

Background

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Cronyism: Undermining Economic Freedom and Prosperity Around the World

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Abstract: *Backroom deals between members of the governing class and their hand-picked cronies influence the legislative, executive, and regulatory actions of governments around the world. Examples of this ancient form of corruption abound. Government intrusions into the private sector as a partner, financier, or outright owner are not only morally hazardous, but toxic to economic freedom. Such special-interest arrangements directly contradict the principles of freedom, incentives, and opportunity detailed in The Heritage Foundation's Index of Economic Freedom. Citizens of any country need a system of non-discriminatory markets and impartial credit allocation, as well as rewards for individual success, in order to get ahead based on merit and hard work.*

It is common these days for those who feel “exploited by the system” to lash out at capitalism as the cause of their economic woes. When their complaints are examined, however, what stands out is not anger at an actual free-market capitalist system, but frustration with the prospect of an almost insurmountable economic system of privilege based on cronyism. In many parts of the globe, aspiring entrepreneurs, willing to work hard and full of ideas and energy, start out against a stacked deck because they lack political or family connections.

To get ahead based on sheer merit and hard work, citizens of any country need a system that maintains non-discriminatory markets and impartial credit allocation, as well as rewards for individual success. That

Talking Points

- Around the world, “crony capitalist” arrangements increasingly influence the legislative, executive, and regulatory actions of governments—in foreign countries as well as in the United States.
- Crony capitalism directly contradicts the core principles of The Heritage Foundation's *Index of Economic Freedom*: rewards for individual success, equitable treatment, and open competition.
- Crony capitalism is frequently associated with the ascendance of statist policies. Government intrusion into the private sector as a partner, financier, or outright owner is not only a symptom of morally hazardous crony capitalism, but is also toxic to economic freedom.
- The corrosive effect of crony capitalism on the body politic looms as a major threat to democratic stability.
- Government leaders everywhere should reject cronyism, privatize the firms under state control, and generally maintain arms-length and even-handed relationships with all firms.

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is the recipe for economic freedom—and for the opportunity to escape poverty and build lasting prosperity. Yet in far too many cases the future Sam Waltons, Ray Krocs, and Bill Gateses of the world are trapped in systems dominated by cronyism and corruption, where those with special access to government favors or information and those who already enjoy monopoly power dictate pricing and conditions of service, often becoming extravagantly rich in the process, while denying millions of their countrymen that very same access.

In a true capitalist system success is determined by the market, the best mechanism ever discovered to set the value of goods and services—through the collective buying and selling decisions of all participants in the economy, not only through a select few with special access to government overseers or inside information.

The Blight of Crony Capitalism

Every day around the world decisions are made by government leaders to insinuate themselves and their bureaucracies as a partner, financier, or outright owner of formerly private corporations and enterprises, sometimes in joint ventures with labor unions. Often this insidious and growing “crony capitalism” is linked with European corporatist-style industrial policies, hailed by their statist supporters as the “public-private” wave of the future. Those who study history, however, already know the ending of this story, and it is not a happy one.

When the collective decisions of the marketplace are overridden by government regulations, price setting, or even direct control or state ownership of natural resources, then “the system” is something quite distinct from free-market capitalism and truly does become the enemy of the “little guy.”

Depending on the type and extent of government interference in the economy, the system result-

ing from cronyism might fairly be described as socialist, fascist, or communist. All three substitute government decision making for the collective judgment of the marketplace in allocating resources for production and consumption. Any of these systems can work in theory, although socialism has enjoyed long-term success only in a few Western European societies that are highly cohesive demographically and which enjoy high standards of ethical behavior: Their citizens traditionally have trusted each other and their governments to “do the right thing.” It is not socialism *per se*; to the extent that European socialism has succeeded it is thanks to a system that might better be called “extended-family capitalism.”

“Vertical Collectivism”: Less Economic Freedom, Plenty of Corruption

Before they were defeated by the economically freer Allied Powers, two of the massive (and deadly) 20th-century experiments in applied theoretical socialism—fascism and communism—were held together in practice by what could be termed crony-capitalist-like arrangements. Fortunately the “vertically collectivist”¹ and totalitarian states known as Nazi Germany and the Soviet Union finally collapsed onto the ash heap of history, with a big push from the West. They held together as long as they did only by suppression of most human rights. Free-market capitalism, by contrast, has enjoyed long periods of success in a variety of social settings.

The jury is still out on whether Chinese reformers will finally get the upper hand over China’s cronyist *nomenklatura* and “princelings,”² but many European welfare states that did not learn from their sorry history of cronyism (Greece, Spain, and Portugal, for instance) are already facing potential bankruptcy.

1. “Cronyism is most likely to occur in vertical collectivist cultures.” Naresh Khatri, Eric W. K. Tsang, and Thomas M. Begley, “Cronyism: A Cross-Cultural Analysis,” *Journal of International Business Studies*, No. 37 (January 1, 2006), pp. 61–75, at <http://www.palgrave-journals.com/jibs/journal/v37/n1/full/8400171a.html> (July 23, 2010).
2. For more about China’s “princelings,” see James M. Roberts, “Access to Information: Vital for Efficient Markets and Economic Reform,” in Terry Miller and Kim R. Holmes, *2010 Index of Economic Freedom* (Washington, D.C.: The Heritage Foundation and Dow Jones & Company, Inc., 2010), pp. 43–55, at http://www.heritage.org/index/PDF/2010/Index2010_Chapter4.pdf.

From the failed and costly takeover of the British automotive manufacturing sector by a socialist government in the 1970s to the refusal today by the Chinese government to reform its sclerotic state-owned enterprises, the record of statist policies is generally one of commercial failure and a vastly expanded, empowered, and burdensomely expensive public sector staffed by too many meddling bureaucrats.

In economically free societies everyone benefits when honest and hard-working men and women, who have confidence that they can retain the fruits of their labors, have incentives to invest and work harder. That confidence is destroyed when the economic system is controlled by a government that directs the largesse and power of the state to those with connections. This sort of corruption is the definition of cronyism.

Cronyism, Corruption, and Diminished Economic Performance. Beyond the myriad anecdotal stories available around the world, the correlation and causation between cronyism, corruption, and reduced economic performance has been robustly analyzed and established by a number of economists who have rigorously examined the phenomena from a variety of perspectives:

- In 2009, Alexander Butler, Larry Fauver, and Sandra Mortal found “a strong impact of corruption and political connections on financial market outcomes” and concluded that “state corruption and political connections have strong effects on municipal bond sales and underwriting,” and that the greater the level of “pay-to-play” corruption in any given municipality, the greater the credit risk and the higher the bond

yields and underwriting fees. Those higher bond yields translate directly into higher taxes.³

- Examining cronyism and capital controls in Malaysia, Simon Johnson and Todd Mitton concluded that “cronyism increases with capital controls” and demonstrated that “only firms previously connected to Prime Minister Mahathir experienced a disproportionate increase in stock price in September 1998”⁴ in the aftermath of the Asian financial crisis.
- In his study of corruption in South Korea relative to Taiwan and the Philippines, Jong-Sung You noted that the concentration of wealth created by “*chaebol* industrialization increased corruption over time in Korea, in comparison with Taiwan.”⁵ You found that cronyist Korean *chaebols*, the large, family-controlled, vertical monopolies established with the encouragement of South Korea’s dictator-president Park Chung Hee in the 1960s (and modeled on the pre-World War II *zaibatsu* in Japan), intended to spur rapid industrialization, but devolved into economically (and politically) destructive cronyist arrangements.
- Naresh Khatri, Eric Tsang, and Thomas Begley concluded that cronyism is “more likely to occur in vertical than horizontal cultures” and “most likely to occur in vertical collectivist cultures” and “least likely to occur in horizontal individualist cultures.”⁶ They note that “collectivist cultures value in-group relationships based frequently on kinship or other ascriptive ties” and “vertical cultures assume that people are different from one another, take hierarchy as a given, and accent status differences as well as respect for authority,” whereas “horizontal cultures value

3. Alexander W. Butler, Larry Fauver, and Sandra Mortal, “Corruption, Political Connections, and Municipal Finance,” *Review of Financial Studies*, Vol. 22 (2009), pp. 2873–2905, at <http://rfs.oxfordjournals.org/cgi/content/abstract/22/7/2873?maxtoshow=&hits=10&RESULTFORMAT=&fulltext=2009%2C+Alexander+Butler%2C+Larry+Fauver%2C+and+Sandra+Mortal&searchid=1&FIRSTINDEX=0&resourcetype=HWCIT> (July 28, 2010).

4. Simon Johnson and Todd Mitton, “Cronyism and Capital Controls: Evidence from Malaysia,” *Journal of Financial Economics*, Vol. 67, No. 2 (February 2003), pp. 351–382.

5. Jong-Sung You, “Embedded Autonomy or Crony Capitalism? Explaining Corruption in South Korea, Relative to Taiwan and the Philippines, Focusing on the Role of Land Reform and Industrial Policy,” paper delivered at the Annual Meeting of the American Political Science Association, Washington, D.C., September 1–4, 2005, at <http://irps.ucsd.edu/assets/003/5292.pdf> (July 28, 2010).

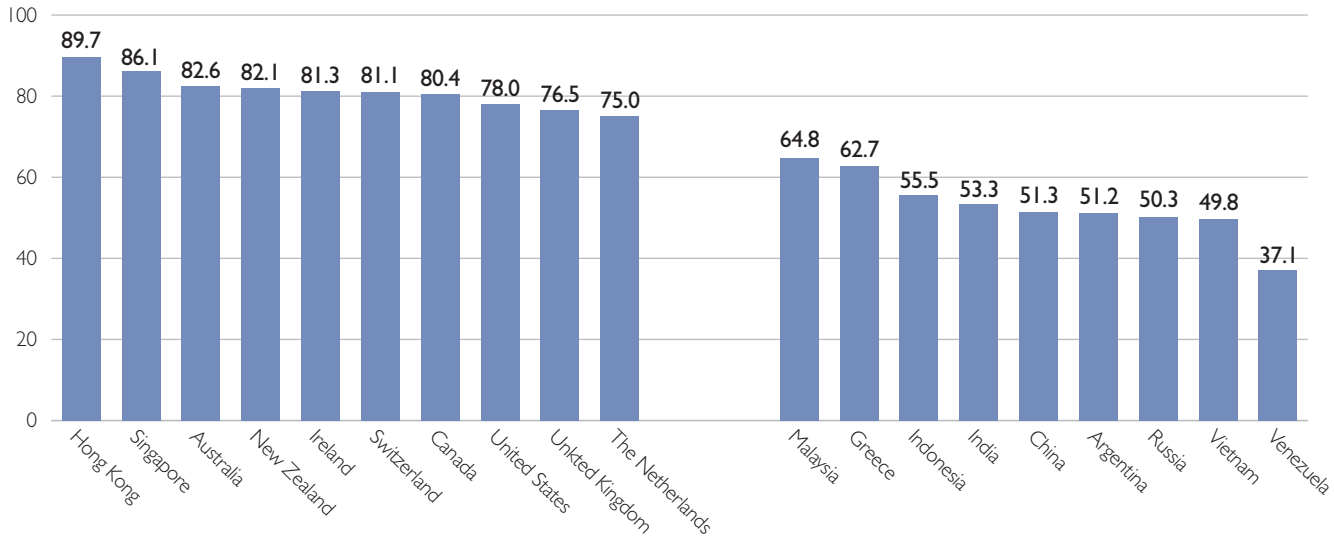
6. Khatri, Tsang, and Begley, “Cronyism: A Cross-Cultural Analysis.”

Economic Freedom in Individualist and Collectivist Nations

“Individualist” Nations

“Collectivist” Nations

Overall Score in the 2010 Index of Economic Freedom



Source: Terry Miller and Kim R. Holmes, *2010 Index of Economic Freedom* (Washington, D.C.: The Heritage Foundation and Dow Jones & Company, Inc., 2010), at www.heritage.org/index; Naresh Khatri, Eric W.K. Tsang, and Thomas M. Begley, “Cronyism: A Cross-Cultural Analysis,” at <http://www.palgrave-journals.com/jibs/journal/v37/n1/full/8400171a.html> (July 23, 2010).

Chart 1 • B 2447  heritage.org

equality, see people as similar to one another, therefore interchangeable, and minimize status and authority distinctions” and that horizontalists “want to ensure that such decisions are made by those who know the limits of their power and subject their decisions to scrutiny.”⁷

It is clear that the values and core principles enshrined in the *Index of Economic Freedom* are more in sync with the “individualists” and “horizontalists” in Khatri, Tsang, and Begley’s paradigm. They note that vertical collectivists tend toward “executive privilege under competitive conditions combined with in-group obligation in a collectivist environment” and that this “orients vertical collectivist cultures toward the highest levels of cronyism.”⁸

A graph of countries according to their *Index* ranking confirms this hypothesis. It clearly demon-

strates that “vertical collectivist countries such as Indonesia and Bangladesh rank among the most corrupt, and horizontal individualist countries such as Finland and Denmark rank among the least,” both on Transparency International’s *Corruption Perceptions Index* and on the *Heritage Index*.⁹ (See Chart 1.)

Case Studies: Cronyism Diminishes Economic Freedom

Excessive government intervention in the marketplace, both in the history of the United States and in other countries, has a sorry track record. As Representative Paul Ryan (R-WI) recently pointed out, in 1970s America “the airlines, railroads, the energy sector, trucking and bus industry were all firmly under government control. The problem was not only excessive government meddling, but large

7. *Ibid.*

8. *Ibid.*

9. *Ibid.*

established firms cooperating to protect their market share and erect barriers to new entrants.”¹⁰

Fortunately, just as Margaret Thatcher began to undo the destructive excesses of the socialist governments that preceded her in the Britain of the 1970s, Ronald Reagan arrived on the scene to roll back the over-regulation that peaked in the Carter years in the U.S. Ironically, even the late Senator Edward M. Kennedy (D–MA) favored deregulation back then and properly saw the high prices and lack of competition as hurting middle-class Americans.¹¹

For a better sense of how crony capitalist arrangements are practiced around the world today and how they produce both predictable as well as unforeseen negative consequences, it is useful to look at some case studies from the *2010 Index of Economic Freedom*.

Business Freedom in India. Countries with high levels of government spending on procurement also have the attendant overregulation and bureaucracy that are breeding grounds for corrupt business practices. Companies will be tempted (or may well be forced) to pay bribes to government officials in order to stay in business.

India’s Business Freedom score for 2010 was relatively poor, dropping from 54.4 (out of 100) the previous year to 36.3, because of India’s stifling regulatory environment, which is reflected in the lengthy procedures and delays required to obtain a business license.

Some observers believe crony capitalism is the cause of India’s poor business environment. Commenting on the extent of it, Indian newspaper columnist R. Jagannathan explains that India has a “high-cost and venal political system” where “government business almost always means corruption” and to

“benefit from it, you have to be a crony capitalist, a friend of politicians.”¹² As Jagannathan notes, “large government is invariably accompanied by crony capitalism. Reason: When government spends more, private companies do more business with it.”¹³

Another classic example of crony capitalism at work is in the government procurement sector. A recent Heritage Foundation report concluded that foreign companies win less than 1 percent of the contracts in the gigantic, government-funded Indian infrastructure construction market.¹⁴

Although the above examples of crony capitalism thriving in an atmosphere of big government spending come from India, they could well be from any number of countries around the world where business freedom has suffered as a result.

Trade Freedom in Tunisia. Increased trade and investment among an expanding group of countries boosts prosperity around the world. The resulting competition both within countries’ borders as well as internationally translates into more and better products becoming available to consumers at lower prices.

Unfortunately, crony capitalists and special interest groups in some countries push for the adoption of policies and laws that feather their own nests at the expense of their compatriots’ well-being. Tunisia’s low Trade Freedom score (53.5) is a case in point. As the *2010 Index* reported, Tunisia suffers from import restrictions, some prohibitively high tariffs, import taxes and fees, various import licensing requirements, export promotion programs, and inconsistent customs administration. All of these burdens, in addition to numerous non-tariff barriers, add to the cost of trade and reduce economic freedom in Tunisia.

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10. Paul Ryan, “Down With Big Business,” *Forbes*, December 11, 2009, at <http://www.forbes.com/2009/12/11/business-government-politics-reform-opinions-contributors-paul-ryan.html> (July 26, 2010).
 11. John Berlau, “Kennedy’s Lasting Gift to America: Airline Deregulation,” *Newsmax*, August 30, 2009, at <http://www.newsmax.com/JohnBerlau/kennedy-deregulation/2009/12/12/id/341870> (July 28, 2010).
 12. R. Jagannathan, “Big Government Means More Crony Capitalism,” *Daily News & Analysis*, September 6, 2009, at http://www.dnaindia.com/opinion/column_big-government-means-more-crony-capitalism_1287960 (July 23, 2010).
 13. *Ibid.*
 14. Derek Scissors, “Is India’s Economy Weakening?” Heritage Foundation *WebMemo* No. 2830, March 11, 2010, at <http://www.heritage.org/Research/Reports/2010/03/Is-Indias-Economy-Weakening>.

Although the Tunisian government formally abolished trade barriers on industrial products with the European Union in 2008, the Bertelsmann Foundation reports that “in practice, Tunisia has seen too little progress in terms of trade liberalization.”¹⁵ Monopolies and oligopolies are not yet well regulated, and “powerful clans and practices of crony capitalism may be increasingly watering down economic freedom.”¹⁶

Trade restrictions due to crony capitalism have resulted in Tunisia lagging behind its North African rival, Morocco, in the economic freedom rankings.

Fiscal Freedom in Sweden. Ironically, Sweden’s socialist model has gradually turned everyone in Sweden into a crony capitalist, collectively dependent on the state while individually becoming less productive. As a result, everyone is suffering from less prosperity and higher taxes. As critic Johan Norberg puts it: Sweden is “rotting from within.”¹⁷

Norberg reminds us that in the 1930s, when Swedish intellectuals Gunnar and Alva Myrdal led the movement to turn Sweden into a welfare state, Swedes had faith in their government, “the civil service was efficient and free from corruption, a Protestant work-ethic meant that people would work hard, even as taxes rose and social assistance expanded, and their work would be very productive, given Sweden’s well-educated population and strong export sector.”¹⁸

It turns out the Myrdals’ faith in the essential goodness and altruism of their fellow Swedes was misplaced. Norberg reports that Sweden’s generous social security system and a heavily regulated labor market have led to “rampant absenteeism” with about 10 percent of the workforce on disability. “In

2004, sickness benefits absorbed 16 percent of the government budget, while health absenteeism has doubled since 1998.”¹⁹

To pay for it all, today Sweden has a very burdensome income top tax rate (effectively 57 percent) and has many other taxes besides, including a value-added tax (VAT), a property tax, and a capital gains tax. As the 2010 *Index* reports, overall tax revenue as a percentage of gross domestic product (GDP) is nearly 50 percent. As a result, Sweden—a government-dependent nation full of crony capitalists who continue to vote for pay-without-work—has evolved into a collective conspiracy against economic freedom.

Government Spending in France. Further south in Europe, the French are giving the Swedes a run for their money in a race to crush economic freedom through heavy tax-and-spend policies. The 2010 *Index* reports that total government expenditures in France, including consumption and transfer payments, were very high. In 2007, the most recent year measured, government spending equaled 52.3 percent of GDP. State-owned or state-controlled enterprises dominate the electricity and rail industries. Government and semi-public companies in which the state holds shares employ approximately 25 percent of the labor force (second highest only to Sweden among OECD countries).²⁰

A good example of how massive government spending breeds cronyism can be gleaned by reviewing how the city government of Paris operated when former French president Jacques Chirac was the mayor from 1977 to 1995.

Chirac was immune from prosecution during his 14 years as president, but since leaving office in

15. Bertelsmann Stiftung, “Tunisia Country Report,” 2010 Transformation Index, at <http://www.bertelsmann-transformation-index.de/145.0.html?L=1> (July 23, 2010).

16. *Ibid.*

17. Johan Norberg, “Swedish Models,” *The National Interest* online, June 1, 2006, at <http://www.nationalinterest.org/PrinterFriendly.aspx?id=11488> (July 23, 2010).

18. *Ibid.*

19. *Ibid.*

20. Elsa Pilichowski and Edouard Turkisch, “Employment in Government in the Perspective of the Production Costs of Goods and Services in the Public Domain,” OECD, January 28, 2008, at [http://www.oecd.org/officialdocuments/displaydocumentpdf?cote=GOV/PGC/PEM\(2008\)1&doclanguage=en](http://www.oecd.org/officialdocuments/displaydocumentpdf?cote=GOV/PGC/PEM(2008)1&doclanguage=en) (July 28, 2010).

2007 has been ordered to stand trial for alleged corruption while he was mayor. Chirac is accused of using government funds “to employ 699 people as consultants,” including friends, colleagues and their relatives, political associates, and even sports stars, who received regular paychecks in exchange for their political support for Chirac during his four presidential election campaigns and for their private work for him “to build a political network across France.”²¹

Prosecutors allege that the funds for these jobs came to the city of Paris “through an elaborate web of illicit kickbacks worth millions of euros from developers, building contractors and other big businesses.”²²

Monetary Freedom in Vietnam. According to the 2010 *Index*, inflation in Vietnam has been very high, averaging 18.1 percent between 2006 and 2008. The government influences prices through regulation, subsidies, state-owned enterprises, banks, and utilities. According to the Economist Intelligence Unit, while inflation dipped in 2009, it is returning with a vengeance in 2010.²³ Further analysis reveals that a significant source of this inflation lies in Vietnam’s networks of crony capitalists.

Vietnam’s economy has boomed in recent years, but as Bill Hayton reported recently in *Foreign Policy*, the Communist Party *nomenklatura* dominates both the public and private sectors. These networking “crony socialists” control the largest state-owned enterprises through “opaque funding arrangements” and are “a threat to Vietnam’s future stability.”²⁴

Along with China and other Southeast Asian countries, Vietnam benefitted during the export boom before the 2008 financial meltdown. Under such circumstances, countries with large trade surpluses of dollars, euros, and other hard currencies would take prudent steps to avoid the “Dutch Disease” and the accompanying inflation that occurs when “currency inflows lead to currency appreciation, making the country’s other products less price competitive on the export market...[leading to] higher levels of cheap imports and...de-industrialization as industries apart from resource exploitation are moved to cheaper locations.”²⁵

If Vietnam’s crony socialists who control the government were the genuine socialists they purport to be they would have taken very well known and prudent steps to “sterilize” the hard currency export earnings to protect the vast majority of poor and middle income Vietnamese from the ravages of inflation (2009 per capita GDP in Vietnam is \$835).²⁶

As economists Alain de Janvry, David Roland-Holst, and Elisabeth Sadoulet of the University of California at Berkeley note, sterilization by depositing the dollars, euros, and other revenue “in a foreign account or buying U.S. Treasury bonds instead of repatriating them” is a difficult political move requiring “a strong government that has the authority to postpone consumption based on these foreign currency earnings.”²⁷ The Chinese government has shown itself capable of this discipline, but the Vietnamese *nomenklatura* apparently has not.

21. Adam Sage, “Jacques Chirac Ordered to Stand Trial over Paris Sleaze Claims,” *The Sunday Times*, October 31, 2009, at <http://www.timesonline.co.uk/tol/news/world/europe/article6896675.ece> (July 23, 2010).

22. Genevieve Roberts, “History Made as Chirac Is Told to Stand Trial,” *The Independent*, October 31, 2009, at <http://www.independent.co.uk/news/world/europe/history-made-as-chirac-is-told-to-stand-trial-1812278.html> (April 28, 2010).

23. Economist Intelligence Unit, “Vietnam Economy: Inflation Fears,” March 18, 2010.

24. Bill Hayton, “Vietnam’s New Money,” *Foreign Policy*, January 21, 2010, at http://www.foreignpolicy.com/articles/2010/01/21/vietnams_new_money (July 23, 2010).

25. *Financial Times Lexicon*, “Dutch Disease,” 2009, at <http://lexicon.ft.com/term.asp?t=dutch-disease&ftauth=1272657504506> (July 23, 2010).

26. Grant McCool, “Vietnam Endures Highest Inflation Rate in a Decade,” *The New York Times*, February 8, 2008, at http://www.nytimes.com/2008/01/28/business/worldbusiness/28iht-dong.1.9543296.html?_r=2 (July 23, 2010).

27. Alain de Janvry, David Roland-Holst, and Elisabeth Sadoulet, “International Finance and Development: Exchange Rates and Foreign Capital Flows,” University of California at Berkeley, October 9, 2009, p. 13, at http://are.berkeley.edu/courses/ARE253/fall2009/papers/Chapter_12_RER-09.pdf (July 23, 2010).

Investment Freedom in Malaysia. Although the 2010 *Index* found that foreign investment is welcome in certain sectors in Malaysia, and some domestic equity requirements have been eliminated, nearly all capital transactions are subject to restrictions or require government approval. Regulations are burdensome and non-transparent.

This uneven playing field favoring politically connected domestic investors over potential foreign investors is symptomatic of the crony capitalism that afflicts Malaysia today. The U.S. State Department's 2010 Investment Climate Statement explains one aspect of it. Malaysia's "complex network of racial preferences to promote the acquisition of economic assets by ethnic Malays and other indigenous groups (*bumiputera*)" has evolved into a "significant impediment to Malaysia's economic growth" that allows the wealthy and well-connected to have "the lion's share of the benefits. The resulting economic distortions in the property, labor, and stock markets inhibit growth and deter both foreign and domestic investment."²⁸

There are other rent-seeking groups in Malaysia, too. Powerful families in some of the provinces restrict the freedom of entry into the local market. For example, during his 28-year rule, the chief minister of the state of Sarawak, Abdul Taib Mahmud, has had complete control over the grant of concessions for hydroelectric and other mega-projects. According to Bloomberg's Yoolim Lee, "at least four prominent Sarawak companies that have received contracts or concessions have ties to Taib or his family."²⁹

Other restrictions on investment in Malaysia are imposed through the issuance of licenses, approved permits, contracts and the manipulation of regulations. Kunio Yoshihara, an expert on Southeast

Asian economies, reports that 50 years of Malaysian cronyism have produced an "entrepreneurially weak, *ersatz* capitalism."³⁰

The monopoly rents that are created from such distortions reflect a diversion of value from the consumers to the favored rent-seeker. Such practices by the government have sparked intense political competition among rent-seekers for the attention and favor of political elites and bred still more crony capitalism with its negative consequences on overall economic competitiveness.

Financial Freedom in Argentina. In the seven years since President Cristina Fernández de Kirchner and her husband, former president Nestor Kirchner, took power in Argentina, economic freedom as measured by Argentina's rankings in the *Index* has declined steadily. As Charles Krauthammer summarized it, Argentina is "a chronically unstable, endemically corrupt polity with a rich history of dictatorship, economic mismanagement and the occasional political lunacy."³¹

The relentless drop in Argentina's score is due to, among other things, the Kirchners' failure to protect private property and fight corruption coupled with their embrace of Argentina's long-standing tradition of cronyism, whose roots date back to the 1940s and the dictatorship of Juan Peron. Argentina's diminished financial freedom reflects severe institutional weaknesses, including onerous regulations, corruption, and a weak judiciary. Argentina's largest bank, Banco de la Nación, is state-owned and the only financial institution available in some areas of the country. International banks that have returned since the 2001 default have not recovered their former prominence. Capital controls remain in place.

This weak performance is also the result of asymmetric and generally poor policy decisions

28. U.S. Department of State, "2010 Investment Climate Statement: Malaysia," March 2010, at <http://www.state.gov/e/eeb/rls/othr/ics/2010/138774.htm> (July 23, 2010).

29. Yoolim Lee, "Getting Rich in Malaysia Cronyism Capital Means Dayak Lose Home," Bloomberg, August 24, 2009, at <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aBC4ld4jmdV4> (July 23, 2010).

30. Nicholas J. White, "The Beginnings of Crony Capitalism: Business, Politics and Economic Development in Malaysia," c. 1955–70," *Modern Asian Studies*, Vol. 38, No. 2 (2004), pp. 389–417. See also, Kunio Yoshihara, *Building a Prosperous Southeast Asia: From Ersatz to Echt Capitalism* (New York: Routledge, 1999).

31. Charles Krauthammer, "Disrespecting Foreign Allies," Real Clear Politics, April 2, 2010, at http://www.realclearpolitics.com/articles/2010/04/02/slapping_friends_105025.html (April 2, 2010).

by a domineering executive branch that has run roughshod over Argentina's civil society and fragile democratic institutions that had been strengthened after some limited reforms in the 1990s. In late December 2001, while the world was still distracted by the aftermath of 9/11, Argentina declared a default on its massive sovereign debt—the largest such default in world history. Since then, the Kirchners have essentially adopted a “take-it-or-leave-it” stance toward any foreign creditors (“holdouts”) who refuse to accept their offer of a 70 percent “haircut” on the debt.³²

The intransigence of the Argentinean government toward the holdouts, while perhaps attractive politically for the Kirchners *vis-à-vis* their supporters, has been costly to the government in other ways. Argentina's reputation among global investors has deteriorated and its borrowing costs have increased.³³ Nevertheless, although already highly indebted, cut off from international credit markets, and facing declining commodity prices, the Kirchners have been determined to maintain an unsustainable level of government spending. So, in the fall of 2008, they seized \$30 billion in 401(k)-type private pension accounts belonging to individual Argentine citizens.

An egregious recent example of the Kirchners' heavy-handed, increasingly autocratic rule was their *de facto* takeover earlier this year of the formerly independent Central Bank of Argentina.

The subordination of the Central Bank epitomizes the unhealthy growth of the role of the state under the Kirchners. It has further alienated the country's productive sector and has ramped up fresh concern among investors about Argentina's long-term viability. Overall, financial freedom in Argentina is shrinking and remains constrained by government influence, political interference with an inefficient judiciary that hinders foreign investment, and other official and informal obstructions to due process imposed by government officials.

Property Rights in Russia. The 2010 *Index* accurately describes protection of private property in Russia as “weak.” The judicial system is unpredictable, corrupt, and unable to handle technically sophisticated cases. The country's own president, Dmitry Medvedev, a law professor by training, repeatedly admitted as much.

Contracts are difficult to enforce, and an ancient antipathy to them continues to impede foreign investment and Russian integration into the West. Mortgage lending remains underdeveloped and violations of intellectual property rights continue to be a serious problem.

Twenty years after the collapse of the Communist utopia, Russia is still suffering from a hangover after the brutal, giddy but doomed attempt by Marxist–Leninist dictators and their massive party and repressive apparatus to create a Soviet Union based on a socialist system in which the market and private property were to be abolished and the state would create and (equitably) distribute all wealth. Noted Soviet scholar and critic Martin Malia has accurately described that fool's errand as not only “inherently impossible” but also an “assault on reality.”³⁴

Old habits die hard. Ex-communist spies who are running Russia expropriated and destroyed YUKOS, the most transparent and successful energy company there. Its owner, Mikhail Khodorkovsky, and his staff are facing a second trial for crimes most observers agree he never committed nor physically could have committed. Even Vladimir Putin's own former and current ministers testified as much.

Writing about a recent visit to Moscow, Anders Aslund of the Peterson Institute for International Economics reported that while Putin's and his KGB kleptocracy's crony capitalism worked well enough while oil prices were rising, Putin's distribution of Russia's oil rents created “neither moral nor economic value.”³⁵ Now that oil prices have fallen from their 2008 highs, the many flaws in Putin's cronyist economic model have been exposed.

32. Martin Krause and Aldo Abram, “CIIMA/ESEADE Study on Foreign Direct Investment,” Argentine Institutions and Markets Research Centre at ESEADE business school, Buenos Aires, October 2007.

33. *Ibid.*

34. Martin Malia, *The Soviet Tragedy: A History of Socialism in Russia, 1919–1991* (New York: The Free Press, 1994), pp. 225, 313.

In his second term as president (2004–2008), Putin routinely violated private property rights, confiscating and re-nationalizing large formerly state-owned corporations that had been privatized after the fall of the Soviet Union. Putin put his old KGB cronies and other state officials in charge of Gazprom, Transneft, Rosneft, Russian Technologies, state banks, and other large firms.

Putin's old buddies may have been successful as spies, but they have made a hash of these businesses. As Aslund notes, "These big state corporations accounted for much, if not all, of the decline in Russia's GDP last year. Their leaders do not know how to run a company, which leads to poor financial results, huge state subsidies, miserable services and enormous corruption."³⁶ Medvedev made his assault on state-run corporations a hallmark of his presidency, even calling for their privatization, but due to his political weakness, so far he has accomplished little.

Freedom from Corruption in Venezuela.

Although Venezuela has been plagued by corrupt governments since its founding in 1821, the intrepid and well-informed analyst of Venezuelan politics Gustavo Coronel has documented that since President Hugo Chávez took power in 1999, "corruption has exploded to unprecedented levels. Billions of dollars are being stolen or are otherwise unaccounted for, squandering Venezuelan resources and enriching high-level officials and their cronies."³⁷

According to Coronel's findings, by 2008 "the total income of Venezuela during Chávez's presidency has been approximately \$700 [billion]. This

formidable amount of money is nowhere to be seen in terms of public works or effective health and education programs," but "national debt has increased from \$22 [billion] to about \$70 billion."³⁸

Indeed, the 2010 *Index* finds that corruption in the Venezuelan government is rampant. Venezuela ranks 162nd out of 180 countries in Transparency International's *Corruption Perceptions Index* for 2009.³⁹ Government tenders are vulnerable because the process frequently lacks transparency. Critics allege that price and exchange controls, government and military officials' involvement in narcotics trafficking, and kickbacks on major weapons purchases are sources of corruption.

Tragically, corruption in Venezuela under Chávez and his cronies has extended far beyond traditional graft, kickbacks, and theft of government funds. As *The Washington Post* reports, in late December 2009, "the Inter-American Commission on Human Rights (IACHR) issued a searing and authoritative report on the destruction of Venezuela's political institutions and the erosion of freedom under President Hugo Chávez."⁴⁰

The IACHR report details the many actions the Chávez regime has taken not only to destroy Venezuela's independent judiciary, impose totalitarian controls on press freedom, strip opposition elected officials of power, and use "bogus criminal charges to silence human rights groups," but also employing "violence and murder" to preserve and strengthen Chávez's grip on power.⁴¹

"The report documents killings of journalists, opposition protesters and farmers; it says that 173 trade union leaders and members were slain

35. Anders Aslund, "The Death of Putin's Crony Capitalism," *Jakarta Globe*, February 28, 2010, at <http://www.thejakartaglobe.com/opinion/the-death-of-putins-crony-capitalism/361150> (July 23, 2010).

36. *Ibid.*

37. Gustavo Coronel, "Corruption, Mismanagement, and Abuse of Power in Hugo Chávez's Venezuela," Cato Institute, *Development Policy Analysis* No. 2, November 27, 2006, at http://www.cato.org/pub_display.php?pub_id=6787 (July 23, 2010).

38. Gustavo Coronel, "The Corruption of Democracy in Venezuela," *USA Today Magazine*, March 2008, at http://www.cato.org/pub_display.php?pub_id=9254 (July 23, 2010).

39. Transparency International, *Corruption Perceptions Index 2009*, at http://www.transparency.org/policy_research/surveys_indices/cpi/2009/cpi_2009_table (July 23, 2010).

40. "Report Details Violence and Lost Freedoms in Venezuela," *The Washington Post*, March 1, 2010, at http://www.washingtonpost.com/wp-dyn/content/article/2010/02/28/AR2010022803492.html?wpisrc=nl_opinions (July 23, 2010).

41. *Ibid.*

between 1997 and 2009 ‘in the context of trade union violence, with contract killings being the most common method for attacking union leaders’⁴² that are carried out by ‘officers from different state security agencies’⁴³ and ‘radical groups allied with Mr. Chávez.’⁴⁴

Meanwhile, Chávez and his henchmen are destroying what is left of Venezuela’s economy and oil sector with their mismanagement. In the past two years, a drought has highlighted the inept management by the government of Venezuela’s once-abundant hydroelectric resources.⁴⁵ Responding to a nationwide meat shortage, Chávez recently ordered the arrest of butchers.⁴⁶

In short, Venezuela in 2010 is a stark reminder to the world of where the crony corruption highway leads: to violence, poverty, and a complete loss of freedom.

Labor Freedom in Greece. A brief analysis of the role of public-sector unions in the Greek economy provides a fitting way to comment on the deleterious effects of such cronyist gangs on economic freedom. The Organisation for Economic Development and Co-operation (OECD) reports that the cost of government in Greece consumes 40 percent of GDP.⁴⁷ As the 2010 *Index* found, Greece’s restrictive labor regulations hinder employment opportunities and productivity growth. The non-salary cost of employing a worker is high, and regulations on the number of work hours have been rigid.

A competitive, merit-based labor market forces both employers and employees to strive to be the

best, every day, and creates a more efficient and prosperous economy. However, powerful unions that impose ‘closed shop’ rules on employers cut off information about jobs from potential applicants and do great damage to the economy and to economic freedom. They may also seek to deny or obscure performance information that should drive wages, as happens when teachers unions in the U.S. oppose independent testing of student accomplishment. While ‘featherbedding’ rules that limit access to jobs are great for union members, they often mean that non-union workers who might turn in a better, more innovative job performance are denied the opportunity to try.

Nevertheless, Greece and much of Western Europe have generally followed what economist Robert Litan calls ‘managerial capitalism’ or the ‘Galbraithan economy’ model centered on ‘big labor, big unions, big government and big firms.’⁴⁸ In the case of Greece and the enormous role of the public sector in its economy, another of Litan’s relevant models is ‘state-guided capitalism,’ where governments ‘enlist the helping hand of the state’ to guide ‘resources to industries and firms that are believed to have the best chance of copying and out-competing firms on the bottom rungs of the economic ladders elsewhere.’⁴⁹ In other words, the government picks winners and losers.

In the case of Greece in 2010, everyone is turning out to be a loser as Greece faces a sovereign debt default brought about by too much spending over too many years by a long series of socialist governments. The people angriest about it, the public-sec-

42. *Ibid.*

43. Inter-American Commission on Human Rights, ‘Democracy and Human Rights in Venezuela,’ December 30, 2009, p. 15, at <http://cidh.org/pdf%20files/VENEZUELA%202009%20ENG.pdf> (July 23, 2010).

44. ‘Report Details Violence and Lost Freedoms in Venezuela,’ *The Washington Post*.

45. Gregor MacDonald, ‘Hugo Chavez’s Venezuela Is Now Just Another Failed Petro-State,’ *Business Insider*, January 21, 2010, at <http://www.businessinsider.com/hugo-chavez-s-venezuela-is-now-just-another-failed-petro-state-2010-1> (July 23, 2010).

46. ‘Hugo Chavez’s Response to Beef Shortage: Arrest Butchers,’ *CNBC*, July 23, 2010, at <http://www.cnbc.com/id/37023580> (July 23, 2010).

47. OECD, ‘Country Note: Greece,’ *Government at a Glance 2009*, October 22, 2009, at <http://www.oecd.org/dataoecd/5/52/44125050.pdf> (July 23, 2010).

48. Robert E. Litan, ‘Innovation and the World Economy: The Second Annual Rocco Martino Lecture on Innovation,’ *Foreign Policy Research Institute*, December 2009, at <http://www.fpri.org/enotes/200912.litan.innovationworlddeconomy.html> (July 23, 2010).

49. *Ibid.*

tor unions whose members have been enjoying the taxpayer-subsidized and debt-subsidized free ride to their retirements at age 53 with full benefits and inflation-protected pensions, are the ones rioting in the streets to demand that they not be forced to sacrifice for the good of the country.

What the U.S. and Other Governments Should Do

Cronyism is a form of deviant economic behavior that sucks the fairness, competition, and vitality out of capitalist systems everywhere. Various types of cronyism are reducing economic freedom in every area measured by the *Index of Economic Freedom*. Those who would defend the free market and aspire to reap its highest rewards must reject all forms of cronyism and insist on policies that empower individuals, avoid discrimination, and ensure open and fair competition for all.

The large expansion of the role of government in the U.S. economy over the last year has included major policies and expenditures that favor special interest groups and those with strong political connections to President Obama or the Democratic Party. Such favoritism is the very definition of cronyism, and will, if unchecked, retard growth and destroy confidence in the U.S. economic system for years to come. Urgent action is needed to restore the even-handedness and fairness of government expenditures, and to roll back and eliminate special interest funding.

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