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Political capitalism and democracy in the short run

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Abstract:

A new monthly measure for political capitalism is introduced. It covers 2001/23. Democracy is measured by the annual polyarchy index. It has a jerky structure with long spells of constancy and occasional jumps. The study uses this structure to identify a set of natural experiments in which polyarchy remains stable for ten years, except for a jump in the middle. Thus, the jump must be in the gap 2005/18. Due to rarity of jumps and the short gap, only 21 cases are found. Causality is suggested by lags. If political capitalism changes during the 60 months before the democracy jump political capitalism may cause the jump. Only a very small effect appears. If political capitalism changes during the 60 months after the democracy jump, democracy may cause the change in political capitalism. A clear but modest effect of an 8% change in the level of political capitalism appears in the direction expected.

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1. Introduction

This paper looks at the short-run interactions of two institutional indices: V, the political system, and S_2, the economic system, taken as the 'capitalist' sector that produces goods sold on the market. It is studied by a proxy for *political capitalism* defined in Table 1. All countries have a mixture of political and market capitalism. We have previously shown that with development the share of market capitalism rises; see section 1.2.

All political systems have insiders. Political capitalism means that they include business leaders, and that they collude to use their power to get rich, using the twin diseases of corruption and rent-seeking. Political competition, an independent police and legal system, and free media are the enemies of these diseases. For political capitalism to thrive, the insiders must have some control over these enemies. And then, it is easy to use it to become rich. This explains the strong long-run negative relation between the S_2 and V.

Table 1. An operational two-stage definition of political capitalism

Political insiders are politicians, administrators, and businessmen with some power over the political system. Such insider groups will be termed PI-groups.
The triplet means that a non-trivial part of national income is acquired by PI-groups colluding to make money by use of their power over the political system.

The definition also covers the two related terms of *state capture* and *crony capitalism*. The three terms may be conceptually different, but they are difficult to distinguish in practice.

1.1 The research design: Using the natural experiments of jumps in the V-index

The two variables change in different ways. V is mainly constant, but it has occasional jumps. S_2 is more continuous. This gives the research design of this paper, where the V-jumps are used as natural experiments. Each experiment is a ***period*** of 10 years for V and 120 months for the same years for S_2. V determines the period: It should have one jump surrounded by five years of constancy to either side. If the jump lasts more than one year, the change is seen as a reform process, where the changes are added up. The experiments study the paths of S_2 in the period. Two possibilities may occur:

$S_2 \supset V$: S_2 changes in the 60 months before the jump. Here S_2 may cause the V jump.
$V \supset S_2$: S_2 changes in the 60 months after the jump. Here the V jump may cause S_2 to adjust.

The new S_2-index covers the period 2001-2023 for 142 countries. Thus, the jump must be in

the gap from 2006 to 2018. As jumps are rare, we only found 21 cases fulfilling the conditions. They are listed in Table 5 of section 4. The study analyzes the path of S_2 in the 10-year period. As the paths for the positive and negative V-jumps are somewhat symmetrical, the size of the jumps can be used as weights. Thus, the downward jumps get a negative weight.

The new S_2 index is presented in section 2, while section 3 reports the relevant properties of the V index. Section 4 discusses theory. Section 5 is the analysis of the relationship between the two indices. The key calculations of the cause and effects of the 21 V-jumps are in section 6, while section 7 concludes.

1.2. Prior research of the long-run relations, and the normative aspects.

A parallel paper (Paldam and Saadaoui 2026) uses the state capture index S_1 of Kaufmann (2024) as the proxy for political capitalism. The S_1 index is only published for nine years, three years apart, and it is a relative index calibrated to have the same cross-country average and standard deviation each of the 9 years. In long-run studies wide cross-country data and long time series are equivalent, so these data can be used to analyze the long run.

The previous paper finds a strong long-run confluence of democracy and political capitalism, which also extends to the corruption index and the economic freedom index. All four variables in this *confluence group* have very similar long-run transitions as a function of income. The confluence appears as simultaneity between the four variables, with numerical long-run correlations between 0.66 and 0.84. Thus, we know that democracy increases while political capitalism decreases in the long run. The Appendix shows that S_2 belongs to this confluence group as well. This paper uses the monthly data for S_2 to study if lags can be detected, suggesting a causal structure. Corruption is not used as an independent variable, as it is a part of S_2.

We believe everybody – except PI members – agree that it improves welfare when political capitalism turns to market capitalism, and when democracy increases. These welfare judgements are taken for granted below. The variables are scaled accordingly. In the long run, economic growth improves both.

The study thus examines the important question if it can be shown that a causal structure may exist between the variables – pointing to the best way to improve welfare in the short run.

2. Measuring political capitalism: The S_2 index

Political capitalism is an old concept that for long received little attention. However, several recent books discuss the concept, including Holcombe (2018) and Miklós and Vahabi (2027). It is an early version of capitalism that gradually is replaced by market capitalism as countries develop. The term has been used both loosely and with several related definitions. We think that the operational definition in Table 1 covers most theoretical definitions. It links the economic advantages of political insiders to the institutions through which those advantages are secured.

Our new monthly political capitalism index, denoted S_2, is defined in equation (1). The index combines three dimensions on a common scale: (D1) collusion between political and economic elites, (D2) politically contingent property rights, and (D3) weak legal-administrative insulation from political pressure. Four ratings from the International Country Risk Guide (ICRG), produced by the PRS Group (see references), provide the underlying observations.

It is important to state that as much as institutional indices are necessary to analyze important questions, they are difficult to measure and have substantial measurement errors; see Appendix.

2.1 The ICRG components for the three dimensions[3]

(D1) uses ICRGs measure of *corruption* defined to cover patronage, nepotism, reciprocal favors, concealed party finance, and close business–political relationships. Its inclusion gives empirical content to the exchange of political influence for private advantage.

(D2) uses contract *viability/expropriation,* a subcomponent of *investment profile*. It assesses exposure to unilateral changes or cancellation of contracts and expropriation of foreign-owned assets. This is the political element in property-rights. The rating supplies a proxy for this contingency. Identifying the beneficiaries, selectivity, and political motivation of individual interventions requires additional evidence.

(D3) combines *law and order* with *bureaucracy quality.* The former assesses legal strength and impartiality together with observance of the law; the latter captures administrative expertise, continuity, and autonomy from political pressure. Together, they describe institutions that constrain discretionary intervention and sustain impersonal administration. They add to (D3).

The full ICRG Political Risk Rating also incorporates *conflict*, *social tensions*, and *government*

[3] This section refers to the International Country Risk Guide methodology and variable definitions from the PRS Group. The terms in italics are the ones used by the PRS.

stability, which describes a broader risk environment. The aggregate *Investment Profile* additionally contains *profit-repatriation* and *payment-delay risks*. Using contract viability separately keeps the property dimension focused. Democratic accountability remains outside S_2, allowing its relationship with the independently measured polyarchy index, *V*.

2.2 Normalization and aggregation

Higher ICRG points indicate more favorable conditions. The four ratings are therefore reversed and divided by their fixed theoretical maxima. For country *i* in month *t*, let C_{it}, P_{it}, L_{it}, and B_{it} denote the original *corruption*, *contract viability*, *law and order*, and *bureaucracy quality* scores. The three dimensions become:

$$\text{(D1)}\quad c_{it} = 1 - \frac{C_{it}}{6} \qquad \text{(D2)}\quad p_{it} = 1 - \frac{P_{it}}{4}$$

$$\text{(D3}a\text{)}\quad l_{it} = 1 - \frac{L_{it}}{6} \qquad \text{(D3b)}\quad b_{it} = 1 - \frac{B_{it}}{4}$$

Each transformed component lies between zero and one, with larger values indicating greater institutional risk. (D3) is the average of l_{it} and b_{it}. The S_2 index used throughout the paper is:

$$\text{(1)}\quad S_{2,it} = \frac{100}{3}\left[c_{it} + p_{it} + \frac{l_{it} + b_{it}}{2}\right]$$

The index ranges from zero to 100. Each conceptual block receives one-third of the total weight; *law and order* (D3a) and *bureaucracy quality* (D3b) each receive one-sixth. A rise in S_2 indicates greater political capitalism; a decline indicates an improvement in the measured institutional conditions. Its units are index points. The selected dimensions jointly define S_2. Theory therefore determines the baseline weights. Fixed score maxima preserves the numerical scale across samples and dates, allowing common institutional improvement or deterioration to remain visible. A monthly value requires all four ratings. If one is missing, S_2 is missing; the weights remain fixed. The construction retains the source observations, including unchanged ratings, and applies no interpolation, smoothing, or extrapolation across gaps.

2.3 Coverage and monthly information

The September 2023 posting of the data covers May 2001–August 2023 for the complete index, a window of 268 months determined by *contract viability* availability. Matching the workbooks by their numerical country identifiers yields 37,544 complete country-month observations for 142 countries. Of these, 139 have complete data throughout the window. Serbia and Montenegro spit, and

Uzbekistan enters in September 2021.

The monthly frequency makes changes in the timing of institutional adjustment observable. Persistence remains substantial: S_2 changes in approximately 5.8% of consecutive observed country-month pairs; see Figure 3 in section 2.6. Constancy spells represent unchanged expert assessments. Consequently, the series describes a slowly evolving institutional stock, with dated revisions that may follow the underlying political developments. Reporting the three blocks separately distinguishes an improvement in property security from a decline in collusion or stronger institutional insulation.

For the analysis around democracy jumps, the complete index supports a common definition across all 120 observations in each event window: 60 months before the event and 60 beginning with the event month. Historical dating determines the alignment; data availability determines whether the episode supplies a complete window. *Corruption, Law and Order*, and *Bureaucracy Quality* have longer histories and permit complementary component analysis of earlier episodes, but the *property component* begins in May 2001.

2.4 Interpretation and robustness

The proxy interpretation follows from the scope of the source ratings. Corruption includes administrative bribery alongside elite collusion; contract risk can reflect generalized insecurity; and legal and bureaucratic ratings also reflect public order and state capacity. The composite captures institutional conditions consistent with political capitalism. Assessing particular transfers of public or common resources to connected beneficiaries requires evidence on the allocation decision, the asset, and the recipient. Such mechanisms are covered indirectly by the monthly ICRG measure.

Three variants assess the robustness of S_2 to component choice. Let $q_{it} = \frac{l_{it} + b_{it}}{2}$ denote the insulation deficit and $a_{it} = 1 - \frac{A_{it}}{6}$ the reversed ICRG Democratic Accountability rating. The narrow version (2) averages corruption and contract risk; version (3) excludes bureaucracy quality. Version (5) adds a_{it} as a fourth, equally weighted block:

$$(2)\ B_{it} = \frac{100}{2}(c_{it} + p_{it}) \qquad (3)\ C_{it} = \frac{100}{3}(c_{it} + p_{it} + l_{it})$$

$$(4)\ E_{it} = \frac{100}{4}(c_{it} + p_{it} + q_{it} + a_{it}) \quad (5)\ G_{it} = 100(c_{it}\, p_{it}\, q_{it})^{\frac{1}{3}}$$

All five versions use the same 37,544 complete country-month observations. The accountability rating is observed throughout this sample. Holding the sample fixed isolates the effect of the definitions. The accountability extension is a descriptive check: it remains outside the baseline

analysis of democracy jumps because its construction already includes a democracy-related component. Table 2 reports the pooled monthly distributions. The S_2 index has a mean of 41.42, a standard deviation of 17.72, and a median of 45.83. Its tenth and ninetieth percentiles are 12.50 and 60.42. The narrow and no-bureaucracy versions have similar means and dispersion.

Table 2. Descriptive statistics for the monthly index variants

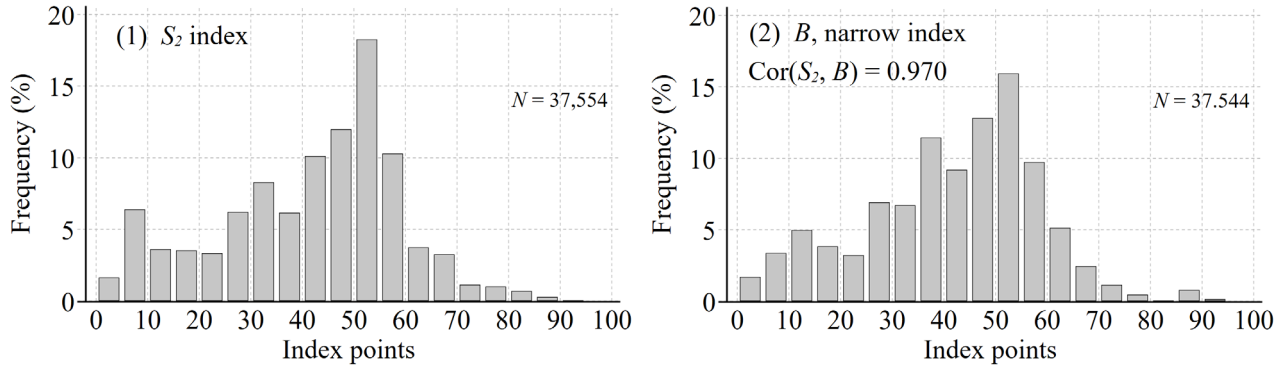
Nr	Version	Mean	Std	P10	Median	P90	Max.	Change
(1)	S_2 index	41.42	17.72	12.50	45.83	60.42	91.67	5.84
(2)	Narrow	41.21	16.74	14.58	43.75	60.42	93.75	4.82
(3)	Without bureaucracy	40.41	16.99	13.89	44.44	59.72	93.06	5.66
(4)	Geometric average	36.12	21.30	0.00	41.78	58.78	91.41	5.33
(5)	With accountability	39.18	17.99	10.42	41.67	60.42	93.75	6.98

Notes: The numbers correspond to the equations. Months are May 2001 to August 2023; 37,544 observations and 142 source entities for every version. All minima are zero. Sdt is the sample standard deviation; P10 and P90 are percentiles.

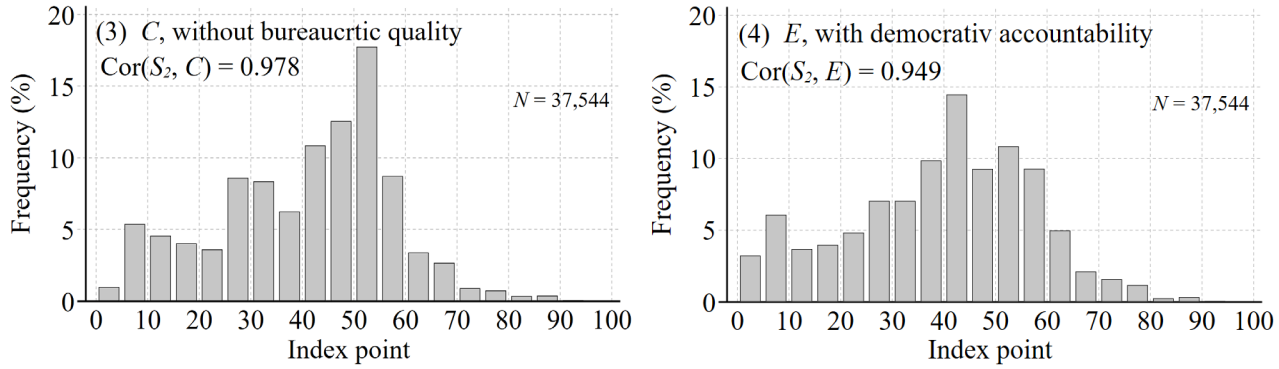
2.5 Descriptive statistics: frequency distributions and path over time

Across the three variants in Figure 1, Pearson correlations with S_2 range from 0.970 to 0.949; the corresponding Spearman rank correlations range from 0.961 to 0.931. Figure 1 uses common bins and scales and reports correlations with S_2. The similar distributions and high correlations support the robustness of S_2.[4]

Figure 1. Monthly distributions of the index variants



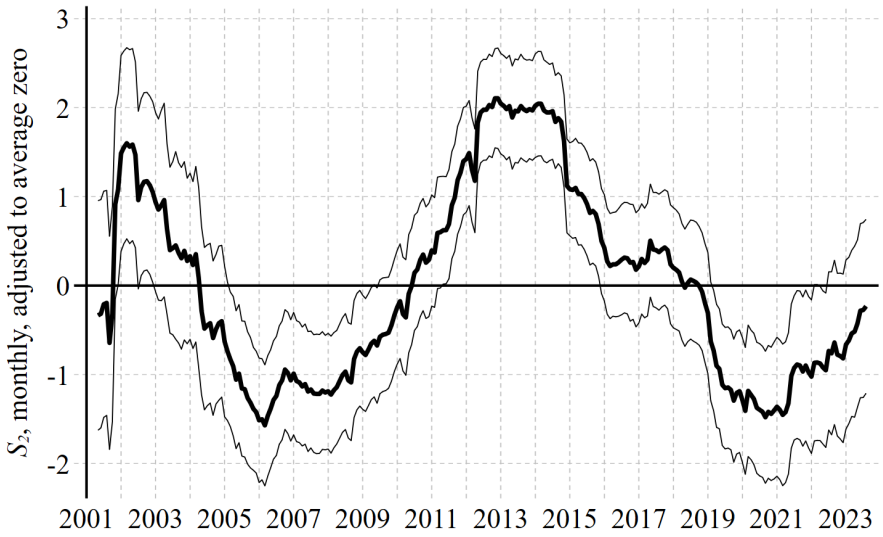
[4] We have also tried the geometric version shown as equation (5). It has a lower mean (36.12) and greater dispersion (21.30). It is zero whenever any of its three blocks is zero, producing an exact zero mass of 18.88%, compared with 0.40% for the S_2 index. This is a consequence of the aggregation rule, even when other blocks indicate substantial risk. The geometric version is therefore unsuitable for S_2 and is not used in the subsequent analysis.



Notes: Panels (1), (2), (3), and (5) use five-point bins and the same frequency scale; N = 37,544 in each panel. Panel numbers refer to equations; Cor denotes the pooled Pearson correlation with S_2. Higher levels indicate higher political capitalism.

Figure 2 shows the monthly path of the S_2 index for the 23 years covered. The average is calculated after the average for each country is deducted for the observations, so the figure shows the average variation around zero. The two thin lines are at confidence intervals of ±2 standard errors. The confidence intervals are fairly constant and about ±0.8 around the average. The Appendix finds evidence that the measurement error on each observation is about 7. The average of 0.8 is for the average of 137 observations. As $\frac{8.67}{\sqrt{137}} = 0.7,$ the measures are close. Thus, it is likely the estimate of the measurement errors is in the right order.

Figure 2. The monthly path of the S_2 index. Average for 137 countries



2.6 Constancy spells in the monthly and annual data

Figure 3 reports the monthly and annual changes in the S_2 index. Fully 92.9% of consecutive monthly observations are unchanged. It is only 41.2% in the annual data. This persistence is present in every version: the fraction changes in a month range from 4.82% for the narrow index to 6.98% for the accountability extension. Monthly frequency supplies the dates of revisions; it does not imply equally frequent changes in the underlying institutional stock. The descriptive distributions weight country-months equally and should not be read as independent monthly draws.

Figure 3. Frequency distributions of the first differences of the S_2 index

Figure 3a. Monthly changes

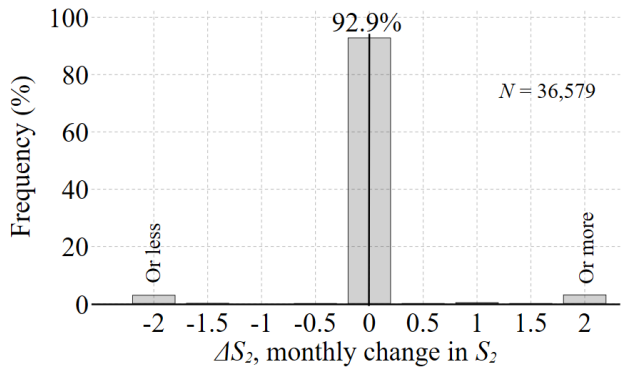


Figure 3b. Annual changes

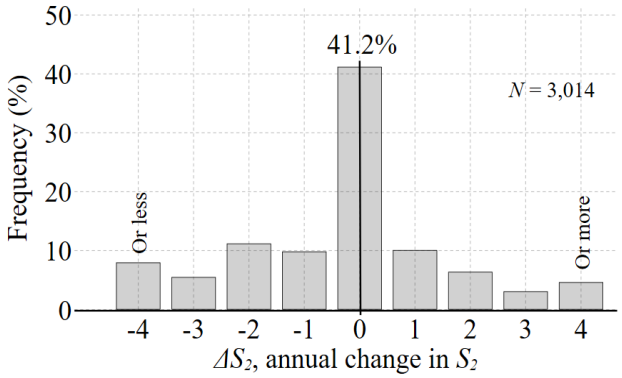


Figure 3b should be compared with Figure 4 (section 3.2) for the annual changes in the V-index. The difference between the two annual frequency distributions of S_2 and V is pronounced. Though both frequency distribution points to substantial constancy spells, the spells are considerably longer in V. This is confirmed by the autocorrelation functions is Figure 7a in section 5.2. This is important for the research strategy, where the changes in S_2 relative to the few jumps in V.

3. The peculiar path of democracy indices: *V* the polyarchy index

Democracy indices measure the degree of democracy in the political system of a country. It does not change if the government changes by a preannounced (legal) process, but it increases, e.g., if elections become (more) competitive, and decreases, e.g., if the government closes critical media. The indices have a peculiar structure with long, but highly variable, spells of constancy separated by jumps, which reflect the realities they try to measure.[5]

Polyarchy, *V,* is the dominating democracy index. It is defined in the open interval]0, 1[. The measurement error for the index is about 0.05. Table 3 gives statistics for the *V*-data. Sections 4 and 5 use the data of row 1 only. The following builds on two studies of the structure of the index in all observations of row 2 in table (Paldam 2026a and b). Figures 4 and 5 and Table 4 are illustrative representatives of a comprehensive set of such figures and tables.

Table 3. Descriptive statistics for V and ΔV

Ro	Period	V level			ΔV, first difference		
		Count	Average	Std	Count	Average	Std
1	1991-2023	5,853	0.503	0.267	4,845	0.0030	0.040
2	All from 1789	26,595	0.261	0.209	26,391	0.0030	0.032

3.1. The transition path, the step curve for individual countries, and the jumps model

The *V*-index has a robust transition path in large, unified datasets, where countries move smoothly from about 0.2 in the traditional steady state to 0.9 in the modern. It is a change of 0.70 that rarely takes less than a century. It is explained by the changes in the power structure caused by the grand transition from a traditional to a modern society.

While the average path for many countries is smooth, the path for the individual countries has a characteristic step-form with long spells of constancy divided by (large) jumps. The smooth path of the average curve shows that the steps are uncoordinated as regards income (there are some coordination over time). The jumps are triggered by seemingly random events. The constancy spells are caused by the big efforts of all regimes to persist.

[5] This section is based on Part II in Paldam (2021), which contains estimates of the democratic transition, triggering events, estimates of the jumps model, and Paldam (2026a) giving a detailed analysis of the constancy spells and jumps in the polyarchy index.

The jumps model says that the transition path acts as an attractor for the jumps that happens randomly.[6] The distance between the actual value of polyarchy and the transition path is a highly significant variable explaining the jump. The coefficient on the distance is 1.5, so the jumps normally overshoot the path.

3.2 Frequency distribution for all annual changes:

Figure 4 shows the democratic transition using all non-OPEC observations of *V* that can be combined with an observation of income (that is the logarithm to real GDP per capita in PPP prices).

Figure 4. The democratic transition in the non-OPEC countries

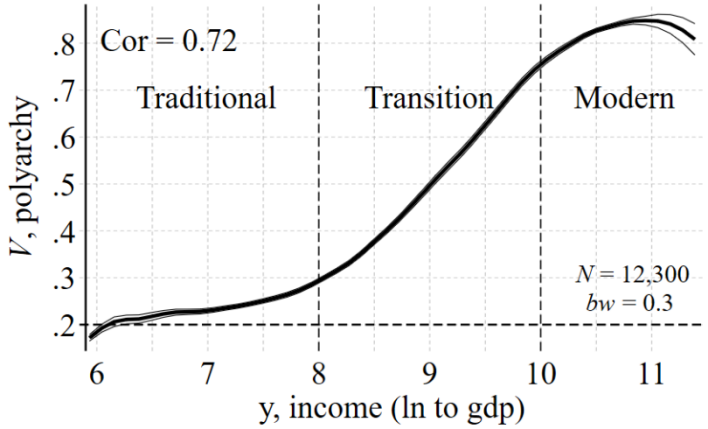
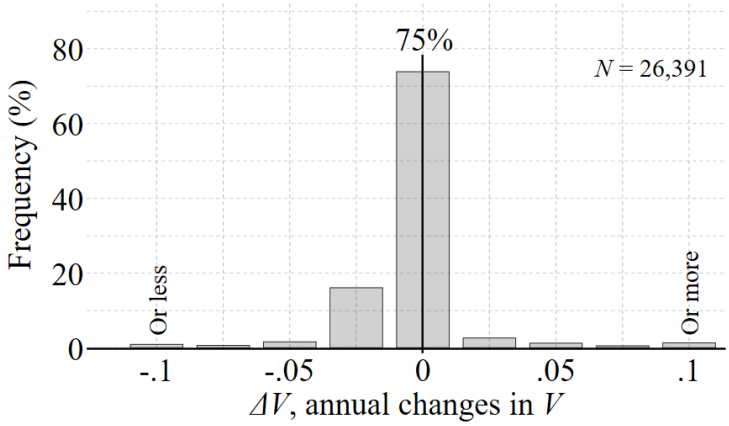


Figure 5. The frequency distribution of the first difference to the polyarchy index



Note: The significance interval [-0.05, 0.05] holds 96% of the observations. Thus, the average constancy spell is 25 years.

[6] The model was introduced by Paldam and Gundlach (2018), see also Paldam (2021, Cpt 5).

Figure 5 is parallel to Figure 3b in section 2.6. Figure 5 shows the frequency distribution of all observations of the first difference to the *V* index. 96% of the 26,391 annual changes are insignificant, i.e., in the interval of [-0.05 0.05]. Thus, the average spell is about 1/(1-0.96) = 25 years. The spells are highly variable. They are (much) higher in the two steady states, and lower during the transition, but the average spell is above 10 years even when the transition is strongest. The period and countries where the S_2 index are available are from 142 countries mainly in the upper level of income. They cover developed countries with no jumps and countries in the transition where the average spell is only a little larger than ten years. Thus, there are not as many perfect cases of natural experiments as one may expect.

3.3 Counts of jumps and the average spell

Table 3 shows some statistics for all 200 countries with *V*-data for as many of the 234 years of the data as available. 1789 when the data starts is the year of the democratic constitution in the USA, which was the first such constitution. The big waves of democratic constitutions in Westen Europe were in the middle of the 19th century with an upward jump after World War I. Later it has spread across the world though few LDCs have reached a consolidated democratic system.

The two last rows of the table explain how columns (7) and (8) are calculated. Column (7) gives the average spell. However, the last spell is not completed, and column (8) gives the endpoint adjustment by the devise of doubling the last spell. If a similar adjustment could be made for the first spell the average would go up as well and probably reach the 25 years found by Figure 5.

The net jumps explain 70% of the increase in *V*. The 27 countries that have made the full transition have seven jumps, where four are upwards and two are downwards. The net jumps explain 80% of the transition, but the gross jumps, which is the sum of the numerical jumps, are 2.3 times larger than the net jumps, indicating a considerable zigzag of the index.

Table 4. Averages for 200 countries, spell length with endpoint adjustment

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Number of	Increase	Period in years		Sum of jumps		Constancy spell in years	
Row	countries	In *V*	Independent	Last spell	Number	Explains	Average	Adjusted
	Nc	T_r	N_y	N_{ls}	N_j		s	s_a
all	200	0.416	100.8	28.5	5.7	69.5%	16.7	21.7
Column (7) is $s = (N_y - N_j)/N_j$, which is all years without jumps divided with the number of jumps. Column (8) is $s_a = (N_y + N_{la} - N_j)/N_j$, as N_{la} is already in N_y it is doubled by adding it one more time.								

Each row is covered by a table with information on the individual countries in Paldam (2026a). Column (5) is the number of jumps larger than 0.05. Column (6) reports how much of the increase in (2) they explain. Columns (7) is and (8) are explained in the text.

4. Theory

This section considers a typical middle-income country with substantial political capitalism and a somewhat authoritarian political regime.[7] The PI-group of political insiders consists of leading political and business leaders. They collude to make arrangements redistributing incomes to the group members. Rumors circulate about these arrangements, but it has substantial costs to challenge them. Opposition groups, journalists, and other whistleblowers are likely to be punished, as the legal system is reluctant to take on the PI-group. Thus, critics face a *first mover disadvantage*. Political protection therefore helps sustain the arrangements through which insiders obtain economic benefits. The concept of *conflict of interest* is only taken seriously in more advanced politico-legal environments.

4.1 Rent-seeking and rent protection

Rust-belt industries use political pressure to obtain and keep protection. Funds set aside to develop new industries that have yet to develop a lobby can be diverted to support old industries that are threatened by foreign competition but have a strong lobby. The allocation of these funds links the political influence of established producers to their continued access to public resources.

The infant industry argument provides a familiar example. The idea was that when infants had developed, the protection should cease. Protection can instead become entrenched as beneficiaries organize to preserve the rents, as illustrated by the rent-seeking mechanism in Krueger (1974). By strategic distribution of the rents to politicians and workers, a strong lobby-coalition can be built. Lobbies of producers, unions and local politicians are known to be very difficult to fight. Concentrated benefits give these groups an incentive to defend the arrangements, while the costs are dispersed among taxpayers and consumers. International tariff agreements can constrain governments' ability to renew such protection.

One of the most durable such arrangements was the sugar beet complex in Northern Europe. Production quotas and protection against competing imports sustained a coalition of producers, unions, and local politicians with an interest in preserving the rents for more than a century.

4.2 Appropriation of public resources

Political capitalism also concerns the appropriation of public and collectively held resources. Political

[7] The average middle-income country has an income level between 8 and 9 where V is between 0.4 and 0.5, see Figure 4. Here the level of political capitalism S_2 is about 50; see Figure A2a (Appendix).

insiders can influence who receives public contracts, controls publicly owned assets, or benefits from transfers and concessions. Appropriation occurs when that influence converts resources held for public or collective purposes into preferential benefits for connected interests. The economic mechanism combines a resource under public control, a favored beneficiary, and political influence over its allocation. Vahabi (2024) gives a particularly explicit illustration in his analysis of Anfal, (in Iran) where political authority constitutes exclusive control over public property. The broader connection is that political power can determine access to assets and the distribution of their returns.

This mechanism clarifies the content of the monthly ICRG index. Its corruption component captures patronage and political-business collusion. Contract Viability/Expropriation addresses the security of claims against political intervention, while Law and Order and Bureaucracy Quality describe legal and administrative constraints on discretion. These dimensions identify institutional conditions through which insiders can obtain and protect economic advantages (PRS Group, n.d.). A government can nevertheless respect existing private contracts while allocating public contracts preferentially. Information on the allocation process therefore adds a distinct dimension to information on the security of private claims and the institutions that constrain political discretion.

The WEF–ICRG extension sharpens the conceptual precision of the measure by bringing preferential allocation and diversion of public resources explicitly into its coverage. The World Economic Forum's Executive Opinion Survey asks about favoritism towards well-connected firms and individuals in government policies and contracts, and about the illegal diversion of public funds to companies, individuals, or groups (World Economic Forum, 2017). The first indicator addresses political selection of beneficiaries. The second addresses the transfer of public financial resources to particular recipients. Together, they provide country-level assessments of two closely related channels through which political influence can confer private economic benefits.

The extension thus connects the institutional conditions captured by ICRG with more explicit indicators of the appropriation mechanism. The favoritism indicator concerns preferential treatment in policies and contracts, while the diversion indicator explicitly concerns illegal transfers of public funds. Their combination broadens the empirical representation of political capitalism across these allocation channels. The WEF component supplies complementary annual information; the monthly ICRG series provides the timing used to study adjustment around political transitions.

4.3 Political competition and gradual adjustment

The dynamics of such a system can operate in both directions.

$S_2 \supset V$: It starts when external pressure or the inner dynamics in the group causes a fall in political capitalism. Three examples are: (i) A corruption scandal may become so widely known that even the insiders know that something must be done. (ii) Tariffs may be reduced as part of an international agreement. (iii) A spontaneous wave of protest occurs that is so great that the first movers cannot be identified and punished. These changes can reduce the income of the *PI-group* and hence its power, making democratic reforms easier. Reduced access to rent weakens the resources available to reward supporters and sustain political protection.

PI-groups can also use their power to restrict democracy in order to increase the rents they expect to obtain. Control over newspapers and TV-stations can help shield preferential arrangements from public scrutiny and discourage challenges by excluded groups.

$V \supset S_2$: It starts with a jump in the political system causing the first mover disadvantage to fall. An investigation of the triggering events setting into motion 262 jumps in the polity index used the historical archives of The Economist (Paldam, 2021). It found that 50% were initiated by the government for reasons unreported,[8] while the remaining triggers were diverse. Events originating in the economic system accounted for 9%, and 23% were external to the country, so almost 70% were domestic political events.

Most of the steps are positive, towards more democracy. They give the opposition greater scope to challenge privileged arrangements and critical journalists more freedom to expose them. Electoral competition raises the political cost of allocating public resources to connected interests, while public scrutiny increases the prospect that preferential treatment will be contested. Excluded firms also gain opportunities to challenge access restrictions. These changes can weaken the protection of insiders and generate a downward adjustment in political capitalism.

The adjustment can take time because existing contracts, administrative practices and business networks survive the initial political reform. Changes in electoral competition and public scrutiny alter the incentives to sustain preferential arrangements, while procurement renewals, budget decisions and changes in enforcement progressively affect the benefits they deliver. Insiders also have incentives to defend established claims and adapt to the new political environment. This persistence allows political institutions and the arrangements supporting rents to adjust at different speeds. The gradual decline in the index following democratizing episodes, as described in Section 5, is consistent with the progressive adjustment of arrangements that sustain insiders' rents.

[8] It has been claimed that many of the upward steps are taken to preempt the threat of revolution, but there are also underlying changes in the zeitgeist that are harder to explain.

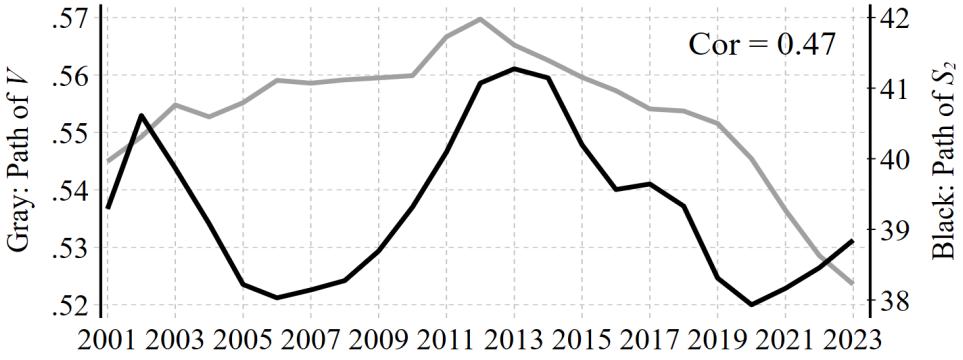
5. The annual correlations of the two series S_2 and V

The annual data for both series is available for 137 countries for 23 years. Thus, N = 3,151. This section uses these data. As mentioned in section 1.2 we have shown that (Kaufmann's) *SI* and *V* have strong long-run confluence, and that this is mainly due to the strong and similar transitions $S_1(y)$ and $V(y)$, where y is income. The Appendix shows that S_2 belongs to the same confluence group.

5.1 The paths of S_2 and V from 2001 to 2023

Figure 2 showed the monthly path of S_2. Figure 6 shows the same graph for the annual data and compares it with the path of the *V*-data. The two time series have a correlation of 0.47 – but there may be some lags involved, as will be investigated below.

Figure 6. The annual path of the *V* and S_2 indices - same countries



Equation (6) shows that the S_2 index has an insignificant trend only.

(6) $S_2 = 33.51(1.6) - 0.016\ (1.6)\ t$, for time, R^2 adj = 0.006, parenthesis holds t-ratios

However, the pattern of correlation is complex.

5.2 Correlations between S_2 and V

Table 5 shows that the unified data for S_2 and *V* are highly correlated and that this is due to the between-country correlation, while the within country correlation is weak. Thus, the correlation is long-run. It is due to the strong and very similar transitions in S_1 and *V* that also occurs in $S_2(y)$, where y is income, see Figure 4 and Figure A2b in the Appendix.

Table 5. Correlations of S_2 and V, between and within countries

Unified data	Between countries	Within countries
-0.757	-0.760	-0.047

Figure 7 gives two analyses of the correlation between S_2 and V. Figure 7a compares the two autocorrelation functions. It shows that both series contain a lot of inertia, but the inertia is highest in the V-data, as expected from Figures 2b and 5. Table 5 shows that S_2 and V have a strong relation in the long run. Figure 7b report correlograms, where the two variables are lagged five years to both sides. They never exceed the confidence intervals around zero.

Figure 7. Correlations with lags, *i.* Averages of analyses made for each country

Figure 7a Autocorrelations cor(x, x_i), for $x = V$, S_2

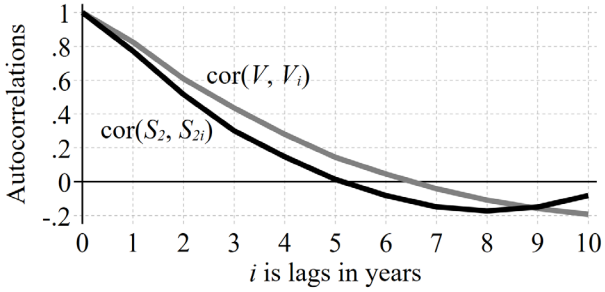
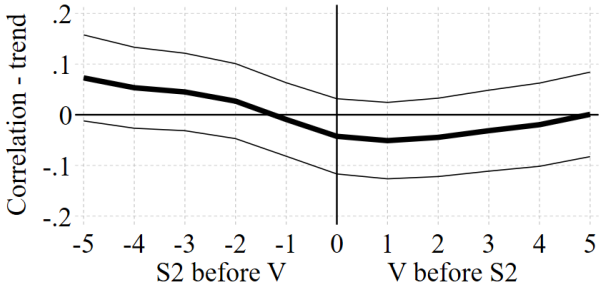


Figure 7b. Correlograms cor(S_2, V_i)



The weak results in Figure 7b contradict the result in section 6, of a modest, but significant connection from increasing democracy to falling political capitalism. However, the fact that both indices are constant most years makes it difficult to find the connection. The natural experiments in the next section concentrate the search on the point of change.

6. The 21 natural experiments

The section is, at long last, the estimate of the effect of democracy jumps The S_2 data only covers 2001 to 2023, and as we need five years before and five years after the jump for the lags, the jumps should be in the 13 years period from 2006 to 2019. As democracy indices have long constancy spells, it is no wonder that we find only 21 cases.

6.1 The 21 V-jumps used as natural experiments

Table 6 is the list of the 21 cases of *V*-jumps. We believe that it is all cases within the parameters of the study. They are ordered by jump size, starting with the largest. The first 13 jumps are positive and the last eight jumps are negative. The comment in the table is a description of the triggering event leading to the jump. This description is limited to at most ten words, so it is surely not the full story.

Table 6. The 21 *V*-jumps

	Country	Year	Size (ΔV)	Comment
1	Tunisia	2011/12	0.577	Popular revolt against military ruler
2	Myanmar	2011/13	0.235	Reforms undertaken by military rulers
3	Congo Ki	2006/07	0.160	General election, and riots
4	South Korea	2017	0.135	President impeached and new one elected
5	Togo	2008	0.086	Some civil disturbances
6	Angola	2011	0.086	New constitution
7	Philippines	2010/11	0.079	New reformist government wins election
8	Malawi	2009/10	0.079	Presidential election – the old president won 2/3 of votes
9	Nigeria	2011/13	0.093	President dies and new hold election to justify his tenure
10	Côte d'Ivoire	2016/17	0.064	New constitution with more rights
11	Cuba	2009	0.062	Reforms by government
12	Croatia	2010	0.060	New president and reforms
13	Namibia	2015	0.056	New reformist government wins election
14	Bahrain	2011	-0.050	Reform by government abolished
15	USA	2017	-0.069	President Trump inaugurated – policies by decrees
16	South Korea	2008	-0.070	New president and public protests
17	Turkey	2007/08	-0.089	Tightening of control by authoritarian leader
18	Honduras	2009/10	-0.106	Constitutional crisis and military coup
19	Turkey	2015/16	-0.118	Tightening of control by authoritarian leader
20	India	2014/17	-0.167	Tightening of control by authoritarian leader
21	Serbia	2013/15	-0.168	Tightening of control by authoritarian leader

In many cases, the jump is not in one year, but part of a reform process announced the first year. Here we take the years of the reform process as the jump. The most prolonged process is the four years of a tightening in India. In this case, the last five years before the jump are 2010-14.

6.2 The 21 experiments

Figures 7 and 8 show the results of the study.

To make the two graphs on Figure 8 comparable the average of S_2 for each country is deducted. Thus, the black curve shows that political capitalism falls by 1.5 S_2-points during the reform process and then by a further 1.7 points after two years. Thus, the total effect of a democratic reform is 3 points. As the mean of S_2 is 41 points, a 3.2-point fall is a fall of 8%. Thus, the fall is not very large, but it is noticeable, and in the long run it is larger. It is highly significant

Figure 8. Averages of the 21 natural experiments 60 months before and 60 months after

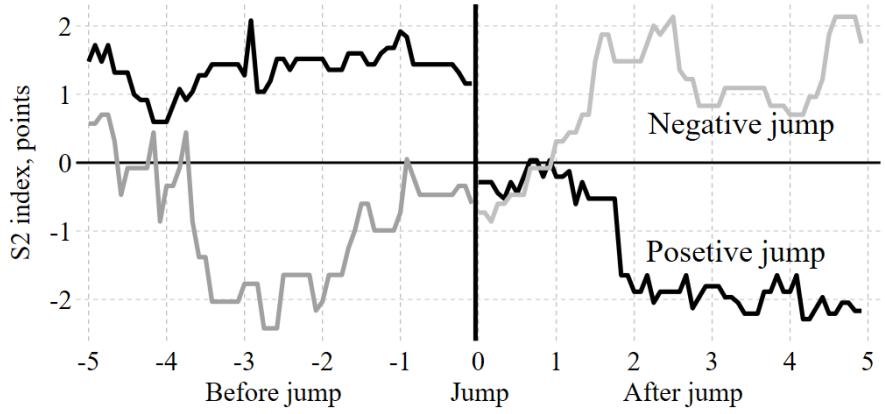
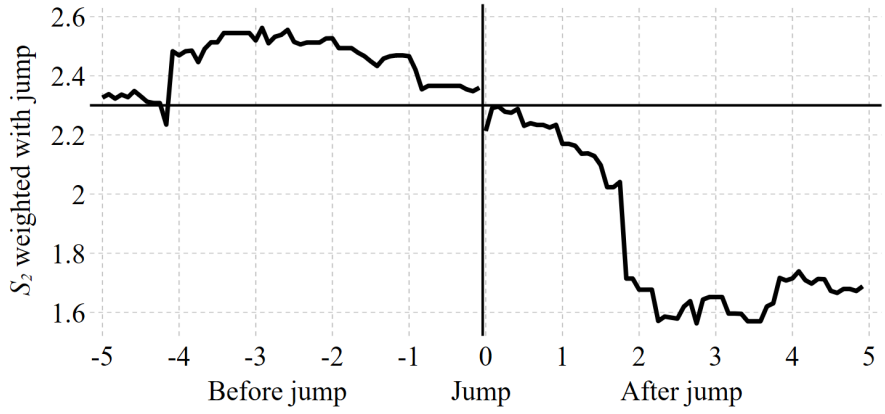


Figure 9. The path of the S_2-curve when the observations are weighted by the size of the jump



The gray line shows S_2 for the downward jumps. It is consistent with the story told above of a PI-group in an authoritarian group tightening control to be able to harvest more rents. They were already increasing S_2 before the jump. Many coups have been justified as needed to combat corruption, but the coup makers rather want to share the rents. Here, too, the effect of the jump is a change of about three points that increases the S_2 index.

Finally, Figure 9 weights the effect with the size of the jump, so that all changes become positive. Here the pre-jump level is fairly constant at 2.5, and the post jump level stabilizes at 1.6 after 2 years. Thus, the total effect is about 4 points. This is a moderate but highly significant effect.

7. Conclusions

Political capitalism and its sister concepts of crony capitalism and state capture are widespread social ills. It is also poorly measured. We have previously analyzed the concept using Kaufmann's state capture index, S_1, which is useful for a long-run analysis only. Consequently, a new – monthly index termed S_2 – is made to catch the short run. The Appendix shows that the two indices are highly correlated, even when both indices have a substantial measurement uncertainty.

The method used is to study the monthly path of political capitalism for ten years around jumps in the polyarchy democracy index. The data contains 21 jumps. In the 60 months before the jump there are only small movements in the S_2 index. Thus, we have no basis to claim that changes in political capitalism cause democratic reforms, even when increases in the S_2 index should!

However, we have found that democratizing reforms cause a clear fall in the level of political capitalism. The fall is moderate, and it comes after a couple of years. In the detailed country studies, it appears that there is considerable variation around the common trend.

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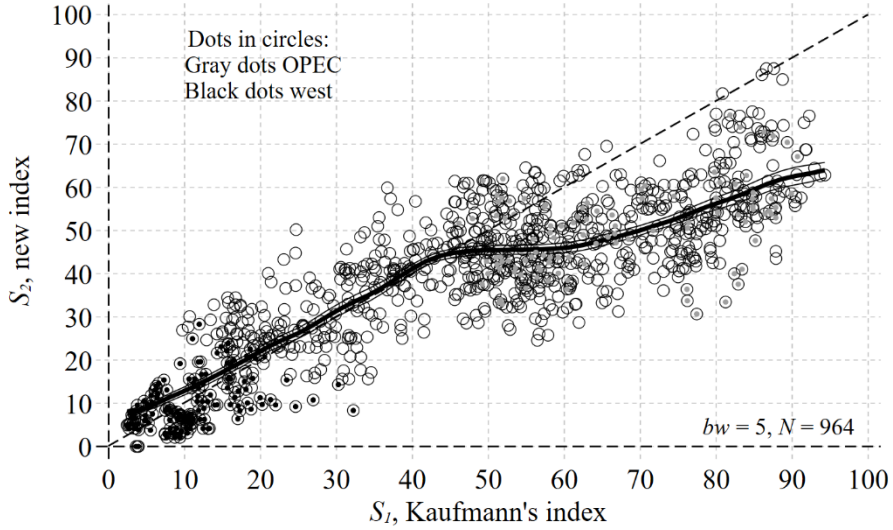
Appendix: Two indices for political capitalism

This appendix deals with Kaufmann's state capture index, S_1, and our new S_2 index. It assumes that they try to measure the same, which is the triplet of similar concepts: Political capitalism, crony capitalism, and state capture, as defined in Table 1 of the paper. An overlapping dataset of 964 observations for 138 countries is used for two purposes: (i) To study if the two indices tell the same story. (ii) To use the difference between the 964 observations to find a measure of the measurement uncertainty of the S_2 index.

A.1. Comparing the indices

Figure A1 shows the scatter of the 964 observations for the two indices. The points scatter substantially around the curve, but the kernel curve giving the average path is well determined as seen from the narrow confidence intervals. Thus, the scatter is random. In the interval [0, 40] the two indices are nicely proportional, but for higher values S_2 is smaller. The two groups of high-income countries do not deviate from the kernel curve but are at both ends of the scale. That is, western countries have low S-values and OPEC countries have high S-values.

Figure A1. Kernel regression explaining S_1 by S_2



The correlations between the two indices are given in Table A1. The normal Pearson correlation and the Spearman rank correlation are very similar so the deviations from normality of the two indices is irrelevant. The correlation of the unified data is the same as the one between countries. The

seven between-country correlations are virtually the same (standard error se = 0.0052). However, the within-countries correlation is much smaller and highly variable (se = 0.045). Another point to note is that the correlations barely change if one of the two *S*'es is lagged by one three-year period.

Table A1. Correlations between S_1 and S_2

Unified data, $N = 964$		Between-countries	Within-countries
Pearson	Spearman	av. for 7 years	av. for 138 countries
0.850	0.822	0.851	0.138

Figure A2. Comparing the transition in the two political capitalism indices

Figure A2a. Kaufmann's S_1 index

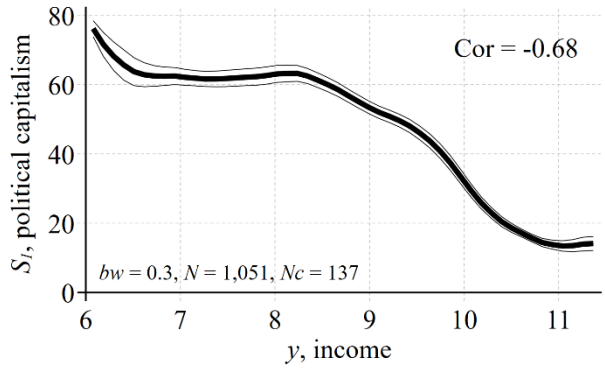
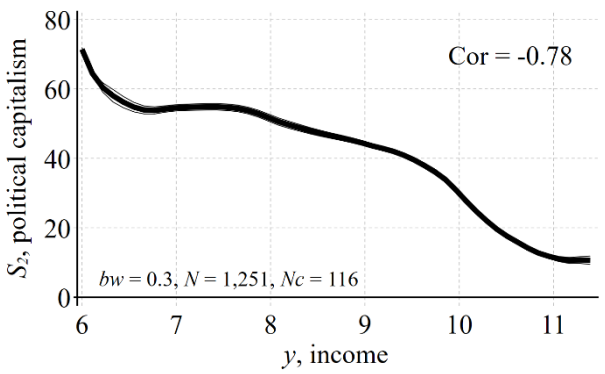


Figure A2b. The new S_2 index



The two Figures A2 show why the long-run correlation is so strong. The key observation from the figure is that both indices have a strong and very similar transition as expected from Paldam and Saadaoui (2026) and Figure A1. The fit is marginally better for S_2, as seen from the higher correlation and narrower confidence intervals.

A.2. Measurement errors

There is a small overlap of the primary series used to form the two indices, but if we treat them as two independent attempts to construct a political capitalism index, we can use their deviation around the curve on Figure A1 as a measure of the error. They are both on a percental scale and for the first half of the scale they are proportional. The kernel curve on Figure A1 is $S_2 = K^S(S_1)$. The measurement error for each observation of S_2 is:

(1) $E(S_2) = S_2 - K^S(S_1)$, which has been calculated for all $N = 964$.

Using a quadratic norm the average measurement error for each observation of S_2 is:

(2) $$\underline{E} = \sqrt{(\sum_{i=1}^{964} E(S_{2i})^2)/946} = 8.67.$$

Admittedly, this is an uncertain estimate, but it is the best we have been able to think of. Hence the error on each individual value of S_2 is 8.67. However, the paper looks at averages where the error is a great deal smaller. The effort is due to a combination of the errors in both S_1 and S_2, but how it should be divided is unclear, and there might be correlated errors as well.