects of tax expenditures, the growth of tax expenditures during the modern era, and tax expenditures for social welfare policy.

Tax Expenditures

In 1967, the tax expenditure concept was created by Stanley Surrey, then Assistant Secretary of the Treasury, as a means to elucidate the political use of tax breaks for means that were usually accomplished through direct spending programs. Secretary Surrey argued that members of Congress were using tax policy not as means to raise and collect revenue but as a ``vast subsidy apparatus" to reward favored constituencies or subsidize narrow policy

[6] The different individual tax programs for social welfare in 1967 and 2007 are listed in tables 3.1. and 3.2.

areas (Surrey 1973, p. 6). The primary purpose of the American tax system is to collect revenue for the operation of government in a manner that is fair to all taxpayers. The federal individual and corporate income taxes supply over 60 percent of total government revenues. Incomes taxes are the main sources of progressivity in the nation's tax system. This system is progressive in that it obtains a larger share of national income from wealthier families as compared to working-class families. The federal income tax system counters the regressive effects of other large revenue sources such as payroll taxes, federal excise taxes, and state and local sales tax. Tax expenditures alter the horizontal and vertical equity of the basic tax system by allowing exemptions, deductions, and credits to specialized groups or activities.

Historically, the U.S. income tax system has been used to promote social and economic goals. Since the initial adoption of the income tax, numerous provisions have been labeled as "tax loopholes" or "tax breaks." These terms were used to identify a tax evasion not foreseen by Congress but discovered by tax lawyers. There is a second category of long-standing tax provisions that encourage homeownership, subsidize the provision of private-group health insurance, encourage retirement savings, and subsidize charitable organizations. It is recognized that most of these provisions were adopted deliberately by Congress as "tax preferences" and were not unintended escape routes for income tax evasion. The tax expenditure concept takes the next step, recognizing that these "tax preferences" are really government spending programs and, consequently, public assistance administered through the tax code. The Congressional Budget and Impoundment Act of 1974 (CBA) officially codified and defined tax expenditures as "those revenue losses attributable to provisions of the Federal tax laws which allow a special credit, a preferential rate of tax, or a deferral of tax liability." The tax expenditure method of social policy financing is the government's primary means to subsidize private-sector social benefits and services.

There are three main types of tax expenditures: exclusions, deductions, and credits (less frequent are preferential tax rates and deferrals of tax liability). The difference between exclusions, deductions, and credits relates to where each provision factors into the calculation of income and tax liability. Exclusions are those items excluded from gross income, which means they never enter into the "top line" calculation of the taxpayer's tax base. Deductions are those items that may be subtracted from gross income in computing taxable income. Credits are allowed against the tax rates imposed by the tax code, thereby reducing an individual's tax liability. Refundable credits provide a payment to the individual even if all of her tax liability is eliminated. For example, the Earned Income Tax Credit (EITC) acts as a wage subsidy for taxpayers at or near the poverty line. The EITC is based on a percentage of a worker's earnings and is usually large enough to compensate for the taxes owed and entitle the worker to a refund (Howard 1997).

The Methodology of Tax Expenditures

The Congressional Joint Committee on Taxation annually estimates tax expenditures in terms of revenues lost to the U.S. Treasury for each special tax provision included in the U.S. tax code. A provision has traditionally been listed as a tax expenditure if it departs from the normal income tax structure and if it results in more than a de minimis revenue loss ($50 million). Under the JCT methodology, the normal tax structure for an individual includes the following: one personal exemption for each taxpayer and one for each dependent, the standard deduction, the existing tax schedule, and deductions for investment and employee business expenses. Most tax benefits to individual taxpayers can be classified as exceptions to "normal income tax law" and therefore qualify as tax expenditures. Each annual tax estimate is a function of subtracting two predicted streams of revenues: predicted revenues under current law from predicted revenue under new and expanded tax provisions. According to the JCT, these estimates have been excellent predictors of actual changes in government tax receipts as calculated by the I.R.S. returns.

The initial step in tax expenditure analysis is to distinguish between the structural component, the normal baseline, and its tax expenditure component. The structural component has the following aspects: provisions that establish the tax base, the definition of income, the tax period, the taxable units, the rate structure, application of taxes to international transactions, and administrative procedures. The remaining provisions constitute tax expenditures for specially designated activities or groups. Congress recognized this distinction with the Budget Act of 1974 that identified tax expenditures as “special provisions” that constitute a “deviation from the normal tax structure.” The crucial task for economists developing an income tax system is to define income for the purpose of tax calculations. The normal tax baseline in based on the Schanz-Haig-Simons (S-H-S) definition of income. The S-H-S concept defines net income as an increase in net economic wealth between two points of time plus consumption during that period. The S-H-S method does not specify which accounting techniques should be used in formulating consumption, so the Treasury uses standard business accounting techniques in establishing the baseline. Essentially, by declaring a provision a tax expenditure, the treasury is stating that the provision is not a function of the normal tax structure.

Economists claim that caution should be used in the summation of individual tax provisions since there is a possible interaction effect. The revenue estimate for a tax expenditure is based on the assumption that it alone is repealed and that all other provisions remain constant. As the JCT analysis states, “In general, elimination of several itemized deductions would increase revenue by less than the sum of revenue gains measured by eliminating each item separately because more tax payers would use the standard deduction. Conversely, elimination of multiple items that are exclusions from the adjusted gross income would increase revenue by more than the sum of individual gains because taxpayers would be pushed into a higher tax bracket” (JCT 2008).

This interaction effect should not preclude the use of the sum of individual tax expenditure items as the total tax expenditures amount. First, the interaction effect would only occur if a tax expenditure for social welfare was eliminated prior to the estimates being reported by the JCT. I was careful in using the tax expenditure estimates from the exact fiscal year reported and not the two, three, or four year estimates. For example, the tax expenditures listed for the year fiscal 1994 comes from the JCT report ``Estimates of Federal Tax Expenditures for Fiscal Years 1994-1998" published at the end of the fiscal year 1993. Therefore, if no individual tax provision is eliminated in the short time period between the end of the fiscal year and the publication of the estimates, the hypothesized interaction effect will not occur. Additionally, the JCT calculates the possible interaction effect of including new tax provisions in their estimates. Next, the same interaction effect occurs in totaling estimated direct outlays. A repeal of one of the public welfare programs may not reduce total outlays by the amount associated with the program. The results occur if benefits under the repealed welfare program must be counted in determining an individual’s eligibility under another welfare program. In essence, repeal of one welfare program could make more people eligible for another, and total government outlays would increase for the program continued. No one asserts that budget outlays cannot be added to produce a total outlay figure, even though the interaction effect described above exists. Nor should this interaction effect prevent tax expenditure items from being totaled.

Collecting and Cleaning the Data

These data were collected by contacting the Joint Committee on Taxation (JCT), a nonpartisan committee of the United States Congress created under the auspices of the Revenue Act of 1926. I requested from the JCT all the documentation of tax expenditures they had over the last fifty years. The first public report was issued in 1972 and a report has been published annually every year since, with the exceptions of 1974 and 2000. The 1972 and 1973 reports were prepared as special requests prior to the Budget Act of 1974, which requires the publication of all tax expenditure estimates. The mandate for annual publication according to the Budget Act began with the 1975 report. There is only one break in the estimates from 1967-2008 when no report was prepared in 1974 and therefore no data is available for 1973. While no report was filed in 2000, there is no break for the estimates of tax expenditures. The tax expenditures categorical values are represented in billions of dollars for each year. From 1967-1985 tax expenditures were calculated in millions; I have converted these figures into billions so that one unit of measurement can be used across the total time period. For the analyses presented in the following chapters, the values are calculated as constant 2007 dollars.

Tax expenditures are organized into budgetary categories that match direct outlays. There are 18 categories or functions of tax expenditures, and they are the following: National Defense; International Affairs; General Science, Space and Technology; Energy, Natural Resources and Environment; Agriculture; Commerce and Housing; Transportation, Community and Regional Development; Education, Training, Employment and Social Services; Health; Medicare; Income Security; Social Security and Railroad Retirement; Veterans' Benefits and Services; General Purpose Fiscal Assistance; and Interest. I chose to organize the data into the following four categories as to represent social welfare: *health care,* which includes the two budget categories of Health (includes Medicaid) and Medicare; *income security,* which includes the budgetary category of Income Security, the subcategory Employment from the Training, Employment and Social Services, Social Security and Railroad Retirement, and Veterans' Benefits and Services; *welfare,* which includes the subcategory of Social Services in the Education, Training, Employment, and Social Services category along with the EITC program that is listed under the budgetary category Income Security; and *education,* represented by the subcategory Education from the category Education, Training, Employment and Social Services. In each category for each provision, the revenue lost is bifurcated into two categories, Corporations and Individuals. I used only the Individuals section of the tax expenditure listings.[7]

The Policy Process of Tax Expenditures

The use of tax expenditures for social welfare policy has been referred to as "hidden," "shadow," or "subterranean" politics (Howard 1997; Hacker 2002; Gottschalk

[7] For each tax expenditure program there are two categories: individual and corporation. I use only the individual category for a number of reasons. First, the vast majority of indirect social spending occurs in this category, over 90%. Next, the category of corporation represents "corporate welfare" and is not the concept I'm measuring and testing in this project.

2000). These descriptions all relate to the clandestine legislative processes from which tax expenditures are passed and expanded that differ drastically from the appropriations process of direct spending programs. Any financial aid or incentive program may be written as a tax expenditure or direct spending program. Tax expenditures are not subject to the same rules and procedures as direct spending in the budgetary process. The budget process has three main goals: to establish spending priorities, to set the upper bound for federal spending, and to evaluate, coordinate, and control spending for particular programs. The congressional budget process divides the spending and revenue functions. Tax expenditures face less scrutiny primarily because they fall on the revenue side of the budget process. Revenue items such as tax expenditures are not reviewed as part of the annual budget process. They are discussed and reported in a separate appendix to the annual budget process, making them less visible. On the spending side, the Budget and Appropriations Committees determine the discretionary spending levels for each budget category. On the revenue side, the tax writing committees are simply given a revenue floor; above the revenue floor, the tax writing committees can trade off tax rate changes with tax expenditures. Indirect and direct spending measures have an inverse relationship in the budget process. Increases in tax expenditures reduce the amounts of available resources for direct outlays. Conversely, reductions in tax expenditures increase revenues available for direct outlays or general tax cuts. In Congress, the Senate Finance and House Ways and Means committees have exclusive jurisdiction in both approving and "appropriating" tax expenditures. Indirect spending provisions are created or expanded in revenue or tax reform bills. In contrast, direct spending measures must pass through standing committees with jurisdiction over a specialized policy area, as well as the Budget and Appropriations committees that fix discretionary spending levels for each budget category. In summary, indirect spending measures follow an alternative policy path, facing fewer veto threats in their creation and expansion and not being subject to any review process.

There have been numerous legislative acts that have attempted to operationally equalize indirect spending to direct spending measures in the budget process. The enactment of the Congressional Budget and Impoundment Act of 1974 requires the annual reporting of tax expenditures by the Treasury Department and Congress. The CBA of 1974 established a Senate and House Budget Committee whose essential function is to develop an overall congressional approach for the annual budget process. This act also required the newly created Congressional Budget Office (CBO) to submit annual projections of tax expenditures for the five succeeding fiscal years. The budget committees use the basic CBO list in preparing their respective reports on direct and indirect expenditure estimates that are given to all the relevant congressional committees. The intent of publishing an annual tax expenditure list was to make it easier for legislators to consider indirect versus direct spending programs under the same policy area. The Budget Enforcement Act of 1990 (BEA) mandated that direct spending and tax expenditures be treated as equivalent for the purpose of setting spending limits under the new pay-as-you-go requirement (PAYGO) for mandatory spending. Since the Omnibus Budget and Reconciliation Act of 1990, discretionary spending programs have been subject to an overall ceiling. The Office of Management and Budget (OMB) creates two lists of tax expenditures: one using the standard methodology of revenue lost, and the second measuring tax expenditures as direct outlay equivalents.[8] The

[8] The OMB has reported tax expenditures as direct outlay equivalents since 1981. This estimate is not used here and in most empirical studies of tax expenditures given the shorter time series, and the methodology

Government Performance and Results Act of 1993 requires yearly examinations of tax expenditures by the White House, yet according to one recent study this has been largely ignored by recent administrations (Hungeford 2008).

The Administration of Tax Expenditures

On the bureaucratic side, the Internal Revenue Service within the Department of Treasury administers tax expenditures. The administration of indirect spending differs from direct expenditures in the visibility of administrative costs and the determination of eligibility and benefits. The costs of administering direct social spending programs appear explicitly as part of the program agencies' budget. On the other hand, the administrative costs to the I.R.S. are not readily identifiable because there is no separate categorization of costs based upon normal tax provisions versus tax expenditures. Economists argue that tax expenditures add complexity to the tax structure and raise the costs for the I.R.S. in enforcement and taxpayer service (Surrey and McDaniel 1985). The Department of Treasury administers close to 70 tax expenditure social programs with no admitted expertise or vested interest in any of the social welfare policies. Therefore, unlike public social welfare programs, such as Social Security, which enjoy strong support from their bureaucratic administrators, tax expenditures exist in spite of little bureaucratic enthusiasm from the I.R.S. (Campbell 2003; Hungerford 2008).

The eligibility for tax incentives depends on characteristics of taxpayers or their behavior. Since tax breaks are self-reported, taxpayers must have both sufficient knowledge to determine which tax provisions they qualify for as well as having adequate economic incentive to itemize their returns. On the contrary, direct spending programs often base

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for calculating these estimates has changed over time with shifts in political party control of the executive branch.

eligibility for public benefits on general criteria or the discretion of an administrator. Direct spending programs' rules are usually enforced more stringently than those involving tax incentives. For most public social welfare programs, beneficiaries have to file claims and sometimes appear in person before an administrator to receive a cash benefit. Conversely, any taxpayer can claim tax expenditures on their returns. The I.R.S. reviews eligibility only after the fact, either in an audit or through calculations on individual returns that are then compared and confirmed with third parties. Additionally, the self-reporting feature of tax returns does not carry the stigma of receiving public benefits and deters fewer people, whether they are eligible or not, from claiming tax benefits. Tax expenditures function as a form of entitlement spending in that everyone who qualifies receives benefits and are not subject to annual reviews. In contrast, funding for direct discretionary spending is set annually, requiring Congress to make a decision every year to continue or not continue funding.

The Policy Effects of Tax Expenditures

Tax expenditures redistribute national income in a different direction than traditional social welfare programs. The majority of tax expenditures, all but tax refundable credits, have regressive effects on national income redistribution. According to economists at the JCT, since the income tax has a progressive structure, tax expenditures formulated as deductions and exclusions generally reduce the progressivity of the tax system by reducing average tax rates more for higher marginal rate taxpayers than for lower marginal rate taxpayers. For example, if a worker in the 40 percent bracket is allowed to exclude $10,000 from her income, she receives a tax expenditure of $4,000. If a similar worker in the 10 percent bracket is allowed to exclude the same $10,000 from her income, her tax break is only $1,000 dollars. If instead of a tax expenditure each worker received a direct government payment of $10,000 and the receipt was taxable, the lower bracket worker benefits more with $9,000 available to her after tax, whereas the other worker is left with just $6,000. Therefore, social welfare benefits directed through tax deductions, exclusions, and nonrefundable tax credits reduce the progressivity of the income tax structure. Conversely, tax expenditures constituted as refundable tax credits generally increase the progressivity of the tax system (JCT 2008). Additionally, it is important to consider if and how these tax cuts are financed with changes in direct federal spending. If an increased deduction for employer-sponsored health care is paid for by a decrease in Medicaid payments, this exchange is certain to cause a rise in economic inequality.

The vast majority of tax expenditure programs disproportionately benefit upper-income groups. Only those who itemize their personal deductions receive benefits from most tax expenditures. As of the mid-1990s, approximately one in three taxpayers itemized their taxes beyond the standard deduction. According to data from the I.R.S., taxpayers in higher income brackets are much more likely to itemize their deductions than those citizens in lower brackets. In 2005 at the federal level, 93.3% of taxpayers making a yearly income of $200,000 and above itemized their returns. In the same year, 89.5% of taxpayers making $100,000-$199,999 itemized their taxes as compared to 76.2% of taxpayers in the income bracket of $75,000-$99,999.[9] In the lowest two income groups, 58.3% of taxpayers earning an income of $50,000-$74,999 itemized their returns while only 17.9% of citizens making under $50,000 itemized in 2005. Additionally, the use of deductions, exclusions, and exemptions excludes nontaxpayers, the poorest Americans, from tax benefits for social

[9] In 2007, if a taxpayer's income was over $156,400, the total itemized deduction amount is reduced.

purposes. Since home ownership along with its accompanying deductions for interest and property taxes is almost essential for an individual to itemize, it is fair to say that the majority of tax expenditures for social benefits are government welfare for wealthy homeowners.

Not only are tax expenditures the primary culprit in creating tax inequity, they also distribute money in a way that most Americans would deem unfair for social programs that usually are targeted towards society's most vulnerable populations. For example, the medical expense deduction is in essence a regressive, national health care program run through the tax system. In the program, there is a deductible, similar to private insurance, in that only medical expenses in excess of 7.5 percent of adjusted gross income qualify for the tax deduction. Additionally, there is a coinsurance element requiring taxpayers to pay a portion of their medical expenses above the deductible level. The regressive nature of this program lies in the coinsurance element, since it is a function of a citizen's marginal income tax rate. If an individual in the 10 percent bracket incurs $100 of medical expenses above the deductible level, under the coinsurance element he or she must pay $90 of those medical expenses and the government pays $10. A taxpayer who makes $60,000 a year in a hypothetical 25% bracket and incurs the same $100 of medical expense above the deductible level will pay $75, and the government will pay $25. Finally, the wealthiest individuals making more than $300,000 adjusted gross income and up will pay $50 of each $100 of medical expenses over the deductible level. Taxpayers that are at or below poverty level and those who do not itemize their personal deductions receive none of this government aid.

The Growth of Tax Expenditures During the Modern Era

In 1967 there were 50 tax expenditure programs at a total cost of $36.5 billion. In 2008 there were 170 tax expenditure programs and the total cost was close to one trillion dollars. Tax expenditures have grown at a much faster pace than direct spending, whether measured by relative percentages or as a percentage of Gross Domestic Product (GDP). In some social budget categories, tax expenditures have assumed far greater importance than direct spending provisions in financing benefits and services. A combination of partisan and institutional features is responsible for the increase in indirect spending. First, tax expenditures face fewer veto points along the policy process than financing for public programs. All else equal, it is easier for a legislator to fund a desired program or please a favored constituency using tax expenditures versus direct spending. Next, the vast majority of tax expenditures are not subject to any review process. The lack of review results in tax expenditures functioning as a type of mandatory spending that grows every year, regardless of political party control or public mood. Finally, during this period there was an increase in public conservatism that resulted in more Republican influence and a rise in tax breaks.[10] Politicians from both parties, responding to the changes in mood, used tax expenditures to promote policy objectives and increase spending in a manner that rhetorically came across to voters as an effort to reduce the size of government.

As Figure 3.1 shows, tax expenditures as measured as per capita grew at a quick pace from 1972-2007. Indirect spending increased exponentially until 1987 and then proceeded to steadily increase again during the 1990's. The steep drop in tax expenditures in 1987 was a result of the Tax Reform Act of 1986. This act was a product of Republican

[10] As measured by Stimson's (1999) public mood measurement of mass opinion.

President Ronald Reagan receiving tax cuts for marginal income and corporate rates from the Democratically-controlled Congress in exchange for eliminating a number of tax breaks for businesses. Interestingly, most of the existing tax breaks for social welfare were not eliminated by this legislation, and indirect social spending continued to grow unabated. Tax expenditures for social welfare have grown over the last thirty years as a percentage of all tax expenditures and now represent over 50% of total tax expenditures in the United States.

Conservative Think Tanks, Tax Expenditures, and the Construction of a Private Social System

The rise of conservative think tanks assisted the Republican Party in creating a policy environment favorable for the construction of a private alternative social system. The 1960s and 1970s saw a series of new organizations to regulate businesses including the Environmental Protection Agency (EPA) in 1970, Consumer Product Safety Commission (CPSA) in 1972, and the Occupational Safety and Health Administration (OSHA) in 1975. These regulatory agencies were created at the end of a period of policy liberalism, which included the creation of Medicare and the strengthening of Social Security. One way that conservative and business leaders responded to a long era of political liberalism was to construct a universe of think tanks for the outlet and marketing of ideas that promote capitalist markets. Andrew Rich (2004) defines think tanks as “independent, non-interest based, nonprofit organizations that produce and principally rely on expertise and ideas to obtain support and to influence the policymaking process”(p.211).[11] In the following sections, I examine the rise of conservative think tanks and their promotion of pro-market policy.

[11] This definition does not preclude ideological think tanks.

Conservative think tanks have grown in power and wealth since 1970. According to recent study, 80.7 % of the think tanks in existence by 1996 were formed after 1970. This same study categories the existing think tanks by ideological leanings and finds that 31% of think tanks are conservative, 19% are liberal and 56% are centrist or unidentifiable (Rich 2004). The 1970s were a period of growth for conservative think tanks including the founding of the Heritage Foundation in 1973 and the Cato Institute in 1977. Although, there were liberal think tanks such as the Center for Budget and Policy Priorities and the Economic Policy Institute, their budgets were and are much smaller than the conservative organizations. For example, conservative think tanks accrued $156.4 million of resources compared to just $47.8 million for liberal groups in the fiscal year 1996. Smith (2007) argues that the economic insecurity and instability of the 1970s allowed conservative think tanks to make arguments around the economic consequences of policy instead of civil rights and civil liberties. Numerous studies argue that conservative think tanks main effort was to publicly laud and promote the benefits of unfettered capitalism while at the same time pointing out the flaws, danger, and inefficiencies of the government (Ricci 1993; Smith 2000, 2007). The American Enterprise Institute, the Heritage Foundation, and Cato Institute moved to reframe arguments to emphasize the potential economic harm from consumer and environmental protection (Ricci 1993). In addition, conservative researchers argued that the freedom of the market was tied with the freedom of the individual; citizens could not be free in a society where the market was restrained by the government. The movement to an economic framework for policy problems was coupled with private alternatives to public programs.

The Republican Party worked in cooperation with think tanks to promote conservative tax policy. Conservative leaders, beginning in the 1970s, believed that the success of the Democrats was largely due to their advantage in the marketplace of ideas. On multiple policy fronts, conservative think tanks advance the specific view that the private market is the main system for social adjudication and wealth production. Conservative think tanks were most successful in promoting an alternative to the dominant Keynesian economic ideology through marketing the idea of "supply-side economics." Supply-side economics theorists argued that decreased taxes for the wealthy, or those who owned capital, would spur investment into new labor, machinery, and supplies. The adherents of supply-side economics further argued that new tax cuts would pay for themselves and not increase the budget deficit since new investment and expanded growth would compensate for the revenue lost through the initial tax cuts. These organizations along with policy groups have pushed for the privatization of Social Security and Medicare.

An integral aspect of the privatization movement is building a private-sector alternative health care and pension structure. Tax expenditures are an important part of this privatization strategy. For example, the National Center for Policy Analysis (NCPA) put forth many ideas for privatizing Medicare, including developing the Medical Savings Account concept that passed as part of HIPAA in 1996 (Callahan 1999). The Medical Savings Account was replaced by the broader, more inclusive Health Savings Accounts passed by President Bush and a Republican Congress in 2003. The NCPA was also responsible for promoting a law that would automatically enroll all employees into their company's 401(k) plans. The Heritage Foundation has been integral in the Republican effort to scale back Social Security. Teles (2007) argues that the Republican Party, with assistance from Heritage, designed a disentrenchment plan for Social Security, which required that conservatives weaken the public's belief in the guarantee of future Social Security benefits and increase their reliance and familiarity with private alternatives. After the Republicans were defeated in reducing Social Security in 1982, Stuart Butler at the Heritage Foundation began promoting the idea of using 401ks and IRAs to construct an alternative to Social Security (Rich 2004). As Teles (2007) argues, "instead of describing an abstract idea, widespread of use of IRAs would allow conservatives to point to something a wide range of individuals were already using and encourage them to compare their returns from Social Security and their IRA" (pg.170). Social Security and Medicare have proven to be too popular for frontal assaults from the Republican Party. Consequently, conservative think tanks and Republican leaders supported a long-term strategy of building a private alternative to the public social system.

Tax Expenditures and Social Welfare

The composition of tax expenditures has changed over the last thirty years. Tax expenditures can be classified as one of two types – business and social tax expenditures. Business tax expenditures are those that are intended to promote investment generally or to help certain industries that Congress considers important for economic development and growth. These include items such as the exclusion of extraterritorial income, accelerated depreciation for investments in machinery and equipment, and tax incentives for energy production such as oil and gas. Social tax expenditures subsidize the consumption of health care, welfare, education and income security. Using these categories, social tax expenditures have grown steadily at the expense of business tax expenditures over the last thirty years.

As figure 3.2. demonstrates, spending for social welfare as a percentage of all tax expenditures has grown rapidly. Social welfare is measured as tax provisions that subsidize health care, income security, welfare, and education. There is a stark upward trend in the percentage of tax expenditures directed towards social policy from 31.2 percent in 1973 to 51.8 percent in 2007. The fastest growth of social welfare tax provisions as a percentage of total tax expenditures occurred in a five-year period from 1986 to 1990, in large part due to the massive decrease in tax expenditures for business purposes as part of the Tax Reform Act of 1986. Not only were tax expenditures for social welfare spared the knife of the 1986 reform, new provisions were added. For example, in the health care category, tax breaks for hospital insurance and supplementary medical insurance were added in 1986. There was another noticeable increase in tax expenditures of ten percent in the period from 2002 to 2007. This change was driven by new tax expenditures for Medicare, expansions of existing tax expenditures for individual retirement plans, and increases in the EITC. At the end of the series in 2007, tax expenditures for social purposes constituted over half of all tax expenditures. This number increases to 60 percent if tax expenditures for interest are excluded from the calculation. In the following sections, social welfare is broken down into the four subcategories of health care, income security, welfare, and education. The following descriptive analyses select four time periods in ten year intervals to demonstrate the growth of tax expenditures in each policy area over the last forty years. The trends are clear – tax expenditures have steadily accounted for more of the government's effort to fund all four areas of social policy.

Health Care

The health care system in the U.S. is bifurcated into a public system that provides services to the elderly and poor and private-market insurance that covers everyone else. In figure 3.3., indirect and direct spending for health care are placed together for the years 1975, 1985, 1995, and 2005. In 1975 tax expenditures represented just one percent of total spending for health care. There were only four tax provisions for health care in 1975: deductibility of medical expenses, disability insurance benefits, the exclusion of employer contributions to medical insurance, and disability to the blind. The percentage of health care spending constituted by tax expenditures grew to seven percent in 1985 and to 13 percent in 1995. By 2005, there were 17 individual tax provisions for health care totaling $156.4 billion in lost revenue. From 1985 to 2005, tax expenditures nearly tripled as a percentage of all health spending, to 19.7 percent. In 2005, around two-thirds of total indirect spending was made up of tax provisions for just employer-provided health insurance.

The growth of indirect spending for health care can be credited to the inclusion and expansion of the tax incentives for employer and individual health insurance. Employee compensation in the form of payments for health insurance premiums and other medical expenses is deducted as a business expense by employers and not included in an employee's gross income. There are three broad categories of tax expenditure programs in the area of health care: insurance purchase subsidies, benefits for taxpayers who have incurred major health-related expenses, and general health benefits. In the category of insurance, there are tax breaks for the exclusion of employer contributions to accident and health plans, self-employed health insurance premium deductions, and the exclusion of benefits under cafeteria plans. In 1985, cafeteria plans were added that allow employees to choose from a selection of fringe benefits, including some that are not subject to tax. Cafeteria plans are more likely to benefit wealthier employees in higher marginal tax brackets, as taxpayers are more likely to choose fringe benefits that receive tax preference. Self-employed people can deduct 30 percent of their total health insurance costs every year. In the second category, personal out-of-pocket outlays for medical expenses exceeding 7.5 percent of adjusted gross income are deductible, along with prescription drug exemptions and dental expense deductions. Finally, the general category includes the medical savings account deduction, long term care credit, disability access expenditure credit, and the blind exemption credit.

Income Security

The income security category constitutes programs that are designed to protect workers against the risks of the economic market and mainly pertains to old-age pensions. The percentage of indirect to direct income security spending is presented in figure 3.4 Paradoxically, income security represents the social welfare category with the highest number of individual tax provisions yet the lowest percentage of indirect spending. In 1975, there were 24 individual tax provisions for programs such as retirement savings, workers' compensation, and unemployment insurance. The number of income security provisions grew to only 27 by 2005 and totaled around 175.7 billion dollars. Income security tax expenditures grew at the slowest pace of all the social welfare categories. As of 2005, tax expenditures accounted for only 13.2 percent of total income security spending. The long-term stability and popularity of Social Security is the primary cause for the relative slow growth of tax expenditures for income security as a percentage of total spending. Although the number and generosity of tax incentives for private retirement plans grew during this period, they did not keep pace with social security payments. This category represents a clear example of a dominant public social program that crowded out the growth of alternatives and has relegated private pensions to a complementary status. The net exclusion of pension contributions and earnings for employer plans, individual retirement accounts, and the Keogh plans represent the three largest tax expenditure programs for income security and together total two-thirds of all expenditures in this category.

The income security tax programs can be organized into two categories: subsidies for investment in retirement plans and other employee related expenses. In the first category of retirement investment are tax incentives for individual retirement accounts, the exclusion of employee contributions to pension plans, and self-employed pension plans. Employee contributions to pension plans and other kinds of personal retirement savings are excluded from an individual's adjusted gross incomes. Pension contributions or benefits must be based on an equal percentage of salary for all eligible workers (up to the max of $30,000 a year). Full-time workers must be given a full right to accrued benefits after five years on the job. All taxpayers without employer-provided retirement plans are eligible for IRA deductions. Workers can deduct annual contributions to an IRA of $5,000 per year for individuals and $10,000 per year for family. In 1981, eligibility for tax-deductible IRAs was granted even to workers with pensions, but that expanded IRA tax break was scaled back in 1986. In 1997, Roth IRAs were expanded, becoming available for more workers with pensions. Self-employed taxpayers can make deductible contributions to their own retirement (Keogh) plans equal up to 25 percent of their annual income.

In the category of other employee-related expenses are provisions such as the exclusion of meals and lodging furnished by an employer, the exclusion of employer-provided education assistance, the exclusion of employee business and miscellaneous expense deductions, the exclusion of miscellaneous fringe benefits, the exclusion of transportation- related fringe benefits, and the moving expense deduction. There are other employer fringe benefits that enjoy the status of tax expenditure. Many employers cover part or all the cost of premiums for employees' life insurance benefits, accident and disability benefits, death benefits, and supplementary unemployment benefits. Again, the amounts are deductible by employers as business expenses and are excluded from employees' gross income. The three largest programs in this second category are the exclusion of miscellaneous fringe benefits, premiums on group life insurance, and premiums on accident and individual life insurance that together add up to around 10 percent of total income security spending.

Welfare

In figure 3.5., the change in welfare expenditures is far and away the most dramatic shift in social spending during this period. In 1975, there were just seven tax expenditures for welfare that totaled 5 percent of all welfare spending. The individual welfare provisions were a deductible for child care facilities, credit for employing AFDC/WIN workers, deductible for charitable contributions, deductible for child and dependent care expenses, Earned Income Tax Credit (EITC), and the exclusion of public assistance. The rise of indirect welfare spending from 1975 to 1985 was driven by the eligibility and benefit expansion of the EITC and the erosion of direct welfare spending. In this same period, only one new tax break for welfare was added and the majority of spending was done through just two individual tax breaks: the EITC and the deductible for charitable contributions. By 2005, there were 12 tax provisions for welfare, with the most significant addition being the tax credit for dependent children under the age of seventeen passed during the Clinton administration. The total amount spent on welfare through tax expenditures was $119.3 billion in 2005, which represented 79.8 percent of all federal welfare spending. This tremendous growth in indirect spending has as much to do with the popularity of EITC and the child tax credit as it does with the reform and devolution of direct federal welfare programs.

The tremendous increase in indirect welfare spending was driven by three tax expenditure programs: EITC, the child credit, and the deduction for charitable contributions. The EITC is designed to supplement the wages of low income workers, primarily working families with children. It is available whether or not a family owes income taxes. That is, eligible workers can get a tax refund even if the credit exceeds what they otherwise owe in taxes. The child credit tax provision was adopted in 1997 and provides $500 for each child under age seventeen. Working families with children get a tax credit for the percentage of their child care expenses. Foster parents are not taxed on the payments they receive for their services. Finally, contributions to charitable, religious, and certain other nonprofit organizations are allowed as itemized deductions for individuals, up to 50 percent of adjusted gross income. The tax provision for charitable contributions has complex effects given that most of the direct monetary benefits go to the wealthiest Americans, yet it has been proven to increase the amount of donations to organizations that primarily service the poor and disabled (Lipsky and Smith 1989).

Education

The federal government has taken on a larger role in post-secondary education largely through the creation of new tax expenditure programs. In figure 3.6., education spending displays a similar pattern to health care and income security. In 1975, four tax expenditures for education totaled less than one percent of education spending. By 1995, the number of provisions had doubled to eight and totaled $4.9 billion dollars. In a ten year period from

1985 to 1995, the percentage of indirect education spending more than doubled to 19.1 percent of total expenditures. In 2005, the number of new tax breaks for education quadrupled from four to 16 at a total cost of $19.4 billion dollars. This increase was aided by new tax credits for post-secondary education passed under a Republican Congress and during President Clinton's second term. For example, the HOPE tax credit, lifetime learning credit and deduction for student loan interest are relatively new tax preferences for postsecondary education. The Educational Individual Retirement Accounts (EIRA) allows a contribution of $500 per year per child to save for educational expenses. Finally, taxpayers can claim personal exemptions for dependent children 19 or over who receive parental support payments of $1,000 a year or more, are full-time students, and do not claim a personal deduction. The three largest tax expenditure programs for education are charitable deductions for educational institutions, tax credits for post-secondary education, and deductions for higher education expenses. These provisions constitute over half the total amount spent in this category.

In summary, indirect spending has risen as a percentage of total spending in each of the four categories. In the cases of education and health care, tax expenditures now represent one out of every five dollars allocated to these policy areas by the federal government. In the category of welfare, indirect spending has replaced direct spending as the dominant policy tool used to direct funds to the nation's poor. This has been driven by the popularity of the EITC program and the narrowed scope of public welfare under the transition from AFDC to TANF. The category where tax expenditures have grown the least is in the area of income security. Although the number and generosity of tax incentives for private retirement accounts have grown, they have not outpaced the increased client base and payment increases of Social Security

CHAPTER IV

THE POLITCS OF SOCIAL POLICY: PARTISANSHIP AND SOCIAL EXPENDITURES

The Democratic and Republican parties' stark differences over the role of government in the provision of social benefits have defined political conflict since the New Deal. This chapter empirically tests the partisan theory of social welfare and changes to direct and indirect social expenditures in the United States from 1967-2006. The goal of these tests is to determine how changes in political party control at the federal level influence the government's efforts to directly fund public social programs or subsidize private benefits. The influence of political party control on direct spending for public social programs is well known. An area of study less understood is how partisanship and public policy affect private-sector social welfare. For the first time in empirical political science, this chapter puts together measures of both direct public financing and government subsidies to the private market in analyzing how partisanship shapes both total social spending and the ratio of indirect to direct social expenditures. In addition, I examine the influence of partisan trends, such as divided government and party polarization, on the direction of social welfare expenditures.

The Divided Social Welfare State

There are two social welfare systems in the United States: one public and the other private (Hacker 2002). The public social welfare state created mainly during the New Deal and Great Society periods is composed of programs such as Social Security, Medicare, Medicaid, and the Temporary Assistance to Needy Families (TANF).[12] The private side of the social welfare state constitutes mainly employer-provided social benefits and private social services. Although the decision to offer employer social welfare is determined by businesses through the private market, these benefits are heavily subsidized by the federal government. The politics of the private social system in the United States has largely been ignored by social scientists with a few notable exceptions (Howard 1997; Hacker 2002). In the fiscal year 2008, the U.S. government allocated more than $600 billion to private-sector social welfare in the form of tax subsidies. Out of this total, more than $300 billion worth of tax breaks went for employer-sponsored health care and pensions alone (Congress 2008). In ignoring private-sector social benefits, scholars unnecessarily exclude a significant amount of government activity from their research and the means through which most American citizens receive social benefits and services. In this chapter, I build on a small but growing body of literature that studies the government's role in both public and private social welfare provision by presenting an empirical examination of the partisan influences on indirect versus direct social spending.

Social policy, properly defined, includes all government efforts to provide social benefits both through direct provision and indirect methods of private subsidization. Indirect

[12] In this project the terms ``social welfare," ``welfare state," and ``social policy" will be used interchangeably. This is common usage in public policy and comparative politics. This differs from studies of American politics that only use the term welfare to represent means-tested programs targeted at the poor.

and direct social spending follow different policy paths, subsidize different social providers, are allocated to different beneficiaries, and have different policy effects. Understanding these differences is critical to properly representing the size, scope, and scale of partisan influences on social welfare policy in America. To date, empirical studies of partisanship and social policy have not systematically analyzed nor tested the influence of political parties on the various forms of public financing used to fund total social benefits, both public and private. This chapter applies a new partisan theory of social policy to address the following questions: first, if both major forms of government financing for social programs, direct and indirect, are included in measuring total social expenditures, do traditional theories of partisanship still explain yearly changes to social spending? Second, considering the important policy consequences that result from using indirect versus direct spending, how does Democratic and Republican party control differ in influencing the ratio of indirect to direct social spending? Finally, how does the presence of divided government or party polarization explain changes to social welfare expenditures, in addition to political party control?

My findings indicate that Democratic party control does not clearly correspond with higher annual increases to total social welfare expenditures. However, partisanship does change the ratio of indirect to direct social expenditures. Republican influence, especially in the legislature, corresponds to increases in the social welfare expenditure ratio. Furthermore, divided government correlates with the social welfare expenditure ratio in the opposite direction than predicted while party polarization demonstrates no effect on spending. These results are important in understanding the political and institutional influences on changes to the public and private social systems in the United States.

Measuring and Testing the Partisan Theory of Social Policy

My theoretical argument suggests a certain relationship between political parties and social expenditures. Contrary to common wisdom and previous research, I do not posit that the two major political parties substantively differ on changes to the total social expenditures. Where the two political parties do differ is on the question of which sector, public or private, should be responsible for the provision and administration of social benefits and services. These divergent philosophies can be captured through changes to the ratio of indirect to direct social expenditures. The partisan theory of social policy argues that each party designs social policy to reflect their electoral strategies and values. Consequently, the Republican Party implements financing tools that do not require public administration and subsidizes the private sector and their supporters, while Democrats promote direct spending that is channeled through public agencies and to their constituencies. I expect that under periods of Republican Party control more indirect social spending will be substituted for direct expenditures.

Direct and indirect spending are the two largest categories of public expenditures for social programs that together summed to over 1.5 trillion dollars in 2006.[13] There are two dependent variables used to represent social policy. The first is a measure of total social spending that combines indirect spending data with appropriations data on direct government expenditures. The other dependent variable is the ratio of indirect to direct social spending represented by the annual change in tax expenditures for social welfare in constant 2006

[13] In table 4.1., I report the descriptive statistics for the social expenditure ratio and all other categories of social spending.

dollars over the annual change in direct appropriations for social welfare in constant 2006 dollars.[14]

I have constructed a new data set of all social tax expenditures which represents indirect spending from 1967-2006 by compiling estimates from the Joint Committee on Taxation. The JCT estimates tax expenditures in terms of revenues lost to the U.S. Treasury for each special tax provision included in the U.S. tax code. A provision has traditionally been listed as a tax expenditure if it departs from the normal income tax structure and it results in more than a de minimis revenue loss ($50 million). Under the JCT methodology, the normal tax structure for an individual includes the following: one personal exemption for each taxpayer and one for each dependent, the standard deduction, the existing tax schedule, and deductions for investment and employee business expenses.[15] Most tax benefits to individual taxpayers can be classified as exceptions to the normal income tax law. Each tax estimate is a function of subtracting predicted revenues under the current law from predicted revenue under new and expanded tax provisions. According to the JCT, these estimates have been excellent predictions of actual changes in government tax receipts as calculated by the I.R.S. returns. In fact, according to a recent study by Burman et al. (2008), summarization of tax expenditure estimates have proven to produce similar aggregated estimates as models that take into account the interaction effects of all tax expenditures under the alternative

[14] I ran two other models that produced similar results: one with the ratio of indirect to direct social spending represented by the percentage annual change in tax expenditures for social welfare over the annual percentage change, and the second with tax expenditures as a percentage of total social spending. The difference between this last model and the one reported is just scale with one range between zero and infinity and the other between zero and one.

[15] The first JCT public report was issued in 1972 and has been published annually every year since with the exceptions of 1974 and 2000. There is one break in the estimates with no data for 1973, which is treated as missing data.

minimum tax structure.[16] The tax expenditures are organized by the JCT into the same budget categories as appropriations spending. The following budget categories from both indirect and direct spending data were selected to represent annual social welfare expenditures: Health; Medicare; Income Security; Education, Training, Employment, and Social Services; Social Security; and Veterans Benefits and Services.

In measuring direct spending, I use appropriations spending data for social welfare from the Policy Agendas Project. Jones, True, and Baumgartner (2007) have developed an appropriations data set back to the fiscal year 1947. The use of outlays versus appropriations makes a difference in capturing political influences, especially in the policy areas of defense and welfare. Wlezien and Soroka (2003) argue that scholars studying government spending should use appropriations spending since appropriations bills mandate the amount of budget authority to an agency or issue area, as compared to direct outlays that often lag behind the appropriations decision.[17] In figure 4.1, I display changes to the social expenditure ratio from 1972-2007. The ratio of indirect to direct social spending represented by tax expenditures for social programs in constant 2007 dollars over direct appropriations for social programs in constant 2007 dollars from 1972-2007. During this period, tax expenditures represented over 25% of direct spending during two Republican administrations from 1982-1987 and again from 2002-2007.

My political variables are Republican control of the executive branch and the percentage of Republicans in Congress. Republican membership in the U.S. Congress is measured as a percentage between zero and one, with a higher percentage corresponding to

[16] These authors find that using the alternative minimum tax to estimate and aggregate tax expenditures actually leads to lower values than adding up tax expenditures without the alternative minimum tax.

[17] In table 4.2 I present the sub-categories that are organized into the measures of indirect and social spending.

more Republican members. In addition, some of the models use dummy variables to measure Republican control of the two houses: the House of Representatives and the Senate. I use these measurements since my theory predicts higher Republican membership results in more indirect versus direct spending. I expect that for every unit increase in Republican Party influence, in both the executive and legislative branches, there will be an ensuing increase in the ratio of indirect to direct social spending. In addition to the political variables, economic controls are included that represent standard ideas about tax expenditures. The first economic variable is the annual percentage change in unemployment, since most indirect spending provisions are tied to employer fringe benefits. A rise in unemployment causes tax expenditures estimates to decrease as fewer employees claim employer tax credits. Also, an increase in unemployment will trigger an increase in public unemployment benefits so that the net effect will be a decrease in the indirect to direct social spending ratio.[18] Next, inflation affects tax expenditure by pushing people into higher tax brackets that in turn provides incentives for taxpayers to seek out more tax breaks, including those for social purposes. Any unit increase in the annual percentage change for inflation should increase that year's estimates for tax expenditures for social welfare.

First, I evaluated partisan changes to total social spending using a two-sample difference of means tests between Republican and Democratic Party control across the executive and legislative branches. If traditional theories of partisanship and social spending are correct, Democratic Party control will be associated with higher annual social welfare expenditures. The partisan theory of social policy predicts that there should be no discernable

[18] These numbers could be complicated by two facts: one is that employer benefits might extend for a period past the original date of unemployment and second, the public unemployment insurance program is a joint federal-state venture.

difference to annual total social spending between the two major political parties. In these tests, I use dummied variables for Republican control of the Presidency, the House of Representatives and the U.S. Senate. In addition to the difference of means tests, I ran an analysis of variance (ANOVA) to account for possible interaction effects of the three federal units and consider the influence of divided government control on spending totals.

In the second set of tests, I use an Error Correction Model (ECM) for both theoretical and statistical reasons. I posit that the relationship between political party control and spending will have both short-run and long-run effects. Political parties form policy strategies that benefit their position in the short and long runs. The expectation is that Republican Party control will lead to higher ratios of indirect to direct social welfare expenditures. This is the type of relationship that is appropriate for ECMs when a dependent variable is expected to respond to short-run changes in the predictors and have a long-run equilibrium relationship with these same variables. When there is a change in political party control, there is an immediate impact in spending changes that will be represented in the budget and tax bills for that year, but since many of the spending increases involve entitlements or spread spending changes over a number of years, the full effects will not be felt at once. An ECM model has the capability to test for both short-term and long-term effects. On the statistical side, ECMs are appropriate when using non-stationary data.[19] A

[19] I ran Augmented Dicky Fuller tests (ADF) with a constant, a time trend, and one lag for three measures: annual public social spending, annual social tax expenditures, and a social spending ratio. For the annual public social spending measure, the t-statistic was 0.826 and the p-value 1.00. The t-statistic for the annual social tax expenditure measure was -0.988 with a p-value of 0.945. Finally, the social spending ratio has a t-statistic of -1.99 and a p-value of 0.603. I also ran regular Dicky Fuller tests (ADF) with a constant, a time trend, and one lag for three measures: annual public social spending, annual social tax expenditures and a social spending ratio. For the annual public social spending measure, the t-statistic was .638 and the p-value .988. The t-statistic for the annual social tax expenditure measure was -0.988 with a p-value of 0.945. Finally, the social spending ratio has a t-statistic of -2.047 and a p-value of 0.266. Not one of these measures reported a negative value less than -3.50, so the null hypothesis of a unit root can not be rejected. These results confirm the initial findings of the three augmented Dicky Fuller tests.

number of the variables tested here contain a unit root and therefore can produce spurious results if not analyzed properly. The typical method for addressing non-stationary time-series is to model change in the variables. However, analyzing change in the variables, rather than levels of change, only captures the short-run effects. If an independent variable has a long-run impact on the model, this effect is not captured. I use a single-equation error correction model since it is more efficient than a two-stage model.

The single-equation error correction model is as follows:

$$\Delta Y_t = \alpha_0 + \alpha_1 Y_{t-1} + \beta_1 \Delta X_{t-i} + \beta_2 X_{t-1} + \epsilon_t$$

I have two parameter estimates for each independent variable $X - \beta_1$ for the differenced variable; its change from time *t* to time point *t + 1*, and for β_2 for the lagged level of the variable. In a simple bivariate example, the β_1 parameter provides an estimate of the initial change in the dependent variable produced in the short-run shock to the independent variable. For example, if inflation increases and the level of tax expenditures responds, the short term coefficient, β_1, provides an estimate of this change. This is referred to as the ``short term" effect, meaning that the effect occurs fully at a specific time point, but it does not imply that the effect is temporary. The long term effect is provided by the error correction part of the model, which is the interaction of β_2 and α_1. The long-run impact is the portion of the correlation between X and Y that does not occur at one particular point in time but is distributed temporally such that a portion of the impact is felt in each time period. The size of the long-run impact is a function of the parameter β_2 but also of α_1, which is called the error correction rate. In an example of this effect, if the impact of inflation on tax expenditures as a percentage of total spending is connected via an error correction mechanism, then a shock to inflation disturbs the long-run equilibrium between inflation and tax expenditure spending, and this divergence from the equilibrium will eventually be corrected over time. In addition to being an important part of the impact of the independent variable on the dependent variable, the error correction rate also tells us how quickly a disturbance from the long-run equilibrium is eliminated. In this ECM, estimates of α_1 will be between zero and negative one, and the closer this parameter is to negative one, the more quickly the errors are corrected. The proper way to interpret this coefficient is the proportion of the disequilibrium that will be corrected at each time period, starting at $t + 1$. From the error correction rate, we can make inferences about how quickly the total long-run impact is felt. In summary, the degree of a short-run effect of X on Y is produced by the estimate of β_1. The size of the long-run impact is determined by the interaction of β_2 and α_1.

The Influence of Partisanship and Economic Factors on Social Spending, 1967-2006

In table 4.3., I present results from the difference of means tests of partisan control and total spending. These test results reveal an uncertain relationship between political party control of government and changes to total social spending. This is true across all three institutions of the federal government. Therefore, the clear correlation between Democratic Party control of government and increased social spending must be called into doubt. Republican presidents slightly outspend Democratic ones, on average annual basis, .051 to .045. Democratic Party control in Congress results in marginally higher spending totals, yet again these differences are not statistically significant. Although not reported in table form, I additionally ran an ANOVA with partisanship as a scaled variable. The scaled variable ranges from three equating to total Republican control, two and one as divided control, and zero to total Democratic control. Again, there was no statistical difference with the partial sum of squares coefficient at .000 and the p-value at .968 with a standard f-value of .05.[20] Regardless of political party control, social spending increased, on average, five percent a year during this period of study. These results provide strong evidence that past findings of Democratic control resulting in higher levels of social spending only account for changes in appropriations for public programs. The similar spending totals, year after year, are driven by the entitlement nature of both indirect and direct social welfare spending. The largest categories of direct spending are for non-means tested programs, and indirect spending provisions accrue benefits to whomever qualifies – resulting in consistent, annual changes to total domestic spending. Although partisan control does not predict changes in total spending, it may still serve as a useful indicator in forecasting the direction of the social expenditure ratio.

The second tests stem directly from the partisan theory of social policy. This theoretical argument predicts that under higher levels of Republican membership, the ratio of indirect to direct social spending will rise. In table 4.4, I present two models: one, measuring Republican legislative membership as a percentage, and the second testing for political party control with dummied variables representing Republican Party control for both chambers of the legislature. It is clear from the results in table 4.4 model 1 that more Republican influence in the legislative branch increases the ratio of indirect to direct spending in both the short and long terms, with a slight additive effect from presidential control. The coefficient for the percentage of Republicans in Congress demonstrates that a positive one-unit shift in percentage of Republicans produces an increase in the ratio of indirect to direct social

[20] I ran this another way interacting the dummy variables so that the full model had the three original dummies and three more representing the presidency times the house, the presidency times the senate, and the house times the senate with the same results. Finally, I ran an ANOVA model that looked at only the differences in social spending the year after a switch in party control. Again, the same results were produced - no statistically significant difference between the political parties in total social expenditures.

spending of 0.145. Over the long-run, this initial increase in the indirect to direct ratio is augmented, mainly due to the entitlement nature of tax expenditures, by an even larger magnitude of 0.199. I find that the presence of a Republican president increases the spending ratio more towards indirect spending in the short-run with a coefficient of 0.020, but the long-run impact is negative and not statistically significant. In total and as predicted, the Republican Party trades off public funds towards private-sector social programs and away from the public sector.[21]

There is a possibility that changes to the social welfare expenditure ratio are determined by economic conditions. An increase in unemployment should decrease the amount of tax expenditures for social welfare, since these individual provisions rely on employment. In periods of creeping inflation, more people would seek and claim tax breaks for social purposes as a means to lower their overall tax burden. The results here indicate that unemployment has no short-term effect but influences social spending ratio in the long-term with a statistically significant coefficient of 0.014. The long-term effects are due to the lagged nature of tax incentives to address unemployment, such as tax breaks for job and work training that affect job rolls years after implementation. In addition, new tax expenditures, once passed, expand slowly only after being properly interpreted and applied under existing worker contracts on an industry-by-industry basis.[22]

[21] I ran two other models: one that represented Republican control by dummying up the Presidency, the House of Representatives and Senate. The other model used the three previous dummies and created three more variables by interacting the Presidency and the House, the Presidency and the Senate and the House and Senate. In both of these models the results mirrored those of the reported ECM - Republican control of the executive matters and control of the legislature matters more. In the first model with just the three dummied variables, Republican control of the Senate reported a higher coefficient than the House.

[22] In order to put these results into perspective, the biggest jump in the social expenditure ratio was between 1982 and 1983. In that year direct spending increased by .06% while indirect spending increased by an astonishing .43%. Conversely, when the ratio fell between 1993 and 1994 – direct spending increased by .05% while indirect spending increased a slight .02%.

In model 2 in table 4.4., I examine differences across the two chambers of Congress - the House of Representatives and Senate. Republican control of both the House and Senate is coded as one and Democratic control is labeled zero. Although there is no theoretical reason to posit that Republicans in the House differ from Republicans in the Senate in their basic ideological preferences towards social policy, the different legislative rules and procedures in the two bodies could produce differences in spending. Specifically, the sixty-vote norm in the Senate needed to pass cloture and most legislation diminishes the efficacy of simple political party control. Republican control of the U.S. Senate results in positively signed and significant coefficients in both the short and long terms. The partisan control of the U.S. House has a weaker effect on social spending changes and only in the short-term. The only period of time in this study in which the Republican Party controlled the Senate but not the House of Representatives was during President Reagan's administration. From 1981 to 1987, direct social spending was cut and substituted with tax breaks that drove up the social welfare expenditure ratio from .249 to .338. President Reagan relied on the Republican controlled Senate along with fiscal conservatives in the House, during the height of conservative public mood, to pass sweeping tax breaks and cut direct public social expenditures. The economic controls, although signed in the right direction, are not statistically significant.[23]

To summarize, the results presented here confirm both arguments: first, that there is no convincing relationship between Democratic Party control of government and changes to total social spending and second, that under Republican leadership, exercised mainly by the

[23] I ran a third base partisan model, with the same dummied presidential variables and an ordinal variable for control of Congress with two being full Republican control and one being a split Congress. The results from this model mirror model one. The most robust predictor is Republican control of the Congress in the long-term with a slight additive effect of Republican presidential control in the short-term. Long-run unemployment is positively signed and significant in the long-run. The total amount of variance explained by this model is similar to model one at .368.

Congress, indirect spending is utilized more than direct spending. I conclude from the results here that party control of Congress is more important than that of the executive given that Republican influence in the legislature was consistently important in directing the social expenditure ratio. First, tax expenditures are controlled by only two committees so once a political party controls Congress there are fewer veto points in changing indirect spending. Second over the course of this study, party leadership in Congress has exercised more control over the rank and file members often resulting in party line votes on important measures such as appropriations votes. As the political parties have polarized, legislators who occupy supermajoritarian positions in the Senate have become more ideologically extreme (and less moderate) and therefore, are more likely to favor highly partisan policy outcomes. Next, the president often works through his own party members in Congress to pass salient legislation, arguably the most important of which concerns annual spending and revenue bills. I interpret these results to mean that the Republicans substitute one type of policy, direct public funding, for another, indirect spending. This achieves multiple short and long term goals. In the short-run, Republicans are able to hold constant or decrease public spending on social programs that benefit mainly Democratic constituents and increase tax spending that allocates government funds to Republican-friendly businesses and private social insurance providers. In the long-run, the substitution of indirect for direct funding accomplishes two goals, one policy and one electoral. On the policy side, an increase in tax expenditures today reduces government revenue into the future and therefore restricts the capacity of future legislators to increase direct spending without running larger deficits. Electorally, the subsidization of private social companies increases their ability to service and attract customers. The more invested citizens are in the health of the economy or private business for their personal economic security, the more likely they are to support conservative policies.

Alternative Explanations for Changes to Social Expenditures

In order to fully investigate the influence of political parties on social spending, I extend the analysis from measures of political party control to include divided government and political party polarization. Some studies theorize that these two recent trends, independent of and, in some cases in addition to, party control, are driving both the increased use of indirect social spending by the federal government and decreases or stagnation in traditional social programs (Howard 1997; Hacker 2002, 2004; Pierson 1996). If one or both of these trends are causing yearly increases in the ratio of indirect to direct social spending, then the previously reported relationship between more Republican influence and higher levels of the social expenditure ratio must be called into question. In the case of divided government, if the President's party does not control Congress, it makes passing sizeable changes to domestic spending or deep tax cuts more difficult. Direct measures follow a more difficult policy path than indirect measures. Social expenditures for public programs go through the entire appropriations process and are subject to review. Conversely, tax spending only passes through two committees and, once passed, operates as a form of entitlement spending. Therefore, periods of divided government might have less influence on the fate of indirect versus direct spending. The effects of party polarization on the ratio of indirect to direct spending are similar to those of divided government. It could be argued that indirect spending is a logical alternative to both political parties dominant policy strategies, increased government spending for the Democrats and cuts in the marginal income and corporate tax rate for the Republicans. In essence, splitting the ideological difference between the two parties' major policy goals, tax expenditures for social welfare could act as both a tax cut for individuals and a form of public financing for social policy.

The following sections present the literature on divided government and party polarization with respect to public policy, government spending, and social policy. Since no existing theories examine these two concepts and tax expenditures, I then theorize how divided government and party polarization may shift the direction of indirect to direct social spending. In order to test these claims, I present additional hypotheses and models: one set which includes divided government and a second which tests for the effects of both divided government and party polarization. The test results indicate that the inclusion of divided government adds to the explanatory strength of the overall model, although partisanship continues to be the most powerful and significant indicator of changes to the social expenditure ratio. Party polarization is signed in the wrong direction and not statistically significant in any of the models.

Divided Government

One of the most popular debates in the annals of political science literature concerns the influence of divided government on legislative productivity. Divided government has become increasingly frequent in the period since World War II. The elections between 1952 and 2009 generated unified governments at the national level just 30 percent of the time. This era stands in stark contrast to the period between 1900 and 1950, when unified governments were elected 84 percent of the time. The traditional divided government hypothesis argues that legislation is less likely to become policy when the President's party does not hold a majority of seats in both chambers of Congress. An additional institutional obstacle to passing legislation is the super majoritarian rule of the U.S. Senate that requires control of sixty seats by the majority party in order to thwart the threat of a filibuster from the minority party. Advocates of the traditional thesis argue that agreement among these three bodies is likely to be difficult during periods of divided government due to divergent member ideologies. While this argument is intuitive, the empirical support has been decidedly mixed.

There is noteworthy scholarship that challenges the traditional explanation of divided government. Mayhew (1991) argues, in perhaps the most influential piece, that divided government does not shape the legislative process in ways that prohibit passing major legislation. Mayhew examines 267 pieces of “important” legislation as defined by journalistic accounts for the period 1947-1990 and concludes that divided government does not change the frequency of passing major legislation. Additionally, Keith Krehbiel (1996) theorizes that unified government has no effect on breaking gridlock in the legislative process. Legislative gridlock is an often-used phrase to denote congressional periods of inefficiency or stalemate in which few bills are passed into law. He goes on to argue that the salient factor in stopping gridlock is the policy position of the status quo relative to legislators’ preferences for new policy. In addition, gridlock only can be overcome when the status quo position is extreme relative to the preferences of the legislators. Finally, partisan preferences and supermajority procedures, such as the presidential veto and the filibuster, make it extremely unlikely that a strong majority party, even under unified government, will be sufficient to alter normal gridlock. Fyrmer (1994), in studying the period from 1977-1992, argues that the conservative block in the Democratic party assisted Republican presidents in passing legislation, even in periods of divided government. The majority of the aforementioned studies measure the effect of divided government on “significant” legislation and not government spending. Given that I represent policy shifts as changes to public spending levels, it is essential to examine more specific studies on divided government and expenditures.

In the matter of government spending, Jones, Baumgartner and True (1998) find no statistical difference between unified Democratic control and divided government in changes to the budget authority. Although in a previous piece, Jones, Baumgartner and True (1996) concluded that divided government corresponds with more budget volatility. Kiewiet and McCubbins (1991) found that Democratic control of Congress and the Presidency results in faster domestic spending increases than under Republican control. The above authors also report that when there is a split Congress, social spending grows slower than under Democratic control but faster than when there is unified Republican control from 1948-1985.

In contrast to the above-mentioned literature, some scholars find that divided government produces less legislative output than under periods of unified government control. Cameron, Howell, Adler, and Riemann (1997) discover that divided government reduces enactment of “landmark” legislation, yet increases enactment of less significant legislation. Binder (1999) argues that divided government produces a mild increase in the proportion of salient legislation that fails, but has no greater effect than other mechanisms such as public mood. Kelly (1993) reworks Mayhew’s list of significant laws, using only the laws that were significant at the time of adoption, to show that unified government does increase the number of important laws passed during a legislative session. Finally, Quirk and Nesmith (1994), in their examination of the George H.W. Bush presidency, claim that divided government only causes gridlock when the issue being debated is highly ideological or if there has been a change in the public mood.

Over the last thirty years, the increase of divided government has corresponded closely with the era of social welfare retrenchment. Paul Pierson (1996, p.17) defines social welfare retrenchment as “policy changes that either cut social expenditures, restructure welfare state programs to conform more closely to the residual welfare state model, or alter the political environment in ways that enhance the probability of such outcomes in the future.” Pierson’s evaluation of retrenchment in the U.S. and U.K. demonstrates that partisan barriers both inhibit social program expansion and create obstacles for legislators who want to completely dismantle the existing social welfare state. As Pierson writes in his assessment of social policy in America, “Economic, political, and social pressures have fostered an image of welfare states under siege. Yet if one turns from abstract discussions of social transformation to an examination of actual policy, it becomes difficult to sustain the proposition that these strains have generated fundamental shifts” (173). Pierson’s conclusions would align with those scholars who argue that divided government restrains majority political parties from enacting policy that matches their members’ preferences. The stagnation of social policy hurts the interests of both the Democratic and Republican Parties. Democratic members who want to expand or index public benefits and services to inflation are forced to accept “policy drift.” Policy drift occurs when social and economic changes alter the effects of policies without significant changes to the actual policy. Hacker (2004) argues that social risks have changed drastically for most workers without much change to the federal law that governs public and private insurance. Although retrenchment has reduced the scope of some welfare programs, the popularity of Social Security and Medicare inhibits the Republican Party from making deep and lasting cuts. Other scholars examining federal and state interactions argue that institutional fragmentation, along with conservative ideology during this same period, has resulted in welfare devolution (Goetz 1995). Devolution is the shifting of public responsibilities, such as financing, management, and/or regulation, from the national government to the subnational level.

Different policies can influence the type of politics practiced at the federal level (Lowi 1963). I argue that divided government increases the ratio of indirect to direct social expenditures due to the different policy characteristics that separate the two types of spending. There are numerous policy advantages for tax expenditures as compared to direct spending: once passed tax expenditures become part of the permanent tax code, they have no sunset provisions, and no standards of performance. Tax incentives for social welfare are created and expanded in revenue or tax reform bills and not through the appropriations and budget processes. Additionally, tax expenditures face fewer veto points in Congress because the House Ways and Means and Senate Finance committees serve as both the authorizing and ``appropriating" committees. On the contrary, when Congress directs federal money to a public social program there are specific goals and objectives that are evaluated annually. Howard (1997) finds that most tax expenditures originate as minor provisions in large tax bills. Moreover, he argues that popular tax credits were usually passed with little to no debate and grew exponentially over time. I expect indirect spending to increase at a faster rate than direct spending regardless of party division due to the historical ease of passing and expanding tax expenditures, the fact that tax expenditures face fewer veto points in the legislature, and since tax breaks are not subject to the annual review process. The preceding logic results in the following hypothesis, that divided control of government increases the indirect to direct social welfare expenditure ratio – all else equal.

Party Polarization

In addition to increased occurrences of divided government, the two political parties have become increasingly polarized on both the elite and mass levels. Since 1990, more than half of congressional votes have featured a majority of one party opposing a majority of the other. This high level of party polarization has increased steadily since the 1970s. As the political parties pull apart ideologically, they also became more uniform internally as measured by the decreased variance of each party's voting coalition. There has been a dramatic rise in ideological polarization between the two congressional parties since the 1970s, whether it is measured through interest group scores (Groseclose, Levitt, and Snyder 1999) or roll call votes (Poole and Rosenthal 1997; McCarty, Poole and Rosenthal 1997).[24] These changes to polarization can be caused by demographic changes to the district or by design. Either way, district constituencies are more politically homogeneous and, therefore, elect more ideologically extreme members. Rhode (1991) and Jacobson (2001), among others, argue that party polarization has been marginally increased after every round of redistricting over the last thirty years.

The lucidity of partisan differences, especially on social issues, has resulted in increased party strength and polarization among the electorate. Changes in national political party polarization have caused responses from the mass electorate that mirror the elite level (Zaller 1991; Carmines and Stimson 1989). There are three major categories of theory in

[24] The DW-Nominate scale is calculated from all non-unanimous roll call votes cast across all Congresses with each vote recorded on a liberal-conservative dimension ranging from –1.0 (most liberal) to 1.0 (most conservative), allowing measurements across time (McCarty, Poole, and Rosenthal 1997).

arguing for what drives polarization in the mass electorate: the electorates' response to the elite realignment (Abramowitz and Saunders 1998, 2000; Putz and Shepherd 2001), shifting partisanship on a single-issue (Riker 1982; Carmines and Stimson 1989) or voters' extending conflict from divisions about social welfare to other issue areas (Carsey and Layman 2002). Hetherington (2001) demonstrates that party polarization in the U.S. Congress created clearer perceptions among voters about the major issue differences between Democrats and Republicans, especially for social welfare.

Party polarization has been blamed for a number of new policy developments including an increase in strategic gamesmanship (Aldrich and Rohde 2000) and decreases in social spending for public programs (McCarty, Poole, and Rosenthal 2006). Jones (2001) argues that it is not divided government but party polarization that leads to legislative gridlock. He concludes that by including party polarization and party seat division in a model along with divided government, the divided government effects on legislative gridlock go away, while polarization and seat division are highly correlated with gridlock. Besides making compromise across the legislative aisle more difficult, party polarization also signals a decrease in the amount of moderate legislators. Moderate legislators have a privileged position in deciding policy outcomes (Krehbiel 1998; Brady and Volden 1998). The long-standing congressional rules like the Senate's filibuster and the constitutional requirements for overriding presidential vetoes force super-majoritarian outcomes. If moderate members become less frequent, more ideological members will fill these pivotal congressional roles in the legislative process. Howard (1997) argues that important new tax expenditures in Congress were sponsored by more moderate members, and, therefore, the decrease of moderate members could result in less support for tax expenditures. McCarty, Poole, and

Rosenthal (2006), in their study of party polarization and income inequality, reveal that party polarization in Congress is associated with diminished social spending and decreases in marginal income tax rates. If McCarty, Poole, and Rosenthal are correct on the social policy effects of polarization, then I expect polarization to correspond with a higher social welfare expenditure ratio.

As the two major political parties diverge on issue areas, they also move away on their preferred strategies of social policy redistribution. Polarization should affect the two major political parties' preferences for indirect versus direct spending in ways that increase the social welfare ratio. It could be that indirect spending represents a preferred compromise position for both parties on social policy, as compared to the status quo. Democrats can claim that federal money was allocated to social welfare goals, while Republicans can claim new tax cuts and a reduction of government bureaucracy. The second possibility is that increased party polarization, along with divided government, creates obstacles to direct legislation and therefore privileges the less scrutinized route of indirect spending. In the past, periods of drastic social spending increases occurred in periods of large Democratic majorities. Conversely, major tax cuts to the income and corporate structure were enacted only in times of significant Republican majorities. Tax expenditures for social welfare represent a natural policy compromise to both higher social spending and marginal tax cuts and, therefore, should rise in periods of increased party polarization.

Measuring and Testing the Alternative Models of Partisan Influences

In the new models, divided government and party polarization represent two distinct hypotheses concerning social policy that are tested alongside the partisan theory of social policy. The first set of models adds the individual variables of divided government and party polarization to the baseline model. I represent divided government as a binary variable with unified party control being labeled as zero and years of divided party control being labeled as one. Party polarization is measured using the common space scores with higher values signaling more polarization (Poole 1998). This measure is created from scaling the DW-NOMINATE scores that allow the House and Senate to be compared across time and space. In Table 4.5, the partisan variables are carried over from the original analysis with Republican control being coded one and Democratic control as zero. There are again economic controls representing yearly percentage changes to both inflation and unemployment. To reiterate, the expected hypotheses are that divided government, independent of partisan control, results in a higher social expenditure ratio and that party polarization also increases the social expenditure ratio.

As is clear in table 4.5., the addition of divided government does not assist the overall explanatory power of the model, nor is the variable signed correctly and statistically significant. Both the short and long-run coefficients are small and not statistically significant. In fact, the long-run coefficient for divided government is signed in the wrong direction and not statistically significant. A higher percentage of Republican members in the legislature again are a robust indicator of greater indirect to direct social welfare expenditures. Interestingly, the inclusion of the divided government measure negates the significance of the short-run effects for Republican control of the executive and legislative branches. The results here indicate the effects of partisanship on social spending changes are distributed across the years after $t + 1$. This is unsurprising given that most of the social spending components included in the indirect to direct ratio measure are types of entitlement spending that, once passed, increase with time. The coefficients for inflation are signed in the right direction, but they are not significant. As in the base model, the long-run coefficient for unemployment is positively signed and significant. Across almost all the models, long-term unemployment has been positively associated with moderate changes to the social welfare expenditure ratio. This is true for two reasons: one, direct spending that addresses unemployment is largely handled at the state level and, therefore, federal spending on public programs would not be triggered by increasing unemployment; second, indirect initiatives to address unemployment are time-lagged investments, such as worker training or incentives for extended formal education.

The results from model 4 in table 4.5. demonstrate that party polarization is signed in the expected direction, but not statistically significant. Republican Party influence, over the long-run, in Congress again is the most efficacious predictor of social spending changes. The combined null results of both the divided government and party polarization measures raise doubts on the proposed use of tax alternatives as a compromise strategy for the two political parties. Also, the positive signs for the party polarization variables diminish the possibility that an increase in moderate members of Congress corresponds to greater levels of indirect to direct social expenditures, as is argued by Christopher Howard in *The Hidden Welfare State*. All of the remaining political variables were in the right direction yet not significant. The only economic control to rise to the level of significance was long-term unemployment.

The analysis above provides considerable support for the partisan theory of social policy. A larger presence of Republican members in the U.S. Congress corresponds to greater indirect to direct social welfare expenditures. This relationship stands up against economic controls and alternative political explanations such as party polarization. The partisanship of the legislature is a more robust and consistent predictor of changes to the social expenditure ratio than that of the executive branch. In fact, a higher level of Republican control was significant and robust across all four models. In one set of models, the presence of divided government does not perform as hypothesized and negatively corresponds with the social spending ratio, resulting in more direct versus indirect expenditures. The divided government results negate the theorized importance of the different policy paths of indirect and direct spending. It does reinforce previous findings that divided government is not in and of itself an obstacle to increased government spending. Party polarization is not statistically significant in any of three alternative models.

The next step for this analysis, and one I plan for the future, would be to use the DW-NOMINATE scores to test the potential influence of gridlock intervals on changes to the social expenditure ratio. I would be interested in determining if certain pivotal positions that are sufficiently liberal or conservative as compared to the status quo move the social welfare expenditure ratio in the expected direction. Additionally, it would be interesting to examine the DW-NOMINATE scores of the relevant committee heads in comparison to the ideological scores of the chamber median and the executive branch. Furthermore, I would like to create a cross-sectional model using four dependent variables representing each social welfare category. The social welfare expenditure data can be broken down into four policy categories: health care, income security, welfare, and education. The previous models assume that all four social categories respond to changes in partisanship in the same way. A cross-sectional model might reveal different political influences than the earlier examination of social welfare as an aggregated measure. For example, there might be no difference between the Republican and Democratic Parties in the category of welfare since both parties have supported increases to the EITC during this period and slashed public welfare spending.

The Policy Effects of Political Changes to the Social Expenditure Ratio

The results presented here have several important implications for political parties, public policy, and economic conditions. First, the traditional narrative of Democratic Party control of the federal government leading to more spending and larger government needs to be reconsidered. The traditional story of the liberal or Democratic social state is now complicated by the fact that Republicans too support a social welfare state, albeit one that utilizes the tax code in place of the appropriations process to direct financial resources to the providers, not the beneficiaries, of social benefits. The shift of social policy from direct to indirect spending moves resources and jurisdiction over social policy from the state to the market.

In 2007, the U.S. budget deficit was 65.6 percent of Gross Domestic Product and has increased, on average, over $500 billion each year since 2003. The political focus on addressing the geometrically growing budget debt has almost solely been on controlling entitlement spending for social programs. Tax expenditures function as a type of entitlement spending, given that any taxpayer who qualifies can claim the benefit, so any new or expanded tax expenditure reduces the revenue of the federal government now and into the future. I would argue that any serious proposal to control entitlement spending as a means of dealing with the budget problem should also address the $1 trillion dollars of annual revenues lost through tax expenditures, most of which are on ``autopilot" and not subject to annual review. Not only do public entitlements drive up the annual budget deficit, but the continual growth of tax expenditures for employer-provided benefits augments this growing fiscal problem.

The policy process for direct spending differs drastically from indirect social spending. Tax expenditures are a prime example of ``off-budget" spending since they are divided from direct expenditure programs in the legislature and the administrative agencies that prepare direct expenditure budgets. For example, the Department of Health and Human Services prepares the budget for means-tested assistance programs for the poor, such as TANF and Medicaid, but has no authority for the Earned Income Tax Credit (EITC) subsidy which also is targeted at the poor. One consequence of the tax expenditure process is that policymakers with no interest or expertise in social policy administer incentives for health care, income security, welfare, and education. In addition, there are no substantive evaluations of who benefits from these expenditures, if they are efficient compared to direct spending programs, or if tax expenditures actually promote the type of private social provision they are intended to stimulate. The lack of annual review and smaller number of committees involved in the tax expenditure process reduce the scope of conflict, which in turn privileges special interests and could diminish the saliency of public opinion (Schattschneider 1960).

Finally, policy processes have feedback loops in that citizen and interest group responses to government programs create incentives and costs for political participation in future policy debates. In traditional public programs, if citizens are unhappy with the quality of social services, there are many public outlets for voicing their displeasure in order to bring about improvements to benefits and services. Tax expenditures for social welfare subsidize mostly employer-provided social insurance and benefits. The government's indirect financing of these social programs obscures the role of political actors and public policy in shaping the access and generosity of social benefits. As Suzanne Mettler (2007) argues about indirect spending, ``this growing sector of social policies, in obscuring the government's role, threatens to undermine citizens' support for more distributive forms of social provision by offering them the illusion that they gain economic security solely through their own individual efforts" (p. 218).

Social policy has many economic effects, the most significant being the redistribution of national income. Public social welfare programs are designed to provide either cash or in-kind benefits to the most economically vulnerable populations in society such as the elderly, the poor, children, unemployed workers, and the disabled. Tax expenditures for social purposes primarily accrue to wealthier, white-collar workers. Nathan Kelly (2005) demonstrates through the conditioning of economic factors Democratic control of government has had progressive effects on the redistribution of income over time. The majority of tax expenditures, all but tax credits, have regressive effects on income redistribution. The results here indicate that tax expenditures increase under Republican control, so a logical extension would be that income inequality should also rise with Republican gains due to increases in tax spending. It is important to consider if and how these tax cuts are financed with changes in direct federal spending. If an increased tax cut for employer-sponsored health care is paid for by a decrease in Medicaid payments, then this exchange is sure to cause a rise in economic inequality. Chapter five systemically tests the relationship among political party control, social spending, and changes to economic inequality.

CHAPTER V

POLITICAL PARTIES, SOCIAL EXPENDITURES, AND THE PRIVATE SOCIAL SYSTEM

This chapter presents a test of the partisan theory of social policy by examining the relationship among political parties, social policy, and the private social system. To date, there are no existing studies which empirically examine the role of political parties or public policy in determining adjustments to private-sector social spending. Contrary to common wisdom, I expect the Republican Party in government to support public funding of social policy. Contrary to Democratic Party preferences for public social expenditures, Republicans favor the subsidization of private-sector social services and benefits. The Republican Party distributes resources to their constituencies and promotes conservatism by using public policy to encourage private social spending.

The private-sector social system is larger in the United States than in any other industrialized country and has rapidly grown over the last thirty years (OECD 2005). The vast majority of Americans receive their social benefits and services through the private market.[25] Private-sector social spending nearly doubled from 7.7 percent of GDP in 1972 to 13.3 percent in 1994. [26] Public spending from social programs, although larger, increased at a slower pace from 16.6% to 21.1% of GDP during the same time period. Total spending for

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[25] I present data on this in chapter three from the SSA and EBRI.
[26] I use these years because the private social spending data only run until 1994.

social welfare programs, both public and private, increased from 23.5 percent of GDP in 1972 to 33.6 percent in 1994. In this chapter, I test how changes to political party control of government, and by extension public policy represented by the social expenditure ratio, determine varying levels of private-sector social spending in the United States.

The private social system refers to health care, pensions, welfare, education, and other services which citizens receive through their employers or other non-government organizations. The majority of private social benefits are offered voluntarily by businesses.[27] This analysis focuses primarily on employment-related social benefits and services since these programs constitute around 96% of total private-sector social expenditures (SSA).[28] The administration and provision of employee social benefits involves the government, businesses, and individual employees. The two largest private-sector social programs are employment-based health care insurance and company pensions. Currently, the two main roles of public policy in the private market are regulating the provision of social benefits and providing incentives through favorable tax treatment and subsidies. Additionally, the government mandates that employers assist in paying for some public social programs such as Social Security, family and medical leave, workers' compensation, and unemployment insurance. Employers voluntarily offer health insurance to employees that range from acute hospital visits to full coverage including dental and eye care. Also, employers provide savings and private pension plans to employees for retirement that vary from older defined benefit plans to newer defined contribution plans that rely on individual accounts. Employers often provide additional benefits and services such as education and training, child care, legal

[27] Given this fact, it is important to note that many of the salient factors that determine private benefits cannot be modeled, such as company level decisions, industry level decisions, and globalization.

[28] Although I include spending data on non-profit and voluntary social services and benefits, I do not theorize about these organizations since they represent such a small percentage of total private spending and the literature focuses mainly on issues of organization and management.

assistance, traveling reimbursements, paid sick leave, vacations, and maternity leave. Finally, employers sometimes provide voluntarily group-life insurance and long-term disability insurance. The generosity of private social benefits is determined by company level decisions, macroeconomic factors, and public policy.

A political party's decision to finance the public or private sector is primarily a function of their members' election goals and core values. Most existing theories of social policy operate from the assumption that the only response available to government officials in response to pressures for social benefits is the expansion of government programs and public spending. Previously, I introduced a theoretical argument that political parties have preferences for the role of government in society. Republican Party members are interested in maximizing individual economic freedom from the perceived advancement of government power and, therefore, use policy to shift public funds to the private market. I have found that more Republican Party influence in the federal government results in higher levels of indirect versus direct spending, which subsidizes private-sector social programs. Therefore, I expect that increased Republican influence in the federal government will produce policy that both lowers the cost of private social provision and creates more demand by cutting public programs. In this chapter, I find that mixed results for the relationship between political party control and private spending. Republican Party control of the Senate increases private-sector social spending although not through changes to the social expenditure ratio. In comparison, if just the percentage of Republicans in Congress is used both Republican influence and the social expenditure ratio correlate with higher private spending. These results have implications for understanding the role of political institutions in the private market, public policy-making, and social policy.

A Brief History of the Private Social System

Private social programs have existed in the United States since the 17th century. The private social state's early development is commonly attributed to the lack of national and state social programs (Brandes 1976). In the absence of federal social programs during the 19th century, civic and social organizations used welfare benefits and social insurance as forms of selective benefits in order to attract members and garner loyalty to their organizations (Lubove 1968; Skocpol 1995; Beito 2000). Some examples of earlier employer programs are Gallatin Glassworks profit-sharing plan in 1797, American Express Company's employer pension plan in 1875, and Montgomery Ward's group health, life, and accident insurance program in 1910. These programs were created to increase worker loyalty and dissuade union activists through offering preemptive employer benefits. Employers also assisted in the formation of mutual benefit societies which maintained contributory employee-financed funds that paid benefits to injured and ill employees. For example, health and accident coverage was first offered in the mining and railway industries by benevolent societies that later turned into industrial unions. In the 1870s railroad, mining, and other industrial industries offered the use of company doctors to workers. This was, for most businesses, the earliest form of health insurance that was later supplemented by medical or hospital coverage. In addition, group sickness and accident insurance guaranteed a daily payment for each day of work missed on account of work-related illness or injury. These types of corporate welfare were successful in cultivating employee loyalty and grew again in the 1940s and 1950s due to policies surrounding World War II.

The second wave of private-sector social benefit growth occurred in response to war time economic policies. Quadagno (1988) argues that there were three policies that together influenced the rise of private social benefits in the middle of the 20th century: the excess-profits tax, the wage freeze, and the tax-exempt status of pension and health insurance payments. She argues that the excess-profit tax spurred firms to increase their before-tax spending on employee fringe benefits. Next, increased labor competition and the federally-mandated wage freeze encouraged firms to increase employee compensation packages through better fringe benefits, as opposed to salaries and wages. At this time, there were a number of federal court cases that ruled employer payments into company pension and health care plans were not wages and were, therefore, tax deductible (Munts 1967). In addition, court cases surrounding the Wagner Act of 1935 gave increased rights and incentives to unions to negotiate and bargain over employer-based benefits. Many union leaders, especially the American Federation of Labor (AFL), believed that union-provided benefits grew their membership rolls. Finally, many union leaders turned towards employer-benefits as they became increasingly frustrated with the Democratic Party's lack of progress on national health care and other benefits.

After World War II, private insurance companies began to realize the economic benefit of selling group policies to businesses. The number of union workers covered by employer-provided health insurance went from 600,000 in 1946 to 12 million workers and 17 million dependents by 1954. First, employed people were relatively healthier and younger than the general population, so social insurance could be sold at a lower cost per unit. Second, insurance companies could avoid the problem of adverse selection since people do not primarily select employment due to the health and pension benefits. In conclusion, businesses worked with private social providers to offer employment benefits as a means to generate worker loyalty, respond to the dictates of collective bargaining, and diminish the incentive for employees to form unions.

The Modern Private Social System

American private-sector social spending grew dramatically as a portion of total social expenditures during the past half century. From 1972-2002, private social welfare expenditures, driven mainly by employer health care and pensions, more than doubled from seven to 15 percent of GDP (SSA 2004). Over the last decade, more than 70% of workers were enrolled in some type of employment-provided insurance program. The participation of workers in employer-based social programs is correlated with macroeconomic conditions such as the unemployment rate. For example, the economic boom of the 1990s produced higher levels of participation in private plans while the economic slowdown in the 2000s resulted in lower levels of worker participation. As employer-based plans have matured over the years, businesses, unions, and the federal government became more comfortable with the prominent role of private benefits in the overall social system. The following sections explore the major components of the modern private social system: employer social benefits and services.

Employer Health Care

Employer-based health insurance provided coverage for 161 million citizens under the age of 65 in 2008. During the same year, 51 million or 19.4 % of the nonelderly population were covered under public programs, an additional 16.7 million, or 6.3 %, were covered by individual policies. In 2008, 98% of Americans with employer-based health plans were enrolled in managed health care. The majority of these managed care plans are represented by Health Maintenance Organizations (HMOs) and Preferred Provider Organizations (PPOs). Almost all employment-based health care plans are subject to payment limitations and require the employee to share in the costs of coverage. These costs include premiums, deductibles, coinsurance, copayments, and maximum caps on benefits. Employment-based health benefits use a variety of administrators: commercial insurance programs, Blue Cross and Blue Shield plans, self-insured plans administered by third-party administrators (TPAs), or multiple employer welfare arrangements (MEWAs). As Table 5.1. shows, employer health insurance declined from 68.4 %t in 2000 to only 61.1 % in 2008. The uninsured population grew over this same time-period and was estimated at 45.7 million in 2008. The public health programs of Medicaid and the State Children's Health Insurance Program (SCHIP) increased from 10.5% of the population in 1999 to 14.9% of the population in 2008. Individually purchased health care insurance has remained at a constant range of 16-17 %from 1996 to 2008.

As with private pensions demographics discussed in chapter three, workers enrolled in employment-based health insurance programs are more likely to be white, wealthy, and working full-time as a professional in a large firm as compared to the average citizen. Among the U.S. adult population, more than 61 % of nonelderly citizens have employer-based health insurance. Large employers providing access to group health coverage often are able to provide health benefits at lower costs than smaller employers, since they are subject to less adverse selection and their administrative costs are lower. In 2008, 64.2% of workers in firms with 1,000 or more employees had social insurance compared with only 26.4% of workers in firms with fewer than 10 employees. In the same year, more than 66% of workers in managerial and professional occupations had personal health care insurance compared with only 33.9% of workers in the service sector. Additionally, more than 66% of full-time or full-year employees were enrolled in employer health insurance programs compared to 13.1% of part-time, part-year employees. In the United States, private health insurance enrollment varies by race and ethnicity. In 2008, a little less than 70% of white workers received health insurance through their employer. Conversely, 49.1% of blacks had coverage and only 40.7% of Hispanics had private coverage. Even when controlling for income levels, whites were still far more likely to have health coverage than racial and ethnic minorities. For example, for families with income levels at least 300 % above the poverty level, 84.5% of whites had coverage compared with 76.9% of blacks and only 72.2 % among Hispanics (EBRI 2009).

Employer Pension Plans

There are two main types of employer-based retirement plans: defined contribution plans (DC) typified by 401(k) and 403(b) pension plans and defined benefit plans (DB) typified by traditional pension plans. Under a DC plan, employer contributions are based on a predetermined formula, and contributions made by both employers and employees are placed in individual accounts on behalf of each participant. Conversely, DB plans typically are funded by the company and do not require participants to contribute. In addition, payments are held in one trust on behalf of all participants, and these contributions are subject to federal funding rules and regulations required to maintain the plan's tax-favored status. The overwhelming majority of individual employees receiving DC plan benefits assume all of the investment risk in their own accounts. On the other hand, DB pension plan participants receive a specific benefit amount calculated from a specific formula, usually based on average salary and years of service, regardless of the investment performance of the plan assets. Next, DC and DB plans differ in the manner in which they pay out benefits to participants. DC plans commonly pay out benefits in a lump sum and employees are responsible for managing this money for the rest of their lifetime. In contrast, DB plans are required to offer life annuities, a certain amount paid out regularly, for as long as the beneficiary lives. In general, a contribution to a qualified plan is immediately deductible in computing the employer's taxes, but only becomes taxable to the employee on subsequent distributions from the plan. The final retirement benefit is a function of the total of employer contributions, any employee contributions, investment gains or losses, and withdrawals and unpaid loans.

The most important trend in the area of private pensions has been the massive shift from DB plans to DC pensions. Research from the I.R.S. demonstrates that the number of private-sector workers participating in a DB pension decreased from 30.1 million in 1980 to 19.9 million in 2006, while private-sector workers enrolled in a DC plan increased from 18.9 million in 1980 to 65.8 million in 2006, an increase of approximately 250%. There has been an overall downward trend in the percentage of workers participating in an employment-based retirement plan. In 2000, the percentage of workers enrolled in employer-based retirement plans reached 44.4% and declined to 40.4% in 2008. The passage of the Pension Protection Act (PPA) in 2006 automatically enrolls employees in defined contribution pension plans, which should result in an increase in employer-provided pension enrollment.

Other Employer Social Services

In addition to pensions and health insurance, there are numerous other social benefits offered by U.S. employers. Employers have long offered group life insurance and more recently have added educational and training assistance, group legal plans, and dependent care. Employers voluntarily provide short-term and long-term disability insurance. The disability compensation becomes mandatory if the employee suffers an injury or illness as a direct result of their job. Many employers provide death benefits for survivors of deceased employees. One type of fringe plan is group life insurance that makes lump-sum payments to a designated beneficiary, and another is a survivor income plan that makes regular payments to survivors. As more women have entered the workforce, employers have increased their child care assistance that includes services such as company-sponsored day care and financial assistance to flexibility in work scheduling. Also, employers provide assistance to employees who want or need more schooling but cannot qualify for federal assistance as a part-time or full-time student due to their work schedule. For these employees, there are tax-favored educational reimbursement programs, educational assistance programs, and qualified scholarship programs.

The Role of Government in Private Social Welfare

Private social benefits are actively encouraged and shaped through government regulation and subsidies. The first real venture of the federal government into employer-based benefits was the Revenue Act of 1926. This legislation exempted from taxation employer contributions to pension plans and postponed taxes on these retirement benefits until they were cashed in by the employees. In 1934, the federal government took over the largest group of employer benefits at the time, the pension plans of railroad companies. The establishment of the Social Security Act of 1935 established a number of public social programs, which diminished the need for private social benefits and services. The majority of employers integrated their pension plans with Social Security, reducing their benefits by the amount of the Social Security stipend.

The start of World War II brought about new federal laws that increased private-sector social benefits. First, the Revenue Act of 1942 required that private pension plans cover at least 70 percent of employees in order for businesses to continue to receive tax exemption for corporate pensions. Second, the provision required that pension formulas for both eligibility and benefits not discriminate based on employee salary. Finally, it introduced a tax on excess profits, thereby encouraging employers to lower their pretax earnings by putting profits back into employee pension and health care plans. In 1943 the National War Labor Board (NWLB) relieved wage pressure, due to the labor shortage caused by the war, by ruling that employer contributions to pension and insurance plans were not counted as wages. Although the main goal of the NWLB was to assist in controlling inflation, this action helped grow the private-sector social system. The election of more Republican members to Congress in the late 1940s resulted in the Taft-Hartley Act of 1947, which banned union control over social benefits and services financed by businesses. The National Labor Relations Board (NLRB) leveled the playing field in the arena of private social benefits by ruling against Inland Steel, thus interpreting Taft-Hartley as requiring businesses to negotiate benefits with employees over benefits and services. The growth of business-sponsored social programs during this period gave the federal government another option in addressing the demands of citizens concerned with income security.

In the modern era, the federal government became more active in regulating and financing private-sector benefits. The Employee Retirement Income Security Act (ERISA) of

1974 is the most comprehensive federal law governing private pensions and health insurance. ERISA was designed to make private pensions more secure, more portable, and more equitable among income levels. ERISA reinforced the political norm that it was the government's responsibility to support the pension and health coverage of workers through assisting employer-based plans. The heavier regulation of traditional employer pensions and health care, along with new tax expenditure programs, resulted in a shift to more individually-based pension and health care plans. In addition, the court rulings that followed ERISA codified employer health care under a preemption clause that was later interpreted as self-insured plans not being subject to state laws. Corporations large and small responded to the court rulings and new tax expenditures by changing health insurance plans to be self-insured. In addition, President Nixon pushed through legislation that incentivized health maintenance organizations (HMOs), which were prepaid group plans that paid panels of doctors either a salary or fixed fee per patient. Also, the Nixon administration lobbied for the creation of tax-advantaged Individual Retirement Accounts (IRAs) and expansions of the Keogh plans, which are retirement vehicles for the self-employed. In conclusion, public policy has become more deeply involved in shaping the contours of business incentives for the provision of employment-related health care and pensions, which has resulted in less traditional and more individually-based plans.

The Role of Indirect Spending in Private Social Welfare

The tax treatment accorded employer benefits and services by the I.R.S. provides incentives for employers to establish social welfare plans and for employees to participate in them. Employer contributions to health care insurance are tax exempt to employees and tax deductible to employers. For the vast majority of private retirement programs, taxes are deferred until the employee receives the actual payment. Additional employee benefits, such as life insurance, dependent care, and educational assistance, are tax exempt up to specific dollar limits. The tax treatment of employee benefit programs has remained relatively constant over the years. The tax code has provided tax incentives for employment-based pension plans since 1926, for compensation related to sickness or injuries since 1939, and for health insurance plans since 1942. In addition to the previously discussed ERISA tax expenditure programs, the Earned Income Tax Credit (EITC) was created in 1975. This refundable tax credit is the federal government's largest and most expensive poverty assistance program aimed at the working poor. In 1993, a number of indirect spending initiates aimed at student loans were included in the Family and Medical Leave Act. The Health Insurance Portability and Accountability Act (HIPAA) of 1996 provided businesses incentives to provide long-term supplemental health plans, such as dental and vision. Finally, the Child Tax Credit was passed in 1997 and is currently the largest federally-sponsored direct or indirect child care program. The government has played a larger role in the private social system as the number and generosity of tax expenditure programs for social purposes has risen over time.

Testing the Partisan Theory of Social Policy and Private-Sector Spending

Political parties in government have preferences for the role of government in society that reflects their election goals and core values. As applied to political party influences over social policy, the difference between direct and indirect spending tilts the balance of power between the public and private sectors. Republican control of government results in higher levels of indirect versus direct social spending that promote capitalist markets and regressively redistribute national income. This policy strategy adheres to conservative governing principles and allocates public resources to Republican-leaning constituencies. I expect to find that political party control will predict changes in private social spending through changes to the social expenditure ratio better than fluctuations in economic conditions or political party control. Figure 5.1. presents the full model of partisanship, social policy and private-sector spending. Specifically, I expect to find that Republican Party control correlates with higher levels of the social expenditure ratio, which in turn stimulates increased private-sector social spending, all else equal. An increase in the social expenditure ratio will correlate with a higher level of private spending through two mechanisms. First, more indirect spending lowers the cost both to employers providing social benefits and employees consuming them. Next, decreases in public social spending and programs should spur more demand for private social services and benefits.

Data and Methodology

In order to test the partisan theory of social policy and the private market, I incorporate a new data set on private social expenditures from the Social Security Administration (SSA) from 1950-1994. The scope of this study is limited to 27 years due to the overlap of the indirect social spending data, which does not begin until 1967, and private-sector spending data that ends in 1994. The SSA estimated private sector welfare benefits across four categories from 1950-1994: health care, income maintenance (mainly private pensions and worker compensation), education, and welfare services.[29] These categories were chosen by the SSA since they correspond with comparative studies of social welfare programs conducted by the Organization for Economic Co-operation and Development (OECD) and the Congressional Budget Office (CBO). In addition, these categories reflect the

[29] In table 5A.1. there is a detailed description of the private-sector social spending measure.

broad subcategories for social policy used in both the appropriations process and the tax code. *It is imperative to note that these data do not include tax expenditures.* These data are purely private-sector social expenditures, which do not include public subsidies or taxes in order to avoid double-counting. I aggregate all of the categories to construct the dependent variable, a measure of annual changes to private-sector social expenditures.

The political variables of interest are carried over from the previous chapters with Republican control of the executive coded as one and Republican influence in the legislature represented by the percentage of Republican members between zero and one. I report Republican control of the House of Representatives and Senate with a dummy variable for both houses. In addition, I measure the ideological direction of the presidency using DW-NOMINATE scores as a substitute for party control of the executive. The DW-NOMINATE procedure applies a spatial model of voting representing a liberal to conservative ideological spectrum. The DW-NOMINATE ranges from -1 to 1 with 1 being a perfect conservative score. I expect that more conservative Republican president's will correlate with higher levels of the social expenditure ratio and private-sector social spending. Republican Party control is used in place of the traditional measurement of Democratic Party control given that the partisan theory of social policy predicts higher levels of private subsidization and spending under Republican leadership.

I import the social expenditure ratio as representative of social policy from chapter three. This variable is the ratio of indirect to direct social spending represented by the annual change in tax expenditures for social programs in constant 1994 dollars over the annual change in direct appropriations for social programs in constant 1994 dollars. In addition, I employ existing ideas about how changes to the macro-economy affect private-sector spending. An increase in the level of unemployment will result in less people being able to claim employer benefits, such as employer-based health care and pensions, and, therefore, should drive down private-sector spending. When unemployment is high, businesses typically cut back on discretionary spending by decreasing fringe benefits and restricting employee eligibility (as much as can be done legally). In addition, newer businesses, due to economic uncertainty, may not voluntarily offer social benefits and services to their employees. Next, a rise in real GDP denotes more production and economic growth, which should relate to increased capacity for businesses to offer more fringe benefits (although there are many outlets for increased profits). The dependent variable is denoted by the annual percentage change in total private-sector social spending in real 1994 dollars.

My theoretical argument implies that political party influence on private-sector expenditures occurs indirectly through changes to public policy. Therefore, in the full recursive model represented in figure 5.1, the influence of party control on the private sector is filtered through changes to social policy. I test for the effects of direct party control on private social spending in order to determine that it is changes in social policy and not other policy directives that are drive increases in private social expenditures. Finally, I address existing political economy theories by including measurements of unemployment and inflation. The full model can be represented as follows[30]

$$Y = a + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + e$$

[30] There are two main reasons why a structural equation is not used to test the direct and indirect relationships of political party control and social spending. One is that there are no latent variables in the model, and second, the intervening variable, the social expenditure ratio, is directly influenced by political party control and therefore not endogenous to the model.

I employ four separate regressions to examine the relationship among political party control of government, social policy, and changes to private-sector social spending.[31] In this model, Y is the annual change in private-sector social expenditures in real 1994 dollars. Political party control of the executive is represented by β_1, and political party control of the House and Senate are represented by β_2. The social expenditure ratio, representing changes to social policy, is characterized by β_3. Finally, the standard economic controls for private sector outcomes are represented by β_4.[32] As with the previously-reported ECM, Republican control of the government should show a direct relationship with higher levels of the social expenditure ratio. Therefore, I expect, in the OLS regression, that Republican Party control of government will correlate with higher levels of private-sector social spending through changes to social policy as represented by the social expenditure ratio so that when the ratio rises, it stimulates private spending on social programs. Additionally, higher levels of the social expenditure ratio will be directly associated with more private-sector social spending, even when controlling for party control and economic factors. I do not expect Republican control of government, in and of itself, to influence changes to the level of private-sector social expenditures.

[31] Also, I ran this model as a seemingly unrelated regression with similar results but choose not to use this due to the correlated error terms.

[32] I also ran an alternative lagged dependent variable model. This model accounts for the time delay involved in the private market learning and incorporating information about policy change into their social expenditure strategies. The results from this model were similar to the above model and considering that the dependent variable is the annual percentage change in private spending, it seemed as if a lagged dependent variable model would be lagging private-sector spending twice, which seemed unnecessary.

Partisan Influence, Social Policy, and Private Social Expenditures

In Table 5.2, this model comes closest to indicating a causal flow among political party control to changes in social policy correlating with increased private-sector spending. It falls short in that although Republican control is positively correlated and significant with higher levels of the social expenditure ratio and this is in turn related to higher levels of private-sector spending, there is no statistically significant relationship between increased Republican influence and higher private social spending. As with the time-series analysis, there is a strong relationship between Republican Party control of Congress and increases in the social expenditure ratio. Republican control of the executive is signed in the wrong direction and not significant. The second model in Table 5.2. tests the direct effect of political party control on changes to private-sector social spending. As with the social expenditure ratio, a Republican legislature is positively signed with increases to private social expenditures while executive control is correlated in the opposite direction, yet neither is statistically significant from zero. In 5.2., the third model tests both the political party and social policy influences on annual changes in private-sector social spending. The previously found strong effects of Republican Party legislative influence are not significant in this model, and in turn, the partisan effects might be filtered through increases to the social expenditure ratio that is both positive and statistically significant. As in the first two models, political party control of the executive is negatively signed and not statistically significant. In the full model, the social expenditure ratio is signed in the right direction and significantly correlated with higher levels of private-sector social spending, even when controlling for theories from political economy. The economic controls are positive, although not statistically significant. These results do not present evidence of a true path dependent effect given that political party control is not correlated with changes to private-sector social expenditures. It can be said that increased government subsidies are more important in driving private social spending than macroeconomic changes such as changes to the unemployment level. Although given the low amount of total variability picked up by the models, the policy effects should be interpreted with caution. In addition, the model fit is diminished by adding the economic controls. There are business elements that at this time are missing from the model which probably determine social spending changes, such as company-level decisions and industry structures.[33]

In table 5.3., Republican control of government across the federal units is tested in relation to increases in private-sector social spending.[34] Republican control of government does not demonstrate the expected relationship with greater private-sector social spending, except for the first model in which Senate control is signed correctly and significant. In addition, the correlation between the social expenditure ratio and increases to private spending although positive do not rise to the level of statistical significance across all three models. Not surprisingly, these models do not fit the data well compared to the models measuring Republican influence in Congress. In table 5.4., the substitution of presidential ideological for party control does not help improve the overall results. An increase in executive conservative is inversely related to higher private spending, although none of the coefficients are significant from zero. Republican control of the Senate is signed correctly yet not statistically significant. Finally, like the previous table the social expenditure table is robust, positive and barely misses the bar for significant levels. The lack of results in this

[33] I ran a model with the dependent variable being change in real dollars and not the percentage change of private-sector social spending. In these models that mirror the independent variables in tables 5.3. and 5.4. only Republican control of the Senate was correctly signed and significant across the different tests.

[34] The Republican Party did not control the House of Representatives during this period.

section could be due to a number of factors. First, is that the time period only covers 27 years and therefore does not include most of the Clinton years or any of the spending changes during the Presidency of George W. Bush. Next, business decisions to increase or decrease private social spending is driven by numerous factors not modeled here such as globalization, unionization, and social insurance costs. Nonetheless, there is still some evidence that Republican control of the Senate and mainly, changes to the social expenditure ratio could be driving private-sector social spending increases in the U.S.

Discussion and Conclusion

The support of the Republican Party for increases to private-sector social spending through public policy changes has implications for the beneficiaries of employer-based social insurance. The private and public social systems are dynamic and interactive, so when the private-sector system changes, it affects the prospects for future growth of public social programs. The Republican Party's support of indirect spending for private social programs pays multiple dividends to party members' electoral and policy interests. There is no better example of the adage that policy affects politics than the electoral success for the Democratic Party following passage of the New Deal package. The Republican Party has realized, through a number of legislative defeats in its attempts to scale back Social Security and Medicare, that in order to diminish the scale of these popular public programs, they would have to build an extensive private social system. The use of public resources to subsidize the private social system allows politicians to argue for the benefits of employment-based insurance and not just argue against the widely popular Social Security and Medicare programs. In addition, subsidizing the private social system using tax expenditure programs decreases it now, and future appropriations to sustain and grow public programs are less available, thereby “starving the beast.”

Citizens have little power over changes to the private-sector social system. While public opinion and interest groups determine policy outcomes for public programs, most citizens relying on employment-based benefits have no institutional leverage in bargaining or negotiating for better benefits. In fact, workers not involved in unions have no formal organization and therefore little influence in changing employer-based social benefits short of switching jobs. Employers develop worker loyalty or dependence from basic provisions such as health care insurance, child care, and pensions. I expect that citizens receiving more social benefits from their employer versus the government would be less supportive of a tax and spending increase for public social benefits, and these attitudes would be visible across time in surveys. Finally, economic studies have demonstrated that workers pay for increased employer benefits in the form of reduced salaries.

The increase of private-sector social spending has the potential to decrease public demand for government-run social programs, thereby “crowding out” public social spending. Economists have developed a theory arguing that welfare spending in one sector reduces "dollar for dollar" welfare spending in another sector (Roberts 1984, 1987; Bergstrom et al. 1986; Andreoni 1987; Steinberg 1987). The logic of the “crowding out” theories is that consumer demand is relatively constant and social products are supplied by the two competing sectors just as in dual-oligopolistic markets. Therefore, an increase in subsidies to private social benefits satisfies consumers so that they demand less from the government. This relationship goes the other way in that increases to government welfare spending can crowd out private social spending. A recent study found a conditional relationship between government redistribution and private charity. Brooks (2000) showed that at lower levels of private charity, government subsidies stimulated, or "crowded in," donations for a charitable cause, while at higher levels, government spending crowded out private donations. Additionally, Karch (2010) demonstrated that states with large Head Start communities were less likely to support increased funding of public preschool programs.

The increased use of tax subsidies can cause distortions in the private social market. If there is no change in current tax policy, an increasing proportion of the relatively wealthy and healthy population will over-buy discounted group health insurance. Tax expenditure programs for employer-based health care provided $160 billion worth of subsidies to the private-market in 2008. These subsidies hide the true cost of employer health insurance and inflate the consumer market for privately-administered health care, which in turn drives up the cost for health products and services for all health care consumers. This artificial inflation caused by public policy disproportionately hurts people with individually purchased health insurance or those with no insurance.

The importance of the private, employment-based social system in the United States political landscape allows the business community to play a large role in federal debates about social policy. This skews the political debate surrounding health care since corporations have access to the healthier, younger population, while the government takes on the poorer and older segment of the population. Additionally, public social programs seem less effective since they serve marginal groups with bigger health and financial problems. In addition, the existence of employer-based insurance has divided the loyalties of union members, traditionally an important part of leftist political party support. Historically, union leaders have oscillated between pushing for generous public social programs and lobbying for more subsidies for employer-based benefits. Finally, both tax expenditures and employer-based social insurance accrue more benefits to wealthier and non-minority workers. So again, increases in indirect spending at the expense of direct spending assist the wealthiest people twice over while taking away public resources from society's poorest and most vulnerable populations.

CHAPTER VI

POLITICAL PARTIES, SOCIAL SPENDING, AND INCOME INEQUALITY

Economic inequality has steadily increased over the last thirty years in the United States. The growth of income inequality is a concern for political science given the importance of money in elections, the overrepresentation of the wealthy in interest groups, and the political response bias that favors wealthier citizens (Jacobs and Skocpol 2005; Bartels 2008). Political party control of government and public policy alter the level of national income inequality, even when controlling for economic trends (Kelly 2009). The Republican and Democratic Parties advocate different social and fiscal policies, which result in contrasting income effects. Studies have found that Republican administrations produce economic conditions and income growth patterns that increase income inequality, while Democratic presidents produce policy and economic outcomes that narrow disparities of income (Bartels 2008; Kelly 2009). In this chapter, I apply the partisan theory of social policy in examining how partisan change in the federal government affects social policy, which in turn influences changes to income inequality. This chapter presents evidence that Republican influence contributes to greater levels of income inequality through changes to the social expenditure ratio, in addition to executive control. The social expenditures ratio is composed of indirect spending that regressively accrues public monies up to wealthier income groups over direct social spending, which tends to progressively redistribute money down the income ladder. Therefore, I expect that increased Republican influence will result in greater income inequality through changes to the social expenditure ratio. These results have implications for understanding the relationship between political trends and increased economic inequality in America.

Economic Inequality in Modern America

Currently, the wealthiest families in America hold half the nation's wealth, and over the last forty years their incomes have grown at a faster pace than the rest of the country. In 2008, the top five percent of the income distribution received 20.5% of the nation's total income, while the top quartile received a hefty 47.8% of total income. In the same year, the bottom quartile received only 4% of total income, and the middle class, the second and third quartile, received a modest 38.6%. The families in the top quartile of income have not controlled this much of America's wealth since 1928 (U.S. Census 2008). Political influences on income inequality were chronicled in a 2002 taskforce report from the American Political Science Association (APSA) and included long term trends such as stagnant social insurance policies that lag economic changes, decreases in the marginal tax rates for the very wealthy, and the increased influence of money in political campaigns that result in policies favoring the wealthy. And although there are a myriad of economic developments that have led to increased income inequality including labor market trends, technological changes, and globalization, this study focuses on how political parties and social policy determine changes to economic inequality.

America's income inequality trends fall into two distinct periods: pre- and post- 1974. Economic inequality generally decreased from 1947 through 1973 and has since grown larger every year. The U.S. Census Bureau has published annual summary data of family income distributions as far back as 1947. The U.S. Census Bureau provides data for annual family income for groups at the 20th, 40th, 60th, 80th, and 95th percentiles of the income distribution. Traditional studies using these data have qualified poor families at the 20th percentile and below, middle-class families at the 40th and 60th percentiles, wealthy families at the 80th percentile and extraordinarily wealthy families at the 95th percentile. If the U.S. were to achieve perfect income inequality, it would mean that each fifth of the population would receive 20 % of the country’s income. From the late 1940s through 1973, American income growth was relatively equal across income quartiles. More precisely, the period from 1946-1976 saw the bottom 90 % experience income growth higher, on average, than the top one percent. After 1974, income growth for the top quartile of the income distribution expanded much faster than the rest of the population, especially compared to the lowest quartile, which actually went down. The cumulative income growth from1974-2006 for families at the 20th percentile was 10.3 %, while it was a healthy 42.9 % for families at the 80th percentile and an outstanding 62.9 % at 95th percentile. The top quartile has received more than 40 % of the nation’s income since 1947. In the period from 1974-2006, real income growth at the 95th percentile was 1.6% a year, while the real income of families at the 20th percentile grew at a paltry 0.4% annual rate. More recent increases in economic inequality have been driven by the wealthiest families in America.

Most of the increase in income inequality has occurred between the median level of income and those families at the very top of the income scale. For example, if we examine the national income share of just the 95th percentile, this group received about 15% of total income at the beginning of this study in 1967. This same elite cohort witnessed their income share increase to 22% by the year 2000. Conversely, the lowest income quartile began the period of this study with a little more than 4.2% of the total income share, and by the century's end, this decreased to 3.6%. According to a report from the Congressional Budget Office (CBO),[35] between 1979 and 2005 the bottom half of the top 1 % experienced an income increase of 105%. The next four-tenths of the top 1 % witnessed their real income rise 161%. Next, the top 0.1 % had their after inflation adjusted income rise an amazing 294%. Finally, the top 0.01%, approximately 11,000 families, had a real income increase of 384% during this period. These trends measured in net worth (including stocks, mutual funds, retirement savings, and property ownership), as opposed to income, reveal that the top 1% currently controls 38.1% of the nation's overall wealth. Conversely, the bottom 90% receives only 29 % of the country's total wealth. From 1951-2006, families at the 20th percentile experienced declining incomes in 20 of the years including 7 years of 3% or more, while those families at the 95th percentile experienced only one year of 3% or more drop in income. A study from Piketty and Saez (2008) demonstrates that the presidency of George W. Bush was especially kind to the wealthiest Americans, as evidenced by exacerbated income inequality from 2001-2008. At the end of 2008, the top 1% of the nation's families accrued a larger share of national income than any other time since 1928. According to the study, real income for the top 1 % of families grew at 62% during these seven years, compared to only 4 % for the bottom 90% of households.

In comparative perspective, the United States has the fastest growing and highest level of income inequality relative to any other industrialized country (Brandolini and Smeeding 2006; Pontusson and Kenworthy 2005). The Luxemborg Income Study (LIS) began in 1983 and is a cross-national study that reports on a number of demographic

[35] 2007, Historical Effective Tax Rates 1979 to 2005

characteristics including family and personal income. In this study, the United States reports greater levels of income inequality than Western European countries in both the pre- and post-tax estimates. The LIS demonstrates that, although the median income level in the United States is higher than that of most other countries, far more American citizens are poor relative to the median income. The experience of other Western, industrialized countries shows that globalization and technological changes result in greater income inequality, yet public policy has an important equalizing effect. In a study from Kenworthy and Pontusson (2005), ten of eleven industrialized countries experienced increased income inequality during the 1980s and 1990s, yet nine of these countries responded with more assertive distributive policies at the end of the period. The United States was not one of these nations.

Increased income inequality has the potential to disrupt the political gains made by minorities and women during the Civil Rights Movement. Since the 1970s, the income disparities between whites and blacks have widened. Throughout the 1980s, unemployment of blacks more than doubled that of white workers, and the income gap between the races grew to levels of those in the 1950s. The economic growth of the 1990s ameliorated the racial income gap somewhat, but with the recent economic recession, blacks are much more likely to be unemployed and living below the poverty level than whites (BEA 2008). It is not a coincidence that class political divides are aggravated by the fact that poorer citizens are disproportionately black and Latino. Gilens (2005) demonstrated that racial discrimination is a salient factor in Americans' general lack of support for social welfare policies. In addition, Alesina and Glaeser (2004) found in a cross-national study that racially and ethnically diverse societies have less generous social spending policies than more racially uniform countries. Similarly, women earn substantially less than men in each occupational sector

(Mishel, Bernstein, and Bushey 2003). This gap is accentuated by the differences between married and single women. The number of single female-headed households has grown since the 1970s. While single female-headed households have experienced incremental income growth, they are still twice as likely as married women to be below the poverty line (Mishel, Bernstein, and Bushey 2003).

The Politics of Income Inequality

The two major political parties promote different social and economic policies, which result in divergent effects on income inequality. Bartels (2008) argues that "significant partisan differences in tax and transfer policies have continued to produce significant partisan disparities in patterns of post-tax growth, with the middle class and especially the working poor experiencing more income growth under Democratic presidents than under Republican presidents" (p.30). In the period from 1948-1978, income inequality decreased by 25% during the 14 years of Democratic control and remained unchanged under 17 years of Republican control (Hibbs 1987). Alesina (1988) demonstrates that the largest difference between Republican and Democratic administrations occurred in the early years of the president's new term. In the first two years under Democratic leadership, middle and low income earners gained more in terms of real GDP than did families at higher income levels. The partisan differences established in these studies are a result of contrasting philosophies represented in fiscal and tax policy.

In America, the class compositions of the parties' respective electoral coalitions have encouraged them to adopt distinctive macroeconomic priorities. The New Deal alignment of the 1930s organized class interests into politics. As party coalitions and partisan competition have evolved, class differences in party coalitions remain. The two parties differ in their electoral bases and in terms of average family income. Republican identifiers and voters are more affluent than their Democratic counterparts. McCarty, Poole, and Rosenthal (2006) demonstrated that a high income has become an increasingly reliable predictor of Republican Party identification and Republican presidential voting since 1950. As the political parties have polarized on economic issues, the public has followed with wealthier citizens aligning more with the Republican Party and the working class leaning more towards the Democratic Party. This has led to contrasting fiscal policies in which the Democrats focus on lowering unemployment as a means to redistribute income to working class constituencies, and Republicans promote lower inflation that assists investments and capital.

Partisan differences in changing income inequality are largely attributable to differences in income growth, unemployment, and inflation. For most of the past century, Democrats in office have pursued higher taxes, high employment, and economic redistribution from the rich to the working class. Republican administrations have sought lower inflation, lower taxes, and redistribution to wealthier constituents. Working and middle-class families experienced large, statistically significant growth in their income under Democratic versus Republican presidents during the last half century. Under Republican presidents, wealthy cohorts experienced considerable income gains compared to poorer citizens resulting in increased income inequality. Bartels (2003) argues that applying consistent Democratic income growth patterns every year from 1948-2005 would have almost negated the real rise in economic inequality. He further argues that the same application of Republican income growth patterns would have increased income inequality by 80% more than it actually grew during this same period. From 1948-2001, the average unemployment rate was 30% lower under Democratic presidents than Republican presidents. Hibbs (1977) demonstrated that "after adjustment lags the unemployment rate tends to be about 2 percentage points lower under the Democrats than under the Republicans and that real output tends to be about six percent higher per year"(p.226). Additionally, the six out of seven recessions that occurred from 1951-1987 were during Republican presidential administrations (Hibbs 1987). Similarly, growth in real GDP was 40% higher under Democratic rather than Republican administrations, and these combined economic effects account for much of the changes to lower and middle class income changes. Over this same period, the average rate of inflation was relatively equal under the two political parties. Recent studies show that growth in GDP and decreases in unemployment accounted for most of the income growth of the lower and middle classes but have little effect on income for the wealthy (Bartels 2008; Kelly 2009). In contrast, lower inflation rates are much more beneficial to income gains at the top of the distribution versus the bottom.

The changes to tax policy, mainly under Republican administrations, in the last thirty years have reduced the progressive structure of income and corporate rates. Although both political parties have promoted tax cuts in the modern era, they have done so in vastly different ways. The Democratic Party has focused on what is termed "middle class" tax cuts aimed at stimulating job growth and lowering unemployment. The Republican Party has advanced the theory of supply-side tax cuts, which focuses on reducing the tax burden for the wealthiest citizens since they are most likely to own businesses and capital. Democratic administrations have cut taxes, targeting the middle and working classes, as a means to stimulate production, employment, and income. The decreases in marginal income and corporate tax rates during George W. Bush's administration were tilted toward the very wealthy. According to recent study, the 2001 tax cut allocated 36 % of the total benefits to the wealthiest 1% of taxpayers, and 63% of the overall benefits to the top income quartile (Citizens for Tax Justice 2002). Bartels (2008) examines the trends in post-tax income growth as compared to pre-tax income growth. From 1980-2003, under Democratic administrations, every income strata grew between 1.4% and 1.6%, while during Republican presidencies, there were small income increases for the top quartile with no income growth for the bottom three income levels. The partisan differences were greater for pre-tax income changes implying different party strategies for Social Security, unemployment, and indirect spending.

Income inequality can distort the political process. Studies have found that political representatives are more attentive to economic elites' opinions than mass opinion (Wright 1989; Bartels 2008). Bartels (2005) examines the responsiveness of U.S. senators by class constituencies, and his analysis suggests that wealthier policy preferences were more influential than simple averages of mass opinion, especially for Republican senators. In addition, state constituents in the bottom third of income distribution had no measurable impact on Senators' voting records. Additionally, Gilens (2005) found that a 10 percentage point shift in the public opinion of the wealthiest respondents was associated with a 7.6 percentage point difference in the likelihood of policy change, while the exact same percentage change among the poorest was correlated with only a 0.5 percentage point change in likelihood of policy shifting.

Social Policy and Income Redistribution

Direct social spending disproportionately benefits working class populations and redistributes public funds down the income ladder. Kelly (2009) demonstrates that 53% of total Social Security benefits go to those citizens in the lowest income quartile and only 23% goes to the top three income categories combined. Medicare's redistributive effects are similar, with 66% of the total benefits going to the bottom 40% of the income distribution and the top two quintiles receiving only 19% of the benefits. In addition, he finds that aggregated public social spending from 1947-2006 reduced the Gini coefficient by over 12% (Kelly 2009, p.35-36).[36] The benefits from Social Security are based on a formula that provides higher benefits to lower-income workers relative to the taxes they paid into the system. According to a report from the Social Security Administration (SSA), without the cash payments from Social Security, more than half of the elderly population would have been below the poverty line in 2007. Although Medicare's benefits are more equally distributed across income levels, it is financed largely from a progressive tax, thereby producing a modest progressive effect on income distribution. Medicare part A is financed by a tax on all wages as compared to Social Security which is financed by the first $76,000 of annual income. Part B is financed by general tax revenues coming from the progressive tax structure. Social Security and Medicare offer more help to lower wage workers, in large part due to the restricted availability of employer benefits that are more likely to be offered to high income professionals. Andrea Campbell (2003) demonstrates that the elderly are one of

[36] The Gini coefficient is a common measure of income inequality that measures the statistical spread of family incomes in a country. The coefficient is based on the Lorenz curve and can range from 0 perfect income equality to 1 perfect income inequality.

the only groups in America whose political participation is not distorted towards the wealthy, and she attributes this to the universality of Social Security and Medicare benefits.

The use of the tax system as a substitute for direct spending is not new. Long-standing provisions of the U.S. income tax provide tax benefits for home ownership, the provision of group health insurance by employers, retirement saving, activities of state and local governments and charitable organizations. The relationship between income class and indirect spending is clear. Indirect expenditures for social benefits increase with each increase in income class category. Table 6.1. presents the average tax returns for nine different class categories for both the medical deduction program, one of the primary tax expenditures for health care, and the charitable contribution program in the fiscal year 2007. The wealthy receive dual benefits from an increase in indirect spending in the form of both lower tax rates and more employer-based social services. An increase in the social expenditure ratio that increases indirect spending at the expense of direct spending should increase income inequality in America. In recent years, tax expenditures have been growing, especially those directed at social policy goals such as health, education, retirement security, and support for low-income families. For example, the earned income tax credit (EITC) has increased more than four-fold since 1990 and now provides as much assistance as food stamps and Supplemental Security Income (SSI).[37] During the period of this study, Republican Congresses enacted new tax credits for expenses of post-secondary education, a new child credit, tax incentives for saving for higher education, and expanded eligibility for tax-favored individual retirement accounts (IRAs).

[37] This could offset the rise in income inequality, yet EITC does not constitute a large enough percentage of total tax expenditures to change the regressive trend.

A Partisan Theory of Social Policy and Economic Inequality

The Democratic and Republican Parties pursue different social policies that result in contrasting effects on income inequality. Direct and indirect government spending represented close to 40% of Gross Domestic Product (GDP) in 2006. The Democratic and Republican Parties direct this substantial portion of the overall economy to different populations in society that reflect their distinctive electoral goals and core values. In figure 6.1., I present the full model of political parties, social policy, and income inequality. The Democratic Party constructs social policy so as to enhance the role of government as a check to private power. This policy choice leads to more direct social spending that progressively redistributes national income, thereby lowering economic inequality. In contrast, the Republican Party uses public policy to aid the private economy through increases to indirect expenditures, which subsidizes business activities and regressively redistributes government resources producing increases in income inequality. Therefore, I expect that increased Republican influence in the federal government will correlate with higher levels of the social expenditure ratio that, in turn, will increase income inequality. Indirect versus direct social spending accrues social benefits to different income classes and redistributes national income in opposing directions.

Measuring and Testing the Partisan Theory and Income Inequality

In order to test the partisan theory of social policy and economic inequality, I incorporate a unique dependent variable that is an annual measurement of post-government income inequality borrowed from Nathan Kelly (2009).[38] The measurement is a ratio of the

[38] This label means it measures income inequality after government taxes and transfers.

aggregate income of the top 20 % of the households to the bottom 20 % (T20/B20). The definition of income in this measurement includes pretax, pre-transfer income plus government cash and noncash benefits (unemployment compensation, state workers' compensation, Social Security, Supplemental Security Income, public assistance, veterans' benefits, public survivor benefits, government pensions, public disability benefits, government educational assistance, Medicare, Medicaid, and food stamps), minus federal taxes. The dependent variable ranges from 1967-2000 due to tax expenditures starting in 1967 and the income inequality set ending in 2000.[39]

In this chapter, I model and test the relationship among political party control of government, social policy, and income inequality. In the first table 6.2., I import all the previous political and economic variables of interest, sand inflation given that there is no expectation of a relationship with income inequality. In table 6.3., I use dummy variables signifying Republican Party control of the presidency, House, and Senate. For all the models, the social expenditure ratio is imported from the original analysis in chapter three and deflated to real 2000 dollars. This variable is the ratio of indirect to direct social spending represented by the annual change in tax expenditures for social programs in constant 2000 dollars over the annual change in direct appropriations for social programs in constant 2000 dollars. In table 6.4. all the previous variables are carried over expect the variable for the presidency. I substitute a measure of the president's ideology, using DW-NOMINATE

[39] I experimented with a number of measurements for income inequality such as the T20/B40 measure, the Gini coefficient, and the income share of the top 5% of the nation's distribution. The results from these measure was mixed. Although any measurement of postgovernment inequality reported similar results to tables 6.2-6.4. I also tested a variable that only measured the income of the top 5% of the income distribution, although theoretically I expect changes at the top and bottom of the income ladder, so this variable was dismissed. Also, I tried the Gini coefficient and a variable named the T5/B40, which produced similar, yet not significant, results to the reported models.

scores, for the dummied variable of political party control. The DW-NOMINATE procedure applies a spatial model of voting representing a liberal to conservative ideological spectrum. The DW-NOMINATE ranges from -1 to 1 with 1 being a perfect conservative score. Since I argue that values and by extension ideology place a role in a political party's behavior, the DW-NOMINATE better captures the degree of conservatism for Republican executives. In model and table 6.5. I substitute the DW-NOMINATE scores for dummies representing each President's term of office from President Nixon to President Clinton.[40] This model is designed to determine the influence of specific administration's policies. I expect that Republican control will result in higher levels of the social expenditure ratio that in turn correlates with higher levels of income inequality. In order to control for economic effects, I include changes to annual unemployment in the model. In economic downturns, workers at the lower end of the pay scale tend to fare worse both in wage cuts and downsizing. Therefore, increased unemployment should result in higher levels of income inequality.

I expect political party control to influence income inequality indirectly through changes to public policy. Yet, I also test for the direct effects of party control on income inequality in order to differentiate between the influences of social policy as compared to other partisan effects that might drive changes in economic inequality. I expect that Republican Party control of government will correlate with higher levels of income inequality through changes to social policy as represented by the social expenditure ratio so that when the ratio rises, it redistributes more income to the wealthy and decreases income to the poor. Therefore, Republican control of the government should show a direct relationship with higher levels of the social expenditure ratio. Next, higher levels of the social

[40] President Clinton's two terms serve as the control of the grouping.

expenditure ratio will be directly associated with more income inequality, even when controlling for party control and economic factors. I do not expect Republican control of government, in and of itself, to influence changes to the level of economic inequality.

Partisanship, Policy, and Income Inequality

In table 6.2, Republican control of the executive correlates with higher levels of income inequality with an additive effect from changes to the social expenditure ratio. Republican influence in Congress performs unexpectedly given that it is negatively signed and not statistically significant. In the full model, Republican control of the presidency still holds as positive and significant with a slight effect from the ratio and changes to unemployment being signed in the wrong direction and significant. In table 6.3., which tests for Republican Party control across units the early results still hold with Republican control of the executive and the social expenditure ratio being robust, positive and significant. These expected effects are conditioned by the Republican control of the U.S. Senate being signed in the opposite direction and significant. This somewhat surprisingly result is probably driven by Republican control of the Senate from 1996-2000, a period of healthy economic growth. Increases to the social expenditure ratio direct higher levels of income inequality, even when controlling for party control and changes to unemployment. Not only is unemployment statistically insignificant, it lowers the fit of the overall model. As with past research, Republican control of the executive results in higher levels of income inequality. In model 6.4., the dummy variable for the executive is replaced with the president's DW-NOMINATE scores. Since I argue that values and, by extension, ideology place a role in a political party's behavior, the DW-NOMINATE better captures the degree of conservatism for Republican executives. The results are largely the same, except that the ideological direction of the executive results in slightly higher coefficients for control of the executive and by extension a better fit for all three models. In table 6.5., the individual president's are dummied from Nixon to Clinton. I would expect that the Republican presidents are positively correlated with higher income inequality while Democratic executive produce less income inequality. The coefficients for Presidents Nixon, Ford, and Carter are in the expected direction with Nixon and Ford being statistically significant. Presidents Reagan and H.W. Bush are signed in the opposite direction but only the Bush presidency is significant. Republican control of the House and Senate is signed in the opposite direction and not significant from zero. Social policy still matters in this model and is both positive and significant, again reporting the largest coefficient of the model. The economic control of unemployment is signed in the wrong direction. In conclusion, the social expenditure ratio correlates with increases to income inequality, even when controlling for political and economic effects. It is difficult to posit a causal relationship among party control, social policy, and income inequality given that the coefficient for Republican executive control increases with the inclusion of the ratio measure and the Senate is signed in the opposite direction. Yet, the strength of the social expenditure ratio'c correlation with income inequality adds to our understanding of how politics and policy affects economic inequality.

Conclusion

We know that changes to partisan power in government relate to changes in economic inequality. Previous studies have related these changes mainly to the economic policies of political parties (Bartels 2008; Kelly2009). This chapter presents strong evidence that social policy change, intended to subsidize the private market, increases income inequality in America. The wealthy benefit twice over in financial and social benefits with higher levels of indirect spending that in turn reduces future government revenue for programs aimed at the poor. There is a tradeoff that occurs with social policy that turns the provision of economic security into a zero sum game for the divergent income classes in the U.S. How supportive would the majority of Americans be for social tax expenditure programs if the line of financial and social benefits to the very wealthy were made clear and visible in policy debates? In addition, given the resource effect of political participation in American politics, the growing income inequality caused by changes to social spending might result in political pressure from the rich that produces future social expenditures ratios that tradeoff more indirect for direct spending.

Can democracy operate in a society with large and increasing disparities between income classes? Economic inequality has insidious and detrimental effects on policy and representation in American government. Economic inequality influences the degree of political equality in the United States. Participation in American politics has bifurcated with the growing breach in economic inequality. The wealthy participate at higher levels in politics, are well organized to communicate their concerns to government, and are more likely to have politicians respond to their demands. Verba, Schlozman, and Brady (1995) have developed a theory that citizenship requires the accumulation of individual resources such as income, money, and time, and richer citizens have these resources disproportionately compared to poorer ones. The authors found occupational and income differences in voting, joining an interest group, reaching out to an elected official, working on a campaign, and taking part in a social movement. Also, wealthy issue activists have replaced traditional activists in both political parties. In order for candidates to succeed in primaries and run expensive campaigns, they need to recruit and attract these elite activists and volunteers to work in and fund campaigns. Debates over how best to provide and administer social programs are worth having, but programs that disproportionally provide resources for economic security to the small population least threatened by income insecurity are a threat to political and economic stability.

CHAPTER VII

CONCLUSION: POLITICAL PARTIES, SOCIAL POLICY, AND INCOME INEQUALITY

Implications

American politics is a turf war between the two major political parties. Democrats and Republicans fight to determine where the line is drawn in establishing the proper balance of power between the public and private sectors in society. A political party in power that is able to move the jurisdictional boundary towards their sector of society also alters the balance of power between the core values of equality and liberty and sets the appropriate mix of democracy and capitalism in America. As demonstrated in this project, Republicans prefer indirect versus direct social spending, which subsidizes the private-sector and redistributes income towards the wealthier groups. Conversely, the Democratic Party is more likely to use direct versus indirect spending that targets public support to vulnerable populations and distributes benefits to more middle and working class populations. Therefore, battles over social policy not only shift the equilibrium between public and private power, but redistribute resources between the rich and the poor and alter the role of government as either an aid or check to capitalist power. This dissertation makes a number of important contributions to the studies of American politics and public policy.

American Government and Institutions

Most importantly, this dissertation presents evidence that Republican Party control of government increases income equality through changes to social policy. This is ironic given that social policy, by definition, is an attempt by government to protect citizens from economic insecurity and calamity. The Republican Party pursues a political strategy that provides government assistance to citizens who enjoy large salaries, generous social benefits, and economic security from their position in the private economy. This social policy strategy hurts populations who are disadvantaged in the private economy, and who do not gain income security through increased indirect social spending. Recent scholarship demonstrates that Republican control of government exacerbates economic inequality through fiscal policy or changing market conditions (Bartels 2008; Kelly 2009). This project adds to the previous literature by showing clearly that certain types of social policy contribute to the general rise of income inequality in the United States, all else equal. Also, I hope that this dissertation adds to the discussion over how best to finance economic security for the majority of Americans. Do we believe that social benefits are a right of citizenship or a commodity within jurisdiction of the private market? Next, which spending type, direct versus indirect, is most efficient in actually producing more and better quality social services? These debates would better serve the future of American democracy than ideological mud fights over the size of government.

The empirical results in this dissertation call into question the usefulness of representing political conflict as a dispute over the size of government. The size of government in modern American politics is not a useful concept. First, I find no clear evidence of differences between the two major parties in changes to total social spending. This raises doubt that only Democratic Party control correlates with increased public social expenditures. Next, as argued throughout this project, political parties spend money in a multitude of ways that contribute to the overall financial footprint of the federal government on society. In fact, if direct spending, tax expenditure, grants, loans, and the cost of regulation were all accounted for in measuring government spending, the political parties might become even more indistinguishable than they are in this project. Also, I doubt that the average citizen really comprehends what the true size of government is at any moment and how it is different than six months ago. Over the course of this project, I wondered if we, as political scientists, frame political conflict as a battle over the size of government due to the path trajectory of survey questions and past research, or if we really believe that it is the fundamental fault line in politics as understood by both the electorate and elites? Citizens expect the political party in power to use public policy and public funds to address societal problems, albeit in different sectors, and both political parties do not disappoint the electorate. It is fantasy to believe that only one political party distributes government resources to their supporters for the purpose of reelection. I hope that this dissertation, along with other works, helps the political rhetoric catch up to the reality of modern politics. The major divide between the two parties is over the role of government in society, not over the size of government.

Class politics matters in American politics. In the history of American politics, class interests have been deemphasized as compared to studies of European politics. This study demonstrates that the political parties, with divergent class coalitions, select specific policy tools to target government benefits and patterns of income redistribution to different income classes. The class bias of social spending is augmented by the fact that different populations are served by the public versus private social system. As citizens of different income classes have polarized politically, it has become more important and easier for political parties to direct public assistance to their preferred constituency by substituting one type of social spending for another. Although social policy debates are not always framed in terms of class politics, the policy results of social spending changes have important and divergent effects for different income classes. Social policy in the U.S. is close to a zero sum game for the different income class cohorts. As I explained here, direct public spending and benefits disproportionately aid middle and working class populations. Conversely, indirect social expenditures accrue both tax and social benefits more to wealthier populations. So while most European welfare states design programs to accrue more benefits to those most in need of economic security, the United States directs benefits to income-classes based upon political party electoral coalitions.

The Republican Party is the party of smaller government in rhetoric and not reality. There is no modern political party that represents citizens interested in smaller government. This project provides evidence, contrary to common wisdom, that the Republican Party finances social programs and increases federal spending in ways that subsidize the private sector and distributes money to the wealthy. Republican Party leadership understands full well the relationship between distributive public programs and electoral fortunes. A significant motivating factor behind the Republican strategy on social policy is to build a private sector social system, through increased government subsidies, which would both construct a viable alternative to popular public programs (that provide an electoral advantage to the Democratic Party) and generate greater citizen investment and loyalty to the private market. Additionally, increasing indirect spending at the expense of direct expenditures represents the “starve the beast” strategy designed to increase the number of tax breaks as a means to choke off revenues for future public social spending.[41] America's history of belief in the principle of limited government provides a net benefit for the Republican Party as long as the false perception over the parties' preferences for government spending persists.

Finally, political parties use public policy to exploit their respective comparative advantages in public opinion. Survey results typically find that the public trusts the Republican Party more on taxes, providing assistance to businesses, and controlling government spending, while clear majorities prefer the Democratic Party to protect public social programs such as Social Security, Medicare, public education, and assistance to the poor. Political elites from both parties recognize that in order to win an election, debates need to be framed using the issues areas in which their political party has a distinct public opinion advantage. Smith (2007) defines the idea of public opinion comparative advantage as the general feeling of the public towards a party versus the public's feeling towards that party in certain issue areas. For example, he argues that "if a party has 55% support on handling the economy and 65% support overall, it would be better directing people's attention away from economic questions and towards other issues for which its backing is higher. Likewise, the other party would gain votes by steering the national political conversation towards the economy, for its disadvantage there is smaller than in other domains" (pg.181). Therefore, political parties benefit by selecting certain policy tools that move the policy debate to areas of public opinion for which they retain a comparative advantage over the other party.

[41] The "starve the beast " strategy assumes that the political party in power will want to control federal spending and the national debt, both of which have not been true of modern parties at the federal level.

Public Policy

Novel to empirical political science research, this project conceptualizes social policy as a choice between different roles for the government in society. Public policy in the United States has never just operated through direct spending on public programs. From the very beginning of American history, private interests have sought out government assistance and subsidies. The steady rise of tax expenditures, and other policy tools that assist the private market, demand that public policy scholars account for as many of these methods as possible when trying to conceptualize public policy. Public policy is better represented as a menu of tools, each tool representing a different degree of government involvement in the private sector, and distributing public resources to different populations in the electorate. Because they allocate resources to different sectors, different populations, and use varying degrees of government bureaucracy, these tools could be placed on an ideological scale. I hope future research makes use of all or most of these policy tools in conceptualizing government activity.

This project introduces a new data set of indirect social spending which allows for a better measurement of social policy and social expenditures. These data represent over a trillion dollars of government spending, follow a unique policy path, and mainly subsidize the private sector. This policy tool allows us to aggregate tax spending with appropriations for a new measurement of total spending and treats the two policy types as a political choice with varying consequences. These data on tax expenditures will allow for future studies of federal housing policy, business policy, and energy policy. In addition, there are tax expenditure data sets for 41 of the 50 states and most of the OECD countries. In the future, I plan to collect these data along with the publicly available data for grants, loans, and regulations. More and more data is becoming available for various policy tools such as government loans, loan guarantees, grants, tax expenditures, and even the cost of regulations. These instruments are measured in real dollars and provide us the opportunity to evaluate and test the policy portfolios deployed by political parties in pursuing political objectives.

Social policy has negative effects on the United State’s budget deficit through the prevalence of two types of entitlement spending: direct and indirect. Only direct social expenditures for public programs such as Social Security and Medicare receives significant media attention in discussions of the growing federal debt. Yet, all indirect social spending programs are entitlement programs, which have no annual review process and no sunset provisions and accounted for over $1 trillion in spending in 2009. The goal behind creating the tax expenditure concept was to empower policymakers to compare spending in the appropriations process versus the tax code. Unfortunately, past attempts to eliminate or decrease the generosity of tax expenditure programs have been dishonestly portrayed by their supports as a tax hike. Therefore, it is politically more advantageous to cut direct spending than indirect expenditures. Any serious attempt to curtail the growth of the U.S. debt must take into account both of these policy instruments. The newly formed bipartisan debt commission would be well served to put both of these spending types on the table for negotiations.

Limitations

This project is limited in scope and exclusively focuses on political party influences to social policy and income distribution. There are numerous issues that this project does not address or areas that are underdeveloped. First, there is a breach between my theoretical argument and the research design of the project. I argue that political party behavior is motivated by core values and electoral strategies, yet the design and analysis can neither confirm nor deny why political parties produce different spending ratios, just that they do. In addition, the time period of the study limits theorizing and testing important changes to social policy, such as the New Deal and Great Society periods. It would be interesting to observe tax expenditures before and after these periods of substantial public program growth. Also, political parties are treated as static, even though the time period of this study witnessed tremendous growth in party polarization. Next, the social expenditure ratio does not represent a perfect measurement of the tradeoff between indirect and direct spending. The measurement, as it stands, does not allow me to posit definitively that a spending tradeoff is occurring in each year.[42] Although, there is difference is party preference for indirect versus direct, the real policy picture is not that stark. There are conditions under which Republicans will support direct spending and Democrats indirect spending.

Next, I ran separate analyses on the four sub-categories of social policy (health care, income security, welfare, and education) and found no statistical evidence of political party influence. There are additional tests I can run to determine if one or more of these specific areas reacts to the theorized changes in partisanship and policy. Finally, there are numerous other factors that are not addressed in this dissertation that determine both changes to social policy and societal outcomes. In not directly testing public opinion and interest group influences alongside political party control of government, it is difficult to claim the motivational and impact factors of party elites. Public opinion, interest groups, and court

[42] I did run ECM's with direct and indirect spending as stand alone dependent variables. The spending types moved in the theorized direction but did not rise to the level of statistical significance in the intermediate terms.

rulings surely affect the fluctuations of the social expenditure ratio and by extension economic inequality.

Future Work

I have already begun working with Christopher Ellis on an extension of my dissertation project which examines the dynamic relationship between public opinion and social policy. First, we have developed a more general theory of public opinion and social policy in the United States, encompassing mass responsiveness to both direct and indirect social spending. We find that increases in tax expenditures for social programs move public mood in a more liberal direction while increases in direct appropriations result in more conservative public opinion. Our results are consistent with a public that is attuned not only to the role of government in the social policy arena, but also the redistributive effects of different types of social policy.

If public opinion and public policy operate in a truly dynamic relationship, then changes to the direction of public mood will result in predictable changes to the type of social spending implemented by government officials. Our early results show that increases in public mood liberalism correlate with lower amounts of tax expenditures for social welfare and higher levels of direct appropriations for public social benefits. We have also tested this relationship using the social expenditure ratio with similar results, indicating that a unit increase in public mood liberalism leads to more direct appropriations spending relative to tax expenditures. In conclusion, both the electorate and political elites are responsive to changes in social policy and the role of government in society.

As an extension of my dissertation project, I intend to examine the role of interest groups in directing changes to the social welfare expenditure ratio. I theorize that both partisan and institutional factors will influence the efficacy of interest group lobbying. For example, I expect that Republican control of the federal government will invite more activity by interest groups interested in providing private-sector social welfare. Conversely, I expect that during Democratic administrations, interest groups representing beneficiaries of government social benefits will lobby for more generous direct public spending. On the institutional side, the lack of annual review and smaller number of committees involved in the tax expenditure process reduce the scope of conflict that in turn privileges special interests. This study could be paired with data on public opinion and provide an interesting test of the “subgovernment” and “iron triangle” theories, which claim that less visible and traceable policy processes favor special interests over public opinion.

In this project I only examine the American case, even though many industrialized countries have divided social systems financed by the government. There are data available from the Organization of Economic Cooperation and Development (OECD) for both direct and indirect spending from 1980-2007 for most of the OECD countries. An obvious extension of this project would be to evaluate if right-leaning parties in industrialized countries produced more indirect versus direct social spending. Other studies have found that public social program retrenchment was not unique to the United States, and many European countries not only cut public social welfare spending but replaced these cuts with tax incentives for private, market-based social programs (Pierson 1996). Consequently, we might expect similar trends in the rise of indirect spending as a policy tool for social programs among industrialized countries.

Baumgartner and Jones (1993; 1998) demonstrate across issue areas that although there are periods of spending stability, government expenditures display greater change than has been typically presented in the policy literature. The measurement of indirect government spending could be evaluated using the ideas of incrementalism and punctuation. I expect that indirect spending might operate in similar ways to direct spending in that there are periods of stability peppered by large expenditure changes in certain years. In addition, I expect that there is a relationship between indirect and direct spending. The observed changes in direct spending could be conditioned or bounded by changes to indirect spending. Dependent upon political party control of government or public opinion, these two policy instruments can be used as either substitute or complementary methods. An exploration of the exact relationship between the two policy tools would provide us a more accurate picture of public policy changes in America.

Finally, I plan to conduct a historical study of the role that political parties and private groups played in the development of early social welfare programs commonly referred to as the "little New Deals" in the American states. Prior to the Social Security Act of 1935, the primary responsibility for social welfare provision fell mainly to private organizations such as churches, unions, fraternal and societal organizations, and benevolent societies. During this golden age of civic participation, private group leaders faced a dilemma in deciding whether or not to lobby for public social welfare programs for their constituencies at the state level. I theorize that private group leaders would lobby against generous state benefits and the perceived interests of their principals, the members, in order to protect private social benefits from public programs. I expect that states with higher levels of certain social capital will produce less generous state-level social benefits.

Table 2.1. An International Comparison of Direct and Indirect Spending as a Percentage of GDP, 2003

Country	Direct	Rank	Indirect	Rank	Total	Rank
United States	16.7	(13)	10	(1)	26.7	(9)
Australia	20.1	(9)	4.5	(5)	24.6	(10)
Belgium	28.2	(4)	3.9	(6)	32.1	(4)
Canada	19.1	(10)	5.4	(4)	24.5	(11)
Denmark	27.4	(5)	2.5	(12)	29.9	(6)
France	31.5	(2)	2.7	(10)	34.2	(2)
Germany	29.2	(3)	3	(9)	32.2	(3)
Ireland	17.6	(12)	0.5	(13)	18.1	(13)
Japan	18.9	(11)	3.3	(7)	22.2	(12)
Netherlands	21.4	(8)	7.7	(2)	29.1	(7)
Norway	25.8	(6)	2.6	(11)	28.4	(8)
Sweden	32	(1)	3	(8)	35	(1)
England	23.4	(7)	6.8	(3)	30.2	(5)

Source: OECD 2005

Table 2.2. Distribution of Income Class of Selected Individual Tax Expenditures, 2006 Rates and Income Levels (Amounts in millions of dollars, returns in thousands)

Income Class	**Earned Income Credit**		**Child Care Credit**		**Student Loan Interest Deduction**	
	Returns	Amount	Returns	Amount	Returns	Amount
Below $10,000	5,747	6,650	1	0	35	2
$10,000 - $20,000	6,407	16,349	112	26	259	16
$20,000-$30,000	4,808	11,353	455	228	464	37
$30,000-$40,000	4,607	6,446	553	302	707	69
$40,000-$50,000	1,815	1,987	603	370	767	95
$50,000-$75,000	534	475	1,193	636	1,602	191
$75,000-$100,000	9	5	1,011	534	1,036	120
$100,000-$200,000	3	5	1,866	984	1,516	249
$200,000 and over	0	0	362	188	NA	NA

Source: The JCT 2007

Table 3.1. Tax Expenditures for Social Welfare in Fiscal Year 1967

Health, Labor, and Welfare	**Millions**
Disability insurance benefits	100
Provisions relating to aged blind and disabled:	
Combined cost for additional exemption-retirement income credit-and exclusion of OASDHI for aged	2,300
Additional exemption for the blind	10
Sick pay exclusion	85
Exclusion of unemployment insurance benefits	300
Exclusion of workmen's compensation benefits	150
Exclusion of public assistance benefits	50
Net exclusion of pension contributions and earnings:	
Plans for employees	3,000
Plans for self-insured persons	60
Exclusion of other employee benefits:	
Premiums on group term life insurance	400
Deductibility of accident and death benefits	25
Medical insurance premiums and medical care	1,100
Privately financed supplementary unemployment benefits	25
Meals and lodging	100
Exclusion of life insurance savings	900
Deductibility of charitable contributions (other than education)	2,200
Deductibility of medical expenses	1,500
Deductibility of child and dependent care expenses	25
Deductibility of casualty losses	70
Excess of standard deduction over minimum	3,200
Credit for employing public assistance recipients under WIN program	(1)
5-year amortization of child care facilities	(1)

EDUCATION	
Additional personal exemption for students	500
Deductibility of contributions to educational institutions	170
Exclusion of scholarships and fellowships	50
VETERANS BENEFITS AND SERVICES	
Exclusion of certain veterans' benefits	550

Source: The JCT 1971

Table 3.2. Tax Expenditures for Social Welfare in Fiscal Year 2007

Category	**Billions**
Education Training Employment and Social Services	
Tax credits for tuition for post-secondary education	4.9
Deduction for interest on student loans	0.8
Exclusion of tax and earnings of Coverdell education savings accounts	0.1
Exclusion of interest on educational savings account	(1)
Exclusion of tax on earnings of qualified tuition programs	0.7
Exclusion of scholarship and fellowship income,	1.5
Exclusion of income attributable to the discharge of certain student loan debt and NHSC Education Loan repayments	(1)
Exclusion of employer-provided tuition assistance benefits	0.8
Exclusion of employer-provided tuition reduction benefits	0.2
Parental personal exemption for students age 19 to 23	0.5
Exclusion of interest on State and local governments qualified private activity bonds for student loans	0.3
Exclusion of interest on State and local governments qualified private nonprofit and qualified public educational facilities	1.1
Deduction for charitable contributions to educational institutions	5.3
Employment:	
Exclusion of employee meals and lodging (other than military)	0.9
Exclusion of benefits provided under cafeteria plans	27.9
Exclusion of housing allowances for ministers	0.5
Exclusion of miscellaneous fringe benefits	6.6
Exclusion of employee awards	0.2
Exclusion of income earned by voluntary	3.3

employees’ beneficiary associations	
Special tax provisions for employee stock ownership plans (ESOPs)	0.3
Work opportunity tax credit	(1)
Welfare to work tax credit	(1)
Deferral of taxation and capital gains treatment on spread on acquisition of stock under incentive stock option plans and employee stock purchase plans	0.3
Social Services:	
Tax credit for children under 17	46.0
Tax credit for child and dependent care and exclusion of employer-provided child care	3.1
Tax credit for employer-provided dependent care	(1)
Exclusion of certain foster care payments	0.6
Adoption credit and employee adoption benefits exclusion	0.4
Deduction for charitable contributions other than health and education	29.1
Tax credit for disabled access expenditures	0.1
Health	
Exclusion of employer contributions for health care, health insurance premiums, and long-term care insurance premiums	90.6
Exclusion of medical care and TRICARE medical insurance for military dependents retirees and retiree dependents	1.9
Deduction for health insurance premiums and long-term care insurance premiums by the self-employed	3.8
Exclusion of workers’ compensation benefits (medical benefits)	6.5
Health savings accounts	0.1
Exclusion of interest on State and local governments qualified private activity bonds for private nonprofit hospital facilities	1.7
Deduction for charitable contributions to health organizations	3.7
Tax credit for orphan drug research	0.3
Tax credit for purchase of health insurance by certain displaced persons	0.2

Exclusion of Medicare benefits:	
Hospital insurance (Part A)	18.5
Supplementary medical insurance (Part B)	12.5
Prescription drug insurance (Part D)	3.4
Exclusion of certain subsidies to employers who maintain prescription drug plans for Medicare enrollees	1.6
Income Security	
Exclusion of workers' compensation benefits (disability and survivors payments)	2.5
Exclusion of damages on account of personal physical injuries or physical sickness	1.4
Exclusion of special benefits for disabled coal miners	0.1
Exclusion of cash public assistance benefits	3.4
Net exclusion of pension contributions and earnings:	
Employer plans	104.1
Individual retirement plans	11.2
Plans covering partners and sole proprietors ("Keogh plans")	9.4
Tax credit for new retirement plan expenses of small businesses	(1)
Exclusion of other employee benefits:	
Premiums on group life insurance	2.5
Premiums on accident and disability insurance	2.6
Additional standard deduction for the blind and the elderly	1.6
Tax credit for the elderly and disabled	(1)
Deduction for causality and theft losses	0.7
Earned Income Credit (EITC)	42.1
Exclusion of cancellation of indebtedness income of Hurricane Katrina victims	0.2
Social Security and Railroad Retirement	
Exclusion of untaxed social security and railroad retirement benefits	23.1

Veterans' Benefits and Services	
Exclusion of untaxed social security and railroad retirement benefits	23.1
Veterans' Benefits and Services	
Exclusion of veterans' disability compensation	3.6
Exclusion of veterans' pensions	0.1
Exclusion of veterans' readjustment benefits	0.2
Exclusion of interest on State and local government qualified private activity bonds for veterans' housing	(1)

Source: The JCT 2008

Table 3.3. Descriptive Statistics for Various Types of Social Spending, 1967-2007

Variable	**N**	**Mean**	**Standard Deviation**	**Minimum**	**Maximum**
Social Expenditure Ratio	40	2.044	3.811	-3.452	16.357
Total Social Spending	40	964.172	676.143	153.458	2423.527
Direct Social Spending	40	711.883	551.266	153.458	2423.527
Indirect Social Spending	40	252.289	127.606	94.094	536.400
Direct Health	40	205.370	194.100	9.372	672.778
Indirect Health	40	73.817	53.392	15.206	205.300
Direct Income Security	40	447.017	316.923	38.435	1091.400
Indirect Income Security	40	128.697	49.507	46.697	193.180
Direct Welfare	40	32.728	22.126	.996	77.328
Indirect Welfare	40	41.636	33.815	10.905	130.375
Direct Education	40	26.766	21.906	4.685	99.955
Indirect Education	40	8.137	5.751	3.796	25.420

Table 4.2. The Organization of Indirect and Direct Social Spending by Categories

Sub-Categories	**Indirect Social Spending**	**Direct Social Spending**
Health Care	Exclusion of employer/employee contributions to medical insurance, deductibility of medical expenses, exclusion of workers medical compensation, 15 other programs listed under Health, please see table 3.2.	Health Care Services(Medicaid), Health Research and Training, Consumer and Occupational Health and Safety, Medicare
Income Security	Net exclusion of pension contributions and earnings including: employer plans, individual retirement plans, Keogh plans, Veterans Benefits and Services, 20 other programs listed under Income Security in table 3.2.	Social Security, Veterans Benefits and Services, Training and Employment, Other Labor Services, Income Security
Welfare	Earned Income Tax Credit (EITC), 10 other programs listed under the category Welfare in table 3.2.	Social Services, Food and nutrition assistance
Education	Tax credit for tuition and post-secondary education, deduction for higher education expenses, 13 other programs listed under Education in table 3.2.	Elementary, Secondary, and Vocational Education, Higher Education, Research and General Education Aids

Sources: The Joint Committee on Taxation (JCT), Policy Agendas Project

Table 4.3. The Percentage Change in Total Social Spending Between the Republican and Democratic Parties, 1967-2007

Institution	Democratic	Republican	T-Score	P-Value
Presidency	.045 (.008)	.051 (.011)	−0.371	.712
House	.051 (.011)	.044 (.003)	0.364	.717
Senate	.051 (.014)	.046 (.005)	0.293	.770

Table 4.4. Annual Change in the Social Expenditure Ratio, 1967-2006

Independent Variable	**Model 1**	**Model 2**
Δ Social Welfare Spending Ratio *t-1*	−.285** (.111)	−.350** (.130)
Δ Republican President *t*	.020* (.010)	.010 (.012)
Republican President *t-1*	−.007 (.012)	.003 (.009)
Δ Republican Congress *t*	.145* (.128)	
Republican Congress *t-1*	.199** (.085)	
Δ Republican House *t*		.023** (.012)
Republican House *t-1*		.017 (.021)
Δ Republican Senate *t*		.053** (.015)
Republican Senate t-1		.038** (.016)
Δ Unemployment *t*	.004 (.007)	.002 (.006)
Unemployment t-1	.014*** (.004)	.003 (.006)
Δ Inflation *t*	.002 (.002)	.003 (.002)
Inflation *t-1*	.004 (.003)	.005 (.003)
Constant	−.103* (.067)	.043 (.062)
N	38	38
Adj. R^2	.361	.499

Note: Entries are OLS estimates with standard errors in parentheses. One-tailed Significance Levels: * p ≤. 10; **p ≤ .05; ***p ≤ .01

Table 4.5. Annual Change in the Social Expenditure Ratio with Institutional Variables, 1967-2006

Individual Variable	**Model 3**	**Model 4**
Δ Social Welfare Spending Ratio *t-1*	−.278* (.116)	−.263* (.119)
Δ Republican President *t*	.016 (.015)	.017 (.015)
Republican President *t-1*	−.006 (.012)	−.009 (.013)
Δ Republican Congress *t*	.144 (.141)	.113 (.162)
Republican Congress *t-1*	.210** (.089)	.203** (.098)
Δ Divided Government *t*	.003 (.012)	
Divided Government *t-1*	−.006 (.009)	
Δ Party Polarization *t*		.079 (.109)
Party Polarization *t-1*		.007 (.069)
Δ Unemployment *t*	.005 (.008)	.006 (.009)
Unemployment t-1	.014** (.004)	.014** (.004)
Δ Inflation *t*	.002 (.002)	.002 (.002)
Inflation *t-1*	.004 (.003)	.004 (.004)
Constant	−.106* (.069)	−.110* (.074)
N	38	38
Adj. R^2	.332	.325

Note: Entries are OLS estimates with standard errors in parentheses. One-tailed Significance Levels: * p ≤. 10; **p ≤ .05; ***p ≤ .01

Table 5.1. Sources of Health Insurance Coverage for the Nonelderly Population, 1996-2008

	1996	2000	2004	2008
Total	100%	100%	100%	100%
Employer-based	64.8	68.4	63.1	61.1
Own name	33.3	34.6	32.0	31.4
Dependent	31.5	33.8	31.1	29.7
Individual	16.8	16.0	17.5	16.7
Public	16.2	14.6	17.7	19.4
Medicare	2.0	2.2	2.5	2.9
Medicaid	12.2	10.7	13.6	14.9
Tricare/CHAMPVA	2.9	2.8	2.9	3.0
No Health Insurance	16.4	15.6	16.9	17.4

Source: Employee Benefits Research Institute (EBRI) 2008

Table 5A.1. Private Social Welfare Expenditure Data

Social Category	***Private***	***Data Sources***
Health Care	Private health insurance, services, supplies, noncommercial medical research, and medical facilities construction	HCFA, SSA
Income Maintenance	Employee benefit plans in the private sector, including group life insurance, sickness and disability insurance, long-term disability insurance, and private pension plans	U.S. Census, IRS, HIAA, ACLI, NIPA, Department of Labor
Welfare	Welfare services designated by SIC: individual and family services, adoption services, child day care services, senior citizen services, counseling and referral services to family and individuals, residential care, halfway homes, group foster homes, recreation and group work, civic and social/fraternal groups, job training, vocational rehab centers and skill training centers	BEA, BLS, NIPA, SIC, Department of Health and Human Services
Education	Private higher education, K-12, vocational schools	Department of Education, NCES

Source: Social Security Administration

Table 5.2. Political Parties, the Social Expenditure Ratio and Private-Sector Social Spending

Independent Variable	**Model 1**	**Model 2**	**Model 3**	**Model 4**
	Social Expenditure Ratio	*Private Spending*	*Private Spending*	*Private Spending*
Republican President	-.013 (.026)	-.066 (.050)	-.058 (.049)	-.055 (.050)
Republican Congress	.724** (.302)	.579 (.519)	.150 (.663)	.268 (.679)
Social Expenditure Ratio			.591* (.338)	.573* (.400)
Δ Unemployment				.005 (.013)
Δ GDP				.018 (.019)
Constant	-.037 (.120)	-.136 (.233)	-.114 (.227)	-.198 (.258)
N	27	27	27	27
Adj. R^2	.136	.009	.045	.021

Note: Entries are OLS estimates with standard errors in parentheses. One-tailed Significance Levels: * p ≤. 10; **p ≤ .05; ***p ≤ .01

Table 5.3. Political Party Control, the Social Expenditure Ratio and Private-Sector Social Spending

Independent Variable	*Private Spending*	*Private Spending*	*Private Spending*
	Model 1	**Model 2**	**Model3**
Republican President	-.017 (.041)	-.031 (.045)	-.030 (.047)
Republican House	NA	NA	NA
Republican Senate	.033* (.023)	.026 (.040)	-.002 (.061)
Social Expenditure Ratio		.307 (.303)	.565 (.504)
Δ Unemployment			.013 (.019)
Δ GDP			.004 (.006)
Constant	.046** (.033)	.017 (.085)	.155 (.218)
Adjusted R2	.031	.060	.098
N	27	27	27

Note: Entries are OLS estimates with standard errors in parentheses. One-tailed Significance Levels: * $p \leq .10$; ** $p \leq .05$; *** $p \leq .01$

Table 5.4. Political Parties, DW-NOMINATE, the Social Expenditure Ratio, and Private-Sector Social Spending

Independent Variable	*Private Spending*	*Private Spending*	*Private Spending*
	Model 1	**Model 2**	**Model 3**
DWNOMINATE President	-.021 (.048)	-.041 (.053)	-.048 (.055)
Republican House	NA	NA	NA
Republican Senate	.035 (.030)	.029 (.031)	.001 (.016)
Social Expenditure Ratio		.327 (.307)	.588 (.507)
Δ Unemployment			.013 (.019)
Δ GDP			.004 (.006)
Constant	.038** (.020)	.037 (.089)	.179 (.222)
Adjusted R2	.032	.064	.103

Note: Entries are OLS estimates with standard errors in parentheses. One-tailed Significance Levels: * $p \leq .10$; ** $p \leq .05$; *** $p \leq .01$

Table 6.1. The Average Income Redistribution of Selected Tax Expenditures for Social Welfare by Income Class, 2007

Income Class	Medical Deduction	Charitable Contribution Deduction
$10,000 & <	NA	NA
$10,000-20,000	$180.9	$91.2
$20,000-30,000	$289.7	$150.3
$30,000-40,000	$361.4	$198.2
$40,000-50,000	$479.1	$244.9
$50,000-75,000	$716.1	$363.9
$75,000-100,000	$920.4	$469
$100,000-200,000	$1,809.6	$837.5
$200,000 & >	$6,463.3	$4,240.2

Source: The JCT/JCS – 3-07

Table 6.2. Political Parties, Social Spending, and Income Inequality

Independent Variable	*Social Expenditure Ratio*	*Income Inequality*	*Income Inequality*	*Income Inequality*
	Model 1	**Model 2**	**Model 3**	**Model 4**
Republican President	-.013 (.026)	.133* (.094)	.112 (.097)	.238** (.090)
Republican Congress	.741** (.362)	-.256 (.915)	-.431 (.941)	-.990 (.864)
Social Expenditure Ratio			.900* (.741)	.124* (.093)
Δ Unemployment				-.096*** (.029)
Constant	.332** (.112)	4.762*** (.396)	4.623*** (.427)	5.575 (.456)
N	33	33	33	33
Adj. R^2	.183	.067	.090	.231

Note: Entries are OLS estimates with standard errors in parentheses. One-tailed Significance Levels: * p ≤. 10; **p ≤ .05; ***p ≤ .01

Table 6.3. Political Party Control, Social Spending, and Income Inequality

Independent Variable	*Income Inequality*	*Income Inequality*	*Income Inequality*
	Model 1	**Model 2**	**Model 3**
Republican President	.147* (.109)	.161* (.104)	.185* (.105)
Republican House	.008 (.164)	.090 (.161)	.101 (.162)
Republican Senate	-.211** (.106)	-.346** (.120)	-.373** (.125)
Social Expenditure Ratio		2.368** (1.151)	2.379** (1.158)
Unemployment			-.225 (.273)
Constant	4.71*** (.087)	4.20*** (.263)	4.129*** (.265)
Adjusted R2	.125	.213	.203

Note: Entries are OLS estimates with standard errors in parentheses. One-tailed Significance Levels: * $p \leq .10$; ** $p \leq .05$; *** $p \leq .01$

Table 6.4. Political Parties, DW-NOMINATE, Social Spending, and Income Inequality

Independent Variable	*Income Inequality*	*Income Inequality*	*Income Inequality*
	Model 1	**Model 2**	**Model 3**
DWNOMINATE President	.206* (.132)	.199* (.129)	.226* (.130)
Republican House	.047 (.170)	.105 (.166)	.116 (.167)
Republican Senate	-.230** (.108)	-.349** (.120)	-.374** (.125)
Social Expenditure Ratio		2.197** (1.147)	2.183** (1.152)
Unemployment			-.218 (.272)
Constant	4.78*** (.055)	4.313*** (.250)	4.322*** (.252)
Adjusted R2	.143	.215	.205

Note: Entries are OLS estimates with standard errors in parentheses. One-tailed Significance Levels: * p ≤. 10; **p ≤ .05; ***p ≤ .01

Table 6.5. Political Parties, Presidential Administration, Social Spending, and Income Inequality

Independent Variable	*Income Inequality*	*Income Inequality*	*Income Inequality*
	Model 1	**Model 2**	**Model 3**
President Nixon	.274** (.131)	.343** (.128)	.421** (.132)
President Ford	.004 (.149)	.207 (.175)	.302 (.179)
President Carter	-.274** (.138)	-.108** (.154)	-.048** (.153)
President Reagan	-.105 (.178)	-.096 (.168)	-.077 (.163)
President Bush	-.257* (.138)	-.174* (.136)	-.109* (.138)
Republican House	-.213 (.178)	-.106 (.175)	-.084 (.171)
Republican Senate	-.105 (.151)	-.169 (.146)	-.184 (.141)
Social Expenditure Ratio		2.474* (1.214)	2.836* (1.194)
Unemployment			-.357* (.217)
Constant	4.852*** (.098)	4.321*** (.318)	4.115*** (.315)
Adjusted R2	.449	.511	.543

Note: Entries are OLS estimates with standard errors in parentheses. One-tailed Significance Levels: * $p \leq .10$; **$p \leq .05$; ***$p \leq .01$

Figure 2.1. The Partisan Theory of Social Policy

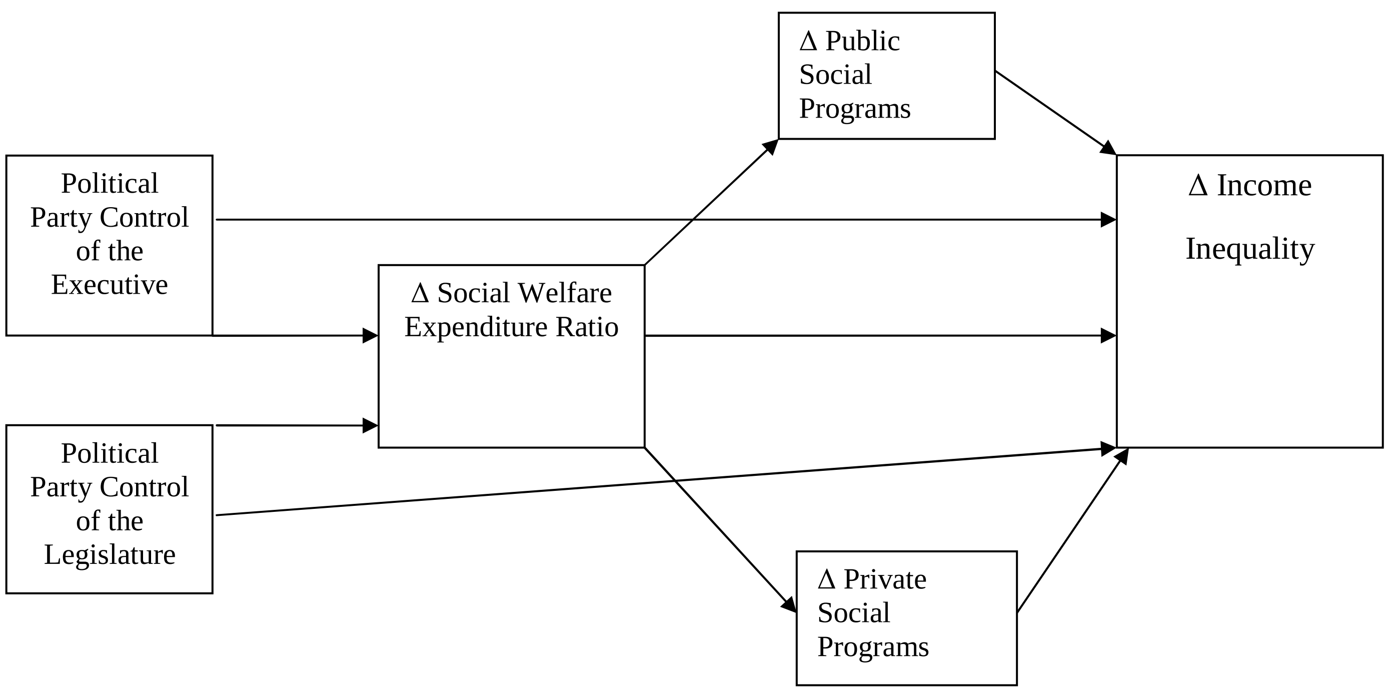


Figure 3. 1. The Growth of Tax Expenditures versus Direct Spending, 1972-2007

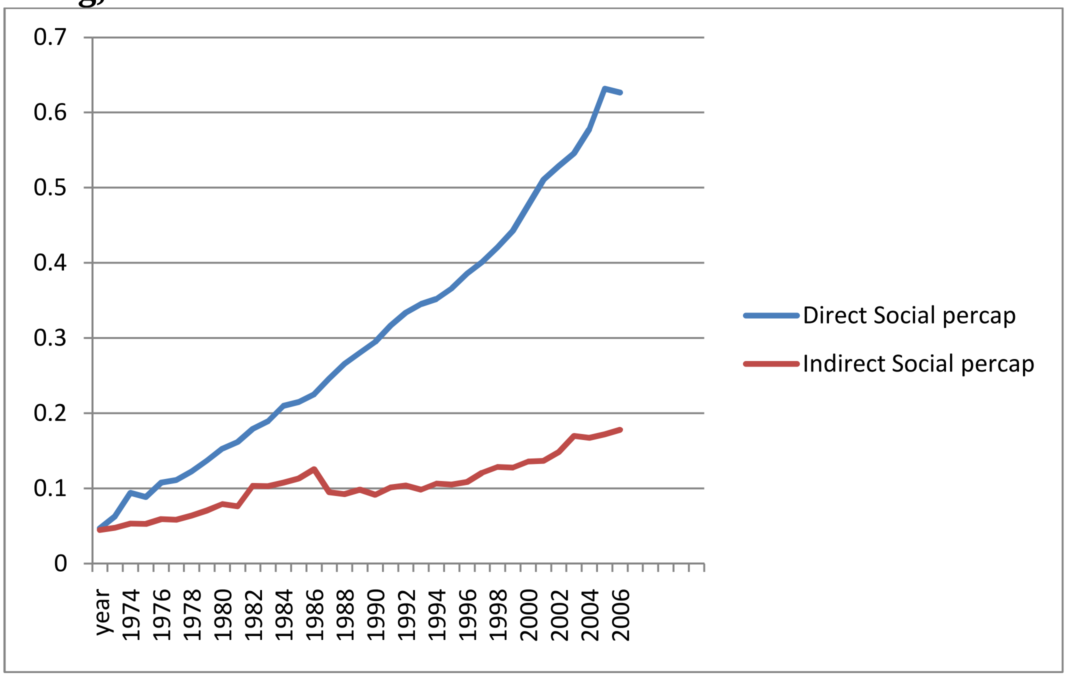


Figure 3.2. Social Welfare Tax Expenditures, 1967 - 2007

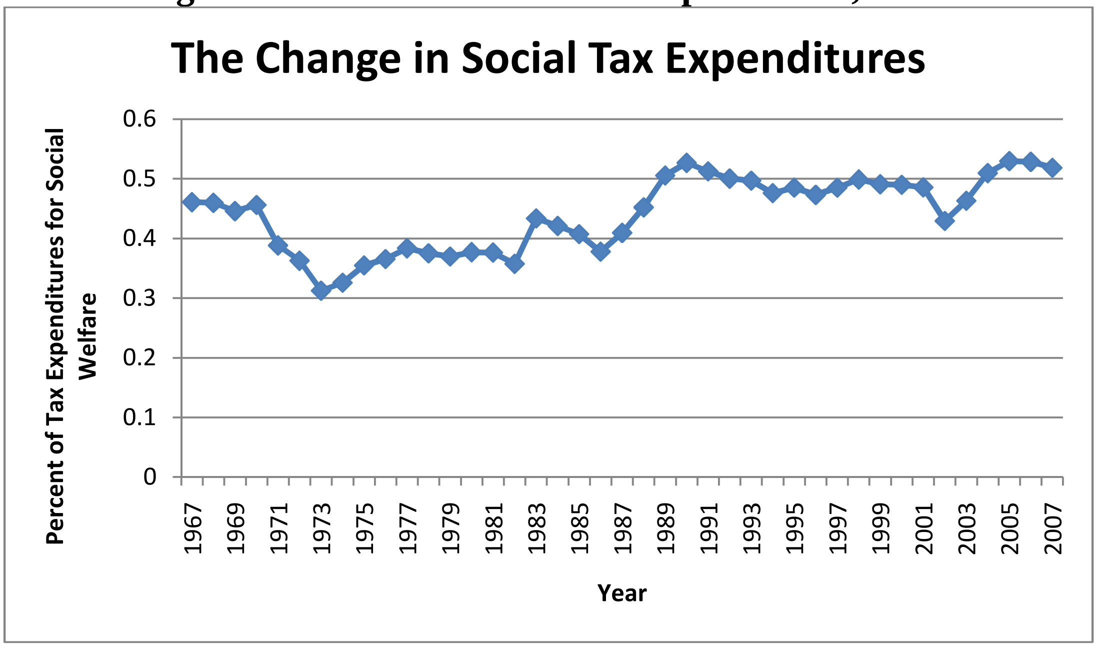


Figure 3.3. The Composition of Health Care Spending, 1975-2005

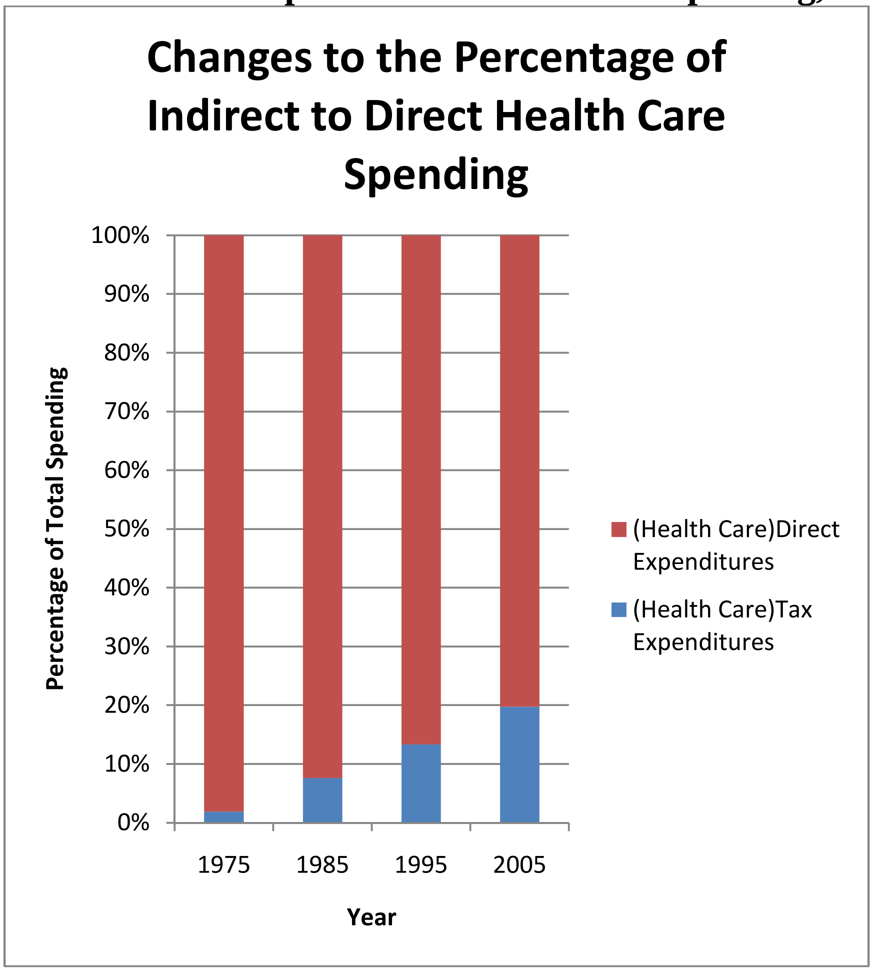


Figure 3.4. The Composition of Income Security Spending

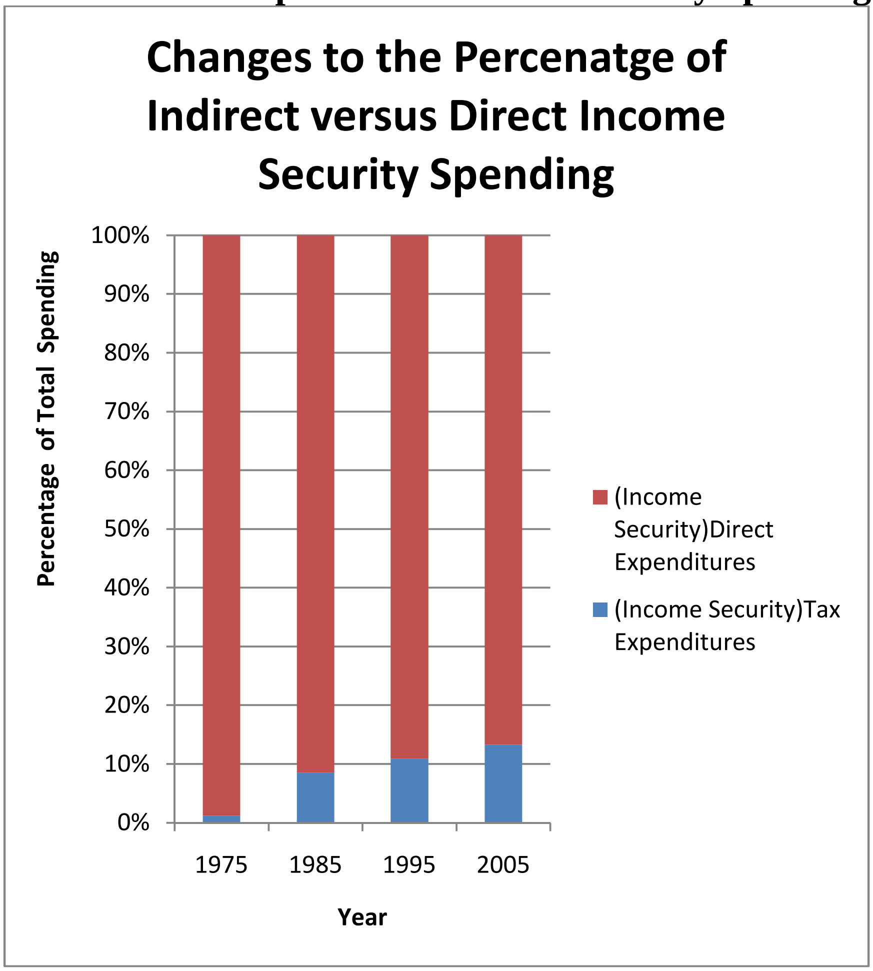


Figure 3.5. The Composition of Welfare Spending, 1975-2005

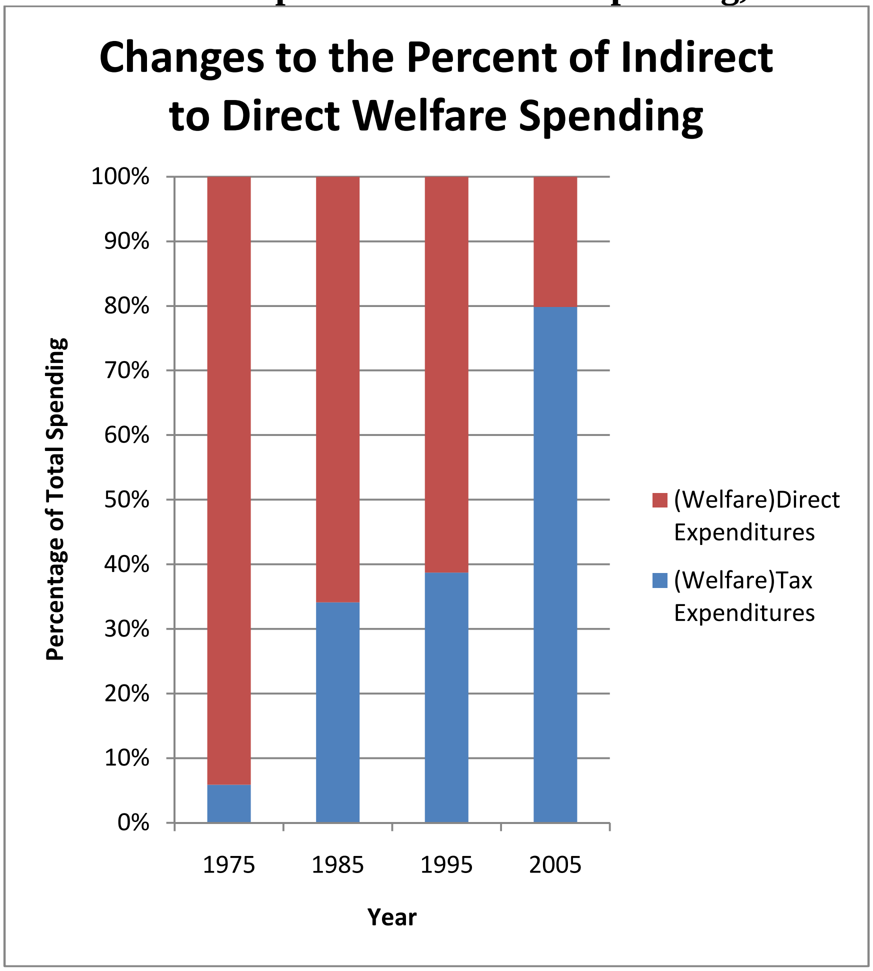


Figure 3.6. The Composition of Education Spending, 1975-2005

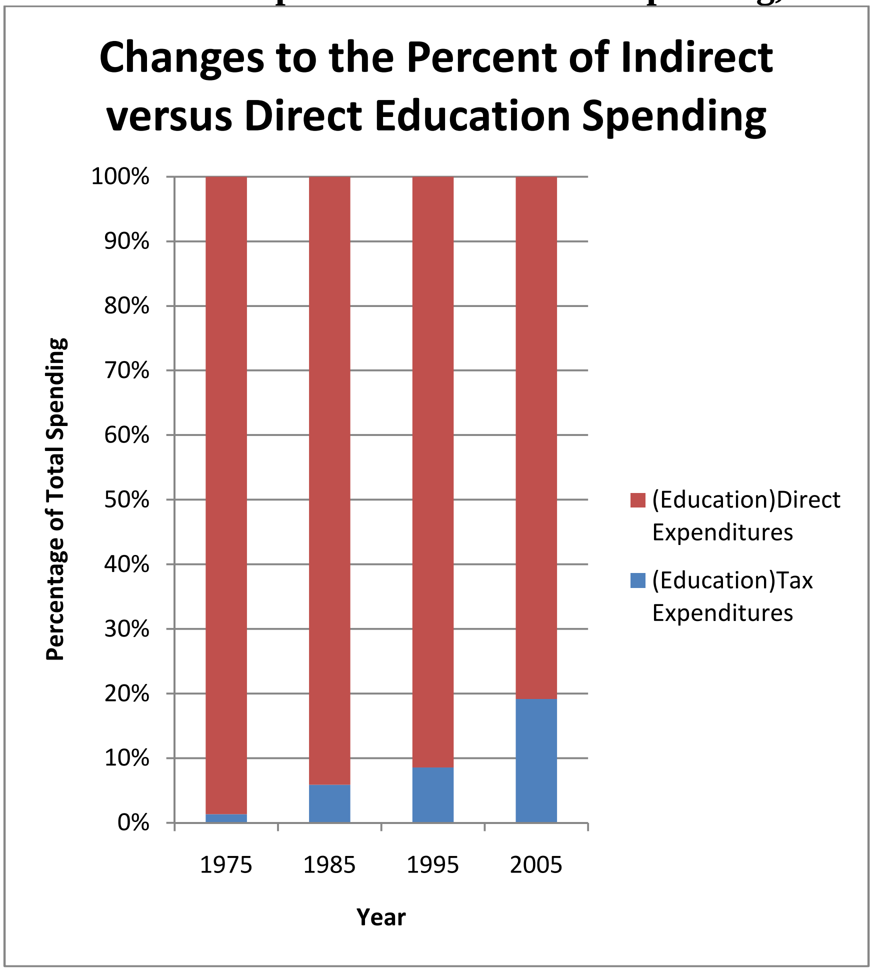


Figure 4.1. The Social Expenditure Ratio, 1972-2007

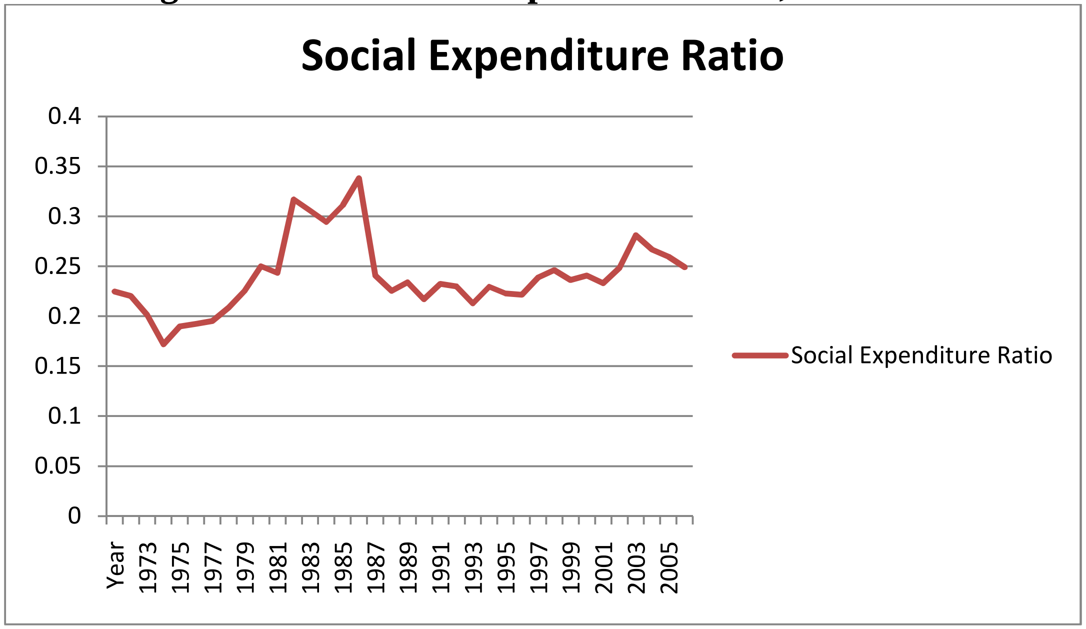


Figure 5.1. The Partisan Theory of Social Policy and Private-Sector Social Spending

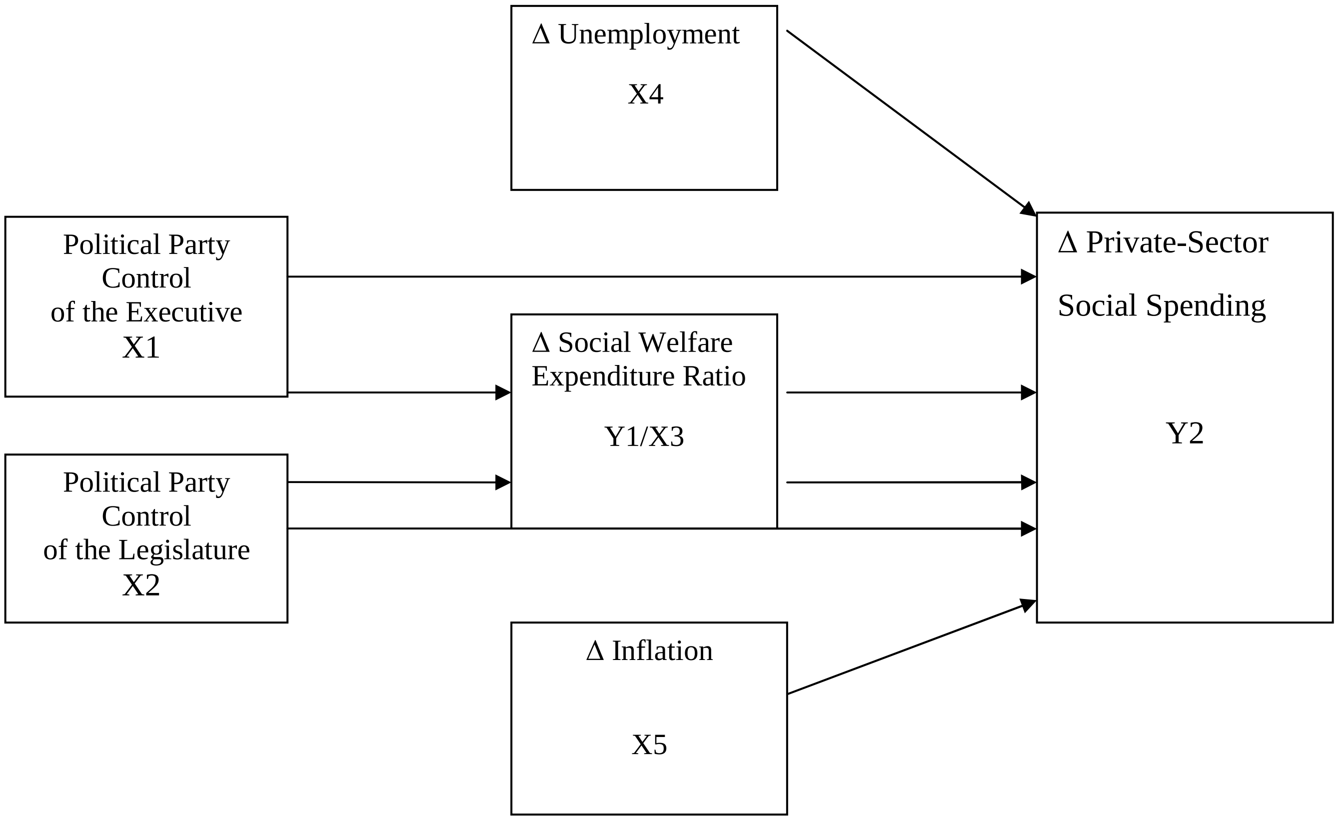
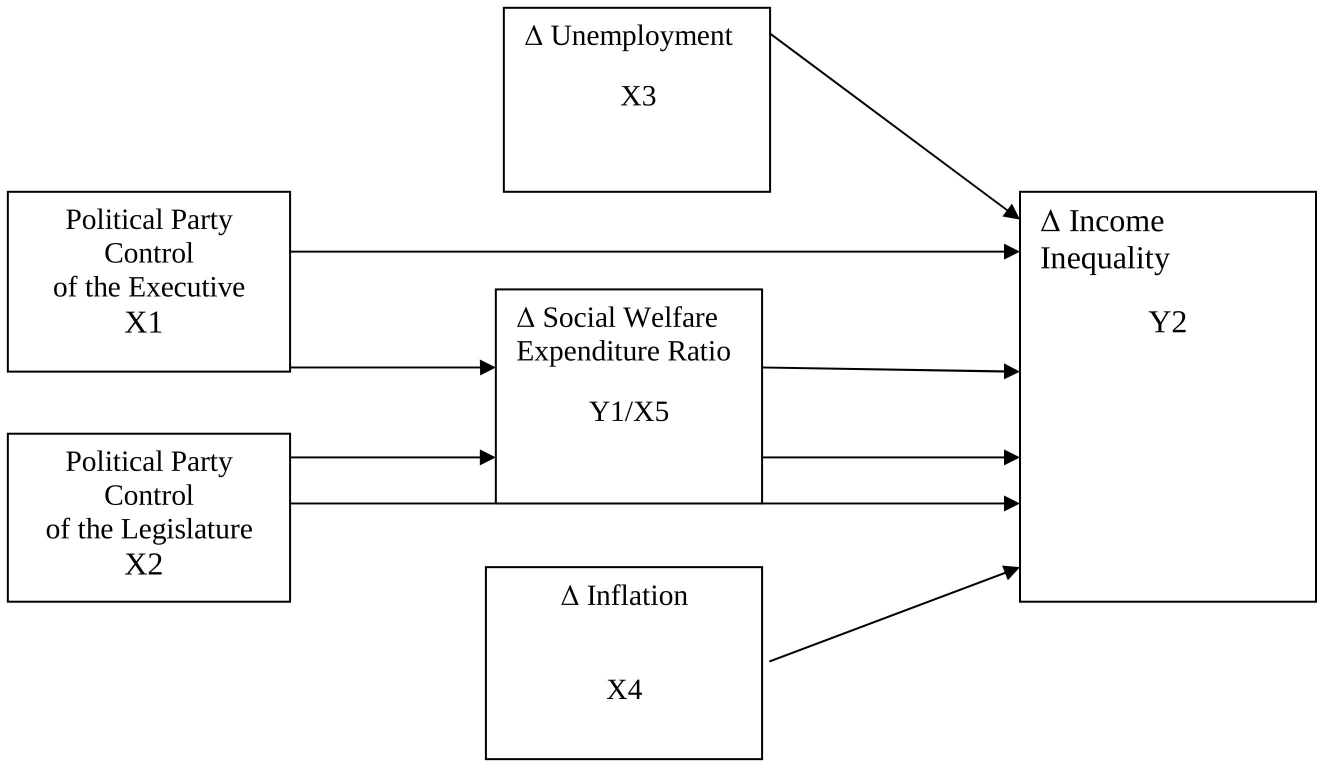


Figure 6.1. The Partisan Theory of Social Welfare and Income Inequality



APPENDIX

Private-Sector Spending by Sub Category

Health Care

The health care expenditure data are collected by the SSA come from the Health Care Financing Administration (HCFA). They include private spending on health services and supplies, noncommercial medical research, private insurance, and medical facilities construction. HCFA's estimates are based on the National Health Accounts that provide a framework for understanding the nature of health care spending in America. The HCFA uses a two-dimensional classification matrix with categories of providers or services along one dimension, and sources of funds across the other. From 1972-1994, health care has represented the largest share of private social spending, in 1994 health care represented 57% of total private spending, but surprisingly health care's percentage of total private social-welfare spending has not changed since 1972. In 1992, total health care spending for both public and private sectors totaled to $820.3 billion or 13.6 percent of GDP.

Welfare

Welfare spending estimates are manufactured from an indicator series developed by the Bureau of Economic Analysis (BEA), and a personal consumption expenditure measure from the National Income and Product Accounts (NIPA), an agency within the Department of Commerce. These data represent the private efforts of employers and nonprofits to assuage poverty, assist in child care, and construct a minimal amount of income security for citizens.

Welfare services are classified by the Bureau of the Census according to definitions provided by the Standard Industrial Classification (SIC). These services include: individual and family services, adoption services, child day care services, senior citizen services, counseling and referral services to family and individuals, residential care, halfway homes, group foster homes, recreation and group work, civic and social/fraternal groups, job training, vocational rehab centers and skill training centers. Public funds and financing are excluded from the private social welfare estimates. Total welfare spending grew to $86.2 billion dollars in 1994 from 7.5 billion in 1972. The Census survey used by the BEA includes 106,000 social service agencies and establishments surveyed in five-year intervals in conjunction with the Economic Census. Welfare costs between census years are estimated by extrapolating wage data collected by the Bureau of Labor and Statistics (BLS). The percentage of welfare services expenditures in this category increased, in relation to total private spending, from 7.9 percent in 1972 to 9.3 percent in 1994. The percentage distribution of spending in 1992 were: social services at 23.9%, individual and family services at 19.6%, residential care at 18.2%, civic and social/fraternal organizations at 18.1%, child day care at 10.9%, and job training and vocational rehab services at 9.4%.

Pensions

Income maintenance expenditures represent outlays for employee benefit plans in the private sector, including group life insurance, sickness and disability insurance, long-term disability insurance, and private pension plans. Income maintenance has experienced the most growth over the past twenty years increasing from 17.1 billion dollars in 1972 to 204.7 billion in 1994. The vast majority of income maintenance spending went towards pension plan benefits at around 85% and private pension plans denote 19.1% of total social spending by the private sector. These estimates are based on an indicator series developed by the U.S. Bureau of Economic Analysis (BEA) for the national income and product accounts on personal consumption expenditures. The primary data are collected by the Census Bureau from its Census of Service Industries. In addition, these data are also collected from: the Health Insurance Association of America, the Internal Revenue Service, the Department of Labor, and the American Council of Life Insurance. Public funds are excluded from the estimates for private social services. In 1992, $10.2 billion was spent for group life insurance benefits that were based directly on an employment relationship. The estimate is adjusted to exclude group policies not based directly on employer-employee relationships, such as insurance for credit card holders, mortgage insurance, fraternal societies, savings or investment groups, professional societies, and employee associations. The data on supplemental unemployment benefits are derived from the NIPA series "Other Labor Income by Industry and by Type". In 1992, sickness and disability welfare benefits were 14.6 billion dollars, most spending in this sector was paid sick leave to workers amounting to $12.7 billion and the remaining $1.9 billion was paid under group and self-insurance programs.

Education

The Social Security Administration constructs private sector education spending data using information from the National Center for Education Statistics (NCES), and the Department of Education (DOE). The BEA also has a measure of public and private education spending that over the years has converged with the SSA series. In 1994, private spending for education was 100.8 billion dollars - 50% of that was for higher education, 28% was K-12 education, 17% was for commercial and vocational schools, and 5% included private funds for school construction. These private expenditures amounted to 11.0 percent of all private social welfare expenditures, down from 15.6 percent in 1972.

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