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GAUGING THE PERCEPTION OF CRONYISM  
IN THE UNITED STATES

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Daniel J. Smith and Daniel S. Sutter



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Mercatus Center  
George Mason University  
3351 North Fairfax Drive, 4th Floor  
Arlington, VA 22201-4433  
(703) 993-4930  
[mercatus.org](http://mercatus.org)

Release date: October 17, 2012

## ABOUT THE AUTHORS

DANIEL J. SMITH is an assistant professor of economics at the Manuel H. Johnson Center for Political Economy at Troy University and an adjunct scholar at the Mackinac Center for Public Policy. He received his PhD in economics from George Mason University in 2011 and a BBA in economics, banking & finance, and business management from Northwood University in 2007.

DANIEL S. SUTTER is the Charles G. Koch Professor of Economics with the Manuel H. Johnson Center for Political Economy at Troy University and a senior affiliated scholar with the Mercatus Center. His research interests include the societal impacts of extreme weather, the economics of the news media, the markets for economists and economic research, environmental regulation, and constitutional economics. Sutter has published over 85 articles in scholarly journals in economics, atmospheric sciences, civil engineering, and political science. He has co-authored with Kevin Simmons two books on the societal impacts of tornadoes.

## ABSTRACT

CRONYISM IS UBIQUITOUS across all political systems. Whenever political actors intervene in economic affairs, they provide the incentive for businesses to take legal (cronyism) and/or illegal (corruption) action to ensure that political actors intervene in their favor. Yet only recently have economists started to seriously study cronyism and its prevalence and economic impact. The lack of scholarly work is largely because cronyism, like corruption, is notoriously difficult to measure, and unlike corruption, cronyism is not illegal, making it even more difficult to define and measure because there are no court or indictment records. This paper surveys the research on cronyism and the available methods of measuring it—in particular, using surveys to measure the perception of cronyism. We also make suggestions for improving our measurements of cronyism.

*JEL* codes: D72; D73

*Merchants and master manufacturers are . . . the two classes of people who commonly employ the largest capitals, and who by their wealth draw to themselves the greatest share of the publick consideration . . . The interest of the dealers, however, in any particular branch of trade or manufactures, is always in some respects different from, and even opposite to, that of the publick . . . The proposal of any new law or regulation of commerce which comes from this order, ought always to be listened to with great precaution, and ought never to be adopted till after having been long and carefully examined, not only with the most scrupulous, but with the most suspicious attention. It comes from an order of men, whose interest is never exactly the same with that of the publick, and who accordingly have, upon many occasions, both deceived and oppressed it.*

–Adam Smith, *An Inquiry Into the Nature of the Wealth of Nations*

**T**HE DEFENSE OF free markets and limited government from Adam Smith and David Hume forward hinges on the key assumption that businesses in the pursuit of profit will serve the public interest. Instead of legislating against or awaiting a transformation of human nature, Smith and Hume argue that capitalist institutions harness human self-interest to advance the well-being of all. As Smith famously states, “It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own interest.”<sup>1</sup> Most economists accept the argument that under market institutions, profit-seeking businesses will generally serve the interests of consumers. Yet profit seeking will not serve consumers if businesses can secure from government monopoly privileges or other regulations inhibiting their competitors. Such a mixed or politicized economic system has been dubbed crony capitalism, or cronyism, to distinguish it from a system of free markets and limited government.

While economists have been aware of cronyism since the beginning of economics, it has only recently become the focus of economic research. Several strands of literature in economics establish the general costs of cronyism and provide guidance for its scholarly investigation. The public choice analysis of rent seeking examines competition for favors or transfers from government and the costs of the transfers and lobbying activities.<sup>2</sup> The analysis of corruption, illegal attempts to secure favors from politicians, establishes the negative impact on the investment environment

1. Adam Smith, *An Inquiry into the Nature of the Wealth of Nations*, Book I (1976 [1776]): 27.
2. Anne O. Krueger, “The Political Economy of the Rent-Seeking Society,” *American Economic Review* 64, no. 3 (1974): 291–303; James M. Buchanan, Robert D. Tollison, and Gordon Tullock, eds., *Toward a Theory of the Rent-Seeking Society* (College Station: Texas A&M Press, 1980), 3–15; Robert D. Tollison, “Rent-Seeking: A Survey,” *Kyklos* 35, no. 4 (1982): 575–602; Gordon Tullock, “The Welfare Costs of Tariffs, Monopoly, and Theft,” *Western Economic Journal* 5, no. 3 (1967): 224–32; Gordon Tullock, “The Cost of Transfers,” *Kyklos* 24, no. 4 (1971): 629–43. Gordon Tullock, “More on the Welfare Costs of Transfers,” *Kyklos* 27, no. 2 (1974): 378–81.

of bribes for favors.<sup>3</sup> And economic freedom has been strongly linked to prosperity and growth,<sup>4</sup> yet as cronyism expands in a country, economic freedom will decline.

The actual measurement of cronyism has proven difficult because the parties involved tend to hide their actions.<sup>5</sup> Cronyism can also be obscured by public interest or consumer protection rationales for regulation, as Yandle's example of the bootleggers and Baptists emphasizes.<sup>6</sup>

This paper explores avenues for measuring cronyism as a means of advancing this new line of research. Although economists' focus on cronyism is relatively recent, extensive literature exists on the related topics of corruption and rent seeking, and any attempt to investigate cronyism should be informed by these literatures. A first challenge is to distinguish cronyism from corruption and rent seeking, a task we consider in section 1. We consider in section 2 some general insights on the costs and measurement of cronyism offered by the corruption and rent-seeking literatures. Our focus then turns to the measurement of cronyism. Scholars have found surveys to be an effective means to measure corruption; surveys could also be used to measure cronyism. Public perceptions of cronyism are important for the future of the free market economic system. Does the public consider cronyism to be endemic to or a corruption of capitalism? The public's perception of cronyism will likely affect the future course of policy and may offer clues about how crony influences could be ameliorated. Section 3 discusses the reasons why perceptions of cronyism matter. Section 4 reviews some of the available evidence on insider and public perceptions.

## 1. CRONYISM AND ITS RELATION TO CORRUPTION

CRONYISM HAS PROVEN difficult to precisely define and differentiate from corruption and rent seeking, which themselves have been defined differently by various authors. The different definitions of corruption and rent seeking serve to identify what constitutes cronyism. De Sardan's observation about the tendency to exclude one's own actions from such definitions is worth keeping in mind in this context. He

3. Andrei Shleifer and Robert W. Vishny, "Corruption," *Quarterly Journal of Economics* 108, no. 3 (1993): 599–617; Paolo Mauro, "Corruption and Growth," *Quarterly Journal of Economics* 110, no. 3 (1995): 681–712.
4. James Gwartney, Robert Lawson, and Joshua Hall, *Economic Freedom of the World 2011 Annual Report* (Fraser Institute: 2011), [http://www.freetheworld.com/2011/reports/world/EFW2011\\_complete.pdf](http://www.freetheworld.com/2011/reports/world/EFW2011_complete.pdf), accessed May 14, 2012.
5. Robert Williams, *Political Corruption in Africa* (Sudbury, MA: Dartmouth Publishing Company, 1987); John T. Noonan, Jr., *Bribes: The Intellectual History of a Moral Idea* (Berkeley: University of California Press, 1984); Edward Glaeser and Claudia Goldin, "Corruption and Reform: Introduction," in *Corruption and Reform: Lessons from America's Economic History*, eds. Edward Glaeser and Claudia Goldin (Chicago: University of Chicago Press, 2008), 3–22; Robert Klitgaard, "Gifts and Bribes," in *Strategy and Choice*, ed. Richard Zeckhauser (Cambridge, MA: MIT Press, 1991); Wayne Sandholtz and William Koetzle, "Accounting for Corruption: Economic Structure, Democracy, and Trade," *International Studies Quarterly* 44 (2000): 31–50.
6. Bruce Yandle, "Bootleggers and Baptists: The Education of a Regulatory Economist," *Regulation* 7, no. 3 (1983): 12–16.

writes, “Only the practices to which one falls victim or from which one is excluded are denounced as being corrupt. Those in which one plays a role oneself never give rise to condemnation.”<sup>7</sup> Several recent papers use the simple definition of corruption as the misuse of public office for private gain.<sup>8</sup> Glaeser and Goldin define corruption as having three features: (1) a payment to a public official above his or her normal salary; (2) an action in response to this payment that violates formal laws or informal norms; and (3) losses to the public stemming from the action undertaken for this payment.<sup>9</sup> Nye defines corruption as “behavior which deviates from the formal duties of a public role because of private-regarding (personal, close family, private clique) pecuniary or status gains; or violates rules against the exercise of certain types of private-regarding influence.”<sup>10</sup>

Forms of corruption include bribery, nepotism, and misappropriation of public funds. Hellman, Jones, and Kaufman distinguish between state capture, administrative corruption, and influence.<sup>11</sup> State capture refers to using illicit means to influence laws. Administrative corruption consists of private payments to public officials to avoid enforcement of certain laws; and influence is any legal means employed to shape laws. Rent seeking has been more consistently defined as attempts to secure rents or wealth transfers through the political process, but Laband and Sophocleus in their effort to measure rent seeking include costs related to crime.<sup>12</sup> There are clearly some uses of political power to benefit politically favored businesses at the expense of other businesses that do not meet these three criteria. Businesses can influence public policy in two different methods: illegally, through what is generally included under the label of corruption, and legally, through what we will refer to as cronyism.

In the free market economy, consumers determine which producers, competing in a market open to competition, earn their dollars. Cronyism, on the other hand, refers to unequal competition, where those with the closest connections to the political process gain an advantage over their competitors in the pursuit for consumers’ dollars. Soreide defines cronyism as when “political networks dominate important

7. J. P. Olivier De Sardan, “A Moral Economy of Corruption in Africa?” *Journal of Modern African Studies* 37, no. 1 (1999): 34.
8. Shleifer and Vishny, “Corruption”; Jacob Svensson, “Eight Questions about Corruption,” *Journal of Economic Perspectives* 19, no. 3 (2005): 19–42; Daniel Treisman, “The Causes of Corruption: A Cross-National Study,” *Journal of Public Economics* 76, no. 3 (2000): 399–457.
9. Glaeser and Goldin, “Corruption and Reform,” 7.
10. Joseph S. Nye, “Corruption and Political Development: A Cost-Benefit Analysis,” in *Political Corruption: A Handbook*, eds. Arnold J. Heidenheimer, Michael Johnston, and Victor T. LeVine (New Brunswick, NJ: Transaction Publishers, 1989), 966.
11. Joel S. Hellman, Geraint Jones, and Daniel Kaufman, “‘Seize the State, Seize the Day’: State Capture, Corruption, and Influence in Transition” (World Bank Policy Research Working Paper 2444, Washington, DC, 2000).
12. David N. Laband and John P. Sophocleus, “An Estimate of Resource Expenditures on Transfer Activity in the United States,” *Quarterly Journal of Economics* 107, no. 3 (1992): 959–83.

private assets, or ‘state capture’, in which private firms are able to influence public power to their own benefit.”<sup>13</sup> Consequently, bribe seeking or bribe taking by minor government functionaries, which counts as corruption, does not constitute cronyism. Rather, cronyism includes lobbying, quid pro quo arrangements, revolving doors between bureaucracies and the industries they regulate, donations to favored charities, honest graft, and campaign donations.<sup>14</sup> Measures of corruption employed in the academic literature generally include illegal methods of influence on government, while enumerated forms of cronyism are generally legal. The rent-seeking literature is often agnostic on the exact channel of influence and its legality. For example, in the Tullock rent-seeking contest, influence seeking is modeled as a monetary expenditure, but only for analytical convenience.<sup>15</sup> Consequently, models of rent seeking can readily be adapted to cronyism.<sup>16</sup>

Cronyism often involves the capture of regulatory agencies by interest groups such as the regulated businesses.<sup>17</sup> Government interventions undertaken in the economy with the intention of helping the consumer can often end up serving as the means for firms to exploit political connections as opposed to fulfilling consumer wants, subverting the decisive role of consumers in the economy. Closely related to regulatory capture is the use of public interest rationales as cover for political measures intended to benefit politically connected businesses, or what can be thought of as by-product protection. An example is Yandle’s anecdote of the Baptists and the bootleggers, in which the Baptists, motivated by what they perceive as the worthy goal of alcohol prohibition, end up acting in the economic interest of bootleggers (although bootleggers admittedly do not fit the profile of the typical crony capitalist).<sup>18</sup>

Regulatory capture and by-product protection render problematic the charac-

13. Tina Soreide, “Corruption in International Business Transactions: The Perspective of Norwegian Firms,” in *International Handbook on the Economics of Corruption*, ed. Susan Rose-Ackerman (Northampton, MA: Edward Elgar, 2006), 387.
14. Glaeser and Goldin, “Corruption and Reform”; Soreide, “Corruption in International Business Transactions.”
15. Gordon Tullock, “Efficient Rent Seeking,” *Toward a Theory of the Rent-Seeking Society*, 97–112.
16. Corporate welfare is widely used and refers to some of the same activities as cronyism. Clientelism is used in some academic literatures roughly interchangeably with cronyism. Anna Grzymala-Busse, “Beyond Clientelism: Incumbent State Capture and State Formation,” *Comparative Political Studies* 41, no. 4/5 (2008): 638–73; Joshua D. Potter and Margit Tavits, “Curbing Corruption with Political Institutions,” in *International Handbook on the Economics of Corruption*, vol. 2 (2011), eds. Susan Rose-Ackerman and Tina Soreide. And cronyism shares similarities with Mussolini’s corporatist state.
17. Simeon Djankov et al., “The Regulation of Entry,” *Quarterly Journal of Economics* 117, no. 1 (2002): 1–37; Hernando De Soto, *The Other Path: The Economic Answer to Terrorism* (New York: Basic Books, 1990); Shleifer and Vishny, “Corruption,” *Quarterly Journal of Economics* 108, no. 3 (1993): 599–617; Gilbert Becker, “The Public Interest Hypothesis Revisited: A New Test of Peltzman’s Theory of Regulation,” *Public Choice* 49, no. 3 (1986): 223–34; George Stigler, “The Theory of Economic Regulation,” *Bell Journal of Economics* 2, no. 1 (1971): 3–21.
18. Yandle, “Bootleggers and Baptists.”

terization of specific government actions as cronyism. Politicians benefit because cronyism brings in votes, campaign contributions, remunerative jobs and speaking engagements after leaving office, and positive publicity if the public accepts the public interest rationale. Directing public policy can prove financially beneficial to politicians. For example, Ziobrowski et al. find that the stock returns of U.S. House of Representatives and U.S. Senate members significantly outpaced the average market return, indicating that a substantial amount of trading occurs based upon information that is only available to political insiders.<sup>19</sup> Soreide found that cronyism in Norway took the form of quid pro quo agreements between firms and local politicians who expect benefits to the local community in the form of donations to specific charities, the employment of local workers, and infrastructure improvements, among others.<sup>20</sup> Sometimes politicians pursue what could be characterized as crony measures for public interest purposes, not private gain. The Baptist politician may have the best of intentions in voting for prohibition and not receive any inducements from bootleggers, but his actions would benefit bootleggers nonetheless.

## 2. THE COSTS OF CRONYISM

CRONYISM CAN ONLY emerge when there is political influence over resource allocation. In a free market, transactions are voluntary, and both parties must believe they will be better off to participate in any given transaction. Thus, producers of goods and services must compete for every consumer dollar by striving to deliver superior value to consumers—the fundamental wealth-creating basis of the market economy. However, politicians with influence over resource allocation can use coercion to direct resources to lower valued uses or even block wealth-creating reallocations of resources. As cronyism expands, economic freedom recedes. Cronyism also alters the structure of incentives that firms face by providing profit opportunities for entrepreneurs who invest in political lobbying, campaigning, and relationships, rather than in true profit opportunities.

Existing research on corruption, rent seeking, and economic freedom provides a guide for research on cronyism. Baumol argues that the structure of incentives within a country determines whether talented entrepreneurs will go into socially productive, unproductive, or even destructive activities.<sup>21</sup> People will allocate their entrepreneurial talents toward the activities yielding the highest returns to themselves. In the politicized world of cronyism, entrepreneurs find that the rewards

19. Alan J. Ziobrowski et al., “Abnormal Returns from the Common Stock Investments of Members of the U.S. House of Representatives,” *Business and Politics* 13, no. 1 (2004); Alan J. Ziobrowski et al., “Abnormal Returns from the Common Stock Investments of the United States Senate,” *Journal of Financial and Quantitative Analysis* 39 (2004): 661–76.
20. Soreide, “Corruption in International Business Transactions.”
21. William J. Baumol, “Entrepreneurship: Productive, Unproductive, and Destructive,” *Journal of Political Economy* 98, no. 5 (1990): 893–921.
22. Kevin M. Murphy, Andrei Shleifer, and Robert W. Vishny, “The Allocation of Talent: Implications

from socially unproductive activities like tax evasion, lobbying, and pleasing politicians outpace the gains from starting new businesses or better satisfying consumers. Murphy, Shleifer, and Vishny find that countries grow slower when more people allocate their efforts to rent-seeking activities.<sup>22</sup> In another article, Murphy, Shleifer, and Vishny argue that this allocation of talented individuals into rent-seeking activities sharply reduces economic growth.<sup>23</sup> As Olson argues,

An increase in the payoffs from lobbying and cartel activity, as compared with the payoffs from production, means more resources are devoted to politics and cartel activity and fewer resources are devoted to production. This in turn influences the attitudes and culture that evolve in society. Lobbying increases the complexity of regulation and the scope of government by creating special provisions and exceptions. A lobby that wins a tax reduction for income of a certain source or type makes the tax code longer and more complicated; a lobby that gets a tariff increase for the producers of a particular commodity makes trade regulation more complex than if there were a uniform tariff on all imports and more complex than it would be with no tariff at all.<sup>24</sup>

A clear line often cannot be drawn between corruption and cronyism, and the substantial evidence on the political and economic costs of corruption provides additional evidence on the costs of cronyism.<sup>25</sup> Morck, Stangeland, and Yeung; Rajan and Zingales; and Acemoglu and Robinson show that special interest groups can influence regulations to prevent technological and economic transitions that would

for Growth,” *Quarterly Journal of Economics* 106, no. 2 (1991): 503–30.

23. Kevin M. Murphy, Andrei Shleifer, and Robert W. Vishny, “Why is Rent-Seeking so Costly to Growth?” *American Economic Review Papers and Proceedings* 83, no. 2 (1993): 409–14.
24. Mancur Olson, *The Rise and Decline of Nations: Economic Growth, Stagflation, and Social Rigidities* (New Haven, CT: Yale University Press, 1982), 69.
25. Some scholars argue that a little bit of corruption is necessary to reduce inefficiencies inherent in any political or bureaucratic organization, especially in developing nations where governments tend to be highly inefficient. See Frank Anichiarico and James B. Jacobs, *The Pursuit of Absolute Integrity: How Corruption Control Makes Government Ineffective* (Chicago: University of Chicago Press, 1996); Samuel Huntington, *Political Order in Changing Societies* (New Haven: Yale University Press, 1968), 59–71; Nathaniel Leff, “Economic Development Through Bureaucratic Corruption,” *American Behavioral Scientist* 8, no. 3 (1964): 8–14; Herbert W. Werlin, “The Roots of Corruption: The Ghanaian Enquiry,” *Journal of Modern African Studies* 10, no. 2 (1972): 247–66; Susan Rose-Ackerman criticizes this view in *Corruption: A Study in Political Economy* (New York: Academic Press, 1978) since it would be difficult, or even impossible, to limit corruption to only economically beneficial areas. M. Shahid Alam finds no empirical support for the hypothesis that corruption improves allocative efficiency in less developed nations in M. Shahid Alam, “Anatomy of Corruption: An Approach to the Political Economy of Underdevelopment,” *American Journal of Economics and Sociology* 48, no. 4 (1989): 441–56.
26. Randall K. Morck, David A. Stangeland, and Bernard Yeung, “Inherited Wealth, Corporate Control

threaten their current economic and political power.<sup>26</sup> Reinikka and Svensson, using a survey of 176 Ugandan firms, find that corruption is a leading constraint to investment.<sup>27</sup> Shleifer and Vishny argue that the structure of government institutions affects the level of corruption within a country.<sup>28</sup> A government with non-competing agencies and bureaucracies will tend to have more corruption because these separate entities will independently extract rents. In addition, they argue that resource extraction through corruption is far more distortionary than taxation because politicians tend to concentrate corruption in industries where secrecy is easier to maintain, pulling productive investment away from sectors like health and education and toward industries like defense and infrastructure. Olken found that Indonesian village officials indeed attempted to keep corruption where it would be difficult to observe.<sup>29</sup>

Assistance to politically favored businesses can take the form of regulations that make it difficult to start new businesses. Entry barriers reduce price competition and protect high cost producers from efficient entrants. Djankov et al. examine business start-up regulations in 85 countries. They find that nations with more burdensome regulations have more corruption, larger black markets, and are less democratic. The authors conclude that these regulations impose significant costs but generate little social benefit.<sup>30</sup> Fisman and Allende find that barriers to entry tend to prevent new firms from emerging to exploit growth opportunities, allowing existing firms to expand and exploit growth opportunities instead.<sup>31</sup> Morck, Stangeland, and Yeung find that countries with fewer signs of rent seeking have more self-made billionaires and more innovation than countries with more signs of rent seeking.<sup>32</sup>

Another cost of cronyism is the cost of resources used in the favor-seeking process. If a business receives favors or tax breaks worth \$1 billion from government, it should be willing to spend up to this amount to secure the favors. Depending on the exact activities undertaken to secure favors, the profits or rents generated by cronyism could be wasted in this process, a point first made by Tullock.<sup>33</sup> The extensive

and Economic Growth: The Canadian Disease?" (NBER Working Paper no. 6814, Cambridge, MA, 1999); Daron Acemoglu and James A. Robinson, "Political Losers as a Barrier to Economic Development," *American Economic Review* 90, no. 2 (2000): 126–30; Raghuram G. Rajan and Luigi Zingales, "The Great Reversals: The Politics of Financial Development in the Twentieth Century," *Journal of Financial Economics* 69, no. 1 (2003): 5–50.

27. Ritva Reinikka and Jakob Svensson, "Confronting Competition: Investment, Profit, and Risk," in *Uganda's Recovery: The Role of Farms, Firms, and Government*, eds. Ritva Reinikka and Paul Collier (Washington, DC: World Bank, 2001).
28. Shleifer and Vishny, "Corruption."
29. Benjamin A. Olken, "Corruption Perceptions vs. Corruption Reality," *Journal of Public Economics* 93 (2009): 950–64.
30. Djankov et al., "The Regulation of Entry."
31. Raymond Fisman and Virginia S. Allende, "Regulation of Entry and the Distortion of Industrial Organization," *Journal of Applied Economics* 13, no. 1 (2010): 91–111.
32. Morck, Stangeland, and Yeung, "Inherited Wealth."
33. Tullock, "The Welfare Costs of Tariffs."

public choice literature on rent seeking provides background for this aspect of the costs of cronyism and has examined this question of rent dissipation theoretically and empirically. Estimates suggest that the rent-seeking costs in the United States could be substantial.<sup>34</sup>

Moving forward with research on cronyism will require a way to measure cronyism and to explore institutional conditions that limit its impact. The illegality of corruption results in indictments, trials, convictions, and resignations, which can be totaled and used as empirical measures.<sup>35</sup> Both parties will typically try to hide corrupt activities, so convictions will be an imperfect measure of opportunities to be corrupt, which can vary between institutional settings.<sup>36</sup> Because legislative debates may hide crony motives, a particularly appropriate technique could be the use of stock-market event studies to estimate the value to firms of political relationships. The efficient markets hypothesis in finance argues that all publicly available information should be incorporated into stock prices, and so unexpected new information should drive stock price changes. Event studies have been recommended as a tool for studying the impact of regulation and legislation on the affected firms.<sup>37</sup> Event studies have also been used when a politician dies unexpectedly or has a critical illness to estimate the value to firms of ties to politicians. Roberts examines the impact of the death of Senator Henry “Scoop” Jackson,<sup>38</sup> the senior ranking minority leader of the Senate Armed Services Committee, while Fisman considers the impact of changes in President Suharto’s health in Indonesia.<sup>39</sup> In both cases, the authors find evidence that politically connected firms financially benefit from their political connections.

The public choice literature also offers several possible methods for measuring cronyism. Numerous empirical studies have examined the determinants of roll call voting by politicians for evidence of interest group influence, including campaign contributions by political action committees.<sup>40</sup> Sobel and Garrett use industry codes to show that U.S. state capitols have a significantly different structure of industries than noncapitol areas.<sup>41</sup> They find measurable evidence that in state capitals traditional economic activity is replaced with rent-seeking economic activity such as

34. Laband and Sophocleus, “An Estimate of Resource Expenditures.”

35. Edward Glaeser and R. E. Saks, “Corruption in America,” *Journal of Public Economics* 90, no. 6–7 (2004): 1053–72.

36. Glaeser and Goldin, “Corruption and Reform.”

37. G. William Schwert, “Using Financial Data to Measure the Effects of Regulation,” *Journal of Law and Economics* 24 (1981): 121–58.

38. Brian E. Roberts, “A Dead Senator Tells No Lies: Seniority and the Distribution of Federal Benefits,” *American Journal of Political Science* 34, no. 1 (1990): 31–58.

39. Raymond Fisman, “Estimating the Value of Political Connections,” *American Economic Review* 91, no. 4 (2001): 1095–102.

40. For a survey, see Dennis C. Mueller, *Public Choice III* (New York: Cambridge University Press, 2003), 481–97.

41. Russell Sobel and Thomas Garrett, “On the Measurement of Rent Seeking and its Social

public relations.

### 3. WHY PERCEPTIONS OF CRONYISM MATTER

SCHOLARLY INVESTIGATIONS OF corruption offer helpful lessons for attempts to measure corruption. While corruption can, in some cases, be measured explicitly, scholars often turn to surveys. Despite the definitional difficulties, people involved in an industry often know when corruption is present.<sup>42</sup>

#### 3.1 Perceptions as a Measure of Cronyism

RECORDING PERCEPTIONS USING surveys has proven to be one of the best ways to measure cronyism or corruption in a country. Surveys, however, have their own shortcomings. Because surveys measure perceptions of corruption, they may actually measure the visibility or openness of corruption rather than its actual extent.<sup>43</sup> Perception will also depend on personal judgments, which can vary between countries,<sup>44</sup> but research has found a surprisingly widely accepted standard of corruption, and presumably cronyism, across different cultures.<sup>45</sup> Johnston argues that surveys measuring actual episodes of corruption experienced by business owners and individuals will be more reliable.<sup>46</sup> Perceptions of corruption will often depend on enforcement, as an increase in prosecutions will raise public awareness of, but not actual instances of, corruption.

Despite these issues, Reinikka and Svensson argue that with appropriate methods and techniques, surveys can be a fairly accurate and important measure of corruption.<sup>47</sup> Olken finds that the perceptions of corruption in an Indonesian village do contain real information but tend to underestimate it since officials reduce

Opportunity Cost,” *Public Choice* 112, no. 1–2 (2002): 115–36.

42. Damarys Canache and Michael E. Allison, “Perceptions of Political Corruption in Latin American Democracies,” *Latin American Politics and Society* 47, no. 3 (2005): 91–111; Olken, “Corruption Perceptions vs. Corruption Reality.”
43. Michael Johnston, “Right and Wrong in American Politics: Popular Conceptions of Corruption,” *Polity* 18, no. 3 (1986): 367–91; Philip H. Jos, “Empirical Corruption Research: Beside the (Moral) Point?” *Journal of Public Administration Research and Theory* 3, no. 3 (1993): 359–75.
44. David P. Redlawsk and James A. McCann, “Popular Interpretations of ‘Corruption’ and Their Partisan Consequences,” *Political Behavior* 27, no. 3 (2005): 261–83; Johnston, “Right and Wrong in American Politics.”
45. David H. Bayley, “The Effects of Corruption in a Developing Nation,” in *Political Corruption: A Handbook*, eds. Arnold J. Heidenheimer, Michael Johnston, and Victor T. LeVine (New Brunswick, NJ: Transaction Publishers, 1989), 935–52; James C. Scott, *Comparative Political Corruption* (Englewood Cliffs, NJ: Prentice-Hall, 1972); Klitgaard, “Gifts and Bribes”; Nye, “Corruption and Political Development”; Sandholtz and Koetzle, “Accounting for Corruption.”
46. Johnston, “Right and Wrong in American Politics.”
47. Ritva Reinikka and Jakob Svensson, “Survey Techniques to Measure and Explain Corruption”

the visibility of corruption.<sup>48</sup> Svensson finds a high correlation between different indices of corruption perception, lending more credibility to survey methods.<sup>49</sup> Consequently surveys offer substantial promise for documenting cronyism as well.

### 3.2 Economic Consequences of Perceptions of Corruption

PERCEPTIONS OF CRONYISM can assume economic significance in their own right. The politicization of the economy can deter business investment, and investment decisions depend upon the subjective perspectives of entrepreneurs and owners. If political favors are necessary for business success, entrepreneurs may choose never to start new businesses or to expand small businesses, to the detriment of the economy. Small business owners who do not know how to curry favor with politicians, or who doubt politicians would ever befriend them, or who find favor-seeking entirely distasteful might never try to expand their enterprises. Even when perceptions of the extent of cronyism are overblown, the perception can be enough to deter would-be entrepreneurs.

A perception that government favors fuel the success of some businesses might spark further lobbying efforts. Olson describes the process of the steady expansion of organization for political action.<sup>50</sup> Although firms will sometimes begin lobbying as a defensive measure in response to lobbying by a rival or threats of rent extraction by politicians,<sup>51</sup> perceptions also can drive this process. In a free market, businesses compete to produce the best product or service at the lowest cost. A rival who courts favor with politicians to achieve through regulation what he could not in the market will be perceived to have violated the rules. Business leaders might have a natural aversion to seeking government aid, but ethical restraints will be undermined when many rivals appear to succeed by breaking the rules.

Political support for the free enterprise system can depend on public perceptions of cronyism. Government bailouts and tax breaks for favored firms are inconsistent with a true market economy and constitute cronyism, but might be perceived by some as inherent to capitalism. Perceptions that big businesses get politicians to change the rules in their favor and against rival businesses or against consumers, or keep profits for themselves but saddle taxpayers with their losses, could erode support for the market elements of the U.S. mixed economy. Cronyism might lead people to prefer government control of businesses to a system of profit maximization and government protection from loss. Media attention tends to focus on the

(World Bank Policy Research Working Paper Series no. 3071, Washington, DC, 2003), <http://sitere-sources.worldbank.org/INTPEAM/Resources/PETS2.pdf>.

48. Olken, "Corruption Perceptions vs. Corruption Reality."

49. Svensson, "Eight Questions about Corruption."

50. Olson, *The Rise and Decline of Nations*.

51. Fred S. McChesney, "Rent Extraction and Rent Creation in the Economic Theory of Regulation," *Journal of Legal Studies* 16, no. 1 (1987): 101-18.

52. Timothy Frye and Andrei Shleifer, *American Economic Review* 87, no. 2 (1997): 354-58.

most egregious instances of cronyism, leading people to overestimate the role government plays in business. And if media coverage ends with passage of a new law, people might be unaware of the extent of regulatory capture and how a wave of “pro-consumer” regulation sets the stage for future cronyism.

#### 4. SURVEY EVIDENCE ON CRONYISM AND CORRUPTION

THE TERMS CRONYISM and crony capitalism have only recently entered common usage and still are not universally used terms. As a result, few surveys have directly asked business leaders or the public about cronyism. Nonetheless, survey questions over the years, some from corruption research and others from opinion polls, have explored aspects of cronyism and provide evidence on attitudes toward cronyism in the United States. The survey literature is undoubtedly far richer than we identify here, in part because the term cronyism cannot be used to search for relevant polls or poll questions. In this section, we review the available survey evidence of attitudes toward cronyism, first examining surveys of businesses and then looking at surveys of public attitudes.

##### 4.1 Business Leaders' Perceptions of Cronyism and Corruption

BECAUSE MANY SURVEYS used to measure corruption include questions on cronyism, a wealth of survey evidence is available on business leaders' perceptions, primarily in developing countries, of cronyism and corruption. These studies offer some generalizations and some questions that could be adopted to measure cronyism in the United States.

Frye and Shleifer argue that interactions between entrepreneurs and bureaucrats tend to fit one of four models: the invisible hand, helping hand, iron hand, or grabbing hand.<sup>52</sup> The invisible-hand model involves uncorrupt and comparatively benevolent intentions, while the helping-hand model involves intervention in the private sector and the picking of winners and losers based off of a unified objective. The iron-hand model is an extreme form of the helping-hand model, with more active intervention into markets and more susceptibility to systematic corruption, while the grabbing-hand model involves disorganized intervention in the market, often leading to rampant corruption. Frye and Shleifer asked questions about the legal and regulatory environment to approximately 50 businesses in both Moscow and Warsaw. While the two cities had enacted similar free market reforms, small businesses were more active in Poland than in Russia. The authors found that Moscow followed a grabbing-hand model, where Poland more closely followed the invisible-hand model, demonstrating the harmful consequences for business activity of perceptions of cronyism.

53. Jakob Svensson, “The Cost of Doing Business: Firms' Experience with Corruption in Uganda”

Among other relevant surveys, Svensson uses self-reported incidence of bribes as opposed to perceptions of corruption for a sample of Ugandan firms.<sup>53</sup> He finds that larger, more profitable, and more export-oriented firms pay higher bribes. He also finds no evidence of firms that pay higher bribes receiving more favorable treatment. Johnson, McMillan, and Woodruff use a 1997 survey of recently formed, small manufacturing firms in Poland, Romania, Slovakia, Ukraine, and Russia to explore how the perception of property rights affects business investment.<sup>54</sup> The authors find that firms reinvest profits to a greater extent where bribes for government services and licenses are the least prevalent and property rights are relatively more secure.

The Business Environment and Enterprise Survey (BEES) is another tool that can aid in corruption research. Hellman, Jones, and Kaufman use this survey and find that firms engaged in cronyism and corruption grow faster than others.<sup>55</sup> The BEES contains questions about cronyism, including a question to evaluate influence on the political process:

When a new law, rule, regulation or decree is being discussed that could have a substantial impact on your business, how much influence does your firm typically have at the national level of government to try to influence the content of that law, rule, regulation or decree?

The question is asked separately of the executive, legislative, ministry, and regulatory branches of government. As new legislation will often affect large firms, elected officials (and the regulators they appoint) may be concerned about the impact of new legislation on large firms even if these firms do not seek influence. The BEES is only administered in developing countries and unfortunately does not provide any insight about cronyism in the United States, but the questions could be adapted for use in future research.

Zingales argues that in the majority of countries, entrepreneurs find that the best way to make money is not to innovate in the marketplace, but to foster connections and relationships with government politicians and bureaucrats. According to Zingales, 80 percent of Italian managers reported that “knowledge of influential people” was the most important determinant of financial success.<sup>56</sup> There are also many case studies of corruption in various countries and across specific coun-

(Africa Region Working Paper Series no. 6, Washington, DC, 2000), <http://www.worldbank.org/afr/wps/wp6.pdf>.

54. Simon Johnson, John McMillan, and Christopher Woodruff, “Property Rights and Finance,” *American Economic Association* 92, no. 5 (2002): 1335–56.
55. Hellman, Jones, and Kaufman, “Seize the State, Seize the Day.”
56. Luigi Zingales, “Capitalism After the Crisis,” *National Affairs* 1 (Fall 2009): 22–35.

tries. For example, cronyism studies have been undertaken in Italy,<sup>57</sup> Indonesia,<sup>58</sup> Turkey,<sup>59</sup> Sierra Leone,<sup>60</sup> India,<sup>61</sup> Malaysia,<sup>62</sup> Portugal,<sup>63</sup> Canada,<sup>64</sup> and Russia.<sup>65</sup>

#### 4.2 Perceptions of Cronyism and Corruption among the Public

PUBLIC OPINION POLLS provide insight into how Americans view relations between favor-seeking corporations and the system within which this cronyism occurs. Gallup surveys conducted in the aftermath of the Enron and corporate accounting scandals in 2002 provide some clues. A February 2002 Gallup poll explored perceptions of the roles of Enron executives, members of the Bush administration, and members of Congress. Figure 1 summarizes the responses. Sixty-five percent of the public clearly believed that Enron executives had done something illegal, while only 2 percent thought they had not done anything seriously wrong. Convictions of top Enron executives validated the public perception. No more than 15 percent of the public believed that the Bush administration or Republicans or Democrats in Congress had done anything illegal. The public was divided about whether politicians' actions were unethical (around 40 percent in each case) or not seriously wrong (about 30 percent).

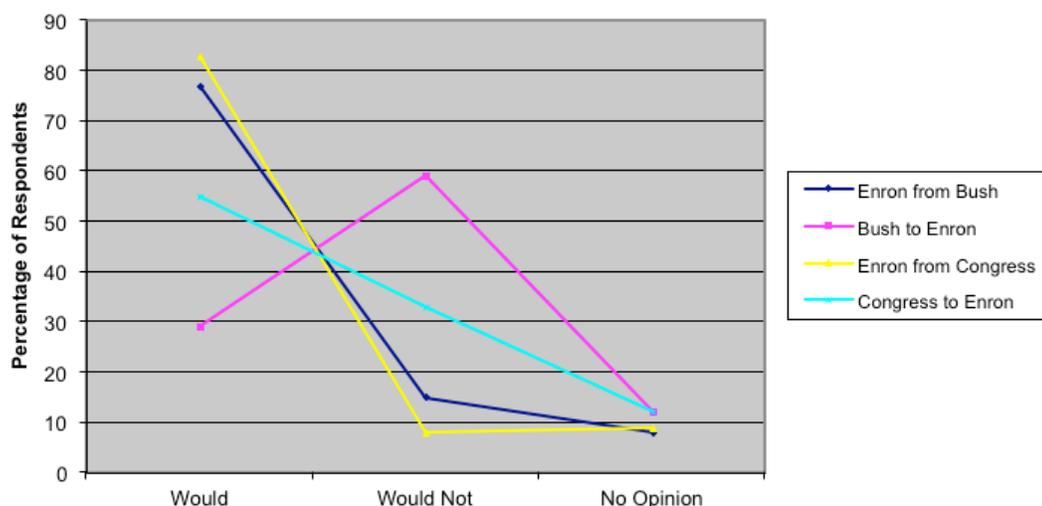
57. Donatella Della Porta and Alberto Vannucci, *Corrupt Exchanges: Actors, Resources, and Mechanisms of Political Corruption* (Hawthorne, NY: Walter de Gruyter, 1999).
58. Benjamin A. Olken, "Corruption and the Costs of Redistribution: Micro Evidence from Indonesia," *Journal of Public Economics* 90, no. 4-5 (2006): 853-70.
59. Hatice Necla Keles, Tugba Kiral Ozkan, and Muhammet Bezirci, "A Study on the Effects of Nepotism, Favoritism and Cronyism on Organizational Trust in the Auditing Process in Family Businesses in Turkey," *International Business & Economics Research Journal* 10, no. 9 (2011): 9-16.
60. Dele Ogunmola, "Socio-Economic Injustice and Cronyism: Warlordism and Tayloryism in the Sierra Leone Civil War" (*Journal of Alternative Perspectives in the Social Sciences* Working Paper no. 3, 2009).
61. Surajit Mazumdar, "Crony Capitalism: Caricature or Category?" (Institute for Studies in Industrial Development Working Paper 2008/02, New Delhi, 2008).
62. Simon Johnson and Todd Mitton, "Cronyism and Capital Controls: Evidence from Malaysia" (NBER Working Paper 8521, Cambridge, MA, 2001).
63. Pedro S. Martins, "Cronyism" (Institute for the Study of Labor Discussion Paper no. 5349, Bonn, Germany, 2010).
64. Morck, Stangeland, and Yeung, "Inherited Wealth."
65. Gulnaz Sharafutdinova, "Crony Capitalism and Democracy: Paradoxes of Electoral Competition in Russia's Regions" (Kellogg Institute for International Studies Working Paper no. 335, Notre Dame, 2007).
66. Arthur Brooks, *The Battle: How the Fight Between Free Enterprise and Big Government Will Shape*

FIGURE 1. ENRON: LEGALITY AND ETHICS

Gallup poll question: Which of the following best describes your view of . . .

1. The actions of executives of the Enron energy corporation?
2. Members of the Bush administration’s involvement with the Enron corporation?
3. The Republicans in Congress’ involvement with the Enron corporation?
4. The Democrats in Congress’ involvement with the Enron corporation?

Poll date: February 8–10, 2002



Source: Gallup.

A January 2002 poll question provides further evidence on expectations of political parties as a result of campaign contributions by Enron. About 80 percent of respondents believed that Enron executives expected to receive special treatment in exchange for contributions to George W. Bush and congressional Democrats. But as figure 2 shows, people were less likely to think politicians would feel they owed Enron executives special treatment as a result of the contributions; about 30 percent thought Bush would feel obligated and about 55 percent thought that congressional Democrats would feel obligated.

FIGURE 2. EXPECTATIONS OF ENRON

Gallup poll questions:

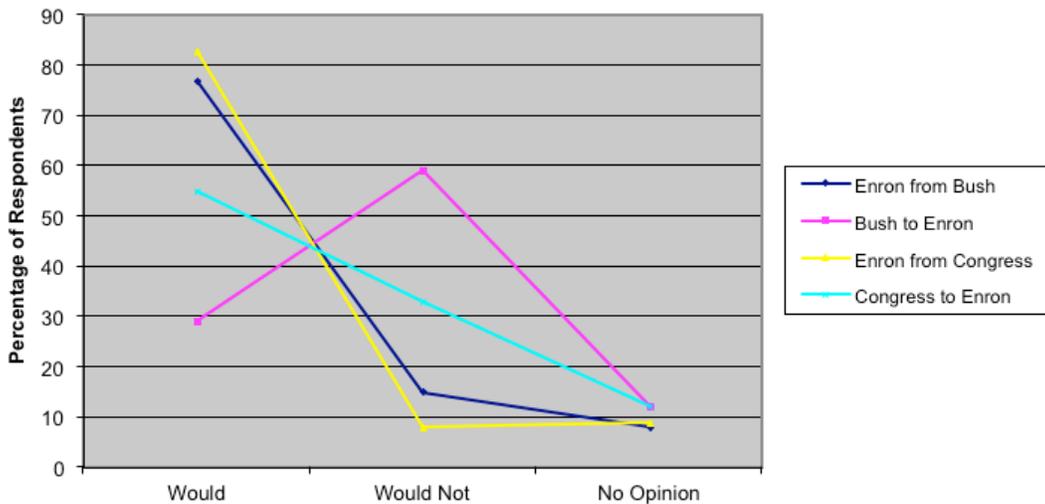
Question 1: As you may know, Enron executives have made major donations to George W. Bush’s presidential election campaign. Do you think Enron executives felt they would—or would not—get special treatment on policy issues in return for making these contributions?

Question 2: Do you think Bush felt he would—or would not—owe Enron executives any special treatment on policy issues by accepting these contributions?

Question 3: As you may know, Enron executives have made major donations to election campaigns for some Democrats in Congress. Do you think Enron executives felt they would—or would not—get special treatment on policy issues in return for making these contributions?

Question 4: Do you think Democrats in Congress felt they would—or would not—owe Enron executives any special treatment by accepting these contributions?

Poll date: January 25–27, 2002



Source: Gallup.

A February 2002 poll asked respondents, “Which of the following do you think is the most important issue in the Enron situation?” As figure 3 shows, only about 10 percent of respondents identified that Enron lobbied the government or that the company failed as the most important issue. About two-thirds of respondents were angered by the losses imposed on Enron employees while executives were going to walk away with riches. This survey indicates that Americans accept that businesses will ask government for favors and that business failures are part of the market

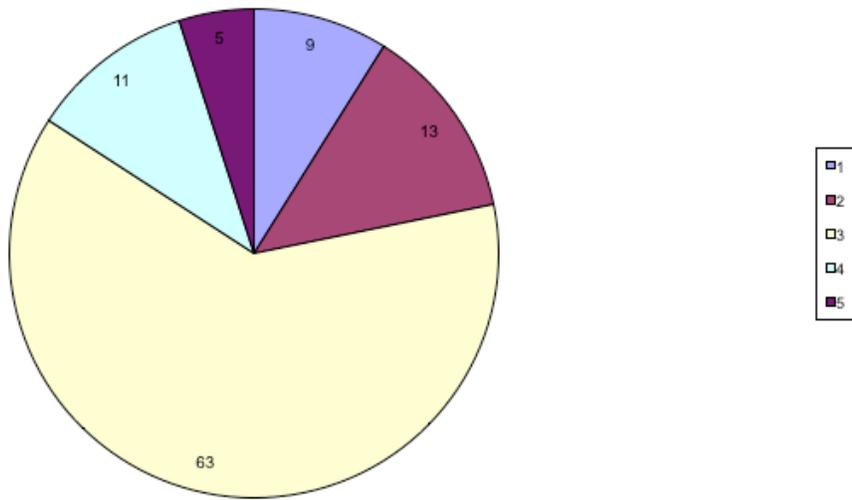
economy. Even the costs of a business failure for all involved (workers, management, and stockholders) are accepted as part of the process. The prospect of executives running a company into the ground and walking away with millions when workers lose everything violates Americans' sense of fairness.

FIGURE 3. THE PROBLEM WITH ENRON

Gallup poll question: Which of the following do you think is the most important issue in the Enron situation?

1. Enron contributed millions of dollars to politicians and may have expected favorable treatment in return.
2. The actions of Enron executives led a large corporation to suddenly collapse and go bankrupt.
3. Many Enron employees lost their jobs and their retirement savings while Enron executives made millions.
4. All/some of the above.
5. None of the above or no opinion.

Poll date: February 8–10, 2002



Source: Gallup.

Americans seem to share Adam Smith’s skepticism of the motives of individual business leaders while having substantial confidence in the free enterprise system. A July 2002 Gallup poll asked:

Would you say top executives of a larger corporation taking improper actions to help themselves at the expense of the corporation—is very widespread, is somewhat widespread, only happens occasionally, or never happens in the business world?

Over 80 percent of respondents chose very or somewhat widespread, while 50 percent in the same survey responded that “the problem of corporate corruption . . . has always been like this.” Yet, around the same time (September 2002), Americans were equally divided between whether government regulation of business was “too much,” the “right amount,” or “too little.” While skeptical of individual businesses, Americans seem to recognize the value of competition among businesses.

Public perceptions of cronyism are important in shaping attitudes toward the market economy. If people attribute the evils of cronyism to capitalism, they could increase their support for government regulation and other restrictions on economic freedom. For instance, two-thirds of Americans polled by Gallup in July 2002 thought that legislation and increased regulation could correct the problem of corporate corruption. Gallup has asked several questions on a repeated basis since the mid-1990s allowing a compilation of several time series on attitudes toward cronyism. Figure 4 reports the results over time for four questions appearing in different Gallup polls. In each case we report poll responses so that a larger percentage indicates greater support for free enterprise than for interventionist or regulatory positions. Because of differences in the questions, a larger percentage of respondents for one question does not necessarily mean greater support for free enterprise than a similar percentage for another question. For example, for two of the questions we report a “net support” for the free enterprise position.

FIGURE 4: PUBLIC ATTITUDES TOWARD FREE ENTERPRISE OVER TIME

Gallup poll questions:

Q1: Next, we'd like to know how you feel about the state of the nation in each of the following areas. . . . How about the size and influence of major corporations?

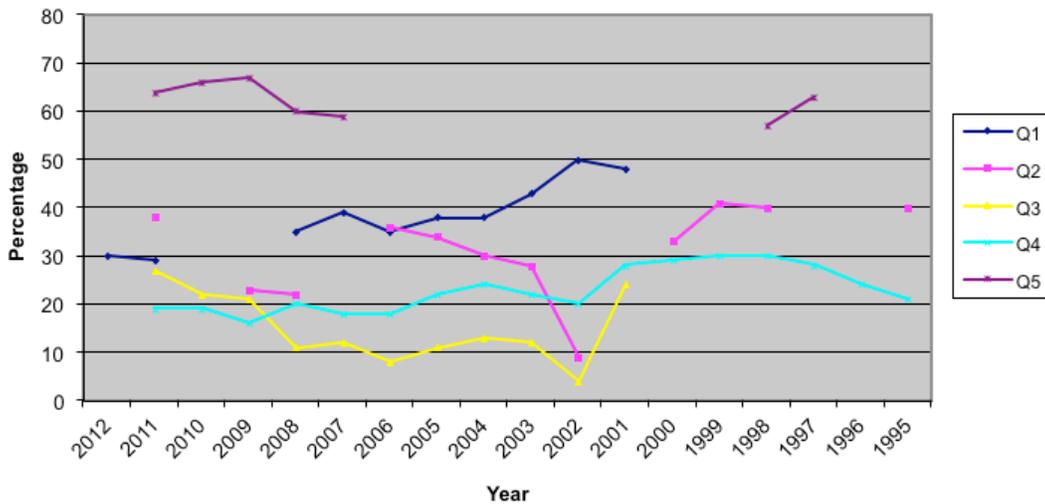
Q2: In your opinion, which of the following will be the biggest threat to the country in the future—big business, big labor, or big government?

Q3: In general, do you think there is too much, too little, or about the right amount of government regulation of business?

Q4: Now I am going to read you a list of institutions in American society. Please tell me how much confidence you, yourself, have in Big Business.

Q5: Please tell me how much confidence you, yourself, have in Small Business.

Poll dates: 1995–2012



Responses:

Q1 – Sum of responses “Very satisfied” or “Somewhat satisfied”

Q2 – Percentage responding “Big Government” minus percentage responding “Big Business”

Q3 – Percentage responding “Too much” minus percentage responding “Too little”

Q4, Q5 – Sum of responses “Great deal” or “Quite a lot”

Source: Gallup.

Figure 4 shows that support for free enterprise fluctuates but never disappears. Cronyism does appear to negatively affect the public’s perception of free enterprise.

The difference in the percentage of respondents who believe that big government is a threat in the future compared to big business (Question 2), for instance, has fluctuated between a low of 9 percent (in 2002) to a high of 41 percent (in 1999) since 1995. Two manifestations of cronyism during this period, Enron in 2001–02 and the financial crisis in 2008, appear to reduce support of free enterprise, with the Enron case (and the bursting of the dot-com bubble) having a larger impact. Indeed the reaction against big government revealed in the 2010 congressional elections was certainly evident in these polls, particularly in the percentage of Americans who view big government as a bigger threat than big business (Question 2) and the percentage who think there is too much regulation of business (Question 3).

Although comparison of percentages across these questions is problematic, Question 4 and Question 5 can be interpreted as demonstrating Americans' displeasure with cronyism. These two questions reveal that Americans have substantially greater confidence in small business (about 60 percent or more since 2007) than in big business (around 20 percent during these years). The esteem for small business could be in part a consequence of a perception of "us" versus "them," as many Americans own or aspire to start a small business or know a small business owner and, consequently, project self-perceived virtues on small business. The difference may also be in part due to cronyism. People recognize the value created by businesses in the economy, but know that favor seeking or lucrative government contacts typically involve large companies, and thus view big business with unease. If so, the support for small business might reflect popular support for free enterprise free of cronyism. The level of support for small business in these Gallup polls is very similar to Brooks' claim of a 70–30 split in America in support of the free enterprise system.<sup>66</sup>

Several Harris polls address ethics and crony influence on elections.<sup>67</sup> A Harris poll found that the number of Americans who believed that elections could not be run honestly rose from 36 percent in 1973 to 50 percent in 1990. The same survey found that 70 percent of respondents believed that the desire to influence government was a major cause of large campaign contributions, and 63 percent of respondents felt that companies regulated by or doing business with the government were a major cause of large campaign contributions. Americans recognize that getting

*America's Future* (New York: Basic Books, 2010).

67. Louis Harris, "Despite Skepticism, Voters Say Government Can Be Made to Work," The Harris Survey #91 (1978a); Louis Harris, "Priorities for the Country," The Harris Survey #76 (1978b); Harris, "Ethics of Top Legislators in Japan Viewed as Much Lower than Those in U.S.A.," The Harris Poll #20 (1989); Harris, "Cynicism About Campaign Spending at All-Time High," The Harris Poll #26 (1990).

politicians more involved in the economy does not lessen crony influence.

## CONCLUSION

CRONYISM CAN HAVE real and significant costs, yet it is challenging to measure objectively. In fact, just the perception of cronyism can inhibit business formation, distort the allocation of entrepreneurial talent, and undermine support for free market capitalism. Refined measures of perceptions of cronyism among both business leaders and the public could help advance our understanding of cronyism and its effects on our economic system. Surveys of the business community have proven to be a valuable way to measure corruption, and so a primary use of perceptions of cronyism among the business class could be as a measure of cronyism in the United States. If a measure of cronyism were available at the industry level, it could allow research into the causes, consequences, and possible remedies for cronyism.

Economists have explored the determinants of corruption, and whether the same factors affect cronyism is an important research question. Do regulation, market structure, or the level of government contracting matter? History is undoubtedly important, and it would be interesting to examine, for instance, whether a firm that began in an industry dominated by crony relations and then expanded through growth or mergers into a less regulated line of business brought its crony culture to the new industry. Questions about the consequences would include whether rates of new business formation, productivity growth, technological change, executive turnover, and market structure over time correlate with the prevalence of cronyism. Patterns across industries of any divergence in perceptions of cronyism with direct measures of crony relations could be particularly valuable, since many times a perception of favoritism will deter entrepreneurs.

Perceptions of and attitudes toward cronyism among the public could help us understand how to reduce cronyism's impact on the economy. Do differences in perceptions of cronyism exist across demographic, ethnic, or economic groups, and if so, how do these differences correlate with voting patterns or media exposure? Does the perception of cronyism vary across states, and if so, do the differences overlap with or crosscut the red state–blue state divide and the level of economic freedom? Does sensitivity to cronyism lead economic freedom to expand or contract over time? If the public attributes the evils of cronyism to the free enterprise system, they might support an expansion of government control over capitalists as a means (albeit likely misguided) to control cronyism and rent seeking. But a high sensitivity to cronyism could also deter businesses and politicians from entering into crony relationships, just as concern over government violation of citizens' rights could be an important force in preserving limited government. Existing surveys on rent seeking and corruption provide a few clues about the answers to these questions, but surveys on cronyism offer a promising direction for future research.