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EDITORIAL DIRECTOR DAVID HAMPTON, (601) 961-7240 SUNDAY JANUARY 8, 2012 THE CLARION-LEDGER ■ CLARIONLEDGER.COM

The economy

Trouble for 'Big Crony'

■ "Too Big Too Fail" creates "pincer" of tea party and Occupy movements

By Ashby Foote
Contributing columnist

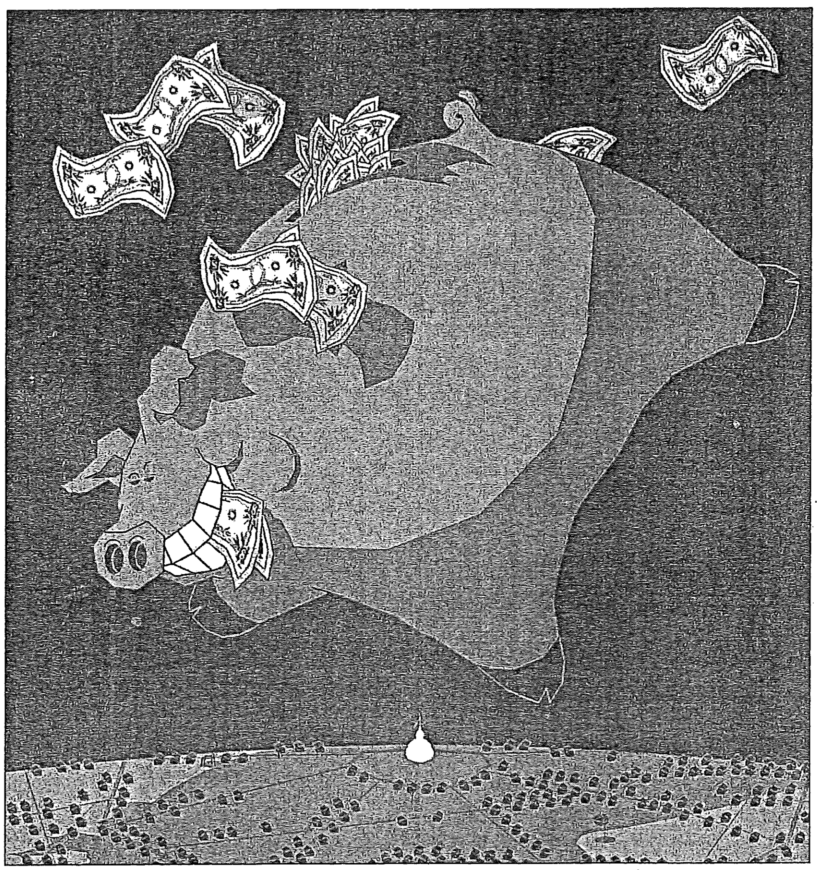
It was last August when a double whammy of hurricane and earthquake rattled the Washington Beltway — a weather rarity but perhaps an ominous foreshadowing of political storms and tectonic shifts headed for the nation's capital.

Foote

These are volatile and pivotal times in politics exemplified by the dramatic grassroots emergence of the Tea Party and Occupy movements. That two such groups from opposing ends of the political spectrum would arise animated by a common grievance — big bank bailouts — should give serious pause to the Beltway establishment. In military history such pincer type maneuvers are called double envelopment and when well executed they end up disastrously for those caught on the inside — ask the Romans about Cannae or the Brits about Cowpens.

"Too Big to Fail" bailouts are just the latest and grossest example of crony capitalism, where political connections seem to matter much more than competence.

Wikipedia defines Crony Capitalism as "A capitalist economy in which success in business depends on close relationships between business people and government officials. It may be exhibited by favoritism in the distribution of legal permits, government grants, special tax breaks, and so forth."



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Big businesses and their close ties with big government are a staple of modern American politics — Big Tobacco, Big Oil, Big Pharma and the list goes on. Isolated, they make for good populist targets, but wrap them together as Big Crony and you have a formidable force at the economic table. It doesn't take a malcontent to connect Big Crony with many of today's Big and serious economic troubles.

To see how far and wide reaching the influence of Big Crony is look at the 72,536 pages of the U.S. tax code. Our mind numbingly complex tax code is mostly a creature of crony capitalism.

It is chock full of special provisions passed to benefit particular industries and even specific companies.

While virtually all politicians trumpet their desire for a simpler and fairer tax code, the hard reality is just the opposite. Special loopholes, be they credits, exclusions, rebates or deferrals are some of the most powerful fund-raising tools politicians have and, with another campaign around the corner, incumbents are loath to give such leverage up.

Big Corn is a classic example of crony capitalism.

America, with only 5 percent of the world's population has 13 percent of the world's arable land and, in 2010, harvested 38 percent of the world's corn, easily making the U.S. and its farmers the OPEC of world agriculture.

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But such market dominance doesn't keep the corn lobby from toiling mightily in the halls of political power for protection from floods and droughts as well as subsidies and mandates that offer the potential to open vast new markets for corn.

Ethanol as a required additive to gasoline is the most notable manifestation of the corn lobby. One is hard pressed to find a worse deal for consumers — higher prices at the pump, fewer miles per gallon and higher prices on corn-related products at your grocer.

But all the puffery of the corn lobby is small fritters compared to the cozy connections in the inner circles of global banking. This is crony capitalism at the highest and most complex level.

For taxpayers, alas, it has also become crony capitalism at its most expensive.

The players are national politicians, regulators (to include central bankers) and the world's biggest banks.

For a primer on this arcane world consider the Basel rules — so called because the international regulators have convened in Basel, Switzerland, since 1988 — where they set liquidity and capital standards for the big international banks. In so doing they determine the pecking order for bank investments with rules that specify how much capital (equity) banks must set aside against specific kinds of assets.

In 2008, the Basel rules required 8 percent against corporate debt, 4 percent against mortgages, 1.6 percent against mortgage backed securities (MBS) and 0 percent against sovereign debt. The not-so-subliminal message from regulators was that sovereign debt, Greek, Spanish or otherwise was "risk free."

For leveraged institutions like banks these are wide spreads which greatly favored and encouraged investment in MBS and sovereign debt. It was an invitation to load up and load up the banks did. This was a

See CRONY, 2C

Crony: Meltdown becomes clear as 'crony cartel'

From 1C

great arrangement for those at the top — for sovereign politicians who garnered easy access to sell ever more debt, for the banks seeking greater profits on finite capital and for the regulators who owe their tenure to sovereign politicians. But then it stopped working and panic reigned.

Looking back through the carnage of 2008 and 2011 the connection is clear. At the heart of these crises is a gross overinvestment and subsequent meltdown in MBS (2008) and sovereign debt (2011) — the two "lowest risk" asset categories in the Basel rules.

At the grassroots, savers have been understandably perplexed at the subsequent turn of events. At a time when cash was most precious to banks, savers saw their participation in the economy via CDs and money market funds pay next to nothing. Such price distortion can only occur when the banking system is functioning not as an intermediary between savers and borrowers, but as a crony cartel.

In the aftermath of 2008, authorities were quick to finger "market failures" as the crisis culprit and call for vast new regulatory regimes.

Such a superficial conclusion fails on two counts. It fails to understand the real problem and it fails to discern the significant differences between free markets and crony capitalism.

The free market doesn't convene in Basel, Switzerland, or Davos or in the salons of K Street. The free market doesn't convene at all.

Free markets are bottom up — crony capitalism is top down.

Free markets are messy, adaptive, diversified, tolerant of failure and full of the upside surprises that grow the economic pie in new and unexpected ways. Crony capitalism is orderly, concentrated and intolerant of failure.

While not illegal, crony capitalism undermines the disciplines of the free market where survival of the fittest becomes survival of the politically connected.

What the tea party and Occupy movements grasp is that crony capitalism is much more about slicing up the economic pie than growing it.

Ashby M. Foote III is president of Vector Money Management in Jackson and a regular contributing columnist to *The Clarion-Ledger.*