SPECIAL INTERESTS AND CORPORATE WELFARE

Congress should

- end subsidies for businesses, including grants, loans, and industry research; and
- end regulations and trade barriers that reduce competition and reward favored businesses at the expense of consumers and other businesses.

Policymakers should have the broad public interest in mind when considering spending and regulations. Unfortunately, the policy process often works in convoluted ways that produce results contrary to the general public interest. Special-interest groups often gain narrow benefits from the government at the expense of the public. This chapter discusses why this occurs and focuses on corporate welfare, meaning cronyism or business subsidies.

Special Interests versus the General Interest

In an idealistic view of democracy, policymakers put average citizens first. They study alternatives in detail and pass laws and regulations that have broad support. They also ensure that their actions are allowable under the U.S. Constitution.

This "public interest theory of government" falls short in explaining the real world of policymaking. Congress often enacts ill-conceived laws that benefit narrow groups at the expense of most citizens. Many federal programs and regulations harm the overall economy and are only sustained because powerful lobby groups support them.

Members of Congress are receptive to these groups, particularly those from their home states. Members receive campaign support from the groups, and they may look forward to post-congressional careers working with them. Also,

Table 1
Majority voting does not ensure that benefits outweigh costs

Legislator	Vote	Benefits received by constituents	Taxes paid by constituents
Smith	Yea	$12	$10
Jones	Yea	$12	$10
Davis	Yea	$12	$10
Garcia	Nay	$2	$10
Miller	Nay	$2	$10
Total	Pass	$40	$50

Source: Author.

members and their staffs get bombarded with seemingly convincing messages from interest groups about why government programs are needed.

Members often believe they are doing the right thing when they support industry subsidies and protections. They may not appreciate that such policies usually make the nation as a whole worse off through higher taxes and economic distortions. The benefits created by subsidies and protections are often visible and tangible, but the higher costs are diffused across millions of taxpayers or consumers.

Table 1 shows how a special-interest bill gains majority support even if it is bad for the nation overall. A five-person legislature votes on the bill, which provides nationwide benefits of $40 but costs taxpayers $50. Assuming that legislators vote in the narrow interests of their states, the bill 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 the benefits created.

Logrolling, or vote trading, makes special-interest provisions even easier to pass. Party leaders or committees bundle 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 2 shows how two subsidy programs, A and B, 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 Smith, Jones, and Davis agree to bundle the two programs into a single bill. They logroll. The two programs get approved, even though each of them imposes a net cost on society.

Logrolling has been around since the 19th century. One early example was omnibus river and harbor bills, which sprinkled dozens of Army Corps of Engineers projects across many states to ensure passage. Even at that early time, experts observed that such bills included low-value projects that did not

Table 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
Smith	$15	$10	$8	$10	Yea
Jones	$15	$10	$8	$10	Yea
Davis	$4	$10	$20	$10	Yea
Garcia	$3	$10	$2	$10	Nay
Miller	$3	$10	$2	$10	Nay
Total	$40	$50	$40	$50	Pass

Source: Author.

have broad support. The magnitude of federal spending is much greater today, and so the logrolling problem is worse. Nearly all federal spending today is through huge bills that bundle many diverse provisions. Members have neither the time nor the incentive to rigorously critique each individual program in these large bills.

Congress recently magnified the logrolling problem with the reintroduction of large-scale earmarking in the omnibus budget bill passed in March 2022. The bill included 367 pages listing about 5,000 specific local projects, such as roads and museums. This is a bad development because earmarking fuels political corruption and distracts members of Congress from truly national issues. And as former Oklahoma senator Tom Coburn noted, earmarking is a “gateway drug to overspending” because it biases members toward passage of massive bills containing budget-busting items that do not by themselves have true majority support.

Eight Types of Corporate Welfare

Governments often pass subsidy programs and regulations that aid favored businesses at the expense of taxpayers, consumers, and other businesses. The federal government spends more than $100 billion a year on business subsidies, including farm subsidies, energy subsidies, broadband subsidies, aviation subsidies, and small-business subsidies. With regard to regulations, federal, state, and local governments impose many rules that favor incumbent firms over new entrants, large firms over small firms, and firms with political connections over outsiders.

Corporate welfare is a complex phenomenon, especially today because government has become so large. Subsidies and regulations that do the following are some of the benefits that businesses seek through government.

1. **Expand sales.** Regulations and subsidies help favored industries expand their sales, often at the expense of taxpayers, consumers, and other businesses. One example is the billions of dollars the federal government spends each year helping favored companies export their products. Another example is the federal Renewable Fuel Standard, which requires that transportation fuels contain biofuel, primarily corn-based ethanol. This benefit for farmers and the biofuels industry costs motorists money, raises food prices, and likely does not benefit the environment.
2. **Expand profits.** Governments provide ongoing subsidies to favored industries, which boosts their profits. Federal farm programs, for example, provide about $30 billion a year in an array of subsidies to agricultural businesses. The largest 15 percent of farm businesses receive about 85 percent of total farm subsidies.
3. **Receive bailouts.** Over the years, the federal government has bailed out failing financial companies, car companies, airlines, and other businesses experiencing down markets. Such policies encourage other firms to expect bailouts down the road, and they undermine growth by slowing the movement of capital from poorly managed and declining firms to well-managed and expanding firms.
4. **Reduce competition.** Regulations and international trade restraints create barriers to competition, which tend to slow innovation and raise consumer prices. State occupational licensing restricts entry into more than one-fifth of American jobs. The rationale for licensing is that it promotes safety, but licensing boards are often dominated by existing businesses aiming to reduce competition. Similarly, many states impose "certificate of need" rules on the health care industry, which create barriers to new health companies wanting to challenge incumbents.
5. **Tilt the playing field.** Governments use subsidies and regulations to benefit some businesses over others within industries. In banking, the "too big to fail" doctrine favors larger banks over smaller ones, and in the beer industry, state regulations on wholesaling often favor big brewers over smaller ones.
6. **Hijack benefits.** Government benefits for disadvantaged individuals are sometimes captured by businesses. The federal low-income housing tax credit is supposed to reduce housing costs for the poor, but

much of the program's benefits are captured by housing developers and banks. Another example is the earned income tax credit. This $70 billion program may make low-income workers better off overall, but it works by increasing the labor supply, which in turn reduces market wages for low-income workers and cuts business costs.

7. **Offload costs.** In some industries, governments pay industry expenses that businesses should pay for themselves. The federal government spends billions of dollars a year subsidizing fossil fuel, nuclear, and renewable energy research, but energy companies should pay those costs. Similarly, the federal government spends billions of dollars a year subsidizing airports and air traffic control. But those activities should be run by businesses, and the costs covered by passenger charges and other market revenues.
8. **Abuse contracting.** Federal contractors are infamous for cronyism, cost overruns, and inflated profits, which is why they are called "Beltway bandits." One company that caught the attention of federal auditors was TransDigm, which produces military parts. *Defense News* reported in 2019, "The Pentagon paid contractor TransDigm $1,443 for a three-inch ring called a 'non-vehicular clutch disk' which is used in the C-135 transport aircraft, though it cost the company just $32 to produce." Auditors found that the company earned "excess profit" on 112 of 113 contracts they reviewed. Another contractor scandal involved Leonard Glenn Francis, who cozied up to U.S. Navy leaders in the Pacific to win hundreds of millions of dollars in deals to resupply ships. He overpriced his contracts and submitted fraudulent invoices. He won contracts by wining and dining naval officers and providing them with cash, gifts, and prostitutes. The scandal exposed "a staggering degree of corruption within the Navy," the *Washington Post* concluded in 2016.

Seven Harms of Corporate Welfare

The following are some of the negative effects of corporate welfare.

1. **Harms taxpayers.** A 2012 Cato report found that the federal government spends about $100 billion annually on corporate welfare, or about $800 for every U.S. household. Recent increases in corporate welfare for farm subsidies, broadband, the electric grid, electric vehicles, and renewable energy have pushed subsidies even higher.
2. **Harms consumers and businesses.** Corporate welfare aids some businesses, but it harms other businesses and consumers. Federal sugar

regulations and trade barriers protect producers, but they increase sugar prices by more than $2 billion a year, thus harming consumers and also food companies that use sugar in their products.

3. **Creates an uneven playing field.** Subsidies give businesses an unfair advantage over their unsubsidized competitors, and they can also hurt businesses in other industries. The U.S. Export-Import Bank has subsidized jet purchases by foreign airlines, but that has given the foreign airlines an unfair advantage over U.S. airlines that paid full prices for their jets.
4. **Duplicates private activities.** Corporate welfare programs often duplicate activities that are available in private markets, such as insurance, loans, marketing, and research. The U.S. Department of Agriculture's Risk Management Agency spends billions of dollars a year providing farm businesses with what it calls "market-based risk management tools," such as insurance. But if these services are "market-based," then Congress can end the program and farmers can buy insurance and other tools in the marketplace.
5. **Fosters corruption.** Corporate welfare fosters corruption as businesses wanting handouts lobby government officials. The Department of Energy (DOE) gave solar panel maker Solyndra a $535 million loan guarantee in 2009. Solyndra was a spendthrift company with uncompetitive products. It went bankrupt and closed its doors in 2011 with taxpayers footing the bill for the failed loan. A *Washington Post* investigation was titled "Solyndra: Politics Infused Obama Energy Programs." It found that the people behind companies receiving federal green subsidies at the time were often Obama campaign donors and that a major Democratic fundraiser and frequent visitor to the Obama White House held a one-third stake in Solyndra. The White House pressured the DOE to approve the subsidy. The scandal was classic cronyism.
6. **Weakens 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. This was true of Solyndra. It was also true of the failed energy company Enron Corporation. Federal export subsidies induced Enron to pursue excessively risky overseas projects that helped bankrupt the company. Another example is Southern Company. Prompted by the receipt of federal subsidies, the company spent more than $6 billion on the disastrous Kemper

"clean coal" power plant in Mississippi, which ended up doubling in cost.

7. **Damages trust in government and business.** Public opinion polls have shown falling support for politicians and big businesses over the decades. Gallup finds that just one-fifth of Americans have "a great deal" or "quite a lot" of confidence in big business and that about three-quarters of people think there is "widespread corruption" in government. The rise of populist politicians in recent years stems partly from the feeling that the "system is rigged" in favor of big businesses. Businesses and political leaders would both garner more respect if they cut their ties with each other by ending corporate welfare.

Conclusion

Corporate welfare and other special-interest subsidies and regulations should be abolished. But federal reforms will only happen if the president and congressional leaders make it a priority. Without restraint-minded leadership, subsidies grow in an environment where politicians think "every man for himself" in handing out benefits to their favored interest groups.

Congress has the ability to end corporate welfare and other sorts of subsidies. But the job would be easier if Congress made structural reforms to force itself to make tradeoffs, such as imposing a cap on overall spending. Also, members need to hear much more from constituents who want to cut programs to counterbalance all the special-interest messages they are bombarded with.

Suggested Readings

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

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