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No More Corporate Welfare

Selective, complicated exceptions to the law do not reduce the burden of government

By: Sheldon Richman – January 20, 2013

When Congress and President Obama came up with their beyond-the-last-minute deal to put off addressing the coming fiscal crisis, *The Wall Street Journal* turned the spotlight on a little-noticed, yet too typical aspect of Washington's machinations: "The bill's seedier underside is the $40 billion or so in tax payoffs to every crony capitalist and special pleader with a lobbyist worth his million-dollar salary. Congress and the White House want everyone to ignore this corporate-welfare blowout," the *Journal* reported.

So a bill that was represented as the first steps toward fiscal responsibility (try not to laugh too hard) contained billions of dollars in corporate welfare. And it was a bipartisan affair.

How sad. How Washington!

Beneficiaries of the various special tax treatments and exceptions includes owners of NASCAR speedways, companies in American Samoa, rum producers, businesses on Indian reservations, railroads, Hollywood moviemakers, and green-energy firms, including wind-power equipment producers.

As the *Journal* commented, "The great joke here is that Washington pretends to want to pass 'comprehensive tax reform,' even as each year it adds more tax giveaways that distort the tax code and keep tax rates higher than they have to be."

Corporate welfare is nothing new, of course, and according to Cato Institute budget analyst Tad DeHaven, in "Corporate Welfare in the Federal Budget," fiscal 2012 saw $98 billion in "programs that provide payments or unique benefits and advantages to specific companies or industries." (DeHaven acknowledges that defining and calculating corporate welfare is "not an exact science." Indeed, not. To the extent the U.S. military safeguards access to, say, Middle East oil fields, that portion of the Pentagon budget can be regarded as corporate welfare, but it's not usually thought of that way. Similarly, highway subsidies to commercial shippers may give certain firms advantages over firms that don't engage in long-distance shipping.)

Manipulating the tax code to benefit particular interests has obvious appeal for politicians—it's a source of power and influence—and a code that did not permit such manipulation would be much less attractive to them. Outright cash subsidies from the taxpayers, while not unheard of, smacks too much of cronyism and is more likely to alienate taxpayers. But complicated exceptions written into the tax laws can be presented as creative governance on behalf of the public interest. But it is cronyism as offensive as outright subsidies.

The benefits of a market economy lie in free competition. When the market is rigged by politics, benefits are diverted from consumers to politically chosen producers (who can be counted on to reward their patrons). This is what corporate welfare accomplishes. In a freely functioning market economy, all products compete with one another, and producers compete not only for customers, but also for scarce factors of production, including labor, land, and materials. Remember: We live in a world of scarcity. Factors used for one purpose cannot be used for another. Tradeoffs are necessary. The price system, which is ultimately configured by consumer preferences, guides the competitive process by which the factors of production are employed in their various purposes. For example, an entrepreneur who expects her product to be more profitable than a rival's product will be in a better position to bid factors away from the rival, and if the entrepreneur's forecast is correct, consumers will have been well served.

But if the government intervenes with corporate welfare to lower the rival's costs, whether by specially reducing taxes or some other manipulative method, consumers will be defied because products they prefer will not be produced or not produced in the quantities desired. The politically connected businessperson will profit at their expense, as well as the expense of the competitors who were treated discriminately by the tax code, especially if the government buys the favored product.

Corporate welfare is not primarily about lowering taxes. That would be a worthwhile goal, of course, and could be achieved simply by slashing tax rates and simplifying the code. But when taxes are lowered selectively by writing complicated exceptions into the law, the goal is to bestow privileges on cronies, not to reduce the burden of government on all. Corporate welfare, among its many sins, violates equal protection under the law.

Essential to a free society is people's ability to go about their peaceful business unmolested by government. A good part of that activity includes producing goods and services for consumers, who in turn are free to say yes or no to the offerings. Corporate welfare is a way for politicians to maintain the façade of a free economy while rewarding some activities and punishing others. The politicians substitute their preferences for the preferences of consumers, distorting relative prices in the process. Thus if government artificially makes it more profitable to produce wind turbines than washing machines, political judgments replace economic judgments. This is not something to be welcomed. Such political judgments are made by men and women who never face the market test and who risk no capital of their own. The failures of their schemes will not be easily traceable to their decisions (what politician or bureaucrat suffered because of the Solyndra fiasco?), and much of the cost of those policies will be in the form of goods and services *not produced* because of the diversion of resources. Thus voters will be in a poor condition to assess the performance of politicians, making officeholders largely unaccountable for their economic meddling. Inevitably, the authors of corporate-welfare schemes will blame the nonexistent "free market."

Even if a particular citizen were to understand the source of the problem, it would take a herculean effort to unseat the politician(s) responsible, and if even that exceeded, it would not necessarily change anything. That citizen would still be forced to support the meddlesome system.

Contrast this with the free-functioning market economy. If entrepreneurs err and destroy value by misusing scarce resources, consumers' retribution may be swift: They can simply withhold their money and reject the ill-conceived products, forcing the entrepreneur out of business and shifting resources to more able hands. Ironically, it is the free market that puts control into the hands of the people. Political democracy is only the palest approximation of the "true democracy" of the marketplace.

As we can see, consumer clout far exceeds voter clout, and therefore economic producers—when they have no access to government privilege or shelter from competition—are far more responsive to the people than are politicians. Officeholders create theatrical effects to impress voters. Entrepreneurs have to produce results.

Tax benefits directed at particular interests are often defended on grounds of "market failure." It's said that under some circumstances rational individual behavior in the market yields a less-than-optimal outcome for the whole public. This can be answered in several ways. First, if such failures truly exist, they represent profit opportunities to entrepreneurs. There's a general principle here that is often overlooked. The case for competitive markets is not that they are perfect—how could they be when they are filled with fallible human beings? Rather, the case is that discovery and correction of errors produces entrepreneurial profit. No lure is more powerful than the prospect of profit.

Moreover, even in the unlikely event a market failure couldn't be corrected, it would not follow that a government solution would be better than adapting to the situation. Why assume politicians won't make things worse, particularly in light of the perverse incentive system described earlier? There is simply no reason to believe that political operatives can have the incentives or information needed for ameliorating undesired market outcomes. One cannot invoke market failure without coming to grips with government failure.