Welfare for the Rich

BY ROBERT P. MURPHY

Advocates of the free market—including those considered "right-wing" and "conservative"—believe it is wrong to violate property rights. Consequently, they oppose egalitarian measures to steal from the rich and give to the poor. Such "income redistribution" represents naked theft and epitomizes the Founding Fathers' fears of unfettered democracy. At the same time, champions of laissez faire devote much of their time to criticizing the thousands of distortionary and punitive regulations imposed on businesses. Indeed, Ayn Rand went so far as to write an essay in which she described big business as "America's persecuted minority."

In light of these tendencies, it is easy to overlook the fact that a large portion of the welfare state is devoted to *the rich*. Although couched in altruistic language and billed as serving the public interest, much of the government's redistribution of wealth is from the hapless taxpayer to the pockets of large corporations. This may seem paradoxical to naïve observers whose political views are shaped largely by political campaigns between Democrats (the ostensible friends of the poor) versus Republicans (the ostensible opponents of welfare). But anyone familiar with political economy can quickly recognize that it makes far more sense for politicians to funnel tax dollars into the hands of powerful (not to mention rich) special interests. Big business learned long ago that the easiest way to handle taxes and regulations is to divert "public" money into its own hands and to influence the regulators to enforce measures that disproportionately burden upstart competitors.

I hope to redress the rhetorical imbalance by outlining the numerous ways rich individuals and big businesses manage to siphon off taxpayer money into their own pockets. To keep the article manageable, I'll focus mainly on actual subsidies, that is, cases where wealthy rent-seekers literally receive cash flows (directly or indirectly) from the government. Beyond these fairly obvious examples there are dozens of clever ways in which rich and unscrupulous special interests use their political influence to enrich themselves at the expense of the public without actually receiving tax dollars. (These include licensing restrictions and import quotas.) Because of space constraints, an extensive analysis of these subtler shenanigans will have to wait for a future article.

One of the most blatant examples of corporate welfare is the bloated system of agricultural price supports, which started in the 1920s and was institutionalized during the New Deal. The rationale behind the program is straightforward: Under pure laissez faire, agricultural markets would (allegedly) prove extremely volatile. In good times with high prices farmers would borrow money to expand their operations and plant more crops. But this would soon lead to a glut on the markets, forcing farmers to slash prices and go into foreclosure. This tremendous uncertainty, as well as the wild swings in crop supply, could (allegedly) be rectified if the federal government stepped in to purchase surplus crops when the market's demand proved insufficient. Such policies would presumably stabilize crop prices and the food supply, providing more rational and orderly markets in agriculture.

As with other forms of government intervention, a pure policy of surplus acquisition would lead to disaster. If farmers were assured that whatever quantity of a crop they grew the government would buy it from them

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at remunerative prices, they would plant the most cost-effective crops with reckless abandon. (Indeed, at the close of 2000 the Commodity Credit Corporation [CCC], a branch of the U.S. Department of Agriculture, held stockpiles of 97 million bushels of wheat, eight million bushels of corn, and five million bushels of soybeans, according to the Food and Agricultural Policy Research Institute. The CCC spent $133.5 million to purchase over a million metric tons of wheat on a *single day* in 1999.) To avoid the accumulation of stockpiles and yet maintain price supports for certain crops, the government hit on the absurd notion of paying farmers *not* to grow the crops in question. It is possible to qualify for such subsidies even if an owner of arable land had never intended to grow the crops in the first place.

From 1995 to 2004 the federal government provided agricultural subsidies of over $143 billion, according to the Environmental Working Group. The recipients of these subsidies are not exactly Dust Bowl migrants from a Steinbeck novel, either. Over $104 billion (72 percent) of the loot during this period went to the top 10 percent of the recipients, which were large farming organizations or cooperatives that each received an average of $33,000 in subsidies every year. To further illustrate the phenomenon, in October 2005 the House Agricultural Committee rejected a proposal by President Bush to place a cap on annual farm subsidies of $250,000 *per person*.

Another classic example of how the well-to-do fleece the taxpayers is the multiplicity of "joint ventures" between the government and big business. Projects such as sports stadiums, railroads, or even amusement parks are deemed "too big for the private sector." Besides being silly—after all, any money that the government spends on such projects was taken *from* the private sector—these pork-barrel expenditures represent a transfer from the poor (and middle class) to the rich.

For example, the fiscal 2006 Transportation/Treasury/Housing and Urban Development (TTHUD) Act contained $350,000 for the Yucaipa Valley Regional Sports Complex (in California) and $100,000 for renovations to the National Orange Show Stadium in San Bernardino. The Act also contained $50,000 for the Capitol Hill Baseball and Softball League. Beyond its support for sports fans, the government also subsidized art lovers and conference attendees (not typically drawn from the downtrodden of society). Citizens Against Government Waste points out that this same Act contained $325,000 each for renovations to the Seattle Aquarium and the Fox Theater, $200,000 for renovations to the Fredonia Hotel and Convention Center in Texas, and $100,000 for D.C.'s Friends of Carter Barron Foundation for the Performing Arts.

These anecdotes, though outrageous, are whimsical when compared with other types of corporate welfare. For example, the federal government provides enormous funding for energy research, which attempts to develop alternative supplies and technologies as well as discover better methods of using existing sources. The Cato Institute estimates that in fiscal year 2003, the Energy Department spent $670 million on such projects. Inasmuch as struggling single mothers are not designing ethanol engines, this largess represents yet more welfare for the rich.

In a similar vein, the government spends billions funding scientific research. In FY2005 the National Institutes of Health alone spent over $24 billion on all awards, and over $20 billion of this consisted in research grants. Large pharmaceutical companies certainly benefit from this convenient assistance.

We close this section with the epitome of a failed government/business partnership, the classic case of Amtrak. In 2005 alone Amtrak lost $1.2 billion, according to the Heritage Foundation, a shortfall made up by the hapless taxpayer. What makes this waste even more despicable is that Amtrak doesn't even fulfill its ostensible purpose, namely, to provide affordable passenger rail service across the nation. In particular, Amtrak doesn't offer service to Phoenix, Las Vegas, Columbus, Nashville, Louisville, Dayton, Tulsa, or Colorado Springs, even though each of these cities has over 500,000 residents. And as anyone who has ridden Amtrak knows, it is far from cheap. For example, its cheapest roundtrip fare from New York City to Washington, D.C., is currently $135 before taxes, compared to $69 for a similar ticket on an admittedly slower bus.

Government Contractors

Even government projects that might be deemed legitimate—such as expenditures on military vehicles or renovations to the Statue of Liberty—represent hidden subsidies to the extent that the contracts are awarded corruptly. The economic principles behind the cost overruns are straightforward enough. Unlike the shareholders of a private firm, if government departments are careful to award contracts to the lowest bidder (who can still get the job done), the politicians and bureaucrats don't pocket the savings, for that would be sheer theft of public funds. On the other hand, by awarding generous contracts, officials stay in the excellent graces of the beneficiaries. This comes in handy when officials retire from government work and look for consulting jobs.

Another source of systematic welfare is the "cost-plus" method of payment. Here, the government doesn't settle on an actual price for goods or services delivered, but rather agrees to meet the contractor's expenses plus some markup. Naturally, this type of arrangement puts no incentive on the contractor to watch costs, and hence represents a hidden subsidy.

We should also consider the effect of timing and the different outcomes in private versus government settings. Congress can agree to spend, say, $20 billion on a space station that will take ten years to complete. Five years into the contract the suppliers can complain that they will require an additional $10 billion to finish the project because of "unexpected" expenses. By this point the voters don't remember the previous expenditures, and it would seem a terrible waste not to finish such a grand project. Thus the government often ends up funding boondoggles that would never have been approved had the actual price tag been known all along.

When it comes to welfare for contractors, no other agency can match the Pentagon, with its classified programs and aura of necessity. Besides the notorious $600 toilet seats uncovered in a 1983 audit, probably all the major purchases of hardware occur at inflated prices. (The difference is, nobody knows how much a B-2 Stealth bomber "should" cost, so its 2001 price tag of $530 million isn't as shocking.) No outsider can really be sure of the exact amount of the hidden subsidy, or what the corporate beneficiary does to win it, but we *can* be fairly sure that the recipients do not reside in the inner city.

On this topic we must mention the case of Halliburton, for this is one issue on which the leftist conspiracy theorists make a decent case. Regardless of the motivations for the invasion of Iraq, it cannot be denied that Halliburton benefited greatly from it. According to a report by the Center for Public Integrity (which required six months and 70 Freedom of Information Act requests to assemble the data), Halliburton received over $2.3 billion in reconstruction contracts in Iraq and Afghanistan. In second place was the engineering and construction firm Bechtel Group, Inc., with just over $1 billion. International American Products, Inc., finished third with a nonetheless-respectable $526 million in contracts. (For those interested in conspiracies, Halliburton and Bechtel contributed roughly $2.38 million and $3.3 million to President Bush, respectively, while International American Products only contributed $2,500.)

The "War on Terror" has been a bonanza for defense and related contractors. According to Robert Higgs, Department of Defense outlays *excluding* payments to military personnel rose from $217 billion in FY2001 to $366 billion in FY2006. In this same period the number of companies with federal homeland-security contracts grew from nine to a whopping 33,890, a jump so large that it renders typical percentage figures—in this case, a growth of 376,456 percent—rather meaningless.

Small Business Administration

The Small Business Administration (SBA) is another agency with an apparently noble mission that nonetheless acts in reverse-Robin Hood fashion. In 2005 the SBA announced that $79.6 billion in federal contracts were awarded to "small businesses." However, according to the *New York Times*, some of this money went to mom-and-pop organizations such as Northrop Grumman, Boeing, Bechtel, and General Dynamics. Indeed, the *Christian Science Monitor* reports that almost $5 billion of the contracts classified as "small business" were for the 13 largest government contractors.

Beyond winning contracts theoretically intended for small businesses, there is another way big business benefits from the SBA. In a scheme that Doug French (himself a Las Vegas banker) calls "welfare for bankers," the SBA guarantees loans for qualifying businesses. Banks are then able to pool such loans and sell them in secondary markets. Now in a simple model of perfect competition, the SBA guarantees would benefit only the loan recipients, because they would acquire funding at lower interest rates. But in the real world, savvy banks acquire "PLP status," meaning they are preferred lenders. This allows them to issue SBA-guaranteed loans without as much paperwork and other hassles as other banks would need to suffer, and so allows these privileged banks to earn a net income from the entire process. To the extent that PLP status represents a hurdle that has nothing to do with merit or business performance, the process is a form of subsidy to certain (rich) bankers.

The Government National Mortgage Association (GNMA or "Ginnie Mae") is a public corporation in the Department of Housing and Urban Development. Ginnie Mae boosts the secondary mortgage market by guaranteeing principal and interest payments on mortgage-backed securities. In a typical case, a bank or other institution will acquire dozens of individual mortgages from homebuyers and place them into a single pool, then issue securities to other investors based on the cash flows from the mortgage payments. In the event of unexpected defaults by the homebuyers, Ginnie Mae would step in to guarantee the payments to the secondary investors.

This pledge obviously makes the guaranteed securities more attractive, lowering their promised rate of return. This in turn lowers the mortgage rates faced by the original homebuyers, but also provides liquidity in the secondary mortgage market and no doubt higher commissions for politically savvy middlemen. (As Ginnie Mae's Wikipedia entry puts it in an unintentionally humorous line, "This arrangement seemingly benefits everyone involved.") Naturally the loser is, as always, the U.S. taxpayer, who must assume the losses from mortgage loans made at rates that do not reflect the true risks involved. Although in recent years Ginnie Mae has itself earned more in service fees than it paid out on defaults (and thus did not use any public funds), this is only possible because the taxpayers are ultimately liable for the outstanding collection of guaranteed mortgage-backed securities; total potential exposure in 2004 was $453.2 billion.

Other Guarantees and Bailouts

The same analysis applies to other government loan guarantees. For example, suppose the federal government guarantees that it will make good on bonds issued by the Mexican government in the event of a default. Such a pledge undoubtedly showers benefits on both the Mexican government and the (typically wealthy) investors in its bonds, while the source of these benefits is undoubtedly the American taxpayer. This is true even if the Mexican government does *not* default on its bond payments. After all, if the taxpayers pledged to pay all costs associated with a fire at any of General Motors' factories, this would certainly be a subsidy to GM, even if no such fire ever occurred. (This is obvious; with the federal guarantee, GM would save the money it otherwise would have spent on fire-insurance premiums.) In a similar fashion, even if the Mexican government doesn't default, it still benefits from borrowing money at lower interest rates than would otherwise be the case.

Of course, if and when the U.S. government has to make good on these types of pledges, the transactions involve funneling taxpayer dollars to wealthy investors both at home and abroad. Sometimes these subsidies are particularly subtle. For example, during the Mexican "peso crisis" of 1994, the Clinton administration contributed some $20 billion to the international bailout effort by providing loan guarantees and currency swaps. This latter move, executed by the Treasury's Exchange Stabilization Fund, swapped cash flows denominated in dollars with those denominated in pesos. Inasmuch as the dollar flows originated (at least partly) with the government Fund, and also because the whole purpose of the intervention was to engage in currency swaps that the private market considered unprofitable, President Clinton's decision used U.S. tax dollars to shield the Mexican government from its irresponsible monetary policies. In short, yet another example of welfare for the rich and powerful.

The celebrated fate of Long Term Capital Management (LTCM), a huge hedge fund that had Nobel laureates Myron Scholes and Robert Merton on its board, presents yet another case of corporate welfare. Because its trading strategy took advantage of slight (but theoretically "irrational") overvaluations of newly issued bonds (versus older "off-the-run" bonds), LTCM was highly leveraged, sometimes with a leverage ratio of over 30. When the Russian government defaulted on its bonds in 1998, this set in motion a chain of events that proved catastrophic to LTCM's positions. In the course of a few months the amazing success story had lost over $4.6 billion. Citing the potential disruptions to the entire financial community if LTCM itself defaulted, the New York Federal Reserve Bank intervened. Though it technically did not use public money in the bailout, the Fed nonetheless used "moral suasion" (backed perhaps by implicit pressure?) to get LTCM's major creditors to allow for an orderly liquidation. Supporters of the move claimed that it prevented a financial meltdown, while critics pointed out that the "too big to fail" mentality would only encourage large institutions to take risky positions in the future, and that the ultimate fallback to the government-sponsored rescue allowed LTCM to reject a private-sector bailout effort led by Warren Buffett. (Under Buffett's plan, the managers of LTCM would have been fired and the shareholders would have fared much worse than they did under the "necessary" Fed-brokered arrangement.)

We cannot leave this section without mentioning the post-9/11 federal bailout of the airlines. The Air Transportation Safety and System Stabilization Act (signed on September 23, 2001) gave $10 billion in loan guarantees, as well as $5 billion in direct "relief," to the airlines. Now even libertarians may differ on the justification for this bailout. After all, the federal government hampered the ability of the airlines to prevent 9/11 (through gun bans and other interventions) and also forced them to lose business by the mandatory flight ban immediately after the catastrophe. Nonetheless, the entrepreneurs involved in the airline industry certainly did not live up to their task of anticipating the future better than others. In a truly free market the consequences of poor preparation are losses. When the critics ask, "If the free market is so good, why did the government need to take over airline security?" the defender of laissez faire can reply, first, that government was involved in security before 9/11 and, second, that airline executives did not actually face the full pressures of the profit-and-loss test. When their inadequate security measures allowed disaster, they didn't bear the full brunt of these shortsighted decisions.

Government Deficits and the Federal Reserve?

Though not as clear cut as some of the other examples in this essay, the annual issuance of hundreds of billions of dollars in new government bonds may qualify as welfare for the rich. If one agrees that the federal guarantee of Mexican bonds represents goodies to the wealthy at the expense of the taxpayer, then by consistency one must also condemn massive federal deficits for the same reason. This is because *all* Treasury bonds are "guaranteed" by the full faith and credit of the U.S. government as a matter of course. This practice allows the Treasury to obtain loans at low rates of interest and undoubtedly showers income on politically connected banks and other financial brokers. As always, the losers are the taxpayers (who must ultimately pay off the Treasury's debts) and the smaller banks that do not enjoy the privileges of Fed membership.

When it comes to the "moral hazard" of federal relief, the standard illustrations are the Federal Deposit Insurance Corporation and federal checks to property owners after natural disasters, such as hurricanes and earthquakes. By insuring checking deposits (up to $100,000), the FDIC provides an incentive for banks to invest in riskier projects because on the margin the (expected) costs of doing so are reduced. In a similar manner, when the government provides massive relief to owners of beachfront condos and hotels after a hurricane, this encourages more development in disaster-prone regions than would otherwise occur (if the owners had to pay full market insurance premiums). To the extent that owners of banks and beachfront property tend to be above-average income earners, these programs represent yet more examples of subsidies to the rich.

The final example we shall discuss is one of the most blatant and economically unjustified: the Export-Import Bank. It is worth quoting the Bank's own mission statement in its entirety:

> The Export-Import Bank of the United States (Ex-Im Bank) is the official export credit agency of the United States. Ex-Im Bank's mission is to assist in financing the export of U.S. goods and services to international markets.

> Ex-Im Bank enables U.S. companies—large and small—to turn export opportunities into real sales that help to maintain and create U.S. jobs and contribute to a stronger national economy.
>
> Ex-Im Bank does not compete with private sector lenders but provides export financing products that fill gaps in trade financing. We assume credit and country risks that the private sector is unable or unwilling to accept. We also help to level the playing field for U.S. exporters by matching the financing that other governments provide to their exporters.
>
> Ex-Im Bank provides working capital guarantees (pre-export financing); export credit insurance; and loan guarantees and direct loans (buyer financing). No transaction is too large or too small. On average, 85% of our transactions directly benefit U.S. small businesses.
>
> With more than 70 years of experience, Ex-Im Bank has supported more than $400 billion of U.S. exports, primarily to developing markets worldwide.

As with most descriptions provided by the agencies themselves, the Ex-Im Bank's statement seems innocuous enough. Yet Henry Hazlitt, in his wonderful *Economics in One Lesson*, long ago exploded the myth that subsidizing exports is good for the economy. For example, when the Ex-Im Bank "levels the playing field" by "matching the financing that other governments provide to their exporters," what does this really mean? It means that the federal government gives money to foreign governments or companies which they then use to purchase products from American exporters. To clearly see what is going on, it would be simpler if the U.S. government first bought the products from domestic producers (using tax dollars, of course) and then *handed them over for free* to the foreign organizations. Yes, this practice benefits the workers and shareholders of the privileged exporting firms, but these gains are more than offset by the losses to the taxpayers. After all, as Hazlitt pointed out, the country as a whole doesn't get rich by giving goods away.

Similar to the Ex-Im Bank is foreign aid in general, to the extent that the recipient governments spend the money on U.S. exports. For example, according to the Cato Institute, in FY2003 $3.7 billion in federal money was used to finance weapons purchases for foreign governments.

Free-market enthusiasts often rail against welfare for the poor, and rightly so. However, as both experience and political economy suggest, the welfare state also redistributes wealth into the hands of the rich and politically powerful. To offer a consistent message—as well as attract support among more-egalitarian observers—advocates of laissez faire should condemn the billions of dollars in annual subsidies for the rich.