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Working Paper Series

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US Social Policy in an Era of Middle Class Decline: Is it drifting from the poor?

Katherine Baird

October 2014



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US Social Policy in an Era of Middle Class Decline: Is it drifting from the poor?

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October 2014

Abstract

This paper examines the evolution of the breadth and target of social policy in the US. By analyzing LIS household data from the US, the paper brings fresh evidence to longstanding debates over how inequality influences income redistribution, whether a welfare retrenchment has occurred, and whether growing inequality within the middle class has been associated with a shift in social policy from the poor to those higher up the income ladder. This I do by examining both income and the sources of that income using household-level data spanning four decades. The evidence in this paper does not indicate that a “welfare retrenchment” has occurred, nor that social transfers have drifted in their target from the poor to the middle class. Rather, the paper shows that the value of social transfers to those with similar levels of earned income along the income distribution show a tremendous degree of stability over time.

A key feature of growing inequality today, and one often overlooked by scholars, is the divide occurring within the middle class. In this paper I take a fresh look at the relationship between inequality and redistributive policies by spotlighting changes within the middle class, and the role this may play in shaping countries' redistributive policies. I develop a case study of the evolution of social policy in the US to provide fresh evidence informing longstanding debates over how growing inequality influences support for social policy, and whether this translates into the political choices nations make. This I do by examining both income and the sources of that income from household-level data in the US, annual data which now spans four decades. My purpose is to investigate if tax and transfer policies in the US have weakened over time, or if they have drifted from the poor to the middle class.

A vast literature exists concerning the influence inequality has on the extent to which countries engage in income redistribution. By focusing on the relationship between middle class stagnation and decline and redistributive policy, this paper contributes to growing scholarly interest in how the *particular* distribution of economic benefits within a country influences social policy. Lupu and Pontusson (2011) insist that it is not inequality *per se*, but the form it takes that determines whether or not public support for social spending increases when inequality widens. They argue that support grows when the economic distance between poor and middle class households shrinks, and when that between middle class and rich households increases. In this instance, the poor and middle class are more likely to form a political alliance supporting greater redistribution. Rehm, Hacker and Schlesinger (2012) similarly emphasize the potential for stronger political alliances supporting income redistribution to occur when economic insecurity among the middle class rises.

The above arguments suggest that today's combination of middle class stagnation, rising incomes at the top, and increasing economic vulnerability within the middle of the distribution could result in growing popular and political support for income redistribution, a position at odds with a large literature arguing that the welfare state is in decline (Rosanvallon 2013; Swank 2005; Streeck 2014). But middle class decline could also lead to selective support for policies that reach higher into the income distribution. Rather than a new alliance occurring that strengthens support for social spending by broadening it, policy could drift away from the politically-marginal poor and toward those with greater political clout, such as a more influential middle class. The increasing emphasis on work-related benefits, the declining value of minimum wages in the US, and falling marginal tax rates on capital could be viewed as emblematic of such a drift. Indeed, evidence in a wide range of countries suggest that minimum protection levels in rich countries has been on the decline (Immervoll 2009; Marchal, Marx, and Van Mechelen 2011).

A concern over a potential drift in policy is especially relevant in the US's particular policy environment. The ability for select policy changes to alter the distribution of social benefits is more likely, due to the US's heavier reliance on targeted as opposed to universal social policies, including the greater reliance on income tax policies for advancing social objectives (Kenworthy 2011; IMF 2013). While traditionally "targeted" policies have been aimed at the poor, select changes can allow the target to drift, for example through broadening eligibility requirements for benefits, or restricting eligibility for particular tax credits to those who pay taxes.

By analyzing the impact and trajectory of income redistribution across the earnings distribution in the US, beginning in the mid 1970s and continuing through the most recent deep

recession, I examine a political context more susceptible to both policy drift and (as many have argued) more prone to a reversal in the government's role in redistributing income. The paper's intent is to investigate evidence for either of these trends.

Social Policy Amidst Growing Inequality and Middle Class Decline

Social policies within rich democracies today face inordinate challenges. Growing public debt, slow economic growth, and an aging population which brings high public expenditures for pensions and health are all contributing to doubts over countries' continued ability to fund last century's social programs. Add to this strong anti-tax, small government movements which in the US and elsewhere are a growing feature of the political landscape (Economist 2014).

Finally, the recent financial crisis piled on new challenges via its legacy of spiraling government deficits and deteriorating national treasuries. Today one finds considerable angst over the potential for the state's role in providing citizens with minimum income and social protection guarantees to erode; indeed many contend that nations are already reducing their commitment to these social objectives (Nelson 2007 and 2010; Korpi and Palme 2003; Clayton and Pontusson 1998; Streeck 2014). In his new book *The Society of Equals*, Rosanvallon terms recent history "The Great Reversal" because, in his view, it is marked by a retreat from societies' prior dedication to creating a more equal society.

Inequality and Social Policy

The premise that a falling commitment to redistribute income is occurring at the same time that income inequality is rising presents something of a theoretical puzzle, however. Social scientists have long argued that growing economic inequality should be met by pressure for the social spending to offset it. For some time scholars mostly accepted this contention, which

primarily dates to Romer's (1975) model of how nations choose to distribute their income tax burden, a model later elaborated and extended upon by Roberts (1977) and Melzer and Richard (1981). Their research gave rise to an extremely influential median-voter model of taxes and social expenditure. Put simply, this contends that politicians seeking votes advocate for the combination of taxes and income redistribution preferred by a decisive median voter. In the case of growing income inequality, the constituency for redistributive policies and the higher taxes they require increases. This results in more redistribution to the bottom of the distribution because democratically-elected officials respond to the growing ranks of those who stand to gain more from redistributive policies than they will lose through higher taxes.

Critics of the median voter theory often challenge the political clout it ascribes to the middle class. Competing theoretical treatments of the nexus between inequality and social spending tend to highlight the inevitable conflict of interest that arises from income redistribution. By taking a more encompassing view of the forces determining social policy, many emphasize the structural features of society created by history, political institutions and organizations, and consider the relative political strength of different interest groups (Hicks and Swank 1992). Scholars often posit that increasing social expenditures requires organizing the power of those who stand to benefit since these efforts will be resisted by those wielding greater power over lawmakers. To understand whether countries expand or contract social spending, one needs to consider not just growing inequality and the preferences spawned by it, but the extent of political organization among the working class, and hence their political power. In his recent book *Affluence and Influence* (2014) political scientist Martin Gilens convincingly establishes the disproportionate impact the wealthy have on public policy, a power that others would have to counter. Especially when inequality is coupled with growing globalization--many

believe the latter contributes to the former--lawmakers may become even more beholden to the interests of the wealthy, the owners of capital, and the judgments of international financial markets, all of which heighten the conflict of interests between the advantaged and disadvantaged members of society (Bradley et al. 2003). In this way, modern capitalism and with it rising globalization and inequality are inconsistent with policies that provide social protection and redistribute income. This change in politics, some claim, is occurring as inequality rises, and in short helps explain the “austerity” mantra present in contemporary political rhetoric and social movements.

Middle Class

How economic inequality influences the state’s role in redistributing income is at heart a question of how income differences among a population affects their attitudes and any political pressure they exert, and finally how lawmakers respond to this pressure. Yet a key feature of growing inequality today, and one that has received surprisingly little attention in the scholarly literature, is the growing divide occurring *within* the middle class.

Middle class stagnation or decline is of growing concern in almost all rich democracies. A recent study of twenty-five rich democracies found that over a two decade period, twelve had fewer people falling within the middle of the income distribution, while only four had more (Bigot et al. 2012). Moreover, Dallinger (2011) found that over the last few decades, many countries have experienced a decline in the *income* share earned by those in the middle of the distribution. Economic stagnation within the middle of the income distribution has been especially strong in the US; middle class households today earn less in absolute terms than do their counterparts in many other rich countries (Leonhardt and Quealy 2014). American

corporations are even taking keen note of growing income polarization as markets catering to the middle class stagnate (Schwartz 2014).

In addition to greater internal differentiation occurring around the middle of the income distribution, these households today experience less income security due to increased competition for skilled jobs; face a greater risk of unemployment (particularly longer bouts of it); own more debt; are experiencing rising health care, childcare, education and housing costs; and have less-protected sources of retirement income (Littrell et al 2010; Weller 2008; Center for American Progress 2014). Worse yet is some evidence that in the US at least, upward mobility is both low and declining, while downward mobility may be increasing (Beller and Hout 2006). Most American middle class adults report that it is getting harder to maintain their standard of living (Pew Research Center 2012). It is not surprisingly then, that politicians and journalists alike frequently refer to the “loss” or “hollowing out” of the middle class--even suggesting the label of “an endangered species” for it (Case 2012). President Barack Obama recently called rebuilding the middle class “my highest priority” (Shear and Baker 2013), and established a Middle Class Task Force charged with raising middle class living standards.

If income inequality affects preferences and the politics surrounding redistribution policy, one might expect that the contribution made by changes within the middle class would be more influential than those within the tails of the distribution. Yet surprisingly, the scholarly literature has not squarely addressed the potential role that pressure from a fraying middle class may play in changing citizens’ preferences for social spending, or the political alliances around this agenda. Some recent research does, however, suggest how this might play out. Lupu and Pontusson (2011) argue that support for social spending is stronger when wages at the bottom half of the distribution are more compressed, while those in the top half are dispersed. In their

view, this increases the chances of a political alliance forming between the poor and the middle class around increased social spending. Cusack, Iversen and Rehm (2006) point out that a person's preference for redistribution will depend not just on his or her income, but also on the amount of risk faced in labor markets. Rehm, Hacker and Schlesinger (2012) extend this, claiming that political alliances around redistribution increase when those who are poor are distinct from those who face income insecurity:

Events that alter the perception of [economic] risk among advantaged citizens are likely to reduce opposition to and polarization concerning social policies and raise average support. This provides a simple basis for the anecdotal observation that economic crises provide a popular basis for welfare-state expansion. (404)

In other words, the current era of stagnant middle class incomes, declining job security, and rapid income growth at the top could be providing the conditions for growing support for social spending and the income redistribution that typically results.

On the other hand, when conditions such as those of recent history make new spending initiatives unlikely, existing policies may likewise have a tendency to drift in their target, with that drift most likely occurring away from the poor. Instead of middle class stagnation leading to new alliances, a new interest group could seek to redirect policy from the more politically-marginal poor toward a more politically-influential middle class.

Evidence in the US indeed suggests that social policy could be drifting from the tail end toward the middle of the distribution. A front page article in the *New York Times* recently detailed how middle class Americans are increasingly reliant on social transfers for their income (Applebaum 2012). Also not long ago, the Congressional Budget Office reported that in 1979, half of all federal transfer payments went to those in the bottom quintile of the income distribution, while in 2007 only about a third did (CBO 2011). Robert Moffitt examined changes in transfers over the course of the Great Recession, and found that government policy did a better

job meeting the increased economic needs of those higher up the income scale than it did those at the very bottom (Moffitt 2013). The increasing popularity of work-related benefits found today in many countries could also be evidence of a drift in social policy from those with weaker attachments to the labor force to those with stronger ones (Nelson 2007 and 2010; Kenworthy 2011).

Empirical investigations of the relationship between rising inequality and redistributive policy have not shed consistent light on how growing inequality may shape social policy. Early efforts measured “redistributive effort” by a nation’s social spending (e.g., Hicks and Swank 1992; Pierson 1996; Rodriquez 1999) and often conflated cross national differences for within-country variation. More recent studies have used direct measures of income redistribution and related these to measures of inequality (Ostry, Berg, Tsangarides 2014; Bradley et al. 2003; Kenworthy and Pontusson 2005; Milanovic 2010; Caminada, Goudswaard and Wang 2012), but have not generated consistent results, in part because authors don’t use similar measures of countries’ redistributive effort.

Using changes in single measures of inequality (the Gini coefficient) to capture the evolving state of redistribution policy within countries is useful for some purposes, but cannot address questions around trends in social transfers at the household level. The accessibility of household-level data over the last few decades, however, has opened up a wealth of research opportunities leading to considerable work on how market income has changed along the income distribution, and the relationship between changing income and the receipt of government transfer payments. Milanovic’s (2000) study was among the first along these lines. Using household level data from twenty-four countries in panels spanning twenty years, he examined the size of government transfers to income deciles to examine how governments responded to

changing income over time. While he concluded that governments redistribute more when inequality increases, his purpose was distinct from this paper's, and is silent on whether social transfers have decreased or shifted in their target over time. Pressman (2007, 2009) focuses on redistribution to the middle class over time, but provides little information on how the magnitude of social transfers may have changed over time, nor does he compare transfers to the middle class with those to the poor. Dallingier's (2011) analysis of trends in social transfers to different quintiles over time suggests that in the US, a relative shift in social transfers from the poor to the middle class may have occurred between the mid 1980s and mid 2000s, although her data and analysis of it is not detailed enough to draw any definitive conclusion.

Income and Social Transfers in the US

Data Description

In this section, I investigate two questions: have US policies that redistribute income become less generous over time, and/or has the target of these policies shifted from the poorest household to those closer to the middle of the income distribution? To answer this, I use household-level information on market earnings as well as taxes paid and government transfers received derived from the US Department of Labor's Current Population Survey. A slightly modified version of this data (used in this paper) is available through the Luxembourg Income Study (LIS), where variables are adjusted to meet international standards. LIS contains ten waves of annual data on income in US households and the sources of that income. The first wave dates to 1974, with subsequent ones spaced every three or four years, with the last in 2010. Each wave contains income data for at least 25,000 and up to 200,000 individuals.

Because my purpose is to examine the changing magnitude and distributional impact of social transfers over a long time span, I begin with a descriptive analysis of both market income and net government transfers by quintile groups, where net government transfers—what I refer to in this paper as social transfers—include the combined effect of taxes paid and cash and near-cash transfers received. I follow this up with a statistical analysis using individual-level data of trends in the magnitude and target of these transfers. In this paper I label the bottom quintile as the poor, and the middle three quintiles as the middle class. Since I am investigating a thirty-six year period (1974-2010), it is important to point out that households in this study are not categorized into groups based on a static definition of income, but rather based on their position relative to the nation's income distribution. This allows me to evaluate changes in the impact of social policy over time as it has affected people occupying the same rungs of the economic ladder over time, rather than those earning similar incomes but occupying different economic positions.

To examine how social policy has responded to the changing distribution of income, particularly among those in the middle, an important question arises about whether or not to include the retired population. In this paper, I follow a common practice of limiting individuals in this study to those below the age of sixty. The reason researchers frequently make this choice is that pay-as-you-go pension policies such as Social Security are primarily intergenerational rather than interpersonal transfers. This feature makes them especially enduring, and not subject to immediate policy changes; these policies thus do not lend themselves to investigating changes over time. Including older citizens is also problematic because they are the primary recipients of social transfers, and those to seniors are especially redistributive (Garfinkle, Rainwater and Smeeding 2005; Wang, Caminada, and Goudswaard 2012). Given the size and distributional

impact of public pension policies, including the elderly in this analysis would mask trends in transfers among the non-elderly population that I wish to focus on. Finally, the problem of endogeneity (the generosity of social transfers determining the amount people earn in markets, instead of the other way around) looms large with older citizens. It is for these reasons that I exclude individuals aged sixty and above.

As mentioned, LIS contains ten waves of US data, the first dating to 1974.¹ Every LIS wave contains detailed income data from tens of thousands of households, each of which is assigned a household weight for making national-level estimations. In this study I disaggregate household income to the person level, with each person in the household given an identical income, called “equivalent income,” which is an estimate of the resources available to him or her arrived at by taking household economies of scale into account (see the Appendix for detail).

For each of the ten waves of household data, I create quintiles based on individuals’ (equivalized) market income. Market income is all income earned from capital and labor markets, plus any income from private pensions. All dollar amounts in this paper are expressed in real 2005 dollars.

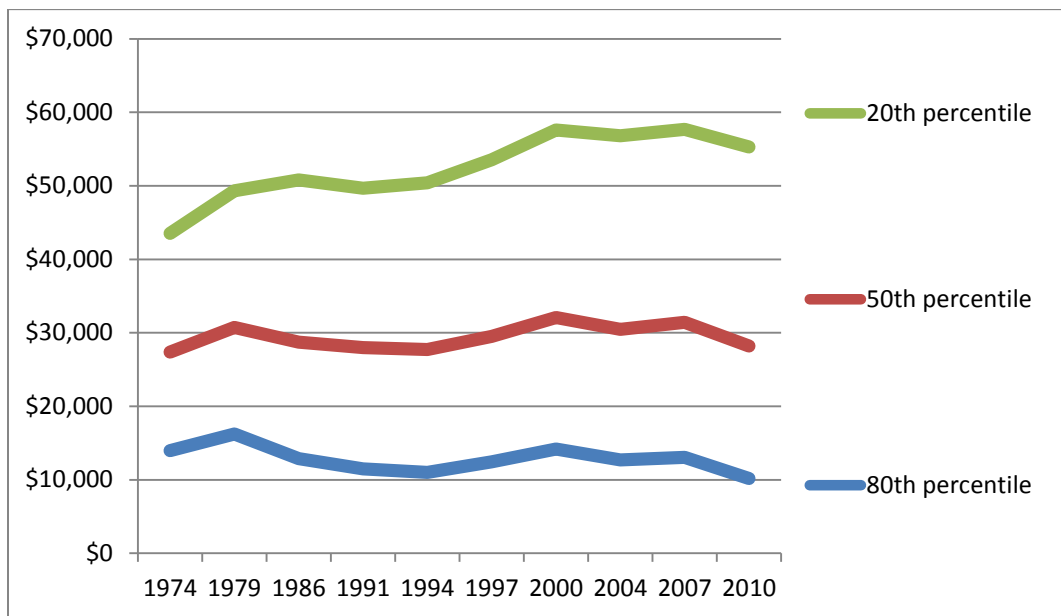
The Distribution of Middle Class Income, 1974-2010

First I describe income trends within the middle three quintiles, my definition of the middle class. Figure 1 shows trends in the lower and upper bounds (the 20th and 80th percentile) of the middle class over the thirty-six years covered in this study; also included is median income (the 50th percentile). As shown, median income has hovered around \$30,000, while the bottom range of the middle class declined over the first half of the period, and held steady at around \$12,000 over the second half. The upper income range of the middle class, on the other hand, has slowly but steadily increased. As figure 1 shows, the combined effect over the last four

¹ The first wave from 1969 cannot be used because some key variables are missing.

decades is a clear widening of the range of income within the middle of the income distribution. In 1974 those among the middle class with the most market earnings had income three times larger than did those at the bottom of the middle class. By 2010, however, this spread between the top and bottom boundary of the middle class had nearly doubled. Clearly, earnings among those in the middle class have become more dissimilar over time.

Figure 1. The Boundaries of Middle Class Market Income, 1974-2010

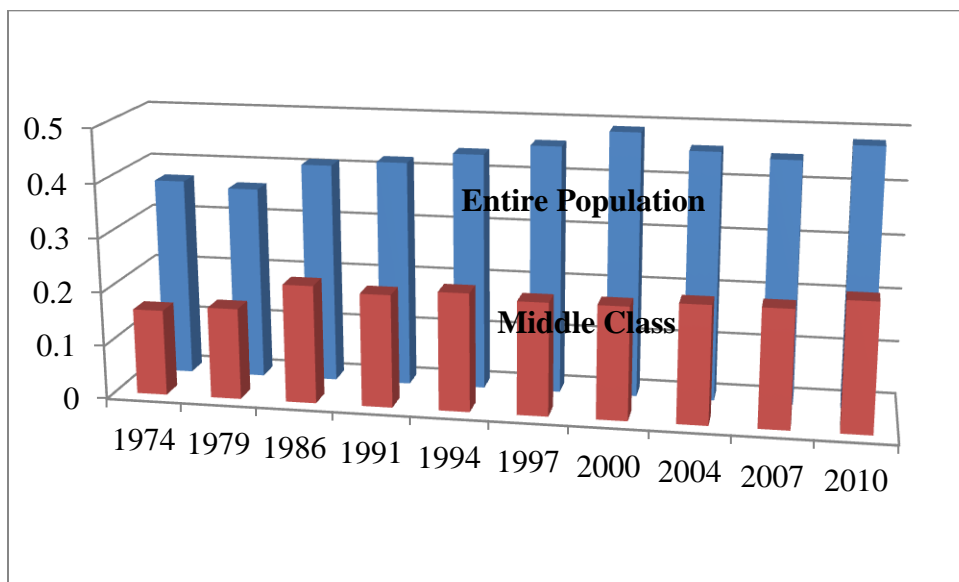


Source: Author calculation.

As an alternative to examining how the top and bottom boundaries of the middle class has changed over time, we can also summarize changes in the distribution of middle class income by calculating a Gini coefficient for those within it. I show the results of this calculation in figure 2 for each of the ten waves of data. For comparative purposes, I also included the Gini coefficient based on combining all five quintiles. Figure 2 shows what is already well known: since 1980, earnings inequality in the US has steadily grown. Less well known, though, but

evident in figure 2, is that growth in earnings inequality among the middle 60 percent of the income distribution outstripped the growth in inequality among the population as a whole. Among the middle 60 percent, the Gini coefficient grew by 50 percent (from .16 to .24), while among the entire population, it grew by only 30 percent (from .37 to .48). In absolute terms, the Gini coefficients for both populations increased by nearly the same amount. This single statistic underscores the significant growth occurring in income dispersion within the middle class, as well as the central role this increase has played in the US's widening income inequality.

Figure 2. Earnings Gini Coefficient, Middle Class Versus Entire Population, 1974-2010



Source: Author calculation.

Redistribution and the Middle Class

Having investigated movements in the distribution of earned income within the middle class over the last four decades, I turn now to analyze trends in social transfers to this group. I do this by both evaluating the magnitude of transfers to the middle class, and by comparing these

with the amount received by the bottom quintile. Is there evidence that social transfers have either become less generous, or have shifted from the poor to the middle class?

In this paper, I define social transfers as the combined effect of both tax payments to and transfer payments from the government. Transfer payments come from federal universal, work-related, and public assistance policies, and include both cash and near-cash benefits such as food stamps and housing subsidies. The calculation of social transfers does not include the value of any health benefits received, nor does it include the many other ways that the federal government provides goods and services that affect some income groups more than others -- parks, libraries, and public schools being but a few examples. In this sense, the paper somewhat narrowly explores the changing influence of the government only on disposable income, rather than examining its influence on a broader and more encompassing measurement of social welfare.²

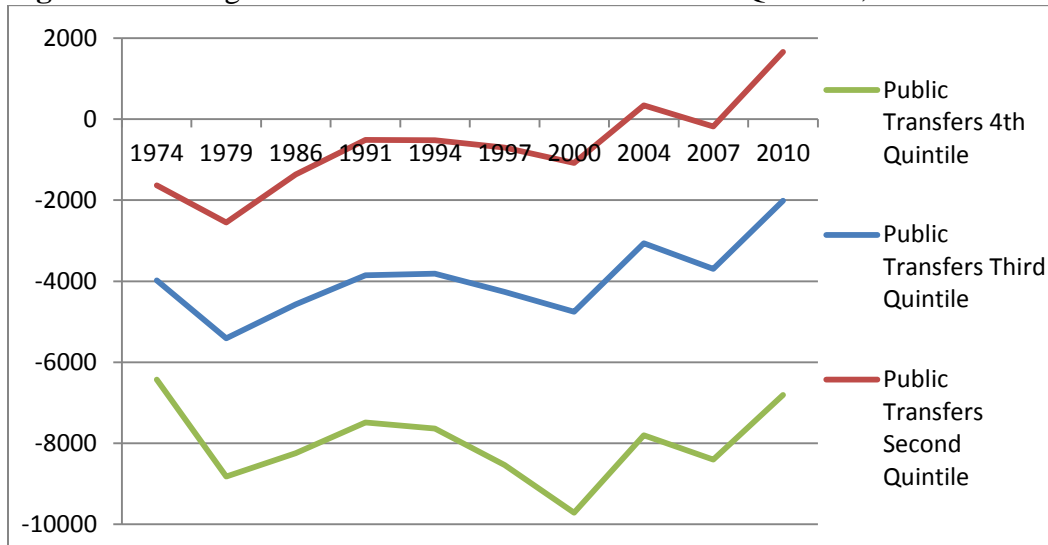
Typically, we expect the value of social transfers to be high for low income households since they usually receive larger amounts of cash and near-cash assistance and pay less in taxes. We similarly would expect social transfers to decline with income, turning negative for higher income households. A negative value for “social transfers” indicates that a household pays more in taxes than it receives in government transfer payments. A final key variable is disposable income—sometimes referred to as “post-government” income. This definition of income accounts for the effect of social transfers on income, and thus is measured as market income plus the value of social transfers.

As displayed earlier in figure 1, over the thirty-six year period of this study median earned income among the middle 60 percent of the population remained steady at around \$30,000, with dispersion around this median increasing over time. Figure 3 below presents the mean value of social transfers received by individuals within each of the middle three quintiles.

² See for instance Janet Currie, 2006, *The Invisible Safety Net*. Princeton University Press.

With the exception of the 1990s, we see that on average social transfers grew steadily for those in the second and third quintiles. This suggests that social transfers have succeeded in at least partially compensating for the adverse labor market trends among those in the lower middle class displayed in figure 1.

Figure 3. Average Social Transfers to the Middle Three Quintiles, 1974-2010



Source: Author calculation.

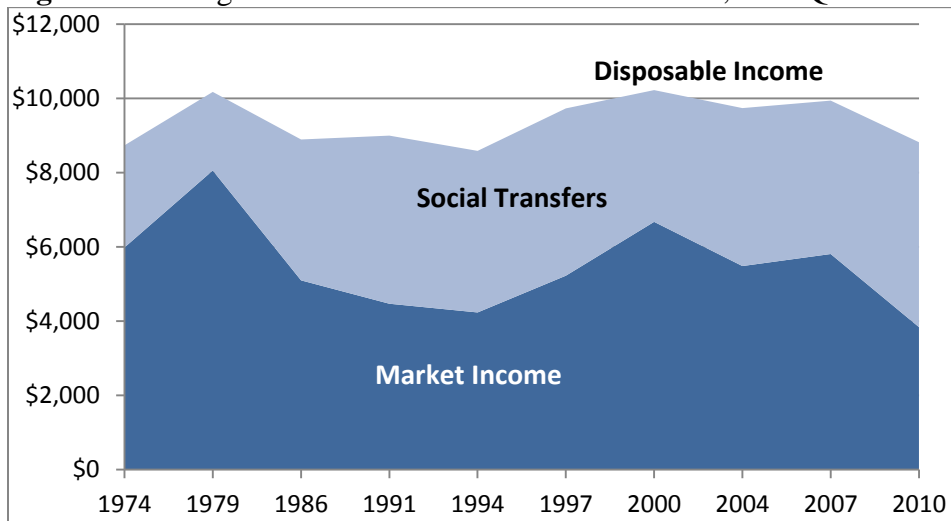
How do trends in social transfers to the middle class compare with those to the poor?

Figure 4 below shows the separate contribution made by earned income and social transfers to disposable income among the bottom quintile. As can be seen, market income has been both volatile and declining over the last decade. Social transfers, on the other hand, have remained fairly steady since the mid 1980's, and have succeeded in stabilizing disposable income so that it averaged around \$9,000 to \$10,000 over the four decades of this study.

Average incomes and trends in these averages provide an incomplete picture of the changing treatment of income groups by government policy, in part because over time the economic context changes. While a net social transfer of \$4,000 in 1974 (adjusted for inflation)

amounted to about 14 percent of average income that year, the same amount in 2007 equaled only 10 percent of that year's average income. To compare transfers over time, we should account for the changing ability of the nation to afford these transfers; similarly, comparisons of

Figure 4. Average Market Income and Social Transfers, First Quintile 1974-2010



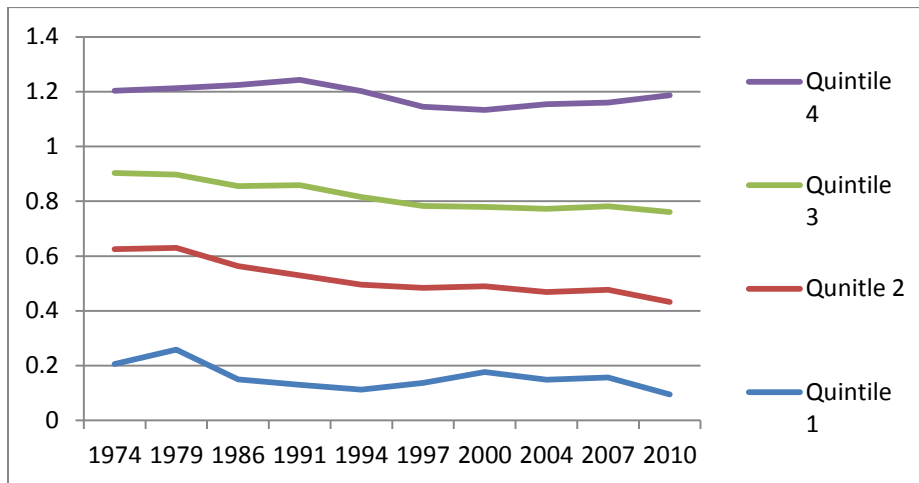
Source: Author calculation.

earned income should account for changes in the nation's ability to generate income. For these reasons, I'll now switch to expressing the value of market income and social transfers to different quintiles by presenting them relative to mean income in that year. With this formulation, if an individual's income equaled the national average, his or her income would be represented by a value of 1, whereas the income of someone with half the national average would be indicated by a value of .5.

Trends in market income (figure 5) and social transfers (figure 6) are presented below by quintile group, with dollar values expressed by this new relative measure of income. Over the last four decades, income among the upper middle class (those falling in the 60-80 percentile) has remained steady at around 120 percent of the nation's average income; meanwhile, income

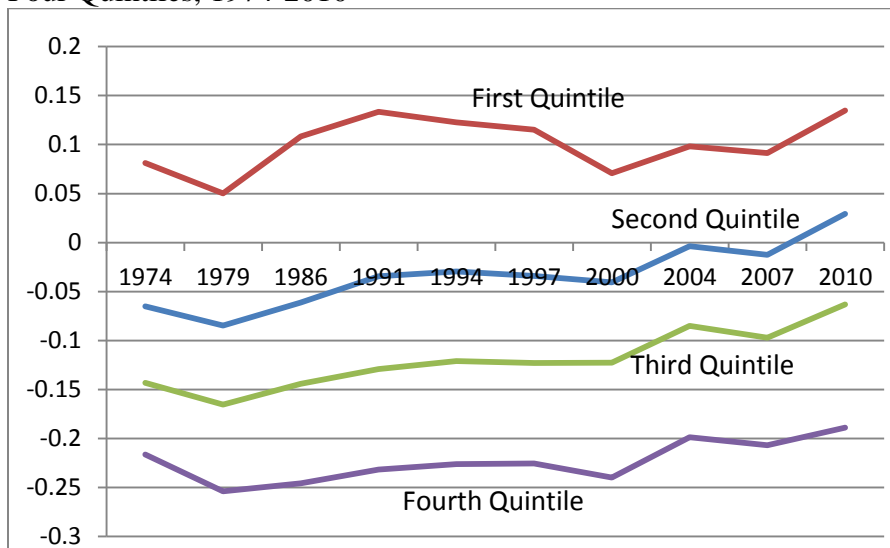
among the first three quintiles has slowly but steadily declined. The poorest quintile suffered the steepest decline in earned income relative to its starting point, falling in half from about 20 percent of mean income in 1974 to about 10 percent in 2010. But income among the second and third quintiles has also witnessed an important erosion over time.

Figure 5. Average Market Income as a Share of Average National Income, Bottom Four Quintiles, 1974-2010



Source: Author calculation.

Figure 6. Average Social Transfers as a Share of Average National Income, Bottom Four Quintiles, 1974-2010



Source: Author calculation.

As shown in figure 6, the income trends displayed in figure 5 have been accompanied by a steady upward trend in social transfers to those in the second and third quintiles, and a more modest upward trend among those in the fourth. Social transfers to the poor, on the other hand—the first quintile--have been more variable and without an obvious long-term trend.

While this visual representation suggests that policy has been more responsive to changes occurring in the middle of the income distribution than to those at the bottom, the aggregated nature of the data obscures extensive information at the household level, making it difficult to tease out statistical relationships over time and across different parts of the income distribution. To that end, I turn now to examining disaggregated individual-level information on both market income and social transfers. I use regression analysis to investigate whether transfers have fallen over time, or perhaps have fallen for those in particular income ranges.

The dependent variable in this analysis is the value of social transfers to individuals expressed as a share of that year's mean national income. Table 1 model 1 presents the statistical relationship between the social transfers individuals receive and their market income (also expressed as a share of mean national income) based on all observations from all ten waves of data. The adjusted R2 of .81 indicates that income is a very strong predictor of the value of social transfers to individuals, explaining 81 percent of the variation in social transfers to individuals within and among years. The coefficient on income of -.36 in model 1 indicates that

Table 1. Estimated Coefficients Associated with Social Transfers to Individuals, 1974-2010

| | Model 1 | Model 2 | Model 3 | Model 4 | Model 5 |
|--|---------|---------|---------|---------|---------|
| <i>Dependent Variable: Transfers as a share of average national earnings</i> | | | | | |
| Constant | 0.18 | 0.20 | 0.19 | 0.19 | 0.16 |

| | | | | | |
|--|-----------|-------|-------|-------|-------|
| Income (unstand) | -0.36 | -0.38 | -0.38 | -0.38 | -0.36 |
| Quintile 1 (D) | | -0.03 | -0.03 | -0.03 | |
| Decile 1 (D) | | | | | 0.03 |
| Quintile 2 (D) | | -0.02 | -0.02 | -0.02 | -0.01 |
| Quintile 4 (D) | | 0.03 | 0.03 | 0.04 | 0.03 |
| Quintile 5 (D) | | 0.04 | 0.04 | 0.02 | 0.00 |
| 1974 (D) | | 0.02 | | | |
| 1979 (D) | | -0.04 | | | |
| 1986 (D) | | -0.01 | | | |
| 1991 (D) | | 0.01 | | | |
| 1997 (D) | | -0.01 | | | |
| 2000 (D) | | -0.03 | | | |
| 2004 (D) | | 0.01 | | | |
| 2007 (D) | | 0.01 | | | |
| 2010 (D) | | 0.00 | | | |
| Time Trend | | | 0.00 | | |
| Q1 * Time Trend | | | | 0.00 | 0.00 |
| Q2 * Time Trend | | | | 0.00 | 0.00 |
| Q3 * Time Trend | | | | 0.00 | 0.00 |
| Q4 * Time Trend | | | | 0.00 | 0.00 |
| Q5 * Time Trend | | | | 0.01 | 0.01 |
| D1* Time Trend | | | | | 0.00 |
| Adj R2 | 0.81 | 0.81 | 0.81 | 0.82 | 0.82 |
| No. Observations: | 1,079,124 | | | | |
| <i>Notes: (D) denotes dummy variable. p<.01 for all coefficients.</i> | | | | | |

a one dollar increase in income is associated with a 36 cent decrease in transfers.³ In model 2, I include quintile and year fixed effects to test if the relationship between income and social transfers differs by year and/or by income level, with the middle quintile (Q3) and 1994 used as reference points.

The values associated with the quintile dummy variables in model 2 indicate a surprising result. Intuitively, we might expect (or hope) that those with lower income would receive larger

³All relationships reported in table 1 are statistically significant at the 1 percent level of confidence. Because of the very large number of observations in this study, that is not surprising. For this reason, more attention should be paid to whether coefficients are *meaningfully* different from zero rather than *statistically* different.

social transfers than income alone would predict, and that richer citizens would receive social transfers below those predicted by a linear relationship between income and transfers. Such a pattern would suggest a more progressive structure to social transfers—disproportionately large relative to income among the poor, and disproportionately small (negative) relative to income for the rich. As model 2 indicates, however, the pattern is the reverse: controlling for a constant relationship (or slope) between income and social transfers among all citizens, social transfers increase as one moves up the income ladder.

The time dummy variables, on the other hand, do not indicate any pattern to the size of social transfers over time; while each year is associated with a statistically significant increase or decrease in average transfers relative to 1994, the variation by year is not large and lacks an obvious pattern. Indeed, replacing the year dummy variables with a time trend variable (model 3) further finds no evidence that social transfers have declined over time.

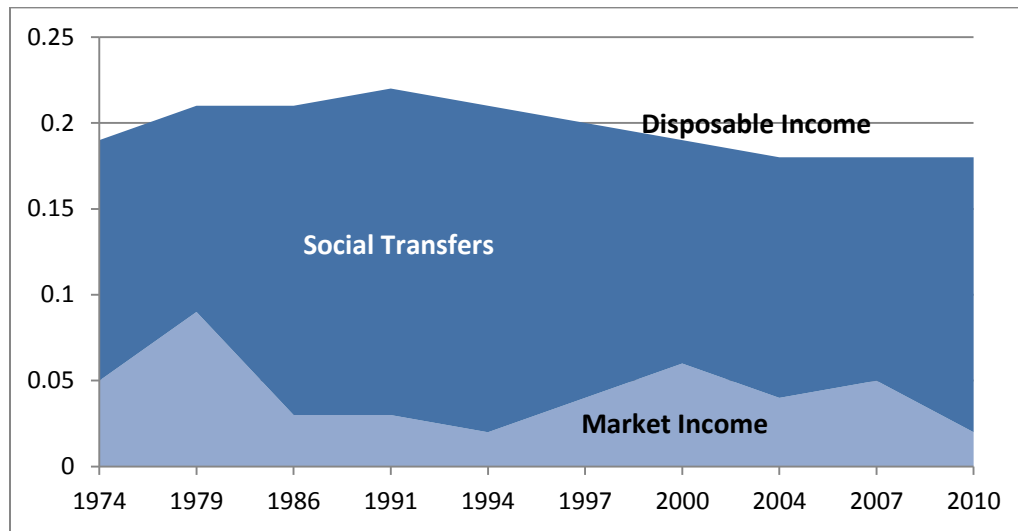
The results so far suggest that holding constant individuals' income, social transfers have overall remained remarkably constant over time: individuals with similar incomes over time have received similar amounts of social transfers. Yet lack of evidence for any general pattern over time could mask changes occurring at different points in the income distribution. For instance, if transfers over time have fallen for the poor but risen for the rich or middle class, any overall assessment of a time pattern may be cancelled out by opposing trends.

To examine this possibility, I test for the presence of different time trends occurring at different points in the income distribution in the size of transfers to these households. The results of this analysis are presented in table 1 model 4. As shown, I find either no or a positive time trend for each quintile, and the one positive value (for the top 20 percent) is small. While

not shown, these results hold up using unweighted observations as well as using a variety of alternative specifications.

The failure to find evidence of a long term trend in the size or target of redistributive policies in the US could be because I have not specifically examined trends at the very tail end of the income distribution. In his book *Progress for the Poor* (2011), Lane Kenworthy focuses on the plight of those in the bottom 10 percent of the income distribution, and shows how in a wide range of rich countries, these individuals are especially dependent on social transfers for their income, and are also especially vulnerable to labor market instability. Moreover, his work suggests that social policies may be moving away from addressing extreme poverty (helping those in the bottom 10 percent) and instead addressing the needs of those with stronger workforce attachments. This tendency is one Moffitt (2013) found when he examined how new spending during the Great Recession was distributed: those around the poverty line received more than those significantly below it. Perhaps the bottom 10 percent, and not the bottom 20 percent, have been increasingly neglected by social policy?

Figure 7. Average Market Income and Social Transfers as a Share of Mean National Income, Bottom Decile, 1974-2010



Source: Author calculation.

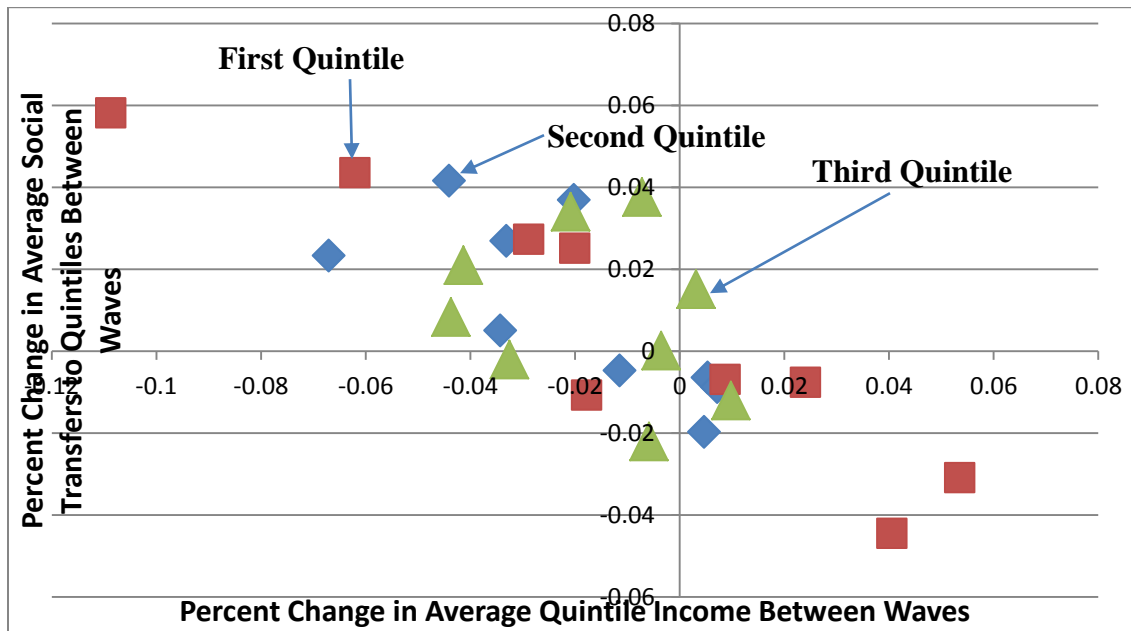
To explore this, I first show in figure 7 the separate average contribution of market income and social transfers to disposal income among the bottom 10 percent of the income distribution. In 1974, households in the bottom decile on average earned the equivalent of 5 percent of mean national income that year, and net social transfers to this group, equaled 14 percent of average national income, leaving those in this income group with an average disposable income equal to 19 percent of the average national income that year. In 2010, the respective numbers were 2 percent for earned income and 16 percent for social transfers, for a total disposable income of 18 percent of average national income.

Have social transfers to this group decreased, either absolutely or relative to other income groups? Table 1 model 5 presents the results of a formal analysis of this question. As shown, controlling for income, the results do not indicate a discernable downward trend in the size of transfers to this group. Instead, social policy has responded to changes in income within this group in a manner consistent over time and consistent with how it has responded to changes in

income among those in other income groups as well. Thus, the evidence again indicates that over the period 1974 to 2010, social transfers in the US have remained amazingly constant both over time and across various points of the income distribution: Those with similar levels of income over the thirty-six year time frame received nearly identical amounts of social transfers. Figure 8 below visually underscores this finding. It presents averages for those among the bottom three quintiles; changes in the average income shares by quintile from one LIS wave to another is presented on the horizontal axis, and the vertical axis corresponds with changes in average social transfers to those in each quintile. The figure displays a striking degree of consistency both over time and across these three quintiles in the manner in which social transfers have responded to the changing economic circumstances of those within different income groups.

One final possibility I investigate is whether holes in the US's safety net have become larger over time, leaving more people beyond the net's reach. Since the 1990s, public assistance policies have prioritized work and sought to restrict eligibility, for instance based on time limits or immigration status. Has this left a larger population excluded from policies providing social protection? To examine this, I looked at the population of non-elderly citizens each year making less than 50 percent of that year's median income (one way of defining "low income"). Since 1990, between 23 and 25 percent of the (non-elderly) population fell in this income range, with the exception of 2010 (27 percent). I then asked what percentage of these low-income citizens received very few social transfers, and defined these as the "socially excluded." I chose a receipt of social transfers equaling less than 2 percent of mean income that year as the cutoff between the socially excluded and the socially included (the average value of social transfers to this low

Figure 8. Percent changes in Income Shares (X) and Social Transfers (Y) Between LIS Waves, Bottom Three Quintiles, 1974-2010



Source: Author calculation.

income group ranged from .07 percent in 1979 to .12 percent in both 1991 and 2010).

Surprisingly, the percent of those with low income who were excluded from social protection has fallen over time. In the 1970s and 1980s, almost 50 percent of those with income less than half the median were excluded “socially excluded;” during the 1990s, this percentage dropped to around one-third of the low-income population; and during the first decade of the 21st century, the “socially-excluded” further dropped to below 30 percent of low income citizens. At least based on this definition of “social exclusion,” I do not find evidence that the US’s safety net has been cast more selectively over time. If anything, a porous safety net has become less so over time.

Discussion

Income among those in the middle class, which I've defined as the middle 60 percent of the non-elderly population, has become increasingly unequal over the last several decades. In fact, income inequality among those in this group has grown at least as fast as it has among the population as a whole. Couple this with growing income volatility and greater downward economic mobility, and it is not hard to imagine how a shift in the target of social policy from the poor to a struggling middle could occur.

Yet despite this, I find that the amount of income redistribution to households occupying different points in the income distribution has been surprisingly consistent over time. Over the four decades covered in this study, I find that income is the single best predictor of social transfers to households; and I do not find evidence that the relationship between income and social transfers has shifted over time, either downward or from one income group to another. Such stability in the size and target of social policy is remarkable, and is especially striking considering the degree of income volatility that has occurred, especially among the bottom 40 percent of the population. With the challenge of growing income inequality and rising income insecurity, the redistribution of income via the combined, aggregated effect of tax and social policy has not noticeably changed. Despite the fears of many (and hopes of others), the state's role in redistributing resources among its citizens is neither in retreat nor drifted away from the poor.

How can we reconcile the evidence presented here with the widespread sense, and indeed evidence of some, that social policy is either in retreat or has at least shifted away from those with the most economic needs?

One possible explanation is that policy retreats have occurred in what we might call the visible welfare state—that is, in the programs citizens are most familiar with, such as food stamps, AFDC/TANF, and on the negative side of the equation, a reduction in the marginal tax rates paid by the wealthiest. Meanwhile, the less visible or unknown elements of it, such as the various tax expenditures and Social Security’s disability payments, have expanded. The more visible elements of social policy might be especially vulnerable politically to retrenchment pressure because of their symbolic value; and changes in these more visible elements might similarly be quickly protested against by those who monitor and guard against a retrenchment in social policy. These more visible policy arenas may have become the political touchstone of those on the right seeking to reduce the state’s role in redistributing income, and those on the left seeking to protect or expand it.

A quick look at the press reveals that indeed food stamps, TANF policies, and marginal taxes on the wealthy receive more attention than their monetary importance alone might merit, while less attention is paid to EITC, the child tax credit, and Social Security’s disability program--all of which have grown dramatically over the last two decades, and in dollar amounts are among the most important components of social policy in the US. For instance, steady expansions to EITC eligibility means that this tax credit is now distributed to about one out of every five Americans filing an income tax return (Tavernise 2012); and since 1985, the percent of workers enrolled in SSDI has doubled (CBPP 2014). Moreover, the extensive press coverage devoted to cuts in the food stamps program generally failed to place those cuts—which as a share of the total food stamps budget were quite small--within the context of the program’s steady growth over the last fifteen years. Politics and political messaging may result in specific programs receiving the public’s attention far in excess of their overall importance, and changes

in these programs may not reflect general trends occurring in social transfers to households. Political pressure on social policy often results in eclectic and inconsistent policy responses, the total effect of which may not be accurately conveyed to or appreciated by the public.

The suggestion, then, is that the politics around social policy in the US may result in directing the public's attention to a subset of changes which are not reflective of the overall trend in social policy. Whether true or not, however, this does not explain why a retrenchment, or a shift in the distribution of social transfers from the poor to the middle class, did not in fact occur.

On this score, the lack of retrenchment may indicate that scholars who have predicted that economic changes may be broadening the pool of constituents in support of social spending, have been right. As discussed earlier, Rehm, Hacker and Schleigner (2012) identify two natural constituents for redistributive policies: the economically disadvantaged, and the economically insecure. As shown in this paper, changes in labor markets over the last several decades have resulted in both declining income and increasing income volatility within many middle class households; this coupled with increased downward mobility could be broadening political support for social spending. Indeed, over the last few decades the US has moved away from its former reliance on means-tested policies to ones that include a much broader range of recipients (Kenworthy 2011; Marx et al. 2013).

A second reason could be that social policies have worked as designed: as more households find themselves slipping down the income ladder, more become eligible for different social programs, and in addition, find their taxes reduced. This is the "automatic compensatory response" (Kenworthy and Pontusson 2005, 453) that we expect of welfare policy.

Another explanation may lie in the important role played by tax policy in redistributing income, a contributing factor that is often overlooked in studies examining the distributional

impact of social policy. The US relies much more on its tax system to redistribute income than do almost all other countries (IMF 2013, 35). Today more than 40 percent of Americans pay no federal income taxes, and many of these even receive a payment from the government (made possible when tax credits exceed tax liability). While there is considerable public attention placed on how much or little wealthy Americans pay in taxes, the importance of tax policy—particular the various deductions and credits—on advancing social objectives is often overlooked, as is the highly progressive nature of federal income taxes. Failure to account for the effect of tax policy on income redistribution omits a key instrument in the government’s tool kit.

A final explanation may rest in one numerous observers of social policy advance: when it comes to social policy, a host of obstacles confront any effort to reverse course. This could be especially true in the US, where federal policy is constrained by political institutions and processes that make difficult any reversal of policy. Perhaps Paul Pierson was and is still right when he asserted in 1996: “The welfare state remains the most resilient aspect of the postwar political economy” (179).

Conclusions

How has a growing divide within the middle class, which is contributing to the growth in inequality taking place in many rich countries, influenced the size and distribution of social transfers? I’ve investigated this question through a case study of the relationship between earned income and social transfers within the US’s non-elderly population beginning in the 1970’s and ending in 2010. In an era of rising budget constraints and growing labor market uncertainty, it is reasonable to expect that middle class voters may have both the political clout as well as the will to reorient social policies to ones that target those higher in the income distribution. Scholars

exploring the relationship between inequality and redistribution have generally not disentangled the sources of growing inequality to examine how the nature of inequality, particularly economic stagnation and growing insecurity among those in the middle of the income distribution, may be affecting the “welfare state.”

While the paper is primarily descriptive and conceptual rather than causal, I’ve investigated two claims: that in the US there has been a reversal in the state’s role in redistributing income, and that social policies have shifted from targeting the poorest citizens to instead targeting those higher up in the income distribution. I have also exclusively limited the examination to the government’s role in redistributing market income, ignoring the role (or potential role) of the federal government in influencing the income citizens earn through markets, an area where governments can have a significant role both in structuring labor markets and influencing the human capital citizens bring to those markets. For the former, the US government’s laissez faire policies contrast with the more active labor market policies characterizing many rich countries; and the latter raises questions around the quality, and distribution of that quality, of the US’s educational system.

In a 1983 article in the *Atlantic Monthly*, Bob Kuttner warned that “The government’s existing income support programs simply are not designed to address this new problem [of the loss of middle income jobs]” and declared the government’s role in redistributing income as “all but extinct.” Kuttner’s comment reflects a longstanding premise among scholars that welfare policies which, like those of the US, rely heavily on means-tested ones, are weak at redistributing income, vulnerable to cutbacks, and lack the political support for expansion. This is in part because, as Korpi and Palme (1998) argue, such policies offer

...no rational base for a coalition between those above and below the poverty line....[It] splits the working class and tends to generate coalitions between better off workers and the middle class against the lower sections of the working class. (663)

While a longstanding belief, my results add to recent evidence indicating that welfare states have been responding in unexpected ways. Kenworthy's (2011) investigation shows that countries' redistributive effort does not depend on their degree of targeting. Marx et al. (2013) engage in an even more thorough investigation of the claim, and convincingly overturn it. It seems, in fact, that social policies with the original intent of primarily providing income support to the poor have the ability to both resist cutbacks and expand their scope and target upward into the income distribution, without reducing assistance to the poor. Indeed, the US's Earned Income Tax Credit (EITC)—a tax credit that provides income support reaching into the middle class--enjoys strong support across the political spectrum.

The evidence in this paper indicates that there has neither been a retrenchment nor a drift in the target of social transfers. Rather, social transfers have shown a tremendous degree of stability over time, which in this paper means that the *relationship* between market income and social transfers has not changed over time nor drifted from one group to another.

A finding of "stability," on the other hand, could be a way of calling the glass half-full. While one could label the US's "welfare state" as having been resilient over the time period covered in this paper, another characterization could be that it has been unresponsive: the collective effect of its policies have done little to improve growing economic insecurity. Given that the income of a majority of households relative to the national average has been falling, that income has become more volatile, and given evidence that transfers are not as progressive as many would judge right, one could consider that the failure of policy over time to do more than exhibit stability or resilience is indicative of the unresponsiveness of policy to the economic

trends affecting the bottom 60 percent of the population. Indeed, one interpretation of this paper's results is that the politics of social policy in the US has matured into a resilient part of American society that also resists the challenges that a turbulent twenty-first century has ushered in.

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Appendix: Definitions of Variables and Sources

Note: All data, except the CPI deflator, come from LIS, and are available at their website <http://www.lisdatacenter.org>. All figures presented in this paper are based on the weighted values for all those under the age of 60. All income and social transfer data are calculated as equivalized values.

Market income: Income earned from labor and capital markets, plus private pensions (factor + hitsilo). All negative income values were bottom coded to zero.

Social Transfers: The value of government transfers (cash and near cash) minus taxes (hitsi-hitsilo+hitsu+hitsa-hxit). Before 2000, US datasets did not include a value for universal benefits (hitsu). For these years, I assumed the value was zero.

Disposable Income: Market Income + Social Transfers. All negative values were bottom coded to zero.

Equivalized Income: Information on income by source is available at the household. To assign income values to individuals within a household, I calculate equivalized values for individuals; all income in this paper are expressed as such. As recommended by LIS, I calculate equivalized income for an individual as the dollar amount for the household divided by the square root of the number of people in the household.

CPI Adjustment: Available from OECD.stat and based on CPI index for all items, with 2005 as the reference year.