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Curbing Favoritism in Government: What the Trump Administration and Congress Should Do

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TO MAKE GOOD ON A CAMPAIGN PROMISE TO “drain the swamp” in Washington, DC, the Trump administration will need to work with the Republican-led Congress to confront the unhealthy relationship between the federal government and commercial interests. Derided by critics as “corporate welfare” or “crony capitalism,” but more simply characterized as “favoritism,” this relationship short-circuits the feedback mechanisms of the market and comes at a considerable price to taxpayers.

Whatever the label, favoritism is a widespread problem in the federal government. In 2016, the federal “corporate welfare” programs cost taxpayers roughly \$50 billion.¹ This figure, however, vastly understates the true extent of government favoritism and its longer-term effects on the economic well-being of the country. As Mercatus scholar Matthew Mitchell explains in his book *The Pathology of Privilege*,

Whatever its guise, government-granted privilege [to private businesses] is an extraordinarily destructive force. It misdirects resources, impedes genuine economic progress, breeds corruption, and undermines the legitimacy of both the government and the private sector.²

In supporting these programs, Congress shirks its duty under the “general welfare” clause in Article 1 of the US Constitution to use the wealth and property of its citizens to create widely shared benefits, not benefits for a select group of individuals, interests, or companies. As such, we should abolish federal programs, along with any special tax and regulatory provisions, that exist to confer a specific benefit upon a particular business or industry.

Eradicating favoritism in the federal government won’t be easy. Given the deep-rooted and mutually beneficial relationship between politicians and

commercial interests, it will require an immense, long-term effort. To begin to unravel this unhealthy relationship, we outline below six actions that can be taken by the new administration and Congress in the coming year.

ACTION 1: ADOPT FAIR-VALUE ACCOUNTING PRACTICES

Advocates for federal loan programs often claim that these programs are “free” or even return money to the US Treasury. But such claims are a misleading byproduct of the government’s current accounting methods. Take the US Export-Import Bank, a government credit agency that provides taxpayer-backed financing to private exporting businesses.³ Advocates often claim that the Export-Import (Ex-Im) Bank’s programs “return money to the Treasury” or “create a profit for taxpayers,” but that’s mostly an accounting illusion.

Current accounting methods, prescribed by the Federal Credit Reform Act of 1990 (FCRA), hide the true costs of the programs. A 2014 Congressional Budget Office (CBO) report looked at the expected budgetary costs of a number of programs—the Department of Education’s four largest student loan programs, the Ex-Im Bank’s six largest export credit programs, and the Federal Housing Administration’s single-family mortgage guarantee program—using CBO’s “fair value” accounting method.⁴ CBO found that rather than saving or making money, these programs combined will cost taxpayers—excluding administrative expenses—roughly \$120 billion over the next 10 years.⁵

CBO explains this discrepancy:

Under FCRA’s rules, the present value of expected future cash flows is calculated by discounting them using the rates on U.S. Treasury securities with similar terms to maturity. . . . In contrast, under the fair-value approach, estimates are based on market values—market prices when those prices are available or approximations of market prices when directly comparable figures

are unavailable—which more fully account for the cost of the risk the government takes on. In particular, the fair-value approach accounts for the cost of market risk, which FCRA procedures do not. . . . When the government extends credit, the associated market risk of those obligations is effectively passed along to taxpayers, who, as investors, would view that risk as having a cost. Therefore, the fair-value approach offers a more comprehensive estimate of federal costs.⁶

The programs reviewed by CBO are not the full extent of taxpayers’ exposure. According to the latest Financial Report of the United States Government, taxpayers are exposed to approximately \$3.5 trillion in direct loans and loan guarantees.⁷ To begin to reduce this exposure is to understand how extensive it is, which is why the administration and Congress should work together to adopt fair-value accounting methods and stop the obscuring of the costs and risks associated with these programs.

The good news is that both the House and the Senate have already considered this issue. In November 2016, the House Budget Committee even put out a proposal to rewrite the budget process that would include switching to fair value accounting.⁸

ACTION 2: CREATE A BRAC-LIKE COMMISSION TO ELIMINATE FAVORITISM

Favoritism is difficult to eliminate because the benefits are concentrated on a few, while the costs are spread across millions of taxpayers and consumers.⁹ Its beneficiaries have a strong incentive to coordinate and protect their privileges, which politicians are often happy to oblige in exchange for financial and political support. In some cases, politicians may also be wary of powerful interest groups. The incentives are different for average Americans since they likely don’t have enough time—or even knowledge about how a particular program is hurting them—to organize their opposition and tell Congress.

A good example is the domestic sugar industry. The federal sugar program employs loan guarantees,

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price supports, and trade barriers to prop up the economically uncompetitive US sugar industry. The result is that American consumers and American companies that use sugar in their products pay, on average, twice what rest of the world pays for sugar.¹⁰ The favoritism enjoyed by the domestic sugar industry does not boost economic growth, as is often claimed; rather, it redistributes wealth away from unsubsidized American firms, employees, and consumers and directs it toward a small number of beneficiaries. In spite of this intentional distortion of the market, these policies continue to exist because the costs are borne by hundreds of millions of Americans, while the relatively small sugar lobby spares no effort in jealously protecting the gains.

One idea that could help solve this dilemma would be the creation of an independent commission tasked by Congress with reviewing programs, tax expenditures, and regulations that confer privileges on commercial interests. The commission would submit a package of privileges to be eliminated that would go into effect unless Congress voted down the entire package. The model for this idea comes from the relatively successful commissions enabled by the 1988 Base Closure and Realignment Act.¹¹ The legislation was enacted in response to the government's bloated stockpile of military bases that were no longer needed yet continued to drain taxpayers because policymakers from districts that had a base targeted for closure would fight tooth and nail to protect their constituents' jobs.¹² As Jerry Brito explains, the BRAC commissions succeeded in achieving base closures because the commissioners were independent experts rather than politicians, and they were given a narrow focus with specific instructions. He notes

that a critical feature was the "silent approval" of a commission's recommendations:

Under the BRAC Act, once the Commission made its recommendations, the Secretary of Defense was *required* to begin closing the designated bases. No further vote in Congress was necessary. Only if a joint resolution disapproving *all* of the Commission's recommendations were passed, and signed by the President, could the bases be spared. This is a high bar indeed.¹³

The commissions gave policymakers political cover by enabling them to support the overall package of base closures while putting up a public fight against closures back in the district to demonstrate they stuck up for their constituents' jobs.

The specifics of crafting similar legislation to create a commission or commissions charged with eliminating favoritism are beyond the scope of this essay. But any plan that includes these elements should make the task seem less like mission impossible.

ACTION 3: TEMPER BIAS IN CONGRESSIONAL COMMITTEE HEARINGS

Congressional committees divide responsibility for the multitude of legislative issues Congress handles by giving select members jurisdiction over specific areas. Although the functions served by congressional committees vary, hearings are a common denominator. A long-standing problem with congressional hearings is that they tend to be biased in favor of those who have a direct financial interest in maintaining or expanding the government agencies and programs under a committee's purview.¹⁴

Take, for example, a 1993 study that examined policy bias in committee hearings. Although the authors found that competition between committees for control of an issue can lessen the influence of an interest group (a finding worth noting on its own), the study confirmed that “committees that are favorable to an economic interest tend to hold hearings that are positively skewed toward that interest.”¹⁵

A 2006 study by political scientist James L. Payne categorized the testimony of witnesses at five randomly selected congressional committee hearings. Payne found that “The comments in favor of spending constitute[d] 96 percent of all evaluative remarks about programs . . . a reflection of the fact that *all 42 witnesses in these sessions were program supporters.*”¹⁶ Payne also examined the words used in 14 randomly selected volumes of hearings held by House appropriations subcommittees from 2001 to 2003. He notes, “The word ‘ineffective’ was not used once anywhere in the 14 volumes of hearings, whereas ‘effective’ was employed 191 times.”¹⁷

One reason for the bias is that the bulk of those testifying (about 80 percent in Payne’s study) are administrators representing government programs. Government officials are motivated by self-interest like other human beings.¹⁸ The fact that an administrator’s career and financial well-being are directly tied to a program’s continued existence creates “a powerful bias for administrators to make their programs appear needed and successful, and to ignore or cover up any failings.”¹⁹

Another reason for the bias is that the “expert” witnesses called to testify usually belong to an organization or interest that also financially benefits from a program’s existence (e.g., lobbyists, trade groups, nonprofit organizations, and state or local government representatives). When Payne looked at the transcript of a hearing held by the Agriculture Subcommittee of the House Appropriations Committee, he found that all 167 people on the witness list were pro-spending and “everyone was paid either by the program being supported or by beneficiaries of the program to lobby for it.”²⁰

With congressional committee hearings often turning into pro–special interest echo chambers, Congress should ensure that at least one critic of an agency or program should testify at every committee hearing. (Representatives from the Government Accountability Office and inspector general offices are supposed to be neutral and thus would not count.) People testifying should be required to state and submit for the record how much taxpayer support the interest they are representing has received over the course of the past five fiscal years.

ACTION 4: ABOLISH THE EX-IM BANK

As mentioned above, the Ex-Im Bank is a government agency that subsidizes the exports of mostly powerful corporations, not capital-strapped firms. The numbers speak for themselves: 64 percent of Ex-Im financing benefits 10 large corporations in the United States, and 40 percent benefits Boeing alone.²¹ Foreign governments also benefit. For example, the many Ex-Im beneficiaries include state-owned companies such as the Mexican oil and gas giant Pemex, and Emirates, the airline of the wealthy United Arab Emirates.²²

Even though proponents of the agency insist that export subsidies are vital, the Ex-Im Bank backs fewer than 2 percent of US exports.²³ Economists have long understood that export credit subsidies do not raise the overall level of trade; rather, they redistribute wealth away from unsubsidized American firms, employees, and consumers and direct it toward a tiny number of subsidy beneficiaries.²⁴ Such programs, and the agency responsible, should be abolished.

The bank almost was abolished on June 30, 2015, when Congress let its charter expire. Unfortunately, in December 2015, after several months of interruption, Congress renewed the bank’s charter through September 2019. However, it hasn’t been able to use taxpayer dollars to guarantee loans above \$10 million (roughly 85 percent of its financing), which benefit major corporations like Boeing and General

Electric. That’s because the agency needs at least three board members to approve such large deals, and the Ex-Im Bank only has two because, until he left the position of chairman of the Senate Banking Committee in January 2017, Senator Richard Shelby (R-AL) declined to allow any of President Obama’s nominees to be approved by his committee.

This is a step in the right direction, given that most of the bank’s activities are presently curtailed.²⁵ Instead of attempting to reinvigorate the Ex-Im Bank’s lending capabilities, Congress should begin the process of winding it down permanently. At the very least, the Ex-Im Bank should remain in its present semi-dormant state if the president refuses to submit a nominee or if the Senate fails to take up the nomination.

ACTION 5: END FARM SUBSIDIES

The 2014 Farm Bill expires in 2018, but Congress should immediately revisit—and rein in—the agricultural subsidy programs it contains. Indeed, some of the most notorious examples of the government privileging the relatively well-to-do come from programs housed by the US Department of Agriculture.

Last year, the department spent more than \$30 billion subsidizing farmers and other commercial agricultural interests, including rural businesses. In addition to being costly, these programs concentrate benefits on a relatively small group at the expense of taxpayers, consumers, and the broader economy. The nonprofit Environmental Working Group reports that “the top 1 percent of farm subsidy recipients received 26 percent of subsidy payments between 1995 and 2014.”²⁶ And while the median farm household had an income of \$76,735 in 2015, the figure for all US households was \$56,516.²⁷

Adding insult to injury, the programs seem to always end up costing much more than was originally projected. For example, the Agriculture Risk Coverage and Price Loss Coverage programs implemented in the 2014 farm bill were supposed to be “cheaper alternatives” to the previous system of

“direct payment” subsidies to farmers. In 2014, the Congressional Budget Office projected that the two programs together would cost \$11.6 billion in FY 2016–2018.²⁸ Two years later, they revised that estimate to \$19.7 billion, a 70 percent hike from the original projection.²⁹

This jump is not unique to these two programs. In fact, previous farm bills have suffered from the same problem of underestimating cost.³⁰ That alone is a reason for Congress to revisit the farm bill now instead of waiting until 2018.

ACTION 6: TAKE A STAND

Republicans are good at *talking* about the ills of budgetary bloat and government interference in the economy. Yet the last time the GOP controlled the White House and both chambers of Congress, federal spending went from 17.6 percent of GDP product to 19.1 percent of GDP and was over 20 percent by the time George W. Bush left office.³¹ During that time, no corporate program, big or small, was terminated. Instead, the bank and auto industry bailouts were put in place. It is the Republicans who took the lead in the process that reauthorized the Ex-Im Bank’s charter in the fall of 2015 after the charter had expired for over five months and while they controlled the House and the Senate.³² They also continued voting for farm subsidies even after food stamps were removed from the farm bill.³³

Far from battling corporate welfare, the GOP delivered a smorgasbord of privileges to commercial interests, including special interest–driven farm, energy, and transportation bills.³⁴

The Trump administration is reportedly planning to propose the elimination of privileging programs at the departments of Commerce and Energy and elsewhere.³⁵ If this turns out to be true, it will be the responsibility of the administration to make the case for the terminations and the Republican Congress’s job to make them a reality.

This is where a BRAC-style commission would be useful. Under such a regime, lawmakers would be

able to put on a show and complain as much as they want about the programs that will be terminated, but it will still happen, and the commission could be blamed instead of them.

Until then, if the Trump administration does call for program eliminations but Congress chooses to side with aggrieved special interests instead of taxpayers and consumers, individual members who have the fortitude to champion the cuts could take up the cause.

That's what Sen. William Proxmire, a Wisconsin Democrat in Congress in the second half of the 20th century, did when he would very publicly decry wasteful government programs through his "Golden Fleece Awards."³⁶ Proxmire wouldn't just release a report on "waste, fraud, and abuse" in government, he would actually make the effort to go after a target. For example, here's a 1971 article from *Time* magazine discussing Proxmire's decade-long work to stop federal funding of the supersonic transport airplane (SST):

Proposals for Government funding of an American supersonic transport date back ten years—the same amount of time Senator William Proxmire has spent opposing it. From 1961 to 1969, Proxmire engaged in five losing campaigns against SST appropriations. He has filibustered and conducted hearings, hammering away in a personal crusade against the "perfectly trivial purpose of developing an SST, seeing how rapidly we can already fly people overseas." It was the kind of tenacity that has made Proxmire the bane of defense contractors, pork-barreling colleagues and consumer frauds.³⁷

Funding was finally cut off in 1971, thanks to Proxmire's tireless efforts. Given the size and scope of the federal government today, Proxmire's successful campaign to eliminate one program might seem like little more than a historical anecdote. But perhaps with multiple "Proxmires" dividing up the responsibility and taking on a stack of programs and policies, some progress could be made toward separating business and state.

NOTES

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