DO TAX-RELATED PUBLIC POLICIES INFLUENCE THE PUBLIC'S APPROVAL OF A DEMOCRATIC NATION'S PRINCIPAL POLITICAL LEADER? AN APPLICATION TO THE U.S.

Introduction

The principal political leader of a democratic nation typically has an agenda, a platform of objectives. The successful pursuit of that agenda can critically depend upon the public's approval of that political leader's *perceived* job performance. To at least some degree, that job-performance perception depends upon the political leader's observed successes as well as his/her observed character traits and behaviors while in office. In turn, of course, if this political leader of the nation has a high degree of public approval/support, there potentially are myriad positive implications for economic prosperity and political stability, both domestically and internationally.

From an individual's viewpoint or from the viewpoint of a family unit, rational behavior includes the pursuit of maximum utility subject to a budget constraint (as well as other constraints). The budget constraint of real-world individuals and family units involves a variety of components, including not only a vector of commodity prices but also an income measure, more specifically, after-tax (disposable) income. In turn, the disposable income level depends significantly upon the tax burden derived from the existing tax system. Clearly, a lower tax burden, *ceteris paribus*, would imply a greater disposable income and a higher utility level. Ergo, tax policies that improve one's disposable income are likely to elevate one's approval of/support for the political leader responsible for that improvement.

Within this perspective, the present study seeks to determine whether central government tax policies play a significant role in determining the popularity of the central government's principal political leader, whether that leader be a Prime Minister or President or possess some other formal title. To begin this formal study, albeit on a preliminary basis, the following hypothesis is investigated in terms of the U.S.: the public's approval rating of the President is significantly and positively affected by the public's perceptions that the President pursues tax policies that are economically beneficial to the populace.

The topic of Presidential approval ratings in the U.S. has received considerable attention not only in the news media but also in the scholarly literature, including studies by Mueller (1973), Monroe (1984), Edwards (1998), Clarke and Stewart (1994), Campbell and Mann (1996), King (1999), Erikson *et al*. (2000), Jones (2001), Cohen (2003), Abramowitz (2004), Canes-Wrone (2004), and Yaffee (2004). In point of fact, Presidential approval ratings are potentially important in a variety of practical ways in the U.S., just as approval ratings for a Prime Minister or other such leader would be in another Democratic nation. For instance, if the approval rating of the incumbent President is either very high or very low, respectively, then the prospects of re-election for that President are likely to be enhanced or diminished (Campbell and Mann, 1996; Jones, 2001; Abramovitz, 2004). In addition, to the degree that the incumbent President has a higher (lower) public approval rating, there very likely will (will not) be political 'coattails' for other candidates with the same political party affiliation for office, especially national office, to ride once election day arrives. Furthermore, a higher public approval rating is likely to increase the inflow of political contributions to election or re-election campaigns. On another issue, a higher (lower) Presidential approval rating might influence the prospects for the successful achievement of the President's political agenda. In other words, high public approval ratings can provide the President *leverage* over Congress to pass legislation, including appropriations, that otherwise might not have a realistic chance for passage; such leverage would presumably be lacking for a President with low public approval. This consideration carries with it myriad implications for the magnitude as well as the composition of the federal budget. Indeed, the balance of power between the Executive and Legislative Branches of the federal government could swing one way or the other in any given short term period based on strong public approval or weak public approval of the President. Even the President's ability to deal with foreign dignitaries and negotiate treaties with other nations can be affected by his public approval rating, as could his ability to address problems such as international and domestic terrorism.

The present study seeks to ascertain whether income-tax-related issues such as federal personal income tax rates, the real federal personal exemption, and perceived genuine efforts at federal income tax reform influence the Presidential approval rating. Since the Presidential approval rating is regarded as a significant predictor of Presidential re-election prospects and is potentially important for a variety of other reasons (as described above), it would seem very useful to determine whether, if at all, these income tax factors play significant roles in determining this approval rating. In Section 2, a simple model establishes the framework for the empirical analysis, an analysis that includes a variety of economic, public policy (tax-related), and non-economic factors. The empirical analysis follows in Section 3, with the Conclusion in Section 4 providing a summary of the results of this study.

2. The model

The public's approval rating of the President (APP) is hypothesized to be an increasing function of the public's *positive perceptions* (POSPERC) of the President and a decreasing function of the public's *negative perceptions* (NEGPERC) of the President:

$$APP = f\ (POSPERC,\ NEGPERC),\ f_{POSPERC} > 0,\ f_{NEGPERC} < 0 \qquad (1)$$

Positive public perceptions of the President are hypothesized to be an increasing function of the President's perceived *successes* while in office, as well as the President's perceived *positive character traits* while in office. Conversely, *negative* public perceptions of the President are hypothesized to be an increasing function of the President's perceived *failures* while on office, as well as the President's perceived *negative character traits* while in office. The public's assessments falling within these two broad categories of perceptions can be further defined so as to provide *measurable* variables that can be investigated for their influence over the Presidential approval rating.

Following Mueller (1973) and Schlesinger (2004), the study begins by considering the potential influence of war on Presidential approval ratings. A President embarking on or conducting a 'popular' war can be expected to experience higher approval ratings, *ceteris paribus*. On the other hand, a President embarking on or conducting an unpopular or highly controversial war may very well expect to experience lower approval ratings, *ceteris paribus* (King, 1999; Putnam, 2000; Yaffee, 2004). In this context, it is hypothesized in this study that the 1991 Persian Gulf War (GULF), given its popularity among the U.S. public as an international joint effort (coalition) to free Kuwait of an invading military force from Iraq and given the implications of a successfully conducted military campaign for protecting crude oil availability and crude oil prices on the one hand and for stabilizing the Middle East politically and militarily on the other hand, provided the President a boost in his approval ratings. This war may have all the more boosted the President's approval ratings because of how 'easy' the victory was perceived by the public to be; in point of fact, the 1991 Gulf War had been portrayed by the news media as potentially a militarily challenging endeavor, making the ease of victory that was actually experienced all the more impressive. By contrast, the Vietnam War (VIETNAM) was arguably the most unpopular war of the second half of the twentieth century for the U.S. Indeed, Putnam (2000, pp. 257, 146, 152) speaks of "… the trauma of Vietnam …," the experiences of riots, widespread demonstrations, "… the clamor for Vietnam draft deferments …", disruptions of national political nominating conventions, and the seemingly unending media coverage of the 'carnage' that came to define this war. Such experiences would seem to imply strongly that the Vietnam War was a highly controversial and generally unpopular war (King, 1999; Putnam, 2000). Consequently, Presidents embarking on and/or perceived as perpetuating this war would be expected to experience a diminished public approval rating.

Since the President is widely regarded as the principal leader of the U.S. government, a course of action or behavior that embodies or projects either significant strength or weakness of character would likely influence the image of the President and hence the Presidential approval rating, *ceteris paribus*. One clear example of such an experience would be that of impeachment of the President (IMPEACH). Two sitting Presidents over the study period have in fact been impeached by the U.S. House of Representatives: Richard M. Nixon, for his involvement in the Watergate scandal, which Putnam (2000, p. 187) associates with an increased "… disillusionment with public life …" and a societal "… slump in civil engagement …"; and Bill Clinton, for his alleged/apparent perjury involving a civil suit and for his sexual misconduct in the White House while in office (and, *de facto,* his public dishonesty regarding same). Regarding the IMPEACH variable, Yaffee (2004, p. 1) observes that "The Watergate scandal is one of the greatest political scandals in American political history". Indeed, Putnam (2000, p. 257) speaks of how Watergate became associated with a "… distrusting of institutions …" and a public sense of alienation from politics. In any case, it is hypothesized in this study (not surprisingly) that the public's approval rating of a

President diminishes if he is in fact formally impeached (Putnam, 2000; Yaffee, 2004), *ceteris paribus*.

Historically, economic issues have been subjects of debate both prior to and during Presidential primaries and during Presidential election campaigns. Arguably, economic factors that could plausibly play a role in the Presidential approval rating might include: (1) reduced federal personal income tax rates *per se*; (2) increased real (constant dollar) personal federal income tax exemptions; (3) *perceived* genuine efforts to reform the Internal Revenue Code; (4) high unemployment rates; (5) high inflation rates; and (6) the performance of the major stock (equity) markets. Items (1), (2), and (3) are, as indicated in the Introduction, the fundamental focus of this study.

Reducing the average effective federal personal income tax rate (AVETAX) reduces the average household's federal personal income tax burden. Since the latter increases the personal disposable income for many segments of the taxpaying population (especially the "middle class"), it is expected that these taxpayers would tend to respond to this policy by raising *their* Presidential approval rating, *ceteris paribus*. Naturally, as a practical matter, for actual or would-be taxpayers with relatively very modest (or low) incomes, cutting the average effective federal personal income tax rate may yield only limited perceived direct benefits. On the other hand, households with very modest incomes are likely to perceive clear and direct tax benefits when the real (constant dollar) federal personal income tax exemption (EXEMPTION) is increased, especially since they on the average have more exemptions per family unit than higher income households. Indeed, for those households with the lowest income levels, increased real personal exemptions in many cases may even remove them from federal personal income taxation altogether (although they may still face Medicare and social security tax liabilities, depending upon circumstances). Hence, increased real federal personal income tax exemptions yield benefits to lower (and, although to a lesser degree, middle) income households, who in turn would likely express their 'appreciation' with a higher Presidential approval rating, *ceteris paribus*. From yet another perspective, whenever the President and Congress act to cut the maximum marginal federal personal income tax rate (MAXTAX), it generally is the case that (1) the overall progressivity of the federal income tax rate structure is reduced, which in turn reduces disincentives to work, and (2) the disposable income of households in a variety of income tax brackets is increased. Moreover, there is recent evidence (Cebula,

2004) that reducing maximum marginal federal personal income tax rates reduces taxpayer resentment of the Internal Revenue Code. Thus, when the maximum marginal federal personal income tax rate is reduced, it is expected that the Presidential approval rating will likely be increased, *ceteris paribus*.

Next, the Tax Reform Act of 1986 (TRA) was portrayed by the media and by leading politicians alike as a *genuine* effort to reform the Internal Revenue Code. As documented in Ott and Vegari (2003, p. 275), among other things, the TRA reduced the number of tax brackets from 14 to three, increased the tax base by limiting tax deductions, reduced the marginal tax rates, and endeavored to "… improve fairness and efficiency …" in the Internal Revenue Code. The TRA also sharply reduced the tax benefits of limited partnerships, which was an effort to make the Internal Revenue Code more equitable as well, although it ultimately caused problems for the real estate industry (Sanger *et al.,* 1990) and the savings and loan industry (Barth, 1991). To the extent that the public regarded the TRA as a genuine and effective initial effort at meaningfully reforming the Internal Revenue Code, it is hypothesized that the Presidential approval rating would be enhanced, *ceteris paribus*.

Aside from tax-related issues, there may be other economic matters that influence the public's approval rating of the President. Indeed, issues such as a high unemployment rate (UN) and a high inflation rate (P) are each likely, *ceteris paribus*, to reduce the public's approval of the President because each of these experiences tends to reduce the public's financial well-being and economic security. Finally, there is the issue of stock market performance. Equity ownership on the major U.S. stock exchanges is not only enormous in magnitude but also broad-based. That is, aside from the wide variety of institutional forms that own equity stock shares, there is a large proportion of the U.S. population that also owns such equity shares. Indeed, many of the nation's largest pension plans are also deeply committed to ownership of equity issues. Accordingly, the better the performance of the equity markets, the better the financial status of a huge portion of the U.S. populace. Using performance of the S&P 500 stock index as the surrogate for the performance of U.S. equity markets in general, it is hypothesized that the better the performance of the real (constant dollar) S&P 500 stock index (S&P), the higher the Presidential approval rating, *ceteris paribus*.

Based upon the framework developed above, the model of the Presidential approval rating is hypothesized to take the following form:

$$APP = f(GULF, VIETNAM, IMPEACH, AVETAX, EXEMPTION, MAXTAX, TRA, UN, P, S\&P),$$
$$f_{GULF} > 0,\ f_{VIETNAM} < 0,\ f_{IMPEACH} < 0,\ f_{AVETAX} < 0,\ f_{EXEMPTION} > 0,$$
$$f_{MAXTAX} < 0,\ f_{TRA} > 0,\ f_{UN} < 0,\ f_{P} < 0,\ f_{S\&P} > 0 \quad (2)$$

3. Empirical analysis

Based on the framework provided in equation (2), the following model is to be estimated:

$$APP_t = a_0 + a_1 GULF_t + a_2\ VIETNAM_t + a_3\ IMPEACH_t + a_4\ AVETAX_{t-1} +$$
$$+ a_5\ EXEMPTION_{t-1} + a_6\ MAXTAX_{t-1} + a_7\ TRA_t + a_8\ UN_{t-1} + a_9\ P_{t-1} +$$
$$+ a_{10}\ S\&P_{t-1} + u \quad (3)$$

where:

APP_t = the average Presidential approval rating in year t;

$GULF_t$ = a binary (dummy) variable to indicate the year during which the 1991 Gulf War was materially conducted: $GULF_t$=1 for 1991 and $GULF_t$=0 otherwise;

$VIETNAM_t$ = a binary variable to indicate the principal years during which the U.S. were significantly militarily involved in the Vietnam War: $VIETNAM_t$ = 1 for those years (1965-1973) and $VIETNAM_t$ = 0 otherwise;

$IMPEACH_t$= a binary variable to indicate the years during which a sitting President was impeached by the U.S. House of Representatives: $IMPEACH_t$ = 1 for 1974 and 1998 and $IMPEACH_t$ = 0 otherwise;

$AVETAX_{t-1}$ = the average effective federal personal income tax rate in year t-1, as a percentage;

$EXEMPTION_{t-1}$ = the value of the federal personal income tax exemption in year t-1, expressed in 1996 dollars;

$MAXTAX_{t-1}$ = the maximum marginal federal personal income tax rate in year t-1, as a percentage;

TRA_t = a binary variable to reflect the year in which the Tax Reform Act of 1986 was enacted;

UN_{t-1} = the average percentage unemployment rate of the civilian labor force in year t-1;

P_{t-1} = the percentage inflation rate of the overall year-to-year consumer price index (CPI) over year t-1;

$S\&P_{t-1}$ = the average real value of the S&P 500 stock index in year t-1, expressed in 1996 dollars.

The data sources are, as follows: Council of Economic Advisors (2004, Tables B-1, B-2, B-42, B-64); http://www.irs.gov; http://www.infoplease.com; and http://www.geocities.com/americanpresidencynet/approval.html. The Presidential approval ratings have been systematically gathered for several decades. The numerical range for the approval rating lies between 0.00 and 100.00. Over the 1960-2000 study period, the average Presidential approval rating was 53.4, with a standard deviation of 10.7. According to the ADF (augmented Dickey-Fuller) and P-P (Phillips-Perron) unit root tests, over the study period, the variables APP, EXEMPTION, and P are stationary in levels, but the variables AVETAX, MAXTAX, UN, and S&P are stationary only in first differences. Accordingly, the latter four variables are expressed in first differences form in the estimation.

Adopting the Newey-West heteroskedasticity correction, the OLS estimate of equation (3) is given by the following:

$$\begin{aligned}
APP_t = {} & 28.5 + \underset{(+9.14)}{18.05}\, GULF_t - \underset{(-2.43)}{9.46}\, VIETNAM_t - \underset{(-2.92)}{7.29}\, qMAXTAX_{t-1} - \underset{(-4.95)}{19.43}\, IMPEACH_t \\
& - \underset{(-1.99)}{6.06}\, qAVETAX_{t-1} + \underset{(+5.37)}{0.24}\, EXEMPTION_{t-1} + \underset{(+7.20)}{14.77}\, TRA_t \\
& - \underset{(-0.24)}{0.30}\, qUN_{t-1} + \underset{(+1.12)}{3.59}\, P_{t-1} + \underset{(+2.49)}{0.13}\, qS\&P_{t-1},\ F = 3.77,\ DW = 1.89,\ Rho = 0.05
\end{aligned} \tag{4}$$

where terms in parentheses are t-values and q is the first-differences operator.

In estimate (4), nine of the ten explanatory variables exhibit the expected signs, with seven of these being statistically significant at the five percent level or beyond and one significant at beyond the six percent level. The estimated coefficients on the inflation and unemployment variables both fail to be statistically significant at even the ten percent level. The DW and Rho statistics indicate the absence of serial correlation problems. Finally, the F-ratio, which is statistically significant at the one percent level, attests to the overall strength of the model.

Focusing first on the fundamentally ‘political’ variables in the system, the coefficient on the GULF variable is positive and statistically significant at the one percent level, implying that a war that is ‘popular’, i.e., strongly supported overall by the American populace, increases the Presidential approval rating. By contrast, the Vietnam War variable, VIETNAM, exhibits a negative coefficient that is significant at the 2.5 percent level; thus, there is strong empirical evidence that a highly unpopular and controversial war acts to lower the Presidential approval rating. Not surprisingly, the coefficient on the IMPEACH variable is negative and significant at the one percent level, implying that the public's regard for/approval of the President deteriorates when his behaviors have been so extreme or unacceptable as to result in a formal Congressional impeachment.

Next, the focus shifts to the income-tax related variables, the crux of this study. The tax rate variable AVETAX is negative and statistically significant at the 5.5 percent level, implying (albeit somewhat marginally) that when Congress and the President jointly act to reduce the average effective federal personal income tax rate, which action reduces the average household's income tax burden, the public's approval rating of the President increases. The estimated coefficient on the EXEMPTION variable is positive and significant at the one percent level, implying that increasing the *real* federal personal income tax exemption increases the public's approval rating of the President, presumably at least in part because – especially at the lower end of the income spectrum – such a policy reduces the federal income tax burden. Indeed, in the cases of the poorest income earners, removal from the tax roles in terms of an income tax burden *per se* is a real possibility, although escaping social security and Medicare taxes is another matter entirely. The estimated coefficient of the MAXTAX variable is negative and significant at the one percent level, implying that reduction in the maximum marginal federal personal income tax rate raises the President's approval rating. This policy may be viewed favorably not only by the direct benefactors, high income earners, but also by others in the income spectrum who may regard reducing the maximum marginal personal income tax rate as reducing the progressivity of the tax structure and the disincentives associated therewith. The coefficient on the TRA variable is positive and significant at the one percent level. Thus, it appears that the enactment of the Tax Reform Act of 1986 may have been perceived favorably by the general public as a genuine and effective effort to reform the Internal Revenue Code. In point of fact, this statute *did* make a number of substantive changes in the Code (Ott and Vegari, 2003; Sanger *et al.*, 1990). Thus, overall, the evidence strongly indicates that federal income-tax-related issues significantly affect the Presidential approval rating.

Finally, the purely economic variables are considered. The coefficients on the unemployment rate and inflation rate variables both fail to be statistically significant at even the ten percent level, implying that neither *systematically and consistently* explains the Presidential approval rating. However, the estimated coefficient on the S&P 500 stock index variable (S&P) is positive and statistically significant at the two percent level. Thus, it appears that the better the performance of the S&P 500 stock index, the higher the public's approval rating of the President. Apparently, the populace raises its approval rating of the President when the equity markets are prospering.

4. Conclusion

This study seeks to provide at least preliminary evidence as to whether, in the context of a democratic system of government, central/federal government tax-related public policies influence the public's support for/approval of a nation's principal political leader. More specifically, if the public perceives that leader as pursuing policies that improve their budget constraints by reducing tax burdens, the public reacts with a higher degree of approval of and support for the leader in question.

This study uses the U.S and the U.S. President as the context within which to test this hypothesis. Based on the empirical estimation results for this context, it appears that over the 1960-2000 study period, the Presidential approval rating was positively and significantly impacted by the 1991 Gulf War (arguably, a surrogate for a 'popular' war), increases in the real federal personal income tax exemption, reductions in the maximum marginal federal personal income tax rate, the Tax Reform Act of 1986 (arguably, a surrogate for an effort to enact *genuine* tax reform), and the growth in (positive performance of) the S&P 500 stock index. In addition, the Presidential approval rating was negatively and significantly impacted by the Vietnam War (arguably, a surrogate for an unpopular/controversial war) and Presidential impeachment proceedings. Finally, there is also marginally significant evidence that reductions in the average effective federal personal income tax rate raised the Presidential approval rating. These overall findings, which include a positive and significant impact on the Presidential approval rating from well-performing equity markets, should prove relevant information for those interested in public perceptions of Presidential job performance and Presidential election forecasting.

Finally, after allowing for a variety of economic and non-economic factors, it also appears that federal income-tax-related issues *do* strongly influence the public approval rating of the President. Indeed, they seem to overshadow inflation and unemployment.

Clearly, although these results are merely preliminary and directly applicable only to the case of the U.S., they may at least provide a foundation or point of departure for similar studies of other democratic nations.

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ABSTRACT

This study empirically investigates whether, in a democratic system, tax-related public policies influence the public’s approval of their principal political leader. To begin this investigation, the case of the U.S. and the U.S. President is considered. In this context, it is hypothesized that federal income tax rates, real personal federal income tax exemptions, and perceived genuine tax reform efforts influence the public’s approval of the U.S. President. After allowing for a variety of political and economic factors, including equity market performance, inflation, and unemployment, it is found that the Presidential approval rating is significantly by all three of these tax-related issues. Thus, preliminary support for the hypothesis is obtained. Clearly, the hypothesis could be applied to other nations.

Keywords: Tax Policies; Public Approval; Political Leader; U.S. President

JEL Classifications: D72, E62, H70

RIASSUNTO

Le politiche della tassazione influenzano il gradimento del leader politico in un paese democratico? Il caso degli Stati Uniti

Questo studio verifica empiricamente se, in un paese democratico, le politiche di tassazione influenzino il consenso pubblico nei confronti del principale leader politico del paese. Per la verifica è stato preso in esame il caso degli Stati Uniti e del loro presidente. In questo contesto è stato ipotizzato che le imposte federali sul reddito, le esenzioni personali dalle imposte e i tentativi di riformare la tassazione influenzino il consenso nei confronti del presidente. Dopo aver tenuto conto di diversi fattori politici ed economici si è riscontrato che il livello di approvazione nei confronti del presidente è significativamente influenzato da queste tre questioni correlate alla politica di tassazione. E' stato quindi ottenuto un supporto preliminare all'ipotesi indicata, la quale potrebbe essere verificata anche per altri paesi.