

Crony Capitalism, Corruption and the Economy in the State of New Mexico

**A Summary and
Action Plan for
Business Leaders**



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University of New Mexico Professor Michael Rocca and the Committee for Economic Development (CED), a Washington, DC-based non-profit, non-partisan, business-led public policy organization, just released a study outlining concerns about the rise of crony capitalism in New Mexico. Produced in partnership with the University of New Mexico, the comprehensive report provides definitions, analysis, research findings, case histories, and recommendations.

Speaking specifically to the state's business leaders, this summary defines crony capitalism, outlines its impact on the New Mexico economy, and lists actions that can be taken to mitigate the negative effects and create a climate that fosters positive economic growth to benefit the state's residents and businesses.

Our report provides actionable recommendations that require little or no change to existing law. All are designed to efficiently and effectively help New Mexico prevent and expose cronyism and corruption.

Overview

New Mexico's economy is stagnant, largely because of the state's reputation for corruption and crony capitalism and an environment that fosters pay to play behavior. Crony capitalism is defined as the unhealthy relationship between some private interests (such as business, anti-business interests, professions, or specific social groups) and government, creating situations that meet the interests of a few at great cost to many.

In the case of New Mexico, the misbehavior of a few unscrupulous public officials has harmed the many who adhere to a higher standard. Several factors have created what might be called a "perfect storm." Several incidents involving corruption – and cronyism, in particular – have tarnished the reputation of public officials in New Mexico at great cost to the state and those who operate with integrity. New Mexico has been ranked the nation's most dependent on federal dollars, next to last in economic growth, and received a D- from the Center for Public Integrity. Although New Mexico has attributes that should allow its economy to thrive, our report concludes that:

- High public corruption and cronyism are to blame for the state's lackluster economic performance;
- To regain stability and foster growth, cronyism and corruption must be rooted out of state government.

We intend our report to offer a platform from which the business community can lead change.

Crony Capitalism: A Working Definition

Crony capitalism exists on a continuum. On one end (sometimes beneficial) are legal transactions where the government distributes benefits to powerful interest groups in return for their political support. The middle ground includes transactions that, while legal, come at the great expense of many New Mexicans. Most nefarious – and completely illegal – are public/private relationships with a quid pro quo, often known as “pay to play.”

- Some public-private sector relationships (such as some tax subsidies) are legitimate policy choices that can, under the right conditions, successfully grow the economy.
- Some, like predatory lending practices, clearly benefit only a small sector of society while spreading significant economic costs to the general public.
- Some, like pay-to-play scandals, are corrupt and illegal and have tremendous short- and long-term economic consequences.

Big Government Fuels Corruption in New Mexico

In New Mexico, government is the largest employer. Its enormous spending power brings vulnerability to corruption, in general, and crony capitalism in particular. For perspective, here's how New Mexico's government compares to other states:

- 23% of the state's non-farm workers are on the state government payroll – well above the national average of 16%.
- New Mexico's governmental workforce ranks 13th in total expenditures per capita in 2012 and 6th highest in the direct-spending growth rate from 2001 and 2011.
- Of total revenues in New Mexico, 38% are derived from federal subsidies, higher than 41 other states.

We have identified three key types of crony capitalism, all amplified by big government such as New Mexico's:

- **Rent seeking:** when businesses seek favors from government officials in return for providing political support.
- **Regulation capture:** when regulatory policies are established by industries to benefit those that are regulated.
- **Interest group politics:** when interest groups become so intertwined in the political process that firms gain more from political activity than from their own economic productivity.

However, other factors also contribute to New Mexico's corruption problems, including:

A poorly compensated citizen legislature.

According to the National Conference of State Legislatures, New Mexico is one of just 16 states with a “citizen legislature” (part-time elected officials whose primary occupation is other than in the legislature). Paid less (under \$20,000 on average vs. over \$80,000 for full-time legislators) and provided fewer resources, citizen legislators are susceptible to interest group politics and lobbyists because they lack staff and resources to do their own research and depend on lobbyists for basic information on issues.

Rising election costs. Election costs grew 211% from 1998 to 2012. Not surprisingly, spending on lobbying also climbed and continues to rise: By May 2015, lobby spending had already reached \$519,000, higher than total spending had been in each of the prior four years.

Corruption is self-perpetuating. The state's long history of corruption, dating back hundreds of years, continues unabated in the 21st century. With spectacular scandals erupting every few years, the state's reputation feeds on itself. Recent statistics show a sorry state of affairs:

- In 2014, only 15% of New Mexico residents said they would trust a state government official, compared to 45% nationally.
- Business leaders in New Mexico are alarmed by

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the influence of money in politics and the lack of campaign finance reform and transparency, with 84% describing the ethical behavior of state elected officials over the past 20 years as a “somewhat serious” or “very serious” issue.

- A recent analysis conducted by professors of economics and political science ranked New Mexico as the fifth most corrupt state in the nation.

3 Case Studies: Crony Capitalism in New Mexico

Case 1: Tax Subsidies

The New Mexico government issued 860 tax subsidies between 2011 and 2013, for a total of \$262,699,040. Private companies can apply for 34 different tax credits in seven industries – or the state legislature can create “targeted” credits by passing legislation. It’s therefore unsurprising that so many take advantage of the opportunities.

But, measured against leading economic indicators, research shows, at best, mixed support for the efficacy of these subsidies. An independent party recently concluded that “tax incentives are of little benefit to the states and localities that offer them and they are actually a drag on national economic growth.” Reasons why include:

Companies don’t base major decisions on tax subsidies. A combination of factors, including variables such as regulations, energy cost, employment pool, and available technical expertise are typically weighed in making a decision.

Politicians use tax subsidies as political currency. Motivated to find opportunities to do “good” things to make a case for being elected, attracting and retaining tax packages is electorally profitable for politicians, even if those packages don’t work.

Without evaluations, we can’t understand the true impact and actual value of tax subsidies.

Many states don’t evaluate tax subsidy programs. Also, job growth estimates are based on anticipated hires, not actual jobs created. It’s estimated that in New Mexico, it takes \$31,000 in tax subsidies to attract a job with an average salary of \$43,000.

Our report offers detailed analyses of several tax subsidy programs, with a range of results. What all have in common, however, is that the industries and companies that receive the subsidies contribute to the campaigns of the public officials who write the subsidies.

Case 2: Predatory Lending (Payday and Installment loans)

Predatory lending practices victimize vulnerable consumers who cannot afford the high interest rates and other costs associated with money they borrow to cover the disparity between low wages and their needs. Unable to pay back their loans, many take on more debt: according to the New Mexico Regulation and Licensing Department, payday loan consumers end up taking out, on average, between five and seven such loans annually.

More than 20% of New Mexico’s residents live below the national poverty level. The state presents a ripe market for these “storefront lenders,” so-called because of their walk-in retail spaces. For a variety of reasons (poor health, no health insurance, older cars, and housing stock), low-income households are more likely to face unexpected expenses but, research shows, typically have only about nine days of liquid assets (or less) in their bank accounts. Also, education and language barriers present further obstacles, since many consumers don’t fully understand the terms of their loans.

Nationally, the burden of repaying payday loans costs the U.S. economy approximately \$943 million per year. Though no available figures reflect New Mexico’s specific contribution, it is clear that the state offers a lucrative market to predatory lenders, at massive cost to everyone else, because of:

- A poor and often financially illiterate population
- Little regulation on storefront lending
- Low-cost lobbying and a political climate where small contributions can make a major difference
- Non-transparent lobbying and campaign financing laws

New Mexico's 2007 Small Loan Act was an attempt to address some of this industry's abusive practices, but the lenders found ways to sidestep the law. Our report details how the industry organized itself and, exhibiting all three of the crony capitalism behaviors (rent seeking, regulation capturing, and interest group politics), circumvented the laws – for instance, by inventing new products, changing loans' payback period, or redefining the type of loan.

Case 3: Pay to Play

The most obvious and egregious form of crony capitalism, “pay to play” arrangements, are transactional and clearly illegal. It's a simple equation: Officials extract payments (campaign donations and/or direct bribes) in exchange for considering or awarding government contracts.

New Mexico has become infamous for its scandals implicating high public officials in pay to play transactions. Two recent, high-profile cases are:

- The 2008 investment scandal during Governor Richardson's bid for the presidency, when corruption charges were filed for allegedly awarding public contracts on the basis of donations to his political action committee (PAC). Still playing out, estimates vary as to what this will cost the state – the low estimate is \$90 million and, at the high end, as much as \$200 million.
- Senator Phil Griego ushered a bill through the committee process devaluing state land and then acted as the real estate agent accepting an unusually large commission for the sale of the recently devalued land.

Under indictment, it has been a contention of several office-holders (including Deputy State

Treasurer Ken Johnson, convicted of conspiracy to commit extortion in 1984) that “this is how business is done” in New Mexico.

How Crony Capitalism Hurts Business

The central problem with crony capitalism is that it benefits the few at great cost to the many. The research supports clear links between a state's corruption ranking and its economic growth rate, connecting corruption to lower economic performance and a greater disparity between the wealthy and the poor. Both outcomes hurt business.

Other ways that crony capitalism hurts economic growth include the following direct or indirect effects:

- Reduces local investment
- Discourages foreign and interstate direct investment
- Inflates government spending
- Shifts government spending away from health, education, and infrastructure and toward less efficient, more malleable public projects
- Distorts the proper functioning of the market economy for the benefit of the few
- Hurts consumer spending (predatory lending)
- Hurts investment returns on government spending (pay to play)
- Makes the state an unattractive place to do business

Long-standing research shows that citizens' level of trust in one another (as well as in government) is closely tied to economic growth, in large part because economic transactions depend on trust. That's a key reason why the state's future economic growth may hinge on the ability to reign in crony capitalism.

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How Can Business Leaders Combat Crony Capitalism?

A multipronged effort to eliminate corruption and crony capitalism would enhance the business climate in New Mexico. Establishing a system that requires transparency and holds government officials accountable for their actions will provide a framework upon which a more successful state economy can be built.

Primarily, the benefit to the business community would be a fairer, more competitive marketplace that rewards merit over influence, a key facet of a capitalistic economy. In turn, this levels the playing field, offering all an equal opportunity to succeed based on what they can do, not who they know – fueling economic growth while promoting clarity and predictability. Over time this will create a stable environment and a more accountable government, attributes that strengthen economic growth and well-being.

Our report lays out three specific recommendations.

Recommendation 1: Require greater disclosure of campaign finance and lobbying.

Hold public officials accountable for providing full, timely and free access to relevant information. Four ways to strengthen New Mexico's laws include:

1. Require that financial disclosure statements identify the donor's employer.
2. Require lobbyists to disclose bills/issues for/ against which they are lobbying.
3. Expand the scope of the Campaign Reporting Act of New Mexico to require public disclosure of as much information about the campaign spending of PACs and other non-candidate campaign participants as is possible, without crossing constitutional boundaries. We believe SB 384, which was sponsored by Senator Peter Wirth (D) and Representative James Smith (R) during the 2015 legislative session, represents the best policy practices and provides an excellent foundation for reforming the

Campaign Reporting Act.

4. Demand development of a user-friendly website providing full and open access to vital campaign finance and lobbying information, in real time, with tools that enable study of how particular types of donors contributed to particular candidates and offices.

Recommendation 2: Establish an Independent Ethics Commission. The commission should be independent, adequately funded, able to protect complainants, have subpoena power, and have the power to discipline violators.

Recommendation 3: Conduct Regular and Rigorous Evaluations of Tax Subsidy Programs.

Ten states and the District of Columbia have recently passed laws requiring regular evaluation of economic development tax incentives or an improved evaluation process. We recommend that NM pass a similar law and charge an appropriate committee or agency (likely in either the legislative or executive branch or both) with conducting regular and rigorous evaluation. The programs need to be studied often enough to provide up-to-date data while also allowed the time to produce thorough, detailed studies.

Action Items for New Mexico Business Leaders

Here are ways that you, your colleagues, and peers can help shape a fairer and more prosperous New Mexico:

- Advocate for greater and more complete disclosure of campaign contributions and lobbying expenditures and efforts.
- Generate demand among peers to establish an Independent Ethics Commission.
- Demonstrate support for policy change that requires regular, rigorous tax subsidy program reviews.



CRONY CAPITALISM in the State of New Mexico

CRONY CAPITALISM EXISTS AT DIFFERENT LEVELS

TAX SUBSIDIES

- Benefits individual companies
- May help grow an industry
- Costs everyone

PRACTICES LIKE PREDATORY LENDING

- Benefits a small industry
- Costs taxpayers and the public



PAY TO PLAY BEHAVIOR

- Illegal
- Benefits a few individuals
- Costs everyone

HOW CRONY CAPITALISM HURTS LOCAL BUSINESS



Anti-competitive deal making rewards influence over merit



Cronyism distorts the market so only those with influence can succeed



Corruption creates a climate that inhibits growth

A PERFECT STORM FOR CRONY CAPITALISM AND A DISENGAGED ELECTORATE



Large reliance on government spending



Public distrust in state government and business leaders



Long history of corruption



Reliance on external expertise, like lobbyists, because legislators are not paid



Campaign funding presents opportunities

ACTION ITEMS FOR BUSINESS LEADERS

- Advocate for greater disclosure regarding campaign contributions and lobbying.
- Generate demand among peers to establish an Independent Ethics Commission.
- Support policy change for regular, rigorous tax subsidy program reviews.

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