

Crony Capitalism and Economic Growth in Latin America: Theory and Evidence

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What's Bad About Crony Capitalism?

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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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Introduction

Crony capitalism refers to a form of capitalism that restricts the allocation of economic resources and opportunity to a country's privileged elite or politically connected 'cronies'. The Asian economic crisis of 1997 brought widespread interest in the concept of 'crony capitalism'. One school of thought argues that the close and enduring relationships between business, governments and banks actually caused the crisis; a weaker version is that they impede recovery from the crisis. Regardless, there is a general consensus that crony capitalism is somehow harmful. Despite the widespread interest in the topic, there has been little systematic analysis of the question of why it is so harmful. The focus of much of the literature is on the resource allocation (or misallocation) costs of cronyism and the need to sustain high levels of economic rents. In addition, it is recognized that the persistence of such rents

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