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GOVERNMENT SUBSIDIES: *Revealing the Hidden Budget*

Today, subsidies remain an indispensable tool the federal government uses to redirect resources and influence economic decisions. From gasoline refineries to California wineries, there are over a thousand separate federal programs and tax provisions that provide some form of subsidy to businesses, individuals, non-profits and other organizations.

■ Summary

The U.S. economy is subsidized, sheltered, protected and otherwise managed in ways that would shock the average citizen. From candy bars to hybrid cars, government subsidies touch our lives every day. Some areas of the economy are deeply affected by subsidy programs. For instance, in 2007 the government spent approximately \$874 billion on health care in the United States, much of it through programs that provide subsidies. This accounted for nearly half of all health care spending.

While subsidies are a necessary means for the government to do its job, taxpayers have a right to know what happens to their money. The federal government should be able to answer questions such as: "Who is getting subsidies?" and "How much are they getting?" The current fiscal climate only heightens the need for such answers. As the federal deficit continues to swell, some difficult choices will need to be made in the coming years. In order to make informed decisions, Congress and the Administration need more accurate data on subsidy spending.

Today, unfortunately, federal subsidies are largely hidden. Subsidy program data are often unclear or of poor quality. A recent study by the Government Accountability Office examined spending data in the Federal Assistance Award Data System, the federal government's primary source of information on grants and other subsidies, and found that data for half of the programs were inaccurate during at least one of three years inspected. In many cases there was no spending data at all.¹

In response, Subsidyscope, an initiative of The Pew Charitable Trusts, is revealing information on subsidies by building the most comprehensive source for subsidy data available. The information we compile will stimulate a more vigorous and informed debate about the full scope of federal subsidies and help policy makers make smart choices.

¹ "Rural Economic Development: More Assurance Is Needed That Grant Funding Information Is Accurately Reported." 2006. Government Accountability Office, GAO-06-294, February, p. 23. Washington, DC: GPO. <http://www.gao.gov/new.items/d06294.pdf>



Subsidyscope is a project of the Pew Charitable Trusts and neither advocates nor opposes specific subsidies. Subsidyscope presents data and fact-based analyses to inform those monitoring the government's stewardship of taxpayer dollars. Maintaining its nonpartisan approach to the issue of subsidies, the project is guided by an advisory board of experts from across the ideological spectrum.



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WHAT IS A SUBSIDY?

“A typical textbook definition of a subsidy is a transfer of economic resources by the Government to the buyer or seller of a good or service that has the effect of reducing the price paid, increasing the price received, or reducing the cost of production of the good or service.”

—U. S. Energy Information Administration, 1992

SUBSIDIES AND SUBSIDY SPENDING

The gross amount the federal government spends on programs that contain subsidies is much higher than the amount spent on a subsidy itself. Spending on programs with subsidies includes administrative expenses that do not benefit the recipient and, therefore, are not a subsidy. Second, the subsidy is the net benefit a recipient enjoys. If a recipient must incur costs in order to qualify for a subsidy in the first place, those costs offset some of the benefits.

■ Indispensable Subsidies

Americans love freedom, and we’ve resisted various forms of government intervention in our affairs. We’ve never liked being told what to do. In 1677, American colonists chafed at a new law decreeing that any goods moved from one American port to another would face stiff duties unless carried on an English ship. The law subsidized English shippers at the expense of farmers and merchants. Demonstrating their outrage, colonists in North Carolina seized the customs house and imprisoned the customs collector.

Americans also love subsidies. From its inception, the United States government viewed subsidies as a necessary tool for advancing the public good. The first substantive act passed by Congress, on July 4, 1789, provided subsidies to various industries. For instance, section 4 of the act provided fishermen five cents for every barrel of pickled fish they exported. As the country grew, so did subsidies. By 1817, a new law decreed that any goods moved from one American port to another must be carried on U.S. ships, subsidizing certain shippers and increasing the transportation costs of farmers and merchants.

Today, subsidies remain an indispensable tool the federal government uses to redirect resources and influence economic decisions. From gasoline refineries to California wineries, there are hundreds of separate federal programs and tax provisions that provide some form of subsidy to businesses, individuals, non-profits and other organizations.

■ Four Categories of Subsidy Programs

In order to make the diversity of subsidies easier to understand, subsidies can be broken down into at least² the four following categories:

1. **Direct Expenditures**, including direct transfers of money, goods or services, such as cash grants or the donation of government surplus. (This does not include contracts for goods and services which are covered in a separate category below.)
2. **Tax Expenditures**, which lower the taxes certain parties pay the federal government by allowing special tax exemptions, deductions or credits.
3. **Risk Transfers**, which convey financial risk to the federal government through insurance agreements, loans, loan guarantees and similar instruments.
4. **Government contracts** for which the government pays more than fair market value for a good or service or provides a preference for certain types of businesses. For instance, the federal procurement system includes preferences for alternative fuel vehicles, and minority owned businesses.

Direct expenditures are probably the most recognizable category of subsidies. They include, for instance, government grant programs. Collecting data on direct expenditure programs is easy. However, measuring the subsidies delivered through direct expenditure programs can be quite hard. Not all of the money spent through direct expenditures is a subsidy, and measuring the subsidy requires economic data, such as market prices for public goods, that is often unavailable.

² This list of categories is not exhaustive. The government provides significant subsidies through regulations and tariffs. While these categories of subsidies can have a dramatic and significant impact on economic behavior, they are not currently covered within the scope of this project.



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INCOME VS. CONSUMPTION TAX BASELINE

Experts disagree on what baseline should be used to measure tax expenditures. Some believe that the current tax system is, or should be, a broad based income tax. Others argue it is, or should be, a consumption tax.

The assumption can make a big difference in what gets counted as a tax expenditure. For instance, using an income tax baseline, the exemption for investment income from Individual Retirement Accounts would be considered a tax expenditure. Using the consumption tax baseline, it wouldn't.

Subsidyscope does not take a position on which tax structure is appropriate but adopts the income tax baseline for measuring tax expenditures. This is because the Department of the Treasury and the Joint Committee on Taxation currently use this baseline in making their estimates.

While direct expenditures increase government spending, tax expenditures result in a loss of federal revenue. Despite the difference, both methods increase the federal deficit and both give the recipient a benefit. Tax expenditures have increasingly grown in popularity because at least two important characteristics of the tax code favor it as a method of delivering subsidies. First, unlike many direct expenditures, tax expenditures do not have to be renewed through the budget process every year. Second, they appeal to politicians who may want to both confer benefits on a certain constituency and, at the same time, campaign on a platform of lower taxes.

These advantages have driven significant changes to the tax code to the extent that it is now riddled with tax credits, deductions, exemptions and other special provisions. For instance, between 1955 and 2005 the number of pages in the tax code quintupled from 409 to 2,139 with most of this increase occurring since 1985.³ Not surprisingly, the size of tax expenditures has also gone up. From 1974 through 2004 the sum of revenue lost due to all tax expenditures, adjusted for inflation, tripled from approximately \$240 billion to nearly \$730 billion.⁴ For individual taxpayers alone, the inflation-adjusted total went from \$190 billion to \$650 billion. The largest tax expenditures projected for 2010 are shown below.

The third category, risk transfers, may be the most difficult to understand and measure. When the federal government insures or provides credit, such as a loan guarantee, to an organization, there is not a direct transfer of money to the recipient. Instead, the recipient has conveyed financial risk to the government which may, or may not result in a cost to the government at a later date. The federal government has a difficult time measuring the cost of risk transfers and the estimates, assuming they are even done, can be highly contentious. For example, rival cost estimates for a recent proposal to substitute a student loan program for a student loan guarantee program differed by more than 40 percent (\$33 billion).⁵

While there is little information available on the subsidy provided through insurance programs, the gross amount of credit the federal government has provided through loans and loan guarantees has been steadily increasing over the last few decades. In the last two years it exploded. This is due not only to the federal bailout of financial institutions, but loans for housing, education and energy projects also boomed as private lending dried up and people and organizations turned to the government for credit.

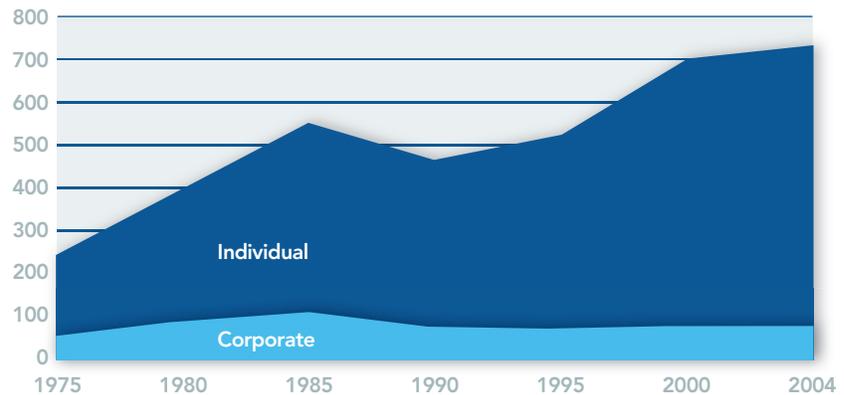
³ The Tax Foundation. "Number of Words in Internal Revenue Code and Federal Tax Regulations, 1955-2005." <http://www.taxfoundation.org/research/show/1961.html>

⁴ "Tax Expenditures Represent a Substantial Federal Commitment and Need to Be Reexamined." 2005. Government Accountability Office, GAO-05-690. September, p. 4. Washington DC: GPO. <http://www.gao.gov/new.items/d05690.pdf>

⁵ Douglas Elmendorf, Director of the Congressional Budget Office, to Senator Judd Gregg, Ranking Member of the Committee on the Budget, July 27, 2009. Public Files of the Congressional Budget Office. http://www.cbo.gov/ftpdocs/102xx/doc10295/Gregg_StudentLoans__09-07-27.pdf

FIGURE 1:

TOTAL TAX EXPENDITURE REVENUE LOSS (\$ BILLIONS)



Source: GAO Analysis of OMB budget reports on tax expenditures, Fiscal Years 1976-2006.

The last category, government contracts, has long been used as a method for subsidizing certain activities the government encourages. For instance, in the 1840s the government wanted to support the development of oceangoing steamships, a relatively new technology at the time. This resulted in Congress offering padded Post Office contracts to shipping companies if they used steamships to deliver the mail. Today, contracts remain an explicit vehicle for delivering subsidies to preferable firms or activities. For example, federal procurement rules favor certain types of businesses, such as minority-owned businesses and certain types of goods, such as recycled paper.

FIGURE 2:

FIVE LARGEST TAX EXPENDITURES (\$ BILLIONS)

(ranked by total fiscal year 2010 projected revenue effect)

Exclusion of employer contributions for medical insurance premiums and medical care	155
Deduction for mortgage interest on owner-occupied homes	108
Deductibility of income put in 401k Plans	53
Deductibility of charitable contributions (other than education and health)	47
Deductibility of non-business State and local taxes (other than on owner-occupied homes)	30
Total	393
Percent of total Tax Expenditures	41%

Source: Office of Management and Budget, Analytical Perspectives, President's Fiscal Year 2010 Budget, p. 308.



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Finally, a subsidy occurs under a contract when the government pays more than fair market value for a good or service. More often than not, a government contract is just a government contract and does not have a subsidy component. Unfortunately, it can sometimes be difficult to determine when a subsidy is taking place since the fair market value may be a matter of opinion. For example, as part of a trade dispute, the European Union claims Boeing, a U.S. aircraft manufacturer, is receiving subsidies through "overpriced [Department of Defense] contracts."⁶ Boeing argues the "payments represent the value of those services [rendered to the government.] They are not subsidies." It may be difficult to prove either side is correct.⁷

Subsidyscope does not attempt to determine which contracts have a subsidy component or measure what that component may be. We do presume, however, that competed contracts—contracts that are subject to an open bidding process—generally do not have a large subsidy component, even though the bidding process may include certain preferences. Thus, we focus on those contracts that are not competed and make this information available to the public. This does not mean non-competed contracts contain a significant subsidy, only that they are more likely to do so.

Whether through contracts or other means, subsidies are an indispensable tool for implementing public policy. That does not, however, mean all subsidy programs are necessary or successful. For instance, in 1971 the federal government guaranteed over \$600 million in loans in a vain attempt to save Penn Central Railroad. Today, people have strong feelings about the need for all aspects of the recent financial bailout. Given changing and improved information, we must constantly ask whether our subsidy programs can be improved.

Government programs change all the time. Some, like housing subsidies, have been a topic of debate for decades. Regardless of whether a subsidy program is considered "good" or "bad", the creation, amendment or termination of such programs should be decided through the political process in an open, transparent and accountable manner based on solid research. Taxpayers and decision makers have a right to know where their money is being spent.

⁶ "US-BOEING: EU Takes US To The WTO Over Subsidies Granted To Boeing." 2004. EU Press Release No. 137-04. October 6. <http://www.eurunion.org/news/press/2004/200400137.htm>

⁷ "EU accuses U.S. of paying billions in Boeing subsidies." 2007. USA Today. March 23. http://www.usatoday.com/travel/flights/2007-03-23-eu-boeing-subsidy-ap_N.htm

⁸ LMC International. Retail and Wholesale Sugar Prices Around the World. "Table 1: Retail Sugar Prices and Sugar Consumption, 2008." June, 2009, p.4. http://www.sugaralliance.org/images/stories/PapersAndTestimony/lmc-report_world-sugar-prices_2008_final.pdf.

■ Subsidies Run Deep...

Many industries receive significant and continuing protection from foreign competition. Few Americans realize, for instance, they pay \$1 more for a five pound bag of sugar⁸ to subsidize domestic sugar beet and cane sugar farmers.

Subsidies, and spending on subsidy programs, can run deep, significantly affecting specific sectors of the economy. For instance, in FY 2007 through one tax provision alone, taxpayers subsidized health insurance coverage that companies provided to their employees by \$133.8 billion.⁹ While a large amount of money, this was only part of over \$874 billion the federal government spent on health care in 2007—amounting to nearly half of all health care spending in the country (see table below).

■ ...and Wide

Subsidies and spending on subsidy programs not only significantly influence particular economic sectors; they also cut a wide swath across the economy. Every major area of the economy is affected by federal subsidy programs.

Subsidyscope recently examined the amount of spending in six different sectors: agriculture, energy, transportation, health, housing and philanthropy. On average, federal spending accounts for 20 percent of all spending in these sectors (see table below).

FIGURE 3:

2007 TOTAL FEDERAL DIRECT AND TAX EXPENDITURES AS A SHARE OF GDP, BY SECTOR

Economic Sector	Total Sector DGP (\$ billions)	Percent of Sector GDP That Is Federal Expenditures (%)
Energy	526	4.0
Transportation	1,496	5.2
Housing	2,321	10.5
Agriculture	371	23.5
Nonprofit	304	26.2
Health	2,009	43.5
TOTAL FOR SIX SECTORS	\$7,027	19.7%

Sources include: BEA, 2007; Census of County Business Patterns 2006; IRS Statistics of Income 2006; OMB FY09 Budget 2008.

⁹ Office of Management and Budget, *Analytical Perspectives*, President's Fiscal Year 2010 Budget, p. 290. <http://www.whitehouse.gov/omb/budget/fy2010/assets/receipts.pdf>



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■ Subsidies, the Budget and the Taxpayers' Right to Know

Subsidies are a surprisingly large part of the federal budget. The amount of subsidies provided to all recipients in fiscal year 2007 through the tax code alone was comparable to the entire discretionary budget requested by President Bush: \$844.2 billion¹⁰ was spent through the tax code on both individuals and corporations,¹¹ while \$870.7 billion was requested in appropriations.¹² Most of these tax breaks are subsidies.

Given the amount spent on subsidies, taxpayers have a right to know where these subsidies are going and in what amounts. Rarely has it been so important that the government act as a responsible steward for the public's resources. The Congressional Budget Office warns that, "under current law, the federal budget is on an unsustainable path."¹³ The federal debt is projected to be 61 percent of GDP in fiscal year 2010,¹⁴ the highest level since shortly after World War II.¹⁵ A solution will require hard choices about who gets how much from government. A dollar spent subsidizing the housing industry cannot be spent on child health programs or reducing the debt, or any other priorities we may have as a nation. As we make these choices it will be necessary to carefully consider how much the federal government spends on which subsidy programs.

■ Subsidies Are Hidden

Unfortunately, most subsidy programs remain largely hidden. Often housed in euphemistically named offices or tucked away in subparts of complicated laws, many subsidies are so narrowly tailored that they are not typically known outside a particular sector or industry. For instance, very few people know that lead and zinc mining companies may deduct a 'depletion allowance' from their taxable income of up to 22 percent of their gross income (not to exceed 50 percent of their taxable income), which can add millions of dollars to their bottom line.¹⁶ The relative obscurity of many subsidies, despite their deep and broad reach into the economy, makes it difficult to weigh them against other government priorities.

¹⁰ Government Accountability Office. GAO analysis of OMB budget reports on tax expenditures, fiscal years 1983-2009.

¹¹ Tax expenditure data presented are estimates of revenue forgone. They represent the lost revenue attributable to the use of the provision, which is not necessarily the same as what would be raised if the tax expenditure was repealed. Summing tax expenditures, while not technically accurate, often provides a reasonably good estimate for the total cost of groups of tax expenditures. The repeal of any single tax expenditure can trigger behavioral effects that in turn affect other tax expenditure amounts or even the total amount of tax revenue flowing into the Treasury. For example, if the tax expenditure favoring employee parking is repealed, more taxpayers may take the tax expenditure for employee transit passes, thus increasing the estimate for that tax expenditure.

¹² Office of Management and Budget, "Budget of the United States Government, FY 2007." <http://www.whitehouse.gov/omb/rewrite/budget/fy2007/tables.html>

¹³ Congressional Budget Office, "The Long-Term Budget Outlook." June 2009, Summary, p. xi. <http://cbo.gov/ftpdocs/102xx/doc10297/06-25-LTBO.pdf>

¹⁴ Congressional Budget Office, "The Budget and Economic Outlook: An Update." August 2009. <http://cbo.gov/doc.cfm?index=10521>

¹⁵ Congressional Budget Office, "Long Term Budget Outlook." June 2009, Summary, p. xii. <http://cbo.gov/ftpdocs/102xx/doc10297/06-25-LTBO.pdf>

¹⁶ Internal Revenue Service. "Business Expenses: For Use in Preparing 2008 Returns." April 2009, Publication 535, Depletion, p. 32-37. <http://www.irs.gov/pub/irs-pdf/p535.pdf>



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Even when the presence of a subsidy is known, information regarding its scope and scale may be hard to find. Currently, information on many subsidy programs is scattered across the government. The Office of Management and Budget administers two large data sets at USAspending.gov, other information is published by Congress' Joint Committee on Taxation and even more data is kept by the Department of the Treasury. However, even when found, this information can be unwieldy, unreliable and hard to understand. For instance, USAspending.gov contains procurement data on over 20 million government contracts. Unfortunately, many of the records are missing important information. Only half of the last decade's procurement records are assigned an industrial classification code providing important information on the source of the good or service. Worse, the system uses a privately owned system to identify contractors, which means the government cannot legally release any ownership data about the contractor associated with each record.

USAspending.gov is also the primary source for information on grant and other assistance programs, but this data isn't much better than the information on contracts. The site relies on the Federal Assistance Award Data System (FAADS). Data in FAADS can be wildly inaccurate. For instance, Subsidyscope's own research indicates that more than half of the funding for Amtrak in fiscal year 2008 is missing and spending on the Merchant Marine Academy for the same year (over \$60 million) is completely omitted.

Finally, the information on a subsidy may not be available in any database. For instance, as part of the recent bailout of financial institutions, the federal government received warrants and purchased preferred stock in a large number of banks. While Subsidyscope does, with effort, calculate the daily value of various federal warrants, it is currently impossible to obtain the value of all the preferred stock the federal government owns.

Over time, these obscure and hidden subsidy programs have accumulated like large rocks on a forest floor. Even if you can find them, it's hard to see what's going on underneath. However, given the extent and influence of subsidies on the U.S. economy, there is a fundamental need for a comprehensive and centralized source of subsidy information.

■ Turning Over the Rocks

Federal subsidies serve many useful purposes. They can correct deficiencies in the marketplace. They can address problems of equity, provide public infrastructure and protect the environment. But they can also be inefficient, ineffective or expensive.

The public has a right to know how much subsidies cost and who is getting them. Further, confronted with a number of extremely difficult budgetary options, the government deserves good information to be in a better position to assess federal subsidy programs and make informed decisions about possible tradeoffs between government priorities.



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Unfortunately, there is no one place to go to find out who is getting subsidies and how much they cost taxpayers. This information is difficult to find and, once found, hard to decipher. It is hidden... until now.

Pew's Subsidyscope project is building the most comprehensive searchable source for federal subsidy information to enable the public to better understand the government's spending priorities. Our project will provide objective facts to the public and decision makers and encourage an informed debate about how best to deploy scarce government resources.

As hard decisions are made, Subsidyscope will provide important information on subsidy programs. The project's data will stimulate a more vigorous debate and help the country make smarter choices. We are taking something that is hard to find and making it easy to get. We are turning over rocks and shining a light on what is underneath. Subsidyscope will help reveal our hidden budget.