

Opinion
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Crony capitalism and protectionism are the despot's way

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Don't be comforted by the health of the economy. The Trump administration's policies and decisions pose a threat to future prosperity.

By [Michael Albertus](#) and [Victor Menaldo](#)

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President Donald Trump has finally figured out a way to make Mexico pay for his border wall: The United States will simply become Mexico, and the ultimate accounting gimmick will finally be complete.

Or, rather, it will become more like Mexico circa last century: An authoritarian country that boasted some of the most protectionist trade policies on earth and where crony capitalism reigned supreme. If this occurs, we would join a notorious club.

At least since World War II, there has been an unholy trinity in which

authoritarianism feeds into crony capitalism, and both fuel trade protectionism. All three rely not on the rule of law, which is the linchpin of democracy and well functioning markets, but on the personal discretion of rulers. Rulers with authoritarian tendencies, or who operate in an authoritarian system, use the law to favor their friends and punish their enemies.



Michael Albertus is assistant professor of Political Science, University of Chicago. **Victor Menaldo** is associate professor of Political Science, University of Washington.

To benefit their friends, these rulers dispense favors, exemptions from regulations, provide subsidies and extend cheap loans that may never be repaid, except by taxpayers. They also exempt them from the import tariffs and quotas that everybody else has to abide by.

To harm their enemies, they expropriate their land, mines, factories and servers, tax them into oblivion, or hit them with antitrust suits. This is not because their enemies are monopolists who artificially ration supply and earn monopoly rents but, in an inversion of common sense and what's best for consumers, because they are

competitive and innovative — and therefore pose a threat to authoritarians.

Authoritarians like to pick winners and losers, not allow the market to do so. When the market does so, it diminishes authoritarians' power, which is vested in using regulation, taxation and the state's coercive powers capriciously to flatter themselves, and enrich themselves and their friends.

The purpose of resorting to crony capitalism and trade protectionism is precisely to distort economic decision-making. In allocating resources inefficiently, based on politics instead of competition, it creates a system in which supplicating to the ruler to dispense favors and artificially increase your profits is rewarded, instead of competition and innovation. This creates a culture of graft and corruption that erodes trust in the law and confidence in politicians to act fairly, prudently and in the service of the greater good.

While market capitalism, trade openness, and democracy do not brook favoritism or exemptions and self-correct to approximate an even playing field where everyone has to play by the rules, the unholy trinity achieves the opposite result. It is explicitly designed to do so.

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In our new book, "Authoritarianism and the Elite Origins of Democracy," we document why and how this is the case. Under most authoritarian regimes, rulers consolidate their hold on power by indulging in crony capitalism. They often resort to trade protectionism to bolster support among their ruling coalition, which can be composed of cartels and monopolists that depend on politicized regulations to survive and thrive. Exploiting cascading tariffs structures, they exempt inefficient domestic manufacturers from import taxes — and, if anything, they subsidize them

with cheap credit and other inputs to production and exempt them from regulations that are reserved for their enemies, including those intended to improve labor conditions, health, safety and environmental conditions.

Authoritarian rulers also hammer firms and business interests that are outside of their coalition with specious antitrust suits, irregular “windfall” taxes, fines, requirements to obtain special licenses, sky-high borrowing costs, and a climate of fear, intimidation and uncertainty.

These policies characterized notorious 20th-century governments such as Mexico under the Institutional Revolutionary Party (PRI) dictatorship, Argentina under Juan Perón and Spain under Francisco Franco. More recently, it is the story of the dictatorships in Myanmar, Egypt, Russia, China and Venezuela. It is the eventual endpoint in Turkey.

For readers who might accuse us of being alarmists, and who doubt that virulent crony capitalism of this variety could ever come to our shores, consider a few examples during President Trump’s short tenure. Right after taking office, he jawboned Carrier, an HVAC maker, to keep an inefficient plant open in Indianapolis, ostensibly in order to save jobs — even though it was merely political theater to appeal to his base. Or take his steel and aluminum tariffs: they might be good for a smattering of American steel and aluminum manufactures that don’t also import some of these metals themselves, but they are going to hammer the aerospace industry, automobile makers, appliance makers, canned goods manufacturers, and the construction industry. They will inevitably pass on their higher costs to consumers, hurting us as well.

And Trump’s fixation with Jeff Bezos is particularly disconcerting. Against all logic and evidence, he has contemplated bringing antitrust measures against Amazon, as well as directed the Post Office to investigate whether it’s being taken to the cleaners when delivering Amazon packages, even though Amazon related business has been a godsend that has helped it staunch its losses. This defies common sense, since the purpose of antitrust is to stop monopoly pricing and encourage innovation: prices on Amazon goods and services keep falling like a stone as its costs keep declining. Plus, the company keeps plowing its profits into research and development, which has allowed it to innovate across its divisions, including e-commerce, cloud computing, entertainment, and retail. This promises even better products and services and lower

prices in the future.

Finally, just last week, Trump told some of America's most productive farmers he would give them aid to redress their losses from Chinese retaliation for tariffs on Chinese imports. This means Americans will pay for these tariffs twice, in the form of both higher prices and higher debt and taxes. Given the recent track record, nobody should hold their breath about the U.S. rejoining the TPP.

That this political-economic model is becoming the new normal, rather than being tossed into the dustbin of history, is disturbing. This approach to a nation's political economy is not sustainable. Eventually, the government has to borrow ever greater amounts to prop up its favored industries and firms. Eventually, because the country becomes closed off from the world economy, it loses its competitive edge, prices spiral upward, domestic innovation grinds to a halt, and new ideas and technologies that would otherwise improve productivity and tame inflation are suppressed.

As the economic winners selected by authoritarians become ever more inefficient and corrupt, the losers who hunger to compete on an even playing field and who have the ability to compete based on their education, skills and ingenuity tend to conspire with the broader population to get rid of their venal overlords.

There can be a silver lining, however. The political and economic incumbents under a capricious political system centered on crony capitalism and protectionism inevitably begin to suffer at some point from the self-inflicted wounds associated with economic distortions and inefficiencies. The economic and political crises that they augur can eventually rejuvenate the political system, empowering a new coalition that favors democracy, markets and openness to the rest of the world.

But because there is no guarantee that these more liberal ideas and the forces that support them will triumph, it is best to avoid falling into a trap that unleashes the unholy trinity in the first place. That is why Donald Trump's penchant for undermining the rule of law, picking winners and losers, and turning to trade protectionism should not be readily dismissed by those who enjoy our current prosperity.

Michael Albertus

Victor Menaldo is a University of Washington political science professor and author of "Authoritarianism and the Elite Origins of Democracy." The views expressed in this Op-Ed are those of the author and not the positions of the UW.