# Political Capitalism vs. Free Market Capitalism

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## Free Market Capitalism

Capitalism involves people who forego currently consuming all their current production (income) in order to SAVE. They then employ their savings in ways that will allow them to produce additional goods or income in the future. They can invest their surplus savings (capital) in various ways that will enable them to earn "profits" on their savings in the future. Profits can be earned when people are able to use their physical capital (improved land, machines, irrigation equipment, etc.), financial capital (financial claims on others accumulated in the past), or human capital (knowledge and skills) in such a way that they are able to earn more income from producing goods and services than they must pay to others in order to operate the production process.

Capitalists (the owners of productive assets or knowledge accumulated by previous saving) try to employ their capital in ways that will allow them to earn the greatest possible return (profits) relative to the risks they take. If they cannot earn profits they likely will lose capital and may even become bankrupt (if they have borrowed from others to facilitate their production and cannot repay their debts in full).

In free markets, capital owners will try to employ their capital where they can produce the goods and services for which they expect to be able to earn the highest profits (relative to risk). Thus, the essence of free market capitalism involves the accretion of savings by people foregoing current consumption over time and investing those savings in ways that will allow the owner to earn profits later. If there are no restrictions upon how the owner allocates his savings (capital) he or she will try to earn the highest possible future return relative to the risk he or she is willing to take.

When capital is allocated in ways that will generate the highest possible return, economic production will be enhanced and an economy will prosper. Because of the profit motive capital investments will tend to flow to where goods and services are in the highest demand (relative to their costs of production). Conversely, few people will want to invest where the expected returns on investment, after all costs are taken into account, are low or negative. Thus, capital investments will tend to flow away from areas where only low or negative profits can be earned and to areas where higher profits can be earned. As a result, resources will move from areas where goods and services are in low demand to areas where goods and services are in high demand. Consequently, by the "invisible hand" of the profit motive, for the economy as a whole, production of goods in high demand will be increased and overall economic efficiency will be enhanced—since productive economic resources will be employed in areas where they can generate the greatest productivity and highest returns. Because of this process, the US has prospered greatly under the (primarily) free market capitalist system established by its founders.

However, at the present time, many of the contemporary media members have been poorly educated in economics. Many, as a result, tend to denigrate capitalism. Following the 19th century lead of Karl Marx, many seem to believe that capitalism is inherently flawed because some people profit more than others in a capitalist system. Thus, the press and socialistic leaning politicians tend to point out examples of "capitalism" that they can disparage because a "capitalist" earns excessive profits in their opinion. Such arguments may be popular with people easily given to envy and may help sell papers, attract internet "views," or gain votes.

## Political Capitalism

Unfortunately, the examples the media and politicians provide of cases where "greedy capitalists" earn excessive profits are often cases where capitalists take advantage of monopoly positions or otherwise earn large profits because of political favors. Those political favors may allow the capitalists in question to avoid the necessity of employing their capital in free markets where they might have to face the risks and rigors of free market competition.

The reality is that in a free market, capitalists who invest their funds in such a way that they earn extraordinary profits will soon face competition from other entities that wish to enter the market so that they too can earn extraordinary profits. Given that increased competition will prompt all participants in the market to offer all potential buyers of their goods and services a better deal in the form of lower prices, enhanced quality, or better service, extraordinary profits will not long persist where free market capitalism exists and new competitors can easily enter markets.

However, politicians often interfere with the workings of the free market. Politicians can be persuaded, given suitable incentives, to provide current producers with protections against new competition. They can do so in various ways. They may require that only “licensed” or politically sanctioned (inspected or approved) producers can produce the good or service in question. They can impose tariffs and quotas to prevent competition from abroad. They can provide exclusive “franchise” operating privileges that prevent other competitors from entering a market (which is why Lyndon Johnson's wife was a principal owner of the only TV station allowed to broadcast in Austin, Texas for a long time). They can agree to buy goods or services from favored producers at elevated prices that would not long persist under open and fair bidding procedures—or they can rig bidding procedures so that the favored entities can obtain the most favorable government contracts to produce government goods and services. They can provide necessary inputs or credits for a production process at subsidized rates that are not available to potential competitors. They can provide explicit or implicit guarantees that allow the favored entities to reduce their risk and lower their operating costs by borrowing at favorable interest rates (as when the government anoints major banks as “too big to fail” and thereby allows them to issue deposits and borrow at lower rates than their smaller bank competitors since “too big to fail” bank depositors or lenders will not have to receive higher interest rates to compensate for potential default risks).

In short, there are many ways that potential “capitalists” can earn and maintain excessively high levels of profits, relative to risk, if they are favored by politicians in any of a large number of ways. Such capitalists are not true “free market capitalists” since they are shielded from competition or are favored in other specific ways by their political “cronies.” Thus, these politically favored capitalists are more appropriately described as “crony capitalists,” not “free market capitalists.”

There are other terms for an economic system that is dominated by ties between crony capitalists and their political allies. Since many of the favored entities may be large and well organized (in part, since large donations may have a larger impact in obtaining favors from politicians), the political system is often referred to as “corporatism. “ A more derogatory term that is applied when the corporate and political elite tends to dominate non-members of the business/political elite to serve their own ends is “Fascism.” Fascism may be the end stage of a crony capitalist system where politicians and their favored crony “elites” move toward total control of the political and economic system. In the earlier stages of a crony capitalist system, politicians may only provide limited aid to the favored few and highly productive individual capitalists may still be able to enter many markets freely and compete effectively. However, such a system may not last long.

**Dangers of Political Capitalism**

The Noble Prize winning economist, Friedrich Hayak, has pointed out that in his famous book, The Road to Serfdom, there are great similarities between Fascism, Communism, and Naziism. All are political systems that try to capture and control the entire economy of a country. Fascism and Naziism (as practiced in Germany under Hitler) tried to take control of the economic system by favoring compliant crony-capitalists who would do the bidding of the government. Communistic (and, related) socialistic systems may actually seize the ownership of all (or many, in the case of socialists) productive resources in a country, and thereby exercise direct control over all significant aspects of the economy. Because the “central planners” in each system are not able to produce goods as efficiently as a free market capitalist system, the central planners tend to become increasingly repressive rather than admit they have made errors. They try to control the press as well as the education and thinking of the populace in order to hide their failures, and may forcibly silence (jail, intimidate, or kill) dissidents who point out their failings. Thus, if a system of political crony capitalism proceeds to the point where it engenders fascist behavior, the entire population can become threatened.

**Conclusion**

It is imperative to always distinguish crony capitalism (political capitalism) from free market capitalism . As the essay above shows, they are not the same. One can provide benefits; the other can lead to danger. Unfortunately, not enough media members, educators, or people in the U.S. are aware of the distinction and of the impending danger that may result as our present system of political crony capitalism advances under our present politicians.