

Abstract

The subject of my work is “Crony Capitalism”, analyzed in three main chapters. The first chapter focuses on the “theory of entrepreneurship”. The entrepreneur is the head of the company, owner of the right to conduct business activities for the production of goods and services for the market. He innovates methods, processes and products, creating opportunities for economic growth and development. He coordinates and controls the factors of production (wages, capital and technology), which are not necessarily his, while assuming the risks inherent to the exercise of such functions.

Manuals of economic theory define the entrepreneur as the one who combines factors of production in order to maximize profit. The entrepreneur is especially characterized by creativity, intuition, innovation and propensity towards risk and innovation.

Many scholars examined the figure of the entrepreneur with different connotations and emphasizing different aspects. Cantillon and Turgot, for example, emphasized the element of risk acceptance and uncertainty, inherent to economic activity. According to Jean Baptiste Say, the entrepreneur plays a decisive role by activating and performing economic processes. Instead, John Stuart Mill separated the entrepreneurial function – which is remunerated by the profit – from that of the capitalist, remunerated by interests.

From the ‘700 to the second half of the ‘900, the figure of the producer-entrepreneur and entrepreneurship were neglected, only to be rediscovered by the Austrian School, which saw the entrepreneur as the one who coordinates and conducts arbitrage functions. In fact, the Austrian School played a major role in the study of entrepreneurship and its main figure, thanks to two of its major exponents: Joseph Schumpeter and Israel Kirzner.

These two greatly important authors in the history of Sociology, had very different point of views on the Theory of Entrepreneurship.

Schumpeter, on the one hand, conceptualized entrepreneurship. He had a dynamic view of the economy due to the image of the entrepreneur which innovates, introduces new products, takes advantage of technological innovation and changes the organization of production. The entrepreneur manages to do so thanks to the banks that provide capital and through the profit generated from innovation. Thus, the entrepreneur creates new equilibriums, through what the authors calls “creative destruction”.

Kirzner on the other hand has a much more critical view on the matter. The entrepreneur moves around the market system noticing and seizing new opportunities, triggering a mechanism that tends towards equilibrium. Thus, he is the engine of the system that allows the exploitation of new opportunities. His purpose is not to innovate – as Schumpeter suggests – but to have a “special perspicacity” that allows him to notice profit opportunities and take advantage of them. In this case, the author does not speak of “creative destruction” but rather of “alertness”.

Kirzner’s aim is to combine Mises and Hayek’s views on the subject, in order to develop a theory that is capable to improve the Austrian School. The author is in fact considered to be one of the greatest authors responsible for the rebirth of the Austrian School in the 70’s, thanks to his works and initiatives at the organizational level, conferences and books. Kirzner is the only living key character of the Austrian tradition and is already considered the most important author that draws a bridge between the classics of the past and the possible future outlets.

In confronting these two authors, we should underline some differences that characterize their paths. First of

all, there are some divergences on the subject of the entrepreneur. As we already noted, Schumpeter's entrepreneur takes on the risk of entrepreneurship, challenges the market, breaks the equilibrium with its innovative capacity, undermines the *status quo*, introduces new combinations of means of production and creates the necessary conditions to create a new equilibrium. His success comes from his courage to challenge the status quo, by introducing new products that can be accepted or not by consumers. With his creative and innovative destruction, he manages to establish himself as a positive figure. He specifies that said risk results from challenging the equilibrium with other entrepreneurs, from innovating and from the fact that they operate in a situation of uncertainty, where the outcome is unknown. From this point of view, the two authors seem to agree but what sets them apart is the initial epistemological considerations from which they start.

Schumpeter's entrepreneur in fact, operates in a state of perfect competition and is considered to be *homo oeconomicus*, owner of all the relevant data and parametric rationality. This situation cancels competition. Kirzner, on the other hand, starts from the theory of dispersed knowledge and so, considers that perfect knowledge of the means and parametric rationality are unrealistic. In such a situation, it seems obvious that the entrepreneur does not face any risks. Competition helps to gather information and represents a discovery, it is the exploration of the unknown, a correction of errors. Thus, the entrepreneur operates in unbalanced conditions but is characterized by a promptness in decision making. He has the capacity to create an equilibrium through his alertness, by selecting and interpreting information coming from the market. In conclusion, Kirzner and the Austrian School bind together the terms of competition and entrepreneurship.

Kirzner's theory of entrepreneurship – and so does Mises – differs from that of Schumpeter's for at least two reasons:

1. Kirzner's entrepreneur is an innovator since he is able to seize opportunities that are already available on the market. Schumpeter instead, believes that the entrepreneur is the one that creates new forms of innovation.

2. Kirzner's entrepreneur operates in an imperfect market, seizing opportunities that generate from this imperfection. He guides the market towards a new condition of equilibrium. Schumpeter's entrepreneur, does the opposite, through a process of creative destruction. Kirzner's himself states that his theory differs from that of many authors which focused on the image of the entrepreneur. For Kirzner, the entrepreneurial role, as much as it obviously is the cause for a movement within the system, it has a balancing influence. It is the entrepreneur's alertness that enables him to seize opportunities that creates a tendency towards equilibrium. Contrary to Schumpeter, Kirzner studies the market process and reveals its dynamic character, in which the entrepreneur creates a balancing effect. This is the prime function of the entrepreneur in the market process, in the center of which Kirzner puts the entrepreneur, claiming that competition and entrepreneurship coincide and there cannot be one without the other. He is critical of some aspects of Schumpeter's theory and shares Mises' idea that the market is not a static conceptualization where the innovative entrepreneur intervenes only as an exogenous third party, bringing the established order to disequilibrium through his creative destruction. The market is a dynamic process that is constantly moving and the entrepreneur seizes opportunities – thanks to his “alertness” –, triggering a mechanism tending towards equilibrium.

Schumpeter and Kirzner see entrepreneurship as a function, an activity or a process. Entrepreneurship is about actions and actions reveal themselves to be entrepreneurial. All actions are entrepreneurial since they are future-oriented choices about economic means, in order to pursue one's ordered preferences. In all real and living economic systems, every actor is an entrepreneur. There is an entrepreneurial aspect in every activity performed on the market. Though the intervening variables are various. If every action is entrepreneurial, then it involves an entrepreneurial aspect, but

individual actions are composed of many other factors. The entrepreneur is not necessarily a businessman and might not even work for a company, but he will act as an entrepreneur.

Kirzner himself realizes that some authors, close to Mises' vision of a competitive market process, did not share his emphasis on the idea that the entrepreneur can passively notice and benefit from changes that emerged independently. Thus he acknowledges Schumpeter's vision of an "active and aggressive entrepreneur".

He then quotes some critical authors such as Graves, Hazlitt, White and High. Hazlitt asserts that an entrepreneur's alertness and insight is not enough, he needs to act on the basis of these characteristics. Entrepreneurship is only an attribute, a feature of his actions. There can only be entrepreneurial actions. Therefore, it seems as though Kirzner, just like Holcombe, has a passive vision of human beings and this vision contradicts the existence of choices. Thus entrepreneurs need to act. Horwitz claims that "alertness" replaces "luck" and "deliberate research", which means that alertness is not a passive state since, as Hazlitt notes, to take advantage of a situation, you need to act.

Kirzner's and Schumpeter's analysis could be combined. The entrepreneur must be an active individual because the action itself can never be passive. The idea that he seizes opportunities could go along with Schumpeter's idea of a spontaneous and innovative individual, moved by creative destruction. The entrepreneur can be one or the other, but he can certainly not be passive because "human actions are always rational, economic and voluntary".

In the second chapter I will analyze different forms of capitalism. Entrepreneurship is an individual phenomenon tied to the individual capacity of generating innovation and growth thanks to a new product that breaks the market equilibrium. Thus entrepreneurship is a creative destruction that needs alertness to find needs and satisfy them. It is creativity, sense of initiative and propensity towards risk. This last element is inevitable in the entrepreneurial process, since it is characterized by uncertainty (a common feature in the natural anthropological condition) which originates from the scarcity of resources and knowledge. Defying uncertainty can lead to profit realization.

When uncertainty and risk are too high in relation to personal capacities, they discourage entrepreneurs. These obstacles can inhibit the entrepreneur and can be addressed through some socio-institutional factors that influence the individuals' propensity towards risk: family network, friends, connections and mentors. This network can act as a solid base for support in order to overcome those limits (uncertainty and asymmetrical information). Those who benefit from these relationships have easier access to financial resources and can develop more easily relations with customers and suppliers, which allows them to acquire more information and hire more qualified personnel. In this case we are talking about "Network Capitalism".

Relational capitalism is based upon networks, relationships and various other types of kinship between citizens and non-profits, non-profit social enterprises and the state, businesses and other actors in the economy, between and within businesses themselves. Credit-based systems have banks as the main source of financing. Those banks, through credits and blocks of shares, exercise control powers on the conduction of the business, and take part either in its board or in its supervisory bodies through members and trustees.

Hence, the "relational capitalism" label: as "relationship" here we mean "collusive networks" between insiders aimed to neutralize beneficial market mechanisms.

Market capitalism is synonymous with private initiative economy, and free market economy as well. Productive activity, in such a system, can be largely described as follows:

1. it is based on the use of capital goods, privately owned by entrepreneurs, and employed by workers who do not own any kind of mean of production;
2. it is rationally related to pricing mechanisms

3. it takes place in a political system which protects private property. Although the state may intervene in the economic activity, it does not constrain directly private actors. Markets need for legal certainty, equality before the law, impartial administrative justice. Competition and free market are the best way to create wealth, and the best antidote against corruption as well.

Networks make up the system which knowledge and expertise flow through, feeding production and consumption processes. When it comes to familial, amicable, patronage relationships, networks feed particularisms and behaviors which hold up outsiders, the ones who are not part of a community based on the aforementioned features.

By the concept of “network” we mean a stable, managed interdependency. It is underpinned by a reliable bond, which allows knowledge to be shared efficiently by members for economic profit. In other words, we mean a cognitive system, a mode of organization aimed at knowledge specialization, sharing, and propagation.

Relational capitalism is an inclusive kind of capitalism, made up of bonds, investments and shared risks. Through a relationship with people, businesses, even territories, economic actors are thus able to develop their productive intelligence. In this framework, a relevant concept is *social capital*, namely the pool of relationships constituting the resources that may be employed by an individual in interacting with others, carry on her goals, and those of her network as well.

“Relational” capitalism is a “social” form of capitalism, as it spills over the societal context, stimulating continuous innovations and making easier new relationships. Summing up, it is an incremental, virtuous cycle.

We refer to “familistic capitalism” when the connections are formed by family networks. With “family networks” we mean various kinds of societal organization, which are different according to the analytical perspective pursued.

Starting from individuals, a network may be simply defined as “nodes” connected by “lines”: nodes consist in individuals related to others by family kinship. This is a case of *parental network*. To a broader extent, a family network may be also the set of relations between a family and distant relatives, friends, neighbours.

“Familistic”, “crony” capitalism is “segregating”: it feeds a vicious cycle because core relationships are marked by self-centeredness, resistance to outsiders, cooptation. This kind of capitalism is ruled by irresponsible oligarchies, which refer only to themselves at the expense of freedom of enterprise and competition.

Crony capitalism is the worst case in point. It is marked by contacts between businessmen, politicians, civil servants and the likes, used to override the law and to damage the freedom of enterprise and competition. In crony capitalism, everyone in the network is protected by his or her relations. A businessman, supported by the complicity of investment banks, may list his firm on the stock exchange at inflated prices, make profit and, as the value of shares crashes, buy them back at much lower price in a process known as *delisting*. The operation may be backed by the same investment banks mentioned above. Market and competition rules are formally respected while overridden in substance, at the expense of ethics and legality.

The fight against clientelism is mainly based on the promotion of free competition and limitation of lobbyism. Intellectuals, acting as opinion leaders, may have a positive influence on the population. Political and economic systems need legitimizing values to underpin them. Capitalist ideal has been taken to its extremes, losing its moral advantage; money overrides any kind of value, ethics. The fight against clientelism is a fight for a renewed moral foundation for capitalism, in the sense of a “capitalism for the people”.

The last chapter is dedicated specifically to crony capitalism and its degenerations.

Crony capitalism may feature favouritism in licence distribution, governmental subsidies, tax breaks and so on.

It is thought that crony capitalism develops when political patronage invades the business environment. Friendship, family kinship affect economy and societies corrupting the selfless ideals of the political and economic world. At its worst, crony capitalism may result in plain political corruption, renouncing to any fiction of free market dynamics.

Crony capitalism is a deeply entrenched phenomenon in many countries. Some influential examples:

- Italy, often dismissed as the motherland of corruption and patronage,
- The United States, an example of meritocracy apparently degenerating into clientelism.

Cronyism, through its relation-based mechanisms of resource control and management, reduces the overall efficiency of economic systems, favouring a limited number of activities. In such economies, success eminently depends on tight relationships between businessman and civil servants. Political clientelism invades the business environment through government control, corrupting political and economic ideals. The term may be used to describe any governmental decision aimed at favouring “cronies” of civil servants. A term interchangeably used is “corporate welfare”, albeit limited specifically to big business subsidizing.

The Italian political system has been characterized by patronage since the unifying of the country. In the meantime, a new form of clientelism has developed. In this new mechanism, managers comply to requests because of “pre-existent personal relationships, ‘weight’ of the claimant in point, shared political affiliation”, managing *case by case* personal relationships with politicians and civil servants.

Examples of “crony capitalists” are businesses which pressure governments and legislator for getting exemptions, monopolies, subsidies, price controls, emergency bailouts, tax breaks, loans at interest rates lower than the market level. Those privileges are grounded on the assumption that a particular business or sector has “special need” and thus needs special treatment.

Italy is widely regarded as the motherland of nepotism and corruption. Tönnies, the German sociologist, argued that Southern Italy in particular was the “emblem” of a reality structured on tacit acceptance of clientelism and intercessions. A hierarchical system, where networks are the lone legitimizing factor. The one who do not take part of that system is, figuratively, non-existent.

Luigi Zingales, an Italian expat to the US, spent many years studying the degeneration of the Italian model and its parallels in America. He maintains that Italy invented the term “nepotism” and refined the concept of “crony capitalism”, where “who you know is more important than what you know”.

Furthermore, Italy lacks meritocracy, due to the strong push towards equality exerted by the political left. In the 1970s every kind of “selective mechanism” was eliminated, since it was seen as discriminating the disadvantaged. A result of such egalitarianism is the lack of barriers to the accession at tertiary education, which led to saturation of formally, but not substantively qualified labour force, forcing business not to hire according to formal qualifications, in spite of other more “reliable” sources: private connections. Accordingly, people who are inside the *right* networks enjoy a clear advantage.

Italy is a country of diffuse lawlessness. Businesses bribe civil servant to eschew regulations and avoid taxes. Diffuse amorality holds economic growth up. Lack of confidence forces businesses to “stay small”, keeping complex, pyramidal proprietary structures still based on family kinship. When the property of those family businesses is inherited by the next generation, their value decrease, even when, were the property passed to outsiders, its value would likely have increased. Family heirs often lack training, qualifications, and are unfit for management roles: only a new management would bring more productivity.

Summing up, there are four main issues:

- Lack of trust: the citizens do not feel protected by the state, which actually tends to sustain and build the system up.
- Lack of meritocracy: it is replaced by networks, relationships. A “*peggiocrazia*” (the opposite of meritocracy) flourishes, and the really qualified are discouraged.
- The so-called “winner takes it all” rule: corruption increases and hope is disrupted. The most disadvantaged, who find themselves fighting against “everyone and everything”, renounce to education and fall into apathy. The transition towards a “knowledge economy” makes their life even more difficult.
- Corruption spread even among intellectuals, opinion leaders, who need powerful contacts to progress.

A “liberal revolution”, fighting for meritocracy, transparency and efficiency, would break the vicious circle that led to crony capitalism. A fair policy reaction is demanded to dismantle it and to give fresh air to a choked country.

The possible solutions to the situation could be:

- Some form of protectionism, aimed at the workers with less political influence;
- A delay to technological advancements, since they widen economic inequality;
- Investments in education, key to competitiveness: the educational system must be reformed in order to improve its quality and incentivize competition.
- A zero-tolerance policy towards lobbyism.
- A safety network against “winner takes it all” economy, to guarantee political support and encourage people to invest in their future.
- Trimming inefficient, complicated legislation.