

Corporate Welfare: Beyond the Budgetary Cost

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March 2020

Over the past couple of decades, the issue of the federal government providing financial benefits to select commercial interests has received growing attention and concern.¹ The concern is shared across ideological and party lines. Indeed, the emergence of the Tea Party on the right and the Occupy Wall Street movement on the left late in the 2000–2010 decade was precipitated by the federal government’s massive bailouts of major corporations during the Great Recession.

Various labels have been used to describe government policies that benefit particular businesses or industries, including *corporate welfare*, *crony capitalism*, *political capitalism*, *government-granted privilege*, and *favoritism*. A case can be made that some labels are preferable to others; however, that’s not a concern of this paper, and we use the terms interchangeably.²

What counts as corporate welfare is subjective. That’s particularly important because various attempts have been made over the years to put a price tag on the budgetary cost of government privileges granted to commercial interests. In addition to that exercise being complicated by subjectivity, many examples of government favoritism do not come with a clear budgetary price tag. Unfortunately, the fixation on price tags, while well intentioned, has distracted the public from recognizing that the biggest problem with government privilege is *not* the direct budgetary cost. The biggest problem is the associated costs and consequences of favoritism.

This essay will attempt to turn the spotlight away from the price tag and focus it instead on the broader problems associated with government-granted privileges. We begin by looking at the issue of measuring corporate welfare and then discuss the various costs and consequences associated with the federal government favoring particular commercial interests.

MEASURING THE COST

The general approach to measuring the cost of corporate welfare has been to add up the budgetary outlays from federal agencies and programs that provide a remunerative benefit to a particular firm or industry. Related efforts have also included tallying up the federal revenues forgone from select tax preferences.³

The first and most obvious issue is the subjective definition of favoritism. Some subsidy programs offer a clear-cut example, such as when the US Department of Agriculture sends money to the owners of a commercial farming operation. The recipient (and the policymakers who support such activities) may offer justifications for this transfer of wealth from taxpayers to a privileged commercial interest, but the occurrence of the transfer itself cannot be denied. Other examples are not as clear-cut, such as federal funding of scientific research that a company eventually uses to produce marketable goods. Do companies financially benefit from the government's subsidization of research? Yes. But accurately identifying and quantifying companies' benefits is a different matter.

The tax code presents its own set of issues. The Congressional Budget and Impoundment Control Act of 1974 defines tax expenditures as "those revenue losses attributable to provisions of the federal tax laws which allow a special exclusion, exemption, or deduction from gross income or provide a special credit, a preferential rate of tax, or a deferral of tax liability."⁴ That sounds cut and dried, and thus any tax expenditure that benefits a particular commercial interest is corporate welfare, right? Actually, there's quite a bit of disagreement on whether a particular tax expenditure is an undue financial benefit provided by the federal government. For example, some would argue that all accelerated depreciation provisions in the federal tax code are a privilege. We agree that accelerated depreciation provisions that would give preferential treatment to particular industries would be a privilege. We would also argue, however, that an equitable tax policy would treat all forms of corporate investment the same, which could be achieved by moving to full expensing, a reform we would support.⁵ That said, it is true that many targeted tax breaks are merely subsidies in disguise.⁶

A second, related issue is that even when there is an explicit budgetary cost associated with a policy, it can be difficult, if not impossible, to determine what component of an expenditure truly deserves the corporate welfare label. Take, for example, the federal government paying a defense contractor to produce tanks that even the military says it does not need or want. This situation occurs when policymakers direct the Pentagon to procure unwanted tanks because tank production is an economic boon in a particular congressional district or districts.⁷ The cost of unwanted military equipment could be considered a form of corporate welfare, but attempting to correctly identify and affix a price tag to each and every example of privilege-based procurement in the Pentagon's budget for the purpose of inclusion in a comprehensive budget tally is probably not feasible.

Another reason why focusing on the budgetary cost is inadequate is that some government programs appear to be “free” or to “make money for the government.” Federal programs that guarantee loans issued by private lenders to businesses can appear to be cost negligible or even profitable because only bad loans result in a direct government expenditure and these programs generally charge fees to help offset the losses. Sometimes the fee revenue is sufficient to cover overall losses; sometimes it is not.⁸ In addition, government accounting can make programs look free, even though under a different accounting methodology they would show an explicit cost, a situation that has been highlighted by the Congressional Budget Office.⁹ It’s therefore inappropriate to consider only the accounting cost and not the associated costs and consequences of favoritism, which we discuss later.

A final problem is that there are forms of government-granted privilege that have only an ancillary budgetary impact because of the nature of the privilege.¹⁰ Two areas that stand out in this regard are trade and regulatory privileges.¹¹

Take the Trump administration’s tariffs on foreign steel, which are a government-granted privilege for domestic steel producers. While the tariffs themselves have a budgetary impact (the federal revenue generated from the tariffs), the associated economic costs cannot be observed in the budget. Nor can related activities be observed, such as the US Department of Commerce weighing tariff-exemption requests from steel-utilizing businesses seeking relief from the administration’s trade policies. According to a *New York Times* investigation, “Two of America’s biggest steel manufacturers – both with deep ties to the administration – have successfully objected to hundreds of requests by American companies that buy foreign steel to exempt themselves from President Trump’s stiff metal tariffs.”¹² That’s textbook political capitalism.

An example of a regulatory privilege whose costs cannot be discerned by looking at the federal budget is the Renewable Fuels Standard (RFS). The RFS is a federal regulation mandating that petroleum refiners incorporate into their products a minimum volume of biofuels that increases over time. This policy benefits politically powerful corn producers by artificially increasing the demand for their product. The costs of the RFS are borne, in the form of higher prices, by consumers, livestock farmers who use corn-based feed for their animals, and oil refineries. Resulting environmental damage is another cost.¹³ None of this shows up as a line-item in the federal budget.

In sum, measuring what is more easily seen (e.g., direct subsidies) is naturally easier than measuring what is not so easily seen (e.g., regulatory privileges).¹⁴ Affixing a price tag creates marketable headlines (e.g., hypothetically, “Corporate Welfare Costs Taxpayers \$100 Billion Annually”) that will generate more media hits than headlines with no price tag, but unfortunately, the implication that the primary problem of favoritism is the dollar cost has arguably done a bit of a disservice to the public’s understanding of the issue. And, perhaps ironically, it has led to claims that crony capitalism isn’t that big of a problem because the total outlays are relatively small when compared to the amount of money spent on other programs, such as entitlement programs. We address that claim in the next section.

THE PATHOLOGY OF PRIVILEGE

From a budgetary standpoint, it is true that corporate welfare expenditures are relatively small when compared to, say, entitlement programs (e.g., Social Security, Medicare, and Medicaid), which collectively account for more than half of total annual federal spending. Budgetary costs, however, are merely the tip of the iceberg: underneath the water is a mountain of economic and social costs that cannot be ignored just because they aren't as visible.¹⁵

Economist Matthew D. Mitchell, our colleague, has been at the forefront of delineating the associated costs and consequences of government-granted privilege to commercial interests.¹⁶ We rely on his research and insights in the following enumeration of these costs and consequences. The list is not exhaustive.

Productive Inefficiencies

Shielded from the discipline of a competitive market, managers and workers at government-privileged businesses may exert less effort and may be less efficient than they would be under competitive circumstances.¹⁷ Production costs in a privileged business, then, will tend to be greater than those of a nonprivileged business. Privileged businesses are also unlikely to be sufficiently attentive to consumer desires and will tend to produce lower-quality or less desired products. The privileged business will also sell less, consumers will gain less from exchange, and the “deadweight loss” to the economy resulting from diminished competition will be larger.¹⁸

Rent-Seeking

A privilege granted by the government to a business can be financially rewarding, at least initially. When a business earns profits beyond that which would have occurred in the absence of the privilege, economists refer to that extra profit as “rent.” Businesses, therefore, will expend time and money seeking rents by lobbying, by undertaking public-relations-inspired media campaigns, by altering their business practices to please policymakers, and by doing other activities intended to curry favor with the dispensers of privilege. Such efforts are of no benefit to consumers and are, thus, a loss to society. Though it is very difficult to pin these sorts of costs down, the estimated annual cost to the US economy runs in the trillions of dollars.¹⁹

Unproductive Entrepreneurship

It is widely understood that entrepreneurs drive innovation, which fuels economic growth. But government favoritism inhibits innovation because privileged businesses have less incentive to invest in productivity-enhancing endeavors. As the late economist William Baumol explained, when the government dispenses privileges, otherwise talented people will be less likely to engage in productive entrepreneurship and more likely to engage in unproductive or even counterpro-

ductive entrepreneurship that destroys wealth.²⁰ For example, society would be better off if the thousands of lobbyists and consultants on K Street in Washington, DC, were instead focused on creating innovative products and services for consumers or engaged in charity-driven pursuits.²¹

Winners and Losers

The commercial interest receiving the government-granted privilege wins, at least for a time.²² So do complementary commercial interests (e.g., banks that issue loans to firms that are backed by the government). The associated lobbyists, lawyers, and political consultants win. The politicians dispensing the privilege may also win if their support for select businesses or industries helps them at the ballot box or a lucrative lobbying career in the future.²³ The losers are pretty much everyone else: taxpayers, consumers, businesses that are not privileged, and the economy in general.

Distorting Economic Activity

Government-granted privilege can incentivize businesses to undertake extra risk, and the privilege allows businesses to reap the benefits of that risk while forcing taxpayers to cover losses (e.g., through loans guaranteed by the government or through the expectation that creditors will be bailed out). And, as evidenced by Boeing's recent woes, privilege can undermine the integrity of a firm's operations.²⁴ Privilege also leads businesses to allocate labor and capital on the basis of politics rather than sound economics. This misallocation of resources, or malinvestment, can ultimately lead to market bubbles that, when they eventually burst, can create widespread economic destruction (e.g., the housing bubble of the early 2000–2010 period and subsequent recession when it popped).

Cronyism and Corruption

When the government privileges a commercial interest, it invites cronyism and corruption. Whether they intend it or not, politicians tend to bestow favors on the basis of personal connections and political expediency. Even the appearance of favoritism toward a commercial interest is enough to invite the public to view capitalism as being inherently corrupt if people attribute the commercial interest's market success to political connections.²⁵ Compounding the problem is the existence of the so-called "revolving door": the tendency for politicians and government officials to join industries or firms that they regulated or had a legislative interest in upon leaving the government. According to the Center for Responsive Politics, there are almost 400 former members of Congress currently engaged in lobbying activities.²⁶

Market Capitalism Undermined

Support for market capitalism is undermined when the government intervenes in economic activity to support particular commercial interests. Indeed, the current support for populist and socialist policies is a direct reflection of the public viewing market capitalism as being inherently unfair. This viewpoint was precipitated by the federal government's bailout of major corporations during the Great Recession and subsequent perception that it was the average citizen who instead bore the pain.²⁷ We argue that it was *political capitalism*—government-induced economic distortions and favoritism toward particular companies and industries—that the public's collective finger should be pointing at.²⁸

Privilege Comes with Strings Attached

Analogous to the mafia, a commercial interest receiving protection from policymakers should be aware that government support comes with strings attached. For example, when General Motors announced in 2018 that it was stopping production and laying off employees at several US facilities, President Trump responded by threatening to cut off the company's subsidies.²⁹ The lesson here is that government-granted privileges come with government shackles.³⁰

Business Attitudes toward Favoritism

Working with a public opinion firm, Mitchell recently conducted a national survey of business leaders that sought to assess the mindset of leaders at firms receiving government-granted privileges.³¹ Among his findings were that those at favored firms were more likely to think government should more heavily regulate markets, that competition is unfair to business, and that government should favor specific businesses and industries.

Inequality under the Law

Privileges bestowed on select commercial interests violate the bedrock American principle of equality under the law. The federal government's proper role in the economy should be that of a neutral referee, with intervention limited to facilitating the free exchange of goods and services.

CONCLUSION

Recognizing that there are broader costs and consequences associated with the federal government conferring privileges on commercial interests is important at a time when market capitalism is under attack from policymakers and commentators from across the ideological spectrum.

Then-candidate Donald Trump promised to “drain the swamp” in Washington if elected president, but once in office the president repeatedly embraced government favoritism.³² On the other side,

the current crop of Democratic presidential aspirants has embraced the notion that the federal government is controlled by a cabal of greedy corporations and that only further federal control and manipulation of economic activity under their omniscient watch can save the average American from capitalist exploitation. Unfortunately, and as epitomized by Elizabeth Warren’s myriad “plans,” it appears that their solutions to the problem with corporate welfare are merely to reallocate *and increase* federal largesse to the commercial (and other special) interests that they favor.³³

Proponents of free markets have been beating the drum against government favoritism for years but do not necessarily subscribe to the conspiratorial notion that “big business controls Washington.” Economist Tyler Cowen, our colleague, recently tackled this topic and others in his book *Big Business: A Love Letter to an American Hero*.³⁴ Cowen argues that “business does have some real political pull, but the basic view that big business is pulling the strings in Washington is one of the biggest myths going.”³⁵

He follows this with an often ignored but salient point:

In reality, corporations, as they relate to our federal government, are devoting more and more of their time and energy to minimizing legal risk, deciphering complex government regulations, and trying to avoid major economic losses from adverse decisions coming from Washington or state and local governments.³⁶

Indeed, the pervasive reach of government into virtually every facet of commerce leaves businesses little choice but to expend resources on socially wasteful activities (e.g., hiring lobbyists, lawyers, tax experts) that could have instead been put toward finding new and innovative ways to serve customers. In that regard, we would argue that the bigger problem is not commercial interests seeking favors from the government; rather, it’s that the government itself gives firms incentives to seek out privilege the same way that a moth seeks out a flame.

But while Cowen’s point that relatively higher budgetary outlays for entitlement programs versus crony capitalist programs is proof that voters’ will—not commercial interests—holds more sway in Washington has merit, we believe that government expenditures, as we discussed earlier, are only the tip of the corporate welfare iceberg. As such, a more thorough understanding of the issue necessitates an examination and recognition of the myriad costs and consequences associated with government favoritism toward commercial interests.

ABOUT THE AUTHORS

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NOTES

1. Although this paper is focused on federal policymaking, the costs associated with political favoritism toward select commercial interests also apply to state and local government.
2. Matthew D. Mitchell, "What Everyone Gets Wrong about Crony Capitalism," *Medium*, July 24, 2015.
3. *A Budget for a Better America: Fiscal Year 2020 Budget of the U.S. Government: Analytical Perspectives* (Washington, DC: Government Publishing Office, 2019).
4. The 1974 Congressional Budget and Impoundment Control Act § 3(3), Pub. L. No. 93-344, 88 Stat. 297 (1974).
5. Jason J. Fichtner and Jacob M. Feldman, "How Does the Corporate Tax Code Distort Capital Investments," in *The Hidden Cost of Federal Tax Policy* (Arlington, VA: Mercatus Center at George Mason University, 2015), 101-125.
6. Matthew D. Mitchell, "Government Privilege: Using and Abusing the Tax Code," *The Bridge*, July 2, 2018.
7. Christopher J. Coyne, Courtney Michaluk, and Rachel Reese, "Unproductive Entrepreneurship in U.S. Military Contracting" (GMU Working Paper in Economics No. 15-50, George Mason University, Fairfax, VA, September 30, 2015).
8. Financial crises, and the penchant for the federal government to intervene with a bailout, highlight the inherent danger with both explicit and implicit government guarantees provided to commercial interests. According to the Federal Reserve Bank of Richmond's "Bailout Barometer," \$26 trillion in financial sector liabilities were either explicitly or implicitly backed by the federal government as of 2016. The potential for a government bailout is itself a form of privilege, since creating the expectation that businesses will be saved by taxpayers in the event of a financial meltdown may encourage risky behavior. Matthew D. Mitchell, "Government Privilege: Bailouts," *The Bridge*, September 7, 2018.
9. Congressional Budget Office, *Fair-Value Estimates of the Cost of Federal Credit Programs in 2020*, May 2019.
10. The taxpayer cost of administering programs and policies that benefit commercial interests does have a budgetary impact, but "such assessments are inherently uncertain," as the Congressional Budget Office has explained. Congressional Budget Office, *Financial Regulation and the Federal Budget*, September 2019.
11. It is true that the macroeconomic feedback effects from regulatory policies (or any government policy, for that matter) will impact the federal budget.

12. Jim Tankersley, "Steel Giants with Ties to Trump Officials Block Tariff Relief for Hundreds of Firms," *New York Times*, August 5, 2018; Christine McDaniel, "Investigating Product Exclusion Requests for Section 301 Tariffs," *The Bridge*, June 27, 2019.
13. The RFS was sold to the public as being beneficial to the environment, but that hasn't turned out to be the case. Arthur R. Wardle, "A Reset for the Renewable Fuels Standard?," *Regulation* 42, no. 3 (Fall 2019): 22–23.
14. Frédéric Bastiat, "That Which Is Seen and That Which Is Not Seen," Foundation for Economic Education, May 29, 2015.
15. Just because budgetary costs are the tip of the iceberg does not mean that these costs are insignificant or relatively unimportant.
16. Matthew D. Mitchell, *The Pathology of Privilege: The Economic Consequences of Government Favoritism* (Arlington, VA: Mercatus Center at George Mason University, 2012).
17. Harvey Leibenstein, "Allocative Efficiency vs. 'X-Efficiency,'" *American Economic Review* 56, no. 3 (1966): 392–415.
18. Deadweight losses are the losses of output that occur because certain exchanges do not happen. That is, any time there is a deadweight loss, there are exchanges that are potentially mutually beneficial that do not take place.
19. Keith Cowling and Dennis Mueller, "The Social Costs of Monopoly Power," *Economic Journal* 88 (1978): 727–48; Richard Posner, "The Social Cost of Monopoly and Regulation," *Journal of Political Economy* 83 (1975): 807–27; Anne O. Krueger, "The Political Economy of the Rent-Seeking Society," *American Economic Review* 64, no. 3 (1974): 291–303; David N. Laband and John P. Sophocleus, "Measuring Rent-Seeking," *Public Choice* 181, no. 1 (2019): 49–69.
20. William J. Baumol, "Entrepreneurship: Productive, Unproductive, and Destructive," *Journal of Political Economy* 98, no. 5 (1990): 893–921.
21. Kevin M. Murphy, Andrei Shleifer, and Robert W. Vishny, "The Allocation of Talent: Implications for Growth," *Quarterly Journal of Economics* 106, no. 2 (1991): 503–30.
22. According to the late economist Gordon Tullock, the privileged firm or industry benefits initially but is not better off in the long run, as the value of the privilege is capitalized. However, removing the privilege would harm the privileged firm or industry, and, thus, the privileged firm or industry will seek to maintain the privilege. Tullock called this the transitional gains trap. Gordon Tullock, "The Transitional Gains Trap," *Bell Journal of Economics* 6, no. 2 (1975): 671–78.
23. Nathan M. Jensen and Edmund J. Malesky, *Incentives to Pander: How Politicians Use Corporate Welfare for Political Gain* (New York: Cambridge University Press, 2018).
24. Veronique de Rugy, "Should I Keep Fighting the Ex-Im Bank or Give Up?," *Daily Economy News*, January 26, 2020.
25. For example, in the wake of the Obama administration's high-profile problems with energy-related loan guarantees, the *New York Times* reported that Solyndra "spent nearly \$1.8 million on Washington lobbyists, employing six firms with ties to members of Congress and officials of the Obama White House." Eric Lipton and John M. Broder, "In Rush to Assist a Solar Company, U.S. Missed Signs," *New York Times*, September 22, 2011. More recently, the Trump administration's tax-privileged Opportunity Zones have come under fire for being susceptible to cronyist influence. Tad DeHaven and Michael D. Farren, "The Right Fix for Opportunity Zones," *The Hill*, January 8, 2020.
26. "Revolving Door," Center for Responsive Politics, updated September 26, 2019, <https://www.opensecrets.org/revolving/index.php>.
27. Mitchell, "Government Privilege: Bailouts."
28. We would argue that a free and open market is actually a threat to the economic elite. Matthew D. Mitchell, "Populism, Markets, and the Elite," *The Bridge*, February 1, 2019; Randall G. Holcombe, *Political Capitalism: How Economic and Political Power Is Made and Maintained* (Cambridge: Cambridge University Press, 2018).
29. Matthew D. Mitchell and Tad DeHaven, "GM Discovers That Government Bailouts Come with Golden Chains Attached," *Washington Examiner*, December 11, 2018.
30. Matthew D. Mitchell, "With Government Shekels Come Government Shackles," *Neighborhood Effects*, April 3, 2014.

31. Matthew D. Mitchell, Scott Eastman, and Tamara Winter, *A Culture of Favoritism: Corporate Privilege and Beliefs about Markets and Government* (Arlington, VA: Mercatus Center at George Mason University, 2019).
32. A nonexhaustive list of examples includes the following: (1) The ousting of a Pentagon official whose sin appears to be trying to protect taxpayers from contractors abusing the US Department of Defense's weapons procurement system. See Martin de Bourmont and Sharon Weinberger, "Trump Tweeted 'Billions of Dollars' Would Be Saved on Military Contracts. Then the Pentagon Fired the Official Doing That.," *Yahoo News*, October 1, 2019. (2) Trump's about-face on the Export-Import Bank of the United States. See Veronique de Rugy, "Corporate Welfare Wins Again in Trump's Washington," *New York Times*, May 7, 2019. (3) Trump's politically motivated support for ethanol. See Matthew D. Mitchell, "Government Privilege: Regulation," *The Bridge*, October 29, 2018. (4) Trump's support for targeted economic development incentives, including Foxconn. See Christian Schneider, "Trump's Foxconn Boondoggle Could End Up Being a Big Liability," *Washington Post*, May 28, 2019. (5) Corruptive tariff exemption practices. See Tankersley, "Steel Giants with Ties to Trump." (6) Trump's implementing the steel tariffs. See Veronique de Rugy, "The Swamp *Is* Alive! It *Is* Alive!," *National Review*, March 1, 2018. (7) Trump's support for Carrier. See NPR Staff, "Is Trump's Deal with Carrier a Form of Crony Capitalism?," December 2, 2016, in *Morning Edition*, radio program, <https://www.npr.org/2016/12/02/504042185/is-trumps-deal-with-carrier-a-form-of-crony-capitalism>.
33. Elizabeth Warren, "A Plan for Economic Patriotism," *Medium*, June 4, 2019, <https://medium.com/@teamwarren/a-plan-for-economic-patriotism-13b879f4cfc7>.
34. Tyler Cowen, *Big Business: A Love Letter to an American Anti-Hero* (New York: St. Martin's Press, 2019).
35. Cowen, *Big Business*, 167.
36. Cowen, 167–68.