The Intersection of Policy Drift and Punctuated Equilibrium Theory:

The Case of the Mortgage Interest Deduction

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APPAM 2019 Student Regional Conference – Washington, D.C.

March 30, 2019

Introduction

In an era in which key policy narratives draw attention to the plight of the forgotten man, the story behind the mortgage interest deduction's century-long transformation from small-scale business tax cut to hidden housing subsidy for the rich offers insight into how the U.S. government facilitated the nation's gaping socioeconomic divide. Federal policy contributed to the problem by helping the wealthy live in ever larger, more expansive homes, while neglecting the nation's most impoverished renters. The program is part of a broader trend that has accelerated over the past 50 years: After the passage of Great Society legislation in the 1960s, the U.S. government has failed to significantly expand critical safety net programs even as social risk has increased dramatically amid growing economic volatility (Soss et. al. 2007). Washington has subsidized housing for the wealthy through the mortgage interest deduction (MID), which allows families to list the interest they pay on their mortgages each year as a tax write-off, while simultaneously failing to make large-scale investments in the nation's affordable housing programs.

The tax cut disproportionately benefits America's economic elites, who pay more in interest as they take on larger mortgages and is projected to cost more than $150 billion from 2018 through 2022 (Joint Committee on Taxation 2018). By bolstering the size of the standard deduction, the Tax Cuts and Jobs Act of 2017 significantly reduced the number of households itemizing the mortgage interest deduction, making the tax expenditure even more regressive and furthering the policy drift (Tax Policy Center 2018). Meanwhile, three out of every four families eligible for rental assistance cannot receive it because of a lack of federal funding, and homelessness remains a persistent problem across the country (Desmond 2017 and U.S. Interagency Council on Homelessness 2018).

Political theory offers constructs to help practitioners better understand the MID and its impact on housing policy. For instance, policy drift is the process through which government makes de facto changes by failing to amend current legislation to reflect evolving socioeconomic realities (Beland et. al. 2016). Much of the so-called drift is hidden within the submerged state, government programs that incentivize consumer behavior through tax breaks or private enterprise (Mettler 2010). Punctuated Equilibrium Theory argues that the policy process is composed of long periods with incremental or limited change, broken up by short periods of transformation (Baumgartner and Jones 2010). Although some of these shifts are caused by electoral results, many occur within the inter-election period (Eissler et. al. 2016). The theory also argues that government officials can only process limited amounts of information. When issues are not prioritized and the neglect results in a crisis, elected representatives often overcorrect by spending more time and energy on an issue than if they had avoided ignoring it.

But how do these theories frame our understanding of the MID and housing policy in light of recent tax reforms? My analysis will be the first to evaluate the twin roles that policy drift and PET play in shaping mortgage interest deduction policy. The paper that follows will offer clues into the political dynamics shaping the fight over a program that costs more than $25 billion annually and is widely-panned by economists as an engine of socioeconomic inequality. Insights from this analysis could be applied to other elements of the submerged welfare state.

Policy Drift and PET: Theoretical Underpinnings

With the notable exception of the Earned Income Tax Credit, the Affordable Care Act, passed in 2010, represents the federal government's first major expansion of social protections since President Lyndon B. Johnson's Great Society. During that 40-year period, welfare reform and work requirements diminished the generosity of public assistance programs. Between the

1970s and 2010s, household economic instability increased dramatically as American manufacturing collapsed, labor union strength weakened, and economic inequality surged (Hacker 2004). However, instead of rolling out new forms of universal social assistance programs like their peers in Western Europe, policymakers in Washington used tax policy to incentivize businesses and private individuals to secure protections the government was unable – or unwilling – to provide (Morgan 2007). Programs that once formed the bedrock of the American social safety net – Social Security for the elderly, Pell grants for low-income college students, and housing assistance for impoverished families – atrophied as Congress refused to strengthen or expand public benefits even as American households faced stronger economic headwinds. What emerged from this policy drift was a new form of government assistance, clandestinely lodged in what would soon be called the submerged state. The new system would be defined by tax-incentive programs and a greater reliance on nonprofit organizations to help Americans meet basic needs (Mettler 2010; Weir and Shimer 2018).

In a groundbreaking 2004 article, Jacob S. Hacker argued that the federal government's inability to expand the welfare state has caused working families, nonprofits, and civil society groups to take on additional financial risk. Many of the changes benefit the rich, while expanding the gaps between the wealthiest Americans and their low-income counterparts. For instance, Congress made 401(k) retirement plans tax deductible, even as it failed to strengthen Social Security. The policy benefits wealthy Americans who can stash savings in 401(k)s, while hurting the impoverished who often rely upon Social Security as their sole source of income in their later years (Hacker 2004).

Chloe Thurston builds on Hacker's work by referring to tax deductions, including the one on mortgage interest, as key components of the public-private welfare state. She argues that these benefits appear closely linked to the market, making the government's role imperceptible to most Americans (2015). Her finding is echoed by Suzanne Mettler who first identified the web of tax credit programs as the submerged state. She notes that "such policies have shrouded the state's role, making it largely invisible to most ordinary citizens, even beneficiaries of existing policies" (2010). This phenomenon makes it less likely that groups that benefit or are hurt from the government programs will mobilize to defend or replace them. For instance, Mettler argues that public support for President Barack Obama's stimulus package was weak partially because taxpayers did not realize they received tax cuts from the law (2010).

PET partially explains the political dynamics within the evolving debate over the MID. Frank Baumgartner and Bryan D. Jones developed the theory to better understand agenda setting within government. The concept argues that the policy process is composed of long periods with incremental or limited movement, broken up by short periods of intense change (2010). Although some of these shifts are caused by electoral results, many occur within the inter-election period. PET also says that government officials can only respond to limited quantities of information. When issues are not prioritized and the neglect results in a crisis, government officials often overcorrect by spending more time and energy on an issue than if they had not ignored it.

Some scholars have already analyzed the role of PET in housing-related policy fields. For example, Virginia Beard (2013) notes that housing and homelessness policy has remained relatively stable since the late 1980s. She argues that much of the issue's framing has been done by advocacy coalitions at the national level. Beard writes that the most significant policy windows regarding homelessness and housing occurred during the 1930s and during the Reagan administration. The Depression, she says, spurred the creation of the Federal Housing

Administration and the passage of the U.S. Housing Act of 1937, which created public housing assistance. As homelessness surged under President Ronald Reagan, Congress passed the McKinney Homeless Assistance Act, which funded local agencies' emergency shelter, food, and housing assistance programs (Beard 2013). Since then, she writes, "changes in [homelessness and housing] policy have been marginal and reflect a form of stasis, regardless of the party in the White House, the ideological bent of the legislature, or macro-level changes in economic outlooks" (Beard 2013).

PET within affordable housing policy has also extended to the states. In Ohio, voters approved a constitutional amendment in 1991 allowing the state to invest in affordable housing programs. Since the early 1990s, the state's housing trust fund has helped more than 1.8 million people through the construction of low-rent apartments and homelessness assistance programs. However, even as county recorder fees, which funded the trust fund, dropped from $73 million in the mid-2000s to $43.8 million during the 2015-2016 fiscal year, politicians in Columbus have been unwilling to sanction additional investments (Coalition on Homelessness and Housing in Ohio 2016). The case indicates the role of PET at the state level by illustrating how policy stasis can prevent officials from making changes even as time renders certain policies inadequate.

The MID: A Closer Look

The MID offers a key example of a century-old policy transformed from its original purpose into a tool through which to help the wealthy quietly gain from public benefits transfers. The MID was initiated by Congress in 1913 to help business owners at a time in which few Americans owned homes. The program's early inception makes it among the first elements of the submerged state. The program was born out of a desire to simplify the revenue collection process as the country implemented the first round of taxes under the 16th Amendment to the

U.S. Constitution, which authorized the income tax (Howard 1997, p. 49). The incentive became more widely used when homeownership rates jumped during the post-World War II housing boom (Desmond 2017). By 1970, approximately 120 million people lived in owner-occupied housing and could benefit from the MID (Howard 1997, p. 106).

Since World War II, the MID has helped homes become the signature source of wealth for American households. It became so important that one scholar remarked that “if one had to name a Holy Trinity of U.S. social programs in the late twentieth century, it would consist of Social Security, Medicare, and the home mortgage interest deduction” (Howard 1997, p. 131). The program provides more than $25 billion in deductions with most of that amount directed toward the wealthy (Joint Committee on Taxation 2018). In 2013, the Congressional Budget Office estimated that the top 20 percent of American earners would receive more than 75 percent of the tax deduction’s benefits. In the same year, the congressional Joint Committee on Taxation reported that only 3 percent of the deductions go toward families with incomes below $50,000 and only 23 percent go toward those with incomes below $100,000 (2013). As noted in Table 1 on the following page, the trend has worsened with the passage of the Tax Cuts and Jobs Act of 2017 (Joint Committee on Taxation 2018). Returns with earnings greater than $200,000 received about 60 percent of the program’s total spending package, while those with incomes below $50,000 received a statistically imperceptible amount from the MID. The tax statistics underscore the increasingly regressive nature of the tax.

Even as the federal government funnels billions of dollars in foregone tax revenue into the MID each year, several studies have labeled the program as ineffective. As early as 1979, economists identified the tax deduction as a leading cause of inflation in the housing market and low-income housing advocates decried the program as a giveaway to the rich (Starr and Esping-

Anderson 1979; Dolbeare 1986). More recently economists have used advanced models to build on earlier arguments that the program achieves few of its objectives. For instance, findings from a July 2017 working paper published by the National Bureau of Economic Research indicates that the tax policy has no impact on homeownership rates.

Table 1. MID Spending

Distribution by Income Class of MID Tax Expenditures at 2018 Rates and 2018 Incomes			
Money Amounts	Number of Returns (in Thousands)	Amounts (in Millions of Dollars)	Amount as a Percent of Total Expenditure
$10,000 to $20,000	32	7	0
$20,000 to $30,000	68	24	0
$30,000 to $40,000	141	75	0.30
$40,000 to $50,000	277	122	0.48
$50,000 to $75,000	1,337	861	3.44
$75,000 to $100,000	1,824	1,719	6.87
$100,000 to $200,000	5,401	7,194	28.77
$200,000 and above	4,648	15,002	59.99
Total	13,728	25,006	100

Source: Joint Committee on Taxation (2018)

However, the authors write that MID does encourage consumers to spend more money, purchase bigger houses, and take on larger mortgages (Kruber, Kleven, Jensen 2017). They explain that by artificially inflating home prices the MID makes it more difficult for low-to-moderate income families to afford down payments on homes. The paper ran economic models to simulate how the housing market would function without the deduction. “Eliminating the mortgage interest deduction causes house prices to decline, increases homeownership, decreases mortgage debt, and improves welfare,” concluded a different study co-authored by Federal Reserve economist Kamila Sommer and American University professor Paul Sullivan (2018). The pair noted that although the program’s lost revenues equate to seven percent of all U.S. income tax revenue, it appears to be counterproductive.

Policy Drift, PET, and MID

Since its inception, few changes have dynamically shifted MID policy. Beginning in the 1960s industry groups representing lenders, home builders and realtors have fervently lobbied Congress to maintain equilibrium and policy drift. Their efforts enabled the program to expand exponentially. “Between 1967 and 1995, the total cost of the home mortgage interest deduction increased by an average of almost 7 percent per year, adjusted for inflation,” wrote Howard (1997 p.106). The amount of revenue lost through the tax deduction increased from $3 billion in 1970 to more than $30 billion in 2018 (Howard 1997 p. 220; Joint Committee on Taxation 2018). During that period, changes were mostly made on the margins. In 1984, the U.S. Department of Treasury recommended reductions to the program’s size. The proposed restrictions would have limited MID to main residences and imposed a dollar limit on deductions. However, the plan collapsed under the weight of President Ronald Reagan’s re-election bid.

Following Reagan-era tax cuts and higher standard deductions, the Congressional Budget Office reported that MID cost less than it did in previous years (Howard 1997 p. 109). In 1987, Congress took further steps to control the MID by placing a $1 million cap on the size of mortgages eligible for the tax deduction. The measure was so unpopular that no member wanted to take credit for it, causing it to be labeled the “immaculate conception provision” (Howard 1997 p. 110). The incremental nature of the move was in keeping with the PET’s focus on slight changes made during inter-election periods. Nevertheless, the MID remained resilient and the

GOP refused to consider changes to the program to balance the budget during the 1990s (Howard 1997 p. 108).

One tax expert described the growing policy drift and emerging equilibrium by noting,

> "Absent some major crisis, little was to be gained politically by suggesting cuts to this program. In the interim, the program continued to expand without conscious effort, driven by inflation in housing prices, interest rates, 'bracket creep' in tax rates, the steady erosion of the standard deduction and personal exemption, and demographic changes" (Howard 1997 p. 106).

In many ways the policy drift and new equilibrium were mixed with path dependency. In describing the path dependency phenomenon one scholar wrote, "once on a particular path, the benefits to be gained by the policy makers, interest groups, and other players increase, as do the costs of shifting to another alternative" (Schneider 2006). The concept accurately describes policy makers unwillingness to lessen the Mortgage Interest Deduction. Special interests such as realtor and home builder trade groups increased the political costs of changing the tax law even as the deduction's expense increased exponentially. Policy stasis in the area became so entrenched that one political scientist poignantly wrote that "if power consists of the ability not only to resist change but also to discourage serious debate over change, then the home mortgage interest deduction is truly powerful" (Howard 1997, p. 93).

By the 1990s, a tax deduction created under President Woodrow Wilson and initially intended for small businesses had drifted into one of the federal government's largest handouts for the wealthy. Instead of taking on responsibility for providing a minimum level of affordable housing for all Americans, Washington used the MID to effectively push additional social risk onto the backs of private individuals, many of whom were not financially equipped to use the deductions to purchase a home. "At a time when the number of renting families in need of housing assistance was surging—years in which housing costs were rising faster than incomes—

fewer new households were receiving it," Matthew Desmond noted when describing the challenges renters faced during the 1990s and 2000s (2018). Even as homelessness and the affordable housing crisis grew more acute, Congress and the executive branch were unwilling to adjust policies.

During his first year in office, President Barack Obama ambitiously sought to puncture the equilibrium and make the tax code more progressive, in part by overhauling the MID. His administration's push came as narratives on economic inequality gained greater salience (Mettler 2010). In a 2009 letter to Obama, the National Association of Realtors, a group that staunchly supports the program, said that changes to the MID would "hurt all families, the housing market and our national economy…At a time when our housing and real estate markets are suffering, we believe it would be irresponsible for the real estate industry and federal policymakers to consider, much less support, any proposal seeking to alter the MID." The group showcased its political muscle by spending more than $19.4 million on lobbying activities in 2009 and shutting down Obama's proposed changes to the MID (Center for Responsive Politics 2018). The organization's membership benefits significantly from the MID, since realtors earn higher commissions when home prices are high. The National Association of Realtors continues to play a major role in national politics. During the 2018 midterm election cycle alone, it gave more than $16.2 million in campaign contributions. In recent years, the group has ratcheted up lobbying efforts, spending more than $54 million in 2017 – more than 10 times what the National Rifle Association, one of the country's most powerful interest groups, spent that year (Center for Responsive Politics 2018). The example of the National Association of Realtors underscores the role interest groups can play in maintaining policy stasis.

Interestingly, few homeowners or bureaucrats have fought to maintain the tax expenditure. Unlike other programs, such as Social Security and Medicare, in which organizations such as AARP emerged as powerful advocates for entitlement recipients, the MID has not engendered a loyal following of direct beneficiaries (i.e., homeowners) who directly lobby for the program. Instead, its most forceful supporters are those that gain from the program indirectly such as home builders and realtors. As noted by Thurston (2015) and Mettler (2011), this situation is characteristic of the submerged state. Since few recipients realize they benefit from the program, they are less likely to fight for it. The MID is also unique in that the cabinet agency that implements it (the Department of the Treasury) has not always fully supported it and has called for it to be reduced several times (Howard 1997, p. 114).

A partial change to the MID in the 2017 Tax Cuts and Jobs Act reduced the maximum amount of mortgage debt qualifying for the deduction from $1 million to $750,000. The small shift fell short of bolder proposals made by progressives and is reflective of the incremental approach characteristic of PET (Emmons 2018). Under the change, the projected size of the tax expenditure fell from $70.2 billion to $25 billion (Joint Committee on Taxation 2017 and 2018). In addition, the number of households itemizing the MID in 2018 has fallen dramatically, expanding upon the expenditure’s regressive nature. The number of tax filers benefiting from the program is expected to fall from 20 percent in 2017 to 8 percent in 2018 (Tax Policy Center 2018). By making the program a more blatant subsidy for the wealthiest homeowners, changes in the new tax legislation further exasperate policy drift occurring under the MID.

Framing the Issue

A key element of PET is issue framing. Scholars believe that how partisans portray an issue shapes the terrain on which policy debates are fought (Baumgartner and Jones 2013). For instance, policy framing has encouraged increased policy drift within the American welfare state. As Rose and Baumgartner note in their study of the media's portrayal of low-income Americans, "the portrayal of the poor as either deserving or lazy drives public policy" (2013). A growing political apathy toward the nation's most disadvantaged populations has shaped the conversation over public benefits programs and affordable housing policy, while enabling policy drift.

In the debate over MID, both sides argue that their plan offers a path to stable, affordable housing. For instance, proponents argue that the MID is a key pillar in making homeownership accessible to all citizens. In a speech to the National Association of Realtors as he ran for re-election in 1984, President Ronald Regan framed his support for the deduction in similar terms. "In case there's still any doubt, I want you know we will preserve the part of the American dream which the home mortgage interest deduction symbolizes," he said (Howard 1997 p. 108).

Increasingly, progressives are not only calling the policy a subsidy for the wealthy, but also referring to reform efforts as a potential boon for the working class. For instance, in a 2017 press release announcing his sponsorship of the Common Sense Housing Investment Act, a bill that would reduce the amount of mortgage debt qualifying for deductions to $500,000 while raising $200 billion over 10 years for low-income housing, former U.S. Rep. Keith Ellison (D-MN) said the effort "creates opportunity for every hard-working family, making our communities better, and stretching the paychecks of hardworking Americans." Ellison's remarks are indicative of progressive framing of the issue.

Other groups are calling attention to what savings from a paired down MID could achieve. Solutions to the nation's affordable housing crisis can be achieved, the National Low Income Housing Coalition insists, "by reforming the MID…and reinvesting the savings to serve those with the greatest needs" (2017). The organization believes that the savings should go toward expanding federal housing programs at a time in which affordable housing programs are chronically underfunded (2017).

Policy Stasis: A Challenging Terrain for Opponents

Until recently, critics of the MID have struggled to effectively mobilize support against it. Some academics have criticized low-income housing activists for being politically feeble, but it is more likely that the deduction's relative invisibility reduces its susceptibility to populist anger (Howard 1997 p. 106). Only highly-informed citizens can decipher the complex labyrinth of programs and tax-incentives that characterize the submerged state and skew public policy toward the benefit of the wealthy. In addition, the long-term challenges confronting low-income housing advocates are not unique to MID policy. Scholars have applied PET to several other policy areas and found that political inertia preserves policy stasis for long periods of time despite public opinion swings. For instance, Givel (2006) analyzed the tobacco industry from the perspective of the PET. By examining state tobacco policy from 1990 to 2003, he found that the industry was able to keep sin taxes low and successfully maneuver through new regulations despite growing public opposition.

Nevertheless, there is increasing pressure for American policymakers to address the growing housing affordability crisis, suggesting a break in the equilibrium could be near. More than 70 percent of households below either the poverty line or 30 percent of area median income spend 50 percent or more on rent, according to the National Low Income Housing Coalition (2017). In Wisconsin alone, there are only 28 affordable rental units per 100 families earning below 30 percent of the area median income.

Neglect and a Looming Correction?

PET predicts that policymakers inherently prioritize certain issues over others because of cognitive limits. Eissler et. al. note that “whether occurring at the individual or institutional level, the need to prioritize can result in imperfect outcomes” (2016). Over the past two decades, housing policy has failed to reach the top of the national agenda under both Republican and Democratic administrations as the U.S. has sought to disentangle itself from two inextricable wars in the Middle East and recover from a crushing recession at home. However, PET argues that governments that neglect a policy area will eventually compensate for their inattention through a significant overcorrection precipitated by a crisis.

Can housing policy experts expect a similar reaction as the nation’s affordable housing problems grow more intense? Housing policy has previously seen policy equilibriums smashed by outside forces. In 1968, the Kerner Commission, a blue-ribbon panel formed by President Johnson to investigate racial inequality in American cities, called attention to rampant housing segregation. “Residential segregation prevents equal access to employment opportunities and obstructs efforts to achieve integrated education,” the commission wrote in its final report. “A single society cannot be achieved so long as this cornerstone of segregation stands.” Two months later, following the death of Martin Luther King, Jr., Congress passed the Fair Housing Act of 1968. The legislation was long-overdue but only became salient after outside crises pushed the issue to the forefront (Driver 2018).

A similar, slow-moving crisis exists today. For instance, a report by the National Low Income Housing Coalition noted that housing choice vouchers were so underfunded that in a survey of 320 public housing authorities the median waitlist for assistance required clients to wait an average of 18 months. The advocacy group noted that 60 percent of those on housing choice voucher waiting lists were families with children (NLIHC 2016). In Milwaukee, 35,000 people applied and only 3,000 were randomly selected to be added to the *waiting list* for vouchers in 2015, the last time it was opened to new applicants (Causey and Crow 2018). In Baltimore, experts believe it would take as many as 16 years for all those on the waiting list to receive a voucher (Wenger 2014). Similar stories of long wait-times can be found in U.S. cities as diverse as Charlotte, Missoula, and Montgomery (UNC Charlotte 2015; Erickson 2018; Edwards 2018). The statistics reveal the staggeringly high opportunity costs subsidizing wealthy Americans' housing, while assistance for low-income tenants falters. The statistics also illustrate the harm caused by the policy drift and equilibrium that allow the MID to continue.

Conclusion

The concepts of PET, policy drift and the submerged state offer key insights into how the MID has evolved from a program aimed at helping small businesses to one that doles out massive subsidies for wealthy Americans. The change is indicative of the broader shift in the American welfare state away from public transfers to one that is submerged and uses tax cuts to hide benefit shifts from public view. This policy drift has harmed programs ranging from higher-education policy to Social Security to affordable housing. Since it is a part of the submerged state, the MID has been solely supported by third-party advocates such as home builders and realtors. These interest groups have made it difficult for presidents ranging from Reagan to Obama to overcome the policy equilibrium and change the program. In many ways, path-dependency overtook MID as politicians avoided making changes for fear of inciting the anger of the construction and realty lobbies. In keeping with PET, this has led to long-term policy stasis, only broken by brief intermittent changes at the margins. The most recent modification – included as part of the 2017 tax reform effort – reduced the size of the expenditure, while making it more regressive and furthering drift. Housing policy experts might expect the equilibrium to be shattered in the future as the nation's affordable housing crisis worsens and federal legislators search for funding to pay for solutions. However, changes to the MID will need to be framed in a manner so as to have broad appeal to the electorate. In addition, long-term change might require a dramatic improvement in how the country views low-income Americans and those in need of affordable housing.

My findings illustrate the dramatic challenges PET, policy drift, and the submerged state pose to advocates attempting to eliminate the MID. Future research should explore how the constructs impact other elements of the submerged state such as college savings 529 plans and retirement 401(k) packages. These incentive programs are relatively young compared to the MID and could provide insight into how more recent decisions have accentuated policy drift and the submerged state.

Until the equilibrium is punctured and the MID is overhauled, the federal government will remain complicit in broadening disparities between America's economic classes by subsidizing wealthy homeowners, while simultaneously underfunding programs for the nation's low-income renters. The ongoing policy drift signals a commitment to using centuries-old law to shift social risk onto the backs of individuals who cannot bear it on their own. This disconcerting trend should cause Americans to question whether their government's policies best serve those in greatest need.

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