

Crony Capitalism: Unhealthy Relations Between Business and Government



SUSTAINABLE CAPITALISM: WHY THIS POLICY STATEMENT?

Capitalism is the economic system, if you will, that underlies all of the economic decisions — big, small, profound, mundane — that we make every day.

But the nature of our economic system is not a question that people necessarily ask every day. Societies do not need a profound philosophy to produce and exchange; the motivation comes from instinct. Adam Smith did not in the 18th century establish the economic system of his time — capitalism; he observed, described, and analyzed what he saw already going on around him.

Pre-Adam Smith, there was less philosophical or analytical underpinning to thought about economic systems. More of the variation in systems came from alternative approaches to ownership. For example, a sovereign might own everything and make the decisions of who gets what, and what they do with it. Alternatively, property (including the individual citizen's own labor) could be owned privately, and all owners could make independent decisions — the system that Adam Smith observed and analyzed. Post-Adam Smith, variations were more self-conscious. Socialism and communism were created, advocated, and put into practice. One might say that they have evolved into “state-owned capitalism,” as it is being practiced today in the formerly communist China and Russia.

But capitalism is our economic system — basically what Adam Smith observed — based on private

property, independent choices of work and investment, and free exchange.

The Committee for Economic Development of The Conference Board (CED) judges capitalism according to three basic criteria — the functions we expect an economic system to perform:

- Allocate capital, accurately and efficiently (i.e. to its best uses, at low transactions cost). If it does, the system will...
- Facilitate the formation of new and innovative businesses, and
- Cause productivity growth, output growth and high employment, and therefore widely shared prosperity (which is CED's stated goal).

By these standards, capitalism has performed spectacularly throughout history. It has supported the development of the greatest economy that the world has known. It has also allowed for the reduction of poverty at home and abroad on an epic scale.

However, in the most recent decade, the U.S. economy has suffered; and some would blame capitalism itself.

- Some would argue that capitalism has imposed a substantial cyclical and perhaps even structural shock on the economy, although of course capitalism's responsibility (as opposed to other forces, such as government policy) is in dispute.
- It arguably has imposed excessive costs of allocating capital (although many dispute that argument).
- It arguably has less accurately allocated capital, judging from very low new business formation (again debated).

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- Since the financial crisis, the economy has generated less employment (though again causation is subject to intense debate), and therefore has shared income growth more narrowly than we would want.

The remarkable success of capitalism in the United States has been made possible by widespread public support for that system. Sadly, in recent years, and especially since the September 2008 financial crisis, that support has seriously eroded. Increasingly the public is coming to view the system as unfairly benefitting the few and as favoring Wall Street over Main Street. Moreover, the system is no longer perceived to be producing the same impressive economic results as before. This apparent recent erosion of consensus about the merits of the U.S. economic system, however well- or ill-founded over the long term, at least reduces the comity of our dialog over public issues, threatens our policymakers' ability to mobilize consensus in any future emergency, and diverts our energy from vital public concerns.

Looking forward, we want to reestablish and fulfill the fundamental objectives of an economic system. But we can't just go back to the "good old days," because the world has changed. We need to adapt capitalism to the changing world — we need to foster "Sustainable Capitalism."

We by no means see fundamental, fatal flaws in our capitalist system. But we do see several respects in which capitalism must change if it is to succeed where it may have stumbled over recent years. This policy statement will address just one of them: the problem of "crony" capitalism.

CRONY CAPITALISM

To some critics, one reason for the perceived recent shortcomings of economic performance — and allegedly capitalism itself — is the rise of so-called "crony capitalism:" deals between some private interests (business, anti-business interests, professions, social groups) and government that "pick winners" and thereby also pick losers, on the

basis of political influence rather than merit. Such deals would inhibit the productive reallocation of society's resources, and reduce innovation and economic growth. Examples of such deals include cash subsidies, tax preferences, earmarked appropriations and no-bid contracts, regulatory and trade protection, among other forms of favorable treatment. They can be crafted to benefit virtually any sector of the economy, and though each alleged deal has its defenders — else it would not exist — the list of questionable private sector-government interactions is long.

The term "crony capitalism" has become a part of our vernacular, and so we use it here. However, it also is to some an indictment of all of the business community, or of capitalism itself; and that is by no means our intent. We emphasize that U.S. business, operating under capitalism, has over the long term produced tremendous improvements in income and living standards for the population at large; and that capitalism must, for that reason, be made sustainable. But we recognize that a small minority in the business community did cause enormous harm in the course of the financial crisis. We also will describe a gradual and perhaps growing tendency of private interests, including but not limited to business, to try to mute or circumvent market competition by influencing the policymaking process in Washington and in state capitals and local governments around the country. Our goal is to raise awareness of this trend, which may have grown so gradually as to attract less attention than its remedy would require. We seek to bring capitalism fully on track, to make it sustainable, and to unite Americans of differing persuasions behind the core principle that our economic system can work for all of us.

Why do such deals happen? Crony deals predate the identification of capitalism, and capitalism itself; sovereigns have rewarded themselves and their families and friends for eons, and any government could exercise policy in such a way as to misallocate resources. Such opportunities might be thought to recede when markets displace sovereign power in the allocation of resources. But

crony deals have been made throughout the history of our Republic.

In practice and for a variety of reasons, government over the past 40 years has become a more important factor in the economy in terms of its share of overall spending, the breadth and influence of that spending across the economy, and its increased regulatory reach. Every increase in the government's reach also increases the number of potential channels of public policy's influence. Every increase in the weight of the government's touch increases its potential leverage in such misallocations. The increased importance of the government has been an incentive for private interests, including but not limited to business, to seek competitive advantage from the government. It has also given those who oppose business an opportunity to secure restrictions on business.

How are such deals achieved? Self-interested private-sector-and-government deals can be achieved in a variety of ways. The simplest nonmonetary deals — as old as elections, and dotting our entire political history — can occur whenever an elected official provides whatever some particular private interest wants, and the private interest provides the elected official with votes and reelection. However, a disturbing trend in recent years has been a growing nexus among crony deals, campaign contributions, and lobbying.

Lobbying is the constitutionally protected petitioning of the government by its citizens. Much of today's lobbying is the non-self-interested communication of important information to busy non-specialist legislators, and argument for what the lobbying organizations deeply believe to be the public interest. Business interests that compete with one another need to express their perspectives, lest only the other side be heard. At the same time, most campaign donors seek to achieve what they wholeheartedly believe to be a better world.

Increasingly, however, to achieve their self-interest, some organizations engage in direct lobbying

of politicians, or more commonly they employ professional lobbying firms. For their part, because of the human instinct of reciprocity, politicians faced with ever-more-expensive electoral campaigns inevitably provide more time for the arguments of the lobbyists who have regularly provided financial support than for those who have not provided such support. To be sure, there is no bright line between campaign contributions that are purely support for like-minded elected policymakers, and those contributions that are self-serving. And some of the worst abuses occur when elected officials demand campaign contributions behind veiled threats of retribution through their governmental power. But abuse is possible when incumbent interests, which may align with either party, have the deep pockets needed to provide campaign finance and engage in sophisticated lobbying, and upstart challengers do not.

This symbiotic and potentially destructive relationship between private interests and government has been evident in basic trends that have characterized U.S. political economy over the past few decades:

- There has been a sharp increase in the costs of election campaigns for all levels of public office. This has made politicians more dependent on raising campaign financing and less focused on solving the nation's problems. The increase in campaign funding surely has increased the need for campaign funding still further, as electoral opponents have engaged in a veritable arms race — “deterrence,” “mutually assured destruction,” and “overkill” — against one another.
- There has been a marked increase in lobbying by all sectors of our economy. Institutions that can afford lobbyists too often dominate legislative consideration of issues that affect those that cannot afford lobbying (although businesses most subject to government intervention might need to lobby so that their real-world perspectives will be brought into the formulation of public policy). Business interests that are involved in either seeking legislative advantage or opposing contrary legislation are often blamed, sometimes for good reason, for the failure of government;

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but many other private interests seek their own rewards, sometimes merely opposing business. Because large incumbent firms have the resources to engage in such lobbying, they tend to be over-represented in business-government deals — often for fully legitimate reasons, but sometimes to forestall competition from young and innovative competitors, and sometimes to achieve competitive advantages over one another. Such manifestations of “crony capitalism” — and lobbying by anti-business interests — can have unfortunate consequences for the economy.

Although there are numerous instances of healthy public-private partnerships, the unhealthy interaction between large government and private interests, when coupled with costly election campaigns and the increased influence of lobbying, has exerted an important toll on the U.S. economy. This has occurred along the following lines:

- It arguably has impeded fundamental economic reforms, which could in principle yield equity and efficiency gains.
- It has reduced the overall degree of competitiveness of the economy by favoring insiders over outsiders.
- It has resulted in the costly introduction of subsidies or tax breaks that benefit vested interests at the expense of the general public.
- It has encouraged rent-seeking rather than economically productive behavior.

If left unchecked, crony capitalism will continue to sap vitality from the economy. It also will continue to undermine public support for the American model of capitalism. This adds urgency to the task of finding solutions to the rise of crony capitalism.

Remedies must touch all parts of this vicious cycle of economic cost and public disillusionment. Reducing the breadth and weight of government’s

involvement in the economy would reduce and lighten the touch-points through which harmful deals have their impact. Here we recommend changes in every major component part of the federal budget — which are necessary to achieve long-run fiscal sustainability in any event. High on the list of changes that we recommend is the reduction or repeal of many of the subsidies that could be classified as crony deals — which include appropriated spending, tax subsidies, and even potential manipulation of purchases under some benefit programs. We provide recommendations through which the regulatory process could be streamlined — which would be beneficial in its own right, but also could remove access points where crony deals could interfere in the marketplace. We recommend changes to the legislative process that would reduce the frequency of occasions for the enactment of anticompetitive tax or spending laws.

Although there are strong differences of opinion on these issues — witness the current controversy surrounding campaign finance — we seek policy decisions based more on the merits, and less on the influence of money in politics. Reducing the role of money in politics also would reduce the potentially undue deference that elected policymakers and candidates must show to lobbying interests that are also potential sources of funding in the now apparently endless arms race of political spending.

Finally, fundamental reforms of the policymaking process in Washington — to ensure transparency and both due diligence and ultimate action on our serious public problems — would improve the performance of our economy and renew our people’s faith in capitalism.

In short, the nation needs reform to make our capitalism sustainable.