

Cronyism in Canada? Surely Not...

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Cronyism is, as we all know an enormous obstacle to economic progress in Third World countries. But you'd be surprised how uncomfortably like industrial countries like Canada the discussion can sound when you read a [high level analysis](#) of the mechanics of cronyism like the one by [Raj M. Desai](#), just published by the [Brookings Institution](#) in Washington.

Try out this checklist (which I have pulled together from various parts of Desai's article) to see how industrial countries fare on these signs of cronyism:

- Governments suppress competition by conferring monopolies, devising market restrictions or tolerating cartels (can you spell CRTC? Airline ownership restrictions? Marketing boards?);
- Tax systems, business and labour regulations become riddled with special exemptions (have you tried to lift the Income Tax Act recently without the use of a crane?);
- Government contracts are awarded on the basis of political connections (my lawyer advises against my making any comment on this one);

- Financing is granted in the form of cheap, publicly-guaranteed credit (hello regional development agencies).

Desai sums the argument up thus:

“Where powerful private-sector interests shape the content of laws and regulations to their own advantage, the results are well known: a small number of powerful firms use their superior resources to manipulate political, legal and regulatory institutions to preserve and extend their privileged positions through inefficient redistribution, anti-competitive measures, and other discriminatory practices. A few companies benefit at the expense of the vast majority, and these privileged firms use their influence to obstruct reforms that would eliminate these advantages. Understanding the extent to which “state capture” exists, then, is an important part of assessing how economies are governed.”

The evidence for the existence of these relationships is quite fascinating. See, for example, the author's analysis of World Bank and other investment climate surveys in the table below. It shows that around the world “[t]he least politically-connected firms face higher real costs due to delivery delays and unpaid sales, have a harder time accessing financing, waste

more time with regulatory burdens, pay more in bribes, and find government services more inefficient than their politically-connected counterparts, even when controlling for country, firm size, and sector.” His conclusion: “a system of policymaking that rewards political influence often punishes the most dynamic companies. While the most influential firms face fewer obstacles to business, they also innovate less.... The most influential firms are also less likely to expand facilities, products and technologies.”

workers at the polls or in the streets.” Similarly they report more of their revenue from sales than non-influential companies who, because they are less likely to be able to negotiate special tax deals, have a bigger incentive to hide their earnings.

So cronyism is a two-way street in which both favoured companies and politicians get significant rewards. According to Desai, that’s why cronyism often survives changes in government and ideology and is far less dependent on personal relationships than one might expect.

Table 1: Influence has its rewards

	Least Influential Firms	Most influential Firms
Working capital from subsidized sources (% total)	0.8	3.3
Likelihood that collateral is demanded for financing (%)	89.8	73.5
Sales lost due to delivery delays (% total)	2.1	0.8
Sales not paid for at delivery (% total)	30.6	20.2
Senior management time spent dealing with regulatory requirements (%)	9.5	7.4
Annual sales paid in bribes (% sales)	2.4	0.9
Bribes paid for government contracts (% contract value)	4.1	2.5
Firms that consider public services efficient or very efficient (%)	5.7	11.6

Source: Investment Climate Surveys

Notes: “Influence” is measured as the difference between the firm’s own ability to affect laws and regulations and the firm’s perceptions of the ability of other domestic firms to do so. All estimated values in this table, as well as in subsequent tables and figures, are derived from stochastic simulations of regression models controlling for country, firm size, and industrial sector. All variables, with the exception of the explanatory variables of interest, are set at their sample means.

Even more interesting is Desai’s discussion of the mutual dependence of politicians and influential firms (who should be clearly distinguished from firms that do a great deal of lobbying – Desai shows convincingly that lobbying is a costly and inefficient substitute for real political influence).

Politicians mistakenly believe that coddling certain favoured firms will encourage these firms to invest and grow, but the evidence shows they don’t. They do however “provide two things that all governments want: employment and tax revenue.” Influential firms employ lots of people they could make redundant and unemployment is a constant anxiety for politicians. “Keeping employment levels artificially high is, consequently, a valuable service to politicians who are less likely to face large numbers of unemployed

Unfortunately Desai is much less strong on solutions to cronyism than he is on the analysis of the problem. Many of the suggestions he makes (e.g. conflict of interest laws, free and independent media, strong legislative oversight of the executive, effective business associations) are more obviously lacking in developing countries than in the West. The one that really reverberates for me, though, is his suggestion of tackling anti-competitive behaviour more vigorously: “Concentration of economic power can be tackled by deepening price and trade liberalization [there’s that pesky Doha Round again], increasing transparency in the ownership structure of firms, introducing greater competition by lowering barriers to entry, and through competitive restructuring.” But then these are precisely the policies that privileged firms and groups obstruct....

The main idea that you should take away and cherish as Ottawa strives to raise Canada's economic game?

“[B]ad investment climates don't just happen; they are deliberately made. The subversion of institutions undermines the security of property rights for those less well-connected *and thus weakens overall investment and growth.*”



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