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The Power of Special Interests in the United States

Sidney Weintraub

A "special interest" as used in this paper could be a single person or a relatively small group of people who seek to influence public policy decisions to obtain a larger share of economic benefits or political influence than they otherwise would have. By definition, this must come at the expense of the rest of society. Mancur Olson, who wrote much on the economic aspects of this theme about two decades ago, pointed out that it is always difficult and sometimes impossible for the average citizen to monitor what is taking place until it becomes a fait accompli.

I chose to discuss this topic because my sense is that the adverse consequences of special-interest actions are now more substantial than in the past. U.S income inequality has increased during the past four decades, and special interests contributed to this outcome. A paper by the Federal Reserve Bank of San Francisco noted that in 1967 the income of the 95th percentile (the richest 5 percent of the population) was 2.6 times greater than the income of 50th percentile (the middle of the income distribution) and rose to 3.6 times greater by 2005. The ratio of CEO to average blue-collar pay has yearly ups and downs, but the trend is clear—from 85 to 1 in 1990 to about 300 to 1 now (Bureau of Labor Statistics). The take-home income of CEOs in the United States is much larger that that of CEOs of comparably sized companies in other developed countries.

Janet Yellen, president and CEO of the Federal Reserve Bank of San Francisco, pointed out in a speech in November 2006 that nearly 50 percent of U.S. productivity gains between 1997 and 2001 went to the top 10 percent of the income distribution scale. The really rich are a special-interest group whose benefits are increasing more than those of the rest of U.S. society, in both percentage and absolute terms.

Recent media reporting made clear to the general public that the enormous income of many hedge fund and private equity fund managers is taxed at the 15 percent capital gains rate rather than at the ordinary income tax rate of 35 percent. The basis for using the capital gains tax rate has not been satisfactorily explained. The extra income that would have come from raising this tax rate for relatively few very rich people was slated to reduce the cost of eliminating the alternative minimum tax (AMT) that now hits the middle class. The effort to increase the tax rate failed in the U.S. Senate. The one-year elimination of the AMT will now be financed by increased government debt—an obligation that affects society as a whole.

Tariffs on just two groups of U.S. imports—shoes and clothing—amounted to $11 billion out of total import tariff income of about $25 billion.[1] The resulting price increases for these items are paid primarily by low-income individuals and families. I wonder if John Edwards realizes this as he simultaneously opposes trade agreements that would lower tariffs and exploitation of the poor, which is intrinsic to the current tariff situation. The United States collects more duties on imports from Bangladesh than from the United Kingdom, and as much on imports from Cambodia as from France, although total import value from the two rich countries are more than 15 times greater than from the two low-income countries.

In addition to monetary rewards, special-interest groups seek to augment their political influence. In U.S. fiscal year 2005 there were 13,492 congressional earmarks totaling $19 billion in appropriation accounts. In light of the fact that the federal government budget now operates at a deficit, these earmarks require federal borrowing that increases taxes for the public at large as interest is paid and the loans are amortized. U.S. society as a whole pays these costs, but the earmarks are deliberately hidden from the public until after they are in place. The congressional earmarkers obviously wish to enhance their ability to be reelected by funding projects for their constituents and to attract campaign contributions from beneficiaries of the earmarks.

One of the most disturbing techniques of congressional and political party self-interest is the practice of redrawing congressional district lines to increase the number of "safe"

[1] Information on tariff collections comes from Ed Gresser of the Progressive Policy Institute.

seats. Media reporting was extensive when congressman Tom DeLay (R-TX) prodded the Texas legislature to drastically redraw district lines in 2003 between decennial censures in order to increase the Republican share of the U.S. House of Representatives; his effort succeeded. The practice of redrawing congressional lines is not unique to either party and is carried out by Democrats as well as Republicans when the situation permits. There is evidence that the normally low congressional turnover rates (largely because of the advantages of incumbency) are about 9 to 10 percentage points lower than they were before the Voting Rights Act of 1982 encouraged the political redrawing of congressional district lines. Gerrymandering as practiced by political parties, as opposed to nonpartisan action following each decennial census, dilutes the concept of one person, one vote—and weakens U.S. democracy in the process.

Other examples of special interests at work could be given, such as extending the life of a patent for drugs close to expiration by making unimportant changes; sole-source government contracting to favored groups and companies; and requests for bids for government contracts written to exclude all but the desired bidder. Nongovernmental organizations that transparently push their positions are not included in this paper's definition of a special interest. Indeed, open advocacy by environmental, health, education, antipoverty, and other interest groups is the way public debate takes place. Immigration and trade legislation, to take two current and complex topics, attract considerable debate, pro and con on facets of these issues—and this is desirable, as long as it is open to public participation and scrutiny.

Special-interest machinations matter because it is the public at large that must pay for them—in the form of higher taxes, higher product prices, and reduced democracy. Much attention was paid to the earmark for the "bridge to nowhere" in Alaska, but secrecy in public appropriations for a bridge to somewhere is also improper. Political parties do not wish to turn over the task of redrawing lines for congressional districts to impartial bodies precisely because the politicians want to dominate the outcome—to their benefit.

The role of special interests is not unique to the United States. Indeed, the process is global and generally more pernicious in poor developing countries than in rich industrial nations. Income inequality, which is one measure of the power of special interests, is also greater in poor than in rich countries. The high degree of income inequality, which goes together with social inequality, is probably the main reason for the ouster of traditional political parties in Latin America in recent years—in Brazil, Bolivia, Venezuela, and almost in Mexico. If income inequality continues to grow in the United States, the structure of U.S. capitalism will be strained, as it is strained in many developing countries. Why live with capitalism if its results are excessively biased toward special interests?

A recent study by the Organization for Economic Cooperation and Development, the grouping of developed countries that has its headquarters in Paris, recently examined what it called "fiscal legitimacy" in Latin America.[2] The study found that income inequality was about the same in Latin America and Europe *before* taxes and transfers and then declined sharply in Europe but not in Latin America *after* taxes and transfers.[3] The legitimacy of giving greater benefits to the rich than to the middle class and poor in the expenditure of taxes has now become an important issue in the United States.

Latin American countries placed high import duties on imports of intermediate and consumer goods in order to favor domestic industries. This broke down when the publics in Latin America protested against the low quality and high prices of the goods they bought. The U.S. market is generally open to foreign goods, but it would not be if protectionists had their way.

The prestige of the U.S. Congress is low and has been declining in recent years. The earmarks and other self-aggrandizing measures surely have contributed to this disdain. The U.S. public has good reason to be proud of the country's democratic structure, but this pride may not withstand too many measures like costly earmarks and partisan redrawing of congressional districts in order to dilute the choice of voters in congressional elections.

I do not wish to overstate: the United States is far from being a "banana republic." But special interests, without taking into the account the potential consequences, are moving the country in that direction.

[2] OECD, *Latin American Economic Outlook 2008* (Paris: OECD, 2007). Fiscal legitimacy refers primarily to the percent of the population that trusts that taxes are well spent.
[3] Based on the gini coefficient, the most widely used measure of overall income inequality.

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