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54. Special-Interest Spending and Corporate Welfare

Congress should

- end direct subsidies for businesses, such as grants and loans;
- end indirect subsidies for businesses, such as research and export promotion programs; and
- end regulations and trade barriers that favor certain businesses at the expense of consumers and other businesses.

When considering policy issues, federal lawmakers should have the broad public interest in mind. Unfortunately, that is not how the policy process often works in practice. Many programs are sustained by special-interest groups that gain narrow benefits at the expense of the general public. This chapter discusses why this occurs and focuses on one manifestation of the problem—business subsidies or "corporate welfare."

Special Interests Trump the General Interest

In an idealistic view of democracy, legislators always put average citizens first. They study alternatives, work toward a consensus, and pass legislation that has broad support. They also ensure that their actions are allowable under the U.S. Constitution.

The problem with this "public interest theory of government" is that it explains very little in the real world. Congress often enacts ill-conceived laws that benefit narrow groups at the expense of most citizens. Many federal programs harm the overall economy, and they are only sustained because interest groups support them.

Basic political incentives are to blame. To secure reelection, members of Congress try to gain the support of special-interest groups, particularly those that are important in their states. Members receive campaign support

from interest groups and may even look forward to a post-congressional job with one of them. Furthermore, members get bombarded with seemingly convincing messages from interest groups about why subsidy programs are needed.

Members believe that they are doing the right thing when they support subsidies for their states or favored industries. What they don't seem to appreciate is that narrow subsidies nearly always make the nation as a whole worse off through higher taxes and economic distortions. The benefits created by subsidies are often visible and tangible, but the larger costs are diffused across millions of taxpayers or consumers.

Table 54.1 shows how special-interest bills can gain majority support even if they are bad for the nation overall. A five-person legislature votes on a program that provides nationwide benefits of $40 but costs taxpayers $50. Assuming that legislators vote in the narrow interests of their states, the program garners a majority vote. The key to passage is that the benefits are more geographically concentrated than the costs. The legislation is a political success, but it is a failure for the nation because it costs more than it is worth.

Logrolling, or vote trading, makes special-interest provisions even easier to pass. Party leaders or committees bundle together many narrow provisions that benefit particular states and interest groups. Such bills often pass, even though the specific provisions do not have majority support on their own.

Table 54.2 shows how two subsidy programs can pass the five-person legislature, even though both have higher costs than benefits. Neither A nor B has majority support, and each would fail if voted on separately. So Sanders, Schumer, and Shelby agree to bundle the two programs in a

Table 54.1
Majority Voting Does Not Ensure That Benefits Outweigh Costs

Legislator	Vote	Benefits Received by Constituents	Taxes Paid by Constituents
Sanders	Yea	$12	$10
Schumer	Yea	$12	$10
Shelby	Yea	$12	$10
Sessions	Nay	$ 2	$10
Shaheen	Nay	$ 2	$10
Total	**Pass**	**$40**	**$50**

Table 54.2
Logrolling Allows Passage of Narrow Subsidies

	Program A		Program B		
Legislator	Benefits Received by Constituents	Taxes Paid by Constituents	Benefits Received by Constituents	Taxes Paid by Constituents	Vote on Bill That Includes A and B
Sanders	$15	$10	$ 8	$10	Yea
Schumer	$15	$10	$ 8	$10	Yea
Shelby	$ 4	$10	$20	$10	Yea
Sessions	$ 3	$10	$ 2	$10	Nay
Shaheen	$ 3	$10	$ 2	$10	Nay
Total	**$40**	**$50**	**$40**	**$50**	**Pass**

single bill. They logroll. The two programs get approved, even though both of them impose a net cost on society.

Logrolling has been around since the 19th century. One early example was omnibus river and harbor bills, which sprinkled Army Corps of Engineers projects across many states to ensure passage. From the beginning, people observed that such bills included low-value projects that did not have broad support. In 1835, Tennessee Rep. Davy Crockett criticized the "log-roll" system, and in 1836, Virginia Rep. John Patton complained that a river and harbor bill being debated was a "species of log-rolling most disreputable and corrupting." In the early 20th century, scholar Chester Collins Maxey lambasted logrolling, arguing that it resulted in half the projects in omnibus bills, such as river and harbor bills, being "pure waste."

The magnitude of federal spending is much greater today, and so the logrolling problem is worse. Nearly all the spending in the $4 trillion budget stems from huge bills that bundle together many diverse provisions. Members have neither the time nor the incentive to rigorously critique individual programs in these large bills. So there is little debate about the real value of most federal spending.

Corporate Welfare

Corporate welfare is one manifestation of the special-interest spending problem. The budget contains many subsidies that aid some businesses at the expense of taxpayers and the overall economy. The government

spends about $100 billion annually on corporate welfare, according to a 2012 Cato study. That amount includes direct grants and loans to companies, as well as indirect aid for industries.

Here are some of the corporate welfare programs in the federal budget:

- **Farm subsidies.** The U.S. Department of Agriculture (USDA) spends about $25 billion a year on an array of subsidies for farm businesses. Roughly a million farmers receive the subsidies, but the payments are tilted toward the largest producers. The largest 15 percent of farm businesses receive more than 85 percent of the subsidies. USDA data show that the average income of farm households was $134,164 in 2014, which was 77 percent higher than the average of all U.S. households.
- **Rural subsidies.** The USDA subsidizes rural businesses through the Rural Housing Service, the Rural Utilities Service, and the Rural Business-Cooperative Service. The programs, which cost about $6 billion a year, subsidize financial institutions, housing developers, utilities, and many other types of businesses—from car washes to clam harvesters.
- **Energy subsidies.** The Department of Energy spends more than $4 billion a year on subsidies for conventional and renewable energy. The subsidies include loans and grants to energy companies, and indirect business support such as industry research.
- **Small business subsidies.** The Small Business Administration provides subsidized loans and loan guarantees to businesses, which costs taxpayers about $1 billion a year. Other federal agencies favor small businesses through preferential procurement rules and other methods.
- **Export subsidies.** The federal government provides aid to exporters through the Department of Commerce, the Foreign Military Financing program, and the Export-Import Bank. The latter agency provides loan guarantees and other aid to some of the nation's largest corporations, such as Boeing and General Electric.
- **Aviation subsidies.** The federal government spends billions of dollars a year on the operation of the air traffic control system and grants to commercial airports. But reforms in Canada and Great Britain show that airports and air traffic control can be separated from the government and self-funded.
- **Earned income tax credit (EITC).** The $70 billion EITC is usually thought of as a subsidy for low-income workers, but the program also subsidizes businesses. The EITC is designed to increase labor supply,

but to the extent that it does, it reduces market wages for low-income workers. In effect, the program allows businesses to hire workers at a lower cost, with federal taxpayers picking up part of the wage bill.

This chapter focuses on spending for corporate welfare, but the government also subsidizes businesses through other means. International trade restrictions protect certain businesses at the expense of consumers and businesses that use imported goods. And in numerous industries, regulations protect established firms from competition by creating barriers to entry.

Another example of corporate welfare through regulation is the Renewable Fuel Standard, which requires that transportation fuels contain biofuel, primarily corn-based ethanol. The standard is a subsidy to corn farmers and the renewable fuels industry. It costs motorists about $10 billion a year, raises food prices, and does not benefit the environment.

What's Wrong with Corporate Welfare?

The above examples illustrate that corporate welfare comes in many flavors. "Crony capitalism" is another name for the problem. These subsidies have many negative effects:

1. They harm taxpayers. A 2012 Cato report found that the federal government spends about $100 billion annually on corporate welfare. Repealing the spending would save every household in the nation an average of about $800 a year.

2. They harm consumers and businesses. Corporate welfare aids some businesses, but it harms other businesses and consumers. Federal import barriers on sugar, for example, raise sugar prices and cost U.S. consumers about $2 billion a year. Some U.S. food companies that use sugar in their products have moved their production abroad to access lower-priced sugar.

3. They create an uneven playing field. Businesses receiving federal subsidies have an unfair advantage over unsubsidized competitors in their industries. Corporate welfare can also have unfair effects on businesses in other industries. As an example, the Export-Import program has subsidized jet purchases by foreign airlines, but that has given the foreign airlines an advantage over U.S. airlines that pay the full prices for their jets.

4. They duplicate private activities. Corporate welfare often duplicates activities that are already available in private markets, such as insurance, loans, marketing, and research. USDA's Risk Management Agency, for example, says that its mission is to help farm businesses "through effective,

market-based risk management tools." But if these services are "market-based," then Congress can end this $8 billion agency and let the private marketplace provide the tools.

5. They foster corruption. Corporate welfare fosters political corruption as businesses looking for handouts try to gain the support of politicians and federal officials. A 2011 *Washington Post* investigation into green energy subsidies was titled, "Solyndra: Politics Infused Obama Energy Programs." The investigation found that the business people behind firms receiving green subsidies were often Obama campaign donors, that Solyndra's corporate decisionmaking was driven by political considerations, and that a major Democratic fundraiser and frequent visitor to the Obama White House, George Kaiser, held a one-third stake in Solyndra through his family foundation. Federal taxpayers lost half a billion dollars on the failed solar company, Solyndra.

6. They weaken the private sector. Corporate welfare draws talented people away from productive pursuits and into wasteful subsidy activities. Companies that take government subsidies often become weaker, less efficient, and distracted from serving their customers. They take on riskier projects, they make decisions divorced from market realities, and they substitute lobbying for innovation. Federal export subsidies, for example, induced Enron Corporation to partake in failed overseas projects that helped pull the company down. And in chasing federal green subsidies, the utility Southern Company has spent more than $6 billion on a disastrous "clean coal" power plant that has doubled in cost.

7. They damage trust in government and business. Public opinion polls show plunging support for politicians and big businesses over the years. Gallup polls find that just one-fifth of Americans have "confidence" in big business, and they find that about three-quarters of people think there is "widespread corruption" in American government. The recent rise of populist politicians partly stems from the feeling that the "system is rigged" in favor of special interests, such as big businesses. Business and political leaders would garner more respect if they cut their ties to each other by ending corporate welfare.

Conclusions

Corporate welfare and other special-interest subsidies should be abolished. But reforms will only happen if congressional leaders make it a priority and members of Congress understand that the nation would gain from overall restraint. In Washington, subsidies have grown in an

environment where members perceive that it is "every man for himself" in securing favored spending.

Structural budget reforms would help Congress make tradeoffs. A balanced-budget requirement and a cap on the annual growth in total spending are mechanisms that would encourage restraint. Special commissions to downsize particular parts of the budget might also work, as they did with multiple rounds of military base closings.

Congress has the ability to end corporate welfare and other subsidy programs. But the job would be easier if Congress made structural reforms to limit special-interest pressures. It would also be made easier if more constituents pressured members to cut subsidies, particularly subsidies to members' own states.

Suggested Readings

Bennett, James T. *Corporate Welfare: Crony Capitalism That Enriches the Rich*. New Brunswick, NJ: Transaction Publishers, 2015.

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Taxpayers for Common Sense. www.taxpayer.net.

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