

Time to Eliminate the *Corporate Welfare State*

By Stephen Slivinski



The federal government spent \$92 billion on direct and indirect subsidies to businesses and private-sector corporate entities—expenditures commonly referred to as “corporate welfare”—in fiscal year 2006. Supporters of federal subsidies to private industry often maintain that government support of business is in the national interest. For instance, government support is said to remedy market failure by assisting disadvantaged groups who cannot receive private funding to establish new businesses. Supporters of corporate welfare programs also justify business subsidies as a way to help maintain the competitiveness of certain critical industries. Yet those justifications do not stand up to scrutiny. There are many reasons why such policies are misguided:

Government Is Ill-Suited to Finding the “Next Big Thing.” The function of private capital markets is to direct investment to industries and firms that offer the highest potential rate of return. The capital markets, in effect, are in the fulltime business of selecting corporate winners and losers. Yet the underlying premise of many federal business subsidies is that the government can direct the limited pool of capital funds just as effectively as, if not better than, markets can. The truth is that capital markets are far more agile than government and are much better suited to acting on sophisticated market signals than government ever could be.

In addition, supporters of government programs often suggest that corporate subsidy programs are necessary to remedy some sort of market failure. On closer inspection, most of those proclaimed market failures simply do not exist. For instance, supporters of the Small

Business Administration allege that the agency provides credit for firms that could not get loans in the private capital markets. Research on the subject, however, has shown that small businesses do not face insurmountable obstacles to finding willing lenders and sources of credit funding. (See, for example, Veronique De Rugy’s article “The SBA’s Justification IOU” in *Regulation*, Spring 2007.) The market failure justification is also used by supporters of programs geared to funding high-tech research, but, as discussed below, the market has not failed to deliver sufficient venture capital to advance important new technological discoveries.

Corporate Welfare Programs Create an Incestuous

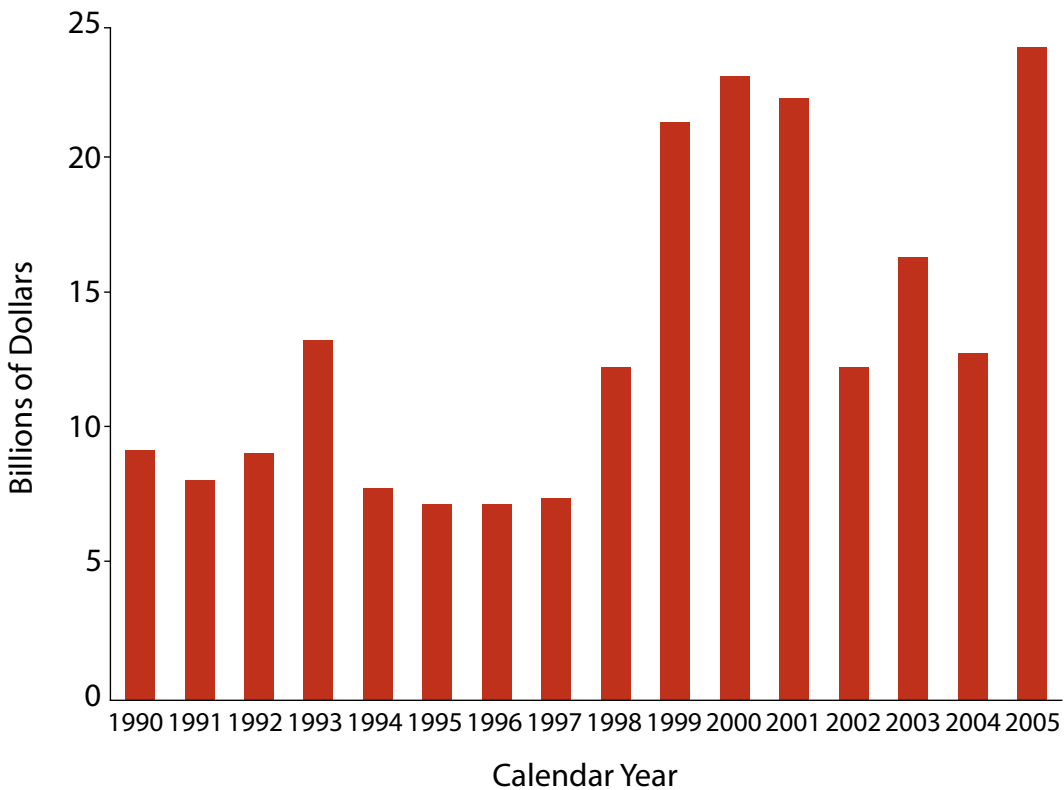
Relationship Between Business and Government. In Washington, D.C., industry trade associations and lobbying firms continually pressure lawmakers to give out new business subsidies or to protect long-standing handouts. That is a natural byproduct of a government that uses its power to give taxpayer money to favored interests. If there were no possibility that subsidies might be offered, demands for them would diminish if not disappear.

That tendency is nurtured by the problem of concentrated benefits and diffuse costs. Subsidies are usually given to a few recipients at the expense of many taxpayers. Because there are such a large number of taxpayers—and each corporate subsidy may cost each taxpayer only a few cents or a few dollars—most individual citizens don’t have an interest in lobbying against subsidies since the cost of doing so far outweighs simply paying the taxes. However, the recipients of those subsidies have a substantial interest in making sure they protect the flow of money to them. That leads to a

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Figure 1:
Direct Government Payments to Farmers, 1990–2005



Source: U.S. Department of Agriculture, Economic Research Service, www.usda.gov/data.

great deal of lobbying by special interests but very little lobbying on behalf of taxpayers.

In addition, subsidies create a perverse incentive for businesses: If an entrepreneur's competitors are receiving help from the government, it may appear to be in his or her interest to try to get some of that help, too. That incentive serves only to turn many businesspeople into lobbyists, sidetracking them from their role as entrepreneurs. That, in turn, leads to an overallocation of private resources to pursuing and protecting government subsidies.

Corporate Welfare Programs Violate Constitutional Principles. Direct corporate subsidies fall outside the limited enumerated functions of the federal government. Nowhere in the

Constitution is Congress granted the authority to spend funds to subsidize industry directly, or to enter into joint ventures with automobile companies, or to guarantee loans to favored business owners. Yet, since the New Deal, by applying very expansive readings of the General Welfare Clause, the Supreme Court has allowed Congress to redistribute wealth from taxpayers to favored business interests.

CASE STUDIES

Agribusiness. The biggest direct subsidy program in the federal budget is crop and farm subsidies. In fiscal year 2006, taxpayers footed the bill for \$21 billion in agricultural subsidies. Eleven years ago, Congress voted to phase down farm subsidies through 2001. Instead,

the opposite has occurred: A series of so-called emergency spending bills and the resurrection of a price support program in 2002 have since hiked subsidy levels to near-record highs.

Figure 1 shows the trend of farm subsidy payments between 1990 and 2005. The years in which farm subsidies were the lowest (1994 through 1997) correspond with two key events: (1) a rise in commodity prices and (2) the passage of the Federal Agriculture Improvement and Reform Act of 1996, often referred to as the Freedom to Farm Act. Subsidy levels before 1996 were set by a formula that triggered an increase in farm subsidies when crop prices fell. Starting in 1995, crop prices began to rise, thereby allowing subsidy levels to drop.

The Freedom to Farm Act, passed in 1996 when commodity prices were high and demand for subsidies was low, ended the price support program and replaced it with a declining fixed payment unrelated to market prices. Farm subsidies were scheduled to decline from \$5.6 billion in 1996 to \$4 billion by 2002. After that, crop subsidies were set to disappear.

The scheduled phaseout remained intact for about two years until Congress reversed course in 1998. When crop prices began to decline that year, Congress passed a large “emergency” supplemental appropriation that hiked total farm subsidies to \$12.4 billion. Subsequent supplemental legislation spurred farm subsidies to new heights, amounting to a total of over \$79.5 billion between 1999 and 2002. That’s \$60 billion more than the Freedom to Farm Act’s phaseout of crop subsidies would have allowed if subsidies had been cut as promised.

In May 2002, President Bush signed into law a new six-year appropriation that put the

final nail in the coffin of the Freedom to Farm Act’s commitment to weaning farmers from taxpayer support. Instead of zeroing out farm subsidies, the legislation created a new version of the old price support program that was estimated to cost taxpayers \$99 billion in direct subsidies over six years. The four fiscal years since the enactment of the 2002 farm bill have already seen an estimated \$72.9 billion spent on farm subsidies.

Although members of Congress from farm states have an interest in continuing to subsidize farmers, the United States has prospered even while the farm sector has shrunk as a percentage of the overall economy. Over the past 50 years, the number of people work-

ing and living on farms has dropped. Farm employment—including farm proprietors as well as wage and salary workers—makes up less than 2 percent of total employment in the United States. The percentage of Americans who live on farms dropped from 16.6 percent in 1948 to around 2 percent in just over 40 years. Yet thanks to technological advances, farm productivity is at a historically high level.

Despite what some farm-state politicians might say, farms do not need to compose a substantial portion of the economy for the United States to remain economically strong. A smaller farm sector is not a sign of economic decline. Quite the contrary: A farm sector that can produce substantial amounts of food with less capital and fewer workers is a testament to economic progress.

However, the conventional wisdom continues to view federal agricultural programs as vital to preserving impoverished and beleaguered family farms in the United States. The

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reality is quite different from the popular notions about farming in America today. Most farmers are relatively wealthy. Average income for farm households has exceeded the national average by 5 percent to 17 percent every year since 1996. By contrast, when large-scale federal farm subsidies began in the 1930s, farmers' incomes were only half the national average. As the Department of Agriculture itself reports, "Farm households have higher incomes, greater wealth, and lower consumption expenditures than do other U.S. households."

Most farmers don't receive direct subsidies from the federal government. The taxpayer-financed handouts go to only about one-third of the nation's farmers and ranchers. So where does all the taxpayer money spent on farmers actually go? Mainly to large corporate agribusinesses and the richest farmers. In 2005, the most recent year for which comprehensive statistics are available, the richest 10 percent of all subsidy recipients received 66 percent of all subsidies.

There are a variety of reasons to terminate farm subsidies. There are, however, no defensible reasons to continue them. These programs exist today mainly as a way for politicians to shower taxpayer money on powerful interest groups.

High-Tech Companies. The Advanced Technology Program and the Small Business

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Innovative Research program show why government is ill-suited to discover and fund the technological advances that fuel the high-tech economy.

The ATP was created in 1988 to support technological research that had the potential to provide broad-based economic benefits for the nation. The presumption was that the program, part of the Commerce Department's National Institute of Standards and Technology, would give a boost to technologies that were "pre-competitive" or "high risk" and could not get funding on their own in private capital markets. Since its inception, the program has funded more than 768 projects at a cost of at least \$2.3 billion in federal matching funds.

Program supporters suggest that ATP is a funder of last resort for high-tech businesses. However, a study by the General Accounting Office (now the Government Accountability Office) found that 63 percent of the companies that applied for ATP grants didn't look for private capital or other sources of investment before they applied for government money. That raises some serious questions: Are the projects that the government funds examples of promising but overlooked entrepreneurial initiatives? Or are they mostly examples of how savvy businesses can get the federal government to underwrite their products' R&D?

The evidence seems to indicate the latter. A recent GAO study points out that some



of the biggest ATP expenditures went to research ventures that were already generously supported by the private sector. For instance, the ATP spent \$1.2 million in the early 1990s to develop a system to recognize cursive handwriting for pen-based computer inputs, such as those used in handheld devices today. In fact, this line of research had begun in the private sector during the late 1950s, and patents for workable versions of the technology were issued five years before the start of the ATP-funded project. Companies like Apple Computers and Motorola were already well on their way to coming to market with versions of this technology. Other technologies that were already well funded and researched by the private sector were methods to expand the capacity of fiber optic cables and technology to regenerate human tissue and organs. The ATP spent roughly \$2 million to duplicate funding for R&D in those technologies. There is obviously no market failure here. These supposedly precompetitive technologies were able to attract substantial funding in the private sector.

ATP grants have gone to some of the biggest companies in America or their subsidiaries—companies that have no trouble funding their own R&D. Over the last 12 years, many *Fortune* 500 companies or their subsidiaries have received millions of dollars of ATP funding. Top beneficiaries of ATP grants over the past 15 years include IBM, General Electric, Honeywell, Xerox, and Dow Chemical.

In addition to being duplicative, government funding of research often ends up simply underwriting other aspects of corporate operations, as a study of the Small Business Innovative

Research program indicates. The SBIR is a less high-profile program than ATP, but its budget is actually much larger—about \$1 billion—because it consists of portions of many federal agency research budgets.

Created in 1982, the SBIR's goal is to stimulate technological innovation. Instead, the result has been a crowding out of private research spending by firms receiving government money. According to regression analysis done by Scott J. Wallsten, for every dollar of SBIR grant money the average company receives, it reduces its own R&D by a dollar (see "The R&D Boondoggle," *Regulation*, 23, Winter 2000, pp. 14–15). That forgone dollar of R&D money does not dis-

appear. It goes to fund another aspect of the firm's operations. The consequence is that, instead of contributing to an overall increase in R&D spending, the federal government finds itself underwriting the profit margins of small businesses and corporations.

Exporters. The mission statement of the Export-Import Bank stipulates that the bank's main purpose is to finance the purchase of U.S. goods in foreign markets. The justification it provides for its fiscal 2008 budget request is more transparent and perhaps more honest: "to sustain U.S. jobs by financing U.S. exports." The Ex-Im Bank does that by using taxpayer money to subsidize loans to foreign purchasers of U.S. products and to provide loans and loan guarantees to U.S. companies seeking to enter export markets. It also provides insurance for companies investing overseas.

The loans and guarantees that the Ex-Im Bank grants to U.S. companies qualify it as the underwriter of the sales of some of the biggest

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Fortune 500 companies, none of which would have trouble getting funding for worthwhile overseas projects. Boeing is the largest corporate beneficiary of Ex-Im Bank loan activity, leading many commentators to refer to the Ex-Im Bank as “Boeing’s Bank.”

Supporters of the Ex-Im Bank suggest that government credit is needed to level the playing field for U.S. companies as they compete against foreign companies that receive support from their governments. Yet the Ex-Im Bank’s most recent annual Competitiveness Report points out that fewer than one-third of all its loans and guarantees go to counter subsidized foreign competition.

Instead, most of the Ex-Im Bank’s loan and guarantee portfolio is geared toward providing credit for overseas projects and purchases that the bank says could not receive private funding. However, 99 percent of capital-intensive projects in developed countries are already financed by private borrowers. The amount for developing countries is 89.7 percent. The Ex-Im Bank provides a mere 2 percent of the financing for projects in developing countries.

Those data do not provide good evidence that there is a failure in the credit markets. Private capital markets have been able to provide virtually all of the funding for overseas projects and acquisitions of U.S. products. If the projects the Ex-Im Bank underwrites were not able to receive funding in private markets, it’s

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probably because those projects simply weren’t ones that investors found worthwhile, or because the interest rates on those loans were higher than the companies were willing to accept. That is not an example of market failure—it is a testament to how well private capital markets work.

HOW TO ELIMINATE THE CORPORATE WELFARE STATE

Any attempt to terminate business subsidy programs will require altering the incentives of legislators. Individual members of Congress lack the incentive to discipline themselves. If they were successful in saving taxpayer money by defunding a particular program, less abstemious members might be able to use that money to bolster the budget of another favored program. Also, member A knows that voting for a decrease in member B’s favored program might result in future reprisals. For those reasons, attempts to defund these programs one by one, or in small groups, during the annual appropriations process are not likely to yield results. An institutional problem of this sort requires an institutional solution.

One way out of this dilemma might be a corporate welfare reform commission (CWRC). General guidelines for a bill creating a CWRC could be as follows:

- The commission would not be composed of sitting members of Congress. It would be chosen by bipartisan agreement between the

President and the leadership of both houses of Congress.

- The commission would convene for the purpose of proposing a list of corporate welfare programs that should be eliminated.

- The commission would address only spending programs, not tax preferences in the budget, and no corporate welfare spending programs should be considered “off the table.”

- The commission’s list of recommended program terminations would be voted on by both houses of Congress, with no amendments, within 60 days of the commission’s final report.

A commission structured along those lines would solve two main problems:

- *The special interests dilemma:* Because the members of the commission would not be incumbent lawmakers, they would be far more insulated from political concerns. While there would still be special interest pressure on the members of the commission, that pressure is likely to be much less effective.

- *The collective choice dilemma:* Because every program would be terminated by an up-or-down vote on an unamendable bill, there would be no vote trading on the specifics of the bill as there is during the normal appropriations process. The commission would have the ability to cast a wide net and create a list of programs that would hit a larger number of special interest constituencies than any one member of, or group within, Congress would propose. To further enhance the possibility of success, the commission could present its list of program terminations to Congress in a nonelection year.

The CWRC has an ancestor in the Base Realignment and Closure Commission. The BRAC was created after the collapse of the Soviet Union, at a time when there was a

general understanding that even though the military base structure then made little sense on the whole, Congress could not bring itself to close specific bases. According to Kenneth R. Mayer, during the 10 years before BRAC, “Congress prohibited studies of whether bases should be closed, required an environmental impact statement for any proposed closure, and attached riders to appropriations bills to bar the spending of funds to close particular bases,” (see “The Limits of Deregulation: The Rise and Fall of BRAC,” *Regulation*, Fall 1999). Although many members of Congress liked the idea of closing military bases in the abstract, they were rarely willing to vote for a bill that would close

a base in their district. Congress was unable, because of institutional and political biases, to downsize the defense budget at a time when doing so was often cited by members of both parties as an important goal.

A final reason to convene such a commission is that sunlight is the best disinfectant. A corporate welfare commission would finally allow scrutiny of those programs in a coordinated public proceeding. That’s not something that happens regularly in Congress today, and it’s long past time for sustained public attention to a debate on the merits of the federal government’s role in subsidizing private companies.

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