

# Cato Handbook for Policymakers

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## 26. Corporate Welfare and Earmarks

### Congress should

- end programs that provide direct grants to businesses;
- end spending that indirectly subsidizes businesses, such as preferential loans and assistance for exporting;
- eliminate trade and regulatory barriers that favor some businesses at the expense of other businesses and consumers;
- eliminate earmarking in spending bills and subject all spending projects—assuming that they are legitimate federal activities—to expert review and competitive bidding;
- expand financial transparency with further Internet disclosures of spending details for proposed and enacted bills; and
- downsize the federal government by terminating programs, reviving federalism, and privatizing activities.

When considering budget issues, federal policymakers are supposed to have the broad public interest in mind. Unfortunately, that is not how the federal budget process usually works in practice. Many federal programs are sustained by special-interest groups working with policymakers seeking narrow benefits at the expense of taxpayers and the general public. This chapter examines how special interests regularly triumph over the general public interest in Washington and focuses on two particular types of spending: corporate welfare and earmarks.

Corporate welfare refers to subsidies and regulatory protections that lawmakers confer on certain businesses and industries. Earmarking refers to the practice of individual lawmakers slipping provisions into bills to fund particular projects in their home states. Earmarks can include subsidies for businesses, nonprofit groups, or state and local governments.

## Special Interests' Domination of the General Interest

How can special interests regularly triumph over the broad public interest in our democracy? For one thing, recipients of federal handouts have a strong incentive to create organizations to lobby Congress to keep the federal gravy train flowing. By contrast, average citizens have no strong incentive to lobby against any particular subsidy program because each program costs just a small portion of their total tax bill.

When average citizens do speak out against particular programs, they are usually outgunned by the professionals who are paid to support programs. Those professionals have an informational advantage over citizens because the workings of most federal programs are complex. The lobby groups that defend subsidy programs are staffed by top program experts, and they are skilled at generating media support. One typical gambit is to cloak the narrow private interests of subsidy recipients in public interest clothing, and proclaim that the nation's future depends on increased funding.

Another reason it is hard to challenge spending programs is that lobby groups, congressional supporters, and federal agencies rarely admit that any program is a failure. Washington insiders become vested in the continued funding of programs because their careers, pride, and reputations are on the line, and they will battle against any cuts or reforms.

How do dubious spending programs get enacted in the first place? Table 26.1 shows how Congress can pass special-interest legislation in which the costs outweigh the benefits. The table assumes that legislators vote in the narrow interests of their districts. The hypothetical project shown creates benefits of \$40 and costs taxpayers \$50, and is thus a loser for the nation. Nonetheless, the project gains a majority vote. The program's

**Table 26.1**  
**Majority Voting Does Not Ensure That a Project's Benefits**  
**Outweigh Costs**

Legislator	Vote	Benefits Received by Constituents	Taxes Paid by Constituents
Clinton	Yea	\$12	\$10
Cochran	Yea	\$12	\$10
Collins	Yea	\$12	\$10
Carper	Nay	\$2	\$10
Coburn	Nay	\$2	\$10
Total	Pass	\$40	\$50

benefits are more concentrated than its costs, and that is the key to gaining political support.

The pro-spending bias of Congress is strengthened by the complex web of vote trading, or logrolling, that often occurs. Table 26.2 shows that because of logrolling, projects that are net losers to society can pass even if they do not have majority support. Because Projects A and B would fail with stand alone votes, Clinton, Cochran, and Collins enter an agreement to mutually support the two projects. That is, they logroll. The result is that the two projects get approved, even though each imposes net costs on society and benefits only a minority of voters.

The popularity of logrolling means that programs that make no economic sense and have only minimal public support are enacted all the time. Earmarked spending and corporate welfare are two manifestations of the problem. It is possible for congressional leaders to counter these pro-spending biases by using party discipline, but in recent years an “every man for himself” ethos has permeated Congress, and members have had free rein to grab all the money they can for their narrow causes.

### Corporate Welfare

One egregious type of special-interest spending is “corporate welfare” or business subsidies. The federal government spends about \$90 billion annually on corporate welfare. That includes direct cash payments to businesses, such as subsidies to farmers and grants to automobile compa-

**Table 26.2**  
**Logrolling Allows Passage of Subsidies That Benefit Minorities of Constituents**

Legislator	Project A		Project B		Vote on a Bill Including Projects A and B
	Benefits Received by Constituents	Taxes Paid by Constituents	Benefits Received by Constituents	Taxes Paid by Constituents	
Clinton	\$15	\$10	\$8	\$10	Yea
Cochran	\$15	\$10	\$8	\$10	Yea
Collins	\$4	\$10	\$20	\$10	Yea
Carper	\$3	\$10	\$2	\$10	Nay
Coburn	\$3	\$10	\$2	\$10	Nay
Total	\$40	\$50	\$40	\$50	Pass

nies. It also includes indirect benefits, such as loans, research, and marketing support for businesses.

In addition to spending programs, corporate welfare comprises barriers to trade designed to protect businesses from foreign competition, and it includes domestic regulations that confer advantages on certain companies at the expense of individual consumers and the general economy.

## A Sampler of Corporate Welfare Programs

The following are some corporate welfare programs that are long overdue for repeal. Where provided, spending totals are for fiscal year 2008.

- **Agriculture Department: Market Access Program.** This program hands out more than \$200 million annually to exporters of agricultural products to pay for their overseas advertising. Some of the recipients include the Brewers Association, the Pet Food Institute, Sunkist Growers, Welch's Food, and the Wine Institute.
- **Commerce Department: Advanced Technology Program.** This \$198 million program gives research grants to high-tech companies.
- **Foreign Military Financing.** U.S. taxpayers fund weapons purchases by foreign governments through this \$4.7 billion program.
- **Amtrak.** The federal passenger rail company receives about \$1.4 billion in subsidies annually. But Amtrak would be better off privatized so it could cut inefficient routes, maximize profits, and innovate.
- **Export-Import Bank.** This agency uses taxpayer dollars to subsidize the financing of foreign purchases of U.S. goods. It makes billions of dollars of preferential loans to foreigners, guarantees the loans of private institutions, and provides export credit insurance. In 2007, a Dallas television station (WFAA) discovered that the agency provided \$243 million in loans to bogus Mexican companies, including drug cartels.
- **Maritime Administration.** This \$591 million agency provides subsidies to the commercial shipping and shipbuilding industries. For example, the agency provides loan guarantees for purchases of ships from U.S. shipyards. But the best way to ensure a vigorous U.S.-owned ship industry is to reduce domestic taxes and regulations, which have encouraged the industry to move offshore.
- **Energy Department: Energy Supply Research.** This \$894 million program aims to develop new and improved energy technologies.

But the energy industry itself should fund such work, since it will earn profits when breakthroughs are made.

- **Small Business Administration.** This \$530 million agency provides subsidized loans and loan guarantees to small businesses. It has a poor record of selecting businesses to support, as its loans have high rates of delinquency.

## **What Is Wrong with Corporate Welfare?**

As the previous examples illustrate, corporate welfare comes in many flavors. Here are six problems that such subsidies create:

1. **Taxpayer cost.** A Cato Institute report in 2007 found that the federal government spends \$92 billion annually on corporate welfare. Thus, Congress could provide every household in the nation with an \$800 per year tax cut by ending corporate welfare.
2. **Uneven playing field.** By aiding some businesses, corporate subsidies put other businesses without political connections at an unfair disadvantage. When corporate welfare props up failing businesses, it makes no sense because such companies likely have second-rate products or poor managers and are a drag on the economy. At the same time, when corporate welfare supports profitable companies, it also makes no sense because these companies do not need taxpayer help.
3. **Duplication of private activities.** Many federal programs duplicate activities that are routinely provided in private markets, such as insurance, loans, and marketing. If government activities of such a commercial nature are useful, then private markets should be able to carry them out. Consider the Department of Agriculture's \$3 billion Risk Management Agency, which says that its mission is to help farmers "manage their business risks through effective, market-based risk management solutions." If the RMA's services really are "market-based," then subsidies are not needed and the agency should be privatized. After all, Wall Street offers a huge array of risk management solutions on which other industries depend.
3. **Harm to consumers and businesses.** When it aids some businesses, the government often damages other businesses and consumers. Consider federal import quotas on sugar, which have pushed up U.S. sugar prices to twice the world level. Those high prices have hurt U.S. candy companies, many of which have moved their production

abroad in recent years to access cheaper sugar. For example, Kraft moved its 600-worker LifeSavers factory from Michigan to Canada in 2002, where sugar is half the U.S. price. Federal regulations in aid of dairy producers are similarly damaging. They push up the costs of milk and cheese for consumers, while hurting U.S. food companies that depend on those products.

4. **A poor track record for picking winners.** Over the decades, many government initiatives have funded new technologies, but most such efforts have been wasteful and ineffective. With regard to energy technologies, for example, the Congressional Budget Office noted in February 2007 that “federal programs have had a history of funding fossil-fuel technologies that, although interesting technically, have limited practical value, and therefore, little chance of commercial implementation.” As one particular example, federal “clean coal” projects have had a very poor financial and performance track record. We should leave the job of funding innovation to businesses and venture capital firms.
5. **An atmosphere that fosters corruption.** Corporate welfare generates an unhealthy relationship between businesses and the government. One scandal in 2002 involved the Maritime Administration’s loan program for shipbuilders. A company called American Classic Voyages received a \$1.1 billion loan guarantee from the program to build two cruise ships in former Sen. Trent Lott’s (R-MS) hometown. Before completion, the company went bankrupt and left federal taxpayers with a \$200 million tab.
6. **A weakened private sector.** Corporate welfare draws talented people into wasteful subsidy activities, and away from more productive pursuits. Companies receiving subsidies often become weaker and less efficient, and they take on riskier projects. Consider, for example, that two federal agencies provided loans of more than \$1 billion to Enron Corporation for dubious overseas projects in the 1990s. Many of Enron’s foreign projects were duds, and the company may not have pursued them if it had not received federal help. When the company collapsed in scandal, taxpayers lost their investment in Enron’s foreign schemes.

## Ethanol: A Case Study in Corporate Welfare

Supporters of federal ethanol subsidies claim that ethanol production reduces America’s dependence on foreign oil. But that effect is negligible,

and it comes at a high cost by distorting the economy and raising food prices.

The federal government subsidizes ethanol—a fuel derived from agricultural products—through a variety of regulatory and tax provisions, including:

- A 9-billion-gallon federal mandate for ethanol usage in vehicles,
- A 51-cent-per-gallon tax credit for ethanol producers,
- A 54-cent-per-gallon tariff on imported ethanol, and
- Subsidies to corn producers, which partly subsidize ethanol production.

As a result of these subsidies, U.S. ethanol production has skyrocketed in recent years, with the effect of transferring much wealth from consumers to farmland owners and agribusinesses. Ethanol subsidies here and abroad are helping to push up food prices worldwide as farmland is converted from food production to fuel production.

As the price of oil has risen in recent years, the prices of agricultural commodities have also risen because of the ethanol link, and that is hurting food consumers everywhere, including many of the world's poorest people. A recent World Bank report concludes that increased biofuel production has been the major factor behind soaring world food prices in recent years.

In 2007, Congress increased the mandated production of ethanol and other renewable fuels to 9 billion gallons in 2008, 11 billion gallons in 2009, and increasing amounts after that. U.S. ethanol is made from corn, and corn producers already receive billions of dollars each year from federal farm subsidy programs. Ethanol subsidies increase the government-generated profits for corn producers and owners of farmland.

Ethanol is damaging to consumers and taxpayers, and it is also not very energy efficient. Studies show varying results, but it appears that the production of ethanol consumes about as much energy as the ethanol itself produces in vehicles, thus providing little net benefit to America's energy needs. Congress should stop fueling the ethanol industry with subsidies and regulations, and let the market decide whether ethanol makes any sense.

## **Earmarks**

The federal budget practice of “earmarking” has exploded during the last 15 years. Earmarks are line items in spending bills inserted by legislators for specific projects in their home states. Some infamous earmarks funded a \$50 million indoor rain forest in Iowa and a \$223 million “bridge

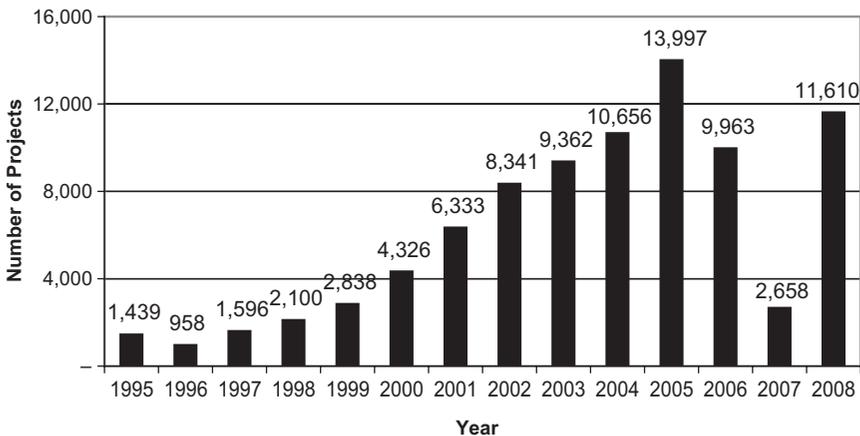
to nowhere” in Alaska. Earmarks can provide recipients with federal grant money, contracts, loans, or other types of benefits. Earmarks are often referred to as “pork” spending.

Figure 26.1 shows that the number of pork projects increased from fewer than 2,000 annually in the mid-1990s to almost 14,000 in 2005. Various scandals and the switch to Democratic control of Congress then slowed the pace of earmarking for a couple of years. But earmarking is on the rise again. The fiscal year 2008 omnibus appropriations bill was bloated with 11,610 spending projects inserted by members of Congress for their states and districts.

Earmarked projects are generally those that have not been requested by the president and have not been subject to expert review or competitive bidding. Thus, if the government had \$1 billion to spend on bioterrorism research, it might be earmarked to go to laboratories in the districts of important politicians, rather than to labs chosen by a panel of scientists. Earmarking has soared in most areas of the budget, including defense, education, housing, scientific research, and transportation.

The main problem with earmarking is that most spending projects chosen by earmark are properly the responsibility of state and local governments or the private sector, not the federal government. The rise in earmarks is one manifestation of Congress’s growing intrusion into state affairs, as

**Figure 26.1**  
**Number of Pork Projects, 1995–2008**



SOURCE: Citizens Against Government Waste.

discussed in Chapter 5. Consider these earmarks from the FY08 omnibus appropriations bill:

1. \$1,648,850 for the private Shedd Aquarium in Chicago, which is also awash with corporate funding;
2. \$787,200 for “green design” changes at the Museum of Natural History in Minneapolis;
3. \$492,000 for the Rocky Flats Cold War Museum in Arvada, Colorado;
4. \$1,950,000 for a library and archives at the Charles B. Rangel Center for Public Service at the City College of New York;
5. \$2,400,000 for renovations to Haddad Riverfront Park in Charleston;
6. \$500,000 for upgrades to Barracks Row, a swank Capitol Hill neighborhood;
7. \$742,764 for fruit fly research, partly conducted in France;
8. \$188,000 for the Lobster Institute in Maine; and
9. \$492,000 for fuel cell research for Rolls-Royce Group of Canton, Ohio.

Projects 1 to 3 give taxpayer money to groups that should be funding their own activities from admissions fees and charitable contributions. Interestingly, the nonprofit Shedd Aquarium has spent hundreds of thousands of dollars on lobbyists to secure federal earmarks, and its chief executive earned a huge \$600,000 salary in 2006. Or consider that the Rock and Roll Hall of Fame in Cleveland has received federal grants, even though there are thousands of music industry millionaires who should be footing the bill.

Projects 4 to 6 are examples of items that state and local governments should fund locally. Unfortunately, state and local officials are increasingly asking Washington for handouts, and lobby groups such as Cassidy and Associates are helping them “mine” the federal budget for grants.

Projects 7 to 9 fund activities that should be left to the private sector. Industries should fund their own research, which is likely to be more cost-effective than government efforts. Besides, successful research leads to higher profits for private businesses, and it makes no sense for taxpayers to foot the bill for such private gains.

## **Earmarks’ Erosion of Fiscal Responsibility**

Defenders of earmarks argue that they are no big deal since they represent just a small share of overall federal spending. The problem is that

earmarking has contributed to the general erosion in fiscal responsibility in Washington. Earmarks have exacerbated the parochial mindset of most members, who spend their time appeasing state and local interest groups rather than tackling issues of broad national concern. Many politicians complain about the soaring federal deficit, yet their own staff members spend most of their time trying to secure earmarks in spending bills.

The rise in earmarking has encouraged a general spendthrift attitude in Congress. Why should rank-and-file members restrain themselves when their own leaders are usually big recipients of pork? Sen. Tom Coburn (R-OK) is right that the problem with earmarks is “the hidden cost of perpetuating a culture of fiscal irresponsibility. When politicians fund pork projects they sacrifice the authority to seek cuts in any other program.” Similarly, Rep. Jeff Flake (R-AZ) concludes that “earmarking . . . has become the currency of corruption in Congress. . . . Earmarks are used as inducements to get members to sign on to large spending measures.”

## **Reforms to Increase Transparency and Downsize the Government**

A first step toward eliminating earmarks, corporate welfare, and other special-interest spending is to further increase transparency in the congressional and agency spending processes. Under pressure from reformers, the government has set up a searchable database of federal grants and contracts at [www.usaspending.gov](http://www.usaspending.gov). A second step is for citizens to use this website and other tools to research federal spending, and then to call their members of Congress and tell them what programs should be cut.

Citizens should also ask their members to support reforms to the budget process. One idea for cutting corporate welfare is to set up a commission akin to the successful military base-closing commissions of the 1990s. It would draw up a list of current subsidies and present it to Congress, which would vote on the cuts as a package without amendment. To make the package a political winner, all budget savings would go toward immediate tax cuts for families.

Ultimately, earmarking and corporate welfare should be abolished, and spending on activities that are legitimate federal functions should be determined by a system of competitive bidding and expert review. Of course, it will not be easy to reform the spending practices of Congress. Members often feel committed to expanding spending in their districts and on their favored programs. But taxpayers fund all those programs, and they need

to do a better job of convincing their members to cut unneeded programs and pass much leaner federal budgets.

### **Suggested Readings**

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—*Prepared by Chris Edwards and Jeff Patch*



## THREATS TO CIVIL LIBERTIES

