

Why capitalist virtue beats cronyist sin

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At a breakout session during the recent Conservative Political Action Conference, one of us posed a question to the audience: What do members of the Tea Party and Occupy Wall Street have in common?

Hint: it has something to do with the 2008 bailout of private banks by American taxpayers. The insidious stink from that sorry episode lingers to this day—on both parties.

Now the reasons for outrage over the bailouts were different for each group. For the Tea Partiers it was an unwarranted intrusion into the free market; for the Occupiers a taxpayer-financed gift to wealthy executives they believe caused the disaster in the first place. Yet whatever their motivations, both groups sense something had gone seriously wrong as never before.

If only. The truth is, those bailouts are just one piece of a long list of privileges government bestows on certain industries and businesses. As Matt Mitchell of the Mercatus Center points out in his study, “The Pathology of Privilege,” those privileges include subsidies, monopoly status, protection from foreign competition, non-competitive bid contracts, loan guarantees, favorable regulations that hinder competitors, and many other goodies.

American free enterprise is the greatest job, wealth and happiness engine ever known, but these days, there’s a sense it has gone off the rails. There’s something to that. Special privileges destroy the idea of voluntary exchange as mutually beneficial, erode the trust on which a vibrant free enterprise system relies, undermines property rights, increases the transactional costs of doing business, and creates barriers to entering the market.

The best antidote to backroom deals are sunlight and diffuse power. But in the U.S. today, cronyism is a complex phenomenon and difficult to address. The challenge is to contrast the virtues of the market with the injustice of rent-seeking. That requires legitimizing real capitalism—the competitive, entrepreneurial kind—from the perverse imitation based on favoritism and connections.

Cronyism is receiving much attention in the Washington political world these days. That is a welcome development. Most Americans honor capitalism for its earned successes and condemn

the taxpayer-funded privileges on which cronyists thrive. For that reason, we find the term “crony capitalist” misleading.

Capitalism is no more discredited by cronyism than finance is discredited by Bernie Madoff. A capitalist system creates wealth; a cronyist system merely reallocates it, usually through government force. Capitalism benefits society; cronyism benefits only the cronyist.

A glance at the news media yields a bleak picture. Stories abound of firms profiting not by producing goods or services consumers want and need, but by having politicians tilt the playing field in their favor. Export-Import Bank loans and renewable energy subsidies are frequent examples.

Yet there is a lot less rent-seeking than media stories suggest. Corporate welfare costs taxpayers about \$100 billion per year, according to a 2012 Cato Institute study—a drop in the bucket in a \$16.77 trillion economy. Therefore, it’s worth asking the question: “Why isn’t there more rent-seeking?” If lobbying for special favors is as profitable as it seems to be, why don’t firms fire their engineers and sales staff and hire only lawyers and lobbyists?

Rent-seeking carries costs, along with risks. While some firms win the political favoritism lottery, many others incur similar costs and receive nothing. Seeking favors may attract negative public attention. And cronyists often have to pay again and again for privileges, given that political favors are rarely granted in perpetuity. In politics, you can only “rent” friends, not buy them.

Perhaps most importantly, America remains a reasonably high-trust nation, where people expect to do business according to market rather than political rules. Many places around the world exhibit far more cronyism than does our nation in total.

For instance, a recent survey of Italian business leaders found that “knowledge of influential people” was the most important aspect of financial success, with “competence and experience” ranking a distant fifth. This suggests that, in America at least, cronyism has not crowded out the honest businessman and that many value earned success more highly than granted success.

Moral outrage over cronyism is important, but too many arguments are framed in purely monetary terms. Yes, cronyism is a problem, but our culture often does surprisingly well at disciplining this errant behavior. So, just as we rightly condemn cronyist sin, we need to place equal importance in praising capitalist virtue.