

The Politics of Tax Expenditures:
Three Essays on Policymaking Through the U.S. Tax Code

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Dedication

The author wishes to dedicate this dissertation to Mike Haselswerdt, still my favorite political scientist.

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Abstract of Dissertation

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In recent decades, American policymakers have often used tax breaks (or tax expenditures) to pursue goals that could be achieved through more direct and transparent government action. Why has the tax code become such a popular policy tool for lawmakers? And what are the implications of this practice for the politics of established programs? My dissertation examines the impact of policy design on political support for and durability of government programs.

In the first essay, I use a newly expanded longitudinal dataset to demonstrate that tax expenditures are more vulnerable to elimination than other types of policies. Moreover, among tax expenditures, those that serve narrower or wealthier constituencies are not as long-lived as those that serve broader populations. In the second essay, I use historical case studies to examine these dynamics qualitatively, and find that in at least some legislative contexts, policymakers are more concerned with avoiding the blame of the general public than with preserving benefits for favored interests or industries. The third essay examines the special appeal that tax breaks seem to hold for American citizens. Using a series of survey experiments, I demonstrate that Americans are more favorably disposed toward government interventions in three different policy areas when they are carried out through the tax code, even when the costs and other policy characteristics are held constant. I demonstrate the complex interplay between what government does and what citizens think government should do.

Taken together, these essays contribute significantly to our empirical and theoretical knowledge on tax expenditures and indirect governance by testing hypotheses about indirect governance and tax expenditures with new and systematic data. In so doing, it yields new theoretical insights.

Table of Contents

Dedication.....	iv
Acknowledgements.....	v
Abstract of Dissertation.....	vi
List of Figures.....	ix
List of Tables.....	x
Chapter 1: Introduction.....	1
Chapter 2: The Lifespan of a Tax Break: Comparing the Durability of Tax Expenditures and Spending Programs.....	8
Chapter 3: Oversight, Maintenance and Repeal of Tax Breaks: the Investment and Research and Development Tax Credits.....	45
Chapter 4: Public Opinion, Policy Tools, and Policy Feedbacks: Evidence from a Survey Experiment.....	90
Bibliography.....	118
Appendix 1: Additional Tables.....	128
Appendix 2: Experimental Treatment Wording.....	130

List of Figures

Figure 2.1. Survival of federal tax and non-tax programs, 1974-2003.....	24
Figure 2.2. Factors shaping the vulnerability of federal programs (elimination), 1974-2003 (Model 1).....	30
Figure 2.3. Hazard ratio of tax expenditure variable conditional on program age, conservative definition of program death (Model 1).....	32
Figure 2.4. Hazard ratio of tax expenditure variable conditional on program age, liberal definition of program death (Model 2).....	35
Figure 2.5. Factors shaping the vulnerability of tax expenditures only (Model 3).....	37
Figure 3.1. U.S. Income Tax Subsidies for Capital Investment, 1967-1985.....	64
Figure 3.2. <i>New York Times</i> Articles on High-Tech Industries, 1980-1986.....	78
Figure 4.1. Program Approval by Experimental Condition, Home Mortgage Interest...	104
Figure 4.2: Program Approval by Experimental Condition, Job Training.....	105
Figure 4.3. Program Approval by Experimental Condition, Parental Leave.....	106
Figure 4.4: Impact of Tax/Spend Manipulation by Ideology.....	111

List of Tables

Table 3.1. Summary of findings on the ITC and R&E Credit in the Tax Reform Act of 1986.....84

Table 4.1. Model Results Explaining Program Approval, No Interactions.....108

Table 4.2. Model Results Explaining Program Approval, Interactions Included.....110

Table A1. Cox duration models of new federal program termination, 1974-2003.....128

Table A2. Summary of results from piecewise Cox duration models of new federal program termination (liberal definition), 1974-2003.....129

Chapter 1: Introduction

It is impossible to understand modern American public policy without understanding the tax expenditure. By reducing the tax burden of certain individuals and corporations, tax expenditures (or more commonly, tax breaks) serve as a means through which policymakers can achieve goals that could be met in other, more direct ways. Liberal economist and Treasury official Stanley Surrey pioneered the term “tax expenditure” to emphasize the fact that these provisions are functionally equivalent to spending - their economic impact is no different than if the government simply cut checks to the beneficiaries for the appropriate amounts.

Although tax breaks may be economically equivalent to spending, they are not *politically* equivalent. Indeed, the use of tax expenditures to carry out the business of government has profound political consequences: tax breaks differ from more traditional spending programs in terms of origins, longevity, oversight, and public perceptions. A growing strand of political science research has recognized the political uniqueness of tax expenditures, and has made a number of important theoretical contributions. Still, we lack systematic evidence about the way these provisions differ from other types of government programs, limiting our understanding of the implications of these policymaking trends. In this dissertation, I develop and test hypotheses about how tax expenditures differ from other programs in terms of their legal durability and their popular support.

There is a growing body of literature on indirect or third-party governance in general and on tax expenditures in particular. This work has focused scholarly attention on important policy dynamics, and offered a number of theoretical insights on the political

implications of the growing “submerged” (Mettler 2011) or “hidden” (Howard) state. This work emphasizes that tax expenditures are either hidden from public view or difficult for the public to understand. Combined with the generally regressive nature of almost all tax expenditures, this begets a dynamic in which wealthy, well-organized, narrow constituencies tend to win out over the disorganized public (i.e., taxpayers).

These arguments suggest a number of observable implications. For example, if the aforementioned argument about tax expenditures is correct, we should expect that tax expenditures should survive longer than traditional government programs. Moreover, among tax expenditures, those benefiting narrow or wealthy interests should be especially durable. In terms of public opinion, we should see evidence that Americans fail to understand tax breaks as equivalent to government benefits; for example, at least some of those who normally oppose government action (conservatives) should support tax expenditures to address policy problems for which they believe direct government action is inappropriate. In this dissertation, I use a variety of research methods to search for evidence of these hypothesized patterns. The resulting research comprises three essays. In the remainder of this introductory essay, I will briefly summarize the findings and theoretical insights of each essay, then synthesize them in a concluding section.

Durability of Tax Expenditures

Chapter 2 examines the implications of the tax expenditure policy tool for policy durability. That is, do government programs delivered as tax breaks last longer than policies delivered more directly?

Existing scholarship and some mainstream conventional wisdom suggests this is the case. Witte (1985), Hacker (2002), and Mettler (2011) argue that policies delivered through the tax code or through other “submerged” channels are especially long-lived or politically difficult to eliminate. This view is based on a particular understanding of the tax expenditure policymaking process: that the relative invisibility and economically regressive nature of tax expenditures creates a pattern in which beneficiaries are attentive, wealthy, and well-organized in comparison to the average taxpayer, and certainly in comparison to the (generally poor) beneficiaries of direct government assistance.

By contrast, some other scholars of the tax policy process (Conlan, Wrightson and Beam 1990; Steuerle 1992; Zelinsky 1993) espouse a fundamentally different view of the tax policy process. They emphasize the independent power and broad jurisdiction of the tax committees on Capitol Hill, which also control all mandatory spending. In such a setting, classic theories of policymaking (Schattschneider 1960; Lowi 1964, 1972) see the potential for broad, rather than narrow, interests to prevail.

Thus, the question of whether tax breaks last longer than other types of policies carries with it important theoretical implications for how we understand tax breaks as policy tools. Using a newly expanded dataset, I demonstrate that tax expenditures are in fact more vulnerable to elimination than other types of policies. Moreover, among tax expenditures, those that serve narrower or wealthier constituencies are not as long-lived as those that serve broader populations.

Oversight, Maintenance and Repeal Decisions

Having examined the durability of tax breaks quantitatively, I next turn to a more in-depth analysis of individual tax policy decisions to gain more leverage over the key question of what drives the durability (or lack thereof) of specific tax breaks. Using process tracing, I examine legislative decisions to maintain, modify or repeal specific tax breaks at key points in history.

Chapter 3 focuses on the divergent fates of two policies in the 1986 tax reform effort: the investment tax credit for capital equipment (ITC) and the research and experimentation (R&E) credit. The outcome of the tax reform process for these two provisions is puzzling if it is true that interest group capture drives the tax policy process. The ITC, a favored provision of the well-organized and well-established heavy industry lobby, was repealed in 1986 - in fact, total elimination of the ITC was included in virtually every tax reform proposal (and certainly in every relevant one) as well as at each stage of the legislative process. Conversely, the R&E Credit, which was backed by the relatively small and politically neophyte high tech industry, survived the process intact with relatively little difficulty.

Clearly, lobbying muscle is an insufficient explanation for these outcomes. My historical analysis points to a different conclusion: outcomes in 1986 were driven by the ability of policymakers to justify tax provisions in terms of their public interest benefits. This dynamic, while not necessarily unique to 1986, is not omnipresent in tax policy; rather, it is the result of deliberate and successful framing efforts on the part of key elites. By framing tax reform as a revenue neutral and therefore zero-sum conflict between special interests on the one hand and the public on the other, key elites (e.g., Senator Bill

Bradley [D-NJ], the Reagan Administration) were able to create the conditions under which blame avoidance and public interest justifications drove the outcomes. Under these circumstances, the ITC's status as a huge subsidy for a rich and (traditionally) influential industry became a political liability. By contrast, the R&E Credit benefited a sector that the public and the media viewed as economically important to America's future, particularly given the growth of high-tech industry in competitor nations like Japan.

Existing scholarship on tax expenditures has argued that the public views these policies differently than they do more direct government interventions. Tax expenditures and other forms of indirect governance are said to be "hidden" (Howard 1997) or "submerged" (Mettler 2010, 2011) from public view, meaning that the public is either unaware of them or fails to fully understand that they constitute government policies. This ostensibly creates a scenario in which some Americans support government interventions they would otherwise oppose if they were delivered more directly.¹

In chapter 4, I present the results of three survey experiments conducted on a national sample. In each experiment, a policy intervention was described to respondents, with half reading a description of a tax break and the other half reading an otherwise equivalent description of a direct government payment. As expected, respondents in all three experiments showed a clear preference for the tax break intervention. This preference was strongest among conservatives, highlighting the importance of a relatively representative sample to uncovering such effects. Also of interest was the variation across policy areas. The preference for the tax break was strongest in the policy area

¹ Zelinsky (2005) and Faricy and Ellis (2013) present some mixed evidence that this is the case using experiments on law students and undergraduates, respectively.

(home mortgage interest) in which a tax break is already the established mode of intervention. The effect was greatly reduced for job training aid for the unemployed, an area where direct government intervention is relatively common. I chose the third policy area, paid parental leave, precisely because there is no established government intervention in the United States outside of state-level programs in California and New Jersey. Additional analysis suggests that respondents in those states, where direct government intervention *is* familiar, responded differently to the treatments, in line with my theoretical expectations.

These experiments demonstrate not only the immediate impact of delivery mechanism on citizens' evaluations of a proposed policy (and the way that ideology conditions that impact), but also the cumulative impacts of past policy decisions. Citizens' preferences over the way government should intervene on a given issue is greatly influenced by the ways government has intervened on that issue in the past. This suggests that the move toward indirect government intervention through methods like tax expenditures may have profound implications for the shape of public preferences for public policy.

Conclusion

Taken together, what do these essays tell us about the use of tax breaks as a policy tool?

First, my findings counter the commonly held notion that high-powered lobbyists and narrow interests dominate the making of federal tax policy. Such findings suggest that the tax policy process is actually characterized by a special concern for public response and

the framing of policies. It is not always enough for a particular provision to have the support of a well-funded industry lobby if it lacks a plausible public interest justification. Given the importance of the general public to the politics of tax policy, it may not be appropriate to characterize these policies as “hidden” or “submerged.”

This brings us to a second point, however, that cuts in the opposite direction: the importance of framing and symbolism to elite and public understandings of tax breaks. Although the conditions are in place for tax policy to favor the public interest, there are many opportunities for politicians to use framing and symbolism to appeal to public *opinion* without necessarily advancing the public interest. This is made possible with the fact that, while tax breaks may not be invisible, they are poorly *understood* as a means of government intervention, which is likely the more relevant argument both Howard and Mettler raise. Indeed, tax expenditures are misleading by their nature, in that they expand the size of government while appearing to reduce it. So, while public justification of tax breaks is required, the nature of that justification is highly suspect, and the public is arguably poorly equipped to evaluate the validity of certain frames or symbolic descriptions of policies.

Third, these essays all demonstrate the ways in which tax policy helps to shape politics in the future. Past decisions to conduct government interventions in certain ways seem to influence the preferences of Americans today about what modes of intervention are appropriate. Changes to tax policy over the years shape the patterns of public and activist attention and organization over these issues. The decision to deliver a policy in a certain way also seems to have implications for how future congresses will deal with that policy. Thus, these essays all contribute to literature on policy feedback.

Chapter 2: The Lifespan of a Tax Break: Comparing the Durability of Tax Expenditures and Spending Programs

Recent research in political science, public administration, and public policy suggests that the post-enactment life of federal programs, agencies and initiatives bears further study. In many ways, the politics of legislation only begins at enactment. A new program might later be repealed or amended, underfunded or defunded, or expanded beyond what its creators planned. Additionally, federal programs can alter the political arena in which policymaking takes place – a dynamic often dubbed “policy feedback.” In short, the shape of public policy is determined as much by what happens after the president signs a bill into law as by what happens before.

What conditions shape the fate of enacted federal programs? Existing studies largely focus on the political environment, examining external factors that encourage or discourage lawmakers from revisiting existing programs. Such studies yield important insights, but tend to overlook the impact of policy design on the fate of policy programs. This omission is especially relevant given the diversity of tools that lawmakers employ today, including policies that are delivered through indirect or obscured government involvement. Perhaps the most important and costly of such tools is the tax break or “tax expenditure,” which can achieve the same ends as direct subsidies by reducing the tax burden of individuals and corporations. Are policies delivered through this mechanism longer or shorter lived than other policies? Existing literature on indirect policymaking and tax policy offers conflicting arguments and little systematic evidence.

In this paper, I argue that the unique political characteristics of tax expenditures lead them to be more vulnerable to elimination than policies involving direct outlays of government funds, particularly over time. I use a newly expanded dataset to explore the relative durability of federal spending programs and tax expenditures that were created in the modern era of congressional budgeting. I find that programs delivered through the tax code are less durable than regular spending programs over time, as I hypothesize. Moreover, further analysis of the patterns of vulnerability within the tax expenditure category provides support for my arguments. I conclude by considering the implications of these findings for our understanding of policy longevity and indirect governance and for the prospects of significant tax reform.

Policy Longevity and Program Characteristics

Traditionally, studies of American public policy and legislative decision-making have focused on the process through which new policies and programs are enacted. More recently, some scholars have recognized the importance of understanding the variation in the political lives of these policies and programs *after* they are created. Since a policy's impact on economy and society depends in large part on how long it lasts, these studies have enriched our understanding of government in important ways. Extant literature on post-enactment politics follows two strands, one focused on *policy durability* and the other on policy feedbacks, specifically *indirect governance*. I discuss each of these areas of research in turn.

Research on policy durability studies the length of time until certain federal policies, programs or institutions are eliminated or revised in some way. Such studies have focused on federal agency durability (Lewis, 2002, 2004), federal credit program

termination (Corder, 2004), major legislative reversals (Maltzman and Shipan, 2008; Ragusa, 2010), the reversal of public interest reforms (Patashnik, 2003, 2008), and the durability of federal spending programs (Berry, Burden, and Howell, 2010). These studies typically explore the effects of the political environment on the length of time that policies and institutions survive before elimination or alteration. For example, Maltzman and Shipan (2008) and Ragusa (2010) examine the effect of partisan and ideological configurations of the enacting coalition (e.g., divided or unified government, bicameral disagreement) on the lifespan of major laws, while Berry, Burden and Howell (2010) focus on the effect of change in the governing coalition since enactment on the survival of spending programs. Similarly, Lewis' (2004) study of agency durability demonstrates that agencies that are more insulated from presidential control tend to survive longer because they are more likely to be acceptable to Congress.

Typically unaddressed in such work is the impact of *policy design* on post-enactment outcomes.² Clearly, more work is needed to understand how the characteristics of policies may determine their vulnerability to elimination or repeal. This is especially relevant given the variety of policy tools employed by government today. As many scholars have noted (e.g., Howard, 1997; Hacker, 2002; Salamon and Elliott, 2002; Mettler, 2010, 2011; Morgan and Campbell, 2011), modern American governance is characterized by a diversity of approaches to social and economic problem solving, including but not limited to special tax provisions, loans, government-backed insurance, regulations, and contracts

² Exceptions include Patashnik (2003, 2008), who emphasizes the importance of positive policy feedbacks to the durability of public interest reforms and Corder (2004) who finds that federal credit programs administered as direct loans are shorter-lived than those administered as more visible guaranteed loans. Ragusa (2010) and Berry, Burden and Howell (2010) control for some policy characteristics but do not place theoretical importance on these variables.

with private entities in addition to more traditional and direct forms of bureaucratic intervention and service provision. Indirect government interventions are less visible and transparent to the public than are direct government interventions, and they also tend to differ in terms of policy content (e.g., target groups, policy justifications). A useful understanding of policy durability, then, must take into account the different forms that policies take.

On this point, scholarship on policy feedbacks, and specifically on what I term indirect governance offers some important insights. The policy feedback literature, which has revived Schattschneider's (1935) notion that "new policy creates a new politics," argues that outcomes in the policy process of the present are shaped by the policy decisions of the past.³ This literature has fed into a growing literature on indirect governance. Notable works in this vein include Howard's (1997) study of the "hidden welfare state" of social welfare tax breaks, Hacker's (2002) account of the "divided welfare state," and Mettler's (2011) analysis of the "submerged state." All three note the extent to which indirect tools of governance foster politics that are distinct from more traditional government interventions.

What are the implications of these studies for the longevity of indirectly delivered policies specifically? Here there is no clear agreement. Howard (1997) observes several unique features of the politics of social welfare tax expenditures that could affect longevity, but seem to militate in opposite directions. They tend to benefit upper-income taxpayers much more than direct spending programs, which, given inequalities in political voice (Bartels, 2008; Gilens, 2012), could make them more durable than other

³ See Pierson, 1993; Campbell, 2003; Mettler and Soss, 2004; and Mettler, 2005, among others.

policies. On the other hand, Howard notes a “near absence of interest groups representing the nominal beneficiaries of each program, leaving third-party providers [of goods and services like mortgages and health insurance] as the core societal advocates (9-10).”⁴ This lack of organized grassroots support may make these provisions *easier* to eliminate. Moreover, while most programs enjoy some political support from the executive branch agencies that administer them, Howard (90-91, 181-183) notes that the Internal Revenue Service and the Treasury Department are generally hostile to tax expenditures and advocate for their elimination, since they reduce the government’s ability to collect revenue and conflict with tax experts’ normative preference for neutrality and efficiency (e.g., Surrey 1957, 1970). Specifically on the topic of longevity, Howard (36) refrains from drawing concrete conclusions, noting that “the experience of tax expenditures has been quite varied. Once embedded in the tax code, some tax expenditures have remained hidden from the public view and grown like topsy, and some have not.”

Hacker (2002) and Mettler (2011) come to a different conclusion about the longevity of such policies. Both argue that the beneficiaries of upwardly redistributive programs (service provider industries and the wealthy) are alert and aware of their stake in tax policy, while the general public that stands to benefit from their elimination or reform is quiescent and unaware of the policies’ true impact (see especially Mettler, 2011, chapter 3). Thus, Hacker and Mettler argue that the policy feedback of indirect programs create a

⁴ The findings of Richter et al (2009) suggest that lobbying may be much more important for corporate tax expenditures, as they find a statistically significant negative relationships between the lobbying expenditures of corporations and the taxes they pay.

situation in which narrow, well-heeled interests prevail over the general interest, making reform difficult unless leaders are able to make the stakes clearer to the public.

Scholars of tax policy are similarly divided on the point of the longevity of tax breaks. Witte (1985), in his study of the political development of the income tax, makes a strong case for the argument that, once established, tax expenditures are extremely durable. He argues that there has been an omnipresent and constant pressure for reduced tax revenue since the income tax became a major revenue source during World War II, and that starting in the late 1970s, the tax committees have been unable to resist this demand. The growth in tax expenditures was also accelerated by the recognition of policymakers that the tax code could be used to advance non-revenue-related goals (290). Witte saw these trends as heading down a one-way street toward ever-greater complexity and fragmentation in the tax code, in part because tax breaks would stay in place once enacted. He pointed out that “many more new provisions are created than old ones dropped” (288), and saw scant hope of serious tax reform (298). More recently, Kleinbard (2010, 22) also finds much to criticize in the tax expenditure policymaking process, arguing that “tax expenditures, once implemented, are essentially unmonitored by any arm of Congress, and they simply disappear below the surface into the mainstream of baseline revenues.” Even supposedly temporary tax expenditures, Kleinbard asserts, are usually renewed without challenge (24), since the tax policy process is vulnerable to parochial interests (25).⁵

⁵ Fenno’s (1973) classic taxonomy of committees according to their members’ goals is at least partially in agreement here. According to Fenno, members join the tax committees to further their careers on Capitol Hill. While this produces partisan and ideological conflict in House Ways and Means, Senate Finance is characterized by more interest group pressures and constituency-oriented policymaking (181).

In contrast, Conlan, Wrightson and Beam (1990); Steuerle (1992); and Zelinsky (1993) take a more optimistic view of the tax policy process, influenced by the 1986 Tax Reform Act, which closed many of the more notorious loopholes in the tax code in favor of lower rates for all. Steuerle and Zelinsky make especially relevant points for the question of relative policy longevity. They argue that the institutions of the tax policy process are uniquely suited to the task of standing up to parochial interests and terminating programs that do not serve the public interest. The tax committees' broad purview of the entire tax code and the mandatory side of the spending budget makes tax legislators less susceptible to capture by the interests of any one economic sector than the more specialized committees (Zelinsky, 1993, 1176-1182)⁶ and enables and even compels them to make fiscal trade-offs that would be impossible on committees of lesser jurisdiction (Steuerle, 1992, 78). The impetus to make such tradeoffs may be especially strong in the era of congressional budgeting, which began with the Congressional Budget Impoundment and Control Act of 1974. This legislation created an annual budget resolution and reconciliation process which, when successful, constrains the spending and revenue decisions of committees, most notably the tax committees. It also established the Congressional Budget Office, which ostensibly enhanced Congress' ability to budget by giving it an independent source of budgetary information.

These arguments are reminiscent of classic political science theories of the policymaking process. Schattschneider (1960) argued that a broader "scope of conflict" favors the public interest, which would suggest that the high-profile nature of the congressional tax committees and presidential tax proposals would militate in the

⁶ Though see Kleinbard (2010, 25-26), who takes issue with Zelinsky's analysis.

direction that Steuerle and Zelinsky suggest. Moreover, this reasoning is consonant with Lowi's (1964, 1972) classic typology of public policies. According to Lowi, parochial interests dominate *distributive* policy, where benefits are handed out without thought to costs and interests are never in conflict. But since the tax committees and presidential tax proposals must make certain tradeoffs in the era of budgeting,⁷ distributive policy does not describe the world of taxes. Indeed, Lowi (1964, 691) himself classifies all tax policy as *redistributive*, arguing that "The fact that our income tax is in reality only mildly redistributive does not alter the fact of the aims and the stakes involved in income tax policies...Expectations about what [a policy] *can* be, what it threatens to be, are determinative." From this perspective, all tax policy efforts will take place within the realm of redistributive policy, with the attendant direct conflict between interests. This competition over resources should reduce the longevity of enacted tax breaks.

This is not to say that the tax policy process will always work in favor of the public interest; after all, the same committees enact parochial tax breaks in the first place. This line of argument does suggest, however, that the institutions governing tax policy (i.e., the tax committees and the budget process) are better positioned to terminate the programs they have established than are other institutions.

⁷ In some cases this may mean formal, procedural constraints on budget decisions, as when PAYGO rules have been in effect. In others, the pressure may simply be normative. Notably, the diverse proponents of tax reform in the mid-1980s pursued revenue-neutral reform not to conform to procedural restrictions, but to avoid the appearance of advocating for either a net tax increase or an increase in the deficit (see Birnbaum and Murray 1987).

Expected Durability of Tax-Based Policies

I argue that the unique characteristics of tax expenditures make them more vulnerable to elimination than traditional spending programs. First, the tax committees are in a strong position to make trade-offs.⁸ In an environment in which benefits and costs are weighed together and the scope of conflict is broad, the narrow-but-attentive constituencies fostered by indirect governance (Hacker, 2002; Mettler, 2011) do not necessarily weigh in favor of longevity. Indeed, if this argument is valid, tax expenditures that can count on *broader* public support are more likely to survive, since the need for public interest justifications for policies is higher in such a context.

Some critics would take issue with the claim that the tax policy process is tilted in favor of the public interest. It is well established that tax breaks are more likely to benefit the wealthy and business interests than are traditional spending programs (Howard, 1997; Hacker, 2002; Mettler, 2011), and critics (e.g., Kleinbard, 2010, 24-25; Stevenson and Wolfers, 2012) have charged that tax-based subsidies are subject to a lower level of scrutiny than direct subsidies. Although critics infer from this that tax breaks are more *durable* than other policies, the implications may be different. A lower bar of scrutiny *at enactment* may create a selection effect under which politicians and interest groups turn to the tax code to enact dubious or weakly justified programs, which then in turn are *more* vulnerable to elimination than other policies. Government subsidies achieved through the tax code, then, may be “easy come, easy go.”

Second, tax expenditures are difficult to target and budget, and their impact is hard to predict. They may result in economic consequences or tax sheltering

⁸ Even Kleinbard’s (2010) pessimistic take on the tax policy process extensively discusses the necessity of trade-offs.

opportunities that legislators did not intend or foresee, and may end up costing much more than economists would predict. Unintended consequences are a risk for any policy initiative, but discretionary spending programs are constrained by budget allocations. Moreover, the high-income individuals and corporations that stand to benefit from most tax expenditures have the incentive and the resources (i.e., paid accountants) to devise ways to take advantage of special tax provisions. Thus, tax expenditures may frustrate legislators and increase the likelihood of policy reversal.

Third, tax expenditures lack another, often underrated, base of support: federal bureaucrats. As a number of scholars of bureaucracy have observed (e.g., Huntington, 1952; Niskanen, 1971; Carpenter, 2000), employees of the executive branch are often among the savviest and most effective advocates of the programs they oversee, utilizing professional relationships with Capitol Hill staff and mobilizing constituent groups to lobby when they detect a threat to the programs they administer. In short, bureaucrats are motivated to protect the commitment of resources that make their jobs possible. But tax expenditures do not represent a commitment of resources by Congress to the executive branch. For the bureaucrats at the IRS who deal with these programs most directly, they are essentially unfunded mandates; they complicate the bureaucrats' jobs but do not carry with them extra resources. In fact, they undermine the agency's mission of revenue raising and conflict with the norms of tax professionals (who generally favor a cleaner, more efficient tax code). Thus, no executive agency or department is likely to rally to the defense of a tax expenditure threatened with elimination. Indeed, as Howard (1997, 90-91 and 181-183) demonstrates, the Treasury Department often advocates for their elimination.

These arguments lead to my first hypothesis:

Tax Expenditure Vulnerability Hypothesis: All else equal, tax expenditures will be more vulnerable to elimination than direct spending programs.

This relationship is unlikely to be static over time. As years pass, the dynamics discussed above should grow more important. Unintended consequences will take time to play out, and the difference in bureaucratic support between a traditional government program and a tax break should become more pronounced once the program staff is well-established. This leads to a temporal hypothesis:

Long-Term Tax Expenditure Vulnerability Hypothesis: The vulnerability of tax expenditures relative to direct spending programs will increase with program age.

The scope of conflict of tax policymaking relative to traditional spending policy also has implications for the relative durability of some tax breaks compared to others. Specifically, more narrowly targeted tax breaks should be more vulnerable to elimination than tax breaks that are available to broader portions of the taxpaying public. The latter will have stronger public interest justifications in the context of a broader scope of conflict. This leads to my third hypothesis:

Targeted Tax Expenditure Vulnerability Hypothesis: Tax expenditures targeted to narrow interests or populations will be more vulnerable to elimination than other tax expenditures.

Data and Methods

To test these hypotheses, I expand Berry, Burden and Howell's (2010) federal programs dataset, which incorporates data from the Catalog of Federal Domestic Assistance (CFDA). The original Berry, Burden and Howell dataset, itself an extension of Bickers and Stein's (1991) programmatic database, includes information for all programs listed in the CFDA that were created between 1971 to 2003, organized into a time-series cross sectional format with each observation representing a program-year. The CFDA includes, in the words of Berry, Burden and Howell, any program that transfers "almost anything of value from the federal government to a domestic beneficiary. In short, the CFDA accounts for nearly all of the domestic programs that comprise the federal government" (5). This is accurate by the CFDA's definition of a program, but tax expenditures, which represent the absence of a transfer of funds *from* domestic parties *to* the federal government, are not included.

I expand the dataset to add data from a 2005 Government Accountability Office report, which compiles data from 30 years of Treasury Department tax expenditure budgets.⁹ For all tax expenditures in existence between 1974 and 2004, the report includes the first and, if applicable, last year the provision was in effect.¹⁰ In order to make these data as compatible as possible with Berry, Burden and Howell's data, I exclude from the analysis 67 tax expenditures already in existence in 1974, as well as

⁹ The report can be accessed here: <http://www.gao.gov/products/GAO-05-690>

¹⁰ Like Berry, Burden and Howell, I treat the last year of a policy's existence as the year of its "death," even if the original decision to eliminate the program was made years earlier. Policymakers have the ability to extend supposedly expiring programs if they care to do so, and this happens with great regularity with tax expenditures.

eight provisions that were created in 2004, leaving 132 tax expenditures that originated during the analysis time.¹¹ I also exclude programs from Berry, Burden and Howell's data that were created prior to 1974, leaving 1,821 non-tax programs and 1,953 programs in total.¹² The total number of observations (program-years) is 18,835. There is a considerable degree of right censoring (programs that are not eliminated during analysis time) in the data, with only 206 instances of program elimination. This suggests the general durability of federal programs with respect to outright elimination, at least over a relatively brief time window.¹³

In their analysis, Berry, Burden and Howell measure the post-enactment fate of programs in three ways: outright elimination from the CFDA (or "death"), major revisions that constitute "mutation," and program funding levels. Their results are broadly similar across these three dependent variables. For this analysis, I use only the first indicator of vulnerability: program death. The question of whether major revisions or "mutations" are more frequent for spending policies and tax expenditures is substantively interesting in its own right, but tackling it would present methodological difficulties. Although tax provisions do sometimes undergo substantial revisions, it is not clear that the "mutation" concept as defined by Berry, Burden and Howell could be

¹¹ The exclusion of workers' compensation insurance premiums, listed in the Treasury tax expenditure budgets under the "Health" budget function from 1997 to 2002, was omitted since its appearance and eventual disappearance both seem to be a matter of accounting choices rather than the actual creation or elimination of a new program. The Joint Committee on Taxation budgets continue to list a corresponding tax expenditure under "Health" through 2012.

¹² The full data set is available from the author.

¹³ Lewis (2002) documents that 62% of federal agencies created since 1946 had been terminated by 1997, demonstrating that federal institutions are quite mortal if the appropriate time horizon is considered. Moreover, it is important to note that the median year of enactment for programs in the sample is 1988, making the actual analysis time much briefer than 30 years in most cases.

applied to such changes successfully. For example, one type of mutation they measure is program transfer to another agency, a change that has no analog in the world of tax expenditures. Comparisons of “funding” levels across tax and nontax programs is arguably even less appropriate.¹⁴ Outright elimination, by contrast, provides a relatively objective indicator of program mortality that can be applied to all types of policies.

Even when program death is the dependent variable, there are important measurement choices to be made, however. For example, Berry, Burden and Howell employ a conservative coding scheme in which programs that receive no funding but remain in the CFDA are considered to be “alive.” This conservative approach has merit, as there are many instances in the data of programs that receive zero funding for a period of time, only to receive funding later. The conservative approach to coding death is arguably also the most compatible with tax expenditure death; tax expenditures must either expire or be repealed to come off the books, since they are “funded” automatically. On the other hand, a fair argument can be made that such a definition ignores an important factor that should increase the mortality of discretionary (though not mandatory)¹⁵ spending programs: for discretionary programs to continue to exist in the real world, they must receive funding in annual appropriations legislation. Since these bills originate in the Appropriations Committees rather than the authorizing committees that statutorily create or eliminate policies, discretionary programs arguably require more

¹⁴ Calculating the revenue the federal government would have taken in if a tax expenditure did not exist is a complex endeavor. The Treasury Department and the Joint Committee on Taxation frequently differ on their estimates of tax expenditure cost due to different assumptions built into their calculations. Furthermore, it is not clear that it would be appropriate to treat the cost of a tax expenditure as equivalent to a “funding” level.

¹⁵ Unfortunately, I am unable to distinguish between mandatory and discretionary spending programs in the CFDA dataset.

and broader congressional support than other types of policies to survive. Thus, I employ two different measures of spending program death. The first (Berry, Burden and Howell's conservative measure) counts only deletion from the CFDA as program death, while the second, more liberal measure includes both deletion and defunding. I count a program as defunded when its funding level drops to zero and does not rise above zero for the remainder of analysis time.

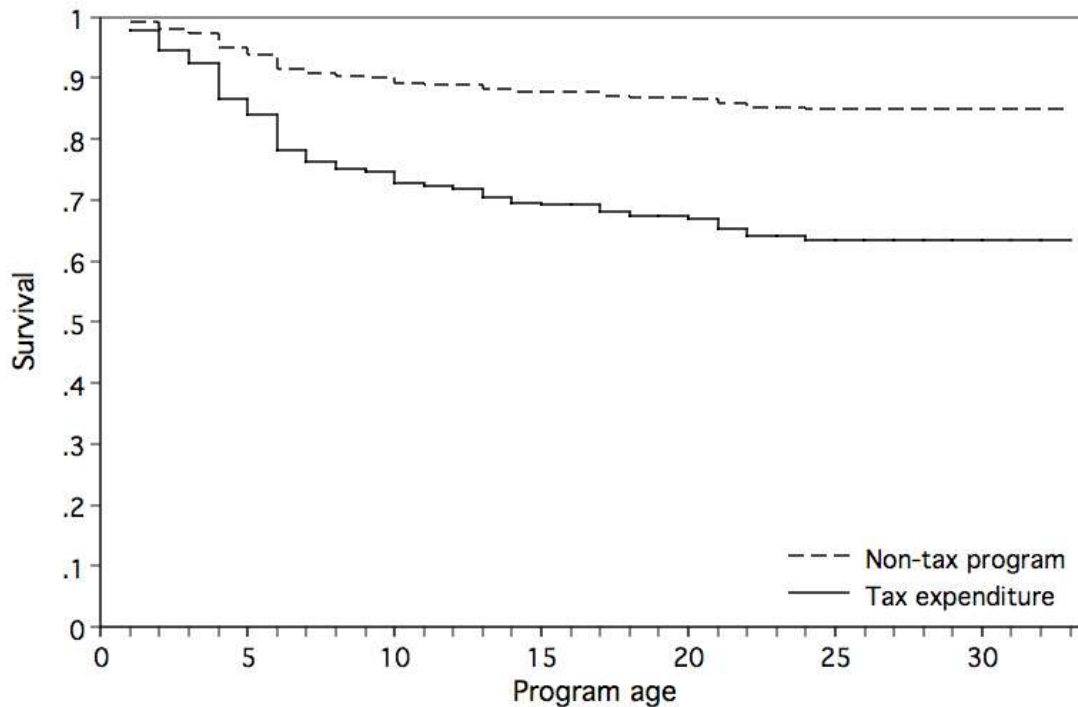
Since the data set excludes the oldest (and some of the largest) policies on both the tax and non-tax side, the findings of the study are time-bound. They apply to the modern era of tax expenditure policymaking, which has taken place in the age of congressional budgeting (beginning with the Congressional Budget Impoundment and Control Act of 1974). Prior to the late 1960s and early 1970s, the "tax expenditure" concept did not exist, and there was no effort to catalogue or budget for special tax preferences. For example, the advent of budgeting in general and tax expenditure budgeting in particular led to the adoption of "sunset" dates for many new tax expenditures. Although Congress regularly renews sunseting tax expenditures in "extender" bills and other legislative vehicles, even this relatively minor legislative effort was not required to maintain tax expenditures in the pre-budgeting era. Hence, it is reasonable to assume that tax expenditures created in that earlier era were less vulnerable to elimination (or expiration as the case may be), as I explore below. Of course, by forcing or at least encouraging fiscal tradeoffs, the advent of congressional budgeting may have changed the post-enactment politics of *all* federal programs, not just tax expenditures. As such, we cannot draw firm conclusions from this study about the post-enactment politics of programs from earlier eras.

Descriptive analysis of the data is inconclusive as to whether tax expenditures are more or less durable than direct spending programs. Using the more conservative definition of program death, the mean duration for tax expenditures (that is, the mean number of years until either elimination or the end of analysis time) is 14.2 years, compared to 9.9 years for other programs. This suggests that tax expenditures are more durable than direct spending programs. This comparison may be deceptive, however, as the mean enactment year of tax expenditures (1985) is earlier than the mean for other programs (1988). Thus, the longer mean duration for tax expenditures may be due to more program-year observations appearing in the dataset for such programs on average rather than a systematic difference in durability. Indeed, note that 32 percent of the included tax expenditures were eliminated during analysis time, compared to just 9 percent of other programs (a statistically significant difference in proportions), suggests that tax expenditures are *less* durable than other programs. A simple survival analysis supports this notion. The survival curves in Figure 2.1 show a clear divergence over time, with relatively fewer tax expenditures surviving than non-tax programs. These results are not an artifact of the remarkable 1986 tax reform effort; even when the tax breaks repealed in that legislation¹⁶ are excluded, the percentage of tax breaks that were eliminated (25 percent) is still significantly greater than the percentage of non-tax programs eliminated. This conclusion also holds up when the more liberal definition of spending program death is employed – the percentage of nontax programs eliminated (18 percent) is still significantly less than the percentage of tax expenditures eliminated.

¹⁶ This includes 12 tax breaks that meet the analysis time requirements. An additional six tax breaks that already existed at the beginning of analysis time were eliminated in the 1986 Tax Reform Act. This count includes tax breaks that were phased out in the law and so continued to exist for several years after 1986.

Given the contradictory conclusions that can be drawn from these descriptive statistics, a multivariate analysis is required to determine if policy delivery mechanism affects program durability and to explore possible dynamic interactions with time.

Figure 2.1. Survival of federal tax and non-tax programs, 1974-2003



I follow the lead of previous studies that examine federal policy durability (Maltzman and Shipan, 2008; Berry, Burden and Howell, 2010; Ragusa, 2010) and use a Cox duration model with time-varying covariates and robust standard errors. In a duration model, the dependent variable is the time before a unit (in this case, a federal program) experiences an event (in this case, elimination), often referred to as “failure.” In a time-series cross-sectional data set such as this, the failure variable takes the form of a dummy variable equal to zero for all the time points that a given unit “survives,” and equal to one at the time point at which the unit experiences failure, if it does so. The chief advantage of the Cox model, as opposed to alternative duration models (e.g., the

exponential, the Weibull and the log-logistic models) is that it does not require the researcher to make any theoretical assumptions about the shape of the underlying hazard function. Instead, the Cox model draws a nonparametric hazard function from the data itself. I use the Efron method to account for ties in the data.¹⁷ In a Cox model, positively signed coefficients indicate that an increase in the variable is associated with increased risk of the event (in this case, program termination), while negatively signed coefficients indicate the opposite.

Independent variables of interest

The variables of interest are a dummy variable coded 1 for tax expenditures and 0 for all other programs¹⁸ and the interaction of this variable with the natural log of program age in years (*tax expenditure* × *logged age*).¹⁹ If the Tax Expenditure Vulnerability hypothesis is correct, the coefficient for the *tax expenditure* variable should be positively signed. Similarly, the Long-Term Tax Expenditure Vulnerability hypothesis predicts a positive sign for the interaction term.

Control variables

Scholarship on the post-enactment life of federal programs suggests the importance of controlling for additional factors. In addition to the tax expenditure

¹⁷ See Box-Steffensmeier and Jones, 2004 for more on event history or duration modeling.

¹⁸ The inclusion of dummy variables for loan and insurance programs (see control variables below) sets spending programs as the excluded group, enabling the comparisons required by the tax expenditure hypotheses.

¹⁹ This is the standard method of accounting for effects that vary with time (a violation of the proportional hazards assumption) in a Cox model (Box-Steffensmeier and Jones, 2004, 136-137).

variables discussed above, I include Berry, Burden and Howell's program type variables for loan programs and insurance programs,²⁰ but not for the various types of direct spending programs (e.g., specified, unspecified, etc.). I do this in order to set direct spending programs as the excluded group, so that the tax expenditure variables represent a comparison to direct spending programs. In a preliminary model, the loan variable was found to violate the proportional hazards assumption, so I include an interaction of this variable with the natural log of time (see note 19). I have no theoretical expectations for the direction of *loan*, *loan* × *logged age* or *insurance*, although Mettler includes such programs in the “submerged state” of indirect programs, suggesting that these variables and the tax expenditure variables should have similar effects.

I also control for important elements of the political and economic environment. Berry, Burden and Howell's *majority party seat gain*, *majority party seat loss*²¹ and *change in party, president* all measure the extent to which the political environment has shifted from enactment to the current year. Majority party losses should be associated with greater risk of elimination, while majority party gains should reduce risk.

I also follow Berry, Burden and Howell in accounting for aspects of the present environment with *divided government, current year*; *policy mood*;²² and *first year of congressional term*. Divided government should reduce the likelihood of legislative action (e.g., Binder 2003) and therefore of program elimination, though Berry, Burden

²⁰ There are 86 loan programs and 4 insurance programs in the sample.

²¹ These variables are based on an average of the normalized change in seats for the majority party across both chambers. *Majority party seat gain* has a mean of .004 and a standard deviation of .013. *Majority party seat loss* has a mean of .05 and a standard deviation of .05.

²² *Policy mood* uses the first dimension score on Stimson's (2004) measure of aggregate public opinion toward government. This variable has a mean of 59.57 and a standard deviation of 4.02.

and Howell find a surprising opposite effect in their model. It is possible that the compromise necessary under divided government leads to more program eliminations, or perhaps that gridlock threatens existing programs due to a failure to fund and maintain them. Higher scores on the *policy mood* index indicate a more liberal public mood tolerant of government intervention, which should reduce the likelihood of program elimination. The first year of a congressional term is usually associated with more legislative activity than the second, making program eliminations more likely. I also introduce dummy variables that measure partisan control of government (*Democratic president, current; Democratic House majority, current; Democratic Senate majority, current*). Since Democrats traditionally support greater government involvement, higher levels of Democratic control should reduce the likelihood of program eliminations.

I follow Maltzman and Shipan (2008) and Ragusa (2010) in accounting for divided government at enactment with a dummy variable (*divided government, enactment*). In their studies of landmark legislation, these scholars disagree over the effect of the governing coalition at the time of enactment; Maltzman and Shipan argue that laws signed under divided government are more likely to be repealed because they are the result of compromise and less likely to be coherent and self-executing. Ragusa contends that laws created under divided government are more durable in the long term, since they have more diverse support. I also control for congressional *polarization*, measured as the average in the difference between the DW-NOMINATE scores of the median legislator in each party in the House and Senate. Since legislating is more difficult in a polarized body, program eliminations should be less likely.

To account for the current fiscal environment, I control for the current-year *surplus/deficit* as a percentage of GDP, and follow Berry, Burden and Howell in accounting for *GDP*, *GDP change* and *war* (on the assumption that war puts strain on the government's resources, although Berry, Burden and Howell find, surprisingly, that war is associated with *less* risk of elimination).²³

Finally, I control for pertinent aspects of the institutional environment in which policies are considered. The most important institutional innovation during the time period under study is the adoption of a chamber "PAYGO" rule. Originating in the Budget Enforcement Act of 1990 and taking effect from fiscal year 1991 to 2002,²⁴ PAYGO required that new spending or changes to the tax code not add to the federal deficit. In addition to making it more difficult to create new programs (including new tax expenditures), PAYGO should theoretically have put existing programs at much greater risk of elimination, since they could serve as offsets for new programs. PAYGO seems to have been a highly effective budgeting constraint, as the federal budget deficit shrank rapidly and turned into a surplus during the 1990s, and anecdotal evidence suggests it constrains the behavior of legislators (Weisman, 2012; though see Kleinbard, 2010 for a counterpoint). To control for its effects, I include a dummy variable coded 1 for the years PAYGO was in effect (0 for all other years).

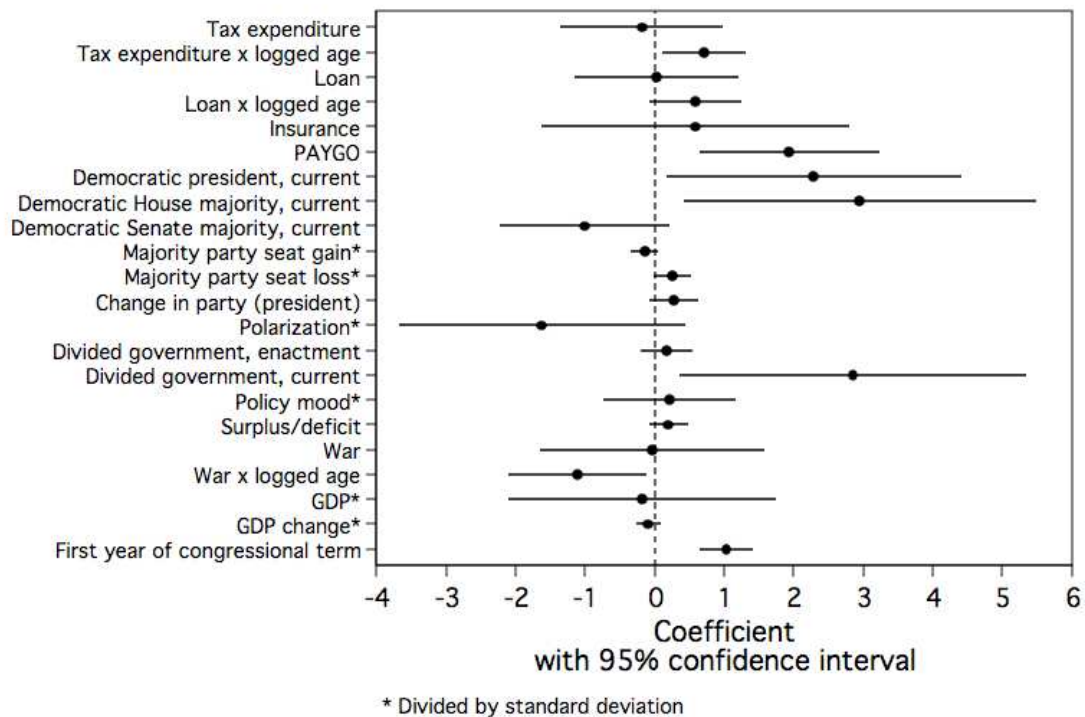
²³ The war variable was found to violate the proportional hazards assumption in preliminary models, so an interaction term with logged program age (*war* × *logged age*) is included to correct this problem.

²⁴ PAYGO was maintained by several Republican-controlled Congresses after the Republican takeover in 1994, but allowed to lapse during the first term of the Bush Administration to pave the way for large tax cuts and the Medicare Part D prescription drug program, both top Republican priorities. When the Democrats retook control of Congress in 2006, PAYGO was added to the House rules, and became federal statute in early 2010. The more recent PAYGO era is not included in the analysis time of this study.

Results and Discussion

The results of Model 1, which uses the conservative version of spending program elimination, are displayed graphically in Figure 2.2. The dots represent coefficient estimates, while the horizontal lines represent 95 percent confidence intervals. Note that some variables have been rescaled for display purposes. Interested readers may view the untransformed coefficients, robust standard errors and p-values for Model 1 in the first column of Table A1 in the appendix.

Figure 2.2. Factors shaping the vulnerability of federal programs (elimination), 1974-2003 (Model 1)



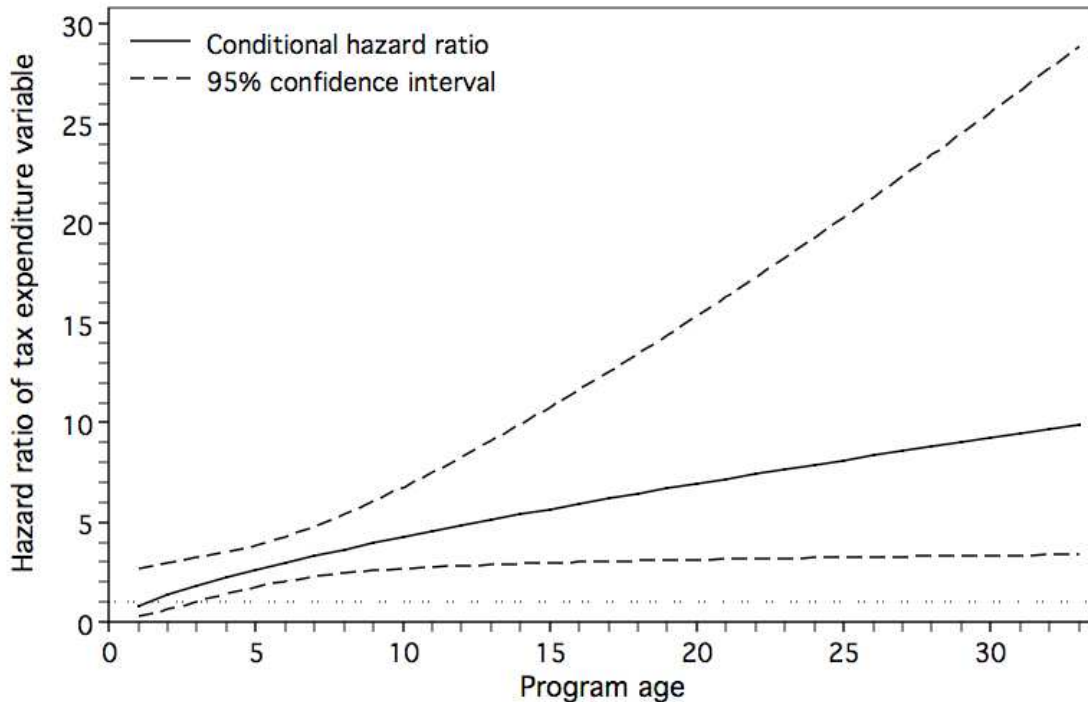
The results of Model 1 provide strong support for the Long-Term Tax Expenditure Vulnerability hypothesis. Although the risk of elimination for tax expenditures and direct spending programs is indistinguishable at the beginning of a program's life (hence the statistical insignificance of the *tax expenditure* constituent

term), the statistically significant positive coefficient for the *tax expenditure* \times *logged age* interaction term ($p=.02$) indicates that tax expenditures become significantly more vulnerable than direct spending programs over time. To aid interpretation of the interaction effect (see Brambor, Clark and Golder, 2006), Figure 2.3 charts the marginal effect (in hazard ratio form) of the tax expenditure delivery mechanism over time, with the 95 percent confidence interval.²⁵ The hazard ratio represents the percentage change in the risk of elimination associated with a one-unit increase in the variable. A hazard ratio greater than one indicates a positive coefficient and therefore an increase in the risk of elimination, while a hazard ratio of less than one indicates the opposite.²⁶ A hazard ratio of exactly one (meaning a coefficient of exactly zero) indicates no effect. The figure demonstrates that tax expenditures become significantly more vulnerable to elimination than comparable direct spending programs after about three years in existence, and that this difference in risk expands over time. At ten years, the model predicts that tax expenditures are 4.2 times as likely to be eliminated as direct spending programs, all else equal. At twenty years, the difference grows to 6.9 times (although note that the confidence interval becomes much less determinate around this point).

²⁵ I follow the procedures recommended by Brambor, Clark and Golder (2006, 73-76) for illustrating conditional marginal effects to generate this figure.

²⁶ For example, a hazard ratio of 1.5 indicates that a one-unit increase in the variable is associated with a 50% increase in the risk of elimination, while a hazard ratio of 0.5 indicates that a one-unit increase is associated with a 50% decrease in the risk of elimination.

Figure 2.3. Hazard ratio of tax expenditure variable conditional on program age, conservative definition of program death (Model 1)



PAYGO also performs as expected. During the *PAYGO* era, the risk of elimination for federal programs increased 194 percent compared to years when it was not in effect, all else equal. This provides strong evidence that Congress’s effort to control the deficit by altering parliamentary rules for the consideration of fiscal measures had a direct effect on the post-enactment life of federal programs.

The other control variables display some interesting results. The positive sign and marginal statistical significance ($p=.082$) of *loan* \times *logged age* suggests a pattern for loan programs (another method of indirect governance) similar to that of tax expenditures. Berry, Burden and Howell’s variables capturing changes in the governing coalition are signed in the expected directions, although neither attains significant at the $p<.05$ level. *Polarization* is negatively related with risk of elimination, though this association also fails to attain statistical significance. Conversely, *divided government*, *current year* is

statistically significant with a positive sign, suggesting that while divided government may make it more difficult to pass legislation generally (see Binder, 2003), it may foster situations in which cutting existing programs is more politically feasible, or cause programs to expire due to lapsed funding. In terms of partisan control, it appears that Democratic control of the presidency and the House are associated with *greater* risk of program elimination.

Divided government at enactment and *policy mood* both fall short of statistical significance. The economic and fiscal indicators also fail to attain statistical significance, with the exception of the *war* \times *logged age* interaction term, which is negative. This replicates Berry, Burden and Howell's puzzling finding that war seems to increase, rather than threaten, the durability of domestic programs. Like Berry, Burden and Howell, I find that programs are in the most danger when a congress is in its first, generally busier year.

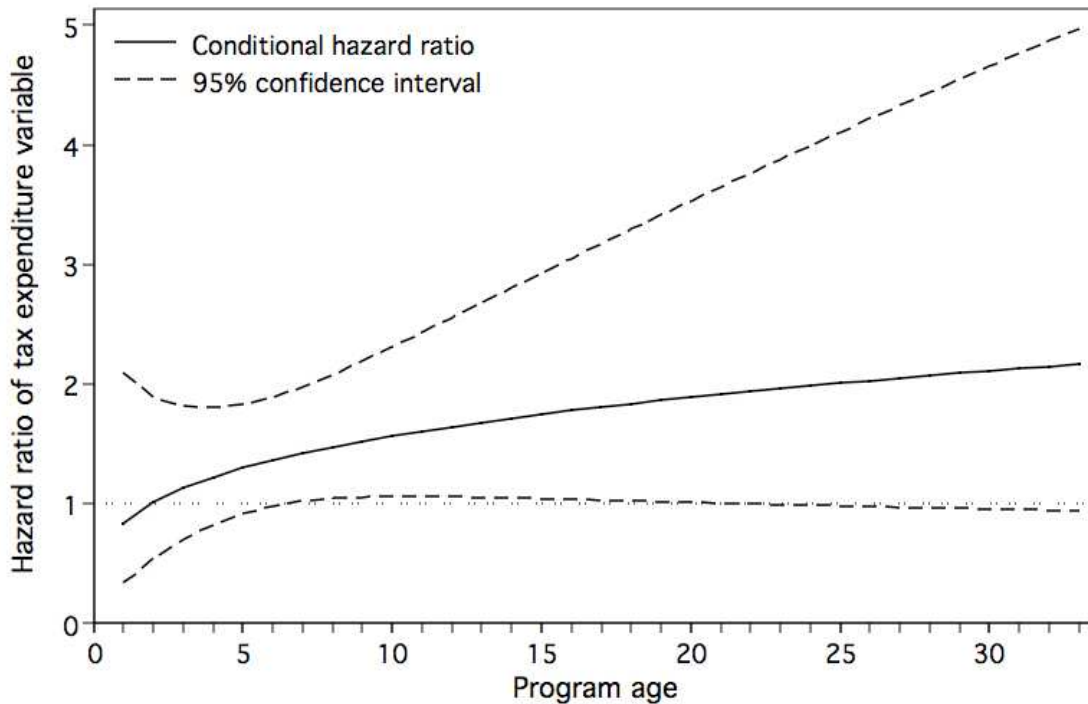
Next, I replicate the model using the more liberal definition of program death (elimination plus defunding). The full results of this model (Model 2) can be viewed in the second column of Table A1 in the appendix. The magnitude of the interactive effect observed in Model 1 is reduced in Model 2. This is true by definition, since this version of the dependent variable only differs from the one in Model 1 for nontax programs. At first, the statistical insignificance of the coefficient for *tax expenditure* \times *logged age* ($p=.25$) would seem to suggest that the relationship observed in Model 1 is not robust to this alternative dependent variable. Again, however, the magnitude and statistical significance of coefficients is insufficient for interpretation of continuous-by-categorical interactions. As Brambor, Clark and Golder (2006, 74) point out, "it is perfectly possible

for the marginal effect of X on Y to be significant for substantively relevant values of the modifying variable Z even if the coefficient on the interaction term is insignificant.”²⁷

Thus, it is possible that tax expenditures are still more vulnerable than regular spending programs for some (perhaps most) values of program age. Figure 2.4, which plots the conditional hazard ratio of *tax expenditure* for Model 2 in the same manner as Figure 2.3 does for Model 1, illustrates that this is the case. The lower 95 percent confidence interval does rise above one (i.e., the 95 percent confidence interval for the coefficient rises above zero) for a portion of program lifespan ranging from roughly six years to roughly twenty years, a span that includes 9,472 of the 18,835 program-year observations. The substantive impact of the *tax expenditure* variable is reduced from that in Model 1, but remains considerable – a tax expenditure is 1.6 times as likely to be eliminated as a spending program at ten years of program age and 1.9 times as likely at twenty years.

²⁷ See also Ai and Norton, 2003, who demonstrate that this issue is especially important for nonlinear models.

Figure 2.4. Hazard ratio of tax expenditure variable conditional on program age, liberal definition of program death (Model 2)



To go beyond the simple “eye test” provided in Figure 2.4, I also ran several piecewise Cox models to provide an objective test of statistical significance for different ranges of program age. Piecewise models are a method of dealing with duration dependence in an event history model; rather than including an interaction with time, the analyst simply re-runs the model on subsets of the data before and after a selected cutoff point. I employ cutoff points of three, five, ten, and fifteen years. The results of the models using the three and five year cutoffs support the Long-Term Tax Expenditure Vulnerability Hypothesis: the coefficient for *tax expenditure* is statistically insignificant in each the models before the chosen cutoff, but positive and statistically significant ($p=.08$ after 3 years and $.004$ after 5 years) after the cutoff. After the ten and fifteen year cutoffs, *tax expenditure* does not attain statistical significance ($p=.15$ and $.38$, respectively), though the magnitude of the coefficients is actually greater than in the

after-three-year model. The reduced significance is likely due to the reduced sample size and the resulting increase in uncertainty reflected on the right side of Figure 4 rather than a real reduction in the effect of the variable. The coefficients and p-values for the *tax expenditure* variable and the sample sizes for the piecewise models are displayed in Table A2 in the appendix.

To test the Targeted Tax Expenditure Vulnerability Hypothesis, Model 3 focuses exclusively on tax expenditures, which reduces the sample size for the analysis to 132 programs and 1783 program-year observations. This model includes a number of dummy variables intended to distinguish tax breaks that serve broad parts of the population from those that benefit narrower interests (the wealthy or business interests). One variable identifies social welfare tax expenditures - those in the policy areas of health, income security, education, employment, training, and social services, community and regional development, housing, and veterans' benefits.²⁸ Another dummy variable identifies provisions benefiting only corporations²⁹. Finally, I include dummy variables for each of the most common tax expenditure types (deductions, exclusions and credits).³⁰

Under the hypothesis, I expect a negative sign for social welfare tax expenditures. Since these policies directly benefit members of the broader public rather than investors

²⁸ These policy areas match up with the budget functions under which tax expenditures are classified, with the exception of housing, which is included in the same budget function as commerce-related tax breaks. Only the housing-related tax breaks under this budget function were classified in the social welfare category. The non-social welfare category includes tax expenditures falling under the following budget functions: agriculture; commerce (non-housing); defense; energy; general purpose fiscal assistance; general science, space and technology; interest; international; natural resources and environment; and transportation.

²⁹ This variable is coded zero for any provision that applies to individual taxpayers, even if it also applies to corporations, which many provisions do.

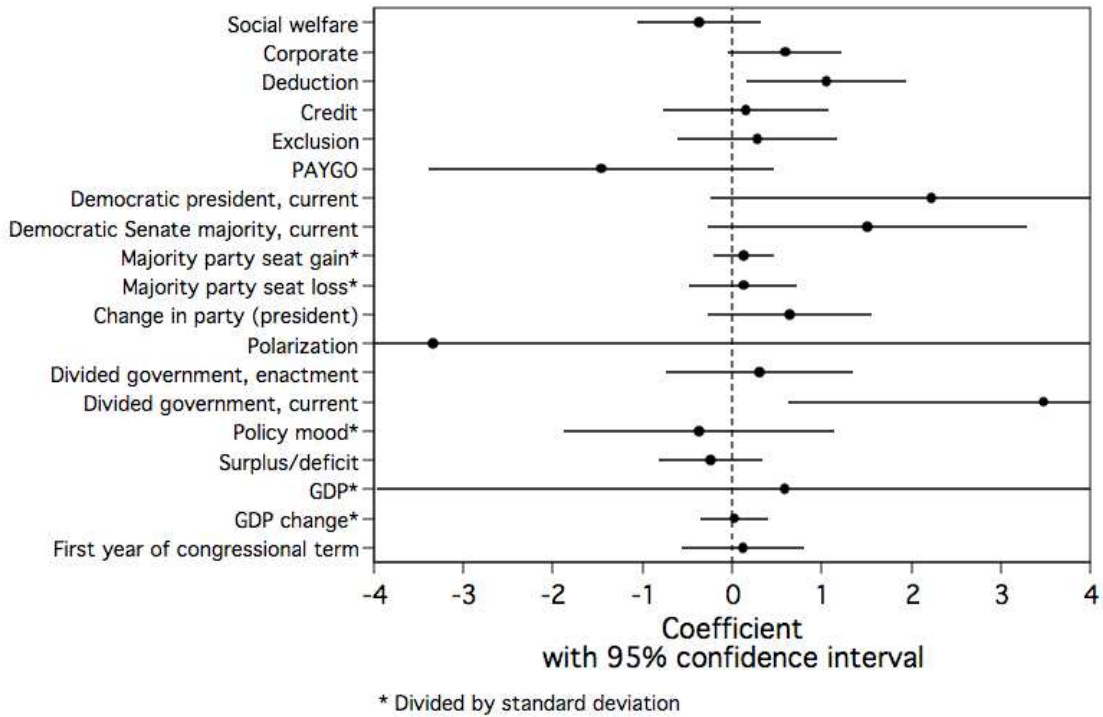
³⁰ The excluded category for this variable includes preferential rates, exemptions, deferrals, and hybrid policies that don't fall clearly into any one category.

and businesses, they can be characterized as broad rather than targeted. As such, the hypothesis predicts that they should be less vulnerable to elimination. Conversely, I expect the corporate variable to be positively signed, since corporate tax provisions do not directly benefit the public. Since deductions disproportionately benefit the wealthiest taxpayers (those who itemize on their taxes and pay a higher marginal rate) over the public at large, I expect these policies to be relatively vulnerable. In this case, the test is not just whether the coefficient for deductions is positive and statistically significant, but whether it is also greater than the coefficients for the credit and exclusion variables. The latter categories include provisions that are more equitable, since they apply to non-itemizers. Also, the value of credits is not determined by the taxpayer's top marginal rate. Model 3 also includes most of the control variables from the first two models, offering an opportunity to explore whether contextual factors affect tax expenditures differently from other policies.³¹ The results for Model 3 are displayed in Figure 2.5.³²

³¹ Note that the war and House Democratic majority variables were dropped for reasons of collinearity.

³² Note that the confidence intervals for the polarization and GDP variables have been truncated for display purposes. Interested readers may view all coefficients and robust standard errors in the third column of Table A1 in the appendix.

Figure 2.5. Factors shaping the vulnerability of tax expenditures only (Model 3)



Model 3 provides support for the Targeted Tax Expenditure Vulnerability Hypothesis. The coefficient for *corporate* is positive and statistically significant at the $p < .10$ level. According to the model, tax expenditures for corporations only are about 1.8 times as likely to be eliminated as other tax expenditures. The coefficient for *social welfare* is signed negatively as expected, although it falls short of statistical significance. It is possible that degrees of freedom limitations prevented stronger findings for both variables. Meanwhile, the coefficient for *deduction* is positive and statistically significant as expected ($p = .02$). Post-estimation tests find that the coefficient is also significantly greater (at the $p < .10$ level) than those of the coefficients for *credit* ($p = .09$) and *exclusion* ($p = .08$), each of which failed to attain statistical significance in the model.

Interestingly, few of the contextual control variables attain statistical significance in this model. Of course, this may be due in part to the small sample size, but note that

the variables indicating the change in the governing coalition and polarization, all of which performed strongly in Model 1, are not close to statistical significance in Model 2, with p-values of 0.4 or more for each. Perhaps even more surprising, *PAYGO* approaches statistical significance in the wrong direction, indicating that tax expenditures may have been *more* durable in the *PAYGO* era. Although inconclusive, the results support the notion that tax policymaking is unique and insulated from some of the external pressures that affect other areas of lawmaking. The *PAYGO* result also supports Kleinbard's (2010, 18) assertion that *PAYGO* has proven to be an ineffective constraint on the tax committees.

Which Tax Expenditures Are Most Likely to Be Eliminated?

The findings of the multivariate models beg further questions about what types of tax expenditures are most likely to be eliminated. If certain types of tax expenditures (e.g., smaller expenditures or those enacted in recent years) drive the results, the interpretation of those results may differ. Although Model 3 disaggregated tax expenditures based on broad categories, data constraints prevent a more fine-grained analysis using such methods. Thus, I turn to descriptive analysis to identify the characteristics of tax expenditures that seem to be associated with a greater likelihood of elimination. An additional advantage of this approach is that it allows me to consider all 207 tax expenditures listed in the Treasury budgets during this era, rather than just the 132 that meet the analysis time requirements for inclusion in the Cox model.

First, I explore whether earlier tax expenditures (those created before 1974) are more durable than those included in the analysis above. Anecdotal evidence suggests that

this is the case: The quintessential “entrenched” tax expenditures are indeed very old. Most notably, the deduction for mortgage interest on owner-occupied homes is as old as the income tax itself (Howard, 1997, chapter 5). Moreover, the attachment of sunset dates to newer tax expenditures likely makes them at least somewhat more vulnerable than older provisions. On balance, the earlier tax expenditures were no less likely to be eliminated than those created since 1974. Of the 67 tax expenditures already in existence in 1974, 31.3 percent were eliminated after 1974, compared to 30 percent of the 140 tax expenditures created after 1974. Still, these eliminated policies were at risk of elimination for longer (in some cases much longer) than policies created during analysis time, and additional evidence suggests that older tax expenditures are less vulnerable than newer ones. Among the tax expenditures that were created between 1974 and 2003, 32 of the 42 observed eliminations (76.2 percent) took place in the first decade of the tax breaks’ existence. In other words, tax expenditures experience the same pattern of initial instability followed by stability (or “institutionalization”) that scholars have found for other types of federal programs (Corder, 2004; Berry, Burden and Howell, 2010; Ragusa, 2010). As the findings of Models 1 and 2 suggest, however, this effect is significantly *less* pronounced among tax expenditures: nearly 90 percent of the observed eliminations of non-tax programs during the same time period took place in the first decade.

Second, I explore the relative size and cost of tax expenditures that have been eliminated. The significance of the patterns observed in the models would be greatly diminished if, for example, only the smallest tax expenditures were vulnerable to elimination. An examination of historical budget estimates from the Treasury

Department³³ suggests that this is not the case: Congress is capable of eliminating substantial tax expenditures. Of the 61 eliminated provisions for which reliable budget information could be found,³⁴ the mean cost estimate (in 2004 dollars) was \$3.058 billion, while the median was \$403 million (reflecting the skewed shape of the data at the high end, which is true of tax expenditures in general). A reasonable point of comparison is the full list of tax expenditures that still existed in fiscal year 2004 – those provisions that survived until the end of the time series analyzed. The mean cost estimate for these provisions (excluding negative tax expenditures) was \$5.131 billion, with a median of \$450 million. Thus, although it is true that surviving provisions tend to be more costly, the difference is relatively small when the median is the point of comparison. The larger difference in the means is chiefly due to the persistence of the very large tax expenditures at the top of the scale: the exclusion of employer contributions for health insurance (\$102.3 billion in 2004), the home mortgage interest deduction (\$61.5 billion), and four other tax expenditures estimated to cost in excess of \$40 billion each in 2004.

Still, not all of the largest tax expenditures are sacrosanct. The investment tax credit (phased out in the 1986 tax reform and expired in 1990) was estimated by the Treasury Department to have reduced revenues by \$42.9 billion (2004 dollars) in 1985. The deductibility of interest on consumer credit (also phased out in 1986 and expired in 1990) had a peak estimated cost of \$30.9 billion. The deferral of capital gains on home sales (eliminated by the Taxpayer Relief Act of 1997) cost an estimated \$21.2 billion in

³³ These estimates were gathered through the White House Office of Management and Budget documents and the Pew Charitable Trust's Tax Expenditure Database.

³⁴ Since tax expenditures are frequently phased out rather than immediately eliminated, the final-year cost estimate for eliminated provisions is often misleadingly low. Thus, I use the highest recent cost estimate before elimination.

1994. Six other tax expenditures estimated to cost \$5 billion or more in 2004 dollars were also eliminated during the period studied.

Large tax expenditures seem to be more durable than small ones. But is this pattern especially pronounced for tax expenditures as opposed to comparable direct spending programs? I answer this question by examining the funding data in Berry, Burden and Howell's original collection of non-tax programs. For their analysis of spending levels (2010, 11-13), Berry, Burden and Howell include the current-year spending level for each program in inflation-adjusted 2000 dollars, enabling a comparison between eliminated and surviving non-tax programs similar to the one for tax expenditures above. Using the conservative definition of spending program death, for the 193 eliminated non-tax programs for which spending information is available, the median maximum spending level is \$6 million, and the mean is \$226 million. For the 1077 surviving programs in 2004, the median maximum spending level is \$12 million and the mean is \$338 million. This is consonant with Bickers' (1991, 902-903) observation that ongoing outlay programs tend to be larger than either newly created or terminated ones. It would seem, then, that there is a general bias in favor of preserving larger programs that is not unique to tax expenditures; in fact, if anything this pattern appears *less* pronounced among tax expenditures. There are numerous plausible hypotheses for why size might be a greater asset for direct spending programs than tax expenditures (e.g., a larger budget for direct spending programs means more government employees who depend on the program for their jobs), but one should tread carefully when making causal inferences regarding the relationship between program size and durability. Both variables are, in part, the product of an implicit third variable: legislative support for the program.

Conclusion

My findings suggest that the post-enactment fate of federal programs varies directly with the means by which the programs are delivered. In addition, this study enriches our understanding of indirect governance and tax policy by bringing systematic evidence to bear on a controversial point in the literature on both topics. That tax breaks are shorter-lived than other types of public policies is neither an obvious conclusion nor definitively settled in existing literature. This finding is robust to different definitions of spending program elimination, although the relative durability of spending programs is reduced when defunding is taken into account.

Further work is needed to uncover the mechanism behind this pattern. The broad scope of conflict and relative independence from capture of the tax committees is one possibility; the results of Model 3 suggest that these patterns are most pronounced among tax policies that benefit narrow or wealthy interests. Alternatively, it is possible that the tax committees *are* receptive to parochial or weakly justified policy demands, but that this creates a selection effect through which tax breaks tend to be relatively short-lived. My analysis systematically compares the durability of policies delivered in different ways, but it is not able to isolate the causal impact of policy delivery mechanism from that of other elements of policy content that may be correlated with delivery mechanism.

A lack of bureaucratic support may also play a role. The fact that the differences in risk of elimination between tax breaks and normal spending programs is most pronounced among *older* policies lends some credence to this idea; older spending programs are more likely to have a large, entrenched, and politically organized staff with

relationships on Capitol Hill, but Treasury Department bureaucrats disdain tax expenditures of all ages.

Whatever the mechanism, these findings suggest that Mettler is correct when she argues that the “submerged state” can be reformed and reshaped under the right circumstances. At least in the aggregate, tax expenditures are not more politically sacrosanct than other types of policies. The fiscal straits in which the U.S. government finds itself have led politicians and policy experts across the ideological spectrum to call for sweeping tax reform in recent years. Such proposals have prompted pessimistic responses from some observers (e.g., Gravelle and Hungerford, 2012), partially on the grounds that eliminating or reforming significant tax expenditures would be politically difficult. My findings do not necessarily contradict this pessimism, as reform of the largest and oldest tax expenditures is a daunting political challenge. The elimination of *any* large, long-standing federal benefits program is a difficult proposition (e.g., Social Security). But my results demonstrate that the tax expenditure delivery mechanism has generally failed to insulate established policies from legislative change.

More generally, these findings can be viewed as evidence of what Oberlander (2003, 156) terms “the independent potential of Congress” – the capacity of Congress to act independently of or in opposition to pressure from interest groups and the public. Although there is little doubt that outside demands shape legislative behavior and policy outcomes, scholars may underestimate the ability of Congress to take on politically difficult reform. As Steuerle (1992) and Zelinsky (1993) might argue, this potential seems particularly strong in the area of tax policy. My findings suggest that the sturdiest

tax expenditures are those that serve broad segments of the public rather than narrow or wealthy interests.

Chapter 3: Oversight, Maintenance and Repeal of Tax Breaks: the Investment and Research and Development Tax Credits

The Tax Reform Act of 1986 brought perhaps the most sweeping series of changes to the tax code since the United States adopted the income tax in 1913. Numerous gaping tax loopholes that benefited powerful interests were narrowed or closed in favor of equity within income groups and lower rates for all. Of these eliminated or trimmed tax breaks (called “tax expenditures” by some policy experts), none was as significant as the investment tax credit for capital equipment, which would have cost the Treasury \$39 billion in revenue in 1988 by one estimate,³⁵ making it the largest tax break ever repealed. This change was made all the more remarkable by the program’s history of bipartisan support (President Kennedy championed its creation, and Ford, Carter and Reagan all supported it) and the fact that many of the same principals involved in the 1986 bill³⁶ had successfully worked to expand the credit and paired it with generous accelerated depreciation provisions only five years before.

While this may be viewed as an impressive exercise of Congress and the President’s political power in the face of organized business interests (in this case, heavy manufacturing industries), the story of the 1986 tax reform is not so cut and dried. After all, dozens of tax breaks were also retained in some form, including many benefiting corporate interests. For example, the 1986 law extended and made more generous the tax credit for increased research and development expenditures, which was set to expire at the end of 1985. This decision is puzzling given that the high-tech sector that enjoyed the

³⁵ See Steurle 1992, 417.

³⁶ Most notably Reagan, House Ways and Means Chairman Dan Rostenkowski (D-IL), and Senate Finance Chairman and later Senate Majority Leader Bob Dole (R-KS).

greatest benefit from the credit was relatively small and new to lobbying, in contrast to the large, influential and well-organized firms that benefited from the investment credit.

Why do some tax breaks survive through periods of reform or budget-tightening, while others are eliminated? This is a question that the existing literature on policy durability and tax politics has not fully answered. The present paper is the part of an ongoing study that seeks to address this question with a series of case studies, beginning with the investment tax credit and the research and experimentation tax credit. This is a novel effort in that past qualitative work on taxes and fiscal policy generally treats pieces of legislation as the unit of analysis, or examines the tax policy process as a whole.³⁷ While this work has produced a wealth of valuable insights on how reform or budget tightening efforts come about, it does not offer complete answers as to why some provisions survive such efforts while others do not.

Expectations for Policy Durability

Policy characteristics

Existing scholarship on tax politics, policy durability and policy feedbacks suggests a number of factors that may affect policymakers' decision to maintain, reform, or repeal a given tax provision. Most directly relevant to the present case is Post and Pierson's (2005) finding that "targeted" tax breaks tend to survive longer than broader ones.³⁸

They argue that this is evidence of narrow interests beating out more diffuse and disorganized interests, as per the classic collective action literature (e.g., Olson 1965).

This line of reasoning also forms an important part of the arguments of Hacker and

³⁷ See, for example, Witte 1985; White and Wildavsky 1989; Conlan, Wrightson and Beam 1990; Steurle 1992; King 1993; Wildavsky and Caiden 2004.

³⁸ The authors define a targeted benefit as one that directly flows to a group that makes up less than five percent of the population.

Pierson (2010), who argue that narrow organized interests trump diffuse public interests in modern economic and social policy. Similarly, Weaver's (1986) theory of blame avoidance also militates in this direction; blame-averse policymakers should work to minimize concentrated losses, especially among politically active constituencies like business, since the gains accruing to others from, for example, a reduction in rates, would be much less likely to provoke a reaction. Notably, Witte (1985) and White and Wildavsky (1989) have argued the opposite: that broad-based tax expenditures benefiting large numbers of people are more durable. In chapter 2, I find results more consistent with the latter argument.

Another relevant characteristic of a given policy is the way that the government executes or delivers it. A growing literature (e.g., Howard 1997, Hacker 2002, Mettler 2011, Morgan and Campbell 2011) has argued that the politics of policies delivered in indirect or less visible ways (e.g., as tax breaks rather than direct outlays) differ from those of more traditional direct government interventions. Corder's (2004) examination of federal credit programs and my own study comparing tax expenditures and direct spending programs (chapter 2) examine the effects of a policy's delivery mechanism on its durability, and come to conflicting conclusions; Corder finds that less visible programs (loan guarantee programs, as opposed to direct loans) were shorter lived, while I find that tax expenditures, though less visible than direct spending programs, were more vulnerable to elimination, and that those benefiting narrower interests (e.g., high-income individuals or corporations) were especially vulnerable. Corder's findings are more consonant with the policy feedback arguments of Hacker (2002) and Mettler (2011), who contend that policies that are less visible to the public engender a politics dominated by

attentive special interests. My own findings fit the arguments of Steuerle (1992) and Zelinsky (1993) that the tax policy system is actually especially *conducive* to fiscal tradeoffs and policymaking in the public interest, even though the public is unfamiliar with much of the tax code.

Of course, arguments about broad or narrow classes of beneficiaries, or about visible or invisible delivery mechanisms, are indirectly about the implications of these policy characteristics for *influence*. Those arguing that invisible policies or those that benefit narrow interests are less likely to be eliminated are arguing that the influence of self-interested beneficiaries (through lobbying or other means) will trump the interests of taxpayers as a whole, that general resources will continue to be used for particularistic purposes. Those arguing the opposite believe that policymakers will take broader interests into account. This may occur because policymakers follow sincere beliefs or ideas about the public good. For example, a tax break might be granted to a specific economic sector to achieve a sincere policy goal, and eliminated when it is deemed ineffective or too great a commitment of public resources. In this line of reasoning, expert opinion (for example, that of tax economists) plays an important role. Alternately, policymakers may favor broader interests through the tax code for purely political reasons. In a democracy, showering benefits on many taxpayers may be more politically valuable than showering them on a few specific groups. Thus, Witte (1985), despite finding that provisions benefiting the poor and middle class are less politically vulnerable, still characterizes the US tax policy system as dominated by self-interested external demands, from both the public and specific interests.

Context

Of course, policies, interest groups, and public demand do not exist in a vacuum. The literature on policy durability (Patashnik 2003, 2008; Lewis 2002, 2004; Corder 2004; Maltzman and Shipan 2008; Berry Burden and Howell 2010; Ragusa 2010) has also found an important role for contextual factors such as the partisan makeup of the governing coalition, economic and fiscal factors, institutional factors, and public opinion. For example, a strong economy is associated with lower likelihood of policy repeal (Ragusa 2010; Berry, Burden and Howell 2010), while a policy is more likely to be eliminated the more the partisan makeup of the governing coalition has changed since enactment (Berry, Burden and Howell 2010). The passage of time itself also seems to play an important role; Corder (2004); Berry, Burden and Howell (2010) and Ragusa (2010) all find a similar pattern in which policies tend to be unstable for the first decade or so of existence, before becoming more stable and institutionalized.³⁹

These findings about context, while important, offer little insight on the question of why one tax break would be eliminated while another is preserved. Steuerle (1992) offers a compelling account of how context affects the fate of specific tax policies. In his study of tax policymaking in the 1980s, Steuerle argues that the “organization” of policy initiatives is crucial to understanding their results. While the 1981 tax-cut bill shepherded through Congress suffered from a “lack of underlying principles” leading to a “‘Christmas tree’ bill in which every ornament could be added with little or no justification required,” the tax reform effort culminating in 1986 was organized in a way

³⁹ See Ragusa 2010, pages 1037-1038. In chapter 2, I find that this pattern exists for tax expenditures, but that it is less pronounced than for other types of policies; that is, older tax expenditures are at greater risk of repeal than older direct spending programs.

that encouraged policymakers to report “to the public on the ways in which the laws can be reformed so as to meet with various accepted criteria and principles and, equally important, to note which aspects of the law meet no standards at all.” (Steurele 1992, 3-4) This view is in contrast to that of Sen. Slade Gorton (R-WA), who expressed early skepticism about tax reform precisely because he saw no reason to expect that different factors would matter in the context of reform: “We have gotten ourselves into the present situation for a good and valid reasons, and future legislation will be subject to the same process and influenced by the same political forces.”⁴⁰

Mettler (2010, 2011) makes an argument that is broadly similar to Steurele’s when she contends that policymakers can only reform hidden or “submerged” policies benefiting narrow interests (like many tax breaks) when they successfully make the stakes clear to the public at large. This echoes the classic argument of Schattschneider (1960) that policymaking in the public interest is most likely to occur when concerned actors successfully broaden the scope of conflict beyond the interests that stand to benefit most directly.

Weaver’s (1986) work on the importance of blame avoidance also offer important insights here. Weaver draws on the prospect theory literature embodied by Kahneman and Tversky (1979), which argues that individuals are fundamentally more loss-averse than they are interested in gains. Weaver extrapolates this to the macro level, arguing that constituencies harmed by policies or policy proposals are more likely to mobilize to promote their interests than are constituencies who stand to gain. This creates a scenario under which blame avoidance, rather than credit claiming, will form the primary

⁴⁰ Gorton 1984, page 38.

motivation of most policymakers. This would suggest that the relevant contextual factor for a legislative effort is the likely assignment of losses and blame.

In the following section, I use these insights to construct my own novel arguments about tax expenditure policymaking.

Argument and Evidence

In this essay, I make the argument that variations in the immediate context surrounding tax policy (i.e., the nature of the legislative effort or window of policy opportunity⁴¹ currently underway) affect a particular tax preference's chances for survival, and that this effect varies based on characteristics of the policy itself. Specifically, the hypothesis of this essay is that *in a legislative context that frames tax breaks as losses for the rest of society, tax breaks that are costly and weakly justified are more likely to be eliminated, even if they enjoy influential group support*. A corollary to this hypothesis, not fully tested in the present essay, is that the relative importance of influential group support will be greater in the context of legislative efforts oriented primarily toward tax reduction (i.e., gains for all relevant constituencies).

Some elaboration is necessary to specify the hypothesis. Since blame avoidance is such an important element of politics, I hypothesize that the framing of losses and the allocation of blame will determine the playing field on which tax expenditure politics takes place. Net tax cutting efforts such as the Economic Recovery Tax Act of 1981 and the Economic Growth and Tax Relief Reconciliation Act of 2001 establish a context in

⁴¹ See Kingdon 1995.

which all relevant parties stand to gain, for all intents and purposes.⁴² In that environment, the public at large will be quiescent and interest groups will be able to work their will on the basis of their influence, even if their requests are of dubious public policy merit. The calculus is fundamentally different in a context of budget balancing or tax reform, since meaningful losses are introduced. It is tempting to suggest that the importance of blame avoidance should *favor* organized interests in such situations, since potential losses should enable them to mobilize more effectively and persuade blame-avoiding politicians to abandon plans to close loopholes. But this reading neglects the importance of framing for the public benefit. A successfully framed deficit reduction or reform effort will cast special tax preferences as *losses for the public*. Indeed, this is the underlying political logic of tax expenditure budgeting.⁴³ If this framing can be achieved, the clout of favored groups will count for much less, since the scope of conflict will be expanded to include the public.

It is also necessary to specify what I mean by “costly and weakly justified.” While measuring the “cost” of tax expenditures is not a straightforward process, both the Treasury Department and the Joint Committee on Taxation produce annual budgetary estimates and these provide a reasonable indication for policymakers and the public of how much revenue is foregone as a result of such provisions. The hypothesis predicts that, all else equal, larger tax breaks are in more danger in a reform or budget balancing effort. The determination of whether a policy is “weakly justified” is less objective and therefore less easily quantified. I consider a policy to be weakly justified when relevant

⁴² Long term damage to public finances may result in costs down the road, but this is not a rallying cry likely to mobilize much outrage.

⁴³ See Surrey 1970.

experts and observers (e.g., media commentators) are skeptical that it achieves the ends it was meant to achieve. Such judgments may originate from technical expertise or from symbolic understandings. For example, a scandal connected to a policy may give that policy a negative valence and convince relevant observers that the policy is unsuccessful, or a stylized notion of economic trends might lead them to conclude that old policies are not longer relevant. I make no claim for the objective correctness of such assessments - in fact, the criteria for making such judgments varies over time even among policy experts. Rather, such a consensus, if and when it exists, offers the best information available to a legislator interested in a policy's value to the public and, perhaps more importantly, how that policy can be symbolically represented *to* the public; this is what it means to "justify" policy in this context. Again, this is of special concern when the policy is framed as a loss to the public.

My argument is somewhat in contrast with those of Hacker and Pierson (2010), who argue that influential organizations are the driving force in modern American economic policy since the wave of business organization that occurred in the 1970s (118). Hacker and Pierson (2010, 83-84) do, however, allow for the possibility of lawmaking in the public interest at least periodically, drawing on Lippman's (1914) arguments in *Drift and Mastery*. In this sense, my arguments can be seen as complimentary to Hacker and Pierson in that they help to specify the conditions under which such instances of "mastery" or "renewal" are likely to occur.

To test my argument, I will examine the political history of several tax breaks, some of which survived major reform or budget balancing efforts and some of which did not. Through this examination, I will seek to answer the following questions:

- *What led Congress to create the provision in the first place?* While this study is concerned with the post-enactment fate of tax breaks, the relative importance of policy justification and interest group influence at enactment may provide circumstantial evidence.
- *What was the fiscal cost of the provision?*
- *How did relevant experts and observers view the policy over the course of its existence leading up to the legislative effort in question?*
- *To what extent were these views reflected in the statements and actions of policymakers?*
- *What economic sectors or populations benefited from the policy? How economically powerful and politically active were they?*
- *How and when was the decision made to maintain, reform or repeal the policy during the legislative effort in question?* The answer to this question will add nuance to what would otherwise be a rather crude dependent variable (maintain, reform, repeal). For example, interpretations of the outcome may vary if a policy was only barely repealed after a prolonged political struggle rather than cast aside with little regard for the opposition.

The present essay examines the fates of the two policies cited in the introduction: the investment tax credit (ITC) for capital equipment and the research and experimentation (R&E) tax credit, both in the context of the Tax Reform Act of 1986. The ITC was eliminated as part of that legislation, while the R&E credit was retained with modified rules (some more generous, some less so). Future incarnations of the

project will incorporate other cases from other legislative contexts. Presently, I have chosen these two provisions because they illustrate different outcomes for two corporate tax credits within the same legislative effort. They also offer variation in terms of size, policy justification and relevant economic sector.

The information in the following sections is drawn from historical documents from the legislative and executive branches, contemporaneous news accounts in the *New York Times*, appropriate volumes of the *CQ Almanac*, and some secondary sources (Witte 1985; Birnbaum and Murray 1987; Conlan, Wrightson and Beam 1990; Steurle 1992; King 1993).

History of the ITC

Creation and Instability - the 1960s

The investment tax credit for capital equipment was first proposed by President John F. Kennedy in 1961, and enacted the following year as part of the Revenue Act of 1962. The provision, as enacted, provided a credit (that is, a reduction of a taxpayer's tax liability) of up to 7 percent of the cost of investment in a piece of capital equipment, mainly machinery.⁴⁴ While the provision enacted by Congress differed significantly from the original proposal (which sought to ensure that the credit would only subsidize investments that would not have been made otherwise), the Kennedy Administration still supported it wholeheartedly.

If it is surprising now to think of a liberal president championing a massive tax subsidy for heavy industry that was to become a favored provision of business lobbyists, it was perhaps no less surprising at the time. Kennedy, like Democratic President Harry

⁴⁴ Buildings were specifically excluded, but otherwise the credit has been interpreted broadly.

Truman before him, had expressed a desire to reform the tax code in the name of fairness. But in practice, the Administration's desire to stimulate the economy and maintain the international competitiveness of American business won out. It was in this context that the ITC was initially conceived.

There can be little doubt that the investment credit was the product of the administration, not demands from business. Business response to the proposal was almost universally negative, at least at first. The business community viewed Kennedy with mistrust, and were skeptical of his attempt to manipulate the economy through a new tax subsidy.⁴⁵ Furthermore, they worried that this novel proposal would take the place of Treasury Department regulatory changes to liberalize equipment depreciation rules, which Kennedy had promised.⁴⁶

Where business was wary, labor was hostile. AFL-CIO Director Stanley Rutenberg blasted the proposal as a multi-billion dollar give-away to rich companies⁴⁷. The response from prominent economists outside of the Kennedy inner circle was even worse. Former Council of Economic Advisors Chairman Leon Keyserling called it “a provision which business does not seek, labor does not want, the condition of the federal budget does not justify, the state of the national economy does not call for, the full consequences of which the public does not appreciate, and which even those economists who favor it have not been able to support with careful or specific empirical analysis.”⁴⁸

⁴⁵ *CQ Almanac*, 1962, pages 481-482.

⁴⁶ The business community, specifically the coal and railroad companies, did eventually come around to supporting the proposal once its terms were loosened.

⁴⁷ *CQ Almanac*, 1962, page 497.

⁴⁸ *CQ Almanac*, 1962, page 499.

Despite this cold reception, the ITC concept had traction in Congress where it mattered - among the moderate legislators that controlled the tax committees. While liberals grumbled about the “trickle-down” economics of the proposal and conservatives decried its fiscal impact, this was not enough to keep a modified version of the ITC from moving forward.⁴⁹

The politics of the ITC remained turbulent through the 1960s. In response to rapid inflation, driven in part by a boom in capital investment that arguably resulted from the ITC, President Lyndon Johnson requested a temporary suspension of the ITC. Congress obliged him, suspending the credit at least in large part from October 1966 through the end of 1967. After reinstatement, the ITC was immediately thrown back on the chopping block as part of an ambitious reform plan authored by President Johnson’s Treasury Department, which had grown increasingly liberal. This plan (which the Nixon Administration grudgingly put forward out of political necessity)⁵⁰ eventually became the Tax Reform Act of 1969. Perhaps the most significant revenue-raiser in this proposal, and in the subsequent legislation, was the repeal of the ITC, estimated at \$2.5 billion for FY 1970. Nixon’s official position was that “national priorities now require that we give attention to the need for general tax relief” over incentives for capital formation.⁵¹

Congress agreed and the ITC was removed from the books.

Thus, in processes that foreshadowed the reform effort of 1986 (though on a smaller scale), the ITC fared poorly when policymakers framed it as a loss for the public,

⁴⁹ *CQ Almanac*, 1962, pages 483-484. Some liberals opposed the measure because it removed the Kennedy Administration restrictions that targeted the credit to truly new investment, but they were not joined in this opposition by the administration itself.

⁵⁰ Witte 185, pages 172-173.

⁵¹ *CQ Almanac* 1969, page 42-A.

but organized business support for the credit was so halfhearted that it is hard to conclude that the events of the late 1960s were evidence of the public interest winning out over determined lobbyists. For its part, the business community did voice opposition to both the 1966-1967 suspension and the 1969 repeal, demonstrating the growing support for the credit, but this opposition was not as full-throated as it might have been. Stuart Saunders of the Pennsylvania Railroad and William Murphy of Campbell's Soup both described the suspension as "bitter" medicine that the business community would agree to swallow.⁵² It appeared that for many firms, the top priority in 1969 was to get the tax reform process over with so they knew whether or not to claim the ITC on their 1969 returns.⁵³

Solidifying Support - the 1970s

If the politics surrounding the ITC in the 1960s (weak support or indifference from business, hostility from liberals and technocrats, frequent threats of elimination) had continued through the 1970s and 1980s, the credit's eventual, final repeal would not have been a puzzle at all. The politics of the ITC were to change fundamentally in the 1970s, however, as support for the credit began to coalesce both in and out of government.

President Nixon proposed reinstatement of the ITC at 10 percent (with reductions to 5 percent in subsequent years) in 1971, in response to a flagging economy, as part of what would become the Tax Reduction Act of 1971. Nixon's Treasury Secretary John Connally argued before the House Ways and Means Committee that "The investment

⁵² CQ Almanac 1966, page 726.

⁵³ In September, the Senate Finance Committee attempted to split ITC repeal from their tax reform bill to attach it to a faster-moving measure to address business' concerns about uncertainty. (*CQ Almanac*, 1969, page 615)

credit can create hundreds of thousands of jobs as American industry becomes a more vigorous competitor in future years.”⁵⁴ This established the ITC as more than a Kennedy Administration brainchild - the idea of stimulating the economy through a credit for capital investment had taken hold politically.

Testimony before House Ways and Means and Senate Finance illustrated the extent to which the politics of the ITC had also changed outside of government. Support for the proposed reinstatement was universal among business witnesses at the year's relevant hearings. Representatives of heavy industries that stood to benefit (e.g., railroads, mining) spoke in support (even forming an “Ad Hoc Committee for an Effective Investment Tax Credit”), while representatives of other sectors spoke not against reinstatement of the credit, but in favor of reinstatement with more generous and inclusive terms.⁵⁵ Opposition to the ITC now came only from policy experts (Keyserling, former OMB Director George Schultz, and various economists), the AFL-CIO, and Ralph Nader’s Public Interest Research Group.⁵⁶ The difference between this outpouring of support and solicitude and the cold reception the Kennedy Administration encountered ten years before could not have been starker. The path through Congress was less contentious as well, though both chambers eventually agreed on a flat seven percent maximum credit, which became law.

The 1971 bill established a political pattern for the ITC that would endure for at least the next decade, defined by the following: 1.) consensus within government that the

⁵⁴ *CQ Almanac*, 1971, page 435.

⁵⁵ Wholesaler-distributors wanted the ITC to apply to inventories, users and manufacturers of imported equipment wanted the existing prohibition on imports to be removed, realtors wanted the ITC extended to buildings, and so on.

⁵⁶ *CQ Almanac*, 1971, pages 435-440 and 441-445.

ITC was good for the economy, 2.) strong support from relevant heavy industries,⁵⁷ 3.) attempts to address the unequal effects of the policy through greater generosity rather than repeal or reform,⁵⁸ and 4.) outright opposition mostly confined to would-be tax reformers, whose influence was on the wane compared to 1969.

Underscoring the solidifying bipartisan consensus on the ITC, poor economic conditions led Presidents Ford and Carter to support expansions of the credit, and Congress was mostly obliging (though neither president got exactly what he wanted). Most notably, the maximum credit was raised to 10 percent under Ford, and that expansion was later made permanent.

The High Water Mark for "Capital Formation" - The Reagan tax cut and the early 1980s

Ronald Reagan came into office on a wave of anti-tax sentiment, and the massive tax reduction bill his administration worked to shepherd through Congress in 1981 (the Economic Recovery Tax Act, or ERTA) was certainly the most significant achievement of his first term. While Reagan's top priority with regard to tax reduction was and would always be lower rates (paying top marginal rates above 90 percent during his acting career was a formative political experience), the president, his associates, and his allies in Congress were friends to business. And while targeted tax incentives were never a

⁵⁷ This included the formation of the "Carlton Group," a regular meeting of heavy-industry lobbyists headed by former Treasury Under Secretary Charls Walker.

⁵⁸ Notably, Senate floor consideration of the 1977 tax bill included an amendment from Senator Edward Kennedy (D-MA) to make the ITC refundable for firms whose profits were either nonexistent or not large enough to benefit from the credit. While the amendment failed, it signaled an important priority for Democrats with regard to the ITC: making the credit available to failing rust-belt firms who owed too little tax to claim it under current law.

consensus plank of the supply-side economics platform⁵⁹, they were at least compatible with the supply-side belief that capitalism would flourish when capitalists had more money in their pockets. The context of the ERTA was one of potential gains for interest groups without offsetting losses to others or to the public at large, at least in any immediate sense; in this context, the fact that the tax code already favored heavy industry was not particularly relevant. The ERTA was a major opportunity for heavy industry lobbyists, and they made the most of it.

The ITC was expanded somewhat in the 1981 bill, but the most relevant changes involved two related provisions. The first was the generous new rules for depreciation of capital investments proposed by the Reagan Administration and known as the Accelerated Cost Recovery System (ACRS), or, colloquially, “10-5-3” for the greatly simplified depreciation schedules it established. This provision, the brainchild of the “Carlton Group” of heavy industry lobbyists, amounted to a generous new subsidy, and it was applied to investments that already benefited from the up-front subsidy of the ITC. Moreover, the ITC itself was liberalized, allowing five year equipment to receive the maximum 10 percent credit.⁶⁰ In a May, 1981 *New York Times* op-ed, two Harvard economists noted that the combination of the enlarged ITC and the ACRS could lead in many cases to a *negative* tax rate on many capital investments, meaning firms or

⁵⁹ David Stockman, Reagan’s first OMB Director and a supply-side purist, disdained tax subsidies, but his attempt to convince the Reagan Administration to go after corporate tax subsidies as vigorously as it did liberal welfare state programs (“attack weak claims, not just weak clients”) was unsuccessful in the early 1980s. Stockman derided the 1981 bill as “decked out with tax breaks for failing industries.” (David Stockman, 1986, *The Triumph of Politics: How the Reagan Revolution Failed*, New York: Harper and Row, pages 126 and 234)

⁶⁰ ITC rules limited the amount of credit that could be claimed based on the depreciation schedule of the equipment, though these rules were changed many times.

individuals would be able to use the benefits to shelter other income from taxation.⁶¹

While awareness of this impact of the law may not have fully dawned on every legislator, it was not an unforeseen mistake. The whole point of the capital investment provisions of ERTA was to provide generous subsidies to heavy industry, and this is what they did. Public-interest concerns did not carry the weight they might have in other contexts. The framing of the ERTA was such that heavy industry's gains imposed no immediately apparent losses on the public.

The second major provision related to the ITC in the bill was so-called "safe-harbor leasing." It offers an illustration of the importance of legislative context in microcosm. One exception to the House bill's acceptance of Reagan's proposals was an ITC refundability provision similar to the one Sen. Edward Kennedy had proposed in 1977 to aid firms with low or no profits. In short, the overall generosity of the Reagan White House's proposals had begotten more generosity from legislators. ITC refundability was good politics for rust-belt Democrats, but Republicans cringed at the idea of large companies receiving cash checks from the Treasury. Still, there was little impetus among legislators to say "no" in the ERTA process. The conferees devised a work-around that they mistakenly thought would avoid a potential scandal: safe-harbor leasing. Under this new provision, derisively referred to as "lease-a-tax-break"⁶² companies unable to use ITC or ACRS benefits due to low tax liability would be allowed to effectively sell them to other companies more in need of tax relief.

⁶¹ Dale W. Jorgenson and Peter Navarro, May 5, 1981, "10-5-3: Deeply Flawed," *New York Times*.

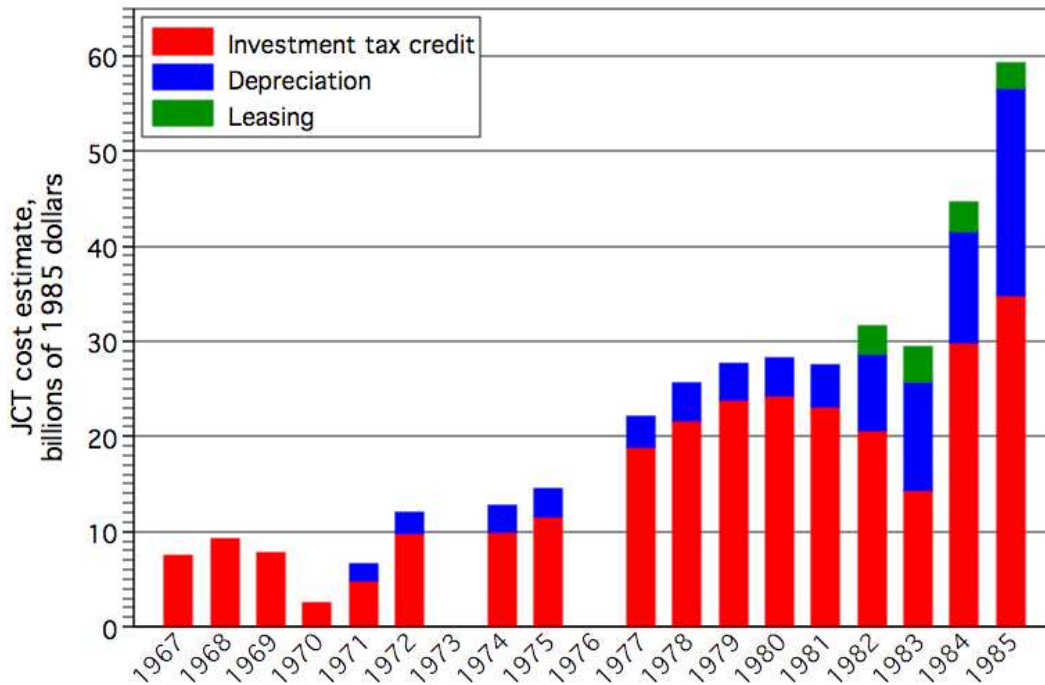
⁶² See Birnbaum and Murray, page 11.

In the end, the ERTA was quite simply a bonanza for capital-intensive industries. Figure 3.1 displays the Joint Committee on Taxation staff “cost” estimates of the tax code’s subsidies for capital equipment from 1967 through 1985⁶³ in constant 1985 dollars. Double subsidization began with the “Asset Depreciation Range” rules in the early 1970s, but clearly exploded following the establishment of the ACRS in 1981. At the same time, extension of ITC and ACRS benefits to previously ineligible firms through leasing added a small but significant cost to both provisions. The added cost of ACRS and leasing was so large that it mostly canceled out the dip in the ITC’s cost resulting from the rate reductions of 1978 and 1981.⁶⁴

⁶³ Many caveats apply when using estimates of a tax expenditure’s cost, but the JCT estimates are regarded as objective and a reasonable indicator of provisions’ scale.

⁶⁴ The 1978 bill dropped the corporate rate from 48 percent to 46 percent, while the 1981 bill dropped the top individual rate from 70 percent to 50 percent. Tax expenditures lose less revenue when rates are lowered, even if the tax expenditure provision itself is untouched.

Figure 3.1. U.S. Income Tax Subsidies for Capital Investment, 1967-1985.



The optics of the leasing provision proved to be far worse for perceptions of the tax code than their actual cost. In the first major lease deal announced late in 1981, IBM purchased Ford Motor Company’s unused ITC and depreciation benefits for between \$100 and 200 million.⁶⁵ While Ford legitimately lacked the profits to claim these benefits, a paper transaction shifting hundreds of millions of dollars in tax preferences between the #6 and #8 companies on the 1981 *Fortune* 500 list did not further equity goals in the eyes of critics. Similar deals followed involving massive firms like Global Marine, Hilton Hotels, and Occidental Petroleum.⁶⁶ A November 1981 *New York Times* article noted that “smaller companies and those that are financially weak have so far been less active sellers of unneeded tax benefits than larger and more profitable companies

⁶⁵ Barnaby Feder, November 6, 1981, “Ford to Sell Tax Credits to IBM,” *New York Times*.

⁶⁶ Birnbaum and Murray, page 11.

with excess tax shelters.”⁶⁷ A *Times* editorial followed in January, labeling leasing “the equitable tax gimmick” and decrying “tax incentives so generous that too many companies have excess benefits to sell.”⁶⁸ The belt-tightening Tax Equity and Fiscal Responsibility Act of 1982 essentially put a stop to new lease deals, but in many ways the public relations damage had been done.⁶⁹ As the *Times* editorial said, the issue was not leasing per se but a tax system that had become unacceptably generous to some large firms.

The public interest group Citizens for Tax Justice, headed by Nader disciple Robert McIntyre, drove this point home with their bombshell 1984 report on corporate taxation in the Reagan years. The report argued that the “demise of the corporate income tax” brought to fruition in 1981 “began with the adoption of the investment tax credit in the 1960s and continued into the 70s as Congress adopted one new loophole after another in response to corporate lobbyists.”⁷⁰ The report estimated that 128 of the 250 major, profitable corporations it examined either paid no income taxes or received tax money back (through carry-forward rebates or leasing) in at least one year between 1981 and

⁶⁷ Leslie Wayne, November 17, 1981, “Tax Leasing Aiding Bigger Companies,” *New York Times*

⁶⁸ Editorial, January 4, 1981, “The Equitable Tax Gimmick,” *New York Times*.

⁶⁹ Leasing arrangements whereby untaxed public entities could purchase tax benefits from corporations continued. The 1982 law also partially reinstated an old rule from the original ITC to slightly reduce the double subsidy with depreciation benefits. The rule required taxpayers to reduce the basis of depreciated property by 50 percent of their ITC benefit. For example, a firm claiming a \$1000 ITC benefit on a \$10,000 investment would only be allowed to depreciate \$9500 of the investment.

⁷⁰ Robert S. McIntyre and Robert Folen, October 1984, *Corporate Income Taxes in the Reagan Years: A Study of Three Years of Legalized Tax Avoidance*. Citizens for Tax Justice, page 1.

1983.⁷¹ Perceived abuses like these helped legitimize the first true tax reform effort since 1969, and the largest such effort since the establishment of the income tax itself.

Skepticism was also growing about the desirability of the incentives' effects. For one thing, they led to vastly different effective tax rates for different industries and different assets. For example, Steurle estimates that the effective tax rate on investments in equipment was 11 percent, compared to 38 percent for structures and 58 percent for inventories.⁷² At the same time, despite the provisions' obvious generosity, there were questions about whether the provisions were really having the desired effect at all. Critics, including Citizens for Tax Justice, charged that they did not actually lead to real increases in capital investment.⁷³

Tax Reform and the ITC

The road to the 1986 tax reform began four years earlier with the release of Sen. Bill Bradley (D-NJ) and Rep. Richard Gephardt's (D-MO) Fair Tax Act proposal ("Bradley-Gephardt"). The plan, largely the brainchild of Bradley and the tax experts he consulted, proposed repeal of the ITC and large cutbacks in accelerated depreciation, as well as many other corporate and individual loophole-closings. The savings were to be plowed back into greatly reduced rates, including a corporate rate of 30% (slashing the existing top rate by more than a third). This zero-sum trade-off of closed loopholes for

⁷¹ Similar horror stories abounded on the individual side of the tax code, where tax sheltering was rampant. Though capital equipment was never as popular an avenue for sheltering individual income as real estate, the combination of the ITC and accelerated depreciation was still frequently used for this purpose.

⁷² Steurle 1992, Table 8.2.

⁷³ McIntyre and Tipps, 1985; see also Gary Klott, July 5, 1985, "How '81 Tax Incentives Have Affected Investing," *New York Times*; and Benjamin Friedman, July 7, 1985, "Did Reagan's 1981 Tax Incentives Work? the Vaunted Investment 'Boom' is a Bust," *New York Times*.

low rates was the political centerpiece of Bradley's vision; he was convinced the plan would fail if it sought to use revenue-raising provisions to reduce the deficit (i.e., increase net taxes), and the whole idea of reform would have been undermined by a plan that increased the deficit. The principle of revenue neutrality was arguably Bradley-Gephardt's most important legacy, more than any particular provision. Revenue neutrality made reform politically viable and gave it the potential for bipartisan support. It also created a context in which policymakers' choices would be radically different than they had been in 1981, even though many of the principle players were the same.

This change in context spelled doom for the ITC. With estimated cost projections in excess of \$25 billion annually, the ITC was just too large a pot of money for any serious revenue-neutral reform effort to ignore. Moreover, revenue neutrality set the stage for large changes in the tax code by framing provisions like the ITC as *losses to other constituencies*. In 1982, 1983 and 1984, Congress successfully attacked the deficit with piecemeal measures (including the end of leasing and a very modest tightening of the ITC-ACRS interaction), but elimination or serious reduction a provision as large and well-supported as the ITC was not feasible in this type of environment. Without the constraint of revenue neutrality, the incentives to back radical reforms for firms treated unfairly under the status quo were weak at best, since such reforms would not guarantee lower rates.⁷⁴ Under Bradley-Gephardt and the plans that succeeded it, a credible commitment to this constraint was essential to securing the limited but significant corporate support the plan would enjoy.

⁷⁴ See White and Wildavsky 1989, page 502, on how revenue neutrality made the politics of this effort qualitatively different from deficit reduction efforts.

The next important stage in the tax reform process was the release of a reform plan by supply-side Republicans Rep. Jack Kemp (R-NY) and Sen. Robert Kasten (R-WI) in April of 1984. While the Kemp-Kasten plan certainly had a conservative flavor and would have added to the deficit, it was nonetheless a bold reform proposal that helped to build the bipartisan alliances that would be essential to reform's success.⁷⁵ It was also a harbinger of the way conservatives would approach tax reform: it proposed sparing the ACRS but fully repealing the ITC.

Meanwhile, Reagan's advisors feared that the eventual Democratic nominee in 1984 might be able to outmaneuver him on the tax reform issue,⁷⁶ and of course the president himself shared Kemp's relentless enthusiasm for lower rates. This led Reagan to request a reform plan from the Treasury Department (then headed by Donald Regan) in his January, 1984 State of the Union address. The plan that Treasury would release in late November of 1984 (dubbed "Treasury I") stunned Washington and the business community. The plan, which Regan told Treasury's tax experts to prepare without regard for politics, proposed the elimination of almost every significant tax expenditure on the corporate side, the ITC and ACRS included, and many on the individual side as well.

⁷⁵ Bradley himself was pleased at the efforts of Kemp and his circle, and communicated with them regularly through Jeff Bell, his former opponent from the 1978 New Jersey senatorial race and a Kemp confidante. (Birnbaum and Murray 1987, page 36)

⁷⁶ While both Gary Hart and eventual nominee Walter Mondale endorsed Bradley-Gephardt, tax reform did not end up being a talking point of the campaign. Mondale, like many Democrats at the time, saw deficit reduction as a more important fiscal priority than reform, and did not relish a fight with interest groups that could be helpful to his campaign. (Birnbaum and Murray 1987, pages 33-36)

Instant hostility from the business community⁷⁷ and an unenthusiastic response from the Reagan White House⁷⁸ led some to declare the plan dead on arrival.

While it was true that Treasury I was never to be seriously considered as legislation in its original form, it did set the agenda for what would follow. Using Treasury I as a blueprint, new Treasury Secretary James Baker III (formerly the White House Chief of Staff, he swapped jobs with Regan in early 1985) began work on a plan that would bear Reagan's personal stamp of approval, Treasury II. Baker's charge was to create a politically viable plan, and he was an experienced political operator well-versed in making deals. Whether ITC repeal and accelerated depreciation would stay in the plan was in doubt - a January 8 *New York Times* article reported that the White House would accept Treasury I's repeal of ITC but retain accelerated depreciation in some form,⁷⁹ while a January 12 piece on Baker's confirmation hearings speculated that he would fight the repeal of both the ITC and ACRS⁸⁰, and a January 23 article on the economy referenced "the near-certain belief that President Reagan will not accept elimination of the investment tax credits and the accelerated depreciation allowances."⁸¹ The Reagan Administration's economic report, released the following month, credited the ERTA tax incentives with helping to spur the economic recovery and seemed to cast doubt on the possibility of significant changes to capital equipment provisions.⁸²

⁷⁷ Jeff Gerth, November 29, 1984 "Arousing Powerful Interests," *New York Times*.

⁷⁸ David Rosenbaum, November 28, 1984, "Treasury Offers Sweeping Revision of U.S. Tax System," *New York Times*.

⁷⁹ David Rosenbaum, January 8, 1985, "Tax Plan Revisions Worked On," *New York Times*.

⁸⁰ Financial Desk, January 12, 1985, "Baker's Texas Philosophy," *New York Times*.

⁸¹ Peter Kilborn, January 23, 1985, "An Unconventional Recovery," *New York Times*.

⁸² White House, 1985, *Economic Report of the President*, Washington: Government Printing Office, page 31.

These doubts proved to be misplaced. While Treasury II preserved much of the accelerated depreciation loophole, it followed Treasury I in supporting full repeal of the ITC. In fact, Baker and Deputy Secretary Richard Darman reportedly had little interest in salvaging the credit even in reduced form.⁸³ While they heard from powerful firms like GE⁸⁴ and Dupont, as well as from the National Association of Manufacturers,⁸⁵ preserving the provision simply did not make sense in the context of what Baker and Darman were trying to accomplish. As Steuerle later argued, “The principles of tax reform required that the effective tax rate on income from all assets be made more equal by either amending or abandoning the investment credit...Elimination, not merely reform, of the investment credit quickly became necessary to finance the rate reductions that were to apply to the corporate sector.”⁸⁶ An anonymous Republican aid quoted by Conlan, Wrightson and Beam (1990, 96) concurred, remarking that “The Lord Himself could have come down and lobbied for the ITC and it wouldn’t have made any difference,” since elimination was so crucial to rate reduction in the revenue neutral context.

Thus, even though Bill Bradley played no direct part in the Republican Treasury Department’s decision-making processes, the context of revenue neutrality that he had successfully created proved to be decisive for their thinking about the ITC. With the playing field defined this way, relevant policy makers not only felt that they had to eliminate the ITC, they felt free to ignore resistance. This pattern would continue

⁸³ Birnbaum and Murray 1987, page 79.

⁸⁴ See Thomas Lueck, May 5, 1985, “Why Jack Welch is Changing G.E.,” *New York Times*.

⁸⁵ See Steven Greenhouse, May 26, 1985, “New Threat to Smokestack America,” *New York Times*.

⁸⁶ Steuerle 1992, page 112.

through the congressional process. The wealthy firms that favored the ITC fought hard to preserve it, paying hundreds of thousands of dollars to lobbyists like Charls Walker, taking out full-page newspaper ads blasting reform, and hiring economists like Martin Feldstein of the National Bureau of Economic Research to argue their case.⁸⁷ To say these pleas fell on deaf ears would be an understatement. Not only was ITC repeal included in every relevant version of the tax reform bill in both chambers of Congress, the provision was never a sticking point in its progress.⁸⁸ The bill seemed doomed at numerous points over issues like oil and gas subsidies, business lunch deductions, and state and local tax deductions, but the ITC was never among the crucial issues, nor was any proposal to save the ITC ever offered as an accommodation.⁸⁹

During Senate Finance Chairman Bob Packwood's (R-OR) disastrous first attempt to produce a bill that pleased all of his committee members by inserting whatever special favors they asked into his original draft, ITC repeal always remained in the bill, though some committee members did express concern about the ITC. When the time came for public markups of the bill, Packwood remarked aloud, "I assume we're going to repeal

⁸⁷ See Conlan, Wrightson and Beam 1990, page 97.

⁸⁸ House Republicans - the least influential faction in the tax reform process, and thus the one freest to position-take without risking real blame for the failure of tax reform - did offer an alternative plan that would have preserved a reduced ITC, but it was not considered a serious document. When House Republicans staged a successful temporary mutiny against the bill in a procedural vote on the floor in December of 1985, President Reagan brought them back into the fold with a letter promising to veto any bill that did not meet certain criteria, but maintaining the ITC was not among them. (Birnbaum and Murray 1987, pages 170-171)

⁸⁹ The final bill did infamously contained an ITC refundability provision for steel companies, allowing unprofitable steel firms to claim an estimated \$500 million in unused benefits, but this was a one-time giveaway. Thus, rust-belt Democrats finally achieved their top priority for the ITC even as they participated in killing it.

the investment tax credit.” Literally not a word was spoken in response.⁹⁰ Later, when Packwood rebooted the effort with a much more radical and “clean” reform bill, he offered almost no specific proposals on the corporate side besides a rate cut and repeal of the ITC. Critics suggested he had dodged the tough corporate issues to get the bill through his famously pro-business committee, but he still proposed to close the largest corporate loophole in the history of the tax code.

Even on the wide-open Senate floor, there was little hope for the ITC. Legislative histories of major tax bills often contain a very familiar pattern: generous tax reduction provisions are added on the Senate floor via amendment and later stripped in conference. Packwood and his allies were successful in protecting the Finance Committee bill from most such amendments in 1986, but it is worth noting that out of over 100 amendments offered, not a single one would have preserved the ITC at any level. While ITC repeal had seemed a foregone conclusion for some time, now it was more or less official. Since both the House and the Senate bills contained repeal, it was not a conferenceable issue, and the conferees were unlikely to bend the rules to save a provision that had been so thoroughly repudiated at every stage of the process. The conference report, which contained ITC repeal, passed both chambers by wide margins, and Reagan happily signed the bill into law. Unlike in 1971, there would be no Lazarus moment; the investment tax credit for capital equipment was truly gone.

The remarkable thing is not so much that the ITC was repealed. As many participants in and observers of the 1986 tax reform process have attested, there were impressive and seemingly unstoppable forces at work. More than one policymaker

⁹⁰ Gary Klott, March 26, 1986, “Tax Panel Favors Faster Depreciation,” *New York Times*.

remarked that the effort seemed to have a life of its own, despite all of the roadblocks thrown in its way. This was an environment in which serious pain could be dealt out even to powerful interests. What is surprising was that the ITC's defeat was so sudden, so complete, and so total. Not just the final legislation, but all of the relevant plans, proposals and bills for tax reform (Bradley-Gephardt, Kemp-Kasten, Treasury I and II, the House bill and the Senate bill) eliminated the ITC completely. Even the irrelevant proposals offered by those friendlier to capital-heavy industries (the lesser-known Roth-Moore and Nickles-Siljander plans and the House Republican alternative to the Ways and Means bill) proposed to significantly reduce the ITC in some way. Though certain stages of the tax reform process (the crafting of Treasury II, the initial Finance Committee process) were notoriously political and accommodationist, no accommodation was made at any point to ITC supporters, and inclusion of ITC repeal did not threaten the enactment of tax reform at any point.

As these process observations make clear, the defeat of the ITC was a total and overwhelming defeat. Did this occur because heavy industry had lost clout since 1981? Did principle policymakers like Reagan, Baker, Rostenkowski and Packwood undergo some sort of conversion in the intervening five years that made them fundamentally revise their attitudes toward heavy industry and the investment credit in particular? Neither scenario seems likely. Instead, the most plausible explanation for the about-face on the ITC is that the specific context of the legislative effort itself required different justifications in 1986 than in 1981, and the assets that had served heavy industry well in 1981 (namely, lobbying clout) were largely irrelevant in 1986 given the key

characteristics of the underlying policy (namely, enormous fiscal cost, questionable effectiveness, and a symbolic association with the “smokestack” industries of the past).

History of the R&E Credit

Origins of the R&E Credit

Like the ITC, the R&E credit originated from a sense that tax policy needed to change in some way to cope with what was seen as the economic future. This time, the year was 1981, and Reagan’s aforementioned tax cut effort (the Economic Recovery Tax Act) was in full swing. The Reagan administration’s initial tax cut proposal did not include incentives for research and experimentation,⁹¹ but momentum behind the idea was building.

The idea of additional tax incentives for research and experimentation⁹² arose in response to growing anxiety about America’s competitive position in a global high-tech economy. A February 8 *New York Times* article notes that US research spending had declined as a percentage of total output since 1961, while it had risen considerably in nations like Japan and West Germany⁹³. This was troubling given the consensus that the future of the economy lay in high-technology fields like the computer industry rather than the “smokestack” industries favored by the ITC and ACRS. Moreover, high-tech companies (the semiconductor industry in particular) were able to make a credible argument in favor of government assistance since their international competitors were receiving protectionist support from their governments (especially Japan). In fact, the

⁹¹ Treasury Under Secretary Norman Ture was credited with keeping such “extraneous” matters out of the initial administration proposal. (Edward Cowen, “Architect of Reagan Tax Policy,” February 18, 1981, *New York Times*)

⁹² Investments in R&E were already expensable under existing law.

⁹³ Clyde Farnsworth, February 8, 1981, “Outlook: Locking Up Advanced Technologies,” *New York Times*.

Semiconductor Industry Association was persuaded not to file a petition for import protection in part because a former US deputy trade negotiator convinced the group that tax incentives for research were on the horizon.⁹⁴

The semiconductor industry was largely alone in its 1981 lobbying push, however. There was no equivalent of the Carlton Group advocating for new R&E subsidies on Capitol Hill, and the nascent high-tech sector was politically disorganized.⁹⁵ Nonetheless, support for a new tax credit, led by Rep. James Shannon (D-MA) and Sen. Bradley (who sponsored legislation creating such an incentive), was widespread. House Ways and Means Chairman Rostenkowski and Senate Finance Chairman Dole agreed on the inclusion of an R&E credit in both of their chamber's tax bills in an unusual May meeting.⁹⁶ The Reagan Administration followed suit in its revised proposal in June, which angered some business interests due to a reduction in the Administration's originally proposed cuts but included the new R&E credit. From that point, the path to enactment for the credit was smooth.

The original incarnation of the R&E credit reduced the tax liability of firms by 25 percent of new investment in research and development.⁹⁷ New investment was defined as an expenditure above the firm's three-year average expenditure. Since the tax code already allowed for the expensing of research and development expenditures, this was a generous up-front subsidy somewhat analogous to the combination of the ITC and

⁹⁴ Ibid.

⁹⁵ Melissa Brown, September 25, 1983, "High Tech's Quiet Push for Lower Taxes," *New York Times*.

⁹⁶ Edward Cowan, May 28, 1981, "Congress Narrows Gap on a Tax Bill," *New York Times*.

⁹⁷ While some supplies, contract research and basic research grants to entities like universities were included, wages for research personnel make up the majority of expenses covered by the credit.

ACRS, though confining it to increases above existing investment made it much more modest in size and seemed likely to prevent egregious abuses.⁹⁸ Importantly, the provision was scheduled to sunset at the end of 1985.

Consistent with my argument about a legislative context focused on gains for interest groups, it has often been remarked that the congressional process surrounding the 1981 bill was a “bidding war,”⁹⁹ with congressional Democrats and Republicans eager to outdo one another and the administration in terms of their generosity. The R&E credit certainly originated as one of these “yes, and” congressional additions to the bill. But while the metaphor of a bidding war may have been apt for some provisions, it does not seem to fit for the R&E credit. Politicians were certainly solicitous toward the high-tech sector, but not in exchange for any sort of crude political quid pro quo. Indeed, the political disorganization of the industry at the time made such a tradeoff impossible, at least in the near term. Instead, the relevant policymakers were anxious to aid an industry they saw as *economically* important to American competitiveness in the new economic reality. Of course, this should not detract from the overall character of the bill as extremely generous to interests who *were* politically powerful and active at the time.

The Early Years of the R&E Credit

The R&E Credit was either successful in stimulating investment in private-sector research or fortunate in its timing, because such investment took off in the early 1980s. Between 1980 and 1985, the National Science Foundation estimated that R&E spending

⁹⁸ See Karen Arenson, September 9, 1981, “Tax Shelters’ Changing Roles,” *New York Times*.

⁹⁹ Steuerle 1992, page 42.

rose 55 percent in the US¹⁰⁰. There was mixed evidence about the extent to which the credit was responsible for new investment¹⁰¹, and some concern about its use for purposes other than technological innovation, but nothing approaching the public relations nightmares of safe harbor leasing or tax shelters related to other parts of the tax code. Furthermore, the credit was relatively cheap, peaking at less than \$3 billion in FY 1985, less than one-eighth the cost of the ITC.¹⁰²

The continued growth in salience of high-tech fields and anxiety about foreign competition in those fields also served to create a favorable political environment for the credit. These trends are visible in Figure 3.2, which displays the total number of items dealing with the information technology and electronics industries in the *New York Times* from 1980 to 1986, as well as the number of those stories that made some reference to Japan.¹⁰³ The total number of stories more than doubled from 1,394 in 1980 to 3,807 in 1985, while the number of those stories referencing Japan more than tripled (from 172 to 580) over the same time period.

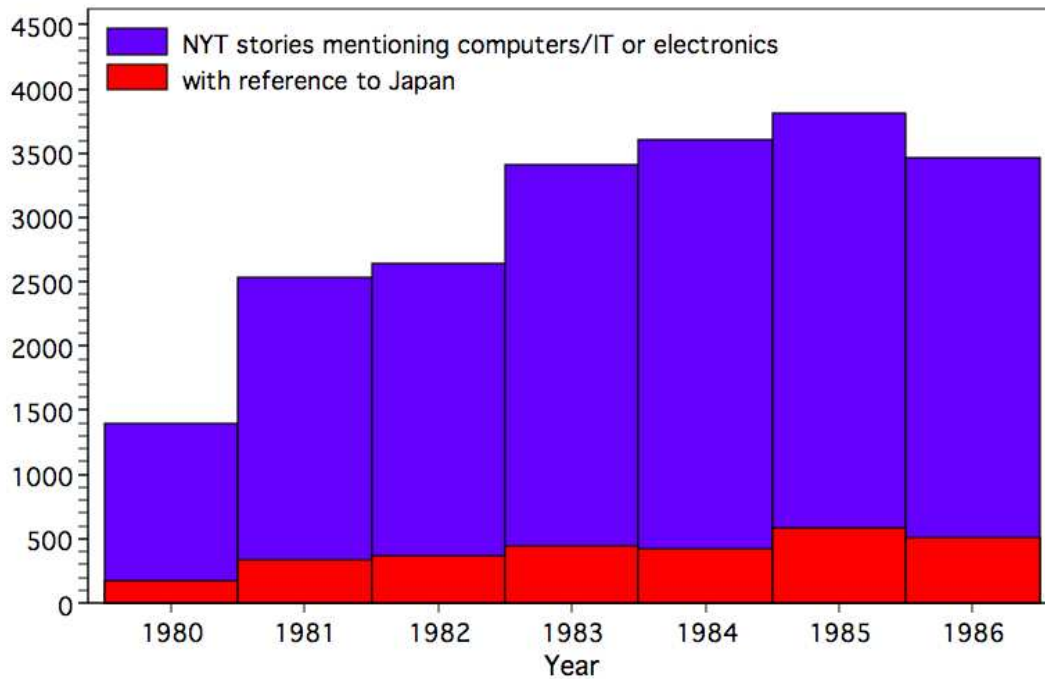
¹⁰⁰ Nicole Simmons, March 24, 1985, "The Market; Research and Development: A Record Pace," *New York Times*.

¹⁰¹ At an August 1984 House Ways and Means Committee hearing on the credit, Johnny Finch of the Government Accountability Office testified that his organization had surveyed 86 companies that had benefited from the credit and 30 admitted that they would have made the same research investments in the absence of the tax incentive. Whether a success rate of about 2/3 constituted an effective policy or not was in the eye of the beholder.

¹⁰² According to "outlay equivalent" estimates in the Office of Management and Budget's 1986 *Special Analysis*.

¹⁰³ These counts were obtained using the "computers & information technology" and "electronics" industry index terms in Lexis-Nexis. Similar trends are present for other major US publications over this time period.

Figure 3.2. *New York Times* Articles on High-Tech Industries, 1980-1986.



Meanwhile, the existence of the credit and its looming expiration date were enough to spur some meaningful political organizing in the high-tech sector. The Ad Hoc Electronic Tax Group was formed, bringing together four trade associations and 20 major companies. The sector was maturing politically, though its efforts still paled in comparison to the traditional economic powerhouses in politics. Paul Oosterhuis, an attorney for the group, speculated that “If we really tried to go toe-to-toe with the big guys it’s not clear how far we’d get.”¹⁰⁴ As such, the tech lobby kept its demands relatively low profile and modest.

Still, these efforts were successful in getting policymakers’ attention. Sen. John Danforth (R-MO), Finance Committee member and champion of the R&E Credit, said

¹⁰⁴ Melissa Brown, September 25, 1983, “High Tech’s Quiet Push for Lower Taxes,” *New York Times*.

that the new lobby was “touching a button that’s really very accessible to them.”¹⁰⁵ The high-tech sector was influential by virtue of *receptivity*, not brute force. The House Ways and Means Committee held a two-day hearing evaluating the credit in August of 1984, hearing positive testimony from a multitude of witnesses from high-tech companies (e.g., Apple Computers, Hewlett-Packard, Motorola) and related organizations (e.g., the National Machine Tool Builders Association, the Semiconductor Industry Association). A number of experts did testify expressing concerns about the effectiveness of the credit, however, including Acting Assistant Treasury Secretary of Tax Policy Ronald Pearlman (one of the leaders of the Treasury I process), Johnny Finch of the Government Accountability Office, and economists Robert Eisner (Northwestern University) and Joseph Cordes (George Washington University). These witnesses argued in favor of changes and a temporary rather than permanent extension of the credit, a position that gained traction in the eventual reform process because it was budget-friendly. The comparatively lukewarm (though not negative) reception to the credit from experts underscores the fact that symbolic understandings of “good” public policy (in this case, subsidies for high-tech innovation) need not always perfectly consonant with expert opinion.

Still, a movement to extend the credit beyond its scheduled sunset, or even make it permanent, was underway. Danforth and Shannon introduced legislation authorizing a permanent credit in 1983, garnering 160 cosponsors in the House and 19 in the Senate. Specific proposals even found their way into the 1984 Republican Party platform and Democratic nominee Walter Mondale’s presidential campaign platform.

¹⁰⁵ Ibid.

Tax Reform and the R&E Credit

In theory, then, the R&E credit was well-positioned to weather the coming storm of tax reform. Still, its survival was far from assured. Bill Bradley may have been one of the credit's original champions, but (perhaps to prove a point), he did not spare it in the original Bradley-Gephardt bill. The Kemp-Kasten proposal also would have eliminated the R&E credit, even as it maintained ACRS. Furthermore, the fact that the provision was scheduled to sunset put its future in doubt in an era when the deficit was spiraling out of control and closing loopholes (especially corporate loopholes) in the tax code became a bipartisan goal. Elimination of the R&E credit was "on the table" in the tax reform push.

The stage at which the credit was "saved" from elimination is telling. The November 1984 "Treasury I" proposal included a brief paragraph advocating the extension of the credit with changes to make it "available only for private research activities that are likely to lead to technological innovations."¹⁰⁶ It was not a ringing endorsement to be sure, but it was remarkable given the context. Treasury I was a deliberately audacious proposal constructed in secret, a display of contempt for tax politics. Its purpose was not to be enacted as-is, but to demonstrate to the political community what an ideal (or near-ideal) income tax system could look like *before* the politicians began the game of handing out concessions. The lukewarm paragraph sparing the R&E credit was tucked among hundreds of pages assailing the existing tax code for its inefficient and unjustified loopholes, and proposing that almost all of those loopholes

¹⁰⁶ *Tax Reform for Fairness, Simplicity and Economic Growth: The Treasury Department Report to the President*, 1984, Page 138.

be closed outright. In short, this was one of the very few punches that the Treasury tax team pulled. It is unlikely that they did so because they feared the Beltway muscle of the new Ad Hoc Electronic Tax Group, even as they staged a full frontal assault on manufacturing and oil companies.

As many observers of the 1986 process (e.g., White and Wildavsky 1989, 502) have noted, passage of the legislation was made possible in part by mobilizing sectors of the business community that stood to benefit - those with high effective tax rates under the status quo. This included high-tech as well as other sectors whose investments tended toward items other than heavy equipment or real estate (e.g., personnel, inventories, structures). This was the approach of the political operators close to Reagan, notably Baker and Darman, and it came later in the process after Baker traded jobs with Regan and brought Darman with him from the White House to Treasury. Indeed, at the point of the release of Treasury I, it was not clear whether Reagan or his political operatives wanted anything further to do with tax reform.¹⁰⁷ Thus, this political strategy is insufficient to explain the preservation of the R&E credit. The R&E credit was spared because it was consonant with the goals of a deficit-neutral, public interest reform effort; it fit into the *context* of what would become the 1986 tax reform.

While the survival of the R&E credit beyond 1985 seems to have been more or less assured since the release of Treasury I, the provision was not totally exempt from the reformist spirit. The House Ways and Means Committee took seriously the Treasury's recommendations to tighten the credit. The House bill ended up reducing the credit from 25 to 20 percent and inserting language to confine the credit to "research that is

¹⁰⁷ See Birnbaum and Murray 1987, page 72.

technological in nature.” Moreover, the credit was only extended for three years rather than made permanent, as some proponents hoped. On the positive side for the high tech sector, the benefits for investing in contracts or grants with other entities (such as universities) were made more generous.¹⁰⁸

On the Senate side, Finance Chairman Packwood granted Danforth a permanent extension of the R&E credit as part of his early, failed push to build support for the tax reform measure.¹⁰⁹ This was the closest the high-tech sector came to a permanent credit, as the Senate bill ended up with only a four-year extension after Packwood’s April 1986 reboot of the process. Senate conferees later dropped their position to three years after learning that new revenue estimates put the Senate bill \$21 billion short of revenue neutrality, necessitating a round of belt-tightening in the Senate proposals.¹¹⁰

Thus, the 1986 Tax Reform Act included a three-year extension of the now somewhat less generous R&E credit. Since that time, the R&E credit has been renewed numerous times, and remains in effect today, an accepted and all-but-permanent part of the US Tax Code.

Conclusion

How could a provision like the ITC that had formed a centerpiece of economic policy for multiple presidents of both parties and become a bonanza for so many powerful companies die such a quiet death? The question is not just why beneficiaries of the ITC failed to protect the credit from elimination, but why they failed to mobilize any

¹⁰⁸ *CQ Almanac*, 1985, page 484; see also *CQ Almanac*, 1986, page 502.

¹⁰⁹ Gary Klott, March 17, 1986, “Regan Asks Shift in Senate Tax Plan,” *New York Times*.

¹¹⁰ David E. Rosenbaum, July 27, 1986, “Senate Conferees Vote Tax Changes To Meet Shortfall,” *New York Times*.

policymaker of consequence in defense of their cause, while the R&E Credit was preserved with a minimum of effort and drama.

Table 3.1 summarizes my historical findings in the form of answers to my stated questions. These answers largely militate in favor of the hypothesis that Congress' decisions on these two provisions was largely a product of the strength of their policy justifications (both on a symbolic and a technical level) in a context of public-spirited reform.

Table 3.1. Summary of findings on the ITC and R&E Credit in the Tax Reform Act of 1986.

	ITC	R&E Credit
What led Congress to create the provision?	Kennedy Administration ideas about spurring investment.	Desire among many legislators to make the tax code more favorable to the industries of the future.
What did the provision cost?	\$25.6 billion in FY 1985 (OMB Special Analysis, 1986); the largest corporate tax break at the time.	\$2.8 billion in FY 1985 (OMB Special Analysis, 1986)
How did relevant experts and observers view the policy?	Skeptical about positive effects; concerned about tax code's bias toward heavy industry; critical of tax shelters, leasing, and low effective corporate tax rates	Largely positively; some skepticism about its relationship with actual investment and technological innovation; cognizant that the tax code was tilted against the high-tech sector
To what extent were these views reflected in the statements and actions of policymakers?	Extensively - tax reform itself was largely predicated on repeal of the ITC; no relevant policymakers attempted to save the credit	Extensively - the policymaking community accepted the normative proposition that the high-tech sector needed better tax treatment.
What sectors benefited and how powerful/active were they?	Heavy industry: railroads, coal, manufacturing, etc. The traditional core of the economy; highly active in terms of campaign contributions and lobbying efforts like the Carlton Group	The "high-tech" sector: computer software and hardware, semiconductors, etc. New to politics; campaign and lobbying involvement was very modest and disorganized, at least at first.
What was the final decision and how was it made?	Repealed. Decision was initially made in the original Bradley-Gephardt proposal and affirmed in every relevant subsequent proposal and bill.	Preserved with some tightening. Decision was initially made in the Treasury I plan and affirmed in both the House and Senate legislation.

In the case of the ITC, the provision simply could not be justified in the context of revenue-neutral tax reform. First, its revenue costs were remarkably high and revenue

neutrality (an important aspect of the reform context) put ITC supporters on the defensive from the beginning. As Assistant Treasury Secretary Manuel Johnson (quoted in Conlan, Beam and Wrightson 1995, 125) remarked, “The whole strategy was to create a zero sum game between special interests and the average taxpayer.” Second, it was a tax break for a sector that was now generously subsidized through another tax break (accelerated depreciation, which survived the reform process), making the burden for justification that much higher. Third, while some economists praised its effects, there was no consensus that it actually encouraged the types of investments it was supposed to, or that such huge subsidies for heavy industry (as opposed to high-tech or service industries) were economically desirable given the direction the world economy seemed to be taking. Moreover, expert support tended to come from sources, like Martin Feldstein, that were on the payroll of the affected industries. Fourth, if the ITC was difficult to justify objectively, it was even more difficult to justify symbolically. A cash-equivalent credit to large and profitable firms was bad enough, but the idea of such firms paying zero or even negative tax rates, of wealthy individuals using the credit to shelter their income, and of companies buying and selling the credits through safe-harbor leasing were arguably fatal to the status quo treatment of capital investment.

By contrast, supporters of the R&E Credit were in a strong position even in the context of tax reform. One of the major goals of tax reform was to reduce the vast differences in the effective tax rates of industries under the status quo, and the high-tech sector (like other personnel-intensive sectors) was a relative loser under the status quo. Moreover, despite the double subsidy with expensing of research expenditures, the benefit of the credit was a modest one in terms of revenue and created minimal

opportunities for abuse. Objections that it was used for some purposes other than technological innovation (e.g., market research) were rather easy to address with modifications. Perhaps most importantly of all, subsidies for research and innovation acquired an overwhelmingly positive valence in the early 1980s, aided by consensus that computers and other high-tech products were the future of the economy and growing concern about competitor nations like Japan. As an anonymous Reagan Administration official remarked to a reporter in 1984, “There is momentum for high technology; it’s evil to be against high technology.”¹¹¹ Champions of subsidies for the “smokestack” industries were never able to claim such heady moral high ground.

This explanation fits the stories of the ITC and the R&E Credit more closely than the competing explanation of tax politics based on interest group influence. Interest group politics are important to the history of the ITC, but they clearly do not tell the whole story. The relevant interest (heavy industry) was largely indifferent and even hostile to the Kennedy Administration proposal in the first place; its adoption was the product of ideas about economic stimulus, not group pressure. Group pressure grew in importance in the 1970s and 1980s with the rise of the Carlton Group, but this formerly powerful lobby found itself entirely excluded from the tax reform process, at least as far as the ITC was concerned. Again, ideas (in this case, the principals and values of tax reform) were more relevant than interests.

In the case of the R&E Credit, organized interests were, again, largely absent at the stage of creation. By the time the tax reform process was underway a few years later, the high-tech sector had coalesced and pursued a cohesive (and obviously successful)

¹¹¹ Jeff Gerth, November 30, 1984, “Tax Credit Plan Implies Shift to Assist High Technology,” *New York Times*.

strategy. But the credit was more or less saved from elimination at a stage (Treasury I) when interest group influence is an implausible explanation. In fact, even the notion that the credit was saved at this stage to preempt organized opposition to the plan is unlikely, since the political operators who favored such a strategy were not involved at the Treasury I stage.

Given that my hypotheses rest in part on a conception of public *interest*, it is appropriate to address the role of public *opinion* in the story of these two policies. Public opinion is a part of the story, but a poor explanation in and of itself for the outcomes of interest. The public's policy liberalism was at unremarkable levels in 1985 and 1986¹¹², and public and media attention to macroeconomic issues was actually on the wane.¹¹³ Moreover, specific polling found public support for tax reform to be weak.¹¹⁴ The public was not *demanding* tax reform in any sense, and they certainly were not demanding the repeal of a specific provision dealing with arcane matters of capital investment, or the retention of a specific subsidy for research and experimentation. The public was important to this story insofar as they were *receptive* to reformist messages and ideas from elites, from Citizens for Tax Justice to President Reagan. The public did not force its way into the tax reform debate, but key actors *brought* it in, just as Schattschneider and Mettler prescribe. Once this occurred, real constraints were set on key policymakers; their overriding concern became avoiding blame (as per Weaver) for failing to move the

¹¹² The policy mood indicator developed by Stimson et al (2004) shows liberalism scores of 55.59 in 1985 and 56.75 in 1986, below the historical mean of 58.63 but within one standard deviation. (Source: http://www.unc.edu/~cogginse/Policy_Mood.html)

¹¹³ According to Gallup's Most Important Problem survey question and *New York Times* coverage of macroeconomic issues. (Source: Policy Agendas Project, <http://www.policyagendas.org/>)

¹¹⁴ See Birnbaum and Murray 1987, page 285.

reform effort along. Repealing the ITC was crucial to doing so, while retention of the R&E credit was arguably consistent with at least some of the goals of the legislation.

It is clear from this analysis that the 1986 tax reform represented a rare, but not necessarily unique, American political moment. The larger political environment was not especially conducive to public interest tax reform - again, trends in public opinion and media coverage were not especially promising, and most of the same key decision-makers from 1981 remained in place. What was different was the framing of the legislative effort itself. The commitment to deficit neutrality, combined with a relentless focus on what the public and larger business community was *losing* under the extant tax code, served to set a context in which decision-makers could only avoid blame if they could offer plausible public interest justifications for their decisions.

The lessons of this study are especially relevant today, as partisan leaders from President Barack Obama to Rep. Paul Ryan (R-WI) discuss “tax reform” as a policy prescription and a political opportunity.¹¹⁵ While Democrats and Republicans are sharply divided on policy goals, the consensus over the need to do *something* about the tax code may yet create the opportunity for legislative progress in this area. The present study underscores the importance of the framing of such an effort to the actual policy decisions that will be made. An effort framed as a chance for gain - for tax reductions for either or both parties’ favored constituencies - will structure the political landscape in favor of particularistic lobbying. One that starts from the standpoint of public interest justifications, emphasizing the *losses* to most citizens or corporations (or to economic

¹¹⁵ See Whitehouse.gov, “Reforming the Tax Code,” (<http://www.whitehouse.gov/economy/reform/tax-reform>) and Paul Ryan, “Tax Reform and Economic Growth” (<http://paulryan.house.gov/top5issues/treg.htm#.Um715JSgnfl>).

efficiency) that result from tax preferences will likely be more successful in structuring the debate on terms favorable to the elimination of dubious tax breaks.

Conclusion

This paper makes an original contribution by using an in-depth historical approach to explain the post-enactment politics of two specific tax breaks, as opposed to an entire reform effort. While only two cases, the ITC and R&E Credit demonstrate the importance of context and of policy justification to a complete understanding of the politics of tax expenditures. Future case studies will seek to test these arguments further by examining legislative efforts aside from the 1986 tax reform and focusing on tax provisions that provide more variation in the independent variables of interest (interest group support and policy justification).

Chapter 4: Public Opinion, Policy Tools, and Policy Feedbacks: Evidence from a Survey Experiment

In recent decades, public policy benefits in the United States have often been delivered indirectly (Kettl 1988; Howard 1997, 2007, 2009; Milward and Provan 2000; Salamon 2002; Hacker 2002; Mettler 2010, 2011; Morgan and Campbell 2011; and Faricy 2011). Most notably, the tax code has become a preferred mechanism of delivery for policymakers across the political spectrum: Tax breaks (or tax expenditures), which are functionally equivalent to federal spending, have often replaced more traditional policy tools such as direct cash assistance. This trend has important and far-reaching implications for the distribution of benefits (Surrey 1970, Howard 1997, Hacker 2002, Faricy 2011, Mettler 2011), the effectiveness and accountability of government (Surrey 1970, Kettl 1988, Kleinbard 2010), and for citizens' ability to understand what government is doing (Toder 2000; Mettler 2010, 2011). Despite the magnitude and importance of this trend, political scientists and other scholars are just beginning to explore underlying political dynamics. Why do policymakers choose indirect over direct transmission of public policy benefits? And what are the consequences of such choices for subsequent politics and policymaking?

In this study, we use survey experiments to answer these questions. We find that Americans prefer indirect policy interventions (specifically tax expenditures) to direct ones across three different policy areas, suggesting that the public's greater receptivity to such interventions helps to drive their growth. This pattern is especially pronounced among conservatives, but extends to liberals in two of the three policy areas. In addition,

we demonstrate that the design of existing policies helps to shape public support for indirect policymaking. Citizens show the greatest preference for delivery of benefits through the tax code in cases where such programs are well established and accepted as a policy tool. In situations in which direct government delivery of benefits is common, the public is less enthused about delivery of benefits through the tax code, while preferences over policy design fall in between the two extremes for novel or unfamiliar programs. The results offer insight into both the causes and consequences of the growth of indirect policymaking, and contribute to the literature on policy feedback within the mass public.

Public Opinion and Indirect Governance

Many scholars have observed that economic and social policy in the U.S. has undergone a marked shift away from direct governance in the last several decades. By direct governance, we mean the provision of services directly to citizens by government employees or direct cash payments from the government to citizens. Lowi (1969), Kettl (1988), Salamon (2002), Hacker (2002), and Morgan and Campbell (2011) all note the extent to which the American state has grown to rely on private entities to provide services, with the result that the line between the state and organized interests has blurred. Lowi famously calls this phenomenon “interest group liberalism.” The work of Howard (1997, 2007, 2009) focused on a related trend: the shift toward making policy, particularly social welfare policy, through the tax code. U.S. income tax law is positively riddled with so-called tax expenditures – credits, deductions, and other exceptions to the general income tax rates that subsidize certain behaviors, investments, individuals and

entities. Taken together, they represent a huge portion of the federal budget (\$1.1 trillion in FY 2014, according to an estimate by Gravelle and Hungerford [2012]), and, as Howard argues, a significant part of the American welfare state.

Howard (1997, 2007, 2009), Hacker (2002) and Mettler (2010, 2011) all offer explanations for the growth of the “hidden” or “submerged” welfare state that rely on arguments about public opinion. Howard (2009, 96-97) argues that tax expenditures offered both Republicans and Democrats a means of addressing social and economic problems that was more acceptable to key constituencies (conservatives and moderates) than traditional welfare state spending, which has generally been associated with New Deal and Great Society liberalism.¹¹⁶ Hacker (2002, 43) and Mettler (2011, 27) argue that indirect interventions have been politically successful because their opaque design obscures from the public “what is at stake,” in Mettler’s words. This argument draws on Arnold’s (1990, 17) insight that the public’s ability to “link policy instruments with policy effects” is contingent on the design of the policy itself, a factor that Arnold refers to as “traceability.” The low traceability of indirect interventions like tax expenditures appears to obscure for many Americans the consequences of these programs (such as their distributive effects; see Mettler 2011, Ch. 3), making them more popular than they would be if citizens had more complete information.

These works suggest that the tax expenditure mechanism should boost the appeal of proposed policies relative to a traditional spending program, but do not address variability across different policy areas. In their discussions of policy feedbacks and

¹¹⁶ The findings of Faricy (2011) support Howard’s contention that partisan politics have been the driving force in the expansion of indirect social benefits. Faricy finds that Republican control of Congress is associated not with lower social spending in the aggregate, but with a higher ratio of indirect to direct social benefits.

mass publics, Pierson (1993, 619) and Mettler and Soss (2004, 62) suggest that the policy status quo may have a powerful effect on citizens' preferences for different policy approaches. In the complex worlds of public policy and politics, citizens seek to apply what lessons they can from past experiences in deciding which policies are appropriate for solving a given problem. As such, the public's evaluations of policy proposals do not take place in a vacuum, but in a political environment that is substantially shaped by the policy decisions of the past. As Mettler and Soss argue,

By pursuing particular types of solutions, policies convey messages about the underlying nature of a problem and shape citizens' perception of an issue - as a matter of individual or societal responsibility, for example, or as a public or private problem. Policy choices may thereby structure the public's expectations in ways that make it increasingly difficult, over time, to promote fundamental change.

Thus, one of the important effects of indirect policy delivery mechanisms like tax expenditures is that they frame the policy problems they seek to address as matters best handled by private actors (such as employers, see Gusmano et al 2002). Conversely, policy problems for which direct government intervention is more commonplace are socially constructed as situations where government action is *appropriate*. Thus, the preference for government intervention via tax expenditure should be greatest in areas where tax expenditures are established as the preferred policy delivery method, and least in areas where direct government intervention is common. On new or unfamiliar policy problems, the importance of delivery mechanism should fall somewhere in between the two, since the public has no existing guidepost for what constitutes an appropriate intervention.

Some extant experimental work has begun to explore citizens' responses to different policy delivery mechanisms. Zelinsky (2005) uses a survey experiment on a

sample of law students to test whether first-year law students perceive a benefit “framed” as a tax break for so-called volunteer firefighters as more appropriate than an equivalent cash payment. He finds that citizens are significantly more favorable toward the tax benefit, particularly at higher dollar amounts, and concludes that a framing effect is at work.¹¹⁷ In a second study, Zelinsky presents the tax break and direct benefit side by side, thus providing fuller information to respondents on the options, but still finds a significant and persistent framing effect.

Faricy and Ellis (2013) conduct a series of three survey experiments on a sample of undergraduates to determine if respondents’ reaction to three government social welfare interventions (aid for home mortgage payments, retirement savings, and food) vary based on delivery mechanism (normal spending vs. tax expenditure) and the inclusion of information about distributive effects (regressive for the first two programs but progressive for food aid). The results show increased support for the retirement savings program when it was described as a tax break rather than a direct payment, while a similar effect for the home mortgage interest subsidy fell short of statistical significance and there was little evidence of any framing effect for food aid. Faricy and Ellis suggest that the latter result is due to the fact that food stamps are already well established as a regular spending program, suggesting the importance of policy feedback as noted above.

¹¹⁷ Krishna and Slemrod (2003) emphasize the importance of “framing” effects in citizens’ attitudes about tax policy. Framing or “prospect” theory (embodied by Kahneman and Tversky 1979) is concerned not with the amount or clarity of information provided but with the way in which situations are presented or framed. Krishna and Slemrod argue (2003, 191) that the proliferation of tax expenditures makes sense when one considers the finding of the price presentation literature that individuals prefer a loss with a comparatively small gain to an equivalent situation presented as a simple net loss. In tax terms, this would be higher tax rate with a deduction or credit as opposed to a lower rate.

Their findings also echo those of Mettler (2011, Ch. 3) in that the upwardly redistributive programs were less popular when their distributive effects were revealed. Faricy and Ellis also document partisan differences in responsiveness to the frames, with Republican respondents exhibiting a greater jump in support when exposed to the tax expenditure (as opposed to spending) frame than did Democrats.

The findings of these experiments with respect to the moderating role of information raise an important question. Given that the costs of tax expenditures to the Treasury are less traceable than those of spending programs (Arnold 1990, 17), would we observe reduced support if respondents were given additional information about program costs? Past work on citizen attitudes on public finance suggests conflicting expectations. Zelinsky (2005) finds that the pro-tax-break framing effect is even *stronger* when the program is more costly, suggesting that additional information about costs is unlikely to mitigate such an effect. Similarly, Mueller (1964, 222-223) finds a lack of “congruence” in citizens’ fiscal preferences, while Sears and Citrin (1985, 70), in their landmark study of the late-1970s tax revolt in California, find that Californians (and Americans) “seem to want ‘something for nothing’ where government is concerned.” In contrast, Welch (1985) and Hansen (1998) find more evidence for optimism about the public’s ability to make trade-offs on fiscal policy. If Welch and Hansen are correct, making cost (i.e., constraint) more salient to citizens should reduce their likelihood of supporting a program.

Hypotheses

Our interpretation of the existing literature on tax expenditures and other indirect programs leads to a number of expectations about how a change in delivery mechanism will affect citizens' support for a proposed public policy. First, the most basic expectation is:

H1: Respondents will be more supportive of a tax expenditure program than an otherwise identical (i.e. same benefits, same cost) regular spending program.

Second, this effect is likely conditioned by the policy status quo and the familiarity of citizens with government intervention in the policy area in question. The federal government has adopted different approaches to different policy problems, and these existing policy interventions (or lack thereof) structure the political environment by communicating to the public how different problems should be viewed and solved. Overt government action in certain policy areas communicates to the public that those areas are legitimate realms for public involvement. Conversely, indirect action (e.g., tax incentives for private actors) communicates that the policy problem in question is best addressed through private action. This argument is consistent with those made by policy feedback scholars on the ability of policies to reshape citizens' understandings of the appropriateness of government activity through a process of learning.

H2: The preference for the tax expenditure version of a program (H1) should be greatest when intervention via tax expenditure in the policy area is familiar, lowest when direct intervention is familiar, and somewhere in the middle when there is no familiar mode of intervention.

Third, we do not expect the positive effect of the tax expenditure delivery mechanism to be equal across all respondents. The findings of Howard (1997, 2009) and Faricy and Ellis (2011) suggest that tax expenditures have been particularly effective at winning over conservative and moderate citizens, and Faricy and Ellis' (2013) experiment substantiates this claim. Whereas liberals should be relatively supportive of a proposed social welfare program in any form, conservatives and some moderates will oppose regular spending programs because of an aversion to government "spending." Since they are unlikely to recognize that tax breaks are functionally the same as spending, the tax expenditure mechanism should affect their support for the program to a greater degree than for liberals.

H3: The positive effect of the tax expenditure delivery mechanism (relative to spending) on program favorability will be stronger among conservatives and weaker among liberals.

Fourth, we expect that more information about the costs of a program (e.g., its likely contribution to the national debt) should reduce respondents' favorability towards it. To make costs more salient to respondents is to remind them that fiscal policy is constrained, and the work of Hansen (1998) suggests that citizens adopt relatively rational attitudes when constraints are made apparent. Thus, a respondent may support a new program in the abstract when she feels unconstrained, but not when she is reminded that the program comes at a cost.

H4: Respondents will be less supportive of a program when information on the program's impact on the national debt is provided.

Lastly, the fact that a program comes at a cost should come as more of a revelation in some circumstances than in others. While the national debt may not be the first thing on a citizen's mind when she considers a regular spending proposal such as a grant program, almost all citizens understand that "spending" can contribute to the fiscal woes of government. By contrast, not all citizens necessarily grasp the fact that a tax break is functionally equivalent to spending, and that it must be "paid for" sooner or later through either reduced spending on other priorities, increased taxes or more government borrowing. This low "traceability" may in fact be a large part of tax expenditures' appeal to policymakers. Thus, providing additional information on the debt impact of a tax expenditure should have a larger effect on respondent support than providing such information for a grant program, even if that information (i.e., the dollar amount) is the same.

H5: The negative effect of debt information on program favorability (H3) will be greater for respondents who have received the tax expenditure treatment than for those who have received the grant treatment.

Experimental Design and Data

To test our hypotheses, we implement three experiments, each using a 2 x 2 full factorial experimental design in which the experimental factors are: (1) the delivery mechanism of a described program (grant or tax expenditure) and (2) the presence or absence of information about the program's contribution to the national debt. Our sample is comprised of 1000 American adults participating in the 2012 Cooperative Congressional Election Study (CCES). Given our expectations about respondent ideology

(H3), this national stratified sample is preferable to the disproportionately liberal student samples used in previous experiments (Zelinsky 2005, Faricy and Ellis 2013).¹¹⁸ Each respondent participated in all three experiments, and each was assigned into the same treatment for all three. The order of the issues was randomly varied for each respondent.¹¹⁹

We conduct experiments focused on three different social policy areas: home ownership, job training for the unemployed, and paid parental leave. We selected these three areas to maximize variation in the policy status quo, enabling us to test H2. In the area of home ownership, a well-known existing tax expenditure (the home mortgage interest deduction) forms the basis of our experiment. Support for the unemployed, including job training, is an area in which direct government intervention through such programs as unemployment insurance and Department of Labor funded training programs is more typical. Lastly, paid parental leave is a largely unfamiliar concept in the United States outside of nascent and modest state programs in California and New Jersey.¹²⁰ Thus, the three studies encompass policy areas in which the status quo is characterized by intervention via tax break (home ownership), direct government intervention (job training for the unemployed), and one in which any sort of government intervention is largely unfamiliar (paid parental leave).

¹¹⁸ More information on the CCES can be found here:

<http://projects.iq.harvard.edu/cces/>

¹¹⁹ In pilot studies, we ran each of the three experiments on independent samples recruited through Amazon's Mechanical Turk. The results were largely similar to what we report here, so we are confident that combining the experiments for each individual did not substantially alter respondents' evaluations.

¹²⁰ See Earle, Mokomane and Heymann 2011 for a discussion of the United States' work-family policies (or lack thereof) in international context.

A description of the study based on the home mortgage interest deduction (HMID) will serve to illustrate the design for all three studies. In reality, the HMID allows homeowners to deduct the mortgage interest from their taxable income. Since this is equivalent to an outlay by the government, it is relatively easy to imagine a version of this benefit that is delivered to recipients through a direct cash payment (e.g., a check) rather than through the tax return. Our first experimental manipulation is based on this alternative reality. Roughly half of respondents (by random assignment) received a description of the actual HMID, which read as follows:

We're going to ask you your opinion about a government policy intended to help Americans afford to own homes. Under this policy, individuals who take out a mortgage to buy a home are eligible to deduct the monthly mortgage interest from their taxable income, thereby reducing their tax burden. Do you approve or disapprove of this policy?

The other half of the respondents were shown a description that differed in one respect: the words “eligible to deduct the monthly mortgage interest from their taxable income, thereby reducing their tax burden” are replaced with “eligible for a cash payment from the government.”¹²¹

The second experimental manipulation varied whether or not additional information on the cost of the program was provided. About half of respondents viewed the tax expenditure and grant treatments as worded above, while the other half viewed them with the following sentence appended to the end: “It is estimated that this program will add around \$390 billion to the national debt over the next four years.”¹²² The end

¹²¹ The experimental treatment questions for all three studies can be read in their entirety in the appendix.

¹²² The HMID cost estimate is based on Joint Committee on Taxation data. We created fictional cost estimates for the hypothetical job training and parental leave programs. The job training program is described as adding \$4 billion to the debt over four years, while the parental leave program is described as adding \$128

result is four experimental conditions: Cash, No Debt; Cash, Debt; Tax Break, No Debt; and Tax Break, Debt.

Variables

Immediately below the program description for all respondents was a question asking if the respondent approves or disapproves of the program, with possible responses ranging on a seven-point scale from “strongly approve” to “strongly disapprove.”¹²³ This seven-point scale forms our dependent variable. Dummy variables for the experimental treatments form our two key independent variables: Tax Break (which we expect to be positively signed as per H1) and Debt (which we expect to be negatively signed as per H4). The interaction between these two factors forms another key independent variable, which we expect to be negative as per H5.

Testing H2 requires a measure of respondent ideology. We use the CCES common content question asking respondents to estimate their own ideology on a seven-point scale from “very liberal” to “very conservative,” with higher values representing more liberal ideology. We rescale this variable to range from 0 to 1.¹²⁴

Since liberals are more favorable to government intervention in the economy than conservatives, we expect the constituent term for ideology) to be positively signed. As

billion. Both reflect our calculations of what such programs could reasonably be expected to cost. As such, the cost estimates do vary considerably across the experiments.

¹²³ The order of the scale was randomly reversed for half of all respondents.

¹²⁴ We have also run the same models using party identification in place of ideology. The results are very similar to what we report here. In our pilot work using Mechanical Turk, we used a more explicit economic ideology measure, and our results here largely mirror those results using economic ideology.

per H2, we expect the two-way interaction between this variable and the Tax Break treatment to be negatively signed.

We also include a number of control variables based on other questions from our survey. While control variables are not necessary in a randomized experiment (since random assignment assures that the treatment variables will not be correlated with any omitted variables), including them can help improve overall efficiency (Franklin 1991). We include controls for age, gender, race (a dummy variable coded 1 for respondents who identify as white/Caucasian [non-Latino]), partisanship (dummy variables for Democrats and independents), education (ordinal scale), and income (ordinal scale). As with the ideology variable, we rescale all non-dichotomous variables to range from 0 to 1. In addition, we include a variable in each experiment intended to capture the respondent's personal stake in the policy area. In the housing experiment, we include a dummy variable for homeownership; in the job training experiment, a dummy variable indicating whether the respondent is unemployed; and in the parental leave experiment, a dummy variable indicating whether or not the respondent is the parent or guardian of any children under the age of 18.

Results

Figures 4.1, 4.2 and 4.3 display the percentages of respondents expressing at least some approval for the described policy (five and up on the seven-point scale) broken down by the experimental manipulations. Support for H1 (the effect of delivery mechanism) is apparent across all three experiments. As Figures 4.1A, 4.2A and 4.3A make clear, respondents were significantly more likely to support policies to increase

homeownership, provide job training for the unemployed and support paid parental leave when the policies were described as tax breaks rather than direct payments ($p < .01$ in all three studies; from a difference of proportions test). Furthermore, the relative size of the effects across the different studies provides support for H2 (the conditioning effect of familiarity). The effect of delivery mechanism is the largest for housing (43.4 percent difference), the area in which there is an established tax expenditure intervention, and the smallest for job training for the unemployed (8.6 percent) the area in which direct government intervention is familiar. For paid parental leave, an area where any policy intervention is unfamiliar to most Americans, the effect falls between the two extremes (16.3 percent).

Figure 4.1. Program Approval by Experimental Condition, Home Mortgage Interest.

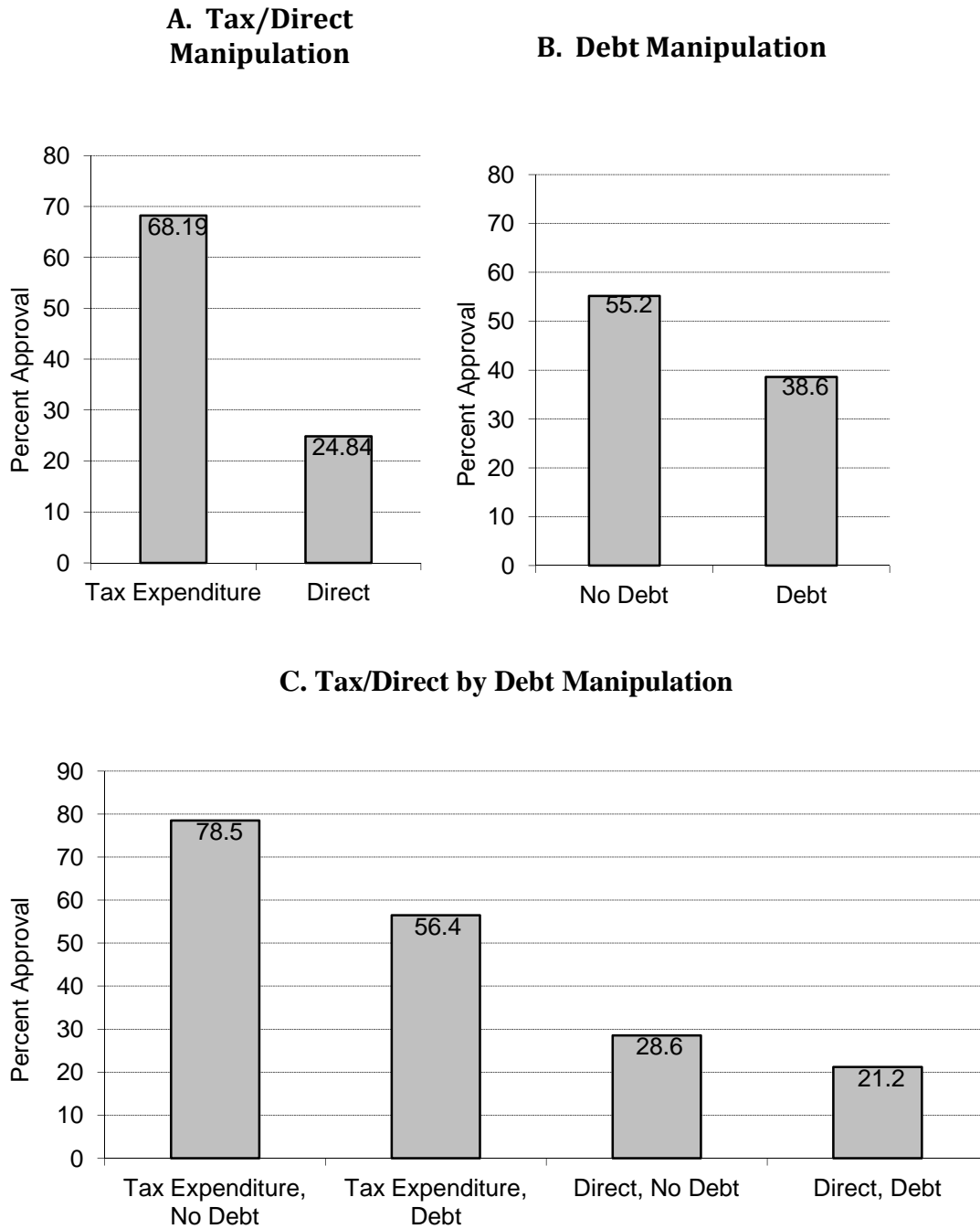


Figure 4.2. Program Approval by Experimental Condition, Job Training.

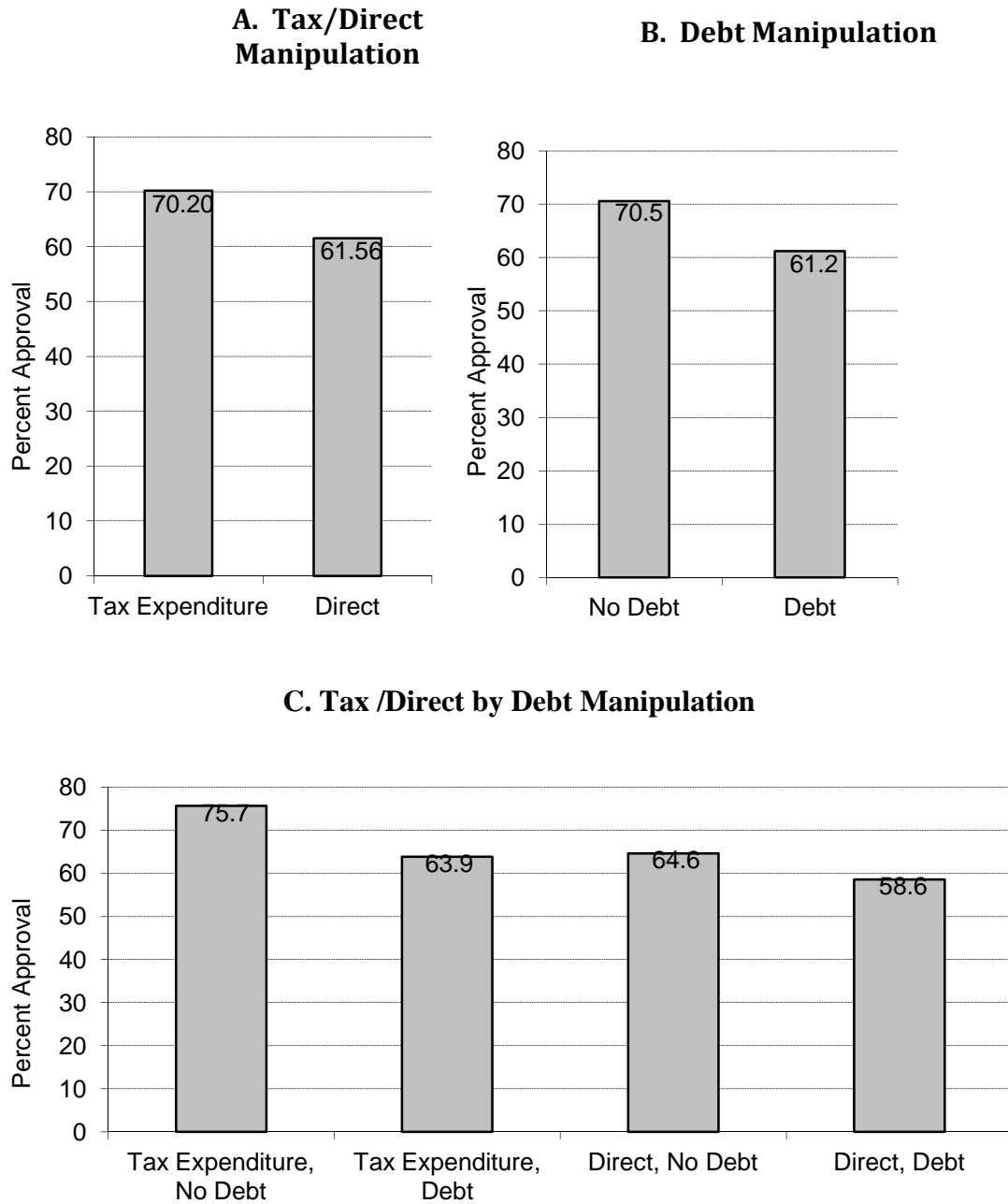
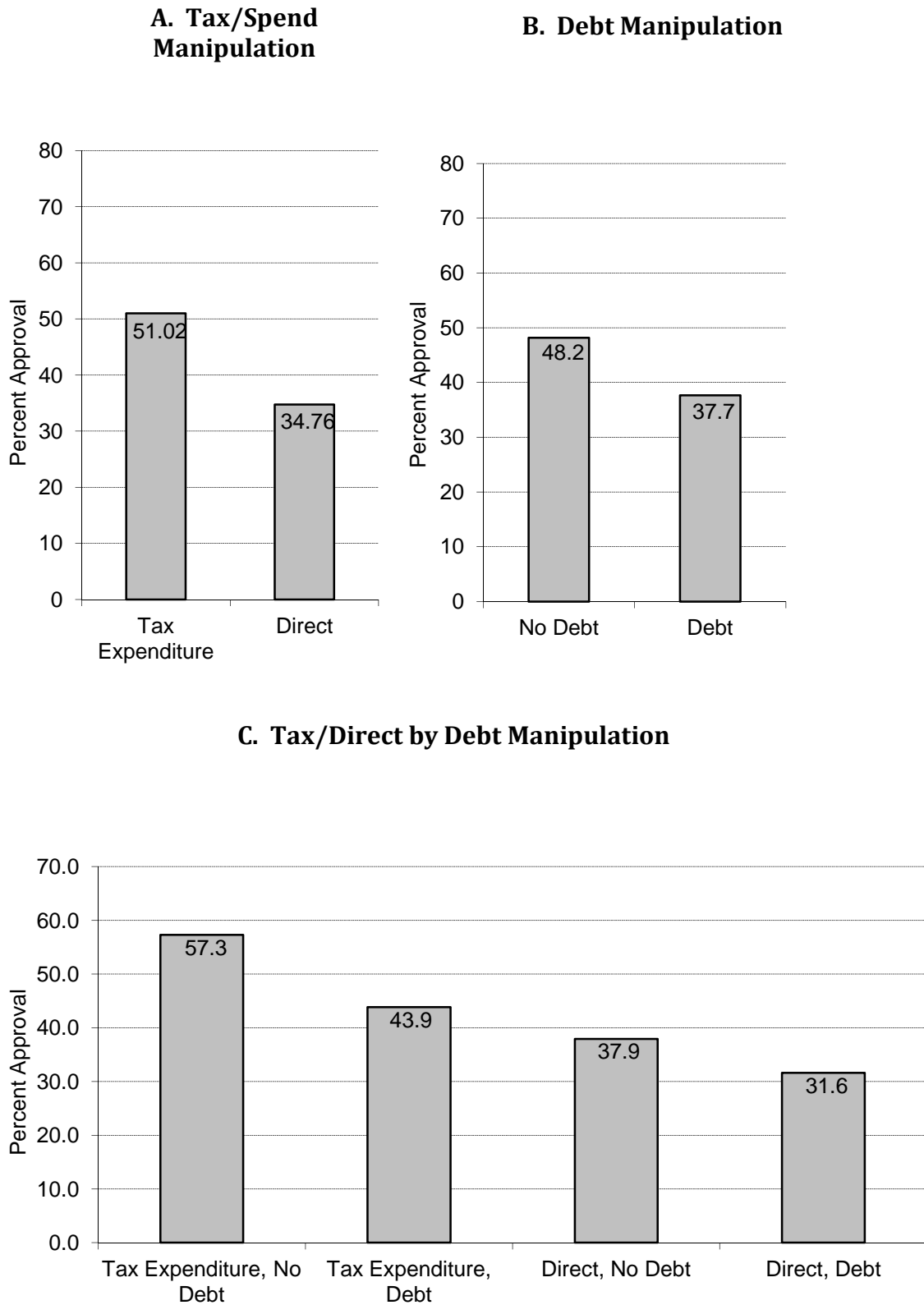


Figure 4.3. Program Approval by Experimental Condition, Parental Leave.



Figures 4.1B, 4.2B and 4.3B show support for H4: respondents were significantly less likely to respond positively to a policy when an estimate of the program's contribution to the national debt was included ($p < .01$ for all three studies). There is also evidence for H5 (the interaction of the delivery mechanism and debt information treatments), as Figures 4.1C, 4.2C and 4.3C display. For all three experiments, the negative effect of the debt information treatment is larger for respondents in the tax expenditure condition than those in the direct payment condition, as H5 predicts.

Multiple regression models in Tables 4.1 and 4.2 report statistical significance tests for these effects and also test our posited interactive effects.. Table 4.1 displays the results of OLS models for each experiment, with the seven-point support scale as the dependent variable and control variables included to improve efficiency. The results of these models support the findings of the descriptive analysis, with positive and statistically significant coefficients for the tax expenditure treatment in all three experiments, supporting H1. The relative size of these effects across the experiments also shows evidence for H2. In the housing experiment, the tax expenditure treatment caused an average jump of two full points on the seven-point support scale. For parental leave the effect was much more modest (.82 points), while for job training it was smaller still (0.50 points). The effect of the debt information treatment is negative and significant for all three experiments, as predicted by H4, though this effect is smaller in magnitude than that of the tax expenditure treatment in each case.

Table 4.1. Model Results Explaining Program Approval, No Interactions.

	Housing			Job Training			Parental Leave		
	Coef.	(SE)	p	Coef.	(SE)	p	Coef.	(SE)	p
Tax Expenditure (=1) v. Spending (=0) Treatment	2.01	(0.11)	0.00	0.50	(0.11)	0.00	0.82	(0.11)	0.00
Debt Treatment	-0.72	(0.11)	0.00	-0.41	(0.11)	0.00	-0.50	(0.11)	0.00
Ideology	1.64	(0.19)	0.00	2.10	(0.17)	0.00	2.30	(0.19)	0.00
Age	-0.03	(0.29)	0.92	0.39	(0.26)	0.13	-1.18	(0.29)	0.00
Female	-0.22	(0.12)	0.06	-0.01	(0.11)	0.95	-0.10	(0.12)	0.41
White	-0.17	(0.14)	0.22	-0.15	(0.13)	0.23	-0.12	(0.14)	0.36
Education	-0.01	(0.21)	0.95	0.13	(0.20)	0.52	0.19	(0.21)	0.35
Income	-0.04	(0.32)	0.91	-0.18	(0.28)	0.52	-0.70	(0.30)	0.02
Homeowner	0.01	(0.14)	0.96	-	-	-	-	-	-
Unemployed	-	-	-	0.01	(0.19)	0.94	-	-	-
Children (0/1)	-	-	-	-	-	-	0.35	(0.15)	0.02
Intercept	2.92	0.24	0.00	3.70	(0.23)	0.00	3.45	(0.25)	0.00
	N=892; F=50.26, p<.001; Adj. R ² =.332			N=916; F=21.30, p<.001; Adj. R ² =.166			N=919; F=33.35, p<.001; Adj. R ² =.241		

The models in Table 4.2 incorporate interaction terms between the delivery mechanism and debt information treatments and respondent ideology. There is some support for H3, as the interaction term for respondent liberalism and the tax expenditure treatment is negatively signed for all three experiments and statistically significant for housing and job training. Put another way, the tax expenditure treatment had a larger positive effect on conservative respondents' support for the described policy than on that of liberal respondents, at least for two of the three experiments. This is represented graphically in Figure 4.4, which displays predicted support levels for liberal and conservative respondents across the two delivery mechanism conditions.¹²⁵ It should be noted that the tax break treatment still has a positive slope for liberals in the housing and parental leave experiments,¹²⁶ indicating that the effect is not limited to conservatives alone even though it is stronger among them.

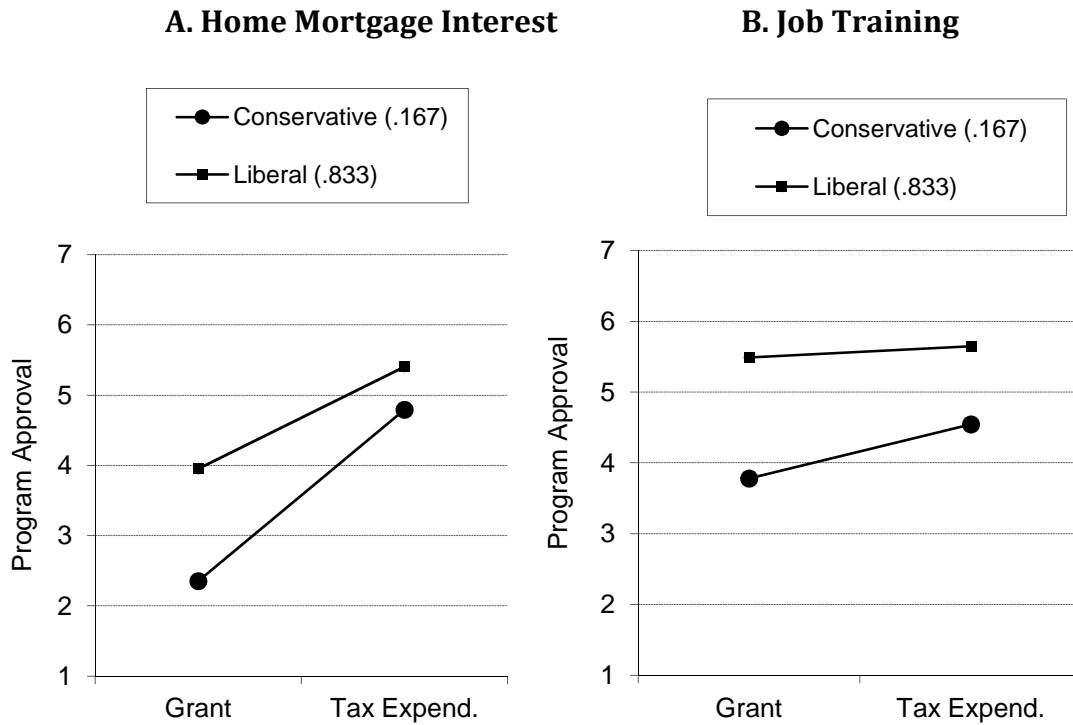
¹²⁵ These values were generated using values of 0.167 (for conservative) and 0.833 (for liberal) on our one-point scale, or 2 and 6 on the full seven-point ideology scale. These are not outliers, as they represent the 31st and 90th percentile respondents in terms of liberalism.

¹²⁶ Regression models using only the 310 liberal respondents in the sample return positive and statistically significant coefficients for the tax break treatment in the housing and parental leave studies, but not in the job training study.

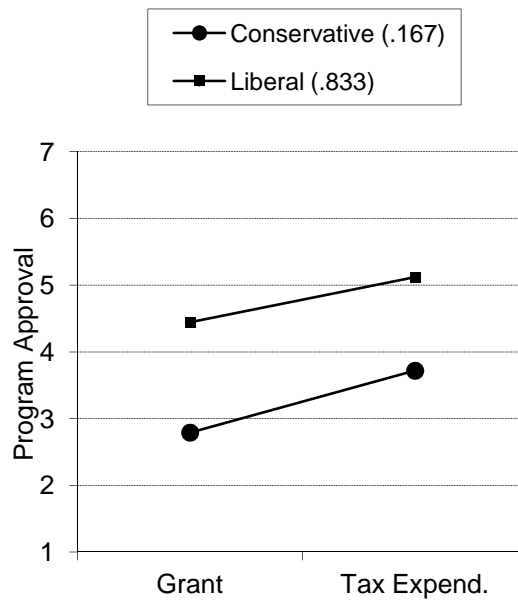
Table 4.2. Model Results Explaining Program Approval, Interactions Included.

	Housing			Job Training			Parental Leave		
	Coef.	(SE)	p	Coef.	(SE)	p	Coef.	(SE)	p
Tax Expenditure (=1) v. Spending (=0) Treatment	3.00	(0.23)	0.00	1.06	(0.21)	0.00	1.08	(0.23)	0.00
Debt Treatment	-0.60	(0.23)	0.01	-0.50	(0.22)	0.02	-0.79	(0.23)	0.00
Ideology	2.18	(0.33)	0.00	2.31	(0.30)	0.00	2.09	(0.32)	0.00
TaxSpend x Debt Treatment	-0.63	(0.22)	0.01	-0.29	(0.21)	0.17	-0.18	(0.22)	0.44
TaxSpend x Ideology	-1.48	(0.36)	0.00	-0.91	(0.34)	0.01	-0.38	(0.36)	0.30
Debt Treatment x Ideology	0.45	(0.36)	0.21	0.52	(0.34)	0.12	0.81	(0.36)	0.02
Age	-0.04	(0.29)	0.90	0.39	(0.26)	0.13	-1.20	(0.29)	0.00
Female	-0.23	(0.12)	0.05	-0.01	(0.11)	0.94	-0.09	(0.12)	0.42
White	-0.14	(0.13)	0.31	-0.15	(0.13)	0.25	-0.12	(0.14)	0.38
Education	-0.04	(0.20)	0.83	0.10	(0.19)	0.60	0.17	(0.21)	0.40
Income	0.03	(0.32)	0.93	-0.14	(0.28)	0.63	-0.66	(0.30)	0.03
Homeowner	-0.01	(0.14)	0.92	-	-	-	-	-	-
Unemployed	-	-	-	0.02	(0.19)	0.92	-	-	-
Children (0/1)	-	-	-	-	-	-	0.34	(0.15)	0.02
Intercept	2.50	(0.28)	0.00	3.51	(0.27)	0.00	3.51	(0.29)	0.00
	N=892; F=41.05, p<.001; Adj. R ² =.350			N=916; F=17.16, p<.001; Adj. R ² =.175			N=919; F=25.72, p<.001; Adj. R ² =.244		

Figure 4.4: Impact of Tax/Spend Manipulation by Ideology



C. Parental Leave



The results for H5 are more ambiguous. While the interaction of the tax expenditure and debt information treatments is negatively signed for all experiments, it is only statistically significant for the housing experiment, in which the estimated debt impact was much larger than that in the other two. Providing information about a policy's cost may mitigate the positive effect of the tax expenditure frame in some cases, but we cannot fully confirm H5 across all issue areas.

The federalized nature of social provision in the U.S. offers a fortuitous opportunity for another test of the familiarity hypothesis (H2). Since two states (California and New Jersey) have implemented paid parental leave policies¹²⁷, direct government provision of this service is more likely to be familiar to respondents from those states than others. If H2 is true, the positive effect of the tax expenditure treatment on the support levels of respondents from those states should be reduced compared to the effect on other respondents. To test for such a pattern, we re-ran the full parental leave model with a dummy variable identifying the 113 respondents from California and New Jersey and an interaction term of this dummy variable with the tax expenditure treatment. While the results of the full model are not displayed here, the coefficient for this interaction term (which is the variable of interest) is negatively signed (-.58), as expected, and approaches statistical significance at a marginal level ($p=.114$).¹²⁸ While not definitive, these results do militate in favor of the hypothesis that the relative attractiveness of the tax expenditure

¹²⁷ Washington state passed a family leave law in 2007, but implementation has been delayed multiple times due to budget shortfalls. Thus, California and New Jersey are the only states in which such benefits currently exist.

¹²⁸ Since the ideology variable and interaction terms are also included, we can be confident that this correlation is not an artifact of the reported ideological inclinations of the respondents from these states.

delivery mechanism is lessened for citizens who are familiar with direct government intervention.

Of course, familiarity varies by individual as well as by policy area and location. While we lack the data to identify the recipients who are eligible for government benefits, or have actually received them, the variables for homeownership, unemployment, and children under eighteen serve as proxies for eligibility for these real and hypothetical policies. It is reasonable to assume that respondents in these categories are more familiar than other respondents with the policy status quo in these three areas of social policy. Given the differences in the status quo, we expect that the positive effect of the tax expenditure treatment will be mitigated in three different ways in the three different experiments for those in the relevant categories. First, the preference for a home mortgage tax expenditure should be *strengthened* for homeowners, since they are directly familiar with the existing federal policy of subsidizing homeownership through a tax deduction. Second, the preference for a job training tax expenditure should be *reduced*, since the unemployed are likely to be more familiar than others with direct government help for the unemployed through the Department of Labor and state and local government agencies. Lastly, the preference for a parental leave tax expenditure should not be systematically different for the parents of young children than for non-parents, since there is no existing paid parental leave policy in most states.

We re-ran all three interactive models, adding an additional interaction of the relevant demographic variable with the tax expenditure treatment variable. The findings, which are not displayed in their entirety here, provide support for our hypothesis. In the housing experiment, the interaction term of the homeownership variable with the tax

expenditure treatment is positively signed (0.88) and strongly statistically significant ($p < .01$), indicating that homeowners reacted even more positively to the tax expenditure treatment than other respondents. In the job training experiment, the interaction of the treatment with unemployment status is negative (-.66) and significant at the .10 level ($p = .08$), indicating that the positive effect of the tax expenditure treatment is weaker for the unemployed. Finally, in the paid parental leave experiment, the coefficient for the interaction of children under eighteen with the treatment is substantively tiny (0.06) and statistically insignificant ($p = .83$). In addition, while the sample size is too small to draw solid conclusions, it is noteworthy that out of the twenty respondents from California and New Jersey with children under the age of eighteen, the mean level of support for the proposed program was identical (4.5 on the seven-point scale) across the tax expenditure and spending treatments, indicating a possible mitigating effect for these respondents similar to the unemployed respondents in the job training experiment, as we would expect.

Conclusion

This experimental study makes an important contribution to our understanding of citizen preferences regarding government programs. In this section, we discuss the findings and suggest directions for future research.

First, it is clear that the delivery mechanism of a government program can have a dramatic effect on citizens' likelihood of supporting that program. In general, Americans are more favorably disposed toward government interventions through the tax code than through more direct channels. This is true across all three of the policy areas that we

examined. The strong results for the housing experiment in particular stand in contrast to Faricy and Ellis' (2013) null finding for their own, similar study of home mortgage interest assistance.

Second, the size of this preference varies with the familiarity of certain types of government intervention. Support for government aid to homebuyers jumps considerably when the policy is described as the familiar home mortgage interest deduction. When the benefit in question is job training for the unemployed, the jump in support for a tax break relative to a direct payment is much smaller; citizens are used to government stepping in to directly aid the unemployed. In the case of paid parental leave, a benefit that is alien to most Americans, the effect falls somewhere in between, reflecting general uncertainty about the appropriate role of government. Our results suggest that the effect of delivery mechanism on support for parental leave is probably smaller in California and New Jersey, where paid parental leave benefits do exist. These findings attest to the power of established patterns of *policy* to affect *politics* - citizens' attitudes about what government should or should not do are structured in part by what government is already doing. Thus, our results speak to the growing literature on policy feedbacks.

Third, citizens' responsiveness to different delivery mechanisms varies predictably with ideology, at least in two of the policy areas we examined. Conservative support for tax breaks was much higher than for otherwise identical cash payment programs across the board. For housing and job training assistance, this effect was relatively muted for liberals. These findings are consistent with the arguments of Howard (1997, 2009) and Faricy (2011; see also Ellis and Faricy 2011) that social welfare tax expenditures have grown in popularity because they offer policymakers a way to address social problems

without offending the sensibilities of conservative or moderate constituents. Still, liberals were not immune to the delivery mechanism effect in the housing or paid parental leave studies. The appeal of tax breaks as a delivery mechanism appears to be near-universal, suggesting it is not entirely dependent on strongly anti-government attitudes. Future work should more fully explore the origins of this preference.

Fourth, as expected, providing respondents with information about the fiscal costs of a policy dampened support across the board. This indicates that fiscal considerations do temper citizens' enthusiasm for government policies. We hypothesized that this effect would be stronger for respondents in the tax break condition. Since citizens may not understand that tax breaks can have the same fiscal consequences as spending, the revelation that the described policy would contribute to the national debt may be more surprising than it would be for a regular spending program. In other words, the preference for tax breaks may be dampened when it is made clear to citizens that tax breaks have costs. This expectation was born out in terms of the sign of the interactive effect, but the effect only attained statistical significance in the housing experiment. Moreover, the tax expenditure treatment still had a positive effect in all models when the interaction term was included. Thus, a lack of awareness about the fiscal costs of tax breaks is not a sufficient explanation for why Americans prefer tax breaks over direct interventions.

In summary, these findings stress the importance of policy design and policy feedbacks to public opinion on policy proposals. More work is needed to uncover the cognitive processes that lead Americans to favor certain types of policy delivery mechanism over others, but our study offers some initial insights on the conditioning

effects of familiarity and ideology. Our results paint a complex picture of the relationship between public opinion and public policy; the growth of indirectly delivered government benefits and Americans' preference for delivering benefits in this manner seem to be mutually reinforcing.

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Appendix 1: Additional Tables

Table A1. Cox duration models of new federal program termination, 1974-2003.

	Model 1		Model 2		Model 3	
	Coef.	RSE	Coef.	RSE	Coef.	RSE
Tax expenditure	-0.18	(0.60)	-0.18	(0.47)		
Tax expenditure × logged age	0.71**	(0.31)	0.27	(0.24)		
Loan	0.02	(0.60)	0.33	(0.47)		
Loan × logged age	0.59*	(0.34)	0.20	(0.26)		
Insurance	0.59	(1.13)	0.61	(0.55)		
PAYGO	1.94***	(0.66)	-0.23	(0.46)	-1.46	(0.98)
Democratic president, current	2.29**	(1.08)	0.59*	(0.34)	2.22*	(1.25)
Democratic House majority, current	2.95**	(1.29)	0.92*	(0.55)		
Democratic Senate majority, current	-1.01	(0.62)	-0.65*	(0.37)	1.51*	(0.91)
Majority party seat gain	-11.10	(7.73)	-14.53**	(6.15)	10.15	(13.33)
Majority party seat loss	5.23*	(2.88)	8.92***	(2.02)	2.51	(6.29)
Change in party (president)	0.27	(0.18)	0.10	(0.13)	0.64	(0.47)
Polarization	-14.63	(9.45)	0.49	(6.24)	-3.34	(18.00)
Divided govt, enactment	0.17	(0.19)	0.35**	(0.14)	0.30	(0.53)
Divided govt, current	2.85**	(1.27)	0.25	(0.44)	3.47**	(1.45)
Policy mood	0.05	(0.12)	-0.03	(0.07)	-0.09	(0.19)
Surplus/deficit	0.20	(0.14)	0.02	(0.09)	-0.24	(0.29)
War	-0.03	(0.83)	1.01*	(0.54)		
War × logged age	-1.11**	(0.51)	-0.22	(0.23)		
GDP	-0.09	(0.51)	0.01	(0.31)	0.30	(1.20)
GDP change	-0.05	(0.05)	-0.01	(0.03)	0.01	(0.10)
First year of congressional term	1.03***	(0.19)	0.38***	(0.12)	0.12	(0.35)
Social welfare					-0.37	(0.35)
Corporate					0.59*	(0.33)
Deduction					1.05**	(0.45)
Credit					0.15	(0.47)
Exclusion					0.28	(0.46)
# of clusters	1953		1953		132	
# of observations	18835		18835		1783	
Log-Likelihood	-1311.49		-2584.99		-170.44	

* p<0.1 ** p<0.05 ***p<.01

Table A2. Summary of results from piecewise Cox duration models of new federal program termination (liberal definition), 1974-2003.

Program age range	Coefficient of <i>tax expenditure</i>	p-value	# of observations
Up to 3 years	0.38	0.28	5277
Older than 3 years	0.32*	0.08	13558
Up to 5 years	-.04	0.90	8047
Older than 5 years	0.61***	0.004	10788
Up to 10 years	0.22	0.25	12846
Older than 10 years	0.51	0.15	5989
Up to 15 years	0.23	0.18	15722
Older than 15 years	0.47	0.38	3113

* p<0.1 ** p<0.05 ***p<.01

Appendix 2: Experimental Treatment Wording

Housing

Tax expenditure, no debt information

We're going to ask you your opinion about a government policy intended to help Americans afford to own homes. Under this policy, individuals who take out a mortgage to buy a home are eligible to deduct the monthly mortgage interest from their taxable income, thereby reducing their tax burden. Do you approve or disapprove of this policy?

Tax expenditure, debt information

We're going to ask you your opinion about a government policy intended to help Americans afford to own homes. Under this policy, individuals who take out a mortgage to buy a home are eligible to deduct the monthly mortgage interest from their taxable income, thereby reducing their tax burden. It is estimated that this policy will add around \$390 billion to the national debt over the next four years. Do you approve or disapprove of this policy?

Spending, no debt information

We're going to ask you your opinion about a government policy intended to help Americans afford to own homes. Under this policy, individuals who take out a mortgage to buy a home are eligible for a cash payment from the government. Do you approve or disapprove of this policy?

Spending, debt information

We're going to ask you your opinion about a government policy intended to help Americans afford to own homes. Under this policy, individuals who take out a mortgage to buy a home are eligible for a cash payment from the government. It is estimated that this policy will add around \$390 billion to the national debt over the next four years. Do you approve or disapprove of this policy?

Job Training

Tax expenditure, no debt information

We're going to ask you your opinion about a proposed government policy intended to encourage the unemployed to pursue training to help them find new jobs. Under this policy, unemployed people who take a job training class are eligible for a tax break, that is, a reduction in the amount of income tax they owe to help cover the cost of the class. Do you approve or disapprove of this policy?

Tax expenditure, debt information

We're going to ask you your opinion about a proposed government policy intended to encourage the unemployed to pursue training to help them find new jobs. Under this policy, unemployed people who take a job training class are eligible for a tax break, that is, a reduction in the amount of income tax they owe to help cover the cost of the class. It is estimated that this policy will add \$4 billion to the national debt over the next four years. Do you approve or disapprove of this policy?

Spending, no debt information

We're going to ask you your opinion about a proposed government policy intended to encourage the unemployed to pursue training to help them find new jobs. Under this policy, unemployed people who take a job training class are eligible for a cash payment from the government to help cover the cost of the class. Do you approve or disapprove of this policy?

Spending, debt information

We're going to ask you your opinion about a proposed government policy intended to encourage the unemployed to pursue training to help them find new jobs. Under this policy, unemployed people who take a job training class are eligible for a cash payment from the government to help cover the cost of the class. It is estimated that this program will add \$4 billion to the national debt over the next four years. Do you approve or disapprove of this policy?

Parental Leave

Tax expenditure, no debt information

We're going to ask you your opinion about a proposed government policy intended to help working parents. Under this policy, working men or women who have a baby and take unpaid parental leave are eligible for a tax break that will reduce the amount of income tax they owe to cover 100% of the pay that they will lose by staying home to take care of the baby for up to 16 weeks. Do you approve or disapprove of this policy?

Tax expenditure, debt information

We're going to ask you your opinion about a proposed government policy intended to help working parents. Under this policy, working men or women who have a baby and take unpaid parental leave are eligible for a tax break that will reduce the amount of income tax they owe to cover 100% of the pay that they will lose by staying home to take care of the baby for up to 16 weeks. It is estimated that this program will add around \$128 billion to the national debt over the next four years. Do you approve or disapprove of this policy?

Spending, no debt information

We're going to ask you your opinion about a proposed government policy intended to help working parents. Under this policy, working men or women who have a baby and take unpaid parental leave are eligible for a cash payment to cover 100% of the pay that they will lose by staying home to take care of the baby for up to 16 weeks. Do you approve or disapprove of this program?

Spending, debt information

We're going to ask you your opinion about a proposed government policy intended to help working parents. Under this policy, working men or women who have a baby and take unpaid parental leave are eligible for a cash payment to cover 100% of the pay that they will lose by staying home to take care of the baby for up to 16 weeks. It is estimated

that this policy will add around \$128 billion to the national debt over the next four years.
Do you approve or disapprove of this policy?