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ECONOMIC CONSEQUENCES OF CRONY CAPITALISM SYSTEM

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Summary. Raising of problem. The most important economic fact of our time is that we are living in an era of growing income inequality. Globalization and technological boom only increase the income gap of different segments of the population. The main reason of economic inequalities in many countries of the world is the strong links between government officials and business structures. The new type of economic system which is called crony capitalism undermines the centuries-old tenets of a free market economy. So there is a rising actuality of systematization of all negative effects of this type of economic system in the world. **Purpose.** On the basis of carried-out research, it will determine the features and economic consequences of crony capitalism system in the different countries of the world. **Conclusion.** The analysis suggests that crony capitalism generates significant economic rents, which result in a misallocation of resources and lower incentives for wealth creation. In addition, the corruption constitutes a considerable impediment to growth and development. The most damaging aspect of crony capitalism is its tendency to discourage equitable distribution of resources and income adjustment at a time when such traits are central to economic success. Crony capitalism promotes monopolization of economy, the growth of social injustice and inequality, creating obstacles for development of entrepreneurship, degradation of healthy competition and provokes corruption. Authors regard a fundamental solution of this problem in rising of effective anticorruption practices of the world countries that will have a multivectorial influence in the scale of international business.

Key words: *economic system, crony capitalism, crony-capitalism index, corruption, oligarchs, shadow economy.*

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The urgency of the problem. The most important economic fact of our time is that we are living in an era of growing income inequality. Globalization and technological boom only increase the income gap of different segments of the population. Also, we are living in the age of plutocracy. It is especially noticeable in comparison welfare of the uppermost layers of the population and all the rest. The most obvious examples of this fact are the USA and the UK, but this is a global phenomenon, peculiar to communist China, post-communist Ukraine and Russia, India and Canada. We see it even in such favorable democratic countries like Sweden, Finland and Germany.

The main reason of all economic inequalities is the strong links between government officials and transnational corporations. The last one has enormous resources of influence on people's social and business life in the country. Today the main problem of all economic activity in the world is new type of system, which is called crony capitalism, undermines the centuries-old tenets of a free market economy

Analysis of publications. Theoretical groundings of crony capitalism system were broadly studied by M. Booth, J. Davis, V. Gelman, S. Gregg, L. Kosals, H. Levis, G. Sharafutdinova, J. Stiglitz, K. Strassel and others. Scientific problems of cronyism in post-soviet Russia were the subject of multiple principle

researches of L. Kosals, G. Sharafutdinova [8, 13]. The hierarchy and the vertical of power in Russian crony capitalism system were investigated by V. Gelman [6]. The factors of influence of crony capitalism and corruption on the socio-economic development of Ukraine were analyzed by O. Dlugopol's'kyi, S. Lazarenko, J. Nadeau [5, 9, 11]. The American style of cronyism was considered in the numerous works of such economic analysts as M. Booth, G. Davis, H. Levis, J. Stiglitz and others. [1, 4, 7, 10, 14, 15, 16]. Still there is a rising actuality of systematization of all negative effects and consequences of this type of economic system in the world.

The purpose of the article is to determine the salient features and economic consequences of crony capitalism in the different countries of the world. Moreover, it is necessary to find a reasonable balance between the government and business structures.

The main material of the research. Crony capitalism is a term describing an economy in where success in business depends on close relationships between business people and government officials [3]. Obviously it includes businesses who lobby governments and legislators for exemptions, monopolies, subsidies, access to "no-bid" contracts, price-controls, bailouts, tariff-protection, preferential tax-treatment, and access to government-provided credit at below-market interest-rates.

The main features of cronyism between entrepreneurs and government officials are similar in all parts of the world. In surprisingly little time, all the bonds of trust and cooperation nurtured by the free price system become frayed or just disintegrate. The way that businesses and investors can make money in this type of system is by getting the government to rig markets in their favour – by erecting barriers to entry to restrict competition, by providing them with cheap credit or by allowing them to use their political connections to grab contracts and other privileges. These gains are not the fruit of value-adding economic activity. Rather than helping to grow the economy, they often merely redistribute wealth.

There have been far too many examples of this kind of behavior in recent years in the

West, in Russia, in Latin America and in the most other parts of the world. Tragically, that world economic system has been moving away from commercial relationships and becoming ever more politicized.

Remarkably, the most developed and economic active countries have become the most affected by crony capitalism. They are populated with lawyers, lobbyists, contractors and others who derive their income from doing deals with politicians. Cronyism has been an important element of capitalism everywhere, but the relationship between cronyism, business, and politics and cronyism's effect on development vary greatly from nation to nation.

Unlike in a free market capitalist system, under crony capitalism it is more often profitable for businesses to spend resources lobbying legislators for monopoly status; noncompetitive bidding or contracts; modifications of tax penalties; deductions, clawbacks, or phase-outs handouts in the form of grants, loans, or tax advantages, and protections against competition in order to increase their profits.

What public officials want from private interests are: campaign contributions; direct campaign assistance, indirect campaign assistance; assistance with "messaging" money (illegal if a bribe, but not necessarily in other cases, e.g. assistance with a loan or access to a "sweetheart" investment); support from "foundations" related to campaign contributors, regulatory fees to support agency jobs; jobs for friends, constituents, or eventually themselves; travel, entertainment, other "freebies"; power, control, and deference. The alliances and relationships formed between public officials and private interests may be counter-intuitive. A company may give more campaign money to a potentially hostile legislator than to a friendly one, in order to forestall trouble.

All these crony capitalist deals not only introduce lying, cheating, and corruption into the economic system. From a purely economic point of view, they also interfere with free economic prices and profits, the signals on which any economy relies. The result is economic chaos as well as corruption. Hobbled prices, linked to growing corruption, are enough to destroy any economy. Nor is it possible to restrain

corruption without allowing truthful, unfettered prices. Oystein Dahle, a Norwegian businessman, perceptively noted that “the Soviet Union collapsed because it would not allow prices to tell the economic truth” [10].

In recent years, the cronyism between corporations and government has increased. A major example of crony capitalism is The United States of America. The U.S. economy is rife with inefficient interventions—laws, regulations, taxes and subsidies that lead to inefficient markets. Many government regulations choke off entirely legal avenues of potential bank profits. The banking bailout is example of cronyism and corporate welfare. The poor lending practices of banks were undoubtedly part of the cause of the Great Recession. But banks, as well as government-sponsored enterprises such as Fannie Mae and Freddie Mac, were under tremendous pressure to make loans to unqualified borrowers [4]. Another reason is that crony capitalism is directly linked to the policies of the ruling elite: the reduction of taxes, the regulation of the financial sector, privatization, weak legal protection of trade unions. All this creates a system where the most of the revenue goes to the top.

For example, post-Soviet countries. Where all political changes are made so that they may go into the hands of a group of "friends", not really taking into account the interests of all the others. The crony capitalism in New Russia was born after the collapse of the USSR. New Russian businessmen who had close links with government during privatization period in 1991-1998 want to get the best factories and industries of post-soviet country. From their turn guaranteed the government their political support in the run up to the presidential election scheduled for the summer of 1996. In this way the Tyumen Oil Company (TNK) passed into the hands of Alfa Bank headed by Mikhail Fridman; the YUKOS oil company became the property of Menatep Bank, headed by Mikhail Khodorkovsky and Sibneft was transferred to a holding company controlled by Boris Berezovsky [6].

But in the beginning of 21st century Russian government tried to do the long-term and diverse reform against corruption and influence

of oligarchs in Russia. However it didn't help. All problems in different sectors of economy of Russian Federation were found in 2008, during the financial crisis. About how, after the deepest financial crisis since the great depression hard to rebuild the banking system we can see now. Or about how it is difficult to make international corporations, including those whose conditional motto is "do no harm" to pay taxes at least approximately to the extent, that of the middle class.

Moreover, crony capitalism can exist in different economic systems like socialism, communism and mixed economy and so on. The great example can be Asian tiger. China is the ultimate crony capitalist state. It's leaders have sought to “manage” the reemergence of China onto the world stage, and in the process may have managed themselves right into a deep recession as only central planners can do. All the banks in China are run by members of the Chinese Communist Party as are the biggest Chinese firms outside of banking. Investments by foreign companies are tightly regulated and foreign companies are regularly shaken down by various means [2].

However, there is one more country in the center of Europe, where national economy is also affected by crony capitalism. Ukraine is the post-Soviet country which is trying to struggle with the problem of cronyism during last decades. But the problem is really big. The influence of such type of economic system is presented in all sectors of national economy. For instance, Ukraine's oligarchs are a force to be reckoned with. Though less notorious than their Russian counterparts, Ukraine's billionaires together command a greater share of their country's wealth than their Russian counterparts. The wealth of only a dozen Ukrainian oligarchs makes up roughly one-fifth of the country's GDP. Having, for the most part, made their fortunes in the lawless transition period between Soviet and capitalist economies, these oligarchs thrive in the shadows, far away from the rule of law [11, 12]. Also, when crony capitalism dominates it is always the high level of shadow economy, which is also harmful to the development of market relations. As a re-

sult, about half of the GDP of Ukraine was "eaten" by shadow economy [9, 13].



Fig.1. The crony-capitalism index

Nowadays this problem is very popular among economists. Therefore the most reputable economic newspaper prepared the article where we can look on this problem more widely. The crony-capitalism index is a new measurement of crony capitalism designed by "The Economist" newspaper. It aims to indicate whether the livelihood of the people from certain country or city with capitalist economy are easily affected by crony capitalism. It is not an international recognized index due to its limitations

On the first graph (Fig. 1) as we can see there are such countries which have developing economies except Hong Kong. For instance there are countries as Russia, Malaysia and Ukraine. They are in hot lines of our list due to the high level of cronyism and strong links between government and business structures which have a big influence on well-being of citizens. So the first ten countries in our list are the most affected by cronyism. Then we can see that the countries with developed economies such as Brazil, India and Argentina. All of them have a low level of crony capitalism. The percent of wealth of billionaires in different sectors of economy are still low. On the second graph (Fig.2) we can see the difference of influence of billionaires in sectors of economy between developed and developing countries.



Fig.2. The difference of influence of billionaires in sectors of economy

As we can see in developing countries the golden age of crony capitalism was before crisis. However, they still have a high level of influence to our days. In developed countries situation much better, but the graph shows us that the level of crony capitalism is slowly rise in recent years.

Conclusion. 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. The most damaging aspect of crony capitalism is its tendency to discourage equitable distribution of resources and income at a time when such traits are central to economic success. Crony capitalism promotes monopolization of economy, the growth of social injustice and inequality, creating obstacles for development of entrepreneurship, degradation of healthy competition and provokes corruption.

There are one of the two opposing solutions that have been put forth to prevent crony capitalism. That solution is to increase government regulation of businesses. Opponents of this option however point out that large corporations and the politically well-connected have too much influence on the legislative process because, more often than not, the politicians and government bureaucrats involved in that process are not able to withstand that influence.

The second solution to truly stifle the mechanisms of crony capitalism is to remove the ability of the government to hand out favors and create transparency and openness in government spending. It is necessary to prevent corruption by using of effective anticorruption practices of the world countries. These measures will lead to a more transparent and equitable distribution of income that helps to improve the welfare of the population and in-

crease the rating of the country in many respects, including the ease of doing business. Thus, in the absence of crony capitalism, the economy is based on free market economy and as a result it leads to more competitive ability. Until this problem has a tendency to increase. In near future we will have more questions and discussion of solving this problem because crony capitalism will become a global problem.

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