

Bad Billionaires and Lazy Capital

Idea In Short

When a country's billionaire wealth concentrates in rent-seeking, corruption-prone industries or inherited fortunes, it signals stagnation. Healthy economies produce new wealth through technology and innovation, not lazy capital protected by political connection.

Too Many Billionaires Can Be Bad

Ruchir Sharma is an investment strategist for Morgan Stanley who focuses on emerging markets. He uses a 10-point system to evaluate the investment-worthiness of countries, and the billionaire index is one of them. He makes a simple but logical macroeconomic argument against having a large percentage of a country's wealth tied up in too few hands.

Too often, this billionaire class is a stagnant elite that stifles innovation, perpetuates the status quo and breeds populist resentment. If you are a wealthy elite, the selfish refrain might be that life is good, so why rock the boat when there is no competition? It sounds medieval or dynastic, but it frankly still exists in most of the world.

The argument is not against wealth itself. It is against wealth that does not create value, wealth that protects itself through political connection rather than serving customers. The distinction between good and bad billionaires reveals whether an economy is dynamic or decaying. ¹

Yes, There Are Bad Billionaires

Beyond the obvious stereotype of a third-world dictator plundering his country's natural resources for selfish profit, there are other kinds of bad billionaires. Those who set up monopolies. Those who merely gift their wealth generation to generation without putting it to productive use. Those who just sit on their money, which is dead money.

The common thread is that these billionaires extract rather than create. Their wealth grows

through protection, connection or inheritance rather than through products and services that benefit society. The economy around them stagnates because the capital is not deployed productively.

Rent Seekers

Rent seeking is a strange phrase that sounds like something out of a classifieds website, but the economic concept is simple. It means getting an economic gain without producing any reciprocating value or wealth for society. This is often done through lobbying the government for tax breaks, legal maneuvering or, worse, straight corruption.

The easiest examples are dictators who steal shamelessly from their country's coffers while their people suffer. Zimbabwe's Mugabe is one such case. Also, the few dozen Russian oligarchs who went from zero to billionaires as they snatched up rights to most of Russia's wealth during the flawed liberalization of the former Soviet Union.

Sharma notes that nearly 70 percent of Russian billionaire wealth comes from politically connected industries, by far the largest share in the world. This concentration in connection-based industries is a red flag for any economy claiming to be a free market. 2

Corruption-Prone Industries

Some industries have been long-associated with corruption, where enormous rent-seeking behavior lets a few people get rich with limited benefit to workers, the environment or society. These people succeed through luck, government connections or violence rather than innovation.

Sharma notes that corruption-prone industries include construction, real estate, gaming, mining, steel, aluminum and other metals, oil, gas and commodity industries that mainly involve digging natural resources out of the ground. Bad billionaires spend more effort winning over politicians and tweaking regulations to favor their monopolies than serving customers.

Peter Thiel, a billionaire himself, notes that in the global Fortune list of people with 10 billion dollars or more, there are twice as many people from mining resources than from technology. This implies a lack of real wealth creation, because commodities are inelastic

goods and farmers make a fortune when there is a famine. A strong economist rebuttal argues that enormous technology and innovation is needed for commodity industries in mature markets, firms like Schlumberger.

Inherited Wealth

When you look at the list of billionaires, you often see several second-, third- and fourth-generational names of the wealthy elite. Their grandfather made his wealth, but what have they done? Are they just collecting dividends?

Inherited wealth is not automatically bad, but a high concentration of it signals an economy that rewards lineage over merit. When new names stop appearing on billionaire lists, the creative destruction that drives progress has slowed. Stagnation follows.

What Emerging Market Billionaires Look Like

Sharma's framework examines three dimensions of billionaire wealth across countries. First, billionaire wealth as a percentage of the total economy. Second, the share of bad billionaires from corruption-prone industries. Third, the prevalence of inherited wealth.

India, Mexico and Taiwan have a lot of their wealth tied up in a few billionaires. India, Mexico, Poland and Russia have many billionaires from industries typically associated with corruption. Brazil, India, Indonesia, South Korea, Taiwan and Turkey have a lot of old money being passed down.

These patterns matter for investors. A country where new wealth comes from technology and consumer products looks different from one where wealth comes from oil, mining and real estate. The composition of billionaire wealth is a leading indicator of economic health. 3

Free Markets Without Lazy Capital

Each of these countries has a mix of good, bad and inherited billionaires. Not all billionaires who inherit wealth are bad. Hyundai continues to invest in good cars. IKEA still does great things with affordable, stylish furniture.

Sharma's main thesis still holds true. A progressive economy where new competitors can

become wealthy by creating new value through technology and business models, rather than stealing rents, indicates a more vibrant, resilient and healthy society. It probably makes for a good and more stable investment too.

This is an argument for free-market capitalism with an eye toward limiting lazy capital, whether that means digging oil out of the ground or inheriting it from your mother. It is an argument for competition and technology, for developing new products and services that improve the world.

In the GDP formula of consumption plus investment plus government spending plus net exports, the focus should be on investment in the future, not consumption now. Lazy capital is consumption disguised as wealth. Productive capital is investment that compounds.

Stewardship Over Stuff

This is a more philosophical point. We are all on earth for 80 to 100 years, and then it ends. What you do with your wealth is a matter of stewardship. It is not the money that matters but what you do with it.

Richard Branson, founder of Virgin Group, wrote on the Giving Pledge website that personal stuff really does not matter. He lived on a houseboat that sank and missed nothing except photo albums. His London house caught fire, destroying everything. His home in the British Virgin Islands was gutted by lightning. Each time, the relief that everyone was safe made the loss of possessions inconsequential.

Branson concluded that stuff is not what brings happiness. Family, friends, good health and the satisfaction of making a positive difference are what really matter. Andy Stanley, pastor of North Point Church, tells people to practice being rich. Do not wait until you are wealthy to be generous and thoughtful with money. Start stewarding your wealth now. Practice being rich.

- 1Ruchir Sharma: The Rise and Fall of Nations
- 2Econlib: Rent Seeking
- 3Time: The Rise and Fall of Nations by Ruchir Sharma Book Review

Summary

Not all billionaires are bad, but too many from extractive industries, rent-seeking or inherited wealth signal an unhealthy economy. Free-market capitalism thrives when new competitors create value through technology and innovation. Practice stewardship now, not later.