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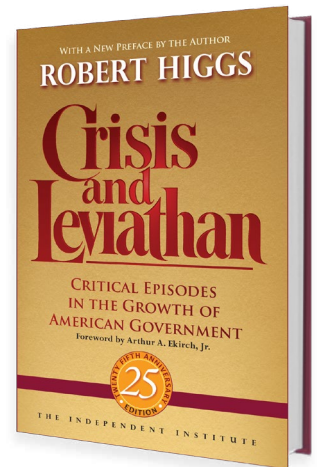
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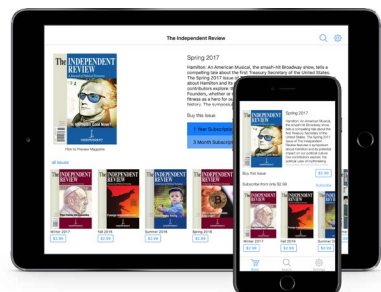
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# The Road to Crony Capitalism

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MICHAEL C. MUNGER AND MARIO VILLARREAL-DIAZ

In 1944, Friedrich Hayek published *The Road to Serfdom* ([1944] 2007). The book is often caricatured, but its actual thesis was explosive enough: any general attempts to plan the economy or manage prices put the society in danger of devolving into full-fledged socialism.

Hayek never said that the “road” had no exits or turnarounds, but he did think that many political leaders in the “free world” were too optimistic about the benefits and blind to the dangers of economic planning. And he has largely been proved correct, on two counts. First, widespread social experiments in economic planning were attempted, just as he predicted. And these experiments largely failed, sometimes catastrophically. Even the most pervasive welfare states, such as Finland, France, and Sweden, have turned back toward prices and markets to animate their economies.

A recent book by Jason Brennan, *Why Not Capitalism?* (2014), reveals the nature of the fallacy that leads to excessive optimism about experiments in planning. Brennan argues that advocates of planning or outright socialism compare a *realistic* vision of market processes, which are in fact flawed and imperfect, with an *ideal theory* of socialist planning. Brennan argues that two alternative, more defensible comparisons put capitalism in a much stronger position. We might summarize his argument this way:

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1. Real-world markets turn out to be better, often substantially better, than real-world socialism.
2. Idealized capitalism is clearly better than idealized socialism because capitalism has mechanisms for cooperation and sharing that socialism lacks.

We don't fundamentally disagree with Brennan's argument or Hayek's predictions. But there is a flip side to Brennan's perfectly valid objections. All too often market advocates envision "real-world" capitalism as retaining many of the features of their own "ideal theory" competitive equilibrium models. When opponents criticize some aspect of markets—solar startup Solyndra's highly subsidized collapse or Martin Shkreli's use of procedures approved by the U.S. Food and Drug Administration to squelch competition—we dismiss those examples. "That's not capitalism. That's *crony* capitalism!" Might not a modern Hayek but of the left be tempted to write his own treatise called "The Road to Crony Capitalism"? The thesis would be that real capitalism is not sustainable and that any attempt to set up capitalism in democracies is a step toward crony capitalism.

Suppose it's true that capitalism has a tendency—it's not inevitable or irreversible, but a tendency nonetheless—to devolve into crony capitalism. Is *laissez-faire* simply the first step on a kind of road to serfdom, where giant corporate syndicates achieve a parallel kind of economic planning every bit as pernicious as that feared by Hayek? Of course, the planning takes the form of cartelized industry, protection from competition, and restrictions on innovation, but it is planning nonetheless. Thus, it is at least possible that cronyism is *intrinsic to* and not *separable from* capitalism.

To make it clear what we're talking about, we need to define capitalism and its evil doppelgänger, cronyism, which some also call "corporatism." A useful version of the distinction comes from Michael Labeit:

*Capitalism* is a social system based upon the recognition of individual rights, including private property rights where all goods, both intermediate goods and final goods, are owned privately. . . . An economy remains capitalist so long as the government, or any other agency for that matter, refrains from intervening coercively in the peaceful private lives of citizens. The implications of this fact are substantial: under pure capitalism there are no taxes, no price ceilings, no price floors, no product controls, no subsidies to either the rich or the poor, no public streets, no public schools, no public parks, no central banks, no wars of aggression, no immigration restrictions, etc. Government neither resorts to aggression under capitalism nor does it sanction its use by others, end of story. . . .

*Corporatism* shares no such description. It is a social system where the government intervenes aggressively into the economy, typically with political instruments that benefit large corporations and enterprises to the detriment of smaller businesses and private citizens. Such instruments include subsidies, tariffs, import quotas, exclusive production privileges such as licenses, anti-trust laws, and compulsory cartelization designs. (2009)

Our question, then—the question of our age—is simple: If real capitalism exists, is it *sustainable*? Or does capitalism in a democracy always devolve into corporatist cronyism?

## Can't Stop, Won't Stop

Many people would answer, “No, capitalism is not sustainable,” meaning that there is no such thing as capitalism, really, and that those of us who defend capitalism as a social system are just playing with ideal types. We don't *want* to believe that, of course. And it's perfectly fair to counter that even if the “road to cronyism” argument is correct, it's *really* the fault of the state, which seduces good, honest entrepreneurs by using the power of rent seeking. Randall G. Holcombe (2013) makes this point clearly.

Crony capitalism is a by-product of big government because the more government is involved in an economy, the more the profitability of business depends on government policy. Even entrepreneurs who prefer to avoid cronyism are pushed into it because they must become politically active to maintain their profitability.

If we measure profits simply as the excess in accounting revenues over accounting costs, any rational investor or CEO will “invest” in state protection from competitors rather than try to invent new products or devise manufacturing processes. At some point, rational companies cut back on hiring engineers and shift their focus to lawyers and lobbyists. The use of patents, lawsuits, professional licensing, and other regulatory barriers to competitive entry into “your” industry or product line can produce enormous revenues, even though it adds nothing to the value of the product and does nothing to benefit consumers.

Robin Feldman and Evan Frondorf (2017) note that for many companies the creation, expansion, and renewal of “protection” of patents have become an industry unto themselves. As one of us has written elsewhere (Couyoumdjian and Munger 2017), it is a great deal to ask of the “character” of managers and corporate leaders to eschew legal means of raising accounting profits and boosting share price.

There are reasons to think that capitalism might be sustainable, of course. In *The Bourgeois Virtues* (2004), Dierdre McCloskey deftly contrasts profit seeking and rent seeking in her discussion of whether capitalism corrodes civic virtue. “Countries where stealing rather than dealing rules become poor and then remain so. . . . It doesn't matter what kind of predation/stealing it is—socialist stealing such as in Cuba, or private/governmental stealing such as in Haiti, or bureaucratic stealing such as in Egypt of today or of ancient times, or . . . stealing at the point of a pen by CEOs in America during the 1990s. By doing evil we do badly. And we do well when we do good. . . . [C]ommercial societies make virtuous citizens” (334). But are citizens virtuous enough to resist using the pen to steal? If even a few large groups of smart people can organize and invest time and money to increase their revenues and reduce their costs, they may not care whether they are investing in engineers or lobbyists. It's hard to see why they would, unless for

some reason corporate CEOs are much more virtuous than the rest of us. Making such a claim would seem to violate the essential “public-choice” axiom of *behavioral symmetry*, which precludes invoking moral superiority as a cure for corrupt systems of organization. Usually, of course, public interest is invoked by defenders of the state, but then aren’t defenders of markets doing the same thing, only in reverse?

Alternatively, one would have to argue that the last dollar invested in engineers is always friendlier to the bottom line than the first dollar invested in lobbying for protection from competition. That might be true for some industries early in their maturation process, but for older industries state “help” can seem a seductively attractive purchase.

Adam Smith recognized the problem and advised state regulators and public officials to avoid requiring the organization of groups of producers into collusive cartels. Even innocent social gatherings are likely to be diverted toward rent seeking:

People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices. It is impossible indeed to prevent such meetings, by any law which either could be executed, or would be consistent with liberty and justice. But though the law cannot hinder people of the same trade from sometimes assembling together, it ought to do nothing to facilitate such assemblies; much less to render them necessary. A regulation which obliges all those of the same trade in a particular town to enter their names and places of abode in a public register, facilitates such assemblies. . . .

A regulation which enables those of the same trade to tax themselves in order to provide for their poor, their sick, their widows, and orphans, by giving them a common interest to manage, renders such assemblies necessary. An incorporation not only renders them necessary, but makes the act of the majority binding upon the whole. ([1776] 1994, 145)

This quotation, or the first portion of it, is often used to argue that Smith favored strong antitrust laws. That is false; he did not. His point is that the state should not have regulations that actively encourage cartels.

Nonetheless, even taking account of the entire quote, there is still a daunting challenge: like many analysts, Smith is too optimistic about the state. The premise of the argument is that the state “wants” what is good for all of society. Why would that be true? The state is made up of people—people just as self-interested as those who are in business or other pursuits. Their interests may be different, and they may be pursuing a version of the public good as they perceive it, but the ability to control the economy and to “do good” are at the center of many politicians’ and regulators’ objectives. Monopolies are much easier to deal with than disparate, complicated, competitive market structures. If a little less competition is the price regulators pay for much better control, well, that’s a price politicians are willing to pay.

The point is that politicians—whether elected or appointed—find it quite useful for their own purposes to “facilitate” *exactly* the sorts of assemblies of business groups Smith warned against. Encouraging corporate dependence on the state and collecting revenues from running artificial rent-seeking contests are primary money-making enterprises of successful politicians. The result is what Smith predicted: concentrated, often highly profitable (in a purely accounting sense) corporations with enormous market power.

Of course, one can say, “That’s not capitalism!” In a competitive environment, these fragile behemoths could never survive. But as things stand now, they can avoid competition by continuing to pay off their government partners. Everybody wins—except consumers and taxpayers, who pay higher prices and taxes, respectively, and innovators, who are blocked from introducing new products or processes.

In Korea, these large syndicates are called *chaebols*; in Japan, *keiretsu*. In the United States, we refer to them as “too big to fail”; in many European nations, “corporatism” is celebrated as a hybrid form of market and social planning by committee.

Of course, the pursuit of protection from competition is not limited to the upper reaches of the size distribution of firms. As William Mellor and Dick Carpenter argue in their book *Bottleneckers* (2016), there is a kind of corrupt bargain between more and more local professions and state regulators, in which licensing restrictions and permission withholding of various kinds are used to enact a conspiracy against the public or a contrivance to raise prices. Far from avoiding such activity, local and state governments welcome the opportunity to gain control over industry and increase private dependence on the state. Mellor and Carpenter call such activity “bottlenecking” and, of course, those who engage in it “bottleneckers”:

**Bottleneck** (*n*): a person who advocates for the creation or perpetuation of government regulation, particularly an occupational license, to restrict entry into his or her occupation, thereby accruing an economic advantage without providing a benefit to consumers. (2016, book epigraph)

With these examples, we can render our concern more starkly: in a system that sells legal protection and bottlenecking, why would a rational manager or stockholder eschew cronyism? You’re expecting investors to leave money on the table because at some point it is nearly certain that it becomes more profitable, at the margin, to invest in lobbying for protection than to invest in engineers for innovation.

Purists will counter that “we” shouldn’t sell legal protection or bottlenecking, but then the question simply evolves: Why would rational politicians eschew using their office to sell valuable services that are entirely within their legal power to provide? Paradoxically, if you believe that the pure form of capitalism is sustainable, you must claim that either corporate leaders or politicians, and probably both, are morally better than the rest of us. But that is just what most market enthusiasts would deny. Because, by the logic of the public-choice model, politicians are *not* better than the rest of us, then

pure capitalism is unsustainable. Pure capitalism requires politicians to forego their own self-interest for the public good.

## Acting Badly Is Dominant

We recognize that we are taking a pessimistic view of human nature. But that view is part of the reason that capitalism is often seen as a useful, even beneficial, form of social organization. Capitalism limits the extent of damage that can be done *even if* people are (mostly) selfish because it rests on competitive limitations on discretion. Even if sales people want to raise prices, their own self-interest leads them to offer lower prices to undercut the competition. Even if manufacturers want to scrimp on materials and cut corners, competitive pressures to maintain quality force them to work harder and improve their products. The argument for capitalism does not require any public spirit or sense of altruistic commitment to the greater good.

Fair enough. But then our side can't invoke character, sense of fair play, or public spirit when it comes time to "Just say no!" to cronyism. Even if everyone agrees that capitalism is the system that produces the most prosperity and growth overall—and that may be a big "if" in today's world—there are still two problems. First, no one person alone can save capitalism from cronyism by acting virtuously. If one producer refuses government protection but competitors embrace it, in fact virtue is *punished* rather than rewarded. As Paul Dragos Aligica and Vlad Tarko (2014) point out, the differences in "ideology" among crony-capitalist states may soften the blow, but those differences are only in central tendency.

Second, no one person alone acting badly does much harm to the system. Even if all my competitors act virtuously, I can make still more money by buying government protection. And all it takes is a few people buying protection to force the issue. We are less optimistic than Aligica and Tarko (2014) in this respect: cronyism may not be *sui generis* but rather "unus multorum et de multis."

This existence of a "dominant" strategy—in this case, "defect" or go full crony capitalist—is characteristic of the kind of strategic setting that game theorists call a "prisoner's dilemma."

And the problem is made worse by government pressure. It may not just be that government offers protection from competition; government can profit most by offering protection from itself! As Raghuram Rajan and Luigi Zingales note, "The behavior of government is determined, in part, by public mood. But to a greater extent, it is also determined by the special interests being regulated. This is why the free market system is fragile. Not economically (as Marx theorized), but *politically*. While everyone benefits from competitive markets, no one in particular makes huge profits from keeping the system competitive and the playing field level. Thus, nobody has a strong vested interest in promoting and defending free markets" (2004, x). Although this claim accords with our overall thesis (and note that it was made almost fifteen years ago,

so we credit these authors for their foresight!), we think they are perhaps interpreting Marx too narrowly. It is true that in some places Marx claims that capitalism has “internal contradictions” on technical grounds. But we would also have to credit Marx’s even longer-term prescience.

The distinction between “economic” and “political” arenas is no longer sustainable. As Marx often claimed, “capitalists” recognize that their self-interest encourages co-optation of the state apparatus. The fact that the agents of the state *want* to be co-opted and even demand to be co-opted to serve their own self-interest does not improve matters.

This insight is hardly novel, of course. The novelty, if there is any, is the claim that the conversion of capitalism to crony capitalism is in the mutual self-interest of both large economic units *and* units of government. Consider the striking similarities in the conclusions of two very different thinkers, Karl Marx and George Stigler. In Marx’s view, “the executive of the modern state is but a committee for managing affairs of the whole bourgeoisie. . . . The ruling ideas of each age have never been the ideas of the government” (Marx and Engels 1988, 3). And “when commercial capital occupies a position of unquestioned ascendancy, it everywhere constitutes a system of plunder” (Marx 1919, 596).

And now George Stigler: “The Chicago students of regulation have usually assumed, explicitly as often as tacitly, that the players who count in regulation are the producers and consumers. Political intermediaries—parties, legislators, administrators—are not believed to be devoid of influence, but in the main they act as agents for the primary players in the construction and administration of public policy” (1988, xv).

There’s more:

The state—the machinery and power of the state—is a potential resource or threat to every industry in the society. With its power to prohibit or compel, to take or give money, the state can and does selectively help or hurt a vast number of industries. That political juggernaut, the petroleum industry, is an immense consumer of political benefits, and simultaneously the underwriters of marine insurance have their more modest repast. The central tasks of the theory of economic regulation are to explain who will receive the benefits or burdens of regulation, what form regulation will take, and the effects of regulation upon the allocation of resources.

. . . A central thesis of this paper is that, as a rule, regulation is acquired by the industry and is designed and operated primarily for its benefit. . . . We propose the general hypothesis: every industry or occupation that has enough political power to utilize the state will seek to control entry. In addition, the regulatory policy will often be so fashioned as to retard the rate of growth of new firms. (Stigler 1971, 1)



In addition,

the state has one basic resource which in pure principle is not shared with even the mightiest of its citizens: the power to coerce. . . . These powers provide the possibilities for the utilization of the state by an industry to increase its profitability. . . . The most obvious contribution that a group may seek of the government is a direct subsidy of money. . . . The second major public resource commonly sought by an industry is control over entry by new rivals. . . . A third general set of powers of the state which will be sought by the industry are those which affect substitutes and complements. Crudely put, the butter producers wish to suppress margarine and encourage the production of bread. . . . The fourth class of public policies sought by an industry is directed to price-fixing. Even the industry that has achieved entry control will often want price controls administered by a body with coercive powers. (1971, 3–4)

### **Institutional Sclerosis: The Olson Thesis**

In his book *The Rise and Decline of Nations* (1982), Mancur Olson claims that “pure” capitalism, if it even exists, will become politically “sclerotic” by the slow accretion of protection arrangements organized by narrow, specific groups. Worse, the political stability that parallels successful free-market economies provides fertile ground for the emergence of distributional coalitions and interest groups. These groups—including coalitions of business owners—use political influence and exchanges to obtain special privileges, in the process often creating economic inefficiencies and distortions. Olson goes as far as to suggest that this process is one of the main causes of slow economic growth in stable democracies and free-market economies.

If Olson’s theory of political sclerosis is correct, it brings into high relief the claim that Milton Friedman made about categories of “freedom” (2002, 7–8). Friedman argued that economic freedoms make growth possible, and at some point citizens come to value political freedoms as their consumption and other basic needs are increasingly met. But if political freedoms cannot be constrained, the result will be the corruption of capitalism into cronyism.

Of course, that means that we have simply independently arrived at the conclusion that Karl Marx advanced in the nineteenth century: capitalism creates conditions that inevitably lead to its own destruction. If prosperity enables democracy and the access to coercive powers of democracy allows businesses to concentrate their power and obtain state protection from competition, the result is cronyism.

Some theorists, including Thomas Christiano, have claimed that the competition for “rents,” or supernormal returns, in market settings makes the pursuit of non-productive but in accounting terms “profitable” rents much less noticeable and therefore much less morally problematic for real market participants. Christiano (2010)

argues that a focus on “profit”—put in quotation marks to connote the accounting meaning, not the economic meaning of revenue minus costs for products produced without artificial state protection—requires a deference to the exercise of rights associated with private property that is ultimately inconsistent with the core norms of democratic liberalism.

This claim is larger than the one we are making, but our argument is congenial with Christiano’s. As Christiano puts it, “Commitment to democratic norms implies that private capitalist firms must cooperate with a democratic assembly and government in the pursuit of the aims of a democratic assembly even when this implies some diminution of the profits of the firms” (2010, 195). In our terms, respect for the size of total economic activity as a joint goal of the society demands that individual firms leave money on the table. The total “size” of economic prosperity is larger if all of us forbear rent seeking, but my share of a smaller pie will be larger if I cheat on this implicit agreement and enlist the coercive powers of the state to protect my market from competition and from new entry by better and cheaper products.

### Is There Any Hope?

We think that there is a clear distinction between cronyism and “real” capitalism; the problem we have addressed is whether capitalism in a democratic setting inevitably tends toward cronyism. In a sense, this is simply the Hobbesian dilemma: each economic agent would be better if she could give up the ability to seek rents and competitive protection from the state, provided that everyone else gives up the same rights and abilities. So the gains to such an agreement, aggressively enforced, are clear. The question is whether such an agreement can be enforced in a democracy. To put it differently, in the terms used by Barry Weingast (1995), can the state make a credible commitment to quell cronyist impulses among capitalist agents and among the state’s own enforcement agents?

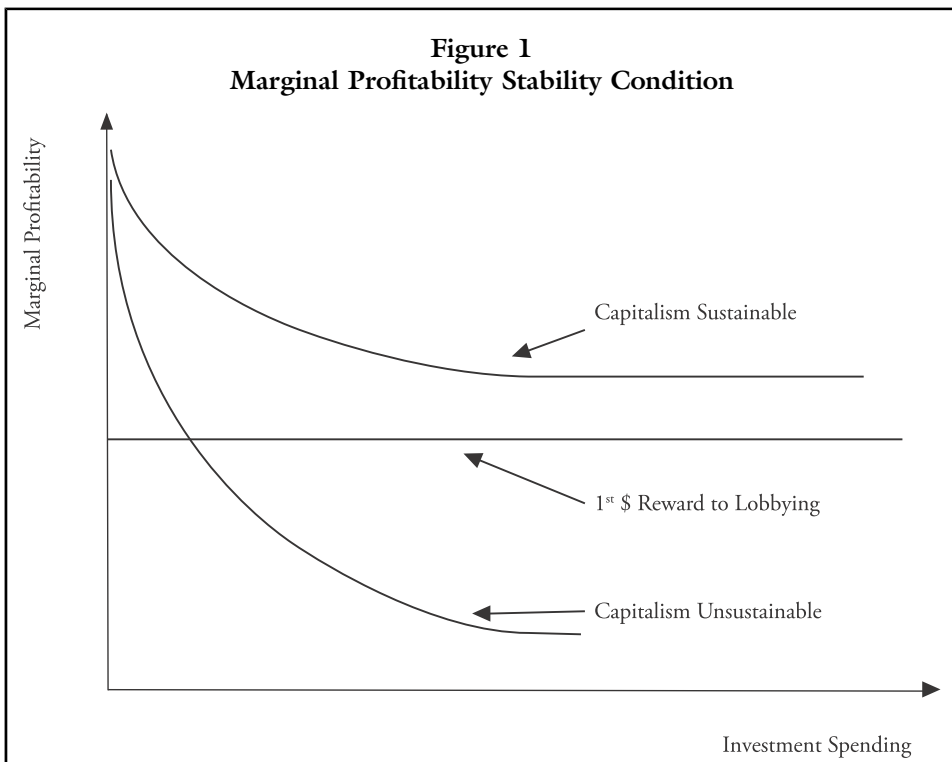
In a democracy, the problem is particularly acute. This is not a call for dictatorship, mind you. We are simply pointing out that allowing real democracy may doom real capitalism, just as many opponents of capitalism have argued. It is useful to reprise our argument, which claims there are two quite separate problems.

First, in a successful pure-capitalist economy, the size of the distributional pie is larger and growing. As free markets thrive, the economic gains increase the amount of goods and services available for consumption. In general, there are two ways an individual or group of individuals may advance his or their interest: one is by engaging in productive activities that create value for others. *Real* profits are a consequence of mutually beneficial voluntary transactions that create a surplus over and above the shares of the pie paid to productive factors. The value to consumers, measured as “consumer surplus,” or the difference between what consumers *must* pay (the price) and what they *would* (choose to) pay, their subjective desire for the product, is often enormous at this stage. Apple makes large profits from selling iPhones, but consumers who would pay

\$1,500 are greatly benefitted by being able to buy one at \$900. In capitalism, profits are a reward for creating value for consumers, much of which is shared with labor and investors.

But existing firms, making existing products, over time find decreasing returns to continued investment in plant and equipment. They also find it increasingly difficult to continue to innovate. At some point, at the margin it becomes more profitable, in an accounting sense at least, to use the power of the state to extract resources from others or to protect those existing products from competition. Such protection is more difficult if the competitors already exist, employ workers, and have political power of their own. As a consequence of this process, firms that were once innovators turn to the second “investment” strategy, in which they focus less on new products or better manufacturing and spend their money instead on lobbyists and political influence. Their goal is to thwart innovation before it happens, to slow down the dynamic processes that animate capitalist development. To an outsider, the difference between real investment and cronyist investment may seem subtle. Firms may not enlist actual violence; licensing obligations from government experts and permission requirements from competitors are quite enough to kill the capitalist goose that until now has been laying the golden eggs of prosperity.

To illustrate the problem, consider figure 1. The condition that “tips” capitalism into crony capitalism is simply the “1st \$” (first dollar) marginal accounting profitability



of lobbying. So long as the marginal profitability of “pure” capitalist investment is above the “1st \$” line, capitalism is sustainable. But if at any point the “last dollar” of investment pays less at the margin than the “first dollar” of lobbying, capitalism tips into crony capitalism.

It is fair to object that the turn from market investing to political scheming is not “real capitalism.” But our claim is that maintaining real capitalism requires that entrepreneurs and investors act irrationally by valuing the public good more than their own self-interest. Otherwise, once the returns to political action exceed the return to honest investment, any rational investor turns rent seeker—unless an enforceable Hobbesian bargain can be struck.

Second, economic freedom is the animating force that allows Leviathan to escape. Public-choice theory shows that the “Leviathan in chains” problem is a hard thing to solve. If the people of a nation have achieved a level of economic prosperity that leads them to seek political freedom and democracy, there is no obvious means by which majorities can be constrained to the domain of the constitutional agreement. In the United States, institutions such as the Bill of Rights can slow the process, protecting minorities from abusive police procedures by using the Fourth Amendment or protecting women from majorities that want to limit reproductive freedoms. In a democracy, however, power metastasizes, breaking the constitutional boundaries through which previous generations sought to limit coercion.

Successful capitalism creates institutions and incentives that make collusion between political power and economic power more “profitable,” at least in the sense of rewarding those who control that power. Power enables its holders to secure and protect special privileges—*dachas* in the former Soviet Union, protection from competition and enormous subsidies against risks of loss in the current United States—at the expense of others. To maintain their rents, which give access to a permanent guarantee of average profits, firms and industries divert more and more of their resources into rent seeking. Of course, that strategy is ultimately fruitless because stock price or land values rise to capitalize the special privileges, and a normal rate of return is restored. But now the “owners” of cronyist privileges are stuck, utterly dependent on the discretion of their state masters to maintain the value of the hard-won artificial rents and market regulations. This is precisely Olson’s “sclerosis”: the interest groups themselves don’t really benefit, but the society and the economy pay dearly in a cronyist system.

José Ortega y Gasset extends a similar concern, in a way beyond the concerns of Christiano and reaching all the way to liberalism itself. He writes in *The Revolt of the Masses* ([1929] 1974):

Liberalism—it is well to recall this today—is the supreme form of generosity; it is the right which the majority concedes to minorities and hence it is the noblest cry that has ever resounded in this planet. It announces the determination to share existence with the enemy; more than that, with an enemy that is weak. It was incredible that the human species should have

arrived at so noble an attitude, so paradoxical, so refined, so acrobatic, so antinatural. Hence, it is not to be wondered at that this same humanity should soon appear anxious to get rid of it. It is a discipline too difficult and complex to take firm root on earth. (76)

In short, liberalism—like “real” capitalism—requires forbearance. There are things that majorities can do that would make the individual members of the majority better off. But those things would harm minorities and ultimately harm society overall in terms of reduced dynamism and innovation. Ortega y Gasset distinguishes between the individual—a hero, he says—and the multitude. In his view, the individual goes beyond the ordinary and embarks on “creative action,” a strategic set of interactions with other human beings and their circumstances. Value creation is central in advancing the hero’s interest. In contrast, the “mass-man” doesn’t recognize any personal responsibility. Seeking a position of privilege in society, he advances the state control of all social efforts, including redistributive ones. It is the collusion of the masses and the state that worries Ortega y Gasset:

This is the gravest danger that today threatens civilization: State intervention—the absorption of all spontaneous social effort by the State, that is to say, of spontaneous historical action, which in the long run sustains, nourishes, and impels human destinies. When the mass suffers any ill-fortune or simply feels some strong appetite, its great temptation is that permanent, sure possibility of obtaining everything without effort, struggle, doubt or risk—merely by touching a button and setting the mighty machinery in motion. . . . The mass-man does in fact believe that he is the state, and he will tend more and more to set its machinery working, on whatever pretext, to crush beneath it any creative minority which disturbs—disturbs it in any order of things, in politics, in ideas, in industry. ([1929] 1974, 120)

The “anxiety” to get rid of liberalism and privilege state action in advancing “desirable”—as viewed by the masses—social goals is spurred on by demagogues and may be an inevitable side effect of free-market liberalism as well. According to Ortega y Gasset, the results will be catastrophic:

The result of this tendency will be fatal. Spontaneous social action will be broken up over and over again by State intervention; no new seed will be able to fructify. Society will have to live for the State, man for the governmental machine. And as, after all, it is only a machine whose existence and maintenance depend on the vital supports around it, the State, after sucking out the very marrow of society, will be left bloodless, a skeleton, dead with that rusty death of machinery, more gruesome than the death of a living organism. ([1929] 1974, 121)

One can be worried without fully buying into Ortega y Gasset's extreme pessimism, which Joseph Schumpeter matched thirteen years later in *Capitalism, Socialism, and Democracy* (1942). It may be the case that cronyism and the tendency to demand redistributive state interventions are features of free-market capitalism. But so is a constant influx of creative individuals who demand adequate conditions to advance their productive efforts.

## Conclusion

Ultimately, then, we are left with something analogous to Hayek's famous thesis, the one he actually advanced rather than the caricature that has been attributed to him. Hayek argued that a reliance on central plans creates a tendency toward increased collectivization, a tendency that can be resisted but that should be worrisome to the analyst, who is obliged to point out where that road leads. We would argue that successful capitalism leads to an impulse on the part of economic powers and political agents to restrict and control the destructive power of entrepreneurship. This unholy partnership is "rational" in the sense that the participants benefit, in some cases creating wealth and privilege far beyond any other mechanism that is available to them.

The solution, if there is one, is to empower entrepreneurs not to want to become rent seekers and to constrain state actors not to sell off rents in the first place. The second part of this solution is the more arduous, perhaps, because it would require institutional changes along the lines of the "universalism" of Hayek (1948), or "politics by principle, not interest" of Buchanan and Congleton (1998). But it is wrong to dismiss such problems as having nothing to do with markets. The road to cronyism leads directly through capitalism.

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