Crony Capitalism

CORRUPTION AND DEVELOPMENT IN SOUTH KOREA AND THE PHILIPPINES

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The Puzzle and the Theory

I am convinced, therefore, that Korean politics will not be reformed unless the standards of the people are raised, a change of generations is promoted, the contents of elections are studied, and an open system for the procurement of political funds is worked out by means of consistent policies.

– Park Chung-hee

Have we earned the right to continue to demand . . . continued trust and confidence in us? Unless we can confidently answer these questions, we dare not proceed. . . . Now is the time to cut off the infected parts of society from active public life, before they endanger the entire body politic.

– Ferdinand Marcos

When the Hanbo Steel Company of South Korea went bankrupt in early 1997, an inquest discovered that at least two billion dollars had evaporated from its accounts, most likely ending up in the pockets of political or business elites.[1] Upon his arrest for bribery, Hanbo's chairman, Chung Tae-soo, privately let it be known that if the government pressed its case against him too vigorously he would unleash an "atomic bomb" (*poktan*) and implicate bankers and politicians who had been involved with Hanbo over the years.[2] Chung was convicted, although the case was not pursued with particular vigor. While numerous observers professed to be shocked – Shocked! – at the revelations, in reality such scandals are a recurrent theme in Korean political history, and the exchange of money for political influence has been not just an open secret, it has been common knowledge. Since independence in 1948, Korea has seen a seemingly endless flow of

[1] Yoon Young-ho, "Chŏng Tae-su wa kŏmŭn ton" (Chung Tae-soo and black money), *Shindonga* (March 1, 1997): 201.

[2] From a businessman close to the investigation, March 1997.

corruption scandals bring down scores of elites. Among those who have served time in jail or been exiled are former presidents Chun Doo-hwan and Roh Tae-woo, members of many presidential staffs, and a slew of military officers, politicians, bureaucrats, bankers, businessmen, and tax collectors.[3]

For decades the scholarly literature largely ignored the prevalence of money politics as inconsequential or as peripheral to the "real story" of South Korea: economic growth led by meritocratic technocrats and austere military generals. Growth was so spectacular that the reality of corruption was concealed or was dismissed out of hand. The rapid growth of the Asian economies evoked a mixture of wonder and fear. Sometimes called miracles, or Tigers, countries such as Korea, Taiwan, Singapore, and Hong Kong leapt from poverty to riches within a generation. And until late November 1997 and the stunning fall of the Korean *won*, observers argued that better government in Asia was a prime reason for that region's spectacular growth. This perspective held up Asia's seemingly neutral bureaucracies, effective politicians, and hardworking businessmen as central factors in economic growth.[4]

In contrast, scholars have held up the Philippines as the paradigmatic corrupt state, typified by its former president Ferdinand Marcos. The Philippines failed to develop rapidly because of government meddling, powerful business sectors that reaped windfall gains from government largess, and incompetent civil servants. The entire world knows about Imelda Marcos's 2,000 pairs of shoes and about the abuses that occurred at the Malacañang presidential palace. The Philippines, to this day, has a public image of cronyism, corruption, and bad government retarding its development.

The Asian financial crisis of late 1997 abruptly changed the West's view of Asia. Overnight, Korea was lumped in with the Philippines and roundly criticized for cozy government-business relationships that – in the pierc-

[3] For good overviews of the 1995 scandals, see Ahn Byoung-yong, "pichagŭm kwa taekwŏn yokŭi chuakhan janch'i" (The disgusting feast of illicit funds and presidential hunger for power), *Shindonga* (December 1995): 112; and Kim Yong-suh, "No Tae-u kusokgwa YS ŭi sŏntaek" (The detention of Roh Tae-woo and Kim Young-sam's choices), *Sisa Wolgan* (December 1995): 56–65.

[4] For representative views, see Peter Evans, *Embedded Autonomy* (Princeton: Princeton University Press, 1995); Alice Amsden, *Asia's Next Giant* (Cambridge: Cambridge University Press, 1989); and Chalmers Johnson, "Institutions and Economic Performance in South Korea and Taiwan," in *The Political Economy of the New Asian Industrialism*, edited by Frederic Deyo (Ithaca: Cornell University Press, 1987), pp. 152–155.

ing hindsight of instant experts – were obviously corrupt, inefficient, and backward. Focused only on explaining successful outcomes, the conventional model provided no analytic way to make sense of the 1997 crisis. Countries previously regarded as miracles now were nothing more than havens for crony capitalists who got rich the easy way. The result was a scramble to reinterpret the newly industrializing countries. But the pendulum may have swung too far – from excessive praise for the Asian juggernaut in the 1980s to excessive contempt for Asian business practices in the 1990s.

How can we reconcile rapid growth in East Asia before 1997 with reports of extensive money politics in those same countries in 1998 and 1999? How do we explain extensive money politics in Asia? How does money politics affect our understanding of the developmental state?

I. *The Argument*

Politics is central to the answer. In this study I make two arguments. First, both Korea and the Philippines experienced significant corruption throughout the postindependence era. Second, political – not economic – considerations dominated policy making in both countries. Focusing on the exchange of favors for bribes between state and business, I argue that politics drove policy choices, that bureaucrats were not autonomous from political interference in setting policy, and that business and political elites wrestled with each other over who would reap the rents to be had. Even in Korea, corruption was far greater than the conventional wisdom allows – so rampant was corruption that we cannot dismiss it; rather, we need to explain it.

Although money politics – corruption and cronyism – is generally seen as inhibiting economic growth, there are certain conditions in which it can actually be beneficial. Developing countries typically have weak institutional structures. In that case, *if there is a balance of power among a small and stable set of government and business elites, money politics can actually reduce transaction costs* and make long-term agreements and investments more efficient, even while enriching those fortunate few who collude together.[5]

[5] For overviews of transaction costs, see David C. Kang, "South Korean and Taiwanese Development and the New Institutional Economics," *International Organization* 49, no. 3 (Summer 1995): 555–587; Oliver E. Williamson, *The Economic Institutions of Capitalism* (New York: The Free Press, 1985); Douglass North, "A Transaction Cost Theory of

This political hypothesis can differentiate Korea and the Philippines while also bridging the boom years and the crisis.[6] For too long scholars have focused on bureaucrats and on outcomes. To understand the contrasting economic outcomes of Korea and the Philippines, one must directly address corruption and politics.

The crisis was not caused overnight, and the historical structures that led to the crisis will endure long after the events of 1997 have faded from memory. Using Korea and the Philippines as case studies, I explore the politics of the developmental state by focusing on the interplay of institutions and money politics. In both countries, growth and corruption existed side by side for decades. Even in the period of rapid Korean growth, a political calculus, not economic efficiency, was the crucial factor in determining economic policy. But the configuration of actors that facilitated rapid growth in Korea in the 1960s was undermined by its very success and eventually led to the crisis of 1997. In the Philippines, a different configuration of actors retarded development for decades. It seems finally to have altered, and perhaps the strong growth of the 1990s is the beginning of an upward trend.

The political hypothesis advanced in this study suggests a new direction for our research about the developmental state. Situated at the intersection of international relations and comparative politics, and comprising a set of ideas about institutional arrangements and policy choices, the developmental-state perspective held up Asia's seemingly neutral bureaucracies, effective politicians, and consistent trade policies as central factors in economic growth.[7]

Politics," *Journal of Theoretical Politics* 2, no. 4 (1990): 355–367; and Barry Weingast, "Constitutions as Governance Structures: The Political Foundations of Secure Markets," *Journal of Institutional and Theoretical Economics* 149 (March 1993): 286–311.

6 For a study with the same goal as mine but for Japan, see Robert Bullock, "Politicizing the Developmental State: Agriculture and the Conservative Coalition in Postwar Japan" (MS, U.C. Riverside, 2001).

7 The focus on state institutions includes Weberian bureaucracies that are autonomous from political and social interference. Among many who hold this view, Peter Evans has argued that "highly selective meritocratic recruitment and long-term career rewards create commitment and a sense of corporate coherence." Evans, *Embedded Autonomy*, p. 12. Alice Amsden also writes that "economic success in Korea challenges the assumption . . . that government intervention degenerates into 'rent-seeking.'" Amsden, *Asia's Next Giant*, p. 327. For other specific instances, see Karl Fields, "Strong States and Business Organization in Korea and Taiwan," in *Business and the State in Developing Countries*, edited by Sylvia Maxfield and Ben Ross Schneider (Ithaca: Cornell University Press,1997), p. 126; Johnson,

However, the literature on the developmental state led us down the wrong analytic path. This literature implied that corruption and growth simply cannot coexist. As a result, our view of Asia has become excessively focused on explaining either why these countries were not corrupt or why growth was not as spectacular as popularly believed.[8] South Korea has reported phenomenal growth over the past thirty-five years; the Philippines has not. Working backward from successful economic outcomes, one easily falls into the presumption that Korea *must* have had less corruption and better government than the Philippines merely because it had such rapid growth.[9]

This is not to argue that there has been no scholarship on Asian corruption. Especially in the wake of the 1997 financial crisis, the past few years have seen a number of studies that have begun to address the issue of corruption in Asia. These works, however, have tended to concentrate on two areas of research that have generally not responded to each other. The first area has focused on explaining different types of corruption, with only passing reference to how this affects our understanding of economic growth.[10] The second area has largely been focused on assessing whether and to what extent corruption was a factor contributing to the 1997

"Institutions and Economic Performance in South Korea and Taiwan," p. 152; and Ziya Önis, "The Logic of the Developmental State," *Comparative Politics* 24 (1991): 114. The major policy focus is on export-oriented industrialization, with a state that "in direct exchange for subsidies . . . exacts performance standards from firms." Amsden, *Asia's Next Giant*, p. 146.

[8] On rent seeking, see James Buchanan, Robert Tollison, and Gordon Tullock, eds., *Towards a Theory of the Rent-Seeking Society* (College Station: Texas A&M University Press, 1980); and Anne O. Krueger, "The Political Economy of the Rent-Seeking Society," *American Economic Review* 64 (1974): 291–303. For a revisionist view of Asian growth, see Alwyn Young, *Lessons from the East Asian NICS: A Contrarian View* (NBER Working Paper 4482, 1993).

[9] "If *H*, then *I*. *I* is true, therefore *H* is true." Carl Hempel, *Philosophy of Natural Science* (Englewood Cliffs, NJ: Prentice-Hall, 1966), p. 7. On selection bias, see Gary King, Robert Keohane, and Sidney Verba, *Designing Social Inquiry* (Princeton: Princeton University Press, 1994).

[10] See Byeong-Seog Park, "Political Corruption in South Korea: Concentrating on the Dynamics of Party Politics," *Asian Perspective* 19 (Spring/Summer 1995): 163–193; Beatrice Weder, *Model, Myth, or Miracle: Reassessing the Role of Governments in the East Asian Experience* (New York: United Nations University Press, 1999); Richard Mitchell, *Political Bribery in Japan* (Honolulu: University of Hawaii Press, 1996); and Jeffrey A. Winters, "Suharto's Indonesia: Prosperity and Freedom for the Few," *Current History* 94 (1995): 420–424.

financial crisis.[11] For example, Stephan Haggard writes that "in Western commentary, these [causes] are frequently reduced to corruption, cronyism, and nepotism . . . but the sources of vulnerability . . . sprang from the political commitments of governments."[12] But this body of literature tends not to explore how the Asian countries experienced rapid growth in the first place. Whereas both strands of research are important, an extended dialogue about the relationship between money politics and Asian development has only begun to occur, and a comprehensive treatment of the issue has yet to appear.[13]

The Korean and Philippine experiences suggest broader implications for the study of government-business relations in developing countries. Most important, a model of politics is central to understanding the developmental state. We cannot assume benevolence on the part of the developmental state. A "hard" view of the developmental state – that the state is neutral, picks winners, and provides public goods because the civil service is insulated from social influences – is difficult to sustain empirically. However, even the "soft" view – that governments can have a beneficial effect however government action is attained – needs a political explanation. The Korean state was developmental – it provided public goods, fostered investment, and created infrastructure. But this study shows that this was not necessarily intentional. Corruption was rampant in Korea, and the state intervened in the way that it did because its doing so was in the interests of a small group of business and political elites. The production of public goods was often the fortunate by-product of actors' competing to gain the private benefits of state resources.

11 On cronyism and corruption as causes of the financial crisis, see Giancarlo Corsetti, "Paper Tigers? A Model of the Asian Crisis," *European Economic Review* 43, no. 7 (June 1999): 1211–1236; Gerald Segal and Davis Goodman, eds., *Towards Recovery in Pacific Asia* (London: Routledge, 2000); Callum Henderson, *Asia Falling: Making Sense of the Asian Crisis and Its Aftermath* (New York: McGraw-Hill, 1998); and T. J. Pempel, ed., *The Politics of the Asian Financial Crisis* (Ithaca: Cornell University Press, 1999). For a counterargument, see Ha-joon Chang, "The Hazard of Moral Hazard: Untangling the Asian Crisis," *World Development* 28, no. 4 (April 2000): 775–788.

12 Stephan Haggard, *The Political Economy of the Asian Financial Crisis* (Washington, DC: Institute for International Economics, 2000), p. 10.

13 Two good works in this vein are Richard Doner and Ansil Ramsey, "Thailand: From Economic Miracle to Economic Crisis," in *Asian Contagion: The Causes and Consequences of a Financial Crisis*, edited by Karl D. Jackson (Boulder, CO: Westview Press, 1998); and Andrew Wedeman, "Looters, Rent-scrapers, and Dividend-collectors: Corruption and Growth in Zaire, South Korea, and the Philippines," *Journal of Developing Areas* 31 (Summer 1997): 457–478.

It is unwise to focus on individual policy choices (for example, export-oriented industrialization, or EOI) or specific institutional arrangements (the bureaucracy) as isolated issues. Institutions and policies are intervening variables, and the larger institutional environment – in this instance the government-business relationship – affects any specific issue.[14] Both institutions and policies comprise a wide range of issues. Institutions are more than just the organization of the state – they can be legal or corporate as well – whereas policies comprise trade, regulatory and financial policies. A distorted picture will emerge if we focus mainly on state institutions and ignore industrial organization, or if we focus on trade policy and ignore lax regulatory and financial policies. The case studies in this book show that political and economic entrepreneurs are quite resourceful and that institutional design or policy choices are subject to manipulation, evasion, and modification.[15]

Additionally, transaction costs – the costs of making, monitoring, and enforcing agreements between actors – are affected by the larger institutional environment. This study shows that certain configurations of government and business elites (what I call "mutual hostages") can reduce transaction costs and actually promote growth. The argument that follows suggests that to understand policy making in developing countries, one must first understand, for each country, the particular political challenges faced by individual leaders, and their close supporters, and the manner in which business attempts to influence policies. The strategic allocation of economic policy and benefits is an important political resource. The relationship between government and business elites differs in each country, and another source of constraints is the international system. Different countries face different international pressures, and not all countries race from the same starting line nor run under similar conditions. Most important in the international system are the external threats that can cause leaders to pay more attention to growth and efficiency.

One reason that scholars have not dealt with these issues in detail has been an overwhelming preoccupation with explaining economic outcomes. Those analysts who are not trying to explain growth tend to paint a far

[14] Douglass North, "The New Institutional Economics," *Journal of Theoretical and Institutional Economics* 142 (1986): 230–237; and Oliver Williamson, "Comparative Economic Organization: The Analysis of Discrete Structural Alternatives," *Administrative Science Quarterly* 36 (1991): 269–296.

[15] Oliver Williamson, *The Economic Institutions of Capitalism* (New York: Free Press, 1985).

darker and more abusive picture of Korean politics than those trying to explain why what was essentially gangster rule in Korea was actually good for growth. Mark Clifford describes Korea as a "culture of rage," Gregory Henderson depicts Park Chung-hee's rule as a swirl of factions unable to cohere, and Bruce Cumings sees a pattern of authoritarian strongmen.[16] Although it may be difficult to describe Korean politics in such pejorative terms and then explain Korea's remarkable economic outcomes, we must avoid falling into the trap of deciding a priori that Korean politics cannot have been corrupt because the country experienced strong growth. Alternatively, we need to explain the pattern of money politics in the Philippines, not just assert its existence.

I begin with an overview of Korea and the Philippines in which I emphasize both similarities and differences between the two countries. Domestic politics, the organization of society in both countries, has been more similar than is generally recognized, and much of the early economics in both countries was also similar. However, Korea and the Philippines differ in how both colonialism and the external environment at independence affected them. In Korea, Japanese and U.S. influences tended to disrupt the old order, and a severe threat from North Korea provided an impetus for growth. In contrast, in the Philippines, Spanish and American colonialism tended to reinforce traditional political and economic patterns, and the absence of any realistic threat provided Philippine leaders with little incentive to alter the existing arrangements.

This study next focuses on the role of the bureaucracy. One of the core tenets of the developmental-state perspective is the important role of the bureaucracy. However, the bureaucracy under Park Chung-hee was not substantially more autonomous or coherent than that under Syngman Rhee or Ferdinand Marcos. In addition, Korea did not have a "pilot ministry" directing development. Finally, government subsidies were not exchanged for performance standards – the endemic overcapacity of Korean industry is prima facie evidence that economic policy decisions were made for political reasons. In contrast, the Philippine bureaucracy was far more competent than is popularly believed. In both Korea and the Philippines rulers have reigned *and* ruled, and the bureaucracy has not been autonomous from political regime interests. The difference in quality

[16] Mark Clifford, *Troubled Tiger* (New York: M. E. Sharpe, 1994), p. 11; Gregory Henderson, *The Politics of the Vortex* (Cambridge, MA: Harvard University Press, 1967); and Bruce Cumings, *Korea's Place in the Sun* (New York: W. W. Norton, 1997).

between the Philippine and Korean bureaucracies is overstated. Although the Philippines suffers from poor political leadership, the bureaucrats themselves are well-trained and dedicated.

I then turn to domestic politics. The relative strength of the state and the business sector determines the form and level of money politics, which in turn has an impact on a country's development trajectory. I provide a model built upon an analogy with the economic example of markets to describe the pattern of corruption in Korea and that in the Philippines. This highly stylized model of corruption relies on the analogy between state/business to producers/consumers. Looking at the business sector as either concentrated or dispersed, and at political leadership as either coherent or fractured, leads to a matrix that predicts levels and types of corruption. In the most interesting combination, both state and business are strong and concentrated, leading to a situation of "mutual hostages" where both sides potentially benefit, and opportunism and exploitation are constrained.

Governments engage in three generic types of economic policy: trade policy, financial policy, and regulatory policy. In Korea, although trade policy in the 1960s was generally supportive of exports, financial and regulatory policies tended to work at cross-purposes. State control of the financial sector created incentives for business to focus on expansion over efficiency, and extensive and contradictory regulatory and tax policies gave the state discretionary power over the firms. The few dominant firms in Korea (the *chaebol*) thus nurtured their political connections as an important component of business strategy. The coherence of the state and the business sector prevented either from dictating events, and although money politics existed, it was constrained.

Understanding policy decisions requires understanding the political incentive structure within which actors make economic decisions. Political leaders use both pork and public goods strategically: neither pork nor policy is preordained, and both have political benefits and costs. Korea under Park may not have been different from Korea under Syngman Rhee in the extent to which the bureaucracy was politicized. However, whereas Korea has plenty of corruption and politicization in public works contracts and loan allocations, pockets of the bureaucracy were staffed with educated and trained people recruited through a competitive examination process. Park Chung-hee created a bifurcated bureaucracy that allowed him to meet his patronage requirements and still pursue economic efficiency. Such a bifurcation allowed Park to follow both an internal agenda aimed at retaining political power and "buying off" supporters and an external agenda focused on economic development.

Although the Philippines has exhibited some of the classic traits of a weak and predatory state, important distinctions also exist. The democratic era in the Philippines saw corruption, jurisdictional battles between the executive and the legislature, and a bureaucracy permeated by outside interests. The state was unable to formulate consistent or coherent economic policies. Under Marcos, however, the state became both more coherent and more autonomous from social interest groups. The problem under martial law was not a lack of state strength but the uses to which such strength was put. Marcos, like Park, followed an explicit political strategy, destroying the most potentially dangerous elite families, coopting others, and ignoring the rest. Marcos's strategy temporarily succeeded; there was substantial acquiescence to his rule for the first half of martial law. However, Philippine governmental policies always remained subject to manipulation, with trade policies focused on import substitution, financial policies never consistently implemented, and regulatory policies often a contradictory mix of special dispensations to favored cronies.

The pattern of Philippine money politics swung like a pendulum from excessive bottom-up rent seeking by society during the democratic period, to excessive top-down predation by Marcos and his cronies under martial law. From 1946 to 1972, particularistic demands from business overwhelmed the ability of the state to meet them, leading to corruption and incoherent policy making. With martial law beginning in 1972, the direction of corruption reversed, and Marcos used the power of the state to expropriate wealth for himself and his associates. Under Marcos, the Philippines had the potential to pursue a more disciplined developmental path, with a coherent bureaucracy and considerable state power. But Marcos lacked any constraint on his excesses, and as a result the Philippines lost its opportunity to grow rapidly.

The patterns in both Korea and the Philippines changed significantly with their democratic transitions in the mid-1980s. In Korea, the transition to democracy in 1987 diffused the power of the state. This led to increased demands for political payoffs as politicians began to genuinely compete for electoral support and to decreased ability of the state to resist or contain the demands of the business sector. The small number of massive Korean firms, unrestrained by any market forces because of their size, made increasingly risky decisions. Thus "too much" democracy combined with a still collusive business-government relationship resulted in increasingly ineffectual policy making, and the Asian financial crisis of 1997 brought this to light.

In contrast, by the early 1980s Ferdinand Marcos had run the Philippines into the ground. The dramatic uprising of "People Power" in 1986 leveled the playing field for both state and business. As the Philippines slowly recovered, state and business were less powerful and less coherent, leading the Philippines in the early 1990s to begin a painful restructuring process. The Philippines was less affected by the crisis of 1997 because some of those collusive government-business ties had been broken by the downfall of Marcos, speeding the process of reform. Largely owing to policy reforms and increased regulation of the financial sector, the Philippines fared relatively well in the crisis of 1997. The prospect for continued economic and political growth appears, if not inevitable, quite likely.

This book is about politics, and it centers on explaining the patterns of money politics. The argument adduced here, however, leads naturally to a question about economic growth. If both Korea and the Philippines experienced extensive corruption, why did Korea grow much faster than the Philippines? In the concluding section of the book I shift the emphasis from explaining money politics to exploring the relationship between money politics and development. Simply put, the balance of power among elites in Korea reduced transaction costs, while bandwagoning politics in the Philippines raised transaction costs. Although an imbalance between economic and political elites can lead to corruption spiraling out of control and choking off growth, where a rough balance does exist, corruption is contained. However, corruption is only one of many variables that affect development, and to answer the larger question of why Korea has developed but the Philippines has not we must be sensitive to a number of other factors that existed in Korea but not in the Philippines, including an external threat, extensive U.S. aid, and land reform, in addition to the balance that limited corruption and that is described in this book.

Leaders of states make deliberate choices about whether to constrain their ability to steal domestic capital. Standing at the intersection of domestic and international politics, and restrained by domestic institutions and international pressures, the leaders must deal with foreign countries, survive in domestic politics, and also craft economic policies. In making sense of why Korea initially succeeded, but the Philippines did not, we have to understand the broad contours of the relationship between big business and the state. By comparing the two countries, this book not only sharpens our perspective on the individual countries but also leads to further comparative research on politics, corruption, and development.

II. The Theory: Money Politics, Rent Seeking, and Corruption

I focus on the rent seeking and corruption that occur between public and private actors. At the heart of the model is the idea that those actors with excessive power will tend to abuse it. The dependent variable is the exchange between state and business of favors for bribes. The independent variable is the relationship between state and business. My analytic focus is on this larger institutional environment – the actual institutions of governance all exist within this larger relationship, and each specific institution is affected by this environment.

I use the term "money politics" because it is less normative than "corruption" and also because it highlights public-private interaction. Both "corruption" and "rent seeking" are broader terms, describing activities that can occur at the private-private level as well as vis-à-vis the state. James Buchanan defines "rent seeking" as "that part of the payment to an owner of resources over and above that which those resources could command in any alternative use."[17] Thus rents are created when an actor manipulates prices and causes them to diverge from competitive levels, and the existence of rents can lead to corruption by various actors attempting to gain access to the rents. By manipulating prices, the actor himself, or some other actor on whose behalf the price manipulator is acting as an agent, is able to reap "excess profits."[18]

Rents can be created in a number of ways, but a principal way is through state intervention.[19] The state uses its power to manipulate prices and

[17] James Buchanan, "Rent Seeking and Profit Seeking," in *Towards a Theory of the Rent-Seeking Society*, edited by James Buchanan, Robert Tollison, and Gordon Tullock (College Station: Texas A&M University Press, 1980), p. 3.

[18] Pranab Bardhan, "Corruption and Development: A Review of Issues," *Journal of Economic Literature* 35 (1997): 1320–1346; Serguey Braguinsky, "Corruption and Schumpeterian Growth in Different Economic Environments," *Contemporary Economic Policy* 14 (1996): 14–25; Kofi O Nti, "Comparative Statics of Contests and Rent-Seeking Games," *International Economic Review* 38, no. 1 (1997): 43–59; and Yoram Barzel, "Measurement Cost and the Organization of Markets," *Journal of Law and Economics* 25 (1982): 27–48.

[19] Ha-joon Chang, *The Political Economy of Industrial Policy* (New York: St. Martin's Press, 1994); Susan Rose-Ackerman, *Corruption: A Study in Political Economy* (New York: Academic Press, 1978); Andrei Shleifer and Robert Vishney, "Corruption," *Quarterly Journal of Economics* 108 (August 1993): 599–617; Margaret Levi, *Of Rule and Revenue* (Berkeley: Uni-

markets to generate rents. For example, import licenses confer rents by restricting the amount of goods that come into a country; actors who can import the restricted goods are able to sell those goods at a higher than market price, thereby obtaining rents.[20] By intervening, the government creates incentives for business to try to influence policy decisions. Corruption occurs when businessmen use bribery, personal connections, or some other means to attempt to influence policy decisions and gain rents. The distribution and volume of rents are thus a function of the relative strengths of the state and the business sector.

1. The Politics of Corruption

Were there no government distributing rents, there would be no corruption, and thus a key issue is how to model the government-business relationship. In examining both the supply and the demand for political corruption, this simplified model of the government-business relationship necessarily abstracts from a rich reality.

Following Shleifer and Vishney, a state can range from coherent to fractured.[21] A state is coherent if it can formulate preferences independent of social influences and if political leaders have internal control over their bureaucrats.[22] Although there are many possible configurations of the relationship among political leaders, bureaucrats, and political organizations (domestic politics: parties, associations, etc.), for the sake of simplicity I

versity of California Press, 1988); Paul Milgrom and John Roberts, "Bargaining Costs, Influence Costs, and the Organization of Economic Activity," in *Perspectives on Positive Political Economy*, edited by James E. Alt and Kenneth A. Shepsle (Cambridge: Cambridge University Press, 1990); Parimal Kanti Bag, "Controlling Corruption in Hierarchies," *Journal of Comparative Economics* 25 (1997): 322–344; and Mushtaq Khan, "The Efficiency Implications of Corruption," *Journal of International Development* 8, no. 5 (1996): 683–696.

[20] Corruption is thus a subset of rent seeking. Rents may be allocated purely on merit, or they may be allocated toward bribes.

[21] Shleifer and Vishney model different types of government structures, but they avoid studying how business organization may affect corruption. Shleifer and Visheny, "Corruption." Susan Rose-Ackerman discusses types of state organization similar to my work, although she does not use the terminology I employ here. See Rose-Ackerman, *Corruption*.

[22] On autonomy and state strength, see Peter Katzenstein, ed., *Between Power and Plenty: Foreign Economic Policies of Advanced Industrial States* (Madison: University of Wisconsin Press, 1978). On internal control (agency costs), see Matthew McCubbins and Thomas Schwartz, "Congressional Oversight Overlooked: Police Patrols versus Fire Alarms," *American Journal of Political Science* 28 (1984): 165–179; and Frances Rosenbluth and Mark Ramseyer, *Japan's Political Marketplace* (Cambridge, MA: Harvard University Press, 1993), Chs. 6 and 7.

focus on only two polar cases. The most coherent situation exists when political leaders have full control over their political organizations and their bureaucrats, and in this case leaders actively use domestic politics as a means of ensuring continued rule. At the other pole, the most fractured situation exists when leaders survive only tenuously, when they engage in constant conflict with political organizations over the form and content of the state, and bureaucrats can play off "multiple principals" to their own advantage.[23] At the heart is the question of control.

It is the interaction of government and business that is of interest, however, and we therefore need to understand business organization as well as government organization. My view of the business sector builds on the work of Michael Shafer.[24] He argues that the organizational characteristics of the predominant economic sector (e.g., mining or agriculture) have different implications for its relationship to the state. In sectors with high asset specificity and high production inflexibility, companies will be less responsive to market signals, and it will be harder for them to adjust quickly to exogenous shocks, either political or economic. These types of firms will have more incentive to resist attempts by the state to intervene. Alternatively, in sectors with low asset specificity, low production inflexibility, and low factor inflexibility, firms will be more easily influenced by exogenous forces.

The approach used here examines business more broadly than does Shafer. In this model, a strong concentrated business sector is the diversified business group, comprised of well-organized firms that cover many sectors of the economy.[25] As Ben Ross Schneider puts it, "big (and encompassing) is beautiful."[26] This definition of diversified firms is one in which companies cover many sectors rather than one, may have import-competing subsidiaries as well as export-oriented subsidiaries, and may have agricultural and urban firms. Given their cross-ownership of various subsidiaries and the range of their interests, these firms' interests cannot be neatly categorized. In addition, the larger that diversified business

[23] Pablo Spiller, "Politicians, Interest Groups, and Regulators: A Multiple-Principals Agency Theory of Regulation, or 'Let Them Be Bribed,'" *The Journal of Law and Economics* 33 (April 1990): 65–101.

[24] Michael Shafer, *Winners and Losers: How Sectors Shape the Developmental Prospects of States* (Ithaca: Cornell University Press, 1994).

[25] Amsden, *Asia's Next Giant*, p. 8.

[26] Ben Ross Schneider, "Elusive Synergy: Business-Government Relations and Development," *Comparative Politics* 31, no. 1 (October 1998): 109.

		state	
		coherent	fractured
business	small-N (concentrated)	I: mutual hostages type: PD collusion amount: medium	II: rent seeking type: bottom-up amount: large
	large-N (dispersed)	III: predatory state type: top-down amount: large	IV: laissez-faire type: residual amount: small

PD = Prisoner's Dilemma

Figure 1.1. The Four Types of Corruption

groups are relative to the economy as a whole, the more they are likely to attempt to influence government policy and the more they are likely to wield political influence. These conglomerates can be differentiated from single-sector, smaller, and less-diversified firms. On a spectrum, we might put individual artisans at one end, with Japanese *keiretsu*, Korean *chaebol*, Philippine family conglomerates, and Mexican *grupos* at the other end.[27]

We can now build the analogy for politics and corruption, with a coherent/fractured state along one axis and a concentrated/dispersed business sector along the other (Figure 1.1). In this model I take as given the initial distribution of rights and the type of actors. These are exogenous to the model, and I remain agnostic as to why and how society came to look a certain way.

2. Types of Corruption: Bottom-Up or Top-Down

Although the model is a simplified abstraction of the government-business relationship, it allows us to parsimoniously capture the underlying dynamics of how corruption occurs. There are two analytically distinct types of

[27] On Latin American conglomerates, see Kurt Weyland, "'Growth with Equity' in Chile's New Democracy?" *Latin American Research Review* 32 (1997): 37–68.

corruption: the top-down predation by a strong state on society, and the bottom-up rent seeking of powerful groups that overwhelm the ability of the state to contain and channel their demands. Neither one of these is analytically prior to the other, and both can occur under the right circumstances.

Top-down corruption has been best explicated in the notion of a "predatory" state.[28] The predatory state is one in which the state takes advantage of a dispersed and weak business sector. Political elites pursue outright expropriation; they also solicit "donations" from businessmen who in turn are either "shaken down" by the regime or who volunteer bribes in return for favors, and employ other means as well.[29] In contrast, bottom-up corruption occurs when social actors have the power to overwhelm the state. When the strength of the business sector is enough to force concessions from the state, rent seeking behavior results. Potential state influence over economic life is vast, and those businessmen or groups privileged enough to receive low-interest loans or import quotas will benefit at the expense of others.[30] Indeed, a typical problem in developing countries is being able to resist society's demands on the state.[31] When rent seeking demands become too onerous, the state is incapable of implementing decisions and growth is stifled.

The first two possibilities I consider are analogous to either a predatory state or a rent-seeking business sector. The typical case is that some group or segment of society has far more access to power than others, as in Cell III. When a country has a coherent state and a dispersed business sector, the result is predatory behavior by the state (top-down behavior) in which political elites can scrape off rents in a predatory manner. Political elites presiding over a coherent state will have the opportunity to take advantage of a fractured business sector.

Alternatively, when a concentrated business sector and a fragmented state exist, as in Cell II, the result is rent seeking (bottom-up behavior).

[28] Levi, *Of Rule and Revenue*, pp. 32–45.

[29] Charles Tilly, "The State as Organized Crime," in *Bringing the State Back In*, edited by Peter B. Evans, Dietrich Rueschemeyer, and Theda Skocpol (Cambridge: Cambridge University Press, 1985).

[30] For an interesting discussion along these lines, see Milgrom and Roberts, "Bargaining Costs, Influence Costs, and the Organization of Economic Activity"; and Chang, *The Political Economy of Industrial Policy*.

[31] Joel Migdal, *Strong Societies and Weak States: State-Society Relations and State Capabilities in the Third World* (Princeton: Princeton University Press, 1988).

Here rents created by the state flow to business, because the latter has colonized the former and transformed it into a sort of "executive committee." A business sector composed of strong interest groups may overwhelm the state with its various demands, leading to either policy incoherence or policy indecision. Many analyses of third-world countries emphasize that the state is a relatively recent, and hence weak, addition to the political scene. Strong interest groups may be able to capture control of the state and use the power of the state for their own ends.

Two other possibilities exist. In Cell IV there are numerous interest groups and diffuse power within the state. In this situation, no single group could have too much influence, and the "political market" would come close to clearing. This builds on Susan Rose-Ackerman's notion that "the role of competitive pressures in preventing corruption may be an important aspect of a strategy to deter bribery."[32] When both state and business are weak, rents are all but eliminated. Neither state nor business is powerful enough to take advantage of the other, and so exploitation is difficult. Many of the advanced industrial democracies – at least when compared with less-developed countries (LDCs) – may approximate this situation. As bureaucrats compete with each other to offer policy, thus driving the cost of a bribe toward zero, numerous capitalists also compete with each other for the policy, also driving the price toward zero. In Cell IV, corruption is lowest.

The final and most interesting case is Cell I, where both government and business are equally strong: there is a relatively coherent state but also a small number of powerful interest groups. In this instance, the level of rents is limited and the division relatively equitable. The result is "mutual hostages" in which the state and those powerful groups may collude with one another, but neither has the advantage. Cell I reflects the old saw: "If you owe the bank a little money, the bank owns you. If you owe the bank a lot of money, you own the bank." In this mutual hostage situation, both the political and economic elites are powerful enough to harm the other but are deterred from such actions by the damage that the other side can

[32] Susan Rose-Ackerman, "Bribery," in *The New Palgrave Dictionary of Economic Thought*, edited by John Eatwell, Murray Milgate, and Peter Newman (London: Macmillan, 1988), p. 278. See also Christopher Bliss and Ragael Di Tella, "Does Competition Kill Corruption?" *Journal of Political Economy* 105, no. 5 (1997): 1001–1023; and Shleifer and Vishney, "Corruption."

inflict.[33] As will be argued more fully in Chapter 7, this situation reduces transaction costs for both government and business elites.

In Cell I, rents can be had and corruption can occur, but the level of rents is constrained by the power of the other group. Small-N (business concentration) reduces transaction costs, and hence rent seeking, because a small-N eases monitoring and enforcement costs. In this situation, although there are rents to be earned by both business and state, the amount will be less than in the polar cases where one group dominates the other, and more than in the case where both groups are dispersed into a large number of small actors.

In this sense, strategic interaction between state and business corresponds to a prisoner's dilemma. Although in the short run either actor may be better off by defecting and gaining all the rents, the other actor retains the ability to punish defection over time, and thus grudging cooperation may ensue.[34] Cooperation in the strong/strong (Cell I) is not automatic. As in a prisoner's dilemma, both sides are better off defecting and grabbing all the rents for themselves. Indeed, Cell I could lead to a war of attrition, with both sides slugging it out. Even without active cooperation, however, exploitation will be limited by the power of the other side. In the Korean example, we will see that Park initially tried to take advantage of the business sector but then realized he was unable to do so.[35]

Thus the least corruption would occur in situations where both state and business are weak and disorganized, for neither group could take advantage of the other and all the groups would compete against each other, driving the price of corruption close to zero. The most corruption would occur when only one side is coherent, either state or business. A middle position exists when both state and business are strong and can take partial but not total advantage of each other.

3. Measurement

The theoretical concepts in this book are widely accepted and used in the social sciences, even though the difficulty in measuring them is also widely

[33] This is based on the idea of bilateral monopoly. See David Kreps, *Microeconomic Theory* (Princeton: Princeton University Press, 1992), pp. 551–573. See also Roger Blair, David Kaserman, and Richard Romano, "A Pedagogical Treatment of Bilateral Monopoly," *Southern Economic Journal* 55, no. 4 (April 1989): 831–841.

[34] Robert Axlerod, *The Evolution of Cooperation* (New York: Basic Books, 1984).

[35] The 1961 "Illicit Wealth Accumulation Act," or *puchŏng ch'uk'je an*, is an example of this.

acknowledged.[36] Recognizing this difficulty, in this study I focus on the polar cases in an attempt to lay out the ranges of the variables and test the model's plausibility.

Measuring the dependent variable of corruption and influence peddling is difficult. By their very nature these are acts that their actors wish to keep hidden. Although other scholars have used as evidence polls of perceptions of corruption, traced one pattern of corruption, or relied on corruption scandals, there is no comprehensive indicator of corruption.[37] But a variety of indicators can give us a sense of the size and pattern of corruption.[38] Occasional scandals reveal the pattern of influence. Estimates of campaign spending, kickbacks, and secret funds are useful first approximations. Tracing patronage and cronyism requires deep ethnographic knowledge.

Measuring the independent variables is only marginally easier. To measure the strength of the business sector I focus on a series of indicators, including sectoral concentration, employment, sales, and peak associations. Firms' value added as a proportion of gross domestic product (GDP) gives an indicator of their market and political power, and the

[36] See Stephen Krasner's discussion in *Defending the National Interest: Raw Materials Investments and U.S. Foreign Policy* (Princeton: Princeton University Press, 1978), esp. Ch. 1.

[37] Daniel Treisman, for example, uses the Transparency International index of perceived corruption as his measure of actual corruption in "The Causes of Corruption: A Cross-national Study" (MS, UCLA, 1997); Robert Wade traces the sale of office in India in "The Market for Public Office: Why the Indian State is Not Better at Development," *World Development* 13, no. 4 (April 1985): 467–497; and Chalmers Johnson follows the corruption scandals in Japan in "Tanaka Kakuei, Structural Corruption, and the Advent of Machine Politics in Japan," *Journal of Japanese Studies* 12, no. 1 (Winter 1986): 1–28. Other theoretically informed empirical work includes Stephen D. Morris, *Corruption and Politics in Contemporary Mexico* (Tuscaloosa: University of Alabama Press, 1991); Richard Doner and Ansil Ramsey, "Rents, Collective Action, and Economic Development in Thailand," paper prepared for presentation at the conference on "Rents and Development in Southeast Asia," Kuala Lumpur, August 27–28, 1996; Edgar Kiser and Xiaoxi Tong, "Determinants of the Amount and Type of Corruption in State Fiscal Bureaucracies: An Analysis of Late Imperial China," *Comparative Political Studies* 25, no. 3 (October 1992): 300–331; Richard Levy, "Corruption, Economic Crime, and Social Transformation since the Reforms: The Debate in China," *Australian Journal of Chinese Affairs* 95, no. 33 (1994): 1–25; and Andrew Wedeman, "Systemic Change and Corruption in China," paper delivered at the 95th Annual Meeting of the American Political Science Association, Atlanta, GA, September 2–5, 1999.

[38] Paul Hutchcroft, "Obstructive Corruption: The Politics of Privilege in the Philippines," in *Rent-Seeking and Development: Southeast Asia's Political Economies*, edited by K. S. Jomo and Mushtaq Khan (forthcoming); Wayne Sandholtz and William Koetzle, "Accounting for Corruption: Economic Structure, Democratic Norms, and Trade" (MS, UC Irvine, 1998).

composition and concentration of their bank loans indicate the firms' vulnerability to the state and other actors. Measuring state strength is necessarily more qualitative. To measure state coherence and low agency costs, I rely mainly on detailed case studies that follow the process of policy making, and I do not attempt to provide a single quantifiable measure for the variables. Case studies can reveal whether leaders act on their parties and domestic politics or whether they respond to them. Process tracing of both policy decisions and institutional origins can reveal whether there is agency slack between leaders and bureaucrats.

III. Conclusion

Korea and the Philippines both had extensive corruption that permeated the normal politics of elections, economic policy making, taxation, and the day-to-day running of the country, and similar institutional structures led to similar patterns of money in both countries. However, Korea and the Philippines had different social organizations and different constraints and incentives that affected their pattern of money politics. Corruption in Korea, although endemic, was constrained by the collusion of a powerful business class and a coherent state. Each major group was able to benefit from its close relationship with the other, but neither could ever gain the upper hand. Despite each group's constant bemoaning of its counterpart's utter lack of qualifications, each needed and relied upon the other. In contrast, corruption in the Philippines swung like a pendulum. As one group or the other gained predominant power, it would busily set about lining its own pockets, aware that in the next round its fortunes might well be reversed.

The key to understanding patterns of money politics is the government-business relationship. Too much power in the hands of either political or economic elites invites abuses in the form of rent seeking and corruption. A balance between elites allows less discretion and less abuse. To explore the abstract propositions presented in this chapter, we now turn to a detailed study of Korea and the Philippines.