

The distributive politics of tax expenditures: how parties use policy tools to distribute federal money to the rich and the poor

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In this paper, I theorize and show that Democrats and Republicans both distribute money to their core class consistencies through the selection of different types of tax breaks, formally referred to as tax expenditures. The popularity of tax expenditures allows each political party to distribute federal money to unpopular constituencies in ways that reflect the economic ideology of their members. I expect and find that Democratic Party control of the White House results in an increase in the generosity of tax credits that target the working poor, and Republican Party power produces a large expansion of tax deductions, which disproportionately benefit the rich. These results have implications for distributive politics and the partisan politics of income inequality.

Keywords: class; equality; political parties; political inequality

The Republican Party “owns” the issue of tax cuts and is more trusted by the public to lower federal taxes (Petrocik 1996; Egan 2013; Piston 2014). Ronald Reagan and George W. Bush made income tax cuts and adding new tax breaks the centerpiece of the modern Republican domestic policy agenda. In turn, the American mass electorate considers an increase in the overall level of tax breaks to be an example of policy moving to the ideological right (Ellis and Faricy 2011). One of the main reasons that tax breaks are viewed as conservative policy is that most of their economic benefits accrue to the wealthy and, therefore, increase income inequality (Howard 1997; Faricy 2011, 2015). Consequently, when a Democratic president proposes new or expanded tax breaks, it is often viewed with suspicion either as a political move to attract Republican votes, a triangulation of liberal Democrats and more conservative Republicans, a move to appease wealthy campaign donors, or worse as a capitulation of liberal principles. For example, President Clinton’s support of new higher education tax credits was viewed as a “triangulation” between liberal legislators and a Republican congressional majority, and President Obama’s inclusion of new tax credits in the stimulus was considered an attempt to attract Republican support early in his presidency. Did Clinton move to the right by passing the Hope and Lifetime Learning tax credits? Were the inclusions of the Making Work Pay and American Opportunity tax credits a quixotic attempt to gain Republican votes for the 2009 stimulus package? In short, why would the Democratic Party promote a type of policy that is known to favor the rich andacerbate inequality?

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The recent trend of Democratic presidents turning to the tax code to fund social programs is not so mysterious when examined through the framework of policy tools (Salamon 1989, 2002). A discussion of general increases or decreases in tax breaks misses the differences among tax breaks, and the fact that some tax designs provide more money to the wealthy while others distribute federal resources to the working poor. It is this crucial difference, the difference in the redistribution effects of different types of tax breaks, that explains one of the major tax policy differences between the Republican and Democratic parties. In this article, I develop a theory of the politics of policy tools and tax expenditures (the formal term for tax breaks). My theoretical argument employs the following logic. First, the mass public and a majority of Democrats favor spending through the tax code (Faricy and Ellis 2014). Second, the two political parties' main socioeconomic target groups (the rich and the poor) are not popular with the majority of voters (Gilens 1999; McCall 2013). Therefore, both political parties use tax expenditures as a means to distribute money to unpopular groups. The diversity of tax expenditures allows both Democrats and Republicans to distribute federal money to electorally important socioeconomic groups at either end of the income distribution. I argue that Republicans are more likely to increase tax deductions since this design provides more money to wealthier voters (and increases inequality) and Democrats will create and expand tax credits, which distribute more money to the working poor (reducing inequality). The result is that while both political parties increase federal tax expenditures while in office, Democrats use tax breaks to distribute money to the working poor and Republicans to the rich.

I find, using new measures of federal tax expenditures, that a transfer of political party power produces a change in the mixture and level of tax expenditures. I employ dynamic analysis in testing the relationship between political party control and changes in two types of tax expenditure types: deductions and credits. I demonstrate that the election of a Republican president results in an immediate increase in the level of tax deductions. Second, a switch to a Democratic president results in an increase in the level of federal tax credits even when controlling for economic factors. In total, Republicans target wealthier households and businesses through deductions, and Democrats direct federal benefits to the working poor through tax credits. The implication of these results is that while Republicans are considered to be the party of tax breaks – both political parties distribute federal money through the tax code, albeit using different types of tax breaks with divergent effects on the direction of income inequality.

The concept of federal tax expenditures and how parties distribute tax benefits

While the concept of tax expenditures is well known among economists and policy-makers, it is relatively new to political science (although see Howard 1997, 2007; Mettler 2011). A tax expenditure is a policy tool that allows political parties to spend money through the tax code. There are two components of the federal tax system: the first is the structure needed to gather revenue from households and corporations, and the second part is a collection of specific tax preferences that are purposeful departures from the accepted baseline of net income and a means to subsidize certain groups or activities. This first part of the tax structure is recognizable to citizens as the income and payroll taxes they pay every year, and the second part of the tax structure is equally familiar to citizens but better known as tax breaks. While citizens may consider these special tax preferences as getting their own money back; policy-makers, budget experts, and economists consider tax breaks to be functionally equivalent to budgetary expenditures and, therefore, a form of federal government spending.

A fact of modern policy-making is that the federal government pursues policy goals using multiple financing mechanisms. For example, if the federal government wants to support homeownership for Americans (the policy outcome) policy-makers have the option of helping citizens

reach this goal through different means such as a direct purchase of homes for low-income families, underwriting and guaranteeing private low-income loans through the backing of a government corporation, or offering generous tax subsidies aimed at home mortgage interest payments and property taxes. All three of the above-mentioned policy tools target the same policy goal, home ownership, but follow different policy procedures, accrue money to different types of homeowners, and privilege different political actors in the policy process.

The primary off-budget policy tool is a tax expenditure program. Lawmakers think of tax expenditures as similar to direct spending since a \$350 million loss of revenue that occurs because of a new tax expenditure program is roughly equal to a \$350 million increase on the appropriations side of the budget. If the federal government increases either tax expenditures or direct spending, it must pay for the revenue loss with spending cuts, higher taxes or more borrowing. In a way, tax expenditures are a synchronized transfer of money – a taxpayer or business writes a check for their full tax liability to the US Treasury, and the federal government in return sends them a check to fund entitled activities (e.g., capital investment, health care insurance, and home ownership). While tax expenditures are similar to traditional federal spending in that they cost the government money, they diverge from traditional expenditures in who benefits.

The most important difference between budgetary spending and tax expenditures is the direction in which they distribute federal money. The American public tolerates public social spending, in part, because it is perceived as disproportionately benefitting vulnerable or deserving citizens (Page and Jacobs 2009; Ellis and Stimson 2012). However, since the individual income tax has a progressive structure, tax expenditure programs designed as deductions and exclusions (but not refundable credits) generally reduce tax progressivity by decreasing average tax rates more for high-income taxpayers (with higher marginal rates) than for low-income taxpayers (with lower marginal rates). For example, if a high-income taxpayer in the 39% bracket deducts \$10,000 from her income, she receives \$3900 but if a low-income taxpayer in the 10% bracket excludes the same \$10,000 from her taxable income, her tax subsidy is only \$1000 – a \$2900 difference for the same tax deduction. The implication being that most tax expenditure programs provide more monetary benefits, on average, to the wealthy than they do to middle-class and working-class citizens.

Figure 1 shows the income distribution of a large sample of tax expenditure programs from the federal government in 2013. In the figure, the horizontal axis displays each income quintile from the lowest on the left to the highest on the right and on the far right shows the accrual of benefits to the top 1%. The vertical axis shows the share of total tax expenditures by income quintile ranging from 0% to 60%. The overall relationship between income and total tax expenditure benefits is clear – the higher a household's income, the more benefits they receive from overall federal tax expenditure programs. The lowest two income cohorts receive only 8% and 10% of total tax expenditure benefits. The middle class does not fair much better accruing just 13% of total tax expenditures. However, the wealthiest families (the top 20% of income earners) received over half (51%) of the total tax benefits from the federal government. Therefore, the richest 20% of households, who made a minimum of \$110,000 in 2013, received more tax benefits than the bottom 80% of American households. The top 1% of income earners received 16% of the total benefits from federal tax expenditures, which is more than the entire middle class. The upward distribution of most tax expenditure programs has resulted in these programs, on average, being favored by conservative legislators and the Republican Party (see Howard 2007; Faricy 2011, 2015). However, the distributive effects of a tax expenditure program are determined, in large part, by how they are designed as a deduction, exclusion, or a credit.

A political party in power can select certain types of tax expenditures as a means to distribute money up toward the wealthy or down toward the working class. Tax expenditures can take the form of a deduction, exclusion, exemption, deferral, or a tax credit. The difference among the

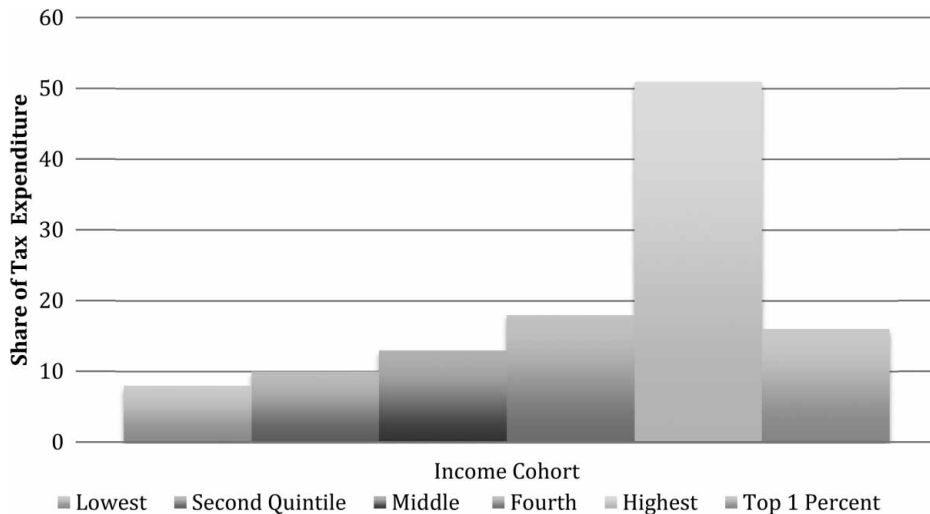


Figure 1. Share of selected tax expenditures by income cohort, 2013.
Data Source: Congressional Budget Office (CBO) 2013.

three major types (deduction, exclusion, and credits) relates to where each tax expenditure program factors into the calculation of income and by extension tax liability. The first type of tax expenditure program – exclusions – distributes federal money the most evenly across income groups. For this reason, I do not expect to find a significant relationship between political party control and the use of exclusions for the targeting of core voting constituencies.¹ Tax exclusions subtract taxable income from gross income, which means that the money never enters into the calculation of a taxpayer’s liability. For example, exclusions for employment-based health insurance are not listed on a 1040 form and, therefore, are not calculated as part of income for tax purposes.

A tax deduction is an atypical form of government spending that gives the most federal money to the wealthiest households. Deductions are tax provisions that subtract money for a specified activity from a taxpayer’s gross income in computing their taxable income. There are two forms of deductions: “above the line” and “below the line.” Tax deductions performed “below the line” are after a taxpayer reports their gross income and require itemization from the taxpayer to claim the benefit. The well-known home mortgage interest deduction is a prime example of a “below the line” deduction. In fact, wealthier homeowners are the most likely group to itemize their tax returns. An “above the line” deduction makes adjustments to a taxpayer’s gross income. As an example higher education tuition deductions are a type of “above the line” program.

In contrast to deductions, tax credits are used to distribute tax benefits to working class households that do not make enough annual income to be subjected to high-marginal income tax rates. Tax credits are permissible against a taxpayer’s income tax rates, thereby reducing an individual’s tax liability. There are two types of credits: nonrefundable, which only count against a person’s tax liability, and refundable. A refundable tax credit delivers a tax refund check to an individual even if all of his tax liability is eliminated. The Earned Income Tax Credit (EITC) is the most popular example of a refundable tax credit. The EITC is an income subsidy for taxpayers at or near the poverty line and is based on a percentage of a worker’s earnings. It is structured so that the provision excuses the often little amount of federal income taxes owed by low-income households and provides a tax refund on top of the exclusion of income taxes. The Obama

administration in their first two years in office used a number of tax bills to transform existing nonrefundable tax credits to refundable tax credits as a means to target federal money to the working poor.

The distributional disparity between tax deductions and tax credits is displayed in Figure 2. The vertical axis here shows the average increase in after-tax income resulting from the type of tax expenditure for each income quintile. The horizontal axis shows the change in each income quintile, from lowest to highest. Tax deductions move in a linear fashion from left to right with each income quintile receiving a higher average benefit from deductions than the previous cohort. The lowest income group receives an average income boost of less than one percent while the wealthiest households accrue an after-tax increase of 2.5% to their annual income – a drastic 50-fold difference. The reverse is true for federal tax credits; the lowest income quintile receives the highest average benefits and the wealthiest receives the lowest tax benefits. The poorest households collect on average an 8% increase in after-tax income due to tax credits, while the wealthiest 20% of households receive one-tenth of 1%. Tax credits give back the most federal money to the lowest quintile, and each successive quintile accrues a little less in tax credit benefits as we move up the income scale. In total, I expect the opposing distributive benefits of tax credits versus tax deductions to have policy consequences in examining the relationship between partisanship and the politics of tax policy tools.

A partisan theory of tax policy tools

Democrats and Republicans select and increase different types of tax expenditure programs as a means to assist their members in distributing government benefits and advancing their members' economic policy goals. In the following sections, I explain the electoral and policy rationales for

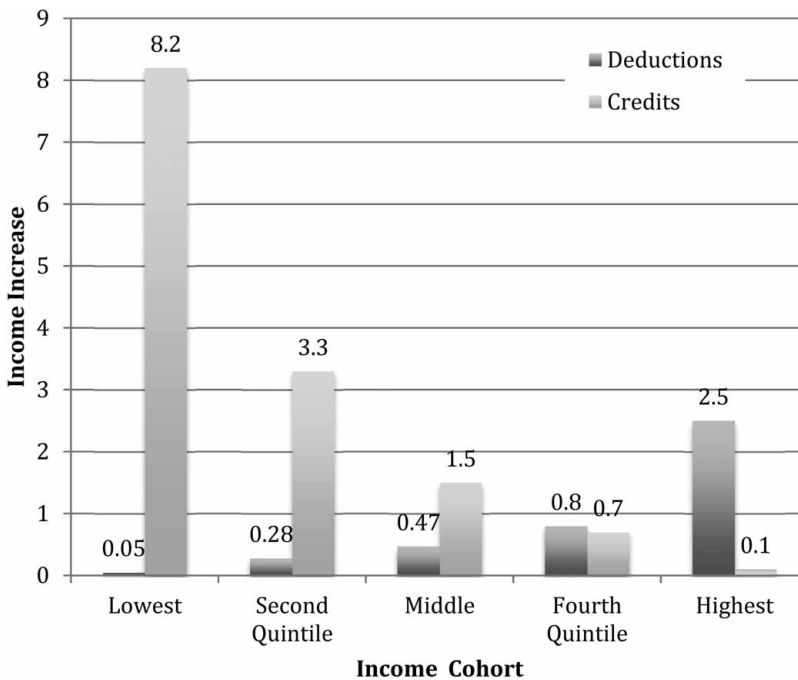


Figure 2. After-tax income change by tax expenditure type and income cohort, 2013. Data Source: Congressional Budget Office (CBO) 2013.

why a political party would choose a tax expenditure program over other forms of government spending. Tax expenditures help both political parties solve a vexing problem of distributive politics. While targeting sympathetic groups with federal benefits, such as children or the elderly, contains little political downside; trying to distribute federal money to unpopular groups is fraught with risk.

The popularity of tax expenditures, specifically deductions for Republicans and credits for Democrats, assists the two parties in targeting federal money to politically unpopular socioeconomic groups within their electoral constituencies. Next, the emphasis of the two political parties on different types of tax expenditures aligns with each party's dominant economic philosophy. These arguments taken together explain why any political party in power would utilize tax expenditures and, in particular, why the two parties favor one tax policy tool over another.

There are electoral incentives for a political party to use tax expenditures as a means to distribute government benefits to their socioeconomic constituencies. First, the mass public prefers tax expenditures to more traditional forms of federal spending (Mettler 2011; Haselswerdt and Bartels *forthcoming*; Faricy and Ellis 2014). In a recent study, Faricy and Ellis (2014) show that voters, on average, favor tax expenditures over direct spending across different policy issues and these programs even generate majority support from Democrats and Independents. In particular, they find that public support for otherwise identical social spending programs is higher when the program is presented as a tax expenditure than when it is represented as a direct public social welfare program. Howard (2007) has argued that tax expenditures have the political advantage of being a form of government spending that can be sold to voters during election time as tax relief and therefore insulate policy-makers from being accused of increasing the size of the federal government. This rhetorical advantage is especially important for Republican policy-makers who are expected to deliver tangible benefits to important constituencies while adhering to their party's principle of small government. Democrats can also utilize the advantages of tax expenditure programs by delivering targeted funds to their voters while protecting themselves from charges of being a "tax and spend" liberal. All else equal, a policy-maker can distribute government benefits through the tax code with less risk of a voter backlash or opposing party attacks. While there are general advantages to spending through the tax code, the selection of different forms of tax expenditures helps each political party solve their own particular problem of partisan distributive politics. Republicans and Democrats have distinct and divergent class constituencies (Stonecash and Mariani 2000; Gimpel and Schuknecht 2001; Stonecash, Brewer, and Mariani 2003; McCarty, Poole, and Rosenthal 2006; Gelman 2008).

Specifically, working-poor and minority voters have become more reliably Democratic while wealthier citizens have become more aligned with the Republican Party (Stonecash 2000; McCarty et al. 2006). The electoral problem that the two political parties face is that the poor and the rich are not popular with the general public (Gilens 2012; McCall 2013). So how do Democrats distribute money to the poor and Republicans target benefits to the rich without triggering the anger of the American electorate? Both political parties can obscure their socioeconomic distributive intentions through the design of tax expenditure programs. Specifically, Democrats can signal to the public the distribution of government benefits to the "deserving" poor through the use of tax credits and Republicans can hide their targeting of federal money to the rich by using tax deductions. The pairing of a popular delivery mechanism for spending with the targeting of unpopular beneficiaries allows both political parties to practice distributive politics while minimizing the political risks. In the next sections, I explain each political party's electoral strategy in turn starting with the Democratic Party.

One of the most persistent electoral problems for the Democratic Party is how to distribute government money to the poor. A majority of voters perceive this group to be lazy, lacking a work ethic, and, therefore, undeserving of government aid (Gilens 1999). Democrats can use

tax expenditures to direct federal funds to the poor while downplaying negative stereotypes associated with welfare, class, and race. The majority of voters, especially white voters, consider welfare recipients to be undeserving and lazy. Gilens (1999) has shown that these attitudes intersect with misrepresentations of African-Americans and produce racialized attitudes toward welfare spending. The racialization of welfare served as part of the motivation behind Clinton's welfare reform efforts, which included work requirements for TANF and increased EITC benefits. Although the evidence to date shows that the transformation from AFDC to TANF has done little to change the public's attitudes toward the poor or welfare (Soss and Schram 2007). The political problem for Democrats is how to direct money toward poor and minority voters without triggering a backlash from middle-class, suburban voters. Democrats use tax expenditures to send a signal about the deservingness of the recipients of government aid. For example, the EITC is aimed at low-income workers as opposed to welfare, which mainly benefits the unemployed. Middle-class voters are also less likely to criticize a policy tool that they benefit from, and therefore, do not view as welfare (Mettler 2011). Next, it allows the Democrats to target government spending with being labeled as "tax and spend" liberals especially by Republican opponents, many of who have pledged to never raise taxes (a pledge that includes not eliminating or reducing tax expenditures). Finally, in periods when Democrats are sharing power with Republicans – tax expenditures serve as a compromise policy tool where Democrats receive increased spending for the poor in exchange for more targeted tax breaks.

Wealthier voters are an integral component of the Republican electoral coalition but unpopular with American voters (McCall 2013). While designating a social program to help sympathetic groups such as veterans or the elderly is relatively straightforward; a political party needs to be more subtle in distributing benefits to groups that are unpopular contenders such as the rich, unions, and minorities (see Schneider and Ingram 1993). McCall (2013) in an exhaustive examination of public opinion finds that increased inequality has produced a public perception of the "undeserving rich" who voters believe have contributed to the rise of income inequality in ways that limit economic opportunities for others. The Democratic Party has successfully sold to the mass public the legislative strategy of raising taxes on the rich to pay for more widely distributed social benefits, in part, because of the public's negative perceptions of the rich. The Republican Party uses the popularity of tax expenditure programs to obscure the design of tax deductions, which disproportionately benefit the wealthiest taxpayers. First, individual tax expenditures programs (i.e., non-corporate) are usually directed at providing financial support for popular social goals such as subsidizing healthcare insurance, saving for retirement, and lowering the costs of higher education. The vast majority of the American public favors increased government spending in these policy areas, even a majority of Republican voters (Ellis and Stimson 2012). Second, although tax deductions mainly direct federal money to the wealthy, many of these programs also provide some limited assistance to the middle class. Republican policy-makers promote tax deductions as a necessary component of middle-class economic security. For example, the popular perception of the mortgage interest deduction as a middle-class benefit hides the fact that the lion's share of the benefits from this program accrue to the very wealthy. Next, Faricy and Ellis (2014) show that Republican voters do not lower their support for tax expenditures when informed that these programs disproportionately help the rich. These results indicate that Republican voters hold positive feelings toward the wealthy or at least these voters do not penalize the wealthy for receiving government benefits. In brief, Republicans can use tax deductions to distribute money to wealthier voters while claiming support for popular social programs or the middle class.

Democrats and Republicans emphasize different tax expenditure types not only as a means to solve political problems of distribution but also as a reflection of their members' ideology. Democrats' mainly liberal economic philosophy and Republicans' conservative economic ideas result

in opposing elite preferences for tax expenditures. Political parties have polarized, over the last four decades, shrinking the ideological distance between members of the same party while increasing the ideological gap between Democrats and Republicans (McCarty, Poole, and Rosenthal 2001; Mann and Ornstein 2012). Republicans have for the last 30 years subscribed to a supply-side theory of taxation and economic growth. Proponents of the supply-side theory argue that cutting tax rates can stimulate economic growth by encouraging productive economic activity such as working, saving, and investing. The higher level of economic activity will produce more taxable income, and thus revenues could rise as the tax base grows, despite lower effective tax rates. A component of the supply-side philosophy is to lower the tax burden on producers of capital and business owners who will, potentially, reinvest their surplus into hiring more workers. The implication of the supply-side theory is that all tax breaks are not equal since tax deductions for investment and capital are more important for wealthy entrepreneurs.

In contrast, Democrats subscribe more to a demand-side theory of economic growth. During recessions, tax cuts, tax breaks, or spending increases can make up for slack in the aggregate demand. Targeted tax breaks can boost private consumption, which creates more demand for goods and services. This increase in aggregate demand causes businesses to hire more workers, which increases workers' income, and further boosts demand. Increased government spending or targeted tax breaks toward the working class produce similar multiplier effects that in turn increases aggregate demand. The Democratic Party's Keynesian logic argues for new and expanded tax credits during economic downturns since lower income families are much more likely to spend the money they receive from a tax break than people with higher incomes (who are more prone to save any tax windfall). These contrasting economic philosophies reinforce the two political parties' electoral calculations to distribute federal money to divergent economic class groups.

Operationalizing and testing the relationship between party and tax expenditures

My theoretical argument results in the following hypotheses. First, I expect Republican Party control of the government to produce higher levels of tax deductions all else being equal. Second, a switch to Democratic Party power will correlate with higher levels of tax credits. The main dependent variables are the annual level of tax deductions and tax credits. These variables are constructed using a unique data set of federal tax expenditures from 1970 to 2012. The Congressional Joint Committee on Taxation (JCT) annually estimates tax expenditures in terms of revenue lost to the US Treasury for each tax break in the tax code. Each tax expenditure estimate is a function of subtracting predicted revenues under the current law from predicted revenue under new and expanded tax provisions. Each dependent variable is constructed using deductions, and credits across all budget categories for individuals (but not corporations) for each year.² A tax break has traditionally been listed as a tax expenditure program if it deviates from the normal income tax structure. Most tax benefits to individual taxpayers can be classified as exceptions to the normal income tax law. Each tax expenditure measures the revenue loss by comparing the revenue raised under the current law with revenue that would be raised if the individual provision did not exist, assuming constant taxpayer behavior and no changes to the tax code. The JCT methodology reflects certain assumptions about taxpayer behavior, based on CBP revenue baselines and JCT projections of gross income, deductions, and expenditures for businesses and individuals. Annual changes in tax expenditure estimates reflect changes to tax law (including sunsets) and changes that alter the baseline of normal income (e.g., tax rate schedule, standard deduction, etc.). The dependent variables are adjusted for inflation and per capita for each year.

The main independent variables of interest measure Democratic Party control of the federal government. I expect that as power moves from a Republican to Democratic president there will be lower levels of tax deductions and higher levels of tax credits. The expectation that a change in presidential power changes patterns of government spending aligns with previous political economy works (see Hibbs 1977; Bartels 2008; Kelly 2009). Next, I use an ordinal variable to measure Democratic control of the legislative branch. The variable ranges from two indicating a unified Democratic congress to zero representing a unified Republican legislature. I expect that more Democratic power will produce higher levels of tax credits and lower levels of tax deductions.³

I also include common economic controls for tax deductions and tax credits. I use different sets of control variables for tax deductions versus tax credits since they are aimed at different socioeconomic groups and therefore influenced by different economic factors. In the first model, I control for changes in the overall economy, the inflation rate, and marginal income tax rates. The first economic control variable is the annual change in national production as measured by the gross domestic product (GDP). As the national economy grows, incomes normally rise and unemployment goes down. These economic trends encourage the use of more tax expenditure programs. First, as households gain more income they may be subject to higher marginal tax rates and therefore have increased incentives to seek out and claim more tax expenditures. Second, as more people gain employment and businesses grow there should be a corresponding rise in the number of tax deductions and exclusions taken as both employers and employees claim business-related tax benefits.⁴ Next, a rise in the overall price level impacts both types of tax expenditures. As inflation creeps up, it pushes some households up to higher income brackets.⁵ Finally, I include a variable that measures the average marginal rate for the top two income brackets at the federal level. The marginal income tax rate relates to the value of deductions for taxpayers; the higher the marginal rate, the more valuable a tax deduction is to the taxpayer. Therefore, I expect that as marginal rates rise for the wealthiest Americans more tax deductions will be claimed in the following year.

In the model on tax credits, I include the variables of Democratic Party control of the White House and Congress along with a control variable: changes in the poverty level. The major tax credits, such as the EITC, are designed to supplement the income of the working poor so that as the number of households below the poverty lines grows the level of tax credits should increase. While tax expenditure estimates keep behavior static this control variable assists in focusing the statistical analysis on the political changes to the level of tax expenditures while controlling for taxpayer activity. In total, I expect that switching to Democratic Party control of the federal government produces increases in tax credits, and decreases in tax deductions even when controlling for economic, demographic, and policy variables.

I use an error correction model (ECM) since the relationship between political party control of the federal government, and tax expenditures will have both short- and long-run effects. There are a number of theoretical and statistical reasons for my choice of an ECM. First, this model properly represents my theoretical argument that political parties in power create tax policy for both a short-run electoral advantage and as a means to influence the long-run ideological direction of economic policy. Next, a change in political party control produces an immediate impact on tax expenditures that will be represented in tax bills for that following year, but since many of the tax expenditure programs spread the subsidies out over a number of years or include automatic inflation adjustments, the full effects will not be observable all at once. Finally, the ECM is consistent with the economic and demographic control variables, which are expected to impact government tax expenditures immediately (such as changes in the number of families below the poverty level and changes in GDP) and create additional effects that are experienced over time.

In particular, I estimate the short- and long-run effects of political party changes on tax expenditures using a single equation method. I utilize a single equation method for the following reasons. First, the single equation estimator model is the better for dealing with smaller sample sizes and in the following models the number of observations is 42 (De Boef and Granato 1999).⁶ Second, a single equation ECM is appropriate for integrated time-series data (De Boef and Granato 1999; De Boef and Keele 2008).⁷ The data for the dependent variables can be treated as an integrated time series since federal tax expenditures are produced by permanent changes in the tax code and therefore cannot be mean-reverting. Also, ECMs are a method to control for a dependent variable that has a deterministic trend such as tax expenditures that may increase over time due to economic and demographic factors. I control for the time trend by constructing the dependent variables as per capita, and inflation adjusted, but the additional control of the ECM also assists in avoiding false inferences.

The single-equation ECM is as follows:

$$\Delta Y_t = \alpha + \alpha_1 Y_{t-1} + \beta_1 \Delta X_t + \beta_2 X_{t-1} + \varepsilon_t$$

In the above equation, changes in the dependent variable Y are a function of short-term changes in the independent variable X as well as the departure from a long-term equilibrium between X and Y , which is produced in part by the error correction rate. In an ECM, there are two estimates of the population parameters: β_1 for the differenced variable and β_2 for the lagged level of the independent variable. The estimator β_1 creates an estimate of the initial change in the dependent variable (the annual change in tax expenditures) in the short run, from a movement in the independent variable. For example, as we change from a Republican to Democratic president the next set of changes in tax policy should produce an increase in the level of tax credits. It is crucial to note that this “short-term” effect is not temporary but simply the effect that occurs in the immediate period. The β_2 estimator is part of the “long-term” effect of X on Y or what is normally denoted as the error correction section of the model. β_2 's influence on the dependent variable does not happen immediately but rather the effects are spread out in each period over time. An example of this is that an increase in Republican power (e.g., a shock to the control of the White House) affects the long-run equilibrium level of tax deductions so that the level diverges from the previous equilibrium and this change in the level will be corrected over time. β_2 alone does not provide the “long-run” impact, by itself, and must be combined with α_1 , the error correction rate, to establish the definite size of the long-run effect. The error correction estimator, or α_1 , can be understood as the proportion of the equilibrium disturbance that will be eliminated in each time period starting with the time period, $t + 1$. In conclusion, ECMs provide the required structure to determine how changes in political party control in government influences both short- and long-term changes in tax expenditures. Next, I present the results of the test between Democratic Party control of the federal government and changes in tax deductions, and tax credits.

The relationship between political party control and changes in tax expenditures, 1970–2012

The results of the analysis show that an increase in Democratic power at the federal level produces an immediate decrease in the annual level of total tax deductions that disproportionately benefit the rich, and an increase of federal tax credits, which help the working class. These results hold even when considering economic, policy, and demographic factors. In the first model on tax deductions, Democratic control of the White House results in an immediate decrease in the level of tax deductions of over \$51 million. A switch to a Democratic president produces

around a 10% decrease in the average level of tax deductions over this period. Although increased Democratic control of the legislature is signed in the right direction, there is not a significant relationship between party control and changes to expenditures. The only control variable that rose to the level of statistical significance was GDP. As GDP increases in the long term, there is a corresponding increase in the annual level of tax deductions. The long-term relationship between economic growth and increases in deductions could be a function of higher wages and more workers pushing up the level of tax expenditures. While both inflation and the top tax rates are signed in the expected direction in the long run; they are not statistically significant from zero. Overall, soon after a Democrat takes control of the executive branch there is a significant reduction in the type of tax expenditure that is designed to provide the most benefits to taxpayers in the highest income brackets. Since the presidency is dummy coded, the reverse is true and new Republican presidents increase distribution to the rich through expansions in tax deductions.

The second model in [Table 1](#) shows that a change to Democratic Party control of the White House results in a large increase in the level of tax credits. A switch to a Democratic president produces an immediate increase of over \$83 million in the level of tax credits. This is a substantial increase of over 20% of the average yearly value of total tax credits during this study. Again while a Democratic congress is signed in the right direction in the short run, the relationship does not rise to the level of statistical significance. There is a long-run relationship between more Democratic power and a reduced level of tax credits. This may be due to Democratic control during periods of divided government that both political parties have long supported increases in the EITC. There is a statistically significant relationship between changes in the poverty level and the level of tax credits in the short run. A one-unit increase in the poverty level results in a federal tax credit increase of \$47 million. And while the poverty level is signed in the right direction in the long term, there is too much variance in the coefficient to produce a statistically significant relationship. In total, Democratic control of the executive branch increases the level of federal tax credits even when controlling for economic productivity and the number of households below the poverty line.

This article set out to theorize and show how a political party in power uses policy tools to distribute money to their constituencies in ways that adhere to their members' economic ideology. I argue that each political party designs tax policy to solve their particular problem of distributive politics. In particular, Democrats use tax credits to appease their base while guarding themselves against attacks from Republicans. Republicans increase tax deductions that target government money to the wealthy while being able to claim that they are providing middle-class tax relief. As public trust in the federal government has declined the two parties have turned more to spending through the tax code. Specifically, Democrats use tax credits to distribute federal money to the poor and Republicans use tax deductions to target government resources to the rich. In addition, Democrats and Republicans select policy tools that adhere to their members' economic philosophy, since tax credits aligns with traditional Democratic Keynesianism and tax deductions reflect Republican views on supply-side economics. The evidence here shows Republican presidential power produces an increase in the level of tax deductions soon after taking office even when accounting for economic controls. Democrats, in contrast, raise the short-term level of tax credits, accruing federal benefits to the working-class through the tax code.⁸

Implications of the distributive politics of tax policy

My analysis of the relationship between political party control of the federal government and changes to tax policy has both political and policy implications. First, an increase in the number and value of tax breaks is not always an example of public policy moving in a

Table 1. Democratic Party control of the federal government and changes to tax expenditures (by type), 1970–2012.

Independent variable	Deductions	Credits
<i>Short-term effects</i>		
Δ Democratic president	-51.41* (27.74)	83.89** (42.26)
Δ Democratic congress	-20.18 (18.69)	17.18 (30.17)
Δ Inflation	-3.92 (5.06)	
Δ GDP	0.001 (0.025)	
Δ Poverty		47.87* (27.26)
Δ Tax rates	-1.53 (2.40)	
<i>Long-term effects</i>		
Democratic president _{<i>t</i>-1}	-14.36 (20.81)	7.55 (31.51)
Democratic congress _{<i>t</i>-1}	-5.31 (11.95)	-29.85* (17.25)
Inflation _{<i>t</i>-1}	0.953 (4.69)	
GDP _{<i>t</i>-1}	0.058*** (0.012)	
Poverty _{<i>t</i>-1}		0.009 (13.62)
Tax rates _{<i>t</i>-1}	0.767 (0.827)	
<i>Error correction rate</i>		
Tax expenditure _{<i>t</i>-1}	-0.996*** (0.217)	-0.117* (0.076)
Constant	-62.20 (51.44)	53.57 (144.9)
Adjusted <i>R</i> ²	0.426	0.080

Note: *N* = 42 for all columns. Two-tailed tests; standard errors in parentheses.

****p* < .001

***p* < .05

**p* < .10.

conservative direction. The conventional wisdom is that traditional government spending is used to help the poor, and tax breaks are passed to profit the rich. The analysis here shows that Democrats distribute federal money through the tax code to the working class while limiting deductions for the rich. So while tax expenditures can generally be considered conservative, the most important ideological feature of a policy tool is the direction in which it distributes federal money. Democratic presidents distribute federal money to the “deserving” poor using a delivery system favored by the majority of voters and using a policy tool that cannot be questioned by their Republican opponents. These political advantages provide a blueprint for policy-makers looking to use a policy tool to provide sustainable income assistance to the poor while minimizing their electoral risks.

Second, these results provide a tax policy explanation for how Republican and Democratic presidents produce different income inequality effects. Bartels (2008) shows that Democratic

administrations have lowered the level of income inequality while Republican presidents exacerbate the growth of inequality levels. Bartels' main explanation for the partisan income differences is that the two parties pursue different macroeconomic policies that indirectly influence changes to the level of income inequality. My analysis provides a specific policy mechanism through which Democrats target billions annually to the working poor and Republicans allocate tens of billions to America's wealthiest households. For example, President Obama used unified Democratic control of the federal government to create two new tax credits in 2009 (Making Work Pay and American Opportunity) while indexing and sun-setting certain deductions.⁹ These changes to tax policy had explicit economic effects. The working poor received new access to more federal money through the credits while the wealthy had fewer opportunities to claim deductions from their high levels of income. The cumulative result is a substantial change to the federal tax code that will produce downward pressure on the level of income inequality.

Finally, the inclusion of tax expenditures into the analysis of distributive politics broadens the scope of who gets what, when, and how from the federal government. My analysis provides evidence that Democrats and Republicans practice distributive politics through the tax code. The results here add the policy tools of tax expenditures to the extant literature on distributive politics. Tax expenditures are just one form of off-budget spending. I hope that future scholarly attention turns to the distributive politics of other federal subsidies (although see Bickers and Stein 1996, 2000). There needs to be more examination of all the ways that a political party in power distributes government benefits to their constituencies outside of the budget process. The story that is commonly told about which groups benefit from government programs and federal social spending is outdated. The common narrative of distributive politics is that Democrats spend federal money in ways that disproportionately help single-female-headed households, the working class, and racial minorities. These groups considered by some as "takers" are pitted against those with high incomes otherwise known as the "makers." This story is oversimplified and wrong since it does not account for who benefits and who pays for the federal government. The reality is that close to 85% of the public pays some form of federal tax, and as the analysis here shows, most citizens also receive financial benefits or "welfare" from the government – whether it be through the formal budget or the tax code.

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Notes

1. I report an ARIMA of party control of the government and changes to tax exclusions in the appendix. The tests produce null results.
2. In this study, I focus on tax expenditures that are designed and distributed to demographic voting groups and not for used for economic development or corporate welfare. Individual tax expenditures account for around 80% of the total tax expenditure value and provide subsidies to both households and businesses. For example, the employer-based pension tax expenditure program accrues benefits to both employees and employers.
3. In order to account for effects between the branches, I ran the models with just an ordinal variable of Democratic Party control of the federal government, ranging from three to zero. In addition, I report the results of ANOVAs for the relationship between party control and changes in various tax expenditures in the appendix.
4. I use GDP instead of unemployment since the level of overall tax expenditures is driven by both the number of workers claiming benefits, worker incomes, and the activity of businesses.
5. The problem of inflation creep was resolved by the Tax Reform Act of 1986; so I expect that inflation will be a larger issue earlier rather than later in the time series.

6. I also ran an ARIMA, given the small N and potential concerns about over fitting the model. The results for tax deductions holds while the coefficient for tax credits is signed in the right direction with more variance.
7. I ran multiple Augmented Dicky Fuller tests (ADF) with a constant, a time trend, and not one of these measures reported a negative value less than -3.50 , so the null hypothesis of a unit root cannot be rejected. These results confirm the theoretical argument for an integrated times series.
8. I also ran ANOVAs for Democratic Party control of the federal government and changes to tax expenditures. The largest difference in examining tax deduction is between unified Republican control and a Democratic majority. The largest difference in studying tax credits is also between unified Republican control and a Democratic majority.
9. These tax changes were made in American Recovery and Reinvestment Act of 2009 and Patient Protection and Affordable Care Act of 2010.

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Appendix

Democratic Party control of the federal government and changes to tax expenditures (by type), 1970–2012.

Independent variable	Deductions	Credits
<i>Short-term effects</i>		
Δ Democratic Party	-28.92** (12.79)	33.43 (21.29)
Δ Inflation	-3.17 (4.84)	
Δ GDP	0.005 (0.023)	
Δ Poverty		38.93 (25.29)
Δ Tax rates	-1.19 (2.71)	
<i>Long-term effects</i>		
Democratic party _{<i>t</i>-1}	-10.97 (9.69)	-17.01 (14.95)
Inflation _{<i>t</i>-1}	2.08 (4.60)	
GDP _{<i>t</i>-1}	0.056*** (0.012)	
Poverty _{<i>t</i>-1}		2.67 (13.66)
Tax rates _{<i>t</i>-1}	0.757 (0.909)	
<i>Error correction rate</i>		
Tax expenditure _{<i>t</i>-1}	-0.972*** (0.216)	-0.098 (0.075)
Constant	-60.61 (54.42)	25.37 (139.5)
Adjusted <i>R</i> ²	0.433	0.075

Notes: *N* = 42 for all columns. Two-tailed tests; standard errors in parentheses.

****p* < .001.

***p* < .05.

**p* < .10.

Democratic Party control of the federal government and changes to tax expenditures (by type), 1970–2012.

	Deductions	Exclusions	Credits
Democratic president	-46.40* (23.20)	6.44 (109.5)	55.01 (33.88)
Democratic congress	-13.84 (28.56)	45.13 (104.1)	33.50 (34.23)
Constant	18.89 (13.58)	49.05 (33.77)	12.19 (20.05)
<i>p</i> -Value	.02	.90	.18

Note: ARIMA, *N* = 42 for all columns. Two-tailed tests; standard errors in parentheses.

**p* < .05.