LIS
Working Paper Series

No. 617

The US Safety Net in an Era of Middle Class Decline: Has it drifted from the poor?

Katherine Baird

October 2014

Luxembourg Income Study (LIS), asbl

The US Safety Net in an Era of Middle Class Decline: Has it drifted from the poor?

Katherine Baird
Associate Professor of Economics
University of Washington Tacoma
kebaird@uw.edu

Revised in December 2014

Abstract

A key feature of growing inequality today, and one often overlooked by scholars, is economic stagnation within the middle class. I take a fresh look at the relationship between middle class incomes and redistributive policies by spotlighting changes within the American middle class, and the role this may play in shaping the US's redistributive polices. Using four decades of household data, the paper brings new 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 resulted in an expansion of social policy or possibly a drift away from the poor. The evidence presented here unambiguously shows that the value of government transfers to individuals (which includes a combination of tax payments and social benefits) has increased over time across the income distribution. While family benefits have drifted from the poor to the middle class, overall I do not find evidence of a general policy drift. However, I do find that government transfers have increasingly targeted the middle class, particularly those in its lower ranges. I trace nearly all of the growth in government transfers to the middle to the Child Tax Credit and the EITC. Accompanying these tax credits, however, have been highly regressive changes in other features of income tax policy. The paper's results highlight the malleable features of US social policy, and shows how the widespread use of tax policy for dispensing social benefits fosters widely dispersed benefits that can also marginalize or possibly even harm the poor.

Key Terms: income redistribution, social policy, American middle class, politics and inequality

A key feature of growing inequality today, and one often overlooked by scholars, is economic stagnation within the middle class. In this paper I take a fresh look at the relationship between middle class incomes and redistributive policies by spotlighting changes within the middle class, and the role this may play in shaping countries' redistributive polices. I use the US as a case study to examine both the size and target of government transfers over time by decomposing household income over a four-decade period into the portion derived from markets and that contributed by government tax and transfer policies. My purpose is to investigate if tax and transfer policies have weakened over time, or if they have drifted in their target from the poor to the middle class.

While a vast literature investigates the role inequality plays in explaining the amount of income redistribution that occurs within countries, 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), for instance, insist that it is not inequality *per se* that influences how much income is redistributed in countries, but the form it takes: when the poor and middle class are economically more similar, and when the middle class and rich are less alike, support for income redistribution is apt to grow.

What effect if any does the combination of stagnating incomes, increasing economic insecurity, and widening gaps among middle class households today have on income protection policies? Has it contributed to broader support that one can see reflected in policy? Or might middle class decline put pressure on a limited budget, and result in shifting the target of policies to those higher up the income ladder? The increasing emphasis on work-related benefits, the declining value of minimum wages in the US, and falling marginal tax rates on capital might be seen as emblematic of such a drift. Indeed, evidence in a wide range of countries suggest that the

social protection provided the most vulnerable has been on the wane (Immervoll and Pearson 2009; Marchal, Marx, and Van Mechelen 2011), and many scholars have voiced concerns over the potential for social policy to drift from the poor (Kenworthy 2011; Moffitt 2013).

Of all countries, the US's particular policy environment may be most vulnerable to such a policy drift. For one, its income protection policies rely more heavily on social assistance as opposed to universal or social insurance policies. While such means-tested social policies have generally been aimed at the poor, select modifications could easily allow their target to drift upward in the income distribution--for example, by broadening the eligibility requirements, or restricting particular tax credits to those who pay income taxes. The US also relies more heavily than does most countries on income tax policies for meeting social objectives (IMF 2013), and these are easier to modify than are direct spending initiatives. A case study of the US, then, investigates 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 whether there is evidence for either of these trends.

SOCIAL POLICY, GROWING INEQUALITY AND MIDDLE CLASS DECLINE

Retrenchment or resilience?

Social policies within rich democracies today face inordinate challenges. Slow economic growth and a costly aging population contribute to doubts over countries' continued ability to fund last century's social programs. To this one must add strong anti-tax, small government movements in the US and elsewhere that have become an important feature of the political landscape (Economist 2014). Finally, the wake of the recent financial crisis has left many nations with large public debts they now struggle to repay. Today one finds considerable angst

over a potential of the state's role of providing citizens with minimum income and social protection guarantees to erode. That nations have been reducing their commitment to these social objectives has become a commonplace observation (Nelson 2007 and 2010; Korpi and Palme 2003; 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 commitment to greater social equality.

At the same time, scholars such as Paul Pierson (1996) have argued that the welfare state is resilient, and they call into question claims that political pressure will reduce it. Pierson contends that welfare state policies are an integral part of the political landscape, have become routinized with bureaucracies and institutional infrastructure that are hard to dismantle, and have strong constituents who guard against cutbacks. Francis Castles (2010, 98) colorfully employs the metaphor of "elephants on the move" to capture the difficulty of changing the welfare state's course:

> Modern welfare states have a massive inertia supplied precisely by the fact that they are an accretion of a vast set of institutional routines established over many, many, decades. Like elephants on the move, they are difficult to divert from their course because their size supplies momentum and their institutional routines supply a thick skin…

Inequality and social policy

Moreover, the premise that a falling public commitment to social protection is occurring at the same time that income inequality is on the rise presents something of a theoretical puzzle. For some time, many social scientists have contended that growing economic inequality should be met by pressure for the social spending to offset it. This position primarily dates to Romer's (1975) model of how countries determine the amount of redistribution each undertakes. Put simply, politicians seeking votes advocate for the combination of taxes and income redistribution

preferred by a decisive median voter. When income inequality grows, more redistribution to the bottom of the distribution results because democratically elected officials respond to the growing ranks of those who stand to gain more from redistributive policies than they will lose through the higher taxes to pay for it.

Critics of this median voter theory of how much redistribution occurs challenge the political influence it ascribes to the middle class, as well as its simplistic portrayal of complex political outcomes. Such critics tend to highlight the conflicts of interests that arise with income redistribution, and they underscore the importance of the political clout of those supporting more of it (Bradley et al. 2003). Many place social policies within the context of growing globalization, the latter of which may cause lawmakers to become even more beholden to the interests of the wealthy, the owners of capital, and the judgments of international financial markets (Bergh and Nilsson 2010). Some also point to the role that pre-existing levels of redistribution and political institutions may have in shaping individuals' preferences for more redistribution (Beramendi and Anderson 2008).

Middle class decline and social policy

How economic inequality influences the state's role in redistributing income is at heart a question of how income differences within a population affect attitudes, the political mechanisms for expressing those attitudes, and finally how lawmakers respond to any change in political pressure. Most academic attention has been devoted to examining the relationship between inequality and a nation's commitment to social protection using aggregate measures of this commitment—for instance reductions in Gini coefficients, or dollars spent on social spending. Yet a key feature of growing inequality today, and one that has received surprisingly little

attention in the scholarly literature, are the changes occurring not at the tails of the distribution, but rather within the middle.

To illustrate this trend, a recent study of twenty-five rich democracies over a two decade period found that twelve had fewer people falling within the middle of the income distribution, while only four had more (Bigot et al. 2012), a trend dating back to at least the 1980s (Pressman 2007). Dallinger (2013) shows many countries experienced a decline in the *income* share earned by those in the middle of the distribution over the period 1985-2005. Economic stagnation within the center of the income distribution has been especially strong in the US; recent data shows that middle class households today earn less in absolute terms than do their counterparts in many other rich countries (Leonhardt and Quealy 2014). Even American corporations are taking note of middle class malaise, as less money is being made on products that do not cater to the top or bottom of the income distribution (Schwartz 2014). Income dispersion within the middle of the income distribution has in fact become an increasingly important factor behind the US's growing income inequality.[1]

Not only is middle class income stagnating and growing more dissimilar, it is also becoming less secure as competition for skilled jobs stiffens. Couple this with rising health care, childcare, education and housing expenses, and less-protected sources of retirement income (Littrell et al 2010; Weller 2008; Center for American Progress 2014), and it is no surprise that the American middle class reports growing difficulty with maintaining their standard of living (Pew Research Center 2012). No wonder politicians and journalists alike frequently refer to the "loss" or "hollowing out" of the middle class--even labeling it "an endangered species" (Case 2012). President Barack Obama recently called rebuilding the middle class "my highest priority"

[1]In 2000, dispersion in market income among the middle 60 percent of the (non-elderly) population explained 27 percent of the Gini coefficient that year, a fraction that has been slowly growing, reaching 30 percent in 2013 (author calculation).

(Shear and Baker 2013), and has established a Middle Class Task Force charged with raising its living standards.

How if at all are such trends within the middle class changing the degree and target of income redistribution? Not many have investigated this question, although some recent work suggests it should expand support for income protection. Lupu and Pontusson (2011) argue that support for redistribution should grow when wages at the bottom half of the distribution become more alike while those in the top half more dissimilar, because the poor and middle classes will find more common political ground. If one considers the role not just of income inequality but income insecurity, less secure employment options within the middle class might also contribute to political pressure for stronger income protection policies, as Rehm, Hacker and Schlesinger (2012) predict.

Yet it is not completely obvious why earnings stagnation and job insecurity within the middle class should result in more social spending, particularly when it is hard to imagine any significant new spending initiative occurring. Especially in the US, increased political pressure from an anxious middle class could result in policy changes that redirect benefits from the more politically marginal poor toward a more politically influential middle class. There is reason to suspect that such a trend has indeed been taking place. A recent front-page article in the *New York Times* detailed how middle class Americans are becoming increasingly reliant on government transfers (Applebaum 2012). In 2011, 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 (2013) examined policy changes in the wake of the Great Recession, and found that new transfers in the US did a better job targeting the increased needs of those higher up the income scale than it did

those at the very bottom. 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).

INCOME AND GOVERNMENT TRANSFERS IN THE US

What effect if any has the combination of stagnating incomes and increasing economic insecurity among American middle class households had on the government role in income redistribution? One possibility is none: that the politics of retrenchment have counteracted any possible increase in political pressure for stronger income support policies. Another is that it has broadened and extended popular support for them. Finally, middle class decline could be putting pressure on a limited budget, leading to shifting policies that reach higher into the income distribution. In this section, I investigate two specific questions: first, has there been an overall reversal in the role of the government in providing income protection? Second, has the magnitude of government transfers to individuals shifted over time from the poorest household to those closer to the middle of the income distribution?

Data description

To examine these two questions, I use household-level information on market earnings, taxes paid and social transfers received from eleven waves of annual US data from the Luxembourg Income Study (LIS). The first wave dates to 1974 with subsequent waves typically spaced every three or four years, with the last transpiring in 2013. Every wave contains detailed income data on 33,000 to 200,000 individuals, with each assigned a weight for making national-level estimations.

Because my purpose is to examine the changing magnitude and distributional impact of government transfers over a long time span, I begin by describing trends in both market income and government transfers within the middle class, where government transfers (defined in greater detail below) consist of the *combined* effect of taxes paid and cash and near-cash social benefits received. Following this, I use regression analysis to investigate the magnitude and target of these transfers overtime. In this paper, I label the bottom quintile as the poor, and the middle three quintiles as the middle class. Since I am investigating four decades (1974-2013), it is important to point out that this categorization of individuals is not based on a static definition of income, but rather on one's position in the nation's income distribution. Defining the middle class as the middle 60 percent of the population instead of as a class of people falling within a particular income range (a common alternative) allows me to describe changes occurring within a constant proportion of the population over time, which makes comparisons across time more intuitive. It is worth noting here, however, that the conclusions I arrive at are not sensitive to this particular definition of the middle class.

To examine trends in social policy while taking into account the changing levels and distribution of income, I limit the sample of individuals to non-elderly ones (sixty and over). Given the size and distributional impact of Social Security (Garfinkle, Rainwater and Smeeding 2005; Wang, Caminada, and Goudswaard 2012) as well as the difficulty of changing its benefit levels, including the elderly in this analysis could mask trends in the more pliable social policies directed at the non-elderly population.

For each of the eleven waves (the first dating to 1974),[2] I calculate an adjusted market income by converting household income into individual income by assigning each household member an identical amount of household income. "Equivalent income," as this modification is

[2] The first LIS wave of US data from 1969 is missing some key variables, and therefore is excluded.

called, is an estimate of the resources available to each household member by adjusting household income by household size.[3]

For descriptive purposes, I first create income quintiles based on individuals' 'equivalized' market income for each of the eleven waves of data., where I define market income as all income earned from capital and labor markets, plus private pensions (Appendix A contains further detail). Disposable income (sometimes called post-government income) is market income plus the effect of government tax and transfer policies (discussed in greater detail below) on income. "Income" in this paper always refers to equivalized income, whether disposable or market, and all data presented here are based on the weighted observations of each year's fifty-nine and under population. Appendix B provides the mean values of variables used in this study by wave and quintile.

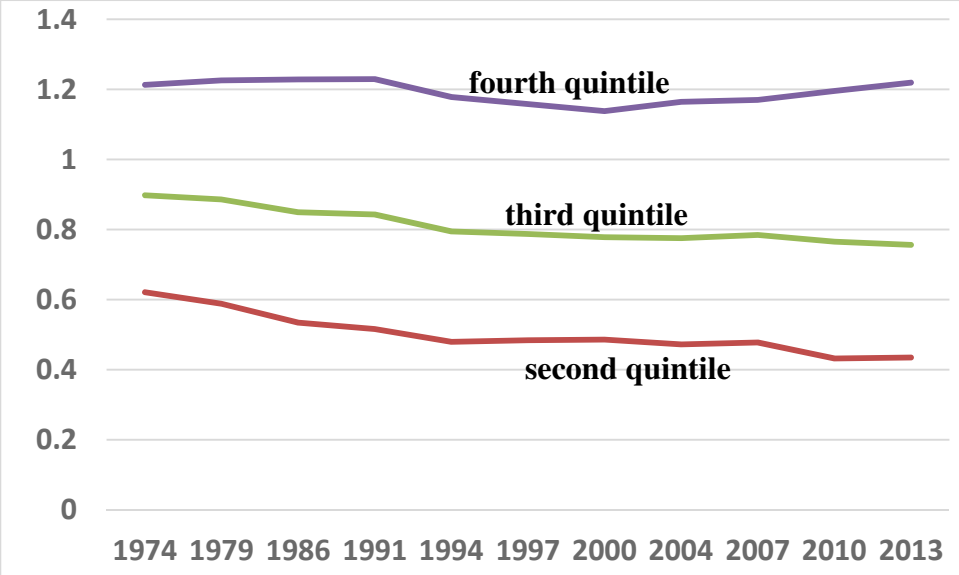
The distribution of middle class income, 1974-2013

To describe trends in the value of both earned income and government transfers to the middle three quintiles, I report dollar values normalized by average national income to account for the changing economic context. This is important because (for instance) a government transfer of $1,000 in 1974, adjusted for inflation, is equal to almost 14 percent of average income that year, while the same real amount in 2013 is less than 9 percent of that year's average income. Comparing absolute incomes and transfers over a long period is difficult when economic productivity varies over time, and using dollar amounts relative to mean income that year accounts for the changing ability of the nation to both generate income and afford social transfers. Adjusting for average income rather than simply inflation reduces the potential of the country's wealth to explain any trend over time.

[3]To calculate equivalized income, I use LIS's recommended formula of dividing household income by the square root of the number of household members.

Figure 1 shows trends in average earned income among the middle three quintiles over the forty years covered in this study. As can be seen, income among the upper-middle class (the fourth quintile, those falling in the 60-80th percentile) has remained steady at around 120 percent of the national average; meanwhile, income has steadily declined among the second (lower-middle class) and third (middle-middle class) quintiles. Figure 1 shows the extent to which the range of income within the middle 60 percent of the population has widened over time.

Figure 1. Average Market Income as a Share of Average National Income, Middle Three Quintiles, 1974-2013



Source: Author calculation based on equivalized income, non-elderly population.

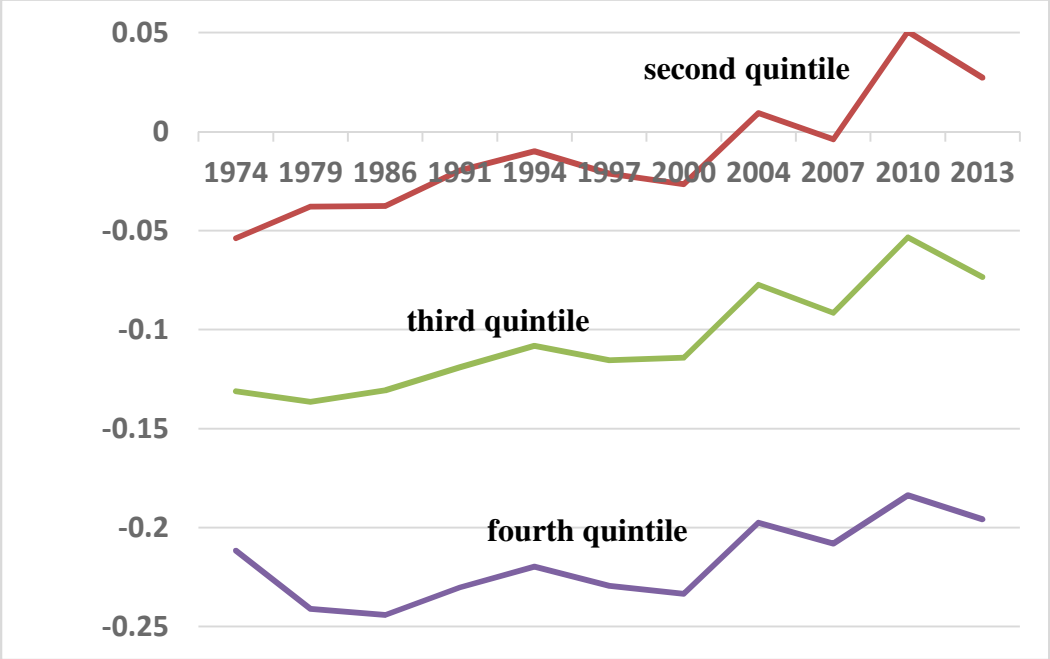
To display the value of government transfers to households over time, I first define these as the combined value of both tax payments to and social transfer payments from the government. Social transfers include both cash and near-cash benefits (such as food stamps, school lunch and housing subsidies), but do not include the value of any health benefits received, nor the many other ways that the government provides goods and services that affect some income groups more than others -- parks, libraries, and public schools being but a few examples. I thus confine myself to measuring the government's influence on disposable income rather than

a broader and more encompassing measurement of social welfare. Social transfers fall into one of three groups: social assistance policies (such as food stamps) that target the poor; social insurance policies to which individuals and their employers have contributed (unemployment and disability insurance); and universal benefits, which are usually provided to all citizens in equal amounts (and of which in the US there are few).

The total value of government transfers (all social transfers plus taxes) obviously should be highest for low income Americans since they typically receive larger amounts of social benefits and pay less in taxes; the value should decline with income and turn negative for higher income individuals. An individual with negative government transfers indicates that he or she paid more in taxes than received in social transfers. For most individuals, government transfers will indeed be negative.

Figure 2 below presents the mean value of government transfers to individuals in each of the middle three quintiles (notice that most values are negative). With the exception of the 1990s, we see that on average the value of government transfers has slowly increased for those in the second and third quintiles, suggesting that government policy has succeeded in at least partially reversing the adverse labor market trends found in figure 1 above. Particularly over the last ten years, the upper middle class (the fourth quintile) has also benefited from noticeable increases in government transfers despite not having experienced the same economic losses as did those in the second and third quintiles.

Figure 2. Average Government Transfers as a Share of Average National Income, Middle Three Quintiles, 1974-2013



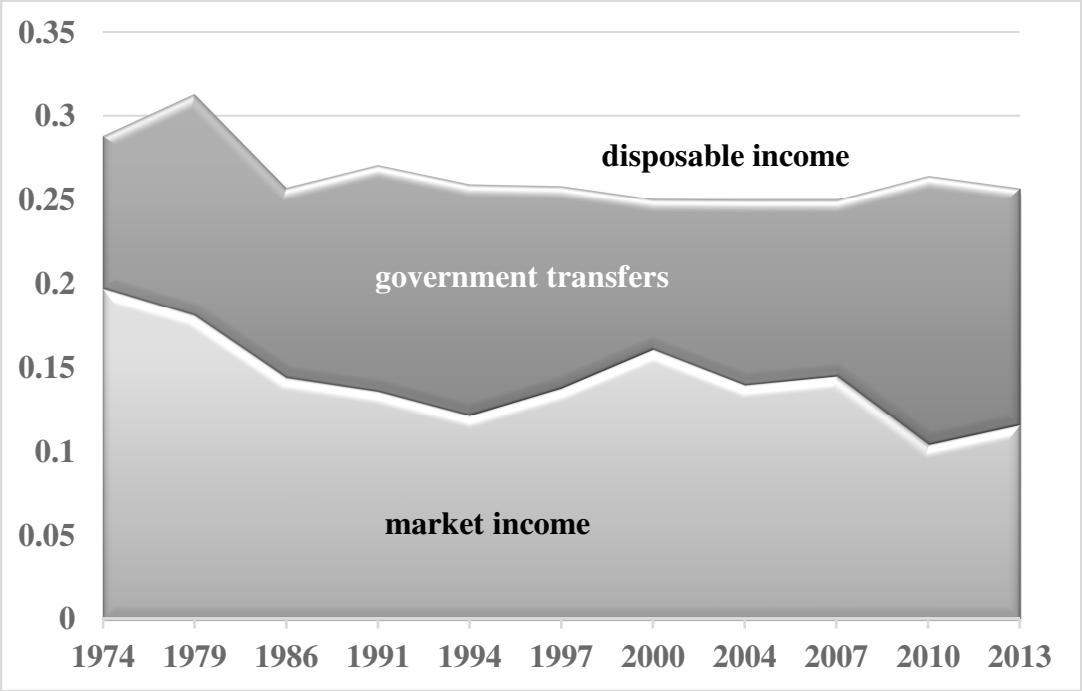
Source: Author calculation based on equivalized income among non-elderly population.

As a point of reference, we might ask how these trends in earned income and government transfers within the middle class compare with those among the poor. Figure 3 below shows the separate contribution made by earned income and government transfers to the bottom quintile's disposable income. We see that while market income has been volatile and since 2000 declining, government transfers have largely compensated for swings in earned income so that disposable income remained consistently around 26 percent of the national average.

To investigate whether government transfers have declined over time for those with similar incomes, and/or have drifted from some income groups to others, I now examine individuals' disposable income by decomposing it into market income and government transfers, and then use regression analysis to investigate the relationship between the two separate components of income over time. Using the data from all (non-elderly) individuals in all eleven

waves allows me to inquire into the changing nature of the relationship between market income and government transfers.

Figure 3. Average Market Income and Government Transfers as a Share of Average National Income, First Quintile 1974-2013



Source: Author calculation.

To begin, table 1 model 1 presents a simple bivariate analysis of the relationship between government transfers (dependent variable) and an individual's market income, where I calculate both as a share of average national income. The adjusted R2 of .76 indicates the central role market income plays in explaining differences in the size of government transfers to individuals. The -.29 coefficient on income in model 1 indicates that on a one-dollar increase in income across time and across individuals results in an estimated 29-cent decline in government

transfers.[4] In model 2 I add quintile dummy variables (with the middle quintile the reference quintile) and year dummy variables (with 1997 the reference year). The quintile dummy variables reveal a progressive structure to government transfers: independent of income, they are highest for lowest-income citizens, and lowest for the highest-income citizens.

Table 1. Estimated Unstandardized Coefficients Associated with Government Transfers to Individuals, Pooled Observations from 1974 to 2013

	Model 1	Model 2	Model 3	Model 4
Dependent Variable: Transfers as a share of average national earnings				
Constant	.13	.08	.09	.09
Income	-.29	-.26	-.26	-.26
Q1 (D)		.05	.05	.06
Q2 (D)		.01	.01	.01
Q4 (D)		-.01	-.01	0
Q5 (D)		-.11	-.11	-.10
1974 (D)		.03	.	
1979 (D)		.01		
1986 (D)		.00		
1991 (D)		.02		
1994 (D)		.01		
2000 (D)		-.02		
2004 (D)		.02		
2007 (D)		.02		
2010 (D)		.05		
2013 (D)		.05		
Time Trend			0.005	
Q1 * Time Trend				.005
Q2 * Time Trend				.009
Q3 * Time Trend				.007
Q4 * Time Trend				.002
Q5 * Time Trend				.001
Adj R2	0.76	0.77	0.77	0.77

No. Observations: 1,519,357
Notes: (D) denotes dummy variable.
p<.01 for all coefficients.

[4]All 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, the reader should pay more attention to whether coefficients are meaningfully different from zero rather than statistically different.

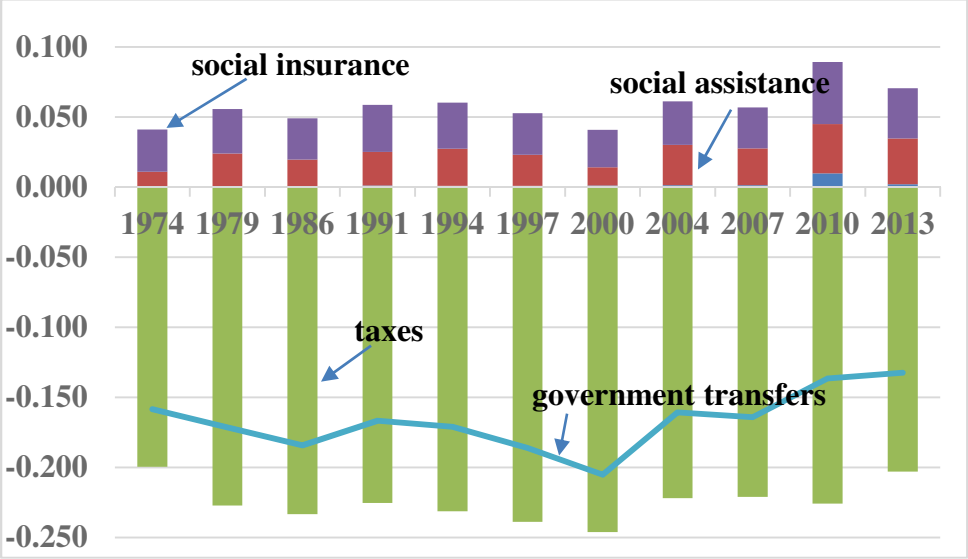
Inspecting the year dummy variables in model 2 does not reveal an obvious time pattern. Most years are associated with a statistically significant change in the size of government transfers relative to 1997 (holding market income constant). However, the differences by year partially reflect each year's unemployment rate. Replacing the year dummy variables with a time trend variable (model 3), where a unit change in the trend variable represents one decade of time, does indicate that the value of government transfers to individuals has increased over time. Holding income constant, the combined effect of government transfers and taxes on disposable income has grown by an average of .5 percent of average national income each decade—or by about two percent of national income over the period of this study. This amounts to a fairly steady increase over time.

This analysis of the government's influence on disposable income is incomplete for at least two different reasons. First, the finding of an increase in the size of government transfers over time does not help identify where these increases went. To further investigate this, in table 1 model 4, I introduce five time trend variables, each distinctly associated with individuals in each of the five quintiles. As shown, the time trend coefficient for all five quintiles is positive, and is largest for those in the second and third quintiles.

A second shortcoming is that "government transfers" refers to a very wide range of policies, and changes in them have different distributional implications depending on where in the income distribution the change occurs: a decrease in transfers at the bottom of the distribution implies less redistribution, while a similar fall among the rich would indicate greater redistribution. And while the collective impact of government policies may show only slow change over time (although as I've just detailed, for those in the second and third quintiles the growth has been especially noticeable), the composition of policies surely has.

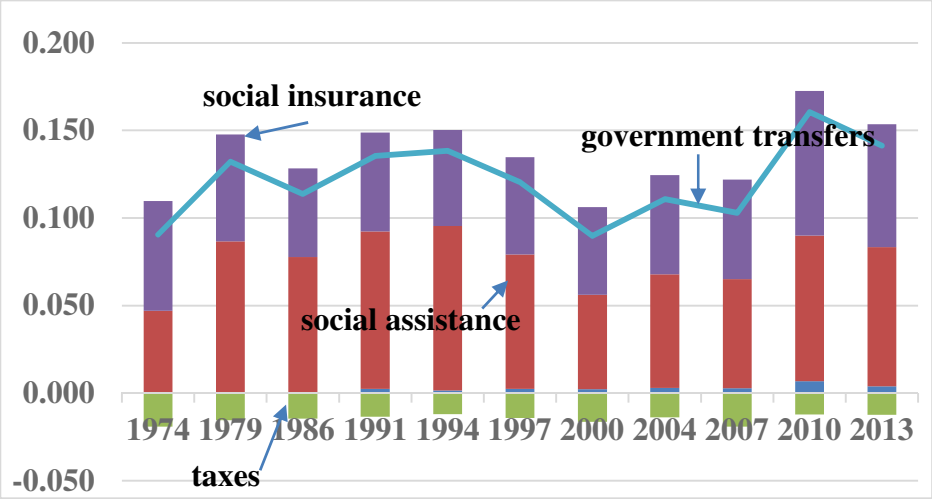
To illustrate the changing composition of policies, Figure 4 shows the average value of government transfers each year, disaggregated into taxes and the three sources of social transfers (social assistance, social insurance, and universal policies). The trend line shows trends in government transfers, that is, in the total size of all four combined. As shown, average government transfers have ranged around -20 to -15 percent of average national income, and since 2000 have trended upward, in 2013 reaching a 40-year high of -13 percent. In terms of influence, taxes by far dwarf the combined value of the three types of social transfers, which is no surprise since tax revenue is what funds social transfers as well as many other expenditures, such as defense and health care. Over the forty years of this study, taxes have consistently averaged between -20 and -24 percent of national income. Social insurance, the largest component of social transfers, has also remained more or less the same, although expenditures grew noticeably in 2010.

Figure 4. Average Value of Government Transfers as a Share of Average National Income, by Component (1974-2013)



Figures 5 through 9 present the average value of the four components of government transfers by quintile. As shown in figure 5, taxes play a very small role in the value of transfers to the first quintile; and while social assistance has declined over the last two decades, social insurance benefits to this group has increased. Those in the second quintile have seen larger social assistance benefits (reflecting the increasing importance of work related benefits, such as EITC), and taxes have decreased.[5] Those in the third quintile have seen steady increases in government transfers resulting from the combination of a lower tax burden, and increased social insurance and social assistance benefits. The size of government transfers to the fourth and fifth quintile are heavily dominated by taxes; the modest increase in government transfers to the fourth quintile is traceable to decreases in taxes coupled with increases in social assistance. In brief, these figures capture the wide variation among income groups in how and by how much government policy influences disposable income, as well as variation in trends over time.

Figure 5. Average Value of Government Transfers as a Share of Average National Income, First Quintile, by Component (1974-2013)



[5] LIS data categorizes means-tested tax credits such as EITC and the Child Tax Credit as social assistance rather than as negative taxes.

Figure 6. Average Value of Government Transfers as a Share of Average National Income, Second Quintile, by Component (1974-2013)

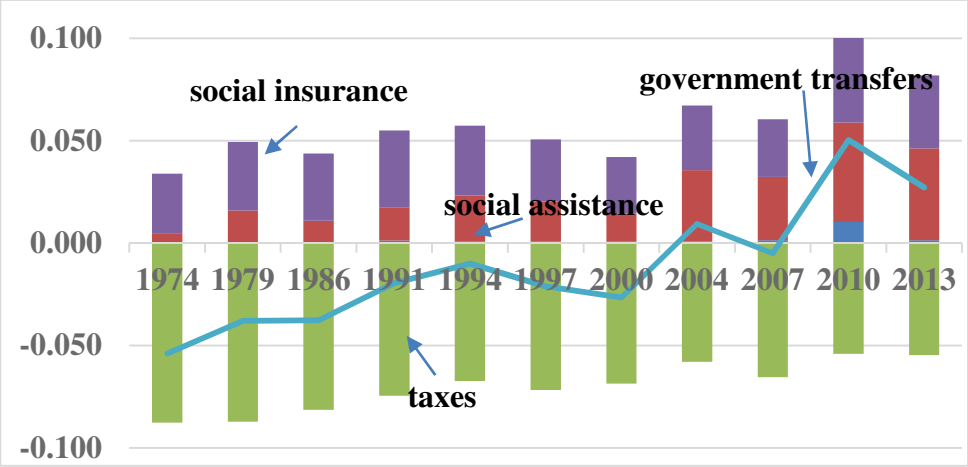


Figure 7. Average Value of Government Transfers as a Share of Average National Income, Third Quintile, by Component (1974-2013)

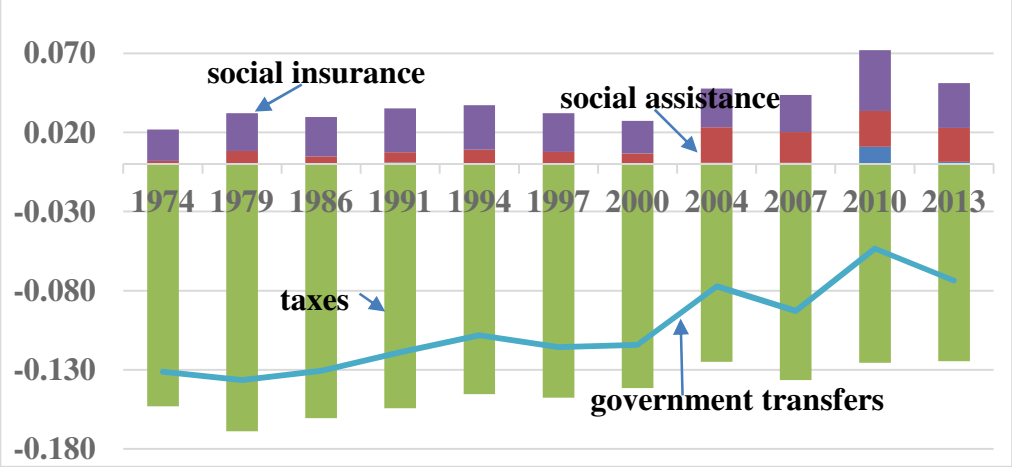


Figure 8. Average Value of Government Transfers as a Share of Average National Income, Fourth Quintile, by Component (1974-2013)

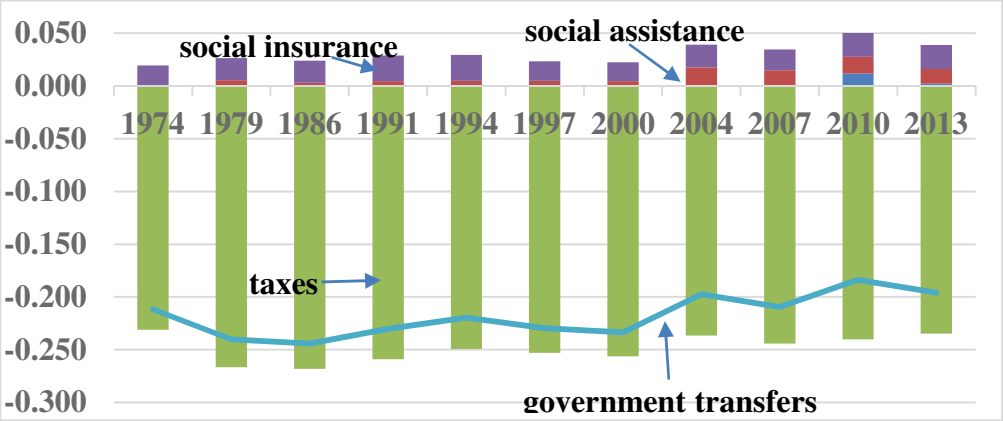
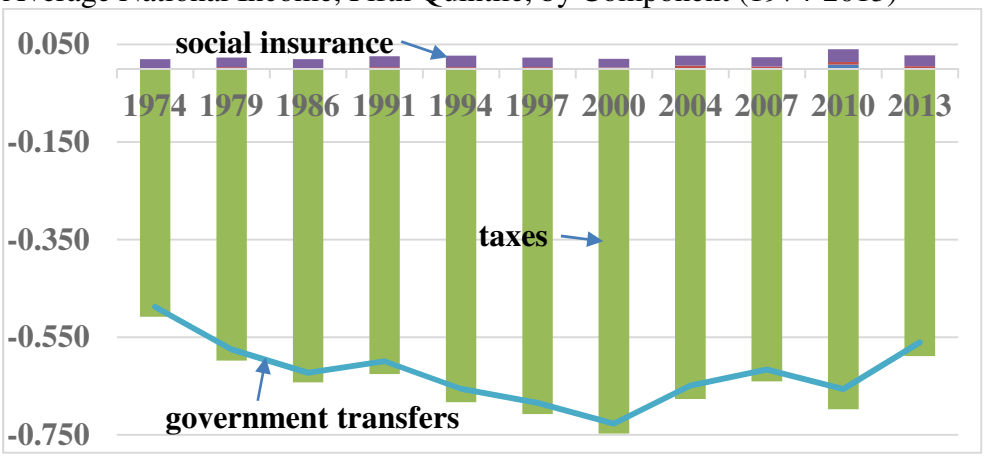


Figure 9. Average Value of Government Transfers as a Share of Average National Income, Fifth Quintile, by Component (1974-2013)



To investigate if the size of the various components of government transfers has changed over time, I repeat the analysis of model 4 in table 1 (reproduced in table 2 column 1), except I replace the dependent variable "government transfers" there with each of its three separate components (I leave out the category of universal benefits since these are miniscule). Table 2, which only reports the coefficients associated with the time trends, presents the results. Two observations stand out. First, the average social assistance and social insurance benefits received by individuals in each of the five quintiles has increased over time. The largest increases have occurred in social assistance benefits, particularly those directed to individuals in the second and third income quintiles. Part of the explanation, then, for why social transfers across the income spectrum have increased is that social insurance but especially social assistance benefits have increased over time. Second, the average amount paid in taxes has also been increasing over time, with Americans across the income distribution experiencing similar dollar increases (increases have averaged about .3 percent of national income every decade). While for each quintile increases in social benefits have exceeded the increase in taxes, tax increases have been regressive: the dollar value of tax increases has been largest for the bottom 20 percent (.4

percent of national income each decade) while smallest for the richest 20 percent (.2 percent of national income). Especially for the bottom income group, the increasing tax burden has offset a good portion of the increase in social benefits directed to them. For the second and third quintiles, tax increases have been modest relative to benefit increases, which accounts for why benefits to these income groups have grown the fastest. The upper two quintiles, on the other hand, have seen increases in social benefits somewhat in line with increases in taxes so that government transfers have not changed much over the period of this study.[6]

Table 2. Estimated Time Trend Coefficients Associated with Different Components of Government Transfers to Individuals, Pooled Observations from 1974 to 2013

	Regression Coefficient on Quintile Time Trend Associated with:						
	Government Transfers	**Taxes**	**Social Insur.**	**Social Assist.**	**Taxes: Income**	**Taxes: Payroll**	**Soc Ass: Family**
Quintile1	.005	.004	.003	.004	.004	.000	-.004
Quintile2	.009	.003	.002	.009	.002	.001	.009
Quintile3	.007	.002	.003	.005	-.002	.004	.005
Quintile4	.002	.003	.001	.003	-.005	.008	.004
Quintile5	.001	.002	.001	.001	-.016	.018	.001
Control Variables: income and a fixed effect for each quintile.							
R2	0.77	0.81	0.02	0.23	0.77	0.78	0.21

No. Observations: 1,519,357
p<.01 for all coefficients.

These two findings help fill out the broad picture painted earlier: the value of social insurance benefits have grown over time, especially to those with income in the bottom 60 percent. Benefits from means-tested social assistance policies have witnessed even greater expansion, both in terms of magnitude and in reach: nearly equal growth took place among those in the fourth quintile as in the first. The primary beneficiaries of new social assistance dollars, however, has been members of the second and third quintiles. At the same time, tax

[6] The upper quintile is an economically heterogeneous lot, which sometimes makes a discussion of averages among this group less appropriate. However, the results discussed here and below hold up even if the analysis is only based on those in the bottom 80 percent of the income distribution in each year.

increases to all have reduced the value of these new transfers, especially for those in the bottom 20 percent.

The last three columns of table 2 provide more detail on trends in taxes and social assistance benefits. Decomposing taxes into its two components of income and payroll taxes reveals highly regressive changes in the income tax burden. The poor have been paying more in income taxes over time while the rich (holding income constant) have experienced sharp declines in their income taxes, amounting to an estimated decreases of 1.6 percent of average national income each decade of the study period. The last column provides time trends on family-related social benefits, a category of social assistance policies that have come to dominate these policies. In LIS this category consists of TANF (Temporary Assistance for Needy Families, formally Aid for Families with Dependent Children), the Earned Income Tax Credit (EITC), and the Child Tax Credit. As shown, family benefits have been declining for those in the bottom quintile, while benefits to the middle class—the lower middle class in particular--have grown. It is in these family benefits then, that one can detect a drift in target from the poor to the middle class.

A BRIEF NOTE ON SOCIAL EXCLUSION

An important characteristic of the US's safety net is not merely the degree of support it does or does not provide to low-income residents, but also the extent to which social policies exclude some poor citizens from its benefits. This might occur because some are barred from eligibility, are unaware they are eligible, or simply choose not to participate because of the stigma of doing so. Since the 1990s, public assistance policies have prioritized those who work, and apart from a longstanding bias against adults without children, it has introduced new curbs on eligibility, for instance through time limits or restrictions on benefits to legal immigrants.

Have such trends left a larger low-income population excluded from social protection policies? If it has, then the finding that average support among the poor has grown slowly over time would indicate that with more selective targeting of benefits, the eligible few would have enjoyed even larger average levels of benefits over time.

To investigate the degree to which low-income Americans have been left beyond the safety net's cast, I considered the population of non-elderly citizens each year earning less than 50 percent of median market income (a common poverty benchmark).[7] I then calculated the percentage of these low-income citizens receiving few government transfers. I chose a receipt of government transfers equaling less than 2 percent of mean income that year as the criterion for "few government transfers."

With these definitions, I find that the percent of low-income individuals excluded from social protection has actually fallen over time. Between 1974 and 2000, about 40 percent of those with income less than half the median received government transfers equivalent to less than 2 percent of average national income. Since 2000, this percentage has been dropping, and by 2010 only 18 percent of the poor were excluded from government benefits. The same downward trend also apparent if we alternatively use a more charitable cutoff of 4 percent of national income, or a less generous one of 0 percent. It even holds if we make use of a more limiting definition of "the poor" by employing the benchmark of one-third of the nation's median income. At least based on these definitions of "safety net exclusion," the US's safety net has become less rather than more porous over time. We hence can conclude that while the safety net for the poor has been cast a tad more broadly over time, the same amount of money has been

[7]Over the four decades of this study, an average of around 23 percent of the population fell into this category, with the average trending upward.

spread among this slightly larger pool, indicating that average benefits for the eligible poor may actually not have increased much.

DISCUSSION AND CONCLUSIONS

The forty-year period of this study documents steady income losses among a large segment of the American middle class. If we couple this with growing income volatility, declining job security, and evidence of downward economic mobility, it is not hard to imagine how political pressure could result in providing the middle class with greater income protection. In this paper, I have analyzed household data spanning forty years to directly measure the government's impact on disposable income over time for those at different points of the income distribution. I have sought to ascertain whether a general reversal in the state's role in redistributing income has occurred, or whether government transfers have increasingly prioritized those in the middle of the income distribution.

On the first question of whether or not a welfare state retrenchment has taken place, the answer is unambiguously no. As a first approximation, the government's role in income redistribution—providing additional resources to those lower in the income distribution by taxing those higher up—has remained fairly constant over time, by which I mean that the amount provided or taken from individuals via government transfers based on their income has not declined over time. In fact, I find that holding constant income, all income groups have experienced an average increase in value of government transfers over time, transfers derived from lower taxes, higher social benefits, or some combination of the two. Over time, then, individuals with identical incomes (relative to the national average) across the income distribution have seen their disposable income increase.

The evidence found here for a lack of contraction in the American welfare state is stronger than this, though. We know that income has not been "holding constant" over time.

The incomes of those in the bottom sixty percent has been falling, which has led to additional increases in government transfers. To illustrate, the median American's market income in 1974 was about 90 percent of the national average. By 2013, median income was only 76 percent of the national average. Those with median income could expect to receive larger government transfers than their earlier counterpart for two reasons: they have lower income relative to the national average, and government transfers holding income constant have increased over time. Indeed, if one does not control for income, the rate of growth in government transfers that I've documented here grows twofold. Thus, as incomes have fallen over time (and while the paper has not focused on it, risen for those in the top 20 percent), the government has engaged in more income redistribution over time: increased social transfers provided to those at the bottom and more taxes collected from those at the top.[8]

Regarding the second question of whether middle class interests have increasingly taken precedence in social policy, the answer here is yes. Growth in government transfers have been swiftest for the lower-middle class, which is also where in the income distribution the steepest absolute declines in income have occurred. For this group, government transfers (holding income constant) have grown by almost 1 percent of national income each decade. Those occupying the very middle of the income distribution (40^{th} to 60^{th} percentile) have experienced the second highest rate of rate of increase, at .7 percent of national income each decade. The upper-middle class, where income has remained fairly stable over time, has experienced small increases in government transfers.

The supposition that growth in transfers to the middle class has occurred through a shift in resources from the poor is not born out here. As just discussed, transfers to all income groups

[8]As further evidence, the Gini coefficient for market income grew over the time period of this study by .11 points (from .37 to .48) while the disposal income Gini grew by a smaller .09 points (from .31 to .40). (Author calculation).

have grown over time, and while increases to those in the top 20 percent have been barely perceptible, I estimate that those to the poor grew by .5 percent of national income each decade. In short, then, growth in government transfers has occurred along the income distribution, and has grown fastest where income losses have been largest. Over the last 15 years, increased government transfers has been a key reason why the bottom 60 percent has not experienced losses in disposable income. The results provide perhaps surprising evidence of the extent to which government policy has responded to the long-term erosion of income among those in the bottom half the distribution.

The one area of social policy where there has been a shift in target is in need-based cash assistance to families. These have declined over time for the poor, accounted for by declines in AFDC/TANF benefits; meanwhile, family benefits have grown for those in the middle of the income distribution, especially among the second income quintile. This is traceable to the dramatic increases in both EITC and Child Tax Credit, both of which target the working poor. In fact, most of the growth in government transfers to the middle class is a result of increases in these two need-based family tax credits. It is in this domain of social policy that one could say that the interests of the middle class have supplanted those of the poor. However, growth in other means-tested benefits to the poor—noteably the Supplemental Security Income Program—has more than shored up cuts to the poor in other domains.

The growth in benefits to the poor as well as the middle class support contentions that declines in income security among the middle class could provoke a political response that strengthens the safety net. More evidence of this is indicated by the finding here that the cast of America's safety net has broadened over time; the increase in average benefits to the poor documented here at least partly reflects a trend toward a more inclusive safety net.

There is at least one caveat to what otherwise may seem like sanguine conclusions about the state of the American welfare state. This qualification is the regressive increases in taxes (excluding tax credits) have occurred alongside the increases in social transfers. While taxes for all income groups have increased, the poor have seen the largest increases. This movement is due to regressive changes in the burden of income taxes. Thus, while social policy has somewhat responded to income losses in the bottom 60 percent, changes in tax policy have counteracted a good deal of this response, especially among the poor.

What does all of this tell us about how middle class decline may be shaping the contours of the welfare state? One premise at the outset of this study was that America's political and institutional context was one where changes in the magnitude and target of social transfers are more likely. Indeed, the US has succeeded in establishing significant new social benefits through new tax credits (EITC and Child Tax Credits being the biggest examples). At the same time, this diversion of social spending through the tax system has been accompanied by other tax changes that have led to declining income taxes among the rich, and paradoxically shifted the tax burden to the poorest. The ability to dispense broad-based benefits, rather than targeted ones, helps explain why tax policy in the US is such a popular mechanism for dispensing social benefits.

Economic stagnation among the middle class is a feature not just of the American economic landscape, but of many industrialized nations as well. A good comparative study of how other nations have responded, both along the income distribution and across the possible policy mechanisms, would provide better insight into the political processes involved in middle class decline, as well as the consequences of those processes for both the middle class and the poor.

References

Appelbaum, Binjamin and Robert Gebeloff. 2012. "Even Critics of Safety Net Increasingly Spend on It," *New York Times* February 11.

Beramendi, Pablo and Christopher Anderson, eds (2008). Democracy, Inequality and Representation. New York: Russell Sage Foundation.

Bergh, Andreas and Therese Nilsson. 2010. "Do Liberalization and Globalization Increase Income Inequality?" *European Journal of Political Economy*. 26(4): 488-505

Bigot, Regis, Patricia Croutte, Jorg Muller, and Guillaume Osier. 2012. "The Middle Classes in Europe: Evidence from the LIS Data." *LIS Working Paper 580*, September.

Bradley, David, Evelyne Huber, Stephanie Moller, Francois Nielsen, and John Stephens. 2003. "Distribution and Redistribution in Postindustrial Democracies." *World Politics* 55: 193-228.

Case, David. 2012. "Is the Middle Class an Endangered Species?" *Salon.com*, October 24.

Castles, Francis. 2010. "Black Swans and Elephants on the Move: The impact of emergencies on the welfare state." *Journal of European Social Policy*, 20(2): 91-101.

Center for American Progress. 2014. "The Middle Class Squeeze." Center for American Progress, September.

Congressional Budget Office. 2011. "Trends in the Distribution of Household Income Between 1979 and 2007." October.

Dallinger Ursula. 2013. "The Endangered Middle Class? A Comparative Analysis of the Role Played by Income Redistribution." *Journal of European Social Policy* 23(1): 83-101.

Economist. 2014. "Turning Right," *The Economist*, January 4.

Garfinkle, Irwin, Lee Rainwater and Timothy Smeeding. 2006. "A Re-examination of Welfare States and Inequality in Rich Nations: How in Kind Transfers and Indirect Taxes Change the Story." *Journal of Policy Analysis and Management* 25(4): 897-919.

International Monetary Fund. 2013. "Taxing Times." *World Economic and Financial Surveys, Fiscal Monitor.* October.

Immervoll, Herwig and Mark Pearson. 2009. "A Good Time for Making Work Pay?" *IZA Policy Paper No. 3*. April

Kenworthy, Lane. 2011. *Progress for the Poor*. New York: Oxford University Press.

Korpi, Walter and Joakim Palme. 2003. "New Politics and Class Politics in the Context of Austerity and Globalization: Welfare State Regress in 18 Countries, 1975-95." *American Political Science Review*, 97 (3): 425-446

Leonhardt, David and Kevin Quealy. 2014. "American Middle Class no Longer the World's Richest." *New York Times*, April 22.

Luxembourg Income Study (LIS) Database, www.lisdatacenter.org (United States, November-December 2014). Luxembourg: LIS.

Littrell, Jill, Fred Brooks, Jan Ivery, and Mary Ohmer. 2010. "Why You Should Care About the Threatened Middle Class." *Journal of Sociology and Social Welfare*, 37(2): 85-112.

Lupu, Noam and and Jona Pontusson. 2011. "The Structure of Inequality and the Politics of Redistribution." *American Political Science Review*, 105(2): 316-336.

Marchal, Sarah, Ive Marx and Natascha Van Mechelen. 2011. "Do Europe's Minimum Income Schemes Provide Adequate Shelter against the Economic Crisis and How, If at All, Have Governments Responded?" *IZA Discussion Paper* 6264. December.

Moffitt, Robert. 2013. "The Great Recession and the Social Safety Net." *Annals of the American Academy of Political and Social Science*. November.

Nelson, Kenneth. 2007. "Universalism versus Targeting." *International Social Science Review*, 60: 33-58.

Nelson, Kenneth. 2010. "Social Assistance and Minimum Income Benefits in Old and New EU Regimes." *International Journal of Social Welfare* 19: 367-378.

Pew Research Center. 2012. "The Lost Decade of the Middle Class." *Pew Research Center Social and Demographic Trends*, August 22.

Pierson, Paul. 1996. "The New Politics of the Welfare State." *World Politics* 48(2): 143-179.

Pressman, Steven. 2007. "The Decline of the Middle Class: An International Perspective. *Journal of Economic Issues* 41(1): 181-200.

Rehm, Hacker and Schlesinger. "Insecurity Alliances: Risk, Inequality and Support for the Welfare State." *American Political Science Review* 106, no 2 (2012): 386-406.

Romer, Thomas. 1975. "Individual Welfare, Majority Voting and the Properties of a Linear Income Tax." *Journal of Public Economics* 4, no 2: 163–85.

Rosanvallon, Pierre. 2013. *The Society of Equals.* Cambridge: Harvard University Press.

Schwartz, Nelson. 2014. "The Middle Class is Steadily Eroding. Just Ask the Business World." *New York Times*, February 2.

Shear, Michael, and Peter Baker. 2013. "Obama Focuses on Economy, Vowing to Help Middle Class." *New York Times*, July 24.

Streeck, Wolfgang. 2011. "Crisis of Democratic Capitalism." *New Left Review* 71: 5-29.

Wang, Chen, Koen Caminada, and Kees Goudswaard . 2012. "The Redistributive Effect of Social Transfer Programs and Taxes." *International Social Security Review*, 65(3): 27-48.

Weller, Christian. 2006. "The Erosion of the Middle Class: Economic Security after 2001." *Challenges*, Jan/Feb: 45-68.

Appendix A: Definitions of Variables and Sources

Note: All data 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.

Government 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 + Government 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.

Appendix B: Mean Values by Quintile and Year

	1974	1979	1986	1991	1994	1997	2000	2004	2007	2010	2013
National Average											
Mean Income	$7,648	$11,908	$18,808	$23,205	$26,630	$30,862	$36,330	$38,082	$42,653	$41,393	$45,322
Median Income	$6,905	$10,520	$15,924	$19,514	$21,033	$24,217	$28,200	$29,432	$33,255	$31,500	$34,391
Gov. Transfers	-$1,212	-$2,043	-$3,465	-$3,865	-$4,552	-$5,737	-$7,353	-$6,124	-$6,936	-$5,651	-$5,998
Soc. Insurance	$299	$377	$554	$782	$879	$916	$970	$1,179	$1,255	$1,834	$1,621
Universal	$0	$0	$0	$27	$23	$30	$39	$50	$56	$404	$97
Soc. Assist	$85	$286	$371	$555	$705	$684	$580	$1,102	$1,119	$1,455	$1,481
Taxes	$1,526	$2,705	$4,390	$5,228	$6,160	$7,369	$8,942	$8,454	$9,427	$9,345	$9,197
Mean Disp. Income	$6,436	$9,865	$15,343	$19,340	$22,078	$25,125	$28,977	$31,958	$35,717	$35,742	$39,324
No observations	28,523	154,521	130,468	130,517	125,754	110,895	190,772	182,431	176,719	173,040	115,718
Quintile 1											
Mean Income	$1,508	$2,154	$2,701	$3,144	$3,223	$4,241	$5,828	$5,304	$6,168	$4,290	$5,232
Gov. Transfers	$693	$1,571	$2,135	$3,137	$3,680	$3,721	$3,262	$4,212	$4,490	$6,645	$6,398
Soc. Insurance	$480	$727	$952	$1,312	$1,462	$1,713	$1,817	$2,159	$2,429	$3,420	$3,181
Universal	$0	$0	$0	$58	$42	$75	$79	$113	$116	$282	$177
Soc. Assist	$359	$1,032	$1,461	$2,086	$2,500	$2,368	$1,962	$2,472	$2,659	$3,443	$3,603
Taxes	$147	$185	$275	$312	$318	$430	$598	$524	$816	$502	$560
Mean Disp. Income	$2,201	$3,725	$4,836	$6,281	$6,903	$7,962	$9,090	$9,516	$10,658	$10,935	$11,630
Quintile 2											
Mean Income	$4,745	$7,003	$10,051	$11,976	$12,764	$14,927	$17,659	$17,963	$20,379	$17,880	$19,680
Gov. Transfers	-$412	-$451	-$707	-$454	-$266	-$654	-$964	$355	-$165	$2,093	$1,232
Soc. Insurance	$222	$397	$618	$869	$906	$938	$999	$1,206	$1,199	$1,882	$1,618
Universal	$0	$0	$0	$28	$25	$27	$34	$31	$58	$426	$62
Soc. Assist	$37	$190	$205	$378	$596	$598	$495	$1,323	$1,322	$2,010	$2,031
Taxes	$671	$1,039	$1,531	$1,729	$1,795	$2,217	$2,492	$2,206	$2,796	$2,237	$2,479
Mean Disp. Income	$4,333	$6,552	$9,344	$11,522	$12,498	$14,273	$16,695	$18,318	$20,214	$19,973	$20,912

Quintile 3											
Mean Income	$6,866	$10,549	$15,975	$19,566	$21,165	$24,293	$28,248	$29,524	$33,471	$31,679	$34,269
Gov. Transfers	-$1,003	-$1,626	-$2,458	-$2,762	-$2,881	-$3,566	-$4,148	-$2,942	-$3,905	-$2,211	-$3,331
Soc. Insurance	$152	$284	$469	$645	$747	$756	$753	$928	$1,005	$1,595	$1,278
Universal	$0	$0	$0	$22	$19	$20	$25	$35	$39	$457	$61
Soc. Assist	$15	$100	$92	$152	$226	$215	$217	$854	$824	$933	$977
Taxes	$1,170	$2,010	$3,018	$3,580	$3,872	$4,558	$5,143	$4,759	$5,823	$5,196	$5,648
Mean Disp. Income	$5,863	$8,923	$13,517	$16,804	$18,284	$20,727	$24,100	$26,582	$29,566	$29,468	$30,938
Quintile 4											
Mean Income	$9,278	$14,593	$23,102	$28,526	$31,381	$35,739	$41,355	$44,351	$49,888	$49,492	$53,242
Gov. Transfers	-$1,619	-$2,870	-$4,593	-$5,343	-$5,851	-$7,080	-$8,485	-$7,524	-$8,877	-$7,607	-$8,877
Soc. Insurance	$142	$249	$393	$560	$651	$571	$653	$815	$832	$1,185	$1,025
Universal	$0	$0	$0	$14	$15	$12	$32	$40	$46	$494	$97
Soc. Assist	$8	$65	$59	$94	$118	$143	$138	$632	$594	$650	$636
Taxes	$1,768	$3,174	$5,045	$6,011	$6,635	$7,807	$9,308	$9,011	$10,408	$9,937	$10,636
Mean Disp. Income	$7,659	$11,723	$18,509	$23,183	$25,530	$28,659	$32,870	$36,827	$41,011	$41,885	$44,365
Quintile 5											
Mean Income	$15,867	$25,243	$42,227	$52,809	$64,624	$75,123	$88,510	$93,267	$103,404	$103,625	$114,166
Gov. Transfers	-$3,726	-$6,841	-$11,708	-$13,903	-$17,448	-$21,111	-$26,406	-$24,723	-$26,240	-$27,170	-$25,406
Soc. Insurance	$149	$230	$339	$522	$630	$602	$636	$787	$812	$1,087	$1,007
Universal	$0	$0	$0	$15	$17	$14	$23	$30	$23	$360	$89
Soc. Assist	$6	$45	$36	$67	$86	$97	$93	$231	$194	$238	$159
Taxes	$3,882	$7,117	$12,085	$14,507	$18,183	$21,829	$27,158	$25,772	$27,303	$28,857	$26,662
Mean Disp. Income	$12,141	$18,402	$30,519	$38,906	$47,176	$54,012	$62,104	$68,544	$77,164	$76,455	$88,760

Note: Not all components add to aggregate amounts because of small amounts of "other" government transfers not included here, as well as transformation of variables into their equivalence values.

Source: LIS data. All values adjusted for household size, and all observations are for population under sixty years of age.