



## Episode 1,403: The Origins and Evils of Crony Capitalism

Guest: Randall Holcombe

**WOODS:** What is your goal in this book, *Political Capitalism*?

**HOLCOMBE:** Oh, well, that's a big question. Really, what I wanted to do was to paint political capitalism as a distinct and separate economic system. And one of the big lessons out of the book, I think, is that one of the biggest threats to capitalism is not socialists; it's capitalists. Capitalists themselves are undermining the system of market capitalism and displacing it with political capitalism.

**WOODS:** And so how would we define political capitalism as a system?

**HOLCOMBE:** Yeah, political capitalism is an economic and political system where the economic and political elite work together in order to further their mutual interest. And in the system of political capitalism, increasingly profits come not from satisfying consumer preferences, but because of political connections.

**WOODS:** All right, so in the course of our conversation we'll give examples of this kind of thing happening now. I've read the whole book. And I mean, obviously, you know better than anybody, there's a ton of stuff that can be discussed in here. But I'd like to talk a little bit about elite theory. There have been different theories advanced about the nature of elites in society. And it would seem, at least according to the naive version of democracy, that we shouldn't have elites in our society, because after all, we're democratic and everybody has the same political power as anyone else. We all have one vote. It's hard to say that with a straight face, though, so what in fact winds up happening in reality?

**HOLCOMBE:** Well, what happens is that there are a few people who are well connected. Those are the people who make public policy. Most people have almost no political voice at all. There's basically nothing you can do. And there's a discontinuity in political power that doesn't exist with economic power. So if you think about economic power, maybe you're struggling to get by or something, is there any way you could get a little more economic power? Well, maybe you could find a better job. You could work overtime. You could take a second job. Make a little more money, you have a little more economic power. So there's certain continuity there. And when you show up at Starbucks with your \$10, your \$10 has just as much weight as Bill Gates' \$10. But that's not the case when you look at political power, that most people have almost no political power, and there's not very much that they could do to get more political power. If you think you want to exercise more political power, you could contribute to a political campaign or a political party. Maybe you could volunteer and work a little bit for a candidate or for a party, but you still wouldn't have any political power.

It's the well-connected people who make public policy, and most people have no say in public policy at all.

**WOODS:** I think libertarians have done a decent job in laying out some kind of elite theory or a class theory, whereby they can say — for example, I've heard it said that Marx wasn't wrong to think that there were classes; he was wrong in what he identified as the classes, that if we're going to say that one class oppresses another, then it might be better to say that the class that operates the state apparatus oppresses the people who fund the state apparatus. I'm at least willing to consider that kind of framework. But other people aren't making that kind of careful distinction, so if I were to talk to a Bernie Sanders supporter, for example, you could have the purest, most innocent free market capitalist who nevertheless dominates his industry, just through sheer effort and superior quality. And they would look at that person as an elite. So how do we keep this straight in people's minds?

**HOLCOMBE:** Yeah, I think those people with a lot of economic power do fall in the category of elites. But one distinction you need to make between economic power and political power, is that the only way that somebody can get your money in the market is if you voluntarily give it to them. So you can point to McDonald's, how they're poisoning America with their fatty foods, and so forth. But the only way McDonald's gets any money from anybody is if they voluntarily give it. Whereas with the government, I mean, they force you to pay your taxes, whether you want to pay or not. But it is the case that the large corporations, I mean, partly they produce products to try to make a profit, but they also engage in the political process. And I think it's interesting. I mean, I think Marx had some good points along those lines. And Murray Rothbard's book *The Progressive Era* came out after I had written my book, but it's interesting when you read some of the passages in Rothbard how closely they parallel some of the ideas in Marx. In fact, I mean, from political left to political right, people recognize the symptoms of political capitalism. I don't think they really see the causes.

And when you think about elite, one interesting way to frame this is to look at the language of the Occupy Wall Street people, because I think they had some valid complaints when they're talking about the 1% policy favoring the 1% over the 99%. And you go back to the financial crisis, people are being foreclosed out of their homes, they can't pay their mortgages, the economy's in a downturn, the housing market is falling. And what do we? Do we help out those poor people who can't make their mortgage payments? No, we bail out the Wall Street fat cats. So I think the complaint is valid as far as it goes there. But look at what the left is saying as far as a remedy. They want government to step in and do something. But the government, those are the people in the 1%. So if I use the Occupy Wall Street language, what you're saying is public policy is favoring the 1% over the 99%, so I think we should give the 1% more power and hope that this time they'll favor the 99% rather than themselves. I mean, people don't see that it's the interaction of the political elites with the economic elites that's threatening capitalism.

**WOODS:** I'm curious, do you think monetary policy can be an instrument of political capitalism? And if so how?

**HOLCOMBE:** Well, I mean, we certainly saw after the 2008 financial crisis when the Fed got involved in buying up all those so-called toxic assets. I mean, I think one thing that monetary policy might do in the short run is keep interest rates low to make borrowing affordable for corporations. This is something David Stockman has complained about. I think his complaints are valid. But I would more point toward what happened after the financial crisis when the

Fed was buying up all those toxic assets. That was certainly helping out the economic elite. It was a huge subsidy to banks. So yeah, monetary policy can be a tool of political capitalism.

**WOODS:** The key term, one of the key terms that we would associate with political capitalism is rent seeking. It's kind of an unusual-sounding term to the layman. Can you explain what it means?

**HOLCOMBE:** Basically, rent seeking, the term is not that descriptive. It should be transfer seeking, that basically, the rent seekers, what they're seeking is transfers to themselves from the general public, and they're doing that through government action. And the best example that just about everybody would be familiar with is the requirement that motor fuels contain 10% ethanol. And why is that? I mean, if people wanted ethanol in their gasoline, they would voluntarily buy it. But most people probably wouldn't choose that, but it's the corn lobby – Archer Daniels Midland and other agricultural firms, corn farmers – those are the people who want the additional market for their product. So they go to government, and the rent seeking – I mean, what they're seeking is a transfer. Every time you buy gasoline, you're giving a little bit of money to the corn industry, the corn processors, the corn farmers, and so forth. They're doing it through the force of government. And so that's basically what rent seeking is: transfer seeking, it's trying to get the government to force some people to transfer resources to others. The well-connected get the resources; the poorly connected, they're the ones who pay the cost.

**WOODS:** The way that harms society is, in a sense, obvious, that certain people are acquiring ill-gotten gains at the expense of ordinary people, who in almost all cases have no idea that the process is even occurring. So there's something just downright sinister about it. Then also, there's just a loss of resources tied up in the time and energy and money and labor power that are put into getting the transfers and lobbying and influence peddling. Everything that's expended in that direction could have been expended in the normal economy to satisfy consumer preferences, so that's another loss. Is there anything I'm missing as to how this harms society?

**HOLCOMBE:** Yeah, I mean, there's a lot of waste just in the process of rent seeking. And I think sometimes the public choice people overstate the amount of resources that are wasted in rent seeking. You do you see wasted resources, but basically, the reason those rents are created in the first place is the political elite want to get something back from the people who are getting the rents. And if all the rents are wasted, there's nothing left over for the political elite. So basically, again, think about the corn lobby and the ethanol mandate. Why would legislators, why would Congress pass that ethanol mandate? Well, the reason why is that they can come back and essentially ask for payment from the well-organized corn lobby in order to keep that ethanol mandate in place. So the corn producers, they benefit from the forced transfer from the general public, but then legislators could go back to the corn lobby, and say, if you want to keep getting this support, you need to contribute to my political campaign, you need to contribute to my political action committee. So there's actually a form of extortion that's going on in the legislature. I mean, the legislators are saying, we'll keep giving you this benefit, if you keep supporting us politically. So the economic elite supports the political elite. In exchange, the political elite supports the economic elite.

**WOODS:** All right, well, it's an interesting relationship, and I think what seems at least on the surface to be happening right now in the Democratic Party is that for a long time, even the Democrats who were supposed to be the party of redistribution and left-wing economic

policy, they had a very establishment strain in them, in that they also wanted these friendly relationships with the private sector, one way or another. And now you're seeing an uprising of people who, for a long time, have wanted a much more left-wing economic policy, and they just couldn't break through the Democratic establishment. And now they sense that they've got their chance. Is that what you see happening?

**HOLCOMBE:** Oh, yeah, I mean, it's really interesting, the way Bernie Sanders, who calls himself a socialist, has been able to get so much support, and the way that you see so much sympathy these days, especially among younger people, for socialism. And if you go back to the 20th century, especially you look at the Austrian School but if you just look at politics in general, and there was socialism against capitalism. I mean, you had the capitalist democracies like the United States, the Western Bloc, and then in the Eastern Bloc, you had the communist dictatorships. And socialism was seen as the big threat to capitalism. You go back to the 1940s, and a couple of really nice books – Hayek's book *The Road to Serfdom*, and Schumpeter's book *Capitalism, Socialism, and Democracy* – I mean, those are books that are saying socialism is a serious threat to capitalism; we need to keep our eye on that. And I think the Austrian School continues to look at things that way. And meanwhile, we see the rise of people like Bernie Sanders, the increasing popularity of socialism.

But I really think the bigger threat isn't socialism, the bigger threat to capitalism isn't socialism. The bigger threat is this political capitalism that comes from capitalists themselves, that we need to keep an eye on that. A lot of times you hear capitalist supporters, they're supporting big business, but basically, when people talk about supporting big business, almost inevitably, they're talking against the free market. You know, businesses go to Congress; they lobby for tax cuts; they lobby for regulatory protection; they lobby for tariffs. They never lobby for free markets. And it's that big business lobby, those are the people who are the biggest threat to capitalism. It's happening right under our noses. And we're looking at people like Bernie Sanders and socialism and not seeing what's going on, even as we speak, as people who are claiming to be friends of big business are really enemies of the free market.

**WOODS:** Let's go to your chapter on the regulatory state. I'd like you to explain what the capture theory of regulation is and whether you think it really has merit and whether it really describes reality.

**HOLCOMBE:** Oh, I absolutely think it describes reality. The capture theory of regulation, basically, it says that over time, regulatory agencies increasingly favor the interests of those they regulate rather than the general public. And you see this time and time again, where regulatory agencies, nominally, they're established in order to support the public interest, but the general public has very little knowledge about what these regulatory agencies do. The general public is rationally ignorant. I mean, even if they knew what the regulatory agencies were doing, they wouldn't have any power to change what they're doing. And meanwhile, the firms that are regulated, those are the firms that have a big stake in the regulatory activities. Those are the firms – I mean, if they could get a couple of dollars each from everybody in the general public, it's millions and millions of dollars for the regulated firms. And so increasingly, the people in the regulated firms, they have the political connections. They're able to go and lobby the regulatory agencies. They're able to go and lobby the legislature in order to get things to turn out increasingly in their favor. So regulatory agencies, government regulation, basically, essentially favors the firms that are regulated. This is an idea that plays very large

in Murray Rothbard's book on the Progressive Era, but it's something that economic historians have seen for a long time.

**WOODS:** What's driving it? Why does this – in theory, in other words, you could imagine a situation in which you had a very adversarial regulatory body. Why does it trend in this direction?

**HOLCOMBE:** It trends in that direction because the firms that are regulated, they are the groups who know about the regulation. They are the groups who are politically connected. They're the groups that lobby the legislature. And meanwhile, the general public, they have very little interest at all in what's going on in the regulatory arena. I mean, a really good example of regulatory capture is with electric utility regulation in the United States. And it's a good example I think just because most people are familiar with the idea. We have a monopoly electric utility. The government prevents entry, won't let other firms compete with a monopoly utility. And most people have no idea whatsoever about the regulatory process. Meanwhile, the electric utilities, those are the people who show up at the regulatory hearings, those are the people who control the information that's available to the regulators. So the idea is, the firms are regulated to get a fair rate of return. But where did the regulatory agencies get their information about what would be a fair rate of return? Well, all the financial information comes from the regulated firms themselves. So you see the process, where essentially, it's the firms themselves who control the process.

Another interesting recent example, probably a lot of your listeners will be familiar with the problems Boeing has had with their 737 MAX jets after a couple of crashes. And what's come out in the process is that the Federal Aviation Administration supposedly is regulating the airliner manufacturers, the airplane manufacturers, but the people who are actually overseeing the process, the people who are actually doing the regulating are employees of Boeing, that there's a process I think the public is becoming more aware of, where it individuals could apply to be designated examiners, who essentially are doing the job of the FAA. You could apply to be a designated examiner, Tom. I could, too. Of course, we have no interest in doing that. Who are the people who get the designated examiner positions? Those are the people who are the employees of the manufacturers.

The same thing is true when you look at the airlines, that airliners have to be inspected every hundred hours of flight, the pilots have to go through recurrent training and testing every six months. But who are the people who are inspecting the airliners? Who are the people who are doing the training? Well, the designated examiners from the FAA, they're employees of the airlines. So basically, the whole process is run by the industry. The general public doesn't tend to see this, because they think the FAA is in charge.

**WOODS:** Let me throw it an objection from Tyler Cowen. He has a new book on big business, and he has a chapter in there on crony capitalism. And he says, of course, I'm an opponent of crony capitalism, and I can point to a lot of examples of it in the economy today. He says, but on the other hand, I think it's exaggerated how much there is. He says, for instance, corporations spend about \$3 billion a year lobbying the federal government. That sounds like a lot of money, but it's very little when you realize that they spend approximately \$200 billion a year on advertising. So to put the 3 billion in perspective, that's about equal to how much General Motors spends on ads during a year. Procter and Gamble spends even more than that. So he's saying if corporations had this amazing influence over federal policy, why are they

spending such a pittance on lobbying? So I mean, he has other arguments. That's one of them. What do you think about that?

**HOLCOMBE:** Well, first of all, I think there's some merit to the argument. But I would ask, you know, don't look at how much they're spending; look at how much they're getting back for what they're spending. I mean, that's the issue, is how much influence does that money buy, and it probably buys a lot more influence than the advertising that they're undertaking. I mean, the United States primarily has a market economy. If you're thinking about the extreme idea of political capitalism, that would be something like fascism and Nazi Germany. We're a long ways away from that. So I'm not saying that's the type of economy we have; I'm saying that's what's threatening market capitalism.

And I mean, it's certainly true businesses have every incentive to provide good products and good service to their customers, because that's how they get repeat customers. I was just talking about the FAA and the way that the inspection process, the regulatory process is basically run by the airlines themselves, by the manufacturers of airplanes themselves. But Boeing has every incentive to provide good, reliable, safe aircraft to their customers. The airlines, Delta Airlines has every incentive to provide good, reliable, safe service to their customers. So there's this illusion that somehow government regulation is looking over the process, but really, the producers themselves have every incentive to satisfy their customers. The problem is that a lot of times they will try to engage with the regulatory state in order to get special benefits for themselves at the expense of their customers and at the expense of their competitors. We just need to recognize that threat.

**WOODS:** The reason I to some degree welcomed the correction by Cowen is that I see so many libertarians, especially young ones, who seem almost incapable of appreciating the amazing achievements of commerce, because they feel like absolutely everything is tainted. And so you can't even write a little tribute to the miracles of commercial society without being hectoring about, *Well, wait a minute, there's a lot of special privilege out there*. I know that, but on balance, there is also still a lot of capitalism, and that's what's generating the prosperity.

**HOLCOMBE:** Oh, and I completely agree with that. I mean, it's just remarkable when you look at our standard of living. Even compared to 50 years ago, not to mention going back before the Industrial Revolution, you just look at the microwave ovens, the flat-screen TVs, the air-conditioned automobiles, the cellular telephones, and it's just amazing how productive capitalism has been. And in my book, *Political Capitalism*, I mean, what I'm trying to do is to shout out a warning. You know, we're afraid of socialism, we're seeing socialism as a threat to capitalism, but really, the bigger threat to capitalism is the interaction of the economic and political elite, where the economic elites are trying to use the political process to generate benefits for themselves.

I think General Electric Company, that's fallen on some hard times lately, I mean, they've been criticized for this, looking for tax benefits, regulatory benefits, and so forth, and especially with regard to wind power, the tax credits for wind power and that sort of thing, basically getting their profits from government rather than from customers. Another interesting company in this regard – I'd be interested to keep an eye on them over the next several years – is Tesla. Because Tesla's barely been profitable. It actually hasn't been profitable, but a lot of the income that Tesla has gotten has come from government benefits, from the federal government tax credit, from California requirements of fuel efficiency,

where Tesla's been able to sell some of their fuel efficiency to other automobile companies. But it's government intervention that's given any income.

**WOODS:** Because you have a chapter on capitalism versus democracy, I want to ask you about what you think the relationship between the two institutions is, or has been, or what the evolution of that relationship is.

**HOLCOMBE:** I think there's a very uneasy relationship between capitalism and democracy, especially the way that people view democracy today. I mean, if you go back again to the Cold War era and it was the capitalist democracies against the communist dictatorships. Capitalism and democracy seemed to go together. And you moved into the 1990s, and it seemed like, well, both of them are victorious. But one way to look at democracy is it's a way to peacefully replace people who hold political power. And that's the way our founding fathers looked at it, that essentially, we had a constitutionally limited government, and that government had certain powers, constitutionally granted powers, and democracy was a method of choosing who exercised those powers.

But today, we look at democracy a lot differently. We think democracy, that's a form of government that carries out the will of the people as determined through some democratic decision-making process. And so rather than having markets, rather than having capitalism allocate resources, when we look at things through a democratic mindset, the democratic government carries out the will of the people, and it's easy for democratic governments to override the market. It's easy for democratic governments to tax away the profits of business. It's easy for democratic governments to regulate business to the detriment of the market economy. And people view that it's carrying out the will of the people.

So I think there's a very uneasy relationship between capitalism and democracy, especially when we view democracy that way, as carrying out the will of the people. I think it would be better to go back to an older vision of democracy. It's a way to peacefully replace those people who hold political power, but the scope of government is determined by constitutional limits, rather than by the will of the majority.

**WOODS:** Well, then finally, as long as there is a state that exists with the power to coerce and tax and regulate, it seems that cronyism has to be inevitable, because obviously, there are a lot of decent people in the private sector, who, they just want to produce a good product at a good price and be proud of that. But there are others who look — as does anybody, they look at the state, and they think this is a shortcut to get what I want. And as long as shortcuts exist, there will be unscrupulous people who want to take those shortcuts. Is there any way out of that?

**HOLCOMBE:** Well, I think limited government. We need to cut way back on the size of government. A lot of times we look at the size of government, we look at government expenditures, and that's one aspect of it. But really, I think the regulatory state is a bigger danger to capitalism than, let's say, the budgetary state. If we divide up government activities that way — budgetary activities, regulatory activities — I think the regulatory state is a bigger threat to capitalism than the budgetary state, that you can have — I mean, big government expenditures, they do put a tax, quite literally, on commercial activity. But a big welfare state, like you tend to happen in the Scandinavian countries, that's a different sort of animal from a big regulatory state that can engage in regulatory activities.

And corruption is so much more facilitated through regulation than it is through spending. Because the only reason to have government regulation, only reason to have regulation at all, is either, number one, to force people to do things they otherwise would not choose to do, or number two, to prohibit them from doing things they otherwise would choose to do. But it's regulators, a lot of times with a lot of discretion, who determine whether you're in compliance with the regulation. And it's easy to slip a bribe or something to a regulator. And a lot of times, I mean, it's not necessarily an explicit bribe. It could be a campaign contribution. It can be, you know, we're buddies; I'll hire your nephew into my firm, but I'm looking for this particular benefit. So the regulatory state really is the bigger threat, I think.

And a lot of times, really, if you talk to the people who engaged in this type of political capitalism looking for benefits from government, they see what they're doing as in the public interest. You never hear somebody asking for a government policy and saying, "The reason I want to do this is it's going to profit me at the expense of other people." They always make a public interest argument in favor of it. Again, you go back and think about the ethanol mandates we were talking about earlier. Nobody in the corn lobby is going in and saying, "We want to take money out of the pockets of people who are buying gasoline and put it in our pockets." They're saying it's good for the environment. They're saying it's good for energy security. And who knows? They may even believe it. But basically, people are entering the political process. They're getting benefits for themselves, but they're arguing that they're in the public interest. That's the big threat that capitalists pose to capitalism.

**WOODS:** One of the points I walked away from this book with that I hadn't known about, hadn't thought about was the helpful point you make about the Scandinavian countries, where you say, relatively speaking, we see less of this problem there, and this could well be because their interventions more take the form of just plain vanilla government spending as opposed to regulation. And that's where cronyism much more easily seeps in, because as you say, that's where the control comes in. That's where it becomes possible to affect the economy directly and to provide these kinds of privileges. So that was an interesting point to bear in mind, and it certainly illustrates the kind of argument you're making.

So the book we've been talking about is *Political Capitalism: How Economic and Political Power Is Made and Maintained*, published by Cambridge University Press, written by our guest, Randy Holcombe. Randy, any final words?

**HOLCOMBE:** I'm delighted that you had me on. I would just pass along the message that we need to keep our eye on the ball; we need to look at the interaction between political and economic elite. That's the big threat to market capitalism.

**WOODS:** Absolutely. All right, thanks so much, Randy. On the show notes page, [TomWoods.com/1403](http://TomWoods.com/1403), we will link to the book and to your faculty page, and people can find out more about your work. Thanks so much.

**HOLCOMBE:** Okay, thanks for having me on, Tom.