Section IV: Principled Entrepreneurship, Crony Capitalism, and Unproductive Entrepreneurship

Part 10. Legal Plunder, Crony Capitalism, Unproductive Entrepreneurship

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Introduction:
This section has two required readings that between them cover all but a few small aspects of this lesson. This document focuses only on those other aspects not covered in the required articles: Bastiat’s *The Law* and the chapter on “Economic Freedom and Entrepreneurship,” from the Fraser Institute by Russell Sobel.

Defining Voluntary vs. Coercion
We know from our earlier lessons that voluntary exchange makes both parties better off. The opposite of voluntary action is coercion. What exactly is coercive? Is a cable company setting high prices coercion?

One good, workable definition of coercion is described by Randall Holcombe in his chapter “The Distinction between Clubs and Governments” in *The Economic Foundations of Government*. He defines an action as coercive if the other party is willing to devote resources to making you worse off if you don’t comply. For example, if a robber points a gun at you and says “give me your wallet” and you say “no thank you, I’d rather not”... the question is what comes next. Is the person willing to devote their time and resources into making you worse off for not complying. The answer is yes, so this is coercive. Government taxation is also coercion, if you do not complying with paying taxes they will indeed devote resources to making you worse off. The cable company on the other hand will not. If you hang up on them when they call to sell you cable, or disconnect your service. they will not come harm you. You will be the same well off as if the cable company never existed. That isn’t the case with the robber.

Legal Plunder and Rent Seeking
This important concept is covered in the reading “The Law” by Bastiat. However, the terminology ‘rent seeking’ is not. *Rent seeking* refers to the process of spending resources to secure an unearned reward through government. If a company hires a lobbyist who helps get a law passed that helps the company have an advantage over its competitors that is rent seeking, for example.

Zero Sum, Positive Sum, and Negative Sum Activities
Voluntary exchanges that benefit both parties, by definition improve the well being of society if nobody else is affected. Jim wins, Mary wins, and nobody is harmed—society is better off. That’s a positive sum activity overall, a net win. A zero sum activity is one that helps one person and harms another in offsetting amounts. I take $5 from your wallet without you noticing and spend it. Most pure transfers like that, however require resources devoted to making them happen. I may need to buy a mask, a crowbar, etc., and you may spend money on a security system trying to prevent it. Thus while the transfer itself is zero sum, the waste of those additional resources, that have an opportunity cost to society, results in a net overall loss. It becomes a negative sum activity. When companies spend
resources to get subsidies from taxpayers, this is a negative sum activity—it hurts the overall well being of society.

**Crony Capitalism**

Crony capitalism is the term used to describe a situation where the institutions of markets are maintained, but the allocation of resources, and the profit and loss of businesses, are determined by political decision making rather than consumer purchases and market forces. To a large degree, the activities of business firms are directed and controlled by government spending and regulation. In turn, many of the business firms will use contributions and other forms of political support to compete for government favors (i.e., rent seeking).

Cronyism, or crony capitalism occurs when political connections replace market forces as the determinant of business success.

**Economic Freedom and Productive Entrepreneurship**

This important concept is covered in the reading on “Economic Freedom and Entrepreneurship,” from the Fraser Institute by Russell Sobel. One key takeaway is that the structure of a country’s laws, policies, and institutions (i.e., Economic Freedom) determines the relative rates of profitability of investing effort in productive entrepreneurship vs. unproductive entrepreneurship. The main differences across countries in the measured rates of entrepreneurship aren’t due to differences in the number of creative people. Just a difference in how they spend their time and talents.

**Constitutions as Constraints**

Preventing widespread legal plunder, or excessive rent seeking, unproductive entrepreneurship, and crony capitalism is, and should be, the job of constraints on the scope of government action through constitutional rules. Constitutions are restrictions on government power and action. Constitutions are indeed formal institutions, and when they are good they can help to promote prosperity. Rules that ban the giving of government handouts to favor special interests are helpful.

Randall Holcombe’s work brings two additional points on this topic worth mentioning. First, in the same chapter mentioned earlier, he notes that constitutions are a substitute for mobility—in that the ability of people to leave is a constraint on government itself. People can move away from a bad local government. But as you move up to higher levels, like the state or the federal government it gets more difficult to escape at low cost. Thus. constitutional constraints are more important on higher level governments. Second, in his 1992 article “The Distributive Model of Government,” in the *Southern Economic Journal*, he provides an interesting example worth mentioning as far as good constitutional constraints against rent seeking are concerned. In the constitution of the failed Confederate States was an interesting clause that does not appear in the U.S. Constitution, “… no bounties shall be granted from the Treasury, nor shall any duties of taxes on importations from foreign nations be laid to promote or foster any branch of industry.” Had that clause been in the U.S. Constitution it may have helped to prevent many of the crony capitalist behaviors we presently experience.

**Broad Based vs. Selective Policies**

Often the design of policies themselves affects the level of unproductive entrepreneurship. When policies are very selective, say different tax rates on each good, it opens the door to a lot of favor seeking to alter those specific rates. On the other hand, broad based policies that apply to everyone equally tend to not encourage as much of this unproductive activity.
**The Chicken or the Egg, and Occupy Wall Street**
Somewhat ironically both many conservatives and many liberals think there is too many hand outs to big favored business corporations. The difference is a question of the direction of causality and how to solve it. Those who participate in activities like the Occupy Wall Street protests think that it is the lobbying that causes the problems. The other argument is that it is the government giving away favors that causes the lobbying. In one view restricting lobbying is the answer, while in the other restricting the scope of government action so they do not have the ability to grant favors is the answer. If a professor had a long line of students outside their office door, because they were willing to change the final grade of anyone who came an cried with a sob story, who would you blame and how should we make it stop? Is it the fault of the students or the professor for giving the favors? Whatever the answer, the point is that if you restrict the professor’s ability to arbitrarily change grades, the line ceases.

**Conclusion**

This chapter has considered legal plunder, rent seeking and unproductive entrepreneurship and how to solve them through stronger constraints on government. By doing so we end up with more productive entrepreneurship. This written document is meant to accompany the two articles as there are things covered in them, particularly the concepts of legal plunder and the definition of unproductive entrepreneurship that are required, important, concepts.