

The Concept of Political Capitalism

Political capitalism is an economic and political system in which the economic and political elite cooperate for their mutual benefit. The economic elite influence the government's economic policies to use regulation, government spending, and the design of the tax system to maintain their elite status in the economy. The political elite who implement those policies are then supported by the economic elite, which helps the political elite maintain their status: an exchange relationship that benefits both the political and economic elite. The elite cooperate to use their political and economic power to retain their positions at the top of the political and economic hierarchies.

This concept is familiar both to the general public and to academics, but political capitalism has not been identified and analyzed as a distinct system of political economy. Some believe that this is simply the nature of capitalism: it benefits the capitalists and exploits the masses. Others view it as the result of corruption within the government. Still others see it as the consequence of creeping socialism and increased government interference on the economy. While there is an element of truth in all these views, they do not present a complete picture because they focus on symptoms rather than analyzing political capitalism as a distinct economic system that generates these symptoms.

In the twenty-first century there has been a popular backlash against cronyism, or crony capitalism, and criticisms of corporatism go back into the twentieth century, along with fascism – all of which are associated with insiders and the well connected using the system to their advantage. The Occupy Wall Street movement that began in 2011 was a backlash against government policies that were bailing out the Wall Street financiers – the 1 percent – while ignoring the problems of the masses of Americans who had lost their jobs and had their mortgages foreclosed – the

99 percent. The dissatisfaction people have with a system that appears to benefit the well connected while ignoring the interests of the general public is widespread, but the source of this dissatisfaction is not well understood. The general public does not have a clear understanding of it, and it is not clearly explained by the academics because, while they have a good understanding of the theoretical building blocks underlying political capitalism, they have not assembled those components to analyze political capitalism as a distinct economic system.

In a 2016 interview, Tom Morello, guitarist for Rage Against the Machine in the 1990s and for Prophets of Rage at the time he gave the interview, said, “The government basically has one function, and that is to serve the interests of the people who own the country.”¹ While one would hesitate to place too much weight on the political and economic views of someone whose fame comes from playing the electric guitar (although Morello does have a bachelor’s degree in social studies from Harvard University), Morello’s statement is a good description of the concept of political capitalism in language understandable to the general public. Morello is far from alone in perceiving that government policies often benefit the well connected and the well off while neglecting the interests of the general public, or even imposing costs on them for the benefit of the well-connected elite.

A variety of strands in the academic political economy literature provide a solid foundation for the theory of political capitalism, but academicians have not assembled the well-established building blocks of a theory of political capitalism into a comprehensive and unified framework. This volume does that, first by depicting political capitalism as a distinct economic and political system, and second by describing a substantial body of economic and political theory that has already established the intellectual foundation for an understanding of political capitalism. The building blocks for a theory of political capitalism already exist. This volume brings them together.

One reason why political capitalism has not been recognized as a distinct economic system is that economists do not focus on economic systems in the twenty-first century as they did in the twentieth. “Comparative economic systems” was a common field of study in the twentieth century, mainly comparing capitalism with socialism and analyzing various methods of central economic planning. That focus fit well within the Cold War politics of the time, which pitted capitalist democracies against communist

¹ *Guitar World* 38, no. 11 (November 2016), p. 48.

dictatorships. With the collapse of the Eastern European centrally planned economies in the late twentieth century, the field fell by the wayside in favor of examining the way that markets work, and the effects – both good and bad – of various government interventions. Using well-established theories from economics and other social sciences, one can see that there are substantial insights that come from analyzing political capitalism as a distinct economic system. It is not capitalism, it is not socialism, and it is not some intermediate system that lies between the two.

Calling this system of political economy “political capitalism” raises two types of questions. First, it may appear to be just another name for a set of institutions that already has a name: “crony capitalism,” a popular term in the early twenty-first century, seems to fit the definition given above, as does “corporatism.” The fascist systems in Germany and Italy prior to World War II also seem to fit the definition.² And Karl Marx, seeing the class struggle between the proletariat and the bourgeoisie, thought that the conspiracy between the economic and political elite to benefit themselves at the expense of the masses characterized capitalism, with no adjective needed. Political capitalism may be more descriptive, and it avoids the negative associations that fascism has with the regimes of Hitler and Mussolini. One motivation is to identify political capitalism as being different from capitalism, as it is commonly understood.

This leads to a second issue with the term. Capitalism’s proponents do not like the term “capitalism” to be associated with the government intervention that characterizes cronyism. They prefer the term “cronyism” to “crony capitalism,” and for the same reason push back against calling this cronyism “political capitalism.” Political capitalism is not capitalism, so the name is pejorative and inappropriate for the economic system that has produced such a high level of material well-being everywhere it has been implemented.³ But there may be a tendency for free market economies to move toward political capitalism, so the term might be viewed as

² See, for example, Charlotte Twight, *America’s Emerging Fascist Economy* (New Rochelle, NY: Arlington House, 1975), for an argument that, as far back as the 1970s, the American economy was moving toward political capitalism. Twight used the more ideologically charged term “fascism.”

³ Excellent historical accounts to back up the productivity of capitalism everywhere it has been implemented are found in David S. Landes, *The Wealth and Poverty of Nations: Why Some Are So Rich and Some So Poor* (New York: W. W. Norton, 1998), Joel Mokyr, *The Gifts of Athena: Historical Origins of the Market Economy* (Princeton, NJ: Princeton University Press, 2002) and Mokyr, *The Lever of Riches* (Oxford: Oxford University Press, 1990).

cautionary as well as descriptive.⁴ It is descriptive because the means of production are privately owned, which is the common identifier of capitalism, but it is cautionary because of the possibility that there is a tendency for market economies to move toward increasing political control, so the profitability of the means of production is affected by the degree to which those who control the capital have connections to the political elite. Connections count, and political capitalism provides rewards to the well connected. Is there a tendency for capitalist economies to move toward cronyism? This is one of the issues that will be explored in the following analysis.

GENERAL OPPOSITION

While there is a large divide in public opinion on many issues, the cronyism that characterizes political capitalism is uniformly criticized from one end of the political spectrum to the other. Ralph Nader discusses an alliance across the political spectrum of individuals committed to dismantling what he calls the corporate state.⁵ The Occupy Wall Street movement that was protesting the policies that worked to the advantage of the 1 percent at the expense of the 99 percent demonstrates the view of at least a subset of the general public that the system benefits a few at the expense of the many. Their language rephrases the language of sociologists and political scientists who talk about the division between elites and masses – or, as Marx characterized it, the bourgeoisie versus the proletariat. On the right, supporters of free markets criticize corporate welfare and cronyism. The left, meanwhile, argues that more government oversight is needed to curb the abuses that result from unfettered capitalism and the unequal concentration of wealth it produces. Popular opinion sides against political capitalism from one end of the political spectrum to the other.

An interesting comparison on the widespread opposition to political capitalism can be made by looking at two books, published at about the same time, critical of government policies that tend to favor the elite over the masses. Joseph Stiglitz's book, *The Price of Inequality*, published in

⁴ Many writers have suggested this tendency, including Joseph A. Schumpeter, *Capitalism, Socialism, and Democracy*, 2nd edn. (London: George Allen & Unwin, 1947) and Mancur Olson, Jr., *The Rise and Decline of Nations* (New Haven, CT: Yale University Press, 1982).

⁵ Ralph Nader, *Unstoppable: The Emerging Left-Right Alliance to Dismantle the Corporate State* (New York, NY: Nation Books, 2014).

2012,⁶ uses the Occupy language of the 1 percent versus the 99 percent to discuss government policy, while David Stockman's book, *The Great Deformation*, published in 2013,⁷ talks about cronyism in government policy. While Stiglitz is commonly viewed as having political views toward the left, Stockman's views tend to be associated with the right. Yet the messages of their books (although not their policy recommendations) are very similar.⁸ Even the subtitles of the book are telling. Stiglitz's subtitle is "how today's divided society endangers the future" while Stockman's is "the corruption of capitalism in America."

Chapter 2 in Stiglitz's book, entitled "Rent Seeking and the Making of an Unequal Society," places much of the blame for inequality on government policy. He argues, "We have a political system that gives inordinate power to those at the top, and they have used that power not only to limit the extent of redistribution but also to shape the rules of the game in their favor."⁹ Echoing those views, Stockman says that policies that try to regulate the market "fail to recognize that the state bears an inherent flaw that dwarfs the imperfections purported to afflict the free market; namely, that policies undertaken in the name of the public good inexorably become captured by special interests and crony capitalists who appropriate resources from society's commons for their own private ends."¹⁰

Stiglitz and Stockman are both saying the process is rigged to favor the cronies – the 1 percent – at the expense of everyone else. Stiglitz talks about rent-seeking and Stockman about interest group capture of the public policy process. Both rent-seeking and regulatory capture are well established within the academic literature, and have separate chapters devoted to them later in this book. The fact that they use concepts in common use in the academic literature reinforces the point that there is already a solid academic foundation on which to build a theory of political capitalism.

Stiglitz discusses the lawyers and accountants working for the elite, saying, "They help write the complex tax laws in which loopholes are put, so their clients can avoid taxes, and they design the complex deals to take advantage of these loopholes."¹¹ Regarding the economic power the

⁶ Joseph E. Stiglitz, *The Price of Inequality: How Today's Divided Society Endangers the Future* (New York, NY: W. W. Norton, 2012).

⁷ David A. Stockman, *The Great Deformation: The Corruption of Capitalism in America* (New York, NY: Public Affairs Press, 2013).

⁸ This is discussed in more detail in Randall G. Holcombe, "What Stiglitz and Stockman Have in Common," *Cato Journal* 34, no. 3 (Fall 2014), pp. 569–579.

⁹ Stiglitz, *The Price of Inequality*, pp. 39–40.

¹⁰ Stockman, *The Great Deformation*, p. 169. ¹¹ Stiglitz, *The Price of Inequality*, p. 53.

elite wields to enhance its income, he says, “The simplest way to a sustainable monopoly is getting the government to give you one.”¹² Stockman agrees, saying, “Like in all instances of crony capitalism, economic outcomes are as much a gift of the state as they are the fruits of capitalist virtue.”¹³ Stiglitz reiterates the point, saying that capitalists write rules in their favor “to extract from the public what only can be called large ‘gifts.’”¹⁴

Stiglitz argues that the elite are writing the rules for their own benefit. “It’s one thing to win a ‘fair’ game. It’s quite another to be able to write the rules of the game – and to write them in ways that enhance one’s prospects of winning. And it’s even worse when you can choose your own referees.”¹⁵ Reemphasizing the idea of regulatory capture, Stiglitz says: “The problem is that leaders in these sectors use their political influence to get people appointed to the regulatory agencies who are sympathetic to their perspectives.”

Stockman argues: “We have a rigged system – a regime of crony capitalism – where the tax code heavily favors debt and capital gains, and the central bank purposefully enables rampant speculation by propping up the price of financial assets and battering down the cost of leveraged finance.”¹⁶ Stockman’s dismal conclusion is that “In truth, the historic boundary between the free market and the state has been eradicated, and therefore anything that can be peddled by crony capitalists . . . is fair game.”¹⁷ Stiglitz adds, “It doesn’t have to be this way, but powerful interests ensure that it is.”¹⁸ Stiglitz’s remark prompts the questions: if it doesn’t have to be this way, why is it? And: what could be done to mitigate the favoritism for the elite to which both Stiglitz and Stockman object?

Stiglitz argues that “[w]hen one interest group holds too much power, it succeeds in getting policies that benefit itself, rather than policies that would benefit society as a whole. When the wealthiest use their political power to benefit excessively the corporations they control, much-needed revenues are diverted into the pockets of the few instead of benefiting society at large.”¹⁹ Stockman agrees, saying that our government “is no longer a system of democratic choice and governance: it is a tyranny of incumbency and money politics.”²⁰ He goes on to say that “the gangs of

¹² Stiglitz, *The Price of Inequality*, p. 54.

¹³ Stockman, *The Great Deformation*, p. 181.

¹⁴ Stiglitz, *The Price of Inequality*, p. 40.

¹⁵ Stiglitz, *The Price of Inequality*, p. 59.

¹⁶ Stockman, *The Great Deformation*, p. 560.

¹⁷ Stockman, *The Great Deformation*, p. 606.

¹⁸ Stiglitz, *The Price of Inequality*, p. 59.

¹⁹ Stiglitz, *The Price of Inequality*, pp. 104–105.

²⁰ Stockman, *The Great Deformation*, p. 672.

crony capitalism will fight tooth and nail to preserve their slice of an imperiled pie, thereby disenfranchising even further ordinary taxpayers and citizens who have no voice in the Washington policy auctions.”²¹ Both Stiglitz, on the left, and Stockman, on the right, tell their readers that the process is controlled by the elite for their benefit, at the expense of the general public.

In a chapter entitled “A Democracy in Peril,” Stiglitz argues,

Politics is a battleground for fights over how we divide the nation’s economic pie. It is a battleground that the 1 percent have been winning . . . In earlier chapters we saw how markets are shaped by politics: politics determines the rules of the economic game, and the playing field is slanted in favor of the 1 percent. At least part of the reason is that the rules of the political game, too, are shaped by the 1 percent.²²

Stockman agrees. “Trying to improve capitalism, modern economic policy has thus fatally overloaded the state with missions and mandates far beyond its capacity to fulfill. The result is crony capitalism – a freakish deformation that fatally corrupts free markets and democracy.”²³ Stiglitz observes, “There has been class warfare going on for the past 20 years and my class has won.”²⁴ As Stiglitz sees it, rising inequality, to a large extent, “is the result of government policies.”²⁵ Stockman concludes,

A government which is responsible for every bob and weave of the entire national economy will quickly succumb to pure crony capitalism, a regime which cannot avoid eventual fiscal insolvency and the destruction of any semblance of a free market economy . . . More importantly, it means a fatal corruption of political democracy.²⁶

The similar views of Stiglitz, on the left, and Stockman, on the right, with regard to the control the elite exercise over economic policy and political power reinforce Nader’s observation that throughout the political spectrum, people agree that this is a problem. Nader calls it corporatism, Stockman calls it crony capitalism, and Stiglitz refers to the domination of the 1 percent using the language of the Occupy movement. The nearly interchangeable quotations from Stiglitz and Stockman indicate that they are lamenting the same problems, and while quotations from these two were chosen for a close comparison, they are far from alone in their

²¹ Stockman, *The Great Deformation*, p. 692.

²² Stiglitz, *The Price of Inequality*, pp. 148–149.

²³ Stockman, *The Great Deformation*, p. 52. ²⁴ Stiglitz, *The Price of Inequality*, p. 225.

²⁵ Stiglitz, *The Price of Inequality*, p. 102. ²⁶ Stockman, *The Great Deformation*, p. 614.

observations.²⁷ The domination of the economic and political elite is perceived, across the political spectrum, as a significant threat to both the economic and political systems.

Despite the very similar description of the problems with the political and economic system expressed by Stiglitz and Stockman, they offer very different policy recommendations. Stiglitz argues that more popular awareness of the problem can lead to policies that will enable government priorities to shift toward policies that benefit the general public. Better regulations and more government intervention in economic affairs can turn the balance. Stockman sees no reason to think that the situation can be reversed. In Stockman's view, big government is the problem, and the (perhaps unattainable) solution would be to drastically cut back government. Whereas Stockman sees less government as the solution, Stiglitz sees more government as the solution.

One might question whether circumstances are really as dire as the picture painted by Stiglitz and Stockman, but to answer that question requires an understanding of the workings of political capitalism. Rather than answer that question directly, this volume lays out a theoretical framework within which it can be analyzed. Noting the very different policy conclusions of Stiglitz and Stockman – is more government control of the economy called for, or less? – again, the question can be answered only with a good understanding of how the system works.

POLITICAL CAPITALISM: WHAT'S IN A NAME?

The term “political capitalism” was first used by sociologist Max Weber in his 1922 book, *Economy and Society*, to describe the political and economic systems of ancient Rome.²⁸ Weber notes five different forms of capitalistic profit-making opportunity. In one, he says, “It may be orientation to opportunities for predatory profit from political organizations or persons connected with politics. This includes the financing of wars or revolutions and the financing of party leaders by loans and supplies.”²⁹ In another, Weber says, “It may be orientation to profit opportunities in unusual transactions with political bodies.”³⁰ These two types, he continues, “will

²⁷ Holcombe, “What Stiglitz and Stockman Have in Common,” gives a substantial number of others with similar views.

²⁸ The book was originally published posthumously in German in 1922. An English translation appears as Max Weber, *Economy and Society: An Outline of Interpretive Sociology*, edited by Guenther Roth and Claus Wittich (New York, NY: Bedminster Press, 1968).

²⁹ Weber, *Economy and Society*, p. 164. ³⁰ Weber, *Economy and Society*, p. 165.

be treated together as ‘politically oriented capitalism.’”³¹ Weber notes, “It is clear from the very beginning that the politically oriented events and processes which open up these profit opportunities exploited by political capitalism are irrational from an economic point of view – that is, from the point of view of orientation to market advantages and thus to the consumption of needs of budgetary units.”³²

Sociologist John Love argues that Weber did not fully develop the concept. “Whereas Weber developed the ideal type of rational capitalism to a high degree . . . unfortunately the same cannot be said of his concept of political capitalism.” Love goes on to define Weber’s concept as “the exploitation of opportunities for profit arising from the exercise of political power (ultimately violence).”³³

Historian Gabriel Kolko adopted Weber’s term “political capitalism” to describe the American political and economic systems that developed during the Progressive Era, which he dates from 1900 to 1916.³⁴ The title of this volume comes directly from Kolko’s use of the term, and the political capitalism he describes as characterizing the Progressive Era is a good example of the political and economic system this volume analyzes.³⁵

The conventional wisdom on the Progressive Era is that government imposed regulation on business to limit the ability of those with concentrated economic power from using it to the detriment of the masses. Prior to the Progressive Era, Americans viewed the role of government as protecting individual rights. The Progressive ideology expanded the vision of the role of government beyond just protecting individual rights to also looking out for people’s economic interests.³⁶ At its founding, the nation

³¹ Weber, *Economy and Society*, p. 166.

³² Weber, *Economy and Society*, p. 166. Weber says in a footnote on p. 1464, “The idea that Roman law promoted capitalism is part of the nursery school lore of the amateurish literati: Every student must know that all the characteristic legal institutes of modern capitalism (from the share, the bond, the modern mortgage, the bill of exchange and all kinds of transaction forms to the capitalist forms of association in industry, mining, and commerce) were completely unknown to Roman law and are of medieval, in part of Germanic origin. Moreover, Roman law never got a foothold in England, where modern capitalism originated.”

³³ John R. Love, *Antiquity and Capitalism: Max Weber and the Sociological Foundations of Roman Civilization* (London: Routledge, 1991), p. 4.

³⁴ Gabriel Kolko, *The Triumph of Conservatism: A Reinterpretation of American History, 1900–1916* (New York, NY: The Free Press, 1963).

³⁵ I have also used the term as the title of my article, “Political Capitalism.” *Cato Journal* 35, no. 1 (Winter 2015), pp. 41–66.

³⁶ A good discussion of the change in American ideology during the Progressive Era is found in Robert Higgs, *Crisis and Leviathan: Critical Episodes in the Growth of American Government* (Oxford: Oxford University Press, 1987).

was mostly agrarian, but as the country became increasingly industrialized, economic power became increasingly concentrated. The popular opinion regarding the new captains of industry, often referred to as Robber Barons, was that they were using their economic power to take advantage of workers, farmers, and small businesspeople. Progressive Era regulation was designed to protect the economic interests of the general population against the concentrated economic power held by a few, in keeping with the new Progressive ideology.

Kolko challenged the conventional wisdom, stating:

Progressivism was initially a movement for the political rationalization of business and industrial conditions, a movement that operated on the assumption that the general welfare of the community could best be served by satisfying the concrete needs of business. But the regulation itself was invariably controlled by leaders of the regulated industry, and directed toward ends they deemed acceptable or desirable . . . It is business control over politics (and by “business” I mean the major economic interests) rather than political regulation of the economy that is the significant phenomenon of the Progressive Era.³⁷

This is what Kolko calls political capitalism. Regulation, nominally designed in the public interest, was in fact designed by the economic elite for their benefit, to aid them in maintaining their elite status by preventing competitors from rising up to challenge them. Kolko’s book has its critics, and the purpose of this section is to give Kolko credit for developing the idea of political capitalism, not to defend or even analyze his recounting of the historical facts. The present volume describes the theoretical foundations of political capitalism, not its history.³⁸

Political capitalism is more than just an explicit recognition that politics influences the economic system – an idea that is well recognized by both academics and the general public. Rather, it is a system in which the political and economic elite design rules so that they can use the political system to maintain their elite positions. The idea has become more prominent as a result of the economic events in the early twenty-first century. Government bailouts of firms following the recession of 2008, subsidies to firms with political connections, and even Federal Reserve policy that has aided the banking industry have been called crony capitalism. The Occupy Wall Street movement that began in 2011 recognized the concept of political capitalism, calling the beneficiaries of government policies the

³⁷ Kolko, *The Triumph of Conservatism*, pp. 2–3.

³⁸ Some historical details, both in the United States and elsewhere in the world, appear in Randall G. Holcombe and Andrea M. Castillo, *Liberalism and Cronyism: Two Rival Political and Economic Systems* (Arlington, VA: Mercatus Center, 2013).