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Capitalism Did Not Win the Cold War

Why Cronyism Was the Real Victor

Sami J. Karam

SAMI J. KARAM is Founder and Editor of populyst.net [1].

When [the Soviet Union](#) [2] collapsed 26 years ago, it was generally agreed that the West had won [the Cold War](#) [3]. This was affirmed by the prosperity and possibilities awaiting citizens of Western countries, as opposed to the political and economic stagnation experienced by those in Communist states. A natural conclusion, much repeated at the time, was that capitalism had finally defeated communism.

This sweeping statement was only partially true. If one took capitalism and communism as the only two protagonists in the post-[World War II](#) [4] struggle, it was easy to see that the latter had suffered a mortal blow. But there was a third, stealthier protagonist situated between them. This was a system best identified today as cronyism. For if capitalism did win over the other two contenders in 1991, its victory was short-lived. And in the years that have followed, it is cronyism that has captured an ever-increasing share of economic activity. A survey of the distribution of power and money around the world makes it clear: cronyism, not capitalism, has ultimately prevailed.

DEFINING CRONYISM

What is cronyism? In a previous [article](#) [5], I objected to the term "crony capitalism" on the grounds that cronyism is itself antithetical to the principles of [capitalism](#) [6] and ought not be viewed as a derivative of it. Cronyism is, rather, a separate system that falls between capitalism and state-controlled socialism. When a country drifts from [capitalism](#) [7] toward socialism, the transitional period is one in which cronies rule the land.

Transitional cronyism claims to be capitalistic, whereas socialism claims to be egalitarian. But they are very similar, except for the size of the group of cronies at the top. In cronyistic societies, a larger group extracts a growing share of society's wealth for themselves and their associates. In socialistic systems, a smaller group vies savagely for wealth and power: because putatively egalitarian economies are usually less efficient at generating wealth, there may be less to go around, making the infighting among socialist leaders that much more bitter.

Malcolm S. Salter of Harvard University provides a useful definition of cronyism as a transition between [capitalism](#) [8] and socialism, although he abides by the term "crony capitalism." In his 2014 working paper [Crony Capitalism, American Style: What Are We Talking About Here?](#) [9], he writes:

In short, cronyism occurs when government officials and business elites collude to benefit themselves in ways that would be impossible if they were limited to arms-length transactions. Collusion undermines both democracy in government and competition in business, and thus has damaging short-term and long-term effects.

In the first case, the democratic principles of fair representation and equal access are jeopardized by the greater political influence that well-connected individuals and interests get through tacit or explicit promises of campaign donations or by way of lucrative future jobs in the private sector.

In the second case, the laissez-faire principles of free competition and just rewards are compromised when weak or failed capitalists endeavor to cement their market positions through favorable regulations or to secure government bailouts when bankruptcy looks inevitable. Under cronyism, all of these tradeoffs become common currency, but they are only available to the deep-pocketed large players, to the detriment of smaller businesses and private citizens.

Salter further identifies the three main elements in the crony capitalism toolkit: campaign contributions to elected officials, heavy lobbying of Congress and rule-writing agencies, and a revolving door between government service and the private sector. Although many industries could conceivably benefit from extractive or rent-seeking ^[10] activities, some are historically more prone to it than others. As *The Economist* ^[10] notes, the finance, energy, infrastructure, and real estate sectors all have a troubling history of attracting and breeding cronies.

CRONYISM IN THE WILD

Having defined cronyism, let's now examine its prevalence in today's world. This can be difficult to ascertain, because linkages between personal incentives and public policy are not always illegal, conspicuous, or even known. It is also, therefore, difficult to measure the scale of cronyism in a given context: that is, to make a judgment on whether—if present—it is a small or large problem.

We can, nonetheless, draw some conclusions about how much cronyism occurs in an economy (cronyism as an input) by looking at that economy's results (its output). Here, four key indicators can serve as warning signs of where cronyism may rule.

First, it should be considered a "red light" if a country scores poorly on widely accepted corruption indices (Transparency International's Corruption Perceptions Index ^[11], for example) and its economy is dominated by extractive industries. In many such places, government and business elites work hand in hand in ways that increase their hold on power and wealth, and close off opportunities to competitors. In many cases, these individuals are assisted by investments from foreign corporations, often in the energy or mining sectors, seeking to curry favor with local authorities in order to secure exploration rights. Here again, the high stakes and large amounts of money solidify the positions of elites, often to the detriment of ordinary citizens.

Some oil-producing nations provide a good example of this phenomenon. For example, the small oil-rich country of Equatorial Guinea ^[12] had a strong GDP per capita (PPP) of \$48,000 in 2012 before the price of oil declined. Yet it ranked 144 of 187 countries on the

United Nations Gini coefficient, a measure of income inequality. It also measured poorly on corruption indicators, with a large share of oil revenues alleged to have accrued ^[13] to those close to the president and his family.

Closing off the circle of money flows, many of these developing country elites then park a sizable portion of their assets in real estate of Western cities such as London or New York, or in Swiss or offshore bank accounts. A large share of these assets is then funneled to asset managers, hedge funds, and others in the large financial centers of the world—not only New York, London, and Hong Kong, but also the Cayman Islands, Panama, Cyprus, and other offshore havens.

Second, if a country lags on political pluralism, the independence of its judiciary, gender equality, or human rights, cronyism can be safely assumed to be a factor. The Rule of Law Index ^[14] produced by the World Justice Project shows Venezuela, for example, to have the worst ranking overall, lower than even war-torn Afghanistan. The country also suffers from very low ratings on measures of open government, civil justice, and criminal justice. Here again, it is no surprise that decisions pertaining to governing and business are made by a small coterie of people. Venezuela is the current living example of socialist-style cronyism, where a former pre-Chavez elite of cronies has been sidelined and replaced by a new power structure that claims to be egalitarian but is fundamentally just as cronyist as the one that it replaced.

The Venezuelan economy has been in a downward spiral ^[15], but the people in charge have reportedly extracted vast amounts of wealth. Activists have charged ^[16] that family members of former strongman Hugo Chavez have amassed huge personal fortunes at the nation's expense. His successor, the incumbent President Nicolas Maduro, is said to be one of the highest-paid politicians in the world. His entourage has also grown rich during his years in office. This has all taken place while the life conditions of the average Venezuelan citizen have deteriorated significantly in recent years.

Third, if a country's economy is overly reliant on raw materials exports or low value-added goods, rather than productivity or innovation, cronyism may well be a dominant factor. Equatorial Guinea and Venezuela are good examples here as well. But among larger countries, Brazil ^[17] and Russia also fit the description. Both are highly dependent on commodity exports, and both are riddled with endemic corruption and cronyism. In Brazil, for example, long-standing collusion between government and business is being exposed in a web of scandals ^[18] that has touched government officials and executives at leading energy, infrastructure, and finance firms Petrobras, Odebrecht, and BTG Pactual.

Fourth, high-income inequality can mean that cronyism has played a role in reducing competition in that economy. Developed nations are not immune to this disease, as cronyism and inequality have grown hand in hand in the United States since the mid 1990s. Much of this inequality has come from the enrichment of individuals working in subsectors of industries such as energy, finance, law, and real estate.

There is ample evidence that cronyism is an endemic problem in BRIC countries and other developing economies. But how much has this cronyism corrupted the economies of developed Western nations? This question is important, because these societies pride themselves on being competitive meritocracies with time-tested, balanced institutions.

There are several ways to evaluate this: first, by looking at the money that has flowed from developing nations into developed ones; second, by using Salter's toolkit; and third, by examining the four output indicators discussed above.

Taking each in its turn:

There is abundant evidence that developed world elites have benefited from the wealth generated by China and other emerging nations. Investment banks have derived billions of dollars in fees by underwriting trillions in equity and debt since the early 1990s. They have curried favor with foreign leaders and other power brokers and have obtained massive contracts in return, some of which were not always in the best interest of the people in those foreign countries. For example, it is evident that some oil-rich countries in Africa have made deals with foreign energy companies that were advantageous to domestic elites but harmful to their own citizenry.

In the same vein, asset managers of offshore funds have developed profitable new income streams managing the wealth that elites of cronyistic emerging-market nations invest in safer, more developed economies. The Tax Justice Network ^[19] estimated in 2016 that \$12 trillion from developing countries alone was parked in offshore havens. The total figure, including money originating from rich nations, is believed to be significantly higher.

Real estate can function in the same way, through the sale of apartments in politically stable markets to the oligarchs from corrupt, emerging-market economies. Pouring money into hedge funds and ultra-luxury real estate is often a poor investment choice, but to a wealthy oligarch, they are safer bets than keeping wealth in his or her home jurisdiction, where shifting politics heighten the risk of expropriation.

The market for ultra-luxury condominiums has boomed for years in the United States, with cities such as New York and Miami attracting billions in foreign investments. "What many Americans might not realize," a Washington Post report ^[20] explained in 2016, "is that foreign-owned shell companies play a big role in the U.S. economy through the real estate market." The report continued: "...in the last quarter of 2015, 58 percent of all property purchases of more than \$3 million in the United States were made by limited liability corporations, rather than named people. Altogether, those transactions totaled \$61.2 billion, according to data from real estate database company Zillow." Also in 2015, an extensive report by the New York Times ^[21] estimated that in six of Manhattan's most expensive buildings, shell companies owned between 57 and 77 percent of the condominiums.

Looking at the four output indicators, we see that all four are increasingly prevalent in Western economies. Since the early 1990s, the financial sector and other rent-seeking industries have grown rapidly to constitute a larger share of GDP and of corporate profits.

The independence of the judiciary has likewise come into question in recent years due to the revolving door and to what Jesse Eisinger ^[22] of Pro Publica has called "elite affinity," which means the propensity of people who attended the same colleges and who worked at the same firms to value cooperation with each other over confrontation, even in cases when confrontation is necessary.

U.S. productivity, meanwhile, has stalled in recent years, and U.S. corporate earnings

have become increasingly dependent on foreign operations.

Last, as the economist Thomas Piketty ^[23] and others have pointed out, the concentration of wealth has grown steadily since 1980. Piketty demonstrated ^[24] that the percentage of income that accrued to the top decile remained near 30 percent for three decades after 1950. But starting in 1980, this percentage grew steadily until today, when it is near 50 percent. To be fair, not all of this rise can be attributed to cronyism and a decline in competition. Technology and the ability to leverage strong brands into new overseas markets also played a role. But there is no doubt that people who have been well positioned in extractive sectors have benefited disproportionately. Among them are executives of some commodities and financial firms.

CRONYISM, VICTORIOUS

The balance of evidence suggests that if one economic system did win after the fall of Soviet communism, it was not capitalism exported from the West to the rest of the world. Rather, it was cronyism, which spread from the rest of the world to take hold in the United States and in Europe.

In today's headlines, the murky relationship between the Trump administration (constituted of operators in finance, real estate, energy, and law) and unspecified Russian interests reinforces the notion that the money and influence emanating from smaller economies can indeed have a deeply corrosive effect on the institutions of wealthy Western nations. Trump's own brand of cronyism ^[25] scoffs at the ethical niceties that had constrained his predecessors of all ideological stripes.

This level of open cronyism has not been seen in the United States for a very long time, if ever. But it rests on decades of corrosion during which the ostensibly open economy of the United States moved further and further from its longstanding laissez-faire principles and closer to genuine cronyism.

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[5] <https://populyst.net/2016/08/30/the-bridge-from-laissez-faire-to-socialism/>

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