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What's Bad About Crony Capitalism?

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Abstract

While there has been much discussion of the negative effects of crony capitalism, there has been little analysis of their precise nature. It is widely agreed that crony capitalism generates significant economic rents, which result in a misallocation of resources and lower incentives for wealth creation. In addition, the corruption that accompanies cronyism constitutes a considerable impediment to growth and development. This paper provides an analysis of the likely costs of cronyism and categorises them into four principal groups: allocative inefficiencies; dynamic inefficiencies; corruption and transaction costs; and problems of social and political stability. The analysis suggests that the most damaging aspect of crony capitalism is its tendency to discourage restructuring and adjustment at a time when such traits are central to economic success. The various linkages between the cost components are also explored. Examination of the claimed benefits of crony capitalism shows that they are more than offset by the negative effects.

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