Following the Money to Determine the Effects of Democracy on Corruption: The Case of Korea

James C. Schopf

Democratization should reduce incentives to engage in corruption, by expanding the size of the winning coalition, heightening transparency, increasing accountability to the electorate, and multiplying the number of veto points required for a corrupt deal. Yet many young, consolidated democracies, such as South Korea, have recorded higher levels of perceived corruption following democratization.

I argue that the apparently higher level of corruption accompanying democratization results from overdependence on perception surveys to measure corruption. As democratization frees the press, more stories of graft lead the public to higher levels of perceived corruption without any corresponding rise in real corruption. A more effective measurement strategy is to objectively “follow the money,” by focusing on outflows of rents and any related personal receipt of favors by relevant officials. Applied to the Korean case, contrary to popular perceptions of increased corruption, objective measurement of elite corruption reveals that democratization produced a sharp reduction in the corrupt exchange of rents through industrial restructuring programs, bank lending, and government procurement contracts. Keywords: corruption, Korea, industrial restructuring, democratization, media, perception, hard data, measurement.

Several younger democracies in Asia, Latin America, and Eastern Europe have recorded higher rates of perceived corruption in recent years, leading to claims that certain aspects of democratization encourage corruption. One common contention, based on an article by A. Shleifer and R. Vishney (1993), is that the democratic diffusion of power compounds corruption problems by requiring more officeholders to participate in a successful exchange of bribes for rents. This line of reasoning misconstructs Shleifer and Vishney’s argument by ignoring the competitive aspect of democracy and the way in which competition deters bribe taking,
which is explained in the “third scenario” of Shleifer and Vishney’s analysis of the “Industrial Organization of Corruption.” In fact, under competitive conditions, the involvement of more actors per corrupt exchange makes detection more likely and corruption less lucrative and more risky for officeholders and private actors.

Why then are many new democracies apparently struggling with higher rates of corruption? This result is likely due to inaccurate and biased images of corruption that are measured through perception surveys, the most common means of estimating corruption. Since the media largely shape popular perceptions of corruption and other crime, greater liberty to report on controversial topics through democratization can generate biased public perceptions of corruption levels, which are subsequently reflected in the survey data. The South Korean transition to democracy, examined here, presents just such a case of press freedom increasing popular perceptions of corruption levels through a surge in media reports. A more effective means to measure corruption, particularly useful for deducing the effects of democratization on corruption, is to “follow the money”—by tracking the outflow of rents through economic policy and investigating linkages to official receipt of personal favors. Reduction in the most important mechanisms for large-scale, efficient provision of rents can signal an overall decline in high-level corruption, since it suggests that the increasing possibility of exposure and penalty (i.e., higher transaction costs) has pushed corrupt deals into less lucrative areas lacking plentiful rents.

In cases lacking political contribution data to show official receipt of favors, analysts can still effectively infer levels of corruption by comparing large transfers of “suspect rent,” which are not bound by transparent criteria, are often inconsistent with official policy objectives, and, most importantly, benefit “undeserving” private firms that have failed to supply public goods or to sacrifice in the public interest. In the case of South Korea (hereafter referred to as Korea), a comparative statics analysis of rent allocation through industrial restructuring programs, before and after democratization, offers a more accurate representation of corruption levels. Results indicate that transactive corruption, in particular, was far more severe under Chun Doo-hwan’s dictatorship in the 1980s than in present democratic Korea. Chun’s industrial rationalization program allocated rents directly in return for bribes and loyalty to the political elite, whereas increased transparency, greater accountability, and more veto points in the democratic Kim Dae-jung government’s corporate restructuring program reduced incentives and raised the costs of corruption and the likelihood of detection. As a consequence, the Kim
government doled out a limited amount of rents, and only in return for implementation of burden-sharing “self-rescue” measures by corporate recipients. This finding, reinforced by proxy measurement of large amounts of rents allocated through government contracts and bank lending under dictatorship but not under democracy, contrasts with the higher perceived levels of corruption under Korean democracy.

In this article, I first explore the theoretical debate over democratization and corruption, arguing that the overall effect of democratic competition is to deter bribe taking. Next, I consider the difficult task of measuring corruption and examine the shortcomings in the conventional reliance on surveys of the public perception of corruption. After offering an argument that the media exert the most influence over popular awareness of corruption, I address a puzzle: If democratization influences media coverage of corruption and thereby public perception, how can we determine democracy’s true effect on corruption? To overcome this conundrum, I introduce a functional definition of corruption and a nonsubjective approach to measuring corruption, focused on the estimation of rents. These tools are then applied in the Korean case to industrial restructuring programs under authoritarian and democratic rule to determine democratization’s impact on rent exchange, revealing reduced corruption.

Theories of Corruption and Democratization
Numerous arguments have been put forth to claim that democracy either increases or decreases corruption. Michael Johnston (2005) mentions several elements of democracy that can increase corruption. While Johnston emphasizes that democracy’s effect on corruption is far from clear, he lists several democracies where corruption is endemic and cites Shleifer and Vishney’s contention that queuing arrangements resulting from democratic institutions can aggravate corruption. In Shleifer and Vishney’s “second scenario,” which is often interpreted to represent democracy, the absence of authoritarian central coordination allows numerous players, including members of the legislature, central ministries, and local government, to act as independent monopolists in the provision of government services and the receipt of bribes (see Table 1). As Johnston describes, under this democratic diffusion of power, “established elite relationships give way to a more fragmented scramble for spoils” (Johnston 2005, 32). To secure government services, each individual monopolist demands a bribe, driving up the bribe price and multiplying individual acts of corruption, in contrast to Shleifer and Vishney’s authoritarian “first scenario,” where a single bribe would suffice.
Table 1 Shleifer and Vishney’s Industrial Organization of Corruption

<table>
<thead>
<tr>
<th>Scenario</th>
<th>Actors Providing Government Goods</th>
<th>Do Actors Compete or Possess a Monopoly?</th>
<th>Effect on Bribe Price</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>One actor</td>
<td>Possesses full monopoly over all government goods</td>
<td>Bribe price lower than in scenario 2</td>
</tr>
<tr>
<td>2</td>
<td>Numerous actors</td>
<td>Each possesses monopoly over a complementary government good</td>
<td>Per unit bribe highest, provision of government goods lowest</td>
</tr>
<tr>
<td>3</td>
<td>Numerous actors</td>
<td>Compete in provision of same government goods</td>
<td>Competition drives bribe price to zero</td>
</tr>
</tbody>
</table>

Other attributes of democracy are also alleged to encourage corruption. Elections may heighten uncertainty, leading to short-term orientation and bribe taking for campaign funds. The new societal actors that helped push through democracy may also choose bribery as a means to bypass underdeveloped democratic institutions (Huntington 1968).

Many younger democracies, in particular, appear vulnerable to higher levels of perceived corruption. Johnston’s plot chart of nations according to perceived levels of corruption and standard of living (human development index [HDI]) reveals that among nations with 2001 HDIs from .8 to .9, only young democracies recorded levels of perceived corruption above the mean. Korea is fairly representative of this group of countries—with an HDI of .87, Corruption Perceptions Index score of 4.1, and polity score of 8 out of 10.

Some advocates of the conventional “developmental state” explanation for Korean development offer a logic similar to Shleifer and Vishney’s second scenario to account for higher levels of perceived corruption under Korean democracy. This statist approach contends that autonomous government bureaucrats were primarily responsible for guiding Korean economic development—directing subsidies and low-interest loans as incentives for private firms to further public objectives through export-led industrialization (Amsden 1989). For some in this tradition, democratization entails the demise of statist bureaucratic control and increased opportunity for politicians and lower-level officials to abuse for personal ends the policy tools that had previously delivered economic development. J. Mo and C. I. Moon (2003) argue that gridlock and policy failure resulting from democracy led to industrial overcapacity and unclear corporate
governance, increasing Korea’s vulnerability to the East Asian financial crisis of 1999.

Cultural values associated with democracy have also been held responsible for corruption. Jon Quah (2004) identifies a shift toward materialism derived from economic growth and democratization as contributing to increasing Korean corruption. The pervasive influence of traditional Korean interpersonal networks, formed and reinforced through Confucian heritage, traditional agricultural roots, and the Korean cultural concept of *lung*, may also have led to a preference for personal cronies and corruption over the public good.

Those arguing that democratic diffusion of authority increases corruption misapply Shleifer and Vishney’s second scenario by ignoring the critical element of competition in democracy. Shleifer and Vishney examine the effects of competition in their third scenario, which includes bureaucratic agencies vying in the allocation of government goods. Whether represented by an economic rivalry between agencies, or by an election between politicians, competition provides a strong incentive to minimize bribes. A corrupt leader faces the real prospect of exposure and defeat in the next election.

Under an incentive structure shaped by political competition, Shleifer and Vishney’s numerous independent monopolists will be far less attracted to corruption. The more deals required to secure favors, the greater the likelihood of exposure and punishment, the higher the transaction costs, and the lower the potential net return of corruption (Root 1994). As the Korean Hanbo case also demonstrated, opposition party members included in a deal may choose to blow the whistle if they think they can inflict more damage than they sustain. Democratic governments are also designed to be transparent, and include a free press, to allow the populace to better hold leaders accountable through elections, further increasing the likelihood of detection.

To maintain power, democratic politicians must reward supporters within their ruling coalition, which can encompass a majority of the populace. Allocating private goods, by buying votes, thus becomes a less effective means for democratic leaders to secure support, relative to provision of public goods. An authoritarian leader, in contrast, has a much stronger incentive to bring in bribes from public office to use securing support from a much smaller ruling coalition (Root 1994, 54).

Under democratic competition, therefore, the larger size of the winning coalition, the greater number of veto points, heightened transparency, increased accountability (horizontally to other branches, and vertically to the voters), and stronger incentives and capacity to expose
the corruption of political rivals make it more expensive and, above all, more dangerous for political leaders to exchange favors with the business elite.

The Challenge of Measuring Corruption
Despite democratic constraints, many younger democracies struggle with higher levels of perceived corruption. To understand why, it is helpful to examine opinion polls, which are the conventional means used by scholars to measure this clandestine social phenomenon. Surveys gauge perception and experience with corruption as a means to estimate overall corruption levels. They inexpensively and efficiently collect information from a large number of respondents. The resulting large sample size makes data easily available for numerous secondary studies of the causes and effects of corruption.

Surveys of experience with and perceptions of corruption have serious shortcomings, however. Attitudes toward corruption may be more strongly related to media coverage than to the actual incidence of corrupt acts, while the strong incentive of complicit respondents to lie makes experience-based corruption polls unreliable. Measuring “suspect rent,” either directly or through proxy, or better yet, gauging the allocation of rents in return for favors, can provide a much more accurate assessment of corruption levels.

The illegal and immoral quality of corruption gives the parties to a corrupt transaction little incentive to reveal their dealings to scholars. As a result, much of the early scholarly work on corruption simply concluded it was “immeasurable and imponderable” (Wraith and Simpkins 1963) and that facts about corruption “cannot be discovered, or that if they can, they cannot be proved” (Leys 1965, 215). Even in 1994, a methodological essay cited corruption as the prime example of an observable social phenomenon that is unquantifiable (Dogan and Kazancigil 1994).

One means to measure corrupt behavior is through surveys of personal experience with corruption. Inevitably, though, most people lack direct experience with many kinds of corrupt behavior, particularly with high-level corruption in boardrooms or ministries, and those engaging in the giving or taking of bribes are understandably reluctant to incriminate themselves or their colleagues (Lancaster and Montinola 1997, 193–194). The accepted solution to the problem of deceptive respondents has been to survey their perception of corruption rather than experience with it.
The major flaw, though, of perception surveys, such as the Corruption Perceptions Index (CPI), the most common diagnostic tool used to assess corruption levels, is that perceptions of corruption lack a solid foundation in equivalent behavior. Survey results are thus often influenced by factors unrelated to the actual incidence of corruption, and numerous scholars have reported a sharp disconnect between perception and experience with corruption.

Few directly experience corruption, particularly the high-level variety, leading most respondents to rely on the media for information about corruption and other crime. Since people employ shortcuts to remember information related to decisionmaking, heavy media corruption coverage can prime this issue in the minds of the citizenry. The public thus fails to correct for the unrepresentative nature of the stories presented and accepts the distorted media view as reality.

The more media stories on crime and corruption, the more likely these issues are to be primed due to easy availability in memory, and the more likely individuals will overestimate their actual frequency. This was especially apparent in the United States in the 1990s, when an 83 percent increase in media crime reporting led to a sharp rise in the number of respondents naming crime as the nation’s “most important problem”—to 54 percent in August 1994, from only 1 percent in 1990 (Saad 2007) in the face of a 20 percent decline in the actual crime rate (US Department of Justice 1999). The advent of twenty-four-hour news and the “Murdoch effect” in the US television news industry in the late 1980s and 1990s was critical in increasing crime coverage and the biased popular perceived level of crime (Krajicek 1998).

The media like stories on crime and corruption because they are easy to market. Full of drama and emotion, they provide concrete events with a powerful impact on ordinary people. Corruption stories are particularly appealing because they almost always contain a prime suspect—a crucial element of any crime story—and are likely to involve crimes of the powerful, which taps into and articulates a strong streak of populism in the audience (Gilliam and Iyengar 2000).

The frequency of media coverage of politically sensitive topics such as corruption is likely to be more strongly affected by the level of press freedom than by actual incidence of the crime. Despite great media interest, corruption stories are an obvious target for authoritarian press censorship, since by definition they focus on the criminal acts of government officials. Democratization, however, grants the press liberty to cover corruption, leading to a sharp rise in these types of stories.
Media-Influenced Perceptions of Corruption in Korea

In the case of South Korea, the transformation from dictatorship to democracy produced a remarkable increase in media corruption coverage. As was true in other countries, increased reporting of corruption primed the public mind and led to increased perceptions of its frequency.

Korean dictator Chun Doo-hwan (1980–1987) had restricted the media’s ability to report on corruption by using the Basic Press Law (BPL) to force newspapers to follow Ministry of Culture and Information (MOCI) reporting guidelines. Periodicals and journalists that refused to comply were forced from the industry, as 172 firms and 711 outspoken journalists were to discover during Chun’s rule. Chun also relied on his intelligence agency, the Korean National Security Planning Agency (NSPA), to silence journalists through intimidation and assault.

The new democratic government replaced the BPL in November 1987 with the Registration of Periodicals and the Broadcast Act, rescinding the MOCI’s right to prescribe press guidelines. Freedom of the press was enshrined in the democratic constitution of October 1987, explicitly guaranteeing freedom of expression and prohibiting censorship. With only basic registration required to open a printing business, the total number of South Korean dailies soared from thirty-two in June 1987 to 111 in March 1992, including left-wing publications such as the Hankyoreh Shinmun, whose senior editorial staff included many imprisoned or dismissed by Chun in 1980.

Unbound from government censorship, Korean media coverage also shifted toward attractive, but previously proscribed, stories such as corruption. The number of articles per year mentioning the word corruption, for instance, in the popular daily newspaper the Chosun Ilbo rose from six and seven in 1986 and 1987, respectively, to 999 in 1993 and 1,828 in 1997 following the democratic transition.20

The large increase in corruption coverage could not help but impact popular perception of the amount of corruption in the country. In fact, survey data showed that perceived corruption increased with democracy, from 3.93 CPI (1980–1985) under the Chun dictatorship to 3.5 under early democracy (1988–1992) (0 most corrupt to 10 least corrupt). The heavy sentences meted out to former presidents Roh Tae-woo and Chun Doo-hwan for corruption in 1995 and 1996 led to a brief reduction in perceived corruption levels. The involvement of scores of high officials and Kim Hyun-chul, son of sitting president Kim Young Sam, in the 1997 Hanbo scandal brought Korea’s CPI back down, however. After twelve years of democracy, perceptions of Korean corruption eventually began to conform to reality, and Korea gradually improved its perception index rankings each year until 2008 (see Figure 1).
Considering the impact of press coverage on popular perceptions of corruption, an alternative, objective means to measure corruption is appropriate in cases of democratization, such as Korea, where surging media coverage is clearly divorced from instances of actual corruption.

**Direct and Indirect Objective Measures of Corruption**

To measure corruption one must first define it. I adopt in this article what Michael Johnston terms a “modern” definition of corruption—focusing on the behavior of government officials and politicians—as opposed to more “classic” notions of corruption, which are concerned with social morality (Heidenheimer 1989). Among commonly accepted modern definitions of corruption are legalistic ones, which classify a corrupt act as the violation of official regulations in return for bribes or status gain, and the patron-agent-client model of corruption, which defines as corrupt...
those instances in which an agent (bureaucrat or politician) defies the will of the patron (in a democracy, the public) to make a deal with a client. In this article, I adopt the most commonly used and accepted definition, Transparency International’s simplification of the patron-agent-client model, with corruption as “the misuse of public power for private gain” (“private” from the perspective of the agent—the government official or politician).

The identity of the principal helps to distinguish between two types of corruption. Grand (high or political) corruption involves the misuse of public office by politician agents for ends diverging from the interests of the citizen principals, particularly for pecuniary gain. Low (petty or bureaucratic) corruption involves an administrative agent’s use of public office in a way inconsistent with the interests of the political leadership.

Bureaucratic reform to eradicate low-level graft may prove pointless if corruption is endemic at the highest levels of the political system. In fact, dictators may carry out anticorruption policies, limiting discretion of low-level officials, simply to concentrate payoff opportunities at the top. Such reform can just as well lead to an increase, rather than decrease, in overall corruption. I therefore focus here on grand corruption, which must be fundamentally addressed in order to combat both types of corruption. I also examine corruption that is “transactive,” involving an exchange of government-provided rents (returns above market level) for either bribes (so-called market corruption) or loyalty (so-called parochial corruption). This form of corruption is likely to be more persistent than extortion, primarily because gaining rents provides the client with an incentive to conceal the corruption.22

While it would be impossible to consider all possible avenues available for leaders to direct rents to private firms, the most important mechanisms for large-scale provision of rents (in this case, low-interest bank loans and government contracts) can be indicative of overall levels of grand transactive corruption. Highly efficient, large-scale corrupt provision of rents signifies little likelihood of detection or punishment, and thus low transaction costs of corruption.23 A reduction in this type of corruption suggests that the increasing possibility of exposure and penalty has pushed corrupt deals into less lucrative areas that lack ample rents. The outcome is similar to the consequences of criminalizing marijuana or prostitution. To avoid detection, purveyors of illegal goods and services must operate on a smaller scale in less lucrative locations such as parks or back alleys. Likewise, politicians or officials fearing detection and punishment will forsake the most lucrative opportunities for rent exchange.
So, where sufficient information allows, the optimal method to measure large-scale, grand transactive corruption, is to take a hard-data approach, select a suspect policy, and identify cases where rents have been exchanged for personal favors. If data on financial contributions, unexplained increases in the value of personal assets, or other indicators of personal gain are inadequate, an alternative is to focus on the supply of government rents to private actors. Rent is easier to identify than bribes and private favors since there is more of it—and its cumulative value is nearly always greater than the bribe for which it is exchanged—and rents are allocated through policy channels, government agencies that conduct business in the public domain. Open sources can also be utilized to construct a proxy for rent. While the presence of rent is no proof of corruption, large-scale rent transfers at the full discretion of officials or politicians, without transparent regulations to reward private firms supplying public goods, can strongly indicate corruption.

**Measuring Corruption in Korea**

Here both methods of objective measurement are applied to assess levels of corruption before and after the Korean transition to democracy. Ample data enables a comparative statics analysis of industrial restructuring programs under Korean dictatorial and democratic governments to test for rents exchanged for private favors. The finding, of reduced corruption under democracy, is supported by proxy measurement of extensive transfers of suspect rents through government contract procurement and bank lending under dictatorship, but not democracy.

Political leaders have numerous channels available through which to direct rents to private firms. I focus here on one of the primary means of Korean government rent allocation, identified by Korean political analysts and specialists as low-interest bank loans, particularly prevalent and observable during industrial restructuring programs. I adopt a comparative statics approach, searching for the illicit exchange of rents for private favors in large-scale industrial restructuring programs involving massive government allocation of assets and capital, both before and after democratization. I compare Chun Doo-hwan’s Industrial Rationalization with democratic corporate restructuring programs under Roh Tae-woo (Daewoo Chosun) and Kim Dae-jung (Big Deal and the Workout).

To qualify as a case of transactive corruption, the officeholder must maximize private gain by exchanging rents, in the form of assets or capital, at below market prices, usually in return for bribes or political loyalty. The existence of rents (or favors), then, is a necessary but not
sufficient condition for the existence of corruption. Rents can be offered as an incentive to induce firms to provide public goods and advance the public interest, such as by investing in high-value industries with externalities, or by improving efficiency in struggling industries through mergers and takeovers.29

The first step, then, to distinguish cases of transactive corruption in industrial restructuring is to identify whether rents have been transferred. It is not uncommon for firms to deny receiving rents, however, instead alleging that financial assistance is merely fair compensation for taking on worthless assets. In the case of the Chun Industrial Rationalization, takeovers proceeded according to the “take over first, settle accounts later” principle, providing new owners control over target firm management and an opportunity to manipulate on-site inspections, to lower the purchase price, and to demand compensation from compliant state-controlled banks.30

Instead of analyzing the results of on-site inspections, invariably a source of friction between the new and old owners, I measure rents by comparing the purchase price to the market’s estimation of target firm value, comparing the firm’s market value before and after the public release of takeover terms to gauge the amount of government financial assistance, if any. I use market capitalization (the price multiplied by the number of shares) to measure firm value. I then use relevant industry indexes to control for alternate sources of share price variation. Increases in firm value are attributed to the provision of financial support only in cases where the firm’s share prices deviate from the industry index.31

To show that firms received rents through industrial restructuring, however, is not enough to demonstrate corruption. In keeping with Transparency International’s corruption definition, rents must be provided to maximize the private gain of the officeholder, not as an incentive for firms to take an individually unprofitable action to further the public interest. The criteria by which firms are selected to receive rents can assist in ascertaining the public or private purpose underlying rent allocation. Rent allocation can be clearly classified as corrupt if it is in exchange for bribes or loyalty. If it can be determined that recipient firms were chosen primarily because of marriage or family connections to the ruling elite, the rents likely served as a means to secure the loyalty of members of the winning coalition. Bribes can be deemed the motive if the recipient firms supplied political contributions at a high rate per asset or sales. Rent allocation can be determined not to be corrupt if recipient firms were required to fulfill transparent criteria designed to further the public interest—for instance, by exporting, or by cutting costs and repaying debt
through asset and affiliate sales to help stabilize the financial system. If rents were allocated to strong performers to improve manufacturing performance, these firms should score higher than their peers in terms of financial performance, according to widely accepted liquidity, stability, and profitability ratios.

**Measuring Corruption in Authoritarian Restructuring: Chun’s Industrial Rationalization**

Application of these measurement techniques reveals that the Korean dictator Chun Doo-hwan corruptly manipulated his regime’s Industrial Rationalization measure, doling out private property and low-interest loans at no cost to firms that had offered him the most bribes and were linked by family ties to members of his ruling elite.

Chun ran a brutal and ruthless dictatorship (ranked with a polity score of –8). His regime abolished national and regional elections, censored and shut down the press, arrested opposition politicians, practiced torture, dominated the judiciary, and closed universities. The complete lack of accountability and transparency of Chun’s rule, along with his monopoly control over policy and motivation to provide payoffs to supporters provided ideal conditions for corruption, allowing Chun to amass at least $1.24 billion in bribes from the corporate sector while in office. His 1985 Industrial Rationalization measure offered a prime opportunity to procure bribes and pay off supporters.

The Chun regime claimed it would spur recovery in the unprofitable and debt-ridden construction, shipping, steel, and textile industries by inducing efficient firms to consolidate excess capacity by taking over financially troubled companies. The government would select well-run firms to take over unviable ones and would determine the price to be paid (to the bank, not the previous owner) and the terms of a financial aid package to compensate the new owner.

A 1993 Constitutional Court case revealed that Chun had played a central role in Industrial Rationalization decisions—selecting targets and recipients—despite announcement of rationalization plan details by the Finance Ministry and the participating banks. In the case of the dissolution of the Kukje Group, the seventh largest chaebol and one of the first and largest rationalization targets, main bank Korea First had designed a recovery plan for the group’s core firms under Kukje owner Yang Jungmoe, in keeping with earlier treatment of Hyosung and Gumho groups. Head Constitutional Court judge Choe Kyu-kwang ruled that Chun had, however, in the final hour “ignored the bank’s independently established
normalization proposal and arbitrarily selected the Kukje Group’s total dissolution, forcing the main bank to comply.\textsuperscript{34} Evidence revealed that Chun directly designated Dongkook Steel for ownership of Union Steel, Kukje’s most valuable and profitable affiliate, and likely influenced the selection of others as well.\textsuperscript{35}

The Chun regime provided 7 trillion won in financial assistance through the Industrial Rationalization to fifty-seven firms it designated to take over others, in the form of postponement of the repayment of interest and principal, write-offs of principal, and new low-interest rate preferential loans.\textsuperscript{36} Another twenty-one firms were designated for “self-rescue”—provided with assistance in return for implementing financial improvement plans.

In order to determine whether Industrial Rationalization financial aid amounted to rent, I analyze the takeover terms, purchase price, and gains in share values in the largest Industrial Rationalization cases, which accounted for 70 percent of takeover firm assets and 99 percent and 91 percent of two primary forms of financial assistance—low-interest loans (so-called seed money) and principal write-off, respectively (see Table 2).

One striking finding was the absence of a purchase price in four of the seven examined takeovers, representing an immediate gain of $20–40 million. Also, in contrast to a common trend for acquiring firm shares to slide in a takeover, in the industrial rationalization cases, firm values all rose appreciably in the short time surrounding public release of the takeover terms, even with share indices controlling for other possible contributing factors.

The existence of rents, though, does not prove corruption, as mentioned earlier. Chun’s regime claimed that it provided assistance as compensation to well-managed firms to take over poorly run, nonviable operations, to help revive struggling industries and preserve jobs.

Analysis of Industrial Rationalization winners and losers reveals no positive link between performance and designation to take over others, however. As measured by five key measures of financial performance, target firms outperformed the firms designated to take them over in four of the five largest cases. Chun’s regime, therefore, did not use rents as claimed. In fact, Daewoo, selected to take over Kyungnam, responded to rumors that it would participate in the Industrial Rationalization by issuing a Korean Stock Exchange public disclosure denying that it had become a rationalization takeover target, or had entered into nonpayment.\textsuperscript{37}

We can discern Chun’s motivations in allocating favors with the help of sealed 1988 National Assembly material that I was able to access under the Korean Freedom of Information Act (Korean Freedom of
Table 2 Estimating Rents in the Chun Industrial Rationalization

<table>
<thead>
<tr>
<th>Acquiring Group/Target Group</th>
<th>Debt Terms (million US dollars): years deferred/interest rate (%)</th>
<th>Takeover Price (won, per share)</th>
<th>Post-support Market Share Value (won)</th>
<th>Gain from Target Share Value (million US dollars)</th>
<th>Gain from Own Share Rise (million US dollars)</th>
<th>Total Gain (million US dollars)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dongkuk/Union Steel</td>
<td>229: credit guarantee write-off</td>
<td>2,517</td>
<td>4,120</td>
<td>Not publicly traded</td>
<td>22+</td>
<td></td>
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<tr>
<td>Hanil/Kukje Commerce</td>
<td>218.8: write-off</td>
<td>1</td>
<td>821</td>
<td>43.09</td>
<td>47.3</td>
<td>90.4</td>
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<td></td>
<td>218.8: 15/15</td>
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<td></td>
<td>263.2: 12/10</td>
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<td>70.3: 10/10/10</td>
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<td>New loans</td>
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<tr>
<td>Kukdong/Kukje Commerce</td>
<td>165: write-off</td>
<td>80</td>
<td>821</td>
<td>8.133</td>
<td>9.367</td>
<td>17.5</td>
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<td></td>
<td>74.0: 15/5</td>
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<td></td>
<td>90.8: 15/10</td>
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<td>64.85: 10/10/10</td>
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<td>New loans</td>
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<tr>
<td>Hanjin/Daehan Sunjoo</td>
<td>494.7: write-off</td>
<td>419</td>
<td>860</td>
<td>15.403</td>
<td>Not publicly traded</td>
<td>15.403+</td>
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<td>438.8: 15/15</td>
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<td>235: 5/5/5</td>
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<td>New loans</td>
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</tbody>
</table>

(continues)
Table 2 continued

<table>
<thead>
<tr>
<th>Acquiring Group/Target Group</th>
<th>Debt Terms (million US dollars): years deferred/years repayment/interest rate (%)</th>
<th>Takeover Price (won, per share)</th>
<th>Post-support Market Share Value* (won)</th>
<th>Gain from Target Own Share Rise (million US dollars)</th>
<th>Gain from Target (million US dollars)</th>
<th>Total Gain (million US dollars)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ssangyong/Namkwang</td>
<td>169.7: write-off 169.5: 15/10 62.6: 10/10 New loans</td>
<td>Free</td>
<td>1,690</td>
<td>27.699</td>
<td>Not publicly traded</td>
<td>27.699+</td>
</tr>
<tr>
<td>Daelim/Samho</td>
<td>340.7: 10/15 48.1: 3/0 34.4: 20/0 111.7: 10/10/10 New loans</td>
<td>Free</td>
<td>1,590</td>
<td>42.297</td>
<td>558.778</td>
<td>601</td>
</tr>
<tr>
<td>Daewoo/Kyungnam</td>
<td>554: 15/15 235: 12/5/10 New loans</td>
<td>1/100</td>
<td>1,695</td>
<td>33.149</td>
<td>269.916</td>
<td>303</td>
</tr>
</tbody>
</table>

Sources: Debt terms from Government of the Republic of Korea (Ministry of Finance) 1988, p. 323, Freedom of Information (FOI) requested material; gains calculated from Korea Stock Exchange database; bribes per asset data from FOI requested material; direct political contribution data from Government of Korea, High Court 1996; financial statistics from Annual Analysis of Firms, various years.

Note: a. Average value two weeks following support.
Information Act Requested Material 1998). Chun kept a record of bribes received while in office and issued receipts for bribes. Not surprisingly, Chun monopolized control over bribes, just as he determined who received rents; he instructed underlings never to take chaebol funds, telling them instead, “I will do it for you.” 38

A look at the bribe list reveals that the largest industrial rationalization rent recipients had also shouldered the greatest political contribution burdens, both overall and in their respective industries. Many large rent recipients also had marriage ties with Chun’s elite—notably, Daelim and Daewoo, both rumored to be on the verge of bankruptcy (see Table 3).

The existence of family ties to Chun’s elite among aid recipients indicates that Chun was engaging in parochial, rather than market corruption, providing rents in exchange for loyalty from his political backers. Logistics regression confirms the tie between rents and bribes (see Table 4) and the lack of any meaningful connection between rents and financial performance under Chun’s Industrial Rationalization. One can see that political contributions and rents are positively correlated and that contributions are highly significant, while financial measures are not. 39

**Measuring Corruption in Democratic Industrial Restructuring**

Chun’s manipulation of the Industrial Rationalization to reward cronies with rents, by reallocating assets and writing off loans, contrasts with the absence of rents in democratic restructuring programs. Democratic institutional features—principally monitoring by the press, civic organizations, and the opposition parties in the National Assembly, and greater accountability to the electorate—precluded the democratic Roh Tae-woo and Kim Dae-jung governments from corruptly exploiting the Daewoo Chosun and Big Deal industrial restructuring programs, respectively. 40 Only limited financial assistance was provided in either case to firms willing to shoulder most of the restructuring burden.

South Korea rapidly democratized following transition to civilian rule in 1987 with free and fair elections, universal adult suffrage, civil liberties, multiparty competition, and a free press. Korea rated an 8 out of 10 according to the polity index, becoming, in 1997, the first East Asian third-wave democracy to peacefully transfer power to an opposition party.

The 1988 restructuring of Korea’s largest private firm, the nearly bankrupt ship manufacturer Daewoo Chosun, clearly illustrated how a more transparent and inclusive democratic policymaking process had introduced new disincentives to engage in corruption.
<table>
<thead>
<tr>
<th>Acquiring Firm/Target Firm</th>
<th>Industry</th>
<th>Sales/Assets</th>
<th>Profit/Financial Cost</th>
<th>Earnings/Assets</th>
<th>Current Ratio</th>
<th>Debt/Assets</th>
<th>Elite Ties</th>
<th>Bribe Per Asset</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dongkuk Steel</td>
<td></td>
<td>45</td>
<td>73</td>
<td>82</td>
<td>91</td>
<td>64</td>
<td>4 ministers</td>
<td>.021</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>1 ambassador</td>
<td>(1st overall)</td>
</tr>
<tr>
<td>Union a</td>
<td></td>
<td>18</td>
<td>27</td>
<td>27</td>
<td>54</td>
<td>9</td>
<td>2 KMA presidents</td>
<td>.038</td>
</tr>
<tr>
<td>Hanil Shoes</td>
<td>Textiles</td>
<td>22</td>
<td>67</td>
<td>78</td>
<td>33</td>
<td>67</td>
<td>Roh Tae-woo NA KMA president</td>
<td>(3rd overall)</td>
</tr>
<tr>
<td>Kukje Shoes</td>
<td></td>
<td>40</td>
<td>40</td>
<td>20</td>
<td>60</td>
<td>40</td>
<td>1 minister</td>
<td>.01331</td>
</tr>
<tr>
<td>Hanjin Shoes</td>
<td></td>
<td>57</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>Daehan Sunjoo Shoes</td>
<td></td>
<td>29</td>
<td>71</td>
<td>71</td>
<td>57</td>
<td>86</td>
<td>.0007</td>
<td></td>
</tr>
<tr>
<td>Ssangyong Construction</td>
<td></td>
<td>86</td>
<td>89</td>
<td>89</td>
<td>11</td>
<td>57</td>
<td>.00426</td>
<td>(8th of 40 in industry)</td>
</tr>
<tr>
<td>Namkwang Shoes</td>
<td></td>
<td>54</td>
<td>48</td>
<td>49</td>
<td>84</td>
<td>68</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>Daelim Construction</td>
<td></td>
<td>32</td>
<td>70</td>
<td>76</td>
<td>78</td>
<td>24</td>
<td>Brother is NA chairman; Chun’s brother is employed by group</td>
<td>.00497</td>
</tr>
<tr>
<td>Samho</td>
<td></td>
<td>65 (45)</td>
<td>81</td>
<td>84</td>
<td>81</td>
<td>78</td>
<td>0</td>
<td></td>
</tr>
</tbody>
</table>

(continues)
### Table 3 continued

<table>
<thead>
<tr>
<th>Acquiring Firm/Target Firm</th>
<th>Industry</th>
<th>Sales/Assets</th>
<th>Profit/Assets</th>
<th>Earnings/Assets</th>
<th>Current Ratio</th>
<th>Debt/Assets</th>
<th>Elite Ties</th>
<th>Bribe Per Asset</th>
</tr>
</thead>
<tbody>
<tr>
<td>Daewoo/Construction</td>
<td>See note</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>.00475 (13th of 40 in industry)</td>
</tr>
<tr>
<td>Kyungnam</td>
<td>76</td>
<td>67</td>
<td>77</td>
<td>40</td>
<td>78</td>
<td></td>
<td>.00016 (bottom of industry)</td>
<td></td>
</tr>
<tr>
<td>Kukdong</td>
<td>Construction</td>
<td>5</td>
<td>3</td>
<td>5</td>
<td>11</td>
<td>5</td>
<td></td>
<td>.027 (2nd overall)</td>
</tr>
</tbody>
</table>

**Sources:** Bribe per asset data from Freedom of Information requested material; direct political contribution data from Government of Korea, High Court 1996; financial statistics from *Annual Analysis of Firms*, various years; family tie data from *Chaebol and Chaebol Families* 1992.

**Notes:** Statistics in parentheses are group, rather than firm, statistics.
- a. Refers to percentage of industry firms ranked higher within its industry by performance than the firm.
- b. Top performer.
- c. Daewoo Corporation, a trading firm, also contained the group’s smaller construction operations. In mid-February 1985, rumors of Daewoo’s collapse led to a 20 percent fall in share value and prompted the group to issue a disclosure denying that Daewoo had become a target of Chun’s industrial rationalization program, or entered into nonpayment (*Chosun Ilbo* 1985).
### Table 4 Logistic Regression of Bribes and Performance to Receipt of Government Rents for Largest Chaebol

<table>
<thead>
<tr>
<th>Independent Variable</th>
<th>Parameter Estimate</th>
<th>Standard Error</th>
<th>Pr &gt; Chi Square</th>
<th>Odds Ratio/ 95% Wald Confidence Test</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bribes/sales</td>
<td>1000.6</td>
<td>428.1</td>
<td>0.0194</td>
<td>&gt;999.999</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>***</td>
</tr>
<tr>
<td>Bribes/assets</td>
<td>1057.2</td>
<td>434.4</td>
<td>0.0149</td>
<td>&gt;999.999</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>***</td>
</tr>
<tr>
<td>Sales/assets</td>
<td>-0.7223</td>
<td>0.9661</td>
<td>0.4547</td>
<td>0.073</td>
</tr>
<tr>
<td>Profit/financial cost</td>
<td>-0.2158</td>
<td>0.6662</td>
<td>0.7460</td>
<td>0.218</td>
</tr>
<tr>
<td>Earnings/assets</td>
<td>0.3835</td>
<td>0.2105</td>
<td>0.0684</td>
<td>0.971</td>
</tr>
<tr>
<td>Debt/assets</td>
<td>-7.251</td>
<td>4.7505</td>
<td>0.1269</td>
<td>&lt;0.001</td>
</tr>
<tr>
<td>Current ratio</td>
<td>0.0039</td>
<td>0.0160</td>
<td>0.8067</td>
<td>0.973</td>
</tr>
</tbody>
</table>

*Sources:* Bribes per asset data from Freedom of Information requested material; direct political contribution data from Government of Korea, High Court 1996; financial statistics from *Annual Analysis of Firms,* various years; family tie data from *Chaebol and Chaebol Families* 1992.

*Notes:* N = 35. Dependent variable is receipt of rents through the Chun Industrial Rationalization measures. The dependent variable is characterized by binomial distribution: one group of firms received government rents, the other did not. Significant if less than 0.05 for Pr > Chi Square, denoted by ***.

To halt Daewoo Chosun's slide, group owner Kim Woo-choong initially employed the strategy that had succeeded under Chun: secret lobbying of the president and his ministers, likely including bribe offers. President Roh Tae-woo refused to act, however, in the face of opposition to aid from university professors, opinion columnists, and the heads of the other ten largest chaebol in the open democratic press.

Kim adapted to the new democratic rules, successfully wooing public opinion by holding press conferences and assembling a pro-Daewoo Chosun relief coalition. This coalition consisted of local citizens groups and labor unions—which launched signature drives and newspaper campaigns—and local opposition party assemblymen, who gained support for assistance from of each of the three opposition parties.

Roh then established an inclusive and transparent process to design the Daewoo Chosun support package. Daewoo and various ministries pitched competing restructuring proposals to the public through the press, and the National Assembly played an active role, holding open hearings before passing legislation to allow government-supported loans to Daewoo. The transparent process kept the government position close to pub-
lic opinion, which polls showed favored limited assistance in return for Daewoo shouldering most restructuring costs. Following seven months of open negotiations, the Daewoo Group agreed to contribute more than the government (400 billion versus 150 billion won),\(^2\) leading to immediate drops in share value of 11 percent, 16.8 percent, 13.9 percent, and 31.6 percent at the four core Daewoo affiliates (compared to a 3.1 percent decline in KOSPI [the Korea Composite Stock Price Index]), representing a net loss to the group of 835.39 billion won, in marked contrast to the share rises coinciding with disclosure of Chun’s financial assistance.\(^3\) To repair Daewoo’s image, Kim exceeded both the contribution target and the repayment schedule, while the government resisted any modifications to the original terms of the agreement.

The largest democratic government industrial restructuring, Kim Dae-jung’s Big Deal and Workout programs following the 1998 currency crisis, were also largely designed and implemented through a transparent process that included opposition lawmakers, the press, and civil society groups. A similar outcome resulted: limited financial assistance highly conditioned on burden sharing. The Kim restructuring was to assist key industries suffering from excess capacity, stagnant profits, and onerous debts. The Big Deal corporate restructuring plan evolved from a five-point restructuring accord reached between president-elect Kim Dae-jung and four of the top five chaebol leaders in January 1998. Under this plan, the Kim government promised financial assistance to chaebol that merged or swapped core affiliates, purportedly to improve productivity by reducing overlapping and excess capacity and supply to concentrate each chaebol’s production within three to five core sectors.

Although chaebol leaders were principally motivated by the prospect of financial support, unlike Chun’s Industrial Rationalization, firms in only three of the five major swaps received assistance, too little to affect their share value, and only in return for implementation of rigorous self-rescue measures to share the restructuring burden by disposing of redundant facilities and manpower, attracting foreign capital, and repaying debt. Without favors there can be no transactive corruption, and that proved true in the Big Deal (see Table 5).

In open and extended negotiations, the chaebol received far less government financial assistance than they initially sought and were forced to cover most restructuring costs. The Kim government responded with a 1.3 trillion won ($967.7 million) counteroffer to a 20 trillion won October 1998 chaebol request, rejecting three of four proposed swaps and demanding more self-rehabilitation capital improvement measures.\(^4\) In December, a committee of twenty-five creditors again rejected chaebol
resubmissions in the semiconductor, ship engine, and power generator sectors; they promised future support to the aircraft and rolling stock deals, but only in return for more self-rehabilitation measures and foreign investment, providing only short-term loan postponement to the petrochemical merger and limited support to the petroleum refining deal in return for attracting foreign investment.

Despite the success of Big Deal firms in trimming debt, selling off assets, and implementing layoffs, two of the five deals still failed to receive assistance after two years of negotiations. This was due either to collapse (in petrochemicals) or to popular opposition to perceived favoritism (semiconductors), while in two others (aircraft and rolling stock), the meager support was too insignificant to increase share value during announcement of the deals or disclosure of assistance terms. Unlike the typical free assumption of shares, the several hundred billion won debt write-off, and the forty-year combined deferment and repayment terms exchanged for bribes and support through Chun’s Industrial Rationalization, which amounted to hundreds of million dollars in rents, firms participating in the democratic Kim government’s Big Deal were lucky to receive one-, three-, and five-year deferments; and instead of debt write-offs, they had to cede ownership and management control through debt-equity swaps. The only firm to record any appreciable gain in share value through Big Deal financial assistance, Hanwha Energy, conceded ownership, while the Hyundai affiliates that took over firms in the semiconductors and petroleum refining deals, paid 22 percent and 87 percent above market price, respectively, and received so little debt relief that their share values collapsed to under 10 percent within two years.45

Creditors of Big Deal firms refused to compromise on self-rescue measures as a condition for financial assistance. The petroleum refining deal, for instance, only received sizable assistance after attracting $500 million in foreign investment, while the aircraft merger implemented cost-cutting measures for a smaller aid package. Rolling stock creditors even allowed the consortium to go insolvent rather than provide assistance without commensurate self-rescue measures, including $160 million in foreign investment.

During Hyundai’s purchase of LG Semiconductor, the active, vocal role of the opposition Grand National Party (GNP) in the National Assembly ensured a fair deal. When Hyundai refused to compromise over the purchase price, the GNP used the National Assembly Interpellation on Economic and Social Affairs to allege government favoritism toward Hyundai and called for cessation of government intervention in the Big Deals. The Kim government responded to GNP representative Paek
Table 5 Limited Rents in the Big Deal (percentage increase or decrease in firm share value at time of public disclosure)

<table>
<thead>
<tr>
<th>Industry</th>
<th>Type of Deal</th>
<th>Financial Aid</th>
<th>Self-rescue Measures</th>
<th>Value of Firm Shares vs. KOSPI and Industry Index</th>
<th>Response to News of Deal</th>
<th>Response to Release of Aid Terms</th>
</tr>
</thead>
<tbody>
<tr>
<td>Semi-conductors</td>
<td>Hyundai takeover of LG</td>
<td>None</td>
<td>None</td>
<td>Hyundai</td>
<td>1.6</td>
<td>None</td>
</tr>
<tr>
<td>Rolling stock</td>
<td>Merger of Hyundai, Hanjin, Daewoo</td>
<td>Temporary low-interest rate on 153.7 billion won</td>
<td>None</td>
<td>Hyundai</td>
<td>0.3</td>
<td>-13.57</td>
</tr>
<tr>
<td>Aircraft</td>
<td>Merger of Samsung, Daewoo, Hyundai</td>
<td>75 billion won debt equity swap; 374.4 billion won</td>
<td>100.2 billion won</td>
<td>Samsung</td>
<td>-2.4</td>
<td>18.4</td>
</tr>
<tr>
<td></td>
<td></td>
<td>won repayment postponed</td>
<td>capital infusion; factory sold; 500 workers (15%) cut</td>
<td>KOSPI</td>
<td>-1</td>
<td>17</td>
</tr>
<tr>
<td>Petroleum refining</td>
<td>Hyundai takeover of Hanwha</td>
<td>5-year deferment/5-year repayment on 1.2 trillion won ($990 million)</td>
<td>$500 million in foreign capital</td>
<td>Hanwha Energy</td>
<td>-20.56</td>
<td>28.38</td>
</tr>
<tr>
<td>Petro-chemicals</td>
<td>Merger of Hyundai, Samsung</td>
<td>Firms not publicly traded and deal collapses</td>
<td></td>
<td>KOSPI</td>
<td>-1</td>
<td>8.73</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Industry</td>
<td>3.42</td>
<td>0</td>
</tr>
</tbody>
</table>

*Source:* Korea Stock Exchange database.

*Notes:* KOSPI is the Korea Composite Stock Price Index. Share response calculated from one week before event to two weeks following the event.
Following the Money

Seung-Hong’s threat to investigate the Big Deals in public hearings under the next government with a tougher line toward Hyundai. Financial Supervisory Commission chairman Lee Hun-jai called for more Hyundai concessions (“If Hyundai really wants the deal, then it should make a more reasonable offer to the seller”), and the Federation of Korean Industries also strongly urged a Hyundai compromise. Four days later, Hyundai raised its offer from 1.2 trillion to 2.56 trillion won, well above market value, sealing the deal.

The pattern of limited assistance in return for burden sharing also held true in another major Kim Dae-jung corporate restructuring policy—the Workout program, which sought to strengthen the fragile financial system by decreasing corporate debt levels. Again, increased transparency, more numerous veto points, and greater accountability under democracy raised the risks of bribe schemes. Firms seeking Workout financial assistance were required to initiate harsh restructuring plans, including selling assets and marginal affiliates, hiring professional managers, and diluting ownership through capital reduction and debt equity swaps. Despite agreeing to such unpopular moves, few owners gained wealth through the program, as Table 6 shows. Two weeks following the announcement of assistance terms, the shares of most Workout firm owners underperformed KOSPI, and eighteen months later 84 percent did.

Notably, the few owners who succeeded in increasing wealth eighteen months later did so by thoroughly implementing self-rescue programs, reducing debt, and increasing capital, as is clear in Table 7. So, the Workout results again illustrate a large reduction in financial favors provided through democratic industrial restructuring. Much less rent was provided than under Chun, and rent recipients were required to act in the public interest to qualify for assistance.

Inferring Corruption from Proxy Measurement of “Suspect Rents”

Greater restrictions on the press and a lack of transparency may make data on political contributions nearly unattainable under authoritarian regimes, making it difficult to tie the allocation of rents to the personal gain of government officeholders. Analysts can still effectively infer corruption levels by checking for “suspect rents,” which are allocated without official guidelines (often at odds with stated policy goals) to benefit firms that are not required, or that fail, to meet conditions that they sacrifice for the public good or act to advance public interests. For instance,
Table 6  Limited Workout Firm Rents: Gain or Loss of Original Workout Firm Owner Wealth Relative to the KOSPI

<table>
<thead>
<tr>
<th>Percentage Above or Below KOSPI</th>
<th>2 Weeks After Terms Announced</th>
<th>3 Months Later</th>
<th>6 Months Later</th>
<th>1 Year Later</th>
<th>18 Months Later</th>
</tr>
</thead>
<tbody>
<tr>
<td>Over 100</td>
<td>2 (4.1)</td>
<td>7 (14.3)</td>
<td>4 (8.3)</td>
<td>2 (4.1)</td>
<td>0 (0)</td>
</tr>
<tr>
<td>50 to 100</td>
<td>4 (8.2)</td>
<td>7 (14.3)</td>
<td>0 (0)</td>
<td>0 (0)</td>
<td>0 (0)</td>
</tr>
<tr>
<td>0 to 50</td>
<td>13 (26.5)</td>
<td>7 (14.3)</td>
<td>7 (14.6)</td>
<td>2 (4.1)</td>
<td>7 (15.6)</td>
</tr>
<tr>
<td>−50 to 0</td>
<td>28 (57.1)</td>
<td>20 (40.8)</td>
<td>10 (20.8)</td>
<td>15 (30.6)</td>
<td>8 (17.8)</td>
</tr>
<tr>
<td>−100 to 50</td>
<td>0 (0)</td>
<td>7 (14.3)</td>
<td>22 (45.8)</td>
<td>13 (26.5)</td>
<td>12 (26.7)</td>
</tr>
<tr>
<td>Below −100</td>
<td>2 (4.1)</td>
<td>1 (2)</td>
<td>5 (10.4)</td>
<td>17 (34.7)</td>
<td>18 (40)</td>
</tr>
<tr>
<td><strong>49 Workout firm average</strong></td>
<td><strong>5</strong></td>
<td><strong>22.6</strong></td>
<td><strong>−14.7</strong></td>
<td><strong>−70.37</strong></td>
<td><strong>−78.24</strong></td>
</tr>
</tbody>
</table>

Average Workout firm market capitalization relative to KOSPI 5.6 67.8 93.82 34.14 19.13

**Sources:** Financial statements from Financial Supervisory Service website: http://dart.fss.or.kr (accessed October 7, 2010); stock prices provided from employees at the Korea Stock Exchange.

**Notes:** KOSPI is the Korea Composite Stock Price Index.
Numbers in parentheses are percentages.

Table 7  Workout Gains Tied to Self-Rescue: Correlation of 18-Month Market Capitalization with Financial Performance

<table>
<thead>
<tr>
<th>18-month firm market capitalization value</th>
<th>Debt/ Assets Change Year 1 to Year 2</th>
<th>Debt Change Year 2 to Year 3</th>
<th>Capital/ Debt Change Year 1 to Year 2</th>
<th>Capital/ Debt Change Year 2 to Year 3</th>
<th>Capital/ Debt Year 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pearson correlation</td>
<td>.347</td>
<td>−.496</td>
<td>−.324</td>
<td>.284</td>
<td>.407</td>
</tr>
<tr>
<td>Significance (2-tailed)</td>
<td>.019</td>
<td>.001</td>
<td>.030</td>
<td>.059</td>
<td>.005</td>
</tr>
<tr>
<td>N</td>
<td>45</td>
<td>45</td>
<td>45</td>
<td>45</td>
<td>45</td>
</tr>
</tbody>
</table>

**Sources:** Financial statements from Financial Supervisory Service website: http://dart.fss.or.kr (accessed October 7, 2010); stock prices provided from employees at the Korea Stock Exchange.

**Note:** Correlation is significant at the 0.05 and 0.01 level (two-tailed).
in the Korean case discussed earlier, even if political contribution data are excluded, the large drop in the allocation of suspect rents to unqualified firms through industrial restructuring programs strongly argues in favor of democratization reducing corruption.

Suspect rents can be directly assessed if the government sells assets at below market prices or purchases resources at rates above the market price. Otherwise, rents can be measured by proxy, as was done earlier through examination of firm share value, controlling for other sources of variation immediately before and after the receipt of rents. Other proxies for rents measured below include estimation of low-interest loans provided by private banks under government pressure to private firms at below market rates, and examination of government procurement of services at above market price through uncompetitive contracting.

Suspect rents can be approximated in the case of bank lending by examining the price of the loan and the borrower’s creditworthiness. The price of long-term bank loans in Korea has long been fixed at a favorable rate by the government. When faced with a financially troubled borrower with poor credit, therefore, a profit-maximizing bank should attempt to minimize loss by persuading the firm to dispose of assets to repay loans or increase paid-in capital, similar to the self-rescue plans pushed by the Kim government through the Workout and Big Deal corporate restructuring programs. Cases like the Hanbo bribery scandal in 1997, in which banks rewarded poor performers with further loans, attract suspicion as possible instances of corruption. In a smoothly functioning financial market, loss-generating, debt-ridden, risky borrowers lack the necessary credit to access low-interest, long-term loans. Not only does this type of borrowing represent a rent transfer, it also diverges from the bank’s objective to maximize return from its loan. In this study, I examine financially troubled chaebol with over 800 percent debt/capital ratio and identify four possible bank-lending responses: tough, punitive, lenient, and favored (see Table 8). With a tough response, the most economically rational strategy, the bank called back loans while the chaebol increased capital. Under a punitive response, the bank cut lending to chaebol that lowered capital. In lenient cases, the bank expanded lending to chaebol that raised capital. Finally, in cases of suspected favoritism, the bank extended more loans despite a chaebol’s capital reduction. Cases of favoritism here serve as proxies for suspect rents, since they represent a bank providing a market rate loan to an extremely risky customer who is unlikely to repay. To control for overall fluctuation in the Korean financial market, which would lead all firms to increase or decrease capital and all banks to extend or reduce loans, I examine relative variation between
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Notes: Total capital and debt statistics for each group were gathered from Table 3.1, Table of Primary Indicators, present in both of the publications cited above.

Statistics for long-term loans, with maturity of over one year, predominantly from banks, were selected to approximate bank debt and gathered from each group’s condensed financial and cash flow statements. Because the maturity of long-term loans exceeded the financial accounting year, this study calculated two-year rolling averages of long-term loans for groups that appeared in consecutive years in the top-thirty list. Annual rates of change were then calculated per group, and the relative rate of change was calculated by comparing each group’s rate with that of the top-thirty average. Because of groups having dissolved or fallen from the top-thirty list, more cases were present with the single year as opposed to two-year rolling average calculation of long-term loans. Note that the table is of relative measures. However, the overall study does show the same trend for both relative and absolute measures.
the case studies (those over 800 percent debt/capital ratio) and the top-thirty average. A capital increase is therefore calculated as one greater than the top-thirty average and a capital reduction is below that average. My study reveals, with absolute and relative measures of long-term loan response and with annual and two-year rolling average loan calculations (because long-term loans overlap annual financial statements), that the transition to democracy brought a shift from favored to tough responses. The change was particularly evident when relative measures are made of the top thirty chaebol. While toughness, the strictest and most economically appropriate response, rose from 13 percent of all cases under Chun Doo-hwan to 41 percent under the democratic governments, suspected favoritism fell from 40 percent to 21 percent. The misallocation of low-interest loans to unqualified risky borrowers and the absence of any other transparent criteria to justify so much rent transfer or to manage its allocation suggest the existence of suspect rents and indicate the likely existence of corruption.

The competitiveness of bidding for government contracts can also serve as a proxy for suspect rent allocation, and indicate likely procurement corruption. By electing to restrict its dealings to a single supplier, the government can provide a firm with a tremendous bargaining advantage and a possible monopoly rent. In fact, immediately following democratization, three separate Korean government investigations identified the prevalent abuse of private (or so-called negotiated) government contracts as a prime means used by the dictator Chun to amass wealth through receipt of bribes and purchase of underpriced public land.50 To block future private contract corruption following democratization, three opposition parties and the ruling party eliminated two articles of the Budget Accounting Law that had provided legal basis for Chun’s use of private contracts—the Public Interest Corporation Contract clause and an article authorizing private contract use depending on “the purpose or characteristics of a project”—and required Assembly approval in place of a presidential mandate for future private contract use only in clearly delineated, exceptional cases.51 The legal revisions produced a major decline in both the overall number and individual size of private contracts used by central and local governments, public organizations, and government enterprises. Central government private contracts constituted 58 percent of the amount of total contracts in 1985 but only 7.7 percent in 1997, while government enterprise private contracts fell from 65 percent in 1982 to 6 percent in 1991, public body private contracts from 47 percent in 1983 to 15 percent in 1993, and local government private contracts from 54 percent in 1982 to 12 percent in 1991.
The average size of individual private contracts also dropped, for local government from 2.7 times the average competitive contract in 1982 to half the average competitive contract in 1994; and for the central government, from 1.7 times the average contract in 1985 to half the average competitive contract in 1995. Korean private sector contracts, conversely, remained stable, and even rose for a brief period during the mid-1990s (see Figures 2 and 3).

Conclusion
Corruption takes place behind closed doors and is difficult to assess. Scholars have thus relied primarily on surveys to measure popular and expert perceptions of corruption. Cheap poll data offer the advantage of a large-N basis for secondary cross-national studies that seek to identify causes of corruption. Popular images of corruption, however, can be heavily influenced by press coverage rather than by actual incidence of the crime, while expert assessments are often based on experts reading

Figure 2 Share of Private Contracts

Source: Construction Association of Korea Statistical Research Division, various years.
the same reports and being influenced by each other’s statements. By freeing the press to cover previously proscribed stories on corruption, democratization can produce an unrelated rise in corruption stories and distort perceptions. Such was the case in Korea.

In such cases, corruption should instead be objectively measured with a hard-data approach that focuses on the outflow of rents—that “follows the money”—and then identifies possible connections to official receipt of personal favors. Even where a lack of data precludes establishing a clear link to private gain, corruption can be implied through cases of large-scale transfer of suspect rents, which lack regulations to direct allocation or limit official discretion or contradict stated policy objectives, and whose beneficiaries are firms that have failed to qualify for compensation through provision of public goods. Applying these tools to
the Korean case reveals that in contrast to popular perceptions, democ-
ratization produced a sharp reduction in the corrupt exchange of rents
through industrial restructuring programs, bank lending, and procure-
ment of government contracts. Developing methods to approximate and
track the allocation of rents thus opens up a potentially promising new
path forward in the study of corruption. Innovative hard-data techniques
can help shed light on previously unexplored territory in the hidden un-
derworld of corrupt dealings, serving as effective assets in the struggle
for good governance.

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nia, San Diego. His research concerns the effects of democratization on corruption,
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years. He was also among the first to use the Korean Freedom of Information Act to
gather sealed data for his dissertation. His articles have appeared in Asian Survey,
Journal of East Asian Studies, and Pacific Review.

Notes
1. Rents are defined by Tollison (1982) as “a return in excess of the resource
owner’s opportunity cost.”
2. Shleifer and Vishney (1993) deduce the cost of bribes based on the num-
ber of actors and degree of competition in the allocation of government services.
3. Johnston (2005) maintains that many nations beginning democratic tran-
sitions experience a surge of corruption and scandal, that democratization in
Central Europe and the Philippines did not reduce corruption, and that democ-
racy has not reduced corruption in India or eliminated corruption as a problem
in Italy and Japan.
4. Shleifer and Vishney (1993) provide the analogy of a tollbooth on a road,
where bribery under centralized authoritarian rule with a small ruling elite is
represented by a single tollbooth on one road, and bribery under democracy by
independent tollbooths at each town along the road.
5. This group of countries includes Slovenia, Hungary, Lithuania, Costa
Rica, South Korea, the Czech Republic, Slovakia, Mexico, Poland, and Ar-
gentina (Johnston 2005, 34).
6. Kang (2002) argues that (Korean) democracy “weakened the power of
the state and created incentives for politicians to provide even greater access to
businessmen in return for political funds.” Kang ignores the motives of Korean
authoritarian leaders for funds to purchase the loyalty of core supporters, how-
ever, and most importantly, Kang’s own data undermine his argument. Kang’s es-
timates of political contributions show a relative decline in annual campaign and
party expenses as a share of GDP—from over 3 percent under “authoritarian”
Park Chung Hee to .22 percent in the 1990s under democracy. Kang seeks to ap-
proximate bribes with corporate jun joseh “quasi-taxes,” which include a wide
range of nonpolitical expenses (such as payments to the national pension, industrial
accident and health insurance, and the Red Cross, and compensation for traffic congestion, garbage disposal, or environmental damage). Quasi-tax accounting is transparent, and firms receive tax deductions for many payments. The political components of quasi-tax likely fell with the elimination of Chun’s forced contributions to his Saemaul Foundation and the Physical Education Foundation following democratization. While claiming otherwise, Kang’s own figures actually show an overall decline in quasi-taxes. Kang compares quasi-tax per sales under Chun (1980–1987) with quasi-tax per profits under democracy (1994–1998), naturally a much larger number, as profits are only a fraction of sales. Measured as a percentage of sales in both periods, quasi-tax payments by the top ten chaebol in the democratic period (1994–1998) averaged .31 percent, well below the .72 percent under authoritarian rule (1980–1987) (NIMA 1994–2000).

7. Quah (2004) quotes Shin Hae-Nam’s observation of democratic Korea: “Ironically, corruption grew as people became more affluent, and it was probably because of people’s new thinking that put material values ahead of moral values.” In “Special Team to Root-Out Graft Among Top South Korean Officials,” Straits Times, March 12, 1993, p. 11.

8. Jung is a type of affectionate bond between friends, which grows over time, reinforcing long-term personal relationships.

9. The third model of Shleifer and Vishney (1993, 610) refers to bureaucratic corruption, but their logic also applies to political competition, a point they concede. Shleifer and Vishney list several features of democracy, such as a system of law and a transparent and independent press that would increase the likelihood of detection and punishment of corruption.

10. Thirty-five government officials and politicians were found to be on the take in the Hanbo scandal. Opposition members gained knowledge of the scandal through the Assembly’s annual inspection of the government, a power gained in democratization that they used to secure hush money. See Schopf (2001) and “A Megaton Bomb, the Circulation of the Second List” (in Korean), Joongang Ilbo, April 16, 1997.

11. Examples include the World Business Environment Survey project and the UN’s International Crime Victims Survey.

12. As Lotspeich (1995) notes, “No party to the [corrupt] transaction has much incentive to report it.”

13. Lamsdorff (2001, 2), the CPI’s founder, concedes that perceptions of corruption may change rapidly, totally unrelated to occurrence of the crime: “Changes might be due to high level political scandals that affect perceptions, but do not reflect actual changing levels of corruption.”

14. Abramo (2005) discovered that perceptions of corruption more closely followed opinions on a variety of other matters than any experience or firsthand knowledge of corruption. Seligson (2006) found no match between perceptions and experienced corruption in a study of Latin America. The International Commercial Crime Survey and a survey by Miller (2006) also revealed a great discrepancy between perception and reported experience of corruption. While Italian and British businesspeople both reported similar levels of corruption victimization (under 2 percent), twice the share of Italians perceived corruption to be common.
15. Lippman (1965) argued that the media played a crucial role in shaping the public’s understanding of the world beyond direct experience. Numerous surveys across several different nations validate Lippman’s views in the modern television era. Knowles (1984), for instance, reports that 94 percent of US residents cited the news media as their most important source of information about crime. Miller, Godeland, and Koshechnkina (2002) found that media reports play a stronger role than experience in shaping respondents’ views of corruption. In Miller’s 2001 Polish Election Survey, 21 percent cited gossip and 47 percent cited the media as sources for views about junior official corruption.

16. As Lupia (1994) reveals, people use shortcuts to access relevant information during decisions, rather than inventoring each memory, especially where detailed information is scarce.

17. Priming information increases its cognitive availability, which Nisbett and Ross (1980, 18) define as “accessibility in the processes of perception, memory or construction from imagination.” The “cultivation theory” of Gerbner and Gross (1976) suggests that viewers come to “cultivate” television information by integrating it into their perceptions. The theory argues that the overrepresentation of crime shown on TV leads people to perceive a greater real-world incidence of crime as well.

18. Shrum (1995) shows that episodic reporting of corruption stories, as a series of unrelated individual events, compounds the problem by depriving consumers of social or historical context necessary for reasoned evaluation.


20. The number of articles in the *Chosun Ilbo* containing the Korean word for corruption (boojung bupeh, boojung biri, or biri) exploded from an average of thirteen per year under the Chun regime (1980–1987) to an average of 748 per year under democratic governments (1988–2005). Media coverage of corruption trials is the prime source of corruption information for the public, and an increase in stories is sufficient to influence its perceived rates of corruption, regardless of the guilt or innocence of the defendant, which may take a year or more to determine.

21. Nye (1967) establishes the legalistic definition of “corruption as a behavior which deviates from the formal duties of a public role because of private-regarding . . . pecuniary or status gains.”

22. Shleifer and Vishney (1993) point this out. They refer to this type of corruption as “provision of government services with theft.”

23. While Johnston (2005) argues that the scale of corruption is not important, scale can indicate transaction cost and is important for that reason.

24. Other scholars also adopt hard-data approaches to measuring bureaucratic corruption. Di Tella and Schargrodsky (2002), Golden and Picci (2005), Reinikka and Svensson (2003), and Olken (2006) have tracked the flow of funds and resources to spot instances of overpayment by government agencies to private actors through procurement, or of undersupply of resources from the central government to local government bodies. This approach is less suited for grand, or elite, corruption, where the political leaders are likely to manipulate ledgers to conceal any resulting discrepancy.
25. Proxy variables are commonly utilized in the social sciences to capture an indicator of unobservable phenomena, including corruption (Maddala 1992). Some examples include using years of education as a proxy for intelligence, per capita auto ownership and caloric consumption as indicators of income (Saltz 1995), refrigerators as a proxy for energy consumption, and the interest rates paid on sovereign debt to estimate transparency of governance.

26. With assistance from the People’s Solidarity for Participatory Democracy (PSPD), I filed a freedom of information request with the National Assembly Administrative Affairs Office on May 19, 1998, under the newly passed Korean Freedom of Information Act. My request covered several hundred thousand pages of sealed documents detailing the exchange of bribes under the Fifth Republic that had been provided by various ministries to National Assembly members participating in the 150th General Assembly’s closed session 38th Special Inquiry into Corruption, held in 1988. Materials I received under this request will be noted as “Korean FOI request material.”

27. Goudie and Stasavage (2000) list numerous means by which the government can channel rents to private firms: public expenditures, purchases of assets and services by suppliers, contractors, and operators, provision of licenses (through price and allocation of licenses), allocation of foreign exchange, privatization (through determination of asset valuation, and terms and conditions of sale), determination of prices in the private sector and allocation of low-priced goods, tax inspection (determining liabilities and collecting them), and purchases by public enterprises. Licenses can be provided for entry into a new sector, import or export of products, zoning for new construction, bidding for a construction job, or purchase of a state industry.

28. Under Chun, most low-interest loans were provided through the industrialization rationalization programs studied in the article.

29. Chang (2006) argues that the Korean government used rents to promote rapid industrial development. Chang argues that this was possible since the bureaucracy enjoyed sufficient information to pick winners, rent-seeking costs were minimized by having only a few chaebol seekers, and the state removed rents after they were no longer needed to compensate for learning costs.

30. Bank financial favors were subsidized by BOK 3 percent loans, and in the first rationalization case (of the Kukje Group) when a bank resisted (Korea First Bank), it was overruled by the Blue House.

31. Based on discussion with professionals in the Korean securities market, the study selects as a time horizon the interval from one week preceding a relevant event to two weeks afterward. Examining the interval before the event takes into account the possibility of news leaks, particularly plausible with regard to the release of financial statements, the preliminary drafts of which must receive firm approval prior to final release.

32. Chun testified that he provided the members of his party with $25 million annually for over seven years. See “Investigation of Chun’s Use of Slush Funds” (in Korean), Joongang Ilbo, February 5, 1996.

34. Immediately prior to implementation of a Kukje’s Korean Federation of Banks (KFB) self-rescue on February 5, Blue House and MOF officials concocted a rival “Plan B” to dissolve the group, which the minister of finance, Kim Mahn-Jeh, presented along with the KFB Kukje rescue plan to Chun, who selected Plan B. Kim Mahn-Jeh then ordered his Financial Bureau chief, Kang Hyun-Wook, to write KFB’s announcement of the Kukje Dissolution, using a copy of KFB president Lee’s signature. Chun then ordered KFB to assume Yang’s assets and shares. Midlevel managers at MOF and KFB were entirely excluded from the decisionmaking process (Yang vs. MOF Ruling 1993).


36. The aid included 4.19 trillion won in postponement and exemption of interest repayment, 1.64 trillion won in postponed principal repayment with normal receipt of interest, 986.3 billion won of principal written off, 460.8 billion won in new preferential rate loans, and 173.9 billion won in tax exemptions.


38. Chun accumulated twice as much in bribes as did his successor Roh Tae-woo (950 billion won versus the latter’s 460 billion won), according to the prosecutor. See “Corruption Styles of the Fifth and Sixth Republics” (in Korean), *Chosun Ilbo*, February, 17, 1997.

39. Logistics regression was used due to the binomial distribution of the dependent variable—one group of firms receiving government rents, another group not. Rent here not only takes financial assistance into account, but also includes an estimation of the above-market price garnered by firms through uncompetitive contracts.

40. Roh’s corruption had migrated to the less lucrative area of licensing.


42. Daewoo would generate 150 billion won by dealing 13 percent of Daewoo Kim’s personal holdings in Daewoo Securities to other affiliates, 150 billion through the sale of five affiliates, and 50 billion through the sale of affiliate shares and real estate, including the Daewoo building. In return, the Korean Development Bank (KDB) would provide a seven-year deferment followed by a ten-year repayment for 250 billion won of Daewoo debt (equivalent to a 147.5 billion won benefit). “Decision to Provide Conditional Support, A Tug of War Beyond the Government’s Ability” (in Korean), *Joongang Kyungjae*, March 28, 1989.

43. From March 22, approximately one week prior to the announcement of the deal, to April 13, two weeks after, Daewoo Corporation lost 102.7 billion won (41.8 million shares x W2,454 below KOSPI), Daewoo Heavy Industry lost 109.293 billion won (32.6 million shares x W3,353 below KOSPI), Daewoo
Electronics lost 92.2 billion (35.9 million shares × W2,653 below KOSPI), and Daewoo Securities lost 531.2 billion won (32.8 million shares × W16,168 below KOSPI). KSE, KSE Data Base (Seoul: KSE, July 1996), CD-ROM.

44. The chaebol requested debt-to-equity swaps, debt write-offs, deferment of debt repayment at privileged rates, infusion of fresh capital, and tax reductions.

45. Hyundai paid 5,264.27 won per share to take over Hanhwa on April 1, 1999, when Hanhwa Energy shares traded at 4,300 won each and had traded under 4,000 won since April 1998. LG was able to secure a price of 28,064 won for shares that had consistently traded under 15,000 won during the preceding year.


49. The Hanbo group, the fourteenth largest chaebol in 1995, received $4.5 billion in bank loans to construct the Tangjin steel plant despite a 1892 percent debt capital ratio and $116 million in losses in the first half of 1996. It was later revealed that Hanbo’s head, Chung Tai-soo, secured the loans with $5 million in bribes distributed to up to thirty-five politicians and bureaucrats (Schopf 2001).

50. The prosecutor’s investigation of New Village Movement corruption in March 1988, and the National Assembly’s Inspection of Government in October 1988 and Special Investigation into Fifth Republic Corruption in January 1989 uncovered wide-scale corrupt manipulation of private contracts under Chun. Chun’s older brother Chun Kyung Hwan had ordered Seoul city mayor Yeom Bo Hyun to use private contracts to generate bribes through land purchases and construction projects. Private contracts were used on 46 percent of Seoul city land sales, and 61 percent of construction orders, 47 percent of the Public Procurement Office’s orders in 1987, 61 percent of large-scale government construction projects, including 90 percent of the Construction Ministry’s orders on the mammoth Peace Dam project, 68 percent of Construction Ministry orders, and most military equipment acquisition. See “Chun Kyung Hwan and 12 Others Indicted” (in Korean), Joongang Ilbo, April 16, 1988; “47 Percent of Public Procurement Office Orders Are Private Contracts” (in Korean), Joongang Ilbo, October 10, 1988; “312 Large-Scale Construction Projects, 61 Percent, Are Private Contracts” (in Korean), Chosun Ilbo, October 9, 1988.

51. Examples are small projects under 100 million won that could not justify the expense of holding a competitive bid; ongoing projects where contracting with the current firm was favorable; natural disaster; national security; or contracting between public bodies. See “Discretion Decreased over Private Contracts” (in Korean), Joongang Ilbo, October 12, 1989.

References


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