

# THE SPECIAL INTEREST EFFECT

*Increasing The Size,  
Scope, and Cost Of  
Government*

SPOTTLIGHT

#495

**Dr. Roy Cordato**  
Senior Economist and  
Resident Scholar





## ABOUT THE AUTHOR



**DR. ROY CORDATO**  
rcordato@johnlocke.org

Roy Cordato is Senior Economist and Resident Scholar at the John Locke Foundation. From January 2001 to March 2017, he held the position of Vice President for Research at the Locke Foundation. He is also an adjunct faculty member in the Department of Economics at North Carolina State University where he teaches “Political Economy of the Market Process,” a course that he designed. In addition, he is faculty advisor for the Austrian Economics Forum and the Society for Politics, Economics, and the Law, both at N.C. State University.

From 1993 to 2000, Cordato served as the Lundy Professor of Business Philosophy at Campbell University in Buies Creek, N.C. From 1987 to 1993 he was Senior Economist at the Institute for Research on the Economics of Taxation (IRET) in Washington, D.C. He has served as full-time economics faculty at the University of Hartford and at Auburn University and as adjunct faculty at Johns Hopkins University. His publications include a 1992 book, *Welfare Economics and Externalities in an Open Ended Universe* (Kluwer Academic Publishers republished in 2007 by the Ludwig von Mises Institute).

His articles have appeared in a number of economics journals and law reviews in addition to *The Christian Science Monitor*, *The Washington Times*, *Investor’s Business Daily*, *The Journal of Commerce*, *The Congressional Record*, *The Orange County Register*, *The Freeman*, *Human Events*, *National Review Online*, *The Washington Examiner*, *Tax Notes* and many other newspapers and magazines. In 2000 he received the Freedoms Foundation’s Leavey Award in Free Enterprise Education. He is also a member of the Mont Pelerin Society and former executive board member of The Association of Private Enterprise Education. Cordato holds an M.A. in urban and regional economics from the University of Hartford and a Ph.D. in economics from George Mason University. He also holds a Bachelors of Music Education from the Hartt School of Music.

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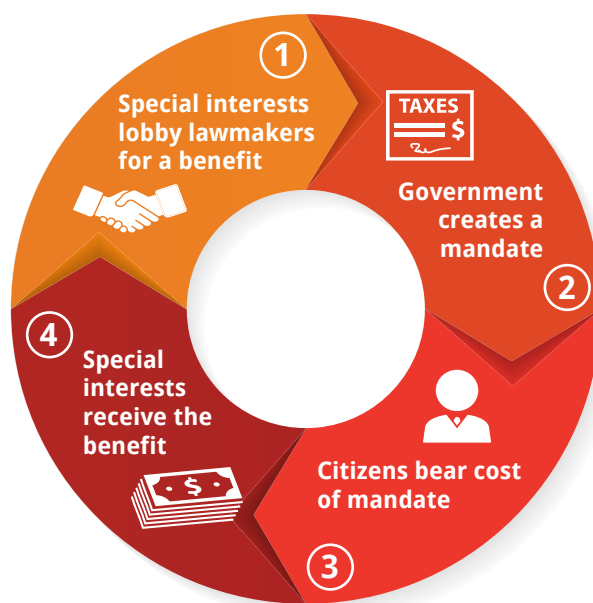
## Increasing The Size, Scope, and Cost Of Government

What do subsidies for “green” energy, mandated health insurance benefits, and quotas on imported sugar all have in common? Most obviously, all three policies generate a wealth transfer from the consumers in the affected markets—energy, health insurance, and sugar—to producers in those markets. With green energy, it is from electricity ratepayers to solar and wind power producers. With mandated health insurance benefits, it is from insurance customers to the providers of the mandated benefits: chiropractors, marriage counselors, etc. And with sugar quotas, it’s obviously from those who consume sugared products to those who provide the sweeteners — which could be sugar cane but are just as likely to be corn farmers, for example, because the No. 1 substitute for cane sugar is corn syrup. But beyond the fact that they result in the transfer of wealth from some sectors of the economy to others, which is typical of legislation and regulation, these three programs are all examples of what economists from the Public Choice school of economics have labeled “the special interest effect.”<sup>1</sup>

### Public Choice economics and the special interest effect

What distinguishes Public Choice economists is not so much their approach to economics but the subject matter of their inquiry. Public Choice economists examine political decision-making, as opposed to market decision-making, which is the typical subject matter of economics. What distinguishes them from more traditional political scientists is that they pursue their analysis of government and politics using the analytical tools of economics. In particular, they analyze how economic incentives, i.e., the costs and benefits facing political decision-makers (legislators, voters, and bureaucrats), impact political outcomes.

The special interest effect focuses on the relationship between legislators and interest groups and is invoked to explain why, over time, the legislative process will tend to generate more expansive government. It goes beyond the widely recognized fact that legislation gives rise to wealth transfers from some groups to others and looks at how the benefits and costs of these transfers are distributed. The distribution of costs and benefits gives rise to special interest coalitions that impact the legislative process.



Noted Public Choice economist James Gwartney describes the effect as follows:

*There will be a strong tendency for politicians to support positions favored by well-organized, easily identifiable special interest groups. When the cost of special interest legislation is spread widely among the voting populace, most non-special interest voters will largely ignore the issue. ... In contrast, special interest voters...will let candidates (and legislators) know how strongly they feel about the issue. ... Given the intensity of special interest voters and the apathy of other voters, politicians will be led as if by an “invisible hand” to promote the positions of special interests.<sup>2</sup>*

In other words, most legislation has “concentrated beneficiaries and diffused cost bearers,” i.e., the benefits are heavily concentrated on a few while the costs are spread thinly throughout the population. This distinction between those who benefit and those who bear the cost creates a divergence in incentives. Those who receive the benefits will have a great deal to gain, on an individual basis, and therefore they will be more likely to come

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together to lobby and devote resources to make sure that favorable legislation is passed or unfavorable legislation is thwarted. In other words, the costs of organizing legislative pressure groups are low relative to the benefits that can be gained through such organizing.<sup>3</sup> Because of their common interest in seeing to it that particular legislation is passed, members and potential contributors to these groups are relatively easy to identify and organize. These could be individuals, companies, or entire industries.

As noted, those who bear the costs of most legislation face entirely different incentives. While the total costs are likely to be high, they will be barely felt by individual citizens because their numbers are so large. As a result, those who pay the price have little or no incentive to organize in opposition to the legislation. Furthermore, they are not likely to be united in a common interest. They will represent workers and taxpayers from across the economic spectrum. Ultimately, most people will not even know that the issue exists.

Because of the way that the costs and benefits are broken down, a small number of special interest groups can exert intense, focused pressure on the political process, thwarting what is, in fact, the general interest.

### **The special interest effect in action: “green” energy**

Subsidies for so-called “green” energy, which come in the form of tax incentives, direct payments, and mandates to purchase wind and solar power, known as renewable

portfolio standards, provide massive benefits to particular companies and represent a textbook example of the special interest effect. Subsidies provided to renewable forms of energy like solar and wind power are so important that these industries would likely disappear if they were repealed. Hence, the renewable energy industry is one of the best-funded and powerful lobbies walking the halls of state legislatures and the U.S. Congress. For several years now, attempts to eliminate or even scale back North Carolina’s Renewable Energy and Energy Efficiency Portfolio Standard (REPS), which mandates the purchase of renewable energy, have been met with intense resistance from the North Carolina Sustainable Energy Association. This is the renewable energy industry’s largest legislative pressure group. They have hired dozens of lobbyists whose purpose is to, as they put it, “drive policy and market development” with the goal of “benefit[ing] all of its stakeholders.”<sup>4</sup>

For much of the renewable energy industry, government subsidies are a question of existence. The costs to any rate-paying family, however, is very small and indeed almost unnoticeable. For example, North Carolina’s REPS can, by law, cost individual families no more than \$36 a year or about \$2 to \$3 a month. At the federal level, there are tens of billions of dollars going into subsidizing solar power.<sup>5</sup> But in terms of any single household tax bill, the amount is negligible. In fact, since at the margin these subsidies are funded with borrowed money, these subsidies have the appearance of being free. So, while the subsidies may be costing ratepayers billions of dollars in

the aggregate, the individual costs are so small that it is in no one's interest to incur the costs of organizing against them. At the same time, highly paid lobbyists for the solar and wind power industries flood the halls of state legislatures and Congress, putting pressure on representatives to keep the subsidies in place or even expand them.

### **The special interest effect in action: health insurance mandates**

The state of North Carolina has 56 health insurance benefits that must be covered if a company is to sell policies in the state. (It should be noted that large companies that self-insure, including the state, are exempt from these mandates.) Obviously, if you are a health care professional, having it mandated that the service you provide must be covered by all insurance policies is a huge benefit. When insurance, rather than the individual, is paying for a service, the patient is less likely to consider costs when using a service, and therefore the service provider can charge more. Also, when third-party payment is guaranteed by all insurance policies, the number of patients likely to use the service is expanded.

On the other hand, these costs are spread widely across all policyholders, including both those who may value the coverage a great deal and those who may not value it all. For example, it doesn't matter that a policyholder has no interest in using chiropractic services; they are forced to pay for a policy that includes payments to chiropractors. The same is true for a woman who is past child-bearing years but is forced to pay for a policy that covers pregnancies and prenatal care. The added costs of covering any one of these services and many others, for a policyholder, is likely to be very small, maybe a few dollars out of thousands a year in premiums. Indeed, for the vast majority of those covered by health insurance who receive their insurance through their employer, the costs are not seen at all. On the other hand, the concentrated benefits to particular health care providers, incentivizes them to organize, lobby, and pressure legislators to ensure that their particular service is included in the list of mandated benefits.

### **The special interest effect in action: the sugar quota**

At the federal level, one of the most often cited examples of the special interest effect is the sugar quota program, which places a cap on the amount of sugar that can be imported from other countries. These supply restrictions generate well over \$1 billion a year in benefits

to U.S. sugar and sugar substitute producers.<sup>6</sup> This would include corn farmers, as corn syrup has become an important sweetener primarily because of the quotas. Commensurate with these benefits, sugar cane and beet farmers contribute “33 percent of crop industries’ total campaign donations and 40 percent of crop industries’ total lobbying expenditures.” This is despite the fact that they make up about 1 percent of total value of livestock and crop production.<sup>7</sup>

Sugar and sugar substitutes are found in all kinds of products from cakes and candies to ketchup, pickles, and salad dressings. But the costs of providing these benefits are spread over many millions of sugar consumers, raising the price of products using sugar by only a tiny amount. In the U.S., the cost of a pound of sugar is increased by only about 6 cents to consumers, which might add up to a few dollars a year depending on how much sugar is consumed. On the other hand, a sugar farm in the U.S. reaps the reward of about \$31,000 annually. This is the perfect scenario for special interests. A few powerful lobbyists, mostly representing corn and sugar growers, control the policy while the masses have no idea that it even exists. And even if they did, there is no incentive to do anything about it.

### **Is there a solution?**

One way to ameliorate the special interest effect is to craft legislation with both concentrated beneficiaries and concentrated cost-bearers. This way special interests are pitted against each other in the legislative process. For example, a rule might be instituted requiring that increased subsidies for one group would always have to be offset with reduced subsidies for another. So, if solar and wind power subsidies are increased, then the subsidy for another industry — for example film production — would have to be reduced. Or, if a new health insurance mandate is added to the list, an existing mandate would have to be eliminated. The point is that concentrated beneficiaries need to be offset by concentrated cost-bearers if the tide of ever-expansive government is to be stemmed.

Ultimately, though, the same special interests that line up to promote their favored policies will oppose any attempts to reform the system. What this means is that legislators have to begin seeing the process for what it is and resist the incentives that they face in terms of gathering campaign contributions and getting re-elected. This not only takes willpower and a strong ethical compass, but also an ability to communicate what is occurring to their constituents. Politicians who are up to this challenge are a rare breed indeed.

## ENDNOTES

1. Jane Shaw, "Public Choice Theory," *The Library of Economics and Liberty*, <http://www.econlib.org/library/Enc1/PublicChoiceTheory.html>.
2. James Gwartney, "Private Property Freedom and the West," *The Intercollegiate Review*, Spring/Summer, 1985, pp.39-40. Found at <https://home.isi.org/private-property-freedom-and-west>.
3. In recent years, members of these groups and the politicians who work with them, to escape the negative connotations of the terms special interest or pressure group, have begun to use the term stakeholders. Typically, what is now referred to as stakeholders is simply another more genteel sounding word for what public choice economists have traditionally called special interests. They face the same incentives discussed in this essay and have the same effect on government decision-making. See Roy Cordato, "Look no further than film incentives, solar subsidies, and the recent vote on craft freedom" at the Locker Room blog, <https://lockerroom.johnlocke.org/2017/05/19/look-no-further-than-film-incentives-solar-subsidies-and-the-recent-vote-on-craft-freedom/>
4. NC Sustainable Energy Association, Mission and Vision statements, found at <https://energync.org/mission-vision/>. See note 3 for the use of the word stakeholders.
5. Barbara Hollingsworth at *CNSnews.com*, "Despite \$39B in Annual Gov't. Subsidies, Solar Produced 0.5% of Electricity in US", February 17, 2015, <http://www.cnsnews.com/news/article/barbara-hollingsworth/despite-39b-annual-govt-subsidies-solar-produced-05-electricity>.
6. *US Trade Policy Gouges American Sugar Consumers*, Heritage Foundation Report, June 5, 2014. <http://www.heritage.org/trade/report/us-trade-policy-gouges-american-sugar-consumers>
7. *ibid.*



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 JOHNLOCKEFOUNDATION  @JOHNLOCKENC

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200 WEST MORGAN ST., #200  
RALEIGH, NC 27601  
919-828-3876  
JOHNLOCKE.ORG

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