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Richard D. Newbold

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Introduction

The real beneficiaries of free markets are consumers and ordinary workers, but they unfortunately lack the political clout of Big Business (Friedman, 1991). Government economic intervention can lead businesses to curry favor with government officials in an attempt to limit competition, which is the ultimate goal of crony capitalism. In turn, taxpayers are forced to sponsor this behavior in the form of increased taxes or additional debt. This paper will highlight key economic interventions and the multiple facets of crony capitalism as engendered by statist economic interventions. Finally, the paper will evaluate statist intervention and speculative finance in the context of the Biblical model of economic statesmanship.

Crony Capitalism

Government intervention can take many forms, including monopoly grants, preferential licenses, preferential subsidies that provide cheaper capital and credit, and protection from competition through tariffs (Aligica, 2014). Substantial government intervention was a common response during the global financial crisis as governments often not only provided liquidity but took equity stakes in floundering institutions. Such interventions were generally unpopular and led to public anger and resentment, especially when state action was followed by austerity measures (Igan, et al, 2019).

Special interest groups expend enormous resources convincing government to utilize its monopoly power to divert the nation's wealth in their direction. If lobbying costs are lower than the benefits received, interest groups will continue this diversion away from productive activities with a net societal gain toward spending with an eye toward wealth redistribution (Zywicki, 2016). While the 2008 financial crisis seemed to appear out of thin air, it had been a long time

coming. During the Reagan administration, savings and loan charters were liberalized, and deregulation encouraged traditional mortgage lenders to foray into commercial real estate and high-yield bonds, areas outside of their core competencies (Stockton, 2013, 405). While the financial crisis did not originate in financial deregulation or loose monetary policy, it was enabled by both (Rasmus, 2009). As the 2008 financial crisis ensued, financial firms significantly increased their lobbying and campaign spending. Not surprisingly, the largest political spenders received, on average, the biggest bailouts. It is clear that favored banks benefited due to their proximity to those in positions of power. The experience of the financial crisis shows that being close to the right people is even *more* important during times of crises than in normal times (Vukovic 2021).

The term "crony capitalism" has become a catch-all phrase for the public's acknowledgment that something within our free-market capitalist framework has gone very much awry. More formally, the Oxford Dictionary defines crony capitalism as "an economic system characterized by close, mutually advantageous relationships between business leaders and government officials" (Oxford, 2022). With cronyism, markets are maintained but resource allocation (and corresponding profit or loss) is determined by politics rather than by consumer choice and free market forces. Activities are directed by government spending and regulation, and businesses support politicians to compete for government favors (Gwartney, 2018).

According to renowned economist Milton Friedman, businesspeople are prone to engage in crony capitalism and generally are enemies of free markets, eagerly lobbying for tariffs, tax deductions, and subsidies. Special interest groups contribute to market distortion in a case of tyranny of the minority. Friedman laments that there is no mechanism in the public sector for recognizing errors and correcting them. When private organizations make bad decisions, they are

forced out of business by market forces, whereas the public sector is often rewarded with additional resources to dedicate to the problem (Friedman, 1991).

In countries like the U.S. that enjoy an established rule of law, crony capitalism restricts entry and competition for rents created for political purposes. As such, crony capitalism is likely *worse* than normal rent-seeking in that it allows rents to be maintained at consistently high levels over time. Crony capitalist exchanges are based on loyalty, trust, and family connections. The most consequential cronyism occurs among the upper class, the political class, and large firms. The term "bribery," meanwhile, is reserved for administrators, small businesses, and other lesser elements of society (Aligica, 2014).

Although it manifests differently around the globe, crony capitalism in the domestic context refers to a political-economic regime resembling traditional political corporatism[1]. It describes how entrenched interest groups such as labor unions join forces with Big Business to promote mutual interests. At the same time, these favored interests enjoy protections[2] and subsidies in exchange for support in carrying out (often broadly unpopular) government policies. Distinguished from political rent-seeking, where businesses take advantage of government to promote their own interests in exchange for political support, the model of crony capitalism involves politicians and regulators using private industry to serve their own political interests. In this cozy relationship, rents are created by government and distributed back to itself and its favored interest groups. Interrelationships during the economic crisis and subsequent legislative

[1] Corporatism is "a system where businesses are privately owned, but there is a comprehensive intertangling of government and private industry, such that the success of various firms or industries is closely tied to government and government frequently uses private industry to directly or indirectly accomplished preferred political goals" (Zywicki, 2016).

[2] Tesla is perhaps the quintessential case study in crony capitalism and state economic protectionism, highlighting the potential for political capture resulting in higher prices and reduced consumer choice (Crane, 2016).

process illustrate the differences between mere rent-seeking and the even more corrosive crony capitalism. The prospect of systemic reform is unfortunately slim unless constitutional structures can be emplaced which guard against such a mutually reinforcing mechanism (Zywicki, 2016).

Rent-Seeking

"Rent-seeking" is a term created by economist Gordon Tullock describing the process by which organized interest groups seek government favors (Tullock, 1967). It involves actions by groups as well as individuals who attempt to reorder public policy in a way that redistributes more income back to themselves and the projects they are promoting (Gwartney, 2018). Rent-seeking involves the acquisition of influence and can take on any of several forms such as lobbying, campaign contributions, and corruption (Stiglitz, 2012; Drazen, 2000). The term implies a misallocation of resources leading to societal incursion of productivity and welfare loss. A prerequisite for such malbehavior is the institutional failure of ill-defined and improperly protected property rights that allow for the creation and existence of pools of contestable prizes which entice self-interested parties (or their agents) to join in the rent-seeking game (Angelopoulos, 2021).

Rent-seeking subverts the workings of internal capital markets and increases the bargaining power of certain individuals and corporations. It allows conglomerates to cross-subsidize unprofitable divisions and support pet projects that generate a disproportionately high income for corporate executives (Sharfstein, 2000). In the U.S., lobbyists and third-party agents play a key role by securing additional benefits for rent-seekers (Igan & Lambert, 2019; Hasen, 2012). Expert intermediaries provide legal and financial advice and even mediate with policymakers to influence decisions in favor of clients they represent. The more complex the

policy area, the greater the opportunity for rent-seeking and lobbying (Angelopoulos, 2021). Financial services is certainly an area that lends itself to having an outsized role for intermediaries. According to an analysis from the Center for Public Integrity, special interest groups spent over $1.3 billion to hire more than five lobbyists per Congressmember in an effort to influence pending financial regulatory reforms. The 3000+ lobbyists worked at the behest of banks, hedge funds, and associations to either weaken or eliminate bank and capital market reforms (Pell & Eaton, 2010).

Speculative Financing, Debt Leverage, and State Intervention

Speculation is a term often associated with gambling—and for good reason. The true cause of the 2008 crisis stems from the changing nature of financial capital in the latter twentieth century and the movement of capital toward more speculative investments, as illustrated by the large U.S. debt runup followed by deflationary unwinding, a credit contraction, and a subsequent recession (Rasmus, 2009). Financial fragility is a fixture of the U.S. economy, and banks by nature are speculative enterprises. However, not all speculative action is detrimental, and the credit intermediation function of banks dictates how much speculation is "acceptable" (Boro, 1986).

Research has shown that political institutions may have built-in biases that favor the interests of certain classes. The "capital-dependence" theory posits that state managers are constrained by a need to create private investment that ensures job creation and viable tax base along with their own political relevance. This reality creates structural pressures to adopt a pro-business posture, especially in light of the increasing mobility of capital (Jenkins, et al, 2006). Structural changes in the economy have positioned many to be able to vote with their feet and

flee to low tax and less regulated environments. This newfound mobility may actually serve to reduce state intervention as forum shopping becomes more popular and smaller businesses gain leverage. That potential leverage, of course, decreases for firms with large (immovable) capital investments[3].

In the midst of a financial crisis, highly leveraged firms invest and consume less due to uncertainty regarding future demand. At the same time, consumer credit becomes tighter. At the outset of a crisis, subprime borrowers are forced to reduce consumer spending due to the loss of value of pledged assets—usually their homes, perhaps in the form of a home equity line of credit. It is then usually the case that households reduce spending and prioritize savings, realizing they will no longer be able to borrow to fill in home budget shortfalls. The consumer crisis then spreads from the financial sector throughout the entire economy (Jucá & Fishlow, 2021). It is often at such times that politicians are pressured to intervene.

There was plenty of blame to go around during the financial collapse, and there were other detrimental factors in addition to banking greed. There was also widespread doubt regarding the credibility of bond ratings attached to mortgage-backed securities, and the various valuation methods created confusion in the markets since no one really knew the numbers on others' balance sheets. Short-term liquidity froze, and MBS trading stopped, resulting in a systemic crisis. One of the bank-related controversies involved mortgage pool pricing and overvaluation. In a normal economy, these pools would be quite liquid, however they are difficult to price when they suddenly become illiquid (Sanders, 2009). This creates a problem for firms trying to pledge mortgage pools as collateral.

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[3] Large manufacturing plants, for example, would be more difficult and expensive to relocate to a low tax environment. However, an internet startup operated from an apartment could easily benefit from a more "business friendly" environment.

Liquidity uncertainty has been an issue percolating for decades. A 1995 Basel Capital Accord[4] amendment mandated that large financial institutions pay greater attention to market and liquidity risks. The 2009 Supervisory Capital Assessment Program (SCAP) was the first exercise for U.S. banks and became the impetus for the recapitalization of the largest bank holding companies (BHC). Stress testing exercises are currently implemented under Comprehensive Capital Analysis and Review (CCAR)[5] and Dodd–Frank Act Stress Testing (DFAST) regimes (Calem, et al, 2020). One of the stress testing rules[6] generally requires certain institutions to conduct stress tests once every two years. Another stress testing rule[7] requires certain institutions to publish a stress test results summary (OCC, 2022). Stress testing was a new term for Americans when Treasury Secretary Tim Geithner made his rounds on the Sunday talk circuit, and the opaque process did little to calm fears at the time.

The government felt a need to reassure the country and the world that banks were no longer in crisis and were indeed strong, and the U.S. stress tests became a central part of the supervisory framework. The tests were "complex exercises involving scenario design, extensive data gathering, close interaction between banks and supervisors, repeated assessment of the internal models and assumptions, careful calibration, and timely disclosure of the results." However, there is ongoing debate regarding the ability of the tests to increase banking transparency (Petrella & Resti, 2013). The stress test report released in 2009, for example,

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[4] International Convergence of Capital Measurement and Capital Standards (1988). Available at https://www.bis.org/publ/bcbs04a.pdf.

[5] The CCAR is "an annual exercise by the Federal Reserve to assess whether the largest bank holding companies operating in the United States have sufficient capital to continue operations throughout times of economic and financial stress and that they have robust, forward-looking capital-planning processes that account for their unique risks." https://www.federalreserve.gov/supervisionreg/stress-tests-capital-planning.htm.

[6] 12 CFR 46.5 – Stress Testing. https://www.ecfr.gov/current/title-12/chapter-I/part-46/section-46.5

[7] 12 CFR 46.8 – Publication of Disclosure. https://www.ecfr.gov/current/title-12/chapter-I/part-46/section-46.8. In accordance with this provision and applicable exceptions, "covered institution must publish a summary of the results of its stress test in the period starting June 15 and ending July 15 of the reporting year."

offered scant details regarding the underlying health of the subject banks, and the list of stress tested banks was not disclosed (Ellis, 2009). If the results were bad, it would have made sense to not disclose the results in order to not further spook the market. What many at the time suspected was that favored banks had received multiple billions in liquidity injections yet were still not able to pass the stress tests, which would have confirmed administration policy failures.

As the crisis was building, regulators acted to ensure the largest banks had enough capital to survive additional losses (Cornett, et al, 2020). The Federal Reserve notes that capital is important to banks and the economy overall because it "acts as a cushion to absorb losses and helps to ensure that losses are borne by shareholders, not taxpayers." Former Federal Reserve Governor Daniel Tarullo stated in 2015 that "supervisory stress tests are designed to ensure that these banks have enough capital that they could continue to lend to American businesses and households even in a severe economic downturn" (Federal Reserve, 2015). So, at least in theory, the recent financial catastrophe will never again be repeated due to strong, helpful decisive interventions and follow-up activities of the Treasury and Federal Reserve. Only time will tell.

The Fed has historically provided backup liquidity to healthy depository institutions but in this case also provided liquidity to nonbank financial institutions (Kohn, 2010). Liquidity means banks have enough assets (although ironically not necessarily in liquid form) to cover debts as well as withdrawals. Insolvency means banks do not have enough assets to begin with. Critics counter that the Fed's liquidity strategy failed in part because the crisis was one of solvency crisis and *not* liquidity. The solvency situation expanded into a broader crisis of confidence throughout the entire financial system. Enhancing liquidity cannot work when assets collapse faster than the rate of liquidity injection (Rasmus, 2009), which was the case here.

One major cause of the housing bubble was the Fed's interest rate policy starting in 2001 that artificially suppressed the federal funds rate (McDonald, 2011). Risky subprime mortgages given to otherwise unqualified individuals drove economic growth—particularly in construction and real estate—as consumers took advantage of $2 trillion in home equity loans and refinancing (Tully, 2006). As home prices began to fall and defaults increased, Wall Street stopped purchasing lucrative albethey riskier mortgages. Fear gripped the markets, resulting in liquidity problems for financial institutions that otherwise had not been trending toward insolvency. Banks then started to default on their loans, which continued the downward spiral that gripped the global economy in 2008 (Reavis, 2012). The financial crisis is a classic case of well-intentioned policies leading to systemic risk and—as a final insult—causing a massive diversion of public funds to a handful of well-positioned private institutions.

With the benefit of hindsight, research has shown that leverage and debt service burden are really two sides of the same coin in that they both effect credit, investment, consumption, and aggregate asset prices. During a "growthless credit boom" brought about by negative leverage combined with a positive debt service burden gap, the growth enhancing effect of credit growth combined with the growth reducing effect of increased debt service burdens work at odds to push demand in opposite directions—the net effect being near zero output. When the debt service burden continues to increase, negative effects overtake any positive effects as assets implode and recession enters the picture. In the years leading up to the financial crisis, these conditions should have served as a warning to the Fed and policymakers who were instead focused on the standard measure of output growth (Juselius & Drehmann, 2020). Over a decade hence, there are still lessons to be learned, and it seems the more we learn the less we understand about how complex markets function. Experts are consistently surprised and confounded. Economists generally have

a horrible track record at predicting, which makes one wonder why they are so heavily relied upon to provide predictions that support and in many cases drive public policy.

Biblical Worldview and Integration

Crony capitalism is a dangerous alliance between Big Government and Big Business, representing the opposite of a free market system. It seeks to limit existing competition while precluding new competition with the goal of increasing profits at the expense of consumers. Government bailouts disincentivize incorrect choices and protect and distort markets, which tend to become more efficient over time in a capitalist environment. Government has a divine mandate at times to regulate business such as in the case of contract protection and enforcement. However, regulation provides an opportunity for favoritism and regulatory capture when the government over relies on industry experts to the detriment of in-house government expertise (Fischer, 2018).

For as long as government has existed, there has been what we today would call crony capitalism. Friends and associates of government officials have always sought to capitalize on their influence for personal financial gain. For example, in ancient Israel the Bible speaks of the corrupt action of the prophet Samuel's close relation: "And his sons walked not in his ways, but turned aside after lucre, and took bribes, and perverted judgment" (1 Samuel 8:3, KJV). When the elders of Israel asked Samuel for a king, God spoke to Samuel warning of the effects of cronyism: "And [the King] will take your fields, and your vineyards, and your oliveyards, even the best of them, and give them to his servants. And he will take the tenth of your seed, and of your vineyards, and give to his officers, and to his servants" (1 Samuel 8:14-15, KJV).

Human nature being as it is, regulators may favor one industry player over another. What we witnessed in 2008 was excessive debt leverage and investment strategies unrelated to market launches of new products and services (Fischer, 2018). Debt leverage was discovered to be the key risk factor affecting the economy, despite the increased influences of a "jobless" recovery and other macroeconomic factors (Murray, 2010). The low interest rate environment resulting from Federal Reserve monetary policy exacerbated the problem, because it became less expensive to gamble. The decision to approve loans for economically disadvantaged buyers—who otherwise would not have qualified for loans—resulted in a government bailout of government sponsored entities who, until their near collapse, had enjoyed private sector returns because of their ambiguous status. In the end, the experts convinced politicians the GSEs had to be bailed out to save the broader economy, which turned out not to be the case. The monsters from the Great Recession may rear their heads sooner than we think, because many banks have not learned any lessons. Regulation, meanwhile, has been largely ineffective, is complex, and is difficult to understand. None of this leads to justice, stability, or economic freedom. Protections for Wall Street exclusively is unjust and has resulted in exploitation of taxpayers, which is the essence of crony capitalism. Economic statesmanship would not support this behavior (Fischer, 2018).

Government has the responsibility to create a level playing field for all participants, which makes creeping crony capitalism so pernicious. A powerful central government teamed with large business interests serves to multiply the threats to the average citizen when competitors can directly or indirectly influence what should be a private business decision. Businesses today know that government action lurks in the background of nearly every business decision. Today we know that private businesses can be shuttered for reasons we had perhaps not

previously considered. A businessman today who disobeys a licensing requirement or mask mandate, or one who ignores a warning not to merge with another company, will likely first receive a polite letter followed by a less polite one—which will be inevitably followed by the arrival of men with uniforms, badges, and guns. In other words, government is predicated on the threat of violence, which is anathema to libertarian principles (Block, 2019).

Conclusion

The dual financial and debt crises have diminished confidence in our economic system and undermined the West's economic dominance. Restoring economic incentives and reducing socialist spending should be a public priority (Creighton, 2013). Perversely, ineffective financial regulators and policymakers have benefited by coming away from the crisis with increased budgets and larger staffs. Banks meanwhile continue to profit from state-guaranteed deposits and low-interest borrowing (Creighton, 2013). Rent-seeking activity that favors elites associated with higher sociopolitical power, relative wealth, and insider positions (Angelopoulos, 2021) should be eliminated in order to achieve justice and equality.

Capital today is increasingly mobile, which scares politicians who are aggressively attempting to track and control every facet of our lives through our financial transactions. If crony capitalism were reduced or eliminated in the U.S., we would witness enormous capital inflows—because everyone else knows the terrible situations in their own countries where, in many cases, what we would consider adequate due process is not required prior to an asset freeze. Capital flight is a sure sign of a collapsing government, which makes crypto regulation—drafted and approved by the same banks who have failed us on many previous occasions—especially worrisome. The U.S. has historically done well with its laissez faire approach

combined with transparent processes—or at least processes more transparent than in most countries. If banking benefitted consumers, banks and regulators would not need to be concerned about alternative banking. However, large federal budgets and the revolving door of corporate lobbyists provide the unwelcomed opportunity for crony capitalists to further enrich themselves and their banking interests. By reducing budgets, increasing reporting requirements, and aggressively auditing, we could potentially starve the beast.

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