



Insight

Myths of American 'Cowboy Capitalism'

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A mantra heard from Western European socialists and American progressives is that a political economy of frontier-style, “cowboy capitalism” runs amok across the fruited plains of the United States. Based on this ideological view of the U.S. business environment, one would think that a pro-market, libertarian utopia existed in America, unfettered by the visible hand of government. The reality, however, is quite different. When one evaluates the data on: 1) federal business regulation, 2) federal and state government subsidies, 3) corporate taxation, and 4) the level of “economic freedom” that exists in the United States, the palette paints an economic landscape with much greater government interference in business than the myth of “cowboy capitalism” would suggest. A factual analysis of these four areas reveals a modern-day America that is much closer to a European socialist-style economy - like Germany, Denmark, or Sweden - than to a capitalist frontier. And by some measures of government intervention, the United States is actually much more “European” than any country in Europe today.

Business Regulation

When it comes to tracking spending by American businesses on federal regulatory compliance, there is no formal administrative process in place. Instead, there are proxies that are used to measure indicators of growth or decline in regulatory activity and spending, such as the number of pages printed annually in the Federal Register (including the number of major new regulations), and the fiscal year budgets of federal regulatory agencies. As we document below, there has been a significant increase in the federal regulatory burden on U.S. businesses, a disturbing trend that is inconsistent with a narrative of “cowboy capitalism” in America.

The Code of Federal Regulations (established in 1938) is where all the administrative rules of U.S. federal agencies are compiled; American businesses, employees, and consumers

must comply with these rules. To provide perspective on the growth of the U.S. regulatory state, the Federal Register, in its first volume, published in 1936, contained 2,620 pages. In 2012, in its 77th volume, the Federal Register contained 77,249 pages – an increase of 2,848 percent. The past decade was the Federal Register’s most prolific, with an annual average volume of 75,413 pages.

While most of that decade encompasses the George W. Bush era of “cowboy capitalism,” President Obama holds the record for the most plentiful consecutive two years (2010 and 2011) of pages published in Federal Register history, with 81,405 pages and 81,247 pages during these years, respectively.

Moreover, according to James L. Gattuso and Diane Katz of the Heritage Foundation, “major” regulations, i.e., those administrative rules that have an expected economic impact of at least \$100 million annually, totaled 106 during the first three years of the Obama administration (for a total estimated regulatory cost of \$46 billion per year), versus 28 major regulations during the first three years of the Bush administration (for a total estimated regulatory cost of \$8.1 billion per year). During the Obama administration’s second term, hundreds of new administrative rules will be finalized under the Affordable Care Act and Dodd-Frank Wall Street Reform statutes.

Not surprisingly, developing, implementing, and enforcing these many additional administrative rules annually via the Code of Federal Regulations requires that federal agencies be funded. Susan Dudley of the George Washington University Regulatory Studies Center and Melinda Warren of the Weidenbaum Center on the Economy, Government, and Public Policy at Washington University in St. Louis, have estimated the annual spending by federal regulatory agencies. They found that total spending by regulatory agencies on social and economic regulations (in constant 2005 dollars) increased from \$2.7 billion in fiscal year 1960 to an estimated \$51.6 billion in fiscal 2012 – a 1,700 percent increase in regulatory agency spending in the last half century. Of the \$51.6 billion in spending by regulatory agencies last year, \$42.4 billion (82.2 percent) was allocated for social regulations related to health, safety, security, and the environment, while \$9.2 billion (17.8 percent) was budgeted for economic regulations targeted toward specific industries (for example, price ceilings or floors, production quantity restrictions, and service parameters). In terms of employment, regulatory agencies employed 283,615 full-time federal employees administering regulatory compliance in fiscal 2012, which represents nearly a five-fold and 397 percent increase from 57,109 full-time federal employees in fiscal 1960.

What is clear from the explosive growth in America’s regulatory burden – measured by the significant increases in pages of regulatory rules at the federal level, spending by regulatory agencies, and the number of federal employees administering regulations – is that the

notion of a “cowboy capitalist” America with minimal regulatory interference from the federal government is clearly inaccurate.

Federal and State Government Subsidies

Government subsidies to firms or industries, also pejoratively known as “corporate welfare,” may take the form of a tax allowance, cash grant, low-interest or guaranteed loan, or a regulatory assist, all used to support a politically desired economic activity that is allegedly more than offset by social-welfare benefits. Subsidies are granted to reduce the market price of a product below its production cost, often for the purpose of keeping domestic products competitive against comparable imported products or to correct supposed market failures.

Federal government subsidies include, for example, the ethanol excise tax credit, also called the “blenders credit,” a 45-cent-per-gallon tax credit that was available until 2011 to those fuel blenders that combined a gallon of pure ethanol with gasoline. The U.S. Government Accountability Office calculated that this ethanol excise tax credit cost taxpayers \$5.7 billion in 2011 alone. Furthermore, a wide variety of federal grants, loan guarantees, tax accounting allowances, credits, exemptions, deductions, depreciation, and other beneficial tax incentives exist for energy and eco-friendly businesses, many of them authorized in the Energy Policy Act of 2005, the Enhanced Energy Security Act of 2006, and the American Recovery and Reinvestment Act of 2009. To place the impact of business subsidies in context, Tad DeHaven, a budget analyst for the Cato Institute, identified \$98 billion of direct and indirect business subsidies to small businesses, large corporations, and industry organizations in the 2012 federal budget.

State government subsidies often parallel those offered by the federal government. In December 2012, the New York Times presented a series of articles, written by Louise Story, Tiff Fehr, and Derek Watkins, under the rubric “The United States of Subsidies.” The Times found that state and local governments offer up to \$80.4 billion in business subsidies each year, including 1,874 separate programs and approximately 157,000 grants. Furthermore, the Times staffers identified 48 companies that have received more than \$100 million in state grants since 2007. These lucky recipients span the spectrum of major companies and industries, and include manufacturers (General Motors, Dow Chemical, and Procter & Gamble), energy conglomerates (Royal Dutch Shell, Anadarko Petroleum, and Marathon Petroleum), information technology firms (Amazon and Microsoft), entertainment-related firms (Ryman Hospitality Properties and Revel Entertainment) and major retailers (Sears).

It appears that General Motors - which has received \$1.7 billion in local and state government subsidies since 2007 - and other auto manufacturers have been adept at

playing one local government entity against another when negotiating for larger subsidies, then pulling out when market conditions alter a few years later. Once again, the reality of massive federal and state subsidies to private companies should dispel the myth of a “cowboy capitalist” system where American companies engage in “Wild West,” free market competition without relying on government assistance, subsidies, or “corporate welfare.”

Corporate Taxes

Contrary to its mythical “cowboy capitalist” reputation, the United States has the distinction of burdening its private businesses with the highest corporate income tax rate in the developed world. According to the Organization for Economic Co-operation and Development (OECD), the U.S. statutory corporate income tax rate was 39.2 percent in 2012. Further, America’s corporate tax rate last year was almost 14 percentage points higher than the simple average corporate tax rate of 25.4 percent for the 34 OECD countries, and almost 7 percentage points higher than the 32.4 percent OECD average tax rate weighted by gross domestic product.

It wasn’t always the case that America’s corporate tax rate was so much higher than those of other developed countries. For instance, from 1987 to 1998, the U.S. corporate tax rate was actually below the OECD weighted average. But then the United States started falling behind. Since 2000, almost all OECD countries (31 out of 34) have lowered their tax rates to become more competitive internationally and to attract and retain businesses, and some of those tax rate reductions have been significant. For example, Germany cut its rate almost in half, from 56 percent in 1998 to 30.2 percent in 2008; Ireland cut its tax rate by more than half in just a few years, from 32 percent in 1998 to 12.5 percent in 2003; and Canada reduced its corporate tax rate 13 times in the last 14 years, bringing its rate from almost 43 percent in 1998 to only 26.1 percent last year.

While America’s corporate tax rate has remained almost unchanged at around 39 percent for the past two decades, the OECD average statutory corporate tax rate has fallen in 16 out of the last 20 years, and from 40.7 percent in 1998 to 32.4 percent last year. Therefore, while almost all other OECD countries have lowered their statutory corporate tax rates over the last several decades to become more competitive and attract and retain multinational corporations, the United States has not kept pace with the developed world. It is worth noting that all of the OECD countries that are most frequently associated with “European-style socialism,” including France, Belgium, Germany, and Sweden, have lower corporate tax rates than “cowboy capitalist” America.

An important issue regarding corporate tax burdens is the distinction between the “statutory tax rate” discussed above and the “effective tax rate” that more accurately

reflects the tax burden that corporations actually face. In a 2011 special report by the Tax Foundation (“U.S. Corporations Suffer High Effective Tax Rates by International Standards”), researchers surveyed almost two dozen studies and found that “by every available measure, the U.S. imposes a very high tax burden on its corporate sector in comparison to other nations, even after credits and deductions are considered.” Specifically, the Tax Foundation concluded that U.S.-headquartered corporations face an effective corporate tax rate of about 28 percent (based on the average of more than a dozen separate studies’ estimates), which is 7.6 percentage points above the average effective tax rate of 20.3 percent in the other countries studied.

The Tax Foundation’s main conclusion is that the tax burden imposed on American corporations - both the statutory corporate tax rate and the effective corporate tax rate - is among the highest in the world. In other words, the “capitalist cowboys” running America’s corporations are taxed at much higher rates than their international counterparts abroad, and would eagerly trade America’s high tax burden for the tax burden in the “European socialist” countries like Germany, Finland, Denmark, and Sweden.

Economic Freedom

If America’s “cowboy capitalist” reputation was accurate, we would expect that reputation to be reflected in high scores for the United States on several different measures of economic freedom. And yet, by two separate indexes that track the economic freedom for countries around the world, the United States has gone from among the most economically free countries in the world in the 1980s and 1990s to the 10th most free country in 2013 by one measure (the Heritage Foundation) and all the way down to No. 19 in 2010 by another index (the Cato Institute).

Specifically, the economic freedom indexes of the Heritage Foundation and the Cato Institute measure the degree of economic freedom in broad areas that include: a) regulation, b) openness to international trade, c) property rights and the rule of law, and d) the size of government.

In January 2013, the Heritage Foundation reported that economic freedom in the United States declined for the fifth straight year, and its economic freedom score of 76 (out of a maximum of 100) was the lowest since the year 2000. Even though it ranked No. 10 in the world for economic freedom in 2013, the U.S. score was 8.5 points below the 84.5 average economic freedom index score for the group of countries ranked as “free economies.” Further, the United States is now economically less free than European countries like Denmark and Switzerland, and just barely ahead of Ireland, the United Kingdom, Luxembourg, and Finland.

It is important to note that many “socialist” countries like Sweden and Germany are getting more economically free over time, while the United States becomes less economically free. For example, Sweden ranked 55th in economic freedom in 1996, when the United States ranked fifth. Since then, Sweden has steadily increased its economic freedom and now ranks 18th, while the United States has steadily declined to 10th place. Similarly, Canada ranked below the United States for economic freedom from 1996 to 2009, but for the last four years Canada has ranked above its neighbor, and the gap widened in almost every year. In its report, the Heritage Foundation commented that America’s “dynamic entrepreneurial growth is stifled by ever-more-bloated government and a trend toward cronyism that erodes the rule of law.”

The findings of the Heritage Foundation are supported by the Cato Institute’s 2012 report on economic freedom. In 2010, the U.S. economic freedom index score fell to 7.70 (out of 10), the country’s lowest score in the history of the index back to 1980, and the U.S. world ranking fell to No. 19, the lowest ranking in the history of the Cato report. According to Cato, “The United States, long considered the standard bearer for economic freedom among large industrial nations, has experienced a substantial decline in economic freedom during the past decade. From 1980 to 2000, the United States was generally rated the third-freest economy in the world, ranking behind only Hong Kong and Singapore. The chain-linked ranking of the United States has fallen precipitously from second in 2000 to eighth in 2005 and 19th in 2010.”

In summary, economic freedom in the United States has been steadily declining for at least a decade based on two different statistical measures. According to the Cato report, the United States is economically less free than countries like Denmark and Finland that are considered to be typical European welfare states, and the United States is even economically less free than Middle Eastern countries like Bahrain, the United Arab Emirates, and Qatar, which historically have not been considered anywhere close to the United States in terms of economic freedom.

The Future of American Capitalism

The historical trends of the last decade show that when it comes to the regulation of American business operations, the direct involvement of government in providing subsidies to specific industries, and the level of federal taxation of corporate income, the “cowboy capitalism” moniker applied to the U.S. political economy is more myth than fact. To the extent that America may have deserved the distinction of being a “cowboy capitalist” nation in the 1980s, that distinction has clearly changed in recent years as economic freedom in the United States has suffered a steep decline since the turn of the millennium.

And what would it take for the United States to regain its ranking among the world's most "free" economies? According to Heritage, it "will require significant policy reforms, particularly in reducing the size of government, overhauling the tax system, transforming costly entitlement programs, and streamlining regulations." Those are serious fiscal and institutional challenges that realistically could take several decades to successfully address, suggesting that any significant shift in the direction of a "freer" market economy and "cowboy capitalism" would be generations away.

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