Political Capitalism

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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 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.

Political capitalism as an economic system was explicitly implemented in the fascist and corporatist economies of Germany and Italy between the World Wars, and as he was leaving office, President Eisenhower warned, in 1961, of the dangers of the military-industrial complex, a manifestation of political capitalism. The idea of the differing interests of the elites and masses has a long history in political science and sociology, but has been less recognized in economics. Economics tends to use individuals as the unit of analysis, so is oriented toward recognizing that different individuals have different interests, rather than that groups of people might work together to further their interests, and that group boundaries might be determined by social divisions. However, an examination of the academic literature in economics shows that the building blocks for a theory of political capitalism are already in place. This article draws

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together several strands in the academic literature to show how they can be woven together to understand political capitalism as a distinct economic system.

The Concept of Political Capitalism

Political capitalism is a concept introduced by Max Weber (1922) to describe the political and economic systems in ancient Rome. However, Love (1991: 4) 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 defines Weber's concept as "the exploitation of opportunities for profit arising from the exercise of political power (ultimately violence)." In a more modern setting, Kolko (1963) adopted the term to describe the American political and economic systems that developed during the Progressive Era, which he dates from 1900 to 1916.

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. According to Higgs (1987), the Progressive Era represented a change in American ideology. Prior to the Progressive Era, Americans viewed the role of government as protecting individual rights. Progressives expanded that view and held that government should look out for people's economic well-being in addition to protecting their rights.

Government regulation of concentrated economic power, according to the conventional wisdom, was a part of looking out for people's economic well-being. Kolko (1963: 2–3) challenges the conventional wisdom, noting:

> 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 be best 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.

This is what Kolko calls political capitalism.[1]

The concept of political capitalism has been recognized in political science, although not as a dominant paradigm and not under that name. It has not been as much a part of mainstream economic thought, although the building blocks for political capitalism are well-accepted by economists. Some recent work in development economics has recognized a similar concept, concluding that poor countries remain poor because the elite who control the political and economic system retain low-quality institutions for their benefit, at the expense of the general population. For example, Acemoglu and Robinson (2012) categorize political institutions of nations as inclusive or extractive, with inclusive institutions producing prosperity while extractive institutions are controlled by an elite to enrich themselves at the expense of the general population. Political capitalism recognizes that the elite design and control political institutions not only in poor countries but in rich countries, and they design those institutions for their benefit.

Political capitalism is more than just an explicit recognition that politics influences the economic system—an idea that is well-recognized in the public choice literature. Rather, it is a system in which the political and economic elite design the rules so that they can use the political system to maintain their elite positions. The idea has gained some credence in more popular analysis of the economic events of the early 21st 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." Likewise, the Occupy Wall Street movement that began in 2011 recognized the concept of political capitalism, calling the beneficiaries of favorable government policies the "1 percent" and contrasting them with the "99 percent" who were often left to bear the costs of policies that favored the 1 percent.

Political Capitalism as an Economic System

Economics as a discipline has not explicitly recognized political capitalism as an economic system for several reasons. The issue is not the failure to use that term, but rather the failure to recognize the

1See Bradley (2009: ch. 5) for an analysis of political capitalism.

concept as fitting within an analysis of comparative economic systems. Up through the 1980s, comparative economic systems was an area of inquiry within economics, mainly focused on a comparison between capitalism and socialism—that is, between a market allocation of resources and government allocation of resources. Loucks and Whitney (1973) is typical of a comparative economic systems textbook of the time: it has one part on capitalism and four parts on socialism. Adams (1955) includes fascism as an economic system in addition to capitalism and socialism. The major question was whether government planning was a better way to allocate resources than markets, with the caveat that all real-world economies have elements of both.

Comparative economic systems as an area of study fell out of favor after the collapse of the Berlin Wall in 1989 followed by the breakup of the Soviet Union in 1991. Capitalism had won the intellectual battle because of the breakdown of socialist economies, but there was still a substantial role in economic analysis for evaluating how a market economy might best be regulated for the public interest. The proof of the uniqueness and stability of general equilibrium by Arrow and Debreu (1954) demonstrated that under the right conditions markets would allocate resources optimally, but for various reasons those conditions are unlikely to exist, leading to what economists call "market failure." A substantial literature explains how market failure can occur and derives conditions under which public policies can correct various market failures.

Capitalism, as an economic system, was depicted as a system of markets in general equilibrium, supported by government interventions designed to correct for market failures. Within that corrective framework provided by government, resources were allocated through markets in capitalism, as opposed to socialism, where resources were allocated through a government plan. No economy allocated resources only through markets or only through government planning, so a comparative systems approach could analyze the degree to which mixed economies were differing combinations of market allocation and government planning. Capitalism, in the comparative systems approach, incorporated government as an institutional feature that would stabilize markets and improve on the efficiency of resource allocation.

Comparative economic systems, as an area of economic inquiry, fell out of favor in the 1990s. Central economic planning was no longer given serious consideration as an alternative economic system and the focus of economic systems shifted to economies in transition—that is, formerly socialist economies that were making the transition to capitalism. The old comparative economic systems question about capitalism remained, namely, what types of government oversight are required to allow a capitalist economy to function efficiently?

Government oversight does not always work as perfectly as it is described in theory, everybody knows. In the capitalist system, there are information problems and incentive problems that lead government intervention to create rent-seeking losses, regulatory capture, and other maladies. Those problems lead to additional challenges for designing policies that can use the visible hand of government to direct resource allocation more efficiently. Still, economists depict market activity in the capitalist model as maximizing behavior on the part of private sector actors within the framework of the institutional constraints designed by government.

Political capitalism is a different economic system. As Kolko (1963) describes it, private sector actors are not merely acting within the framework given by government constraints, the "major economic interests" are designing the constraints under which they act, so that they can retain their dominant positions. The economic elite recognize that the creative destruction of capitalism described by Schumpeter (1934, 1947) works against them, as existing firms are weakened by innovative newcomers. Kolko (1963: 6) states, "In the long run, key business leaders realized, they had no vested interest in a chaotic industry and economy in which not only their profits but their very existence might be challenged." So, they sought government regulation and oversight to preserve the status quo—that is, to stabilize the existing state of affairs and to make it difficult for those outside the elite to displace them.

If this characterization of the American economic system rang true in the Progressive Era, as Kolko claims, it surely rings more true in the 21st century, when the federal government took equity interest in a dozen major banks and two major auto manufacturers to preserve their economic status, even as it allowed hundreds of smaller banks and other firms to fail. The "too big to fail" doctrine, where government allows private firms to retain their profits but underwrites their losses, is perhaps the most obvious manifestation of political capitalism. This system of private ownership but government management of the economy falls under the heading of fascism in the old comparative economic systems taxonomy. Political capitalism is closer to fascism than to either capitalism or socialism.

The standard economic approach to analyzing the interaction of markets and politics is that government policies are designed to provide an institutional framework for markets that can improve their efficiency. Those policies do not always work perfectly, so the policy challenge is to design better policies that can allocate resources more efficiently. Government designs the policies and market participants are constrained by them. Political capitalism is a system in which the policies are designed by the economic elite to enable them to retain their dominant positions. This is not the market economy described by comparative economic systems, nor is it some mixture of markets and central planning. Political capitalism is a distinct economic system.

Despite not being recognized as a distinct economic system, there is a substantial amount of academic economic analysis that provides a foundation for understanding political capitalism. After examining the politics of political capitalism, one of the goals of this article is to discuss the economics literature to describe the existing academic foundation for political capitalism, and to build a framework on that foundation that more accurately depicts the operation of all advanced economies from the Progressive Era up through the beginning of the 21st century.

The Politics of Political Capitalism

Political science has done a better job of recognizing political capitalism than has economics, at least partly because economics depicts individuals voluntarily interacting, limiting the power that any one individual has over others. Even when the individual actor is a giant firm, within the framework of the market that firm can only buy its inputs, hire its labor, and sell its products if the other parties to those transactions voluntarily agree. They must reach agreement within government-designed constraints that sometimes facilitate agreement and sometimes inhibit or prevent potential transactions from taking place. Nevertheless, market transactions only take place when all parties agree. This is not true in politics, where political winners can use government to impose policies by force.

Who are those political winners? Gilens and Page (2014) offer a straightforward taxonomy of four theories that have been recognized in the academic political science literature: majoritarian electoral democracy, economic-elite domination, majoritarian pluralism, and biased pluralism.

Majoritarian Electoral Democracy

Here political outcomes are determined by the average citizen or median voter. Gilens and Page associate this view with Downs (1957) and Black (1958), whose work was instrumental in providing a foundation for modern public choice theory, and has made some inroads into economics through that channel.

Economic-Elite Domination

This theory is consistent with political capitalism in which economic elites determine policy outcomes. Beard's (1913) description of the U.S. Constitution as designed by the economic elite falls into this category, and they mention Mills (1956) as an important contributor to this theory. While Beard's work has been recognized in public choice, Mills' idea of a "power elite" remains outside the bounds of contemporary economic analysis.

Majoritarian Pluralism

This approach is an interest group theory in which the interests of all groups are balanced in the making of public policy. Gilens and Page cite Bentley (1908) and Truman (1951) as significant contributors to this view of politics, showing that it dates back to the era when the study of political economy was separated into economics and political science. This view has also been depicted in public choice through the work of Becker (1983) and Wittman (1989, 1995), to name two examples, so interest group theory has had an impact in the economic analysis of politics.

Biased Pluralism

Here the interests of corporations, business associations, and professional groups are disproportionately represented in the policymaking process. Gilens and Page offer many citations to political scientists who support this theory, but also note the contributions of two economists: Olson (1965) and Stigler (1971). While Gilens and

Page are accurate in their assessment of Olson and Stigler, an economic (and public choice) theory of interest groups tends toward majoritarian pluralism rather than biased pluralism.

Gilens and Page use an extensive data set to empirically investigate the degree to which actual public policy outcomes conform with these four theories, and find that the economic-elite domination and biased pluralism theories fit best. Those theories are also the most consistent with political capitalism.

Elites verses Masses?

One reason economists might question the political capitalism model is that it separates people into two distinct classes: the elites and the masses, or the 1 percent and the 99 percent, to use contemporary language. Economists are more used to thinking about continuous changes rather than discrete changes. So, one might surmise that greater wealth would allow individuals to buy more political influence, but why would there be some arbitrary cut-off where, above that level a person is in the elite, but below, the person is in the masses? Shouldn't one's influence vary more or less continuously with the person's level of wealth? There are several reasons why there might be, effectively, a discontinuity in the influence people have on public policy that would divide the population into elites and masses.

One reason has its foundation in the discontinuity of public policy outcomes. While there may be compromises, as depicted by Becker (1983), public policy measures are often more accurately depicted as having binary outcomes. A party either wins or loses as a measure passes or fails. Participating in the process is not inexpensive, so people who cannot afford the price of entry find themselves in the masses. In markets, people who produce low value receive low incomes, and those who produce high value receive high incomes. In politics, where issues win or lose, the outcome is not continuous, so people who enter that arena must choose to devote sufficient resources to it so they can have their share of victories. Most people realize that they can have no effective influence, so they stay out of the system and choose to be, as Downs (1957) says, "rationally ignorant." Olson (1965) explains why it is that concentrated interest groups can organize to have political influence, while disbursed interests cannot.

A second reason, related to the first, is that for people who cannot afford to buy their way into the process (or choose not to), transaction costs are high and they are unable to bargain. To use the terminology of Coase (1960), the elite are in the low transaction cost group while the masses are in the high transaction cost group; hence, they are unable to bargain to influence public policy. Consider the difference between citizens voting in a general election to elect their representatives and those representatives voting on issues in the legislature. There are a large number of citizens who vote in many different locations using a secret ballot, and all those factors raise transaction costs and make it difficult for citizens to bargain with one another to exchange votes. In a legislature, by contrast, there are a small number of legislators who all know one another, and their votes are a matter of public record, making it easy for them to logroll and trade votes. They are in a low-transaction-cost group.

One of the contributions of Buchanan and Tullock (1962) was to demonstrate how this logrolling and political exchange can enhance the value of political outcomes to members of the trading group. Likewise, lobbyists and other insiders are in a position to bargain with legislators, offering campaign contributions and other forms of political support, so they can enter the low-transaction-cost group. The cost of access means that some people are in the low-transaction-cost group. Those people are the power elite who make public policy, whereas others are in the high-transaction-cost group who cannot bargain to affect public policy outcomes. Those people have no access, and would have little effect on public policy outcomes if they tried. So, they remain outside the process and are part of the masses.[2]

This is a difference between markets and politics. A low-wage worker can put in a few extra hours of work and make a few more dollars. Someone with no political influence can put in a few extra hours and still have no political influence. Thus, people naturally separate into elites and masses.

The observation that the elite determines public policy in modern democratic capitalist societies is as old as democratic capitalism. Marx and Engels (1948: 10–11) argue,

> Each step in the development of the bourgeoisie was accompanied by a corresponding political advance of that class. . . .

[2]A counter-argument to this view that transaction costs prevent some people from influencing political outcomes is found in Wittman (1989, 1995).

> [T]he bourgeoisie has at last, since the establishment of modern industry and of the world market, conquered for itself, in the modern representative state, exclusive political sway. The executive of the modern state is but a committee for managing the common affairs of the whole bourgeoisie.

This is the argument that Kolko (1963) was making when he characterized the Progressive reforms as political capitalism, and that argument carries forward into the 21st century.

Holcombe (2014) notes that in an interesting pair of books, Stiglitz (2012) and Stockman (2013) both argue that contemporary political and economic problems are the result of faulty government policies that are designed by the economic and political elite at the expense of the masses. Stiglitz uses the Occupy language and refers to policies created by the 1 percent at the expense of the 99 percent, and Stockman characterizes the elite as cronies and calls the system crony capitalism. Stiglitz titles one of his chapters "A Democracy in Peril," and Stockman (p. 614) concludes that crony capitalism leads to "the destruction of any semblance of a free market economy. . . . Most importantly, it means a fatal corruption of political democracy." Both Stiglitz and Stockman agree that government policies skewed to benefit the elite at the expense of the masses are damaging both the market economy and democratic government.

Stiglitz writes from the vantage point of the political left while Stockman writes from the vantage point of the political right. They are good choices for a comparison because of the similarities in their conclusions despite differences in their political views, but they are not alone in identifying problems caused by a political system run by and for elites. Schweizer (2013) argues that the special interest political activity that often appears as bribery—interest groups bribing legislatures for favorable outcomes—is more accurately described as extortion. Legislators threaten businesses and other interests with harmful legislation, or threaten to hold up legislation they desire, until those interests make payments to the politicians. He offers lots of examples to make his case, describing a system of cronyism that works for the benefit of the elite but imposes costs on the masses.[3]

[3] McChesney (1987, 1997) makes the same points as Schweizer.

Allison (2013) focuses more narrowly on the 2008 financial crisis and its aftermath, but describes policies that favor the politically connected over the general public in a manner similar to Stockman. Holcombe and Castillo (2013) look at cronyism beyond the United States dating back to the early 20th century, and Holcombe (2013) discusses a strong foundation for this line of reasoning in the literature of academic economics.

While Allison and Schweizer write from the vantage point of the political right, there is a substantial literature on the political left making the same point. Bartels (2008) calls the political privilege the elite enjoy at the expense of the masses the new gilded age, noting how the political process is skewed to benefit the 1 percent, and Hacker and Pierson (2010) and Gilens (2012) argue along with Stiglitz that the growing privilege of the 1 percent is not due to market forces but to the political power of those at the top. Gilens and Page (2014) offer a persuasive empirical analysis and conclude that government policy conforms with the preferences of the elites, and goes in the direction average citizens prefer only when their preferences correspond with those of the elites. Nader (2014) argues that this opposition to crony capitalism unites the political left and right.

A fundamental component of political capitalism is the ability of the economic elite to control public policy for their benefit. The literature in economics and public choice, while recognizing the influence of interest groups, has not depicted this kind of clear division between the elites who determine public policy and the masses who are governed by it. There is not only an argument that supports this division but also a substantial literature that documents it. The next several sections show that there is also an economic theory that lays a foundation for it, even though that foundation has not been fully integrated to develop a theory of political capitalism.

Interest Groups, Rent Seeking, and Regulatory Capture

Prior to the public choice revolution, which began in earnest in the 1960s, economists left political considerations completely out of their policy analysis. Public policy analysis consisted of finding "market failures" where markets failed to meet an ideal benchmark of perfect efficiency, and then deriving conditions under which those market failures could, in theory, be corrected. Two articles that illustrate this paradigm well were written by Bator (1957, 1958). The first article derives the mathematical conditions for a welfare-maximizing general equilibrium, and the second illustrates mathematical conditions that show why an economy can fail to reach that equilibrium. The policy goal is then to design policies that satisfy the conditions for welfare maximization, but from the economist's perspective, the actual process by which those policies would be designed fell under the discipline of political science, not economics.

The public choice revolution brought the analysis of political decisionmaking—and government allocation of resources—under the umbrella of economics. As Buchanan (1975a) explains, public choice uses the tools of economics to analyze political decisionmaking, so that the same tools of analysis and the same behavioral assumptions are applied whether one is looking at resource allocation through markets or through government. Looked at in this way, even if there is a "market failure," trying to fix it through government policy could create a "government failure" that would be even worse. Although the ideas of public choice have become a part of mainstream economics, Holcombe (2012) notes that the bulk of academic economic policy analysis still ignores it and assumes that once economists have derived the theoretically optimal policy, government will implement it. Public choice is a separate subdiscipline, and its lessons are often ignored in policy analysis in other subfields in economics. This is one reason why the study of comparative economic systems has not recognized political capitalism as a distinct economic system.

Public choice has identified the fundamental components of political capitalism, so developing a theory of political capitalism does not mean starting from a clean slate. Mancur Olson has made three major contributions to the economic effects of interest-group politics. Olson (1965) has shown that concentrated interests have an advantage in organizing to get public policies that further their interests, giving an economic foundation to the division of elites versus masses in the policy arena, and Olson (1982) develops a framework to show how, over time, interest groups become more firmly entrenched into the political system so that political decisions become increasingly made for the benefit of well-connected political interests, to the detriment of a nation's overall economic performance. Olson (2000) shows how governments can act as "stationary bandits" and organize the rules in such a way as the maximize the benefits to the rulers.

The importance of special interests in politics is well-recognized within public choice, but that literature has not made the distinction between majoritarian pluralism and biased pluralism, to use the division that political scientists have perceived. To push the interest group theories of politics used in public choice toward laying a foundation for political capitalism would mean accepting the biased pluralism hypothesis with regard to interest group influence. By combining Buchanan and Tullock's (1962) analysis of logrolling for the benefit of those who are able to engage in political exchange with Coase's (1960) notion of transaction costs, a theory can be developed in which the elite are in a low-transaction-cost group so they can engage in political exchange for their benefit, at the expense of the masses who are in the high-transaction-cost group. This happens in politics but not in markets because government is able to force people to pay for their programs regardless of whether they want to participate, whereas in markets even those with substantial economic power can obtain resources from the masses only if they voluntarily agree to participate in transactions.

Rent seeking, first identified by Tullock (1967), has become a major area of inquiry since Krueger's (1974) article gave it that name. The concept makes it clear that some are using the power of government to receive benefits at the expense of others. As with interest group theories, the rent-seeking literature has not identified the recipients of rents as the elite, or the 1 percent. It only divides people into rent seekers, recipients of rents (perhaps a subset of all rent seekers), and the groups who have costs imposed on them as a result of the transfer of rents. It would be a small step to say that the 99 percent are not able to effectively engage in rent seeking, so the beneficiaries are the 1 percent, but the public choice literature has not looked into this issue, and it may not be true. It depends on whether rent seeking is better described as a majoritarian pluralistic activity or a biased pluralistic one.

If one applies the insights of the previous section to these public choice issues, there are arguments supporting the idea that interest group politics and rent seeking are not avenues open to average citizens, so the biased theory would have some credibility, and theories of special interest politics and rent seeking would lay a foundation for a theory of political capitalism. At this point, however, public choice has not even looked into the issue, so these areas of inquiry do not fall into the biased or majoritarian area in the current public choice literature.

Stigler's (1971) capture theory of regulation fits very comfortably within political capitalism. The firms that are able to capture the regulatory agencies that regulate them, so that regulation works for the benefit of the regulated firms, easily fall within anyone's conception of the economic elite. Moreover, just as Kolko (1963) envisioned political capitalism, the elite are able to write the rules to benefit themselves, to stabilize the system, and to keep competitors from eroding their positions at the top.

The building blocks for the theory of political capitalism are already well-established in the literature on public choice, even though economists have not taken the steps to build that theory. Economic models of interest group politics, rent seeking, and regulatory capture do not consider the possibility that these opportunities to use the political system for their own gain may be open to some—the elite—but not open to others—the masses. Political science offers some assistance, because it has developed persuasive theories that depict domination by economic elites and biased pluralism that posit the domination of elites over the masses in the public policy arena.

Regulatory Capture and Transitional Gains

Political capitalism is a two-way street in which the political elite produces policies that benefit the economic elite in exchange for the economic elite's support of the political elite. The capture theory of regulation suggests that regulatory agencies act in the interest of the firms they regulate, but the other half of the story is that the regulated firms act in the interest of those who establish and maintain those regulations. The relationship is reciprocal, to use a term Coase (1960) applied to externalities.

Tullock (1975) described what he called a "transitional gains trap." Rent seekers are able to get government to create policies that transfer rents to them, but over time those rents are dissipated because they become capitalized into the assets that are required to receive the rents. A clear example is the taxicab medallions that are required to drive a cab in New York City. The number of medallions is limited, so a barrier to entry is created into the industry, creating an above-normal profit. The medallions can be sold, so anyone who wants to enter the market must buy one of the existing medallions, which have sold for more than $1 million. The transitional gain has been capitalized into the value of the medallion, so the market value of a medallion is equal to the expected present value of all the future rents that will come to the cab owner because entry has been restricted. The trap is that if one were to undo the policy and allow free entry into the market, existing owners of medallions would suffer a transitional loss of more than $1 million per medallion because the medallions would then become worthless. The value of future rents is capitalized into the value of the medallion, so current owners do not receive above-normal returns from the restriction on entry.

This example generalizes to any government program that creates rents for one group at the expense of others. Farm subsidies, for example, transfer money from taxpayers to farmers, raising farmers' incomes. To get the subsidies, recipients must own farmland, so the value of the subsidy becomes capitalized into the value of the farmland. Doing away with farm subsidies, quotas, and other agricultural programs would lower the value of farmland, making the owners of farmland suffer a transitional loss.

The result is that those firms that have captured the agencies that regulate them, or that otherwise benefit from rent-creating government programs, are dependent on those who control the programs for their continued profitability. One example Tullock gives of the transitional gains trap is the now-defunct Civil Aeronautics Board. The CAB essentially cartelized the airline industry by assigning routes and setting fares. It would allow airlines to expand their routes only if they could show a need for capacity on that route, and would allow airlines to raise their fares but not lower them. This is just what a cartel does: raise prices and restrict output. The system worked well for the airlines that participated.

The transitional gain was dissipated in many ways: high salaries for unionized pilots, good service (at a high price) for customers, and excess capacity. The excess capacity was beneficial because if a competing airline wanted to enter a route already flown by an airline, the airline flying the route could point to that excess capacity, saying "we are only filling 60 percent of the seats we now have on that route, so there is no need for additional capacity."

When the airlines were deregulated in the late 1970s and the CAB was abolished, the existing airlines suffered transitional losses and few survived. Well-established and long-standing airlines like TWA, Eastern, and Braniff disappeared, to be displaced by newcomers like Southwest and USAir. This provides a good example of the political capitalism Kolko described. The purpose of the CAB regulation was to stabilize the industry and allow the existing firms who controlled the market to maintain their dominant positions. The disbanding of the CAB is a rare case where the economic elite lost the protection of the regulatory agency they had captured, upsetting the stable market they wanted to preserve. Airfares did fall, but this creative destruction is not what the economic elite wants. This example shows that regulatory capture creates a dependence of those firms on the regulatory regime that benefits them, so they must support the political structure that maintains that regime or they will suffer transitional losses.

Schweizer (2013) says that special interest politics is often depicted as bribery, but more typically it is extortion. It appears that interest groups are bribing politicians to pass legislation they favor, but Schweizer offers many examples to illustrate that the typical process is for legislators to hold up producing any favors for interest groups until they pay up in the form of campaign contributions, hiring of friends and family members, or other favors. Schweizer offers real-world examples for what McChesney (1987, 1997) has called "rent extraction." Politicians approach interest groups and threaten to pass legislation that will impose costs on them unless they pay up to have the proposed legislation withdrawn. The political elite is able to extract payment from the economic elite because the economic elite is dependent on the political elite for the legal and regulatory environment that ensures their continued profitability and dominance.

The capture theory makes it appear that the benefits go one way, to the firms that benefit from regulation, but there is a transitional gains trap, and as those firms become dependent on that regulation for their continued profitability, the political class is able to extract benefits from the economic elite in exchange for the beneficial legal and regulatory structure they desire. The transitional gains ultimately trap the rent recipients into dependence on the system of political capitalism.

Rent-Seeking Losses

The rent-seeking model developed by Tullock (1967) makes it appear that rent-seeking losses should be much larger than the losses that can be empirically identified, an observation known as the "Tullock paradox." While there will be winners and losers among rent seekers, on average the gains should roughly offset the losses. Otherwise, if rent seeking were on average profitable, that would be a signal for entry into rent seeking until rent seekers just earned a normal profit. Likewise, if rent seeking on average entailed losses, that would encourage exit until rent seekers earned a normal return. The model that describes the welfare cost of rent seeking as equal to the amount of rents generated assumes free entry into rent seeking. Within the political capitalism framework, rents are limited to the elite, who write the rules so that they create a barrier to entry to those not in the elite group.

If a cartel can create a barrier to entry, it can create a continuing stream of profits for its members. By restricting rents to the elite, there is a net benefit to the rent recipients (at the expense of others), and the welfare costs of rent seeking do not equal the entire amount of rents. This explains why the welfare losses from rent seeking are not larger. Most people are barred from competing for rents because they are not a part of the elite—the low-transaction-cost group that is able to maintain a set of public policies for their benefit. Consider that if all of the rents are dissipated as welfare losses, the rent seekers gain nothing on net. By creating a barrier to entry, the political and economic elite can benefit each other. The economic elite gain the rents they are seeking at a cost lower than the rents and transfer some of the rents they gain to the political elite, allowing both the political and economic elite to gain from the rents sought and granted.

A barrier to engaging in rent seeking enhances the efficiency of the economy by lowering the welfare cost of rent seeking, which benefits everyone, but the elite maintain that barrier to entry for their own benefit. As Kolko (1963) notes, concentrated economic interests have an incentive to maintain the status quo, and an essential element of political capitalism is the elite's maintaining their status relative to the masses. The rent seekers are a cartel, as are the rent granters, and they use barriers to entry to maintain a continuing stream of benefits to them from the masses.

The Constitutional Framework of Political Capitalism

Economic analysis examines the way people choose subject to constraints. Buchanan (1990) describes constitutional economics as a study of the choice among constraints. This constitutional framework lays the ultimate foundation for a theoretical analysis of political capitalism. Looking at the components of political capitalism that already have a solid representation in economic analysis—interest-group politics, rent seeking, regulatory capture—those components represent individuals in the private sector as facing a set of constraints in the form of government rules, regulations, and institutions, and maximizing within the constraints that they face. Within the framework of constitutional economics, the rent seekers, the regulated firms, and the interest groups are not merely reacting to the constraints government has placed in front of them; they are designing those constraints themselves, for their benefit.

Kolko (1965) and White (2011) offer a compelling case that the Progressive push to regulate the railroads in the United States was supported by the regulated railroads because regulation benefited them. FDA regulation of pharmaceuticals makes it so costly to bring new drugs to market that small firms have no hope of competing with the established companies. Physician licensure is a common example of a barrier to entry that benefits those who have the credentials, while raising costs to those who use physician services. Economic methodology, which examines people's choices subject to constraints, looks at these individuals as responding to a given institutional environment, whereas constitutional political economy studies the choice among constraints, and opens the analysis to an examination of how it is that those members of the economic elite are able to design the constraints to their benefit. A development of a more complete theory of political capitalism therefore begins with the subdiscipline of constitutional political economy, to describe the mechanisms that allow the elite to design an institutional structure that enables them to maintain their status and to favor themselves over the masses.

Much of the work in constitutional economics, based on the pioneering work of Buchanan and Tullock (1962), Rawls (1971), and Buchanan (1975b), examines the development of constitutional rules through a process based on consensus, where those governed by the rules engage in a collective decisionmaking process to design rules that are agreed to by those who will be governed by them. Political capitalism depicts the choice of constitutional rules as being made not by consensus of the masses, but by the elite, for the benefit of the elite.[4]

The Continuing History of Political Capitalism

After the fall of the Berlin Wall and the breakup of the Soviet Union, Fukuyama (1992) described liberal democratic government and the market economy as "the end of history," in the sense that they represented the end of evolution in political and economic systems. The model of political capitalism tells a different story, because there is an inherent conflict between a market economy and a democratic government. A market economy is based on clearly defined property rights and interaction among individuals through voluntary exchange. People can obtain resources, goods, and services from others only if those others agree. Democratic government, in contrast, allows those with political power to extract resources from others without their consent. In the majoritarian democracy framework, a majority can use the political process to forcibly extract resources from a minority, but in the elite domination or biased pluralism frameworks, a minority is able to use the political process they control to extract resources from the masses.

Whether democratic government is controlled by the elites or the masses, the conflict between democracy and a market economy arises because in a market economy interpersonal interaction occurs only when all parties to those interactions agree, whereas the basis for democratic government is to allow some to use the

[4] The political elite strongly encourage the political participation of the masses, as long as the masses can have no impact on political outcomes. Political participation by the masses has a strong symbolic impact, because it implies the support of the masses for the political elite, as Edelman (1964) notes. However, when people outside the political elite actually can make a difference, their participation is vilified. Note, for example, the complaints about money in politics—especially money that comes from large donors. Politicians are happy to receive donations that support their positions and help maintain their positions in the elite, but when money comes from people who challenge the elite, like the Koch brothers, they are vilified because they are challenging the ruling elites. Participation is encouraged by the political elite, unless that participation can displace members of the elite from their positions of power.

force of government to appropriate resources from some to transfer to others. There is an inherent tension between a democratic political system and a market-based economic system. A good example is found in Piketty's (2014) analysis of capitalism, where he views a market economy as generating ever-increasing inequality, and calls for highly progressive taxes on income (up to an 80 percent marginal rate) and on capital ownership. Piketty sees the tension between a market economy and democratic government, and urges the latter to confiscate income and wealth in the former, not to produce public goods, but to reduce inequality.

This tension was also discussed by Hayek (1944), who saw government allocation of resources as the road to serfdom, and explains how, in government, where the whole purpose is to force people to abide by its rules and policies, the worst get on top. Schumpeter (1947) likewise saw this tension, noting that those who benefit most from capitalism will not stand up to support it. Holcombe (2002a) describes how this tension between capitalism and democracy has grown as government has grown. This is increasingly apparent in the 21st century, where businesses use their political clout not to support free markets, but as Kolko (1963) observed, to create policies that cement their position in the economic elite so they can avoid being the victims of the creative destruction that characterizes a market economy. Olson (1982) describes the solidifying of interest group relationships over time as the cause of the decline of nations. The institutions of democracy eventually undermine the institutions of a market economy.

Baumol (1990, 1993) depicts entrepreneurship as the engine of economic progress, but notes that when institutions are designed so that individuals can benefit from using the force of government to transfer resources from others to themselves, people's entrepreneurial impulses turn toward predatory and destructive activities. As Holcombe (2002b) notes, there are limited opportunities for welfare-enhancing political entrepreneurship, but there is no limit to predatory political entrepreneurship, which imposes costs on some to buy the political support of others. Political capitalism undermines both liberal democracy and the market economy by designing the rules to place the control of economic resource allocation in the hands of an elite minority. In Buchanan's (1990) framework, they design the rules so that they retain their positions in the elite.

There appears to be a stronger argument that the end of history is political capitalism, rather than liberal democracy and a market economy.

Conclusion

Political capitalism is an economic and political system in which the economic and political elite cooperate for their mutual benefit. While the essential idea of political capitalism has a long history, it has not been recognized as a distinct economic system. In part, this is due to the 20th-century vision of economic systems as capitalist, socialist, or a mixed economy that contains elements of both capitalism and socialism. It has also been due to the frequent vision of government as an institution that acts in the public interest, corrects market failures, and controls the activities of business. Political capitalism is an economic system in which business controls government more than government controls business. One goal of this article has been to broaden the vision of economic systems to depict political capitalism as a distinct economic system. It is not some intermediate system lying between capitalism and socialism.

A second goal of this article has been to demonstrate that while political capitalism as an economic system has barely been recognized, the building blocks that form a theoretical foundation for political capitalism are firmly in place and well-accepted. In political science and sociology, the ideas of elite domination and biased pluralism are mainstream concepts that are a fundamental part of political capitalism. In economics and public choice, the concepts of rent seeking, regulatory capture, and special-interest politics are similarly mainstream concepts, although in that literature they have not been linked to the class theories found in political science and sociology. The theoretical foundation also rests on the literature in constitutional political economy, which Buchanan (1990) has depicted as studying the choice among constraints. Economic analysis, including the literatures on rent seeking, regulatory capture, and special-interest politics, has tended to view those activities in the context of economic agents maximizing subject to the rules and constraints present in the political system, whereas political capitalism recognizes that those economic agents are the ones who are designing the rules and constraints for their benefit. The theoretical framework for political capitalism does not have to be developed. The building blocks are already there and just need to be assembled so that the system is recognized.

Critics from throughout the political spectrum have observed and criticized government policies that favor insiders and cronies at the expense of the general public. These observations come from the political left to the political right, from libertarians to proponents of big government. A theory of political capitalism focuses attention on political and economic problems that are widely recognized and command broad agreement. Despite this agreement on the causes and consequences of political capitalism, there is no widespread agreement on policies to deal with it. On the left, there are calls for more government oversight, more government programs, and more government spending, while on the right, critics conclude that government is the problem and that the solution is less government. Rather than delve into those policy differences here, this article focuses on the areas of agreement to describe political capitalism and assemble its theoretical foundation. If the many ideas that build the foundation of political capitalism are recognized as describing a distinct economic system, that foundation can lead toward more productive policy discussions to address the problems political capitalism presents.

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