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## Rent-Seeking and Economic Development in 20th Century South Korea

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RENT-SEEKING AND ECONOMIC DEVELOPMENT IN 20TH CENTURY SOUTH KOREA

by

Asher Bergman

A thesis submitted in partial fulfillment of the requirements  
for graduation with Honors in the International Studies

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Marina Zaloznaya  
Thesis Mentor

Spring 2018

All requirements for graduation with Honors in the  
International Studies have been completed.

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Emily Wentzell  
International Studies Honors Advisor

THE UNIVERSITY OF IOWA

UNDERGRADUATE SENIOR THESIS

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**Rent-Seeking and Economic  
Development in 20th Century South  
Korea**

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*A thesis submitted in fulfillment of the requirements  
for the degree of Bachelor of Arts*

*in the*

College of Liberal Arts and Sciences

International Studies

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# Abstract

Asher Bergman

*Rent-Seeking and Economic Development in 20th Century South*

*Korea*

South Korea is often regarded as a success story of economic development, as it went from a largely agrarian society with widespread poverty to an industrialized and prosperous nation in a handful of decades. However, this development was accompanied by widespread rent-seeking and corruption within the political system. Much of this early growth was created through the rent-seeking relationship between the authoritarian government and the chaebol; the large conglomerate corporations which produced much of the growth observed during the 20th century. Contrary to the popular notion of corruption's negative impact on economic growth, political corruption in Korea actually aided its economic development. This was due to the incentives and constraints attached onto the chaebol's rent-seeking by the government. The government forced the chaebol to use its gains from rent-seeking for productive purposes through the former's control of the banking industry and its guarantee of financial protection as long as the chaebol followed the government's lead. Additionally, rent-seeking in the government was constrained because of the limits placed onto entry into the authoritarian political system. However, this relationship no longer functioned in an effective way after Korea democratized, the consequences of which led to the problems and reforms of the Asian financial crisis.

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## Background:

The Korean peninsula has had a tumultuous experience in modern history, beginning with the collapse of the long-ruling imperial *Joseon* dynasty in 1911 and becoming a Japanese colony, being split in two by the US and USSR and eventually going through several years of civil war. In the wake of these events, South Korea transformed from a very poor nation into the world's 11<sup>th</sup> largest economy. This stark economic and political transformation-which occurred in a remarkably compressed timeframe-has been widely praised as a model for developing nations today.

Yet, the most consequential aspects of Korea's post-war economic model are quite contrary to the prevailing economic doctrine espoused by most developed nations. The high growth that South Korea experienced in the latter half of the 20th century only occurred under the auspice of several authoritarian and often violently repressive political regimes. In addition, these early-modern Korean administrations placed themselves at the center of control and decision-making over the private and financial sectors (Chwa and Lee, 2004, 4).

In addition to being heavily planned by the state, South Korea's economic production during the 20th century was heavily reliant upon the *chaebol*; colossal, horizontally integrated conglomerate corporations which remain the predominant growth producers in South Korea today, such as Samsung, LG, and Hyundai. Unified planning and cooperation between the *chaebol* and the central government was the hallmark of Korea's economic model, particularly during the leadership of Park Chung-Hee (1961-1979). At that time, the state entered into a union with business groups to foster economic development, setting the terms of the arrangement through actions like nationalizing the banks and controlling the *chaebol's* supply of capital. The priorities of the state and the *chaebol*, however, were bound together by a unified interest in catching up with industrialized nations, many describing the two parties as the mechanisms of "South Korea, Inc." (Cheng and Chu, 2002, 33).

However, extensive rent-seeking, often in the form of bribes between *chaebol* executives and government officials in exchange for preferential contracts and guaranteed political support, has accompanied Korea's economic development throughout the 20<sup>th</sup> and 21<sup>st</sup> centuries. Contrary to the conventional wisdom that corruption hampers economic development, the political corruption present in Korea during the mid-late 20<sup>th</sup> century actually bolstered economic development. This occurred because rent-seeking incentives centralized and expedited the economic decision-making process, allowing the central government to command and give economic priority to various *chaebol* in a very efficient way. Secondly, the expedited path that economic directives were able to take minimized the negative effects of the rent-seeking that occurred between the two. Therefore, the net economic result of this system of rent-seeking was quite positive despite its inherent negative consequences. However, this situation was only able to persist because of the highly centralized and repressive political system that was in place in Korea until its democratization in 1988. After the onset of democracy, rent-seeking from the *chaebol* became too fragmented and costly due to the emergence of multiple new political actors, and the positive side of the process no longer outweighed the negative.

While their dominance is arguably declining, the *chaebol* still retain the preeminent role in the Korean economy, as shown by Samsung alone accounting for nearly 20% of Korea's GDP (Weissmann, 2012, 1). In addition, as scandals involving Samsung and the ousted president Park Geun-Hye in 2016 revealed, graft and the transfer of governmental largesse towards *chaebol* executives continues to be a significant issue in Korea. In the global context, Korea ranks somewhat in the middle, as 52nd out of 176 countries worldwide in terms of perceptions of corruption (Transparency International, 2016), which is significantly higher than its peers in the OECD.

There is a firm consensus in the international political community that corruption is bad for economic development, with organizations like the World Bank arguing that it hinders domestic and foreign investment and diverts funds from infrastructure and public works (Wei, 1999, 24). The

experience of South Korea, however, poses problems for this consensus. Corruption has and continues to be a persistent characteristic of Korea's political and corporate system, but the nation experienced nearly three decades of high, uninterrupted economic growth through this state-planned system of rent-seeking. As this analysis will demonstrate, political corruption served as an aid for economic development in the early stages of Korea's growth, but only as an extension of Korea's centrally-planned developmental model, and not in a way that can necessarily be replicated for other kinds of development cases.

The goal of this analysis is to present a logical progression of Korea's economic development and how it was aided by rent-seeking, as well as how democratization made this system ineffective and obsolete. Before I delve into this analysis in earnest, a brief schematic of the progression of my argument is helpful in order to understand its reasoning. Firstly, I define rents, rent-seeking, and political corruption, all of which I use many times throughout the analysis. I then discuss the impact of rent-seeking on economic development in the abstract, and demonstrate that, given the proper composition of the networks in which it is taking place, that rent-seeking can have a positive impact on economic development. I use this abstract theory of rent-seeking as a justification for my discussion of the state-*chaebol* relationship, which is then further bolstered by a theoretical analysis of the composition of rent-seeking networks. This additional theoretical component is necessary because it provides a way to conceptualize the state-*chaebol* relationship in Korea without relying upon the case's specific details to understand the argument.

These components feed into a discussion of Korea's development context, and the mechanisms by which the government ensured cooperation and economic growth from the *chaebol*. Understanding the context is critical, as the beneficial aspects of this rent-seeking relationship are largely hinged upon it. In this way, the nature of the relationship, and its accompanying circumstances, are couched within a theoretical scaffolding that provides a logical reasoning for how rent-seeking benefitted economic development. I then challenge some of the literature that claims that

corruption harms economic development, which provides further rationale for my reasoning of how extensive rent-seeking can augment development.

Finally, I transition to Korea's democratization and its effect on the rent-seeking relationship, which then contributed to the financial crisis and the reorientation of Korea's economic model. This final part is very important, because it demonstrates that the rent-seeking relationship between the government and the *chaebol* was contingent upon the authoritarian and restrictive nature of the Korean government. In addition, it finalizes the chronology of the argument as a whole. Constructing the argument along this chronology is necessary because it makes the argument more logical and easier to understand.

#### Data and Methods:

This analysis, while drawing from South Korea's economic experience in the last decade, focuses on the period between 1961 and 1997, during which high economic growth occurred nearly uninterrupted. These dates are highly consequential bookends for Korea's development. 1961 is the year when Park Chung-Hee, the country's longest serving leader during the 20th century, took power in a military coup and began his far-reaching drive to modernize the nation. Indeed, most economists agree that the 1960's in particular marked Korea's transition from an underdeveloped economy based on subsistence agriculture to a more robust and industrialized one. The military government under Park Chung-Hee undertook a series of five-year plans aimed at industrializing the economy that were quite successful, with the annual GDP growth averaging 8.5% during this decade (Chung, 2007, 13).

Park Chung-Hee was an unapologetic dictator who repressed political rights and often used brutal methods to control the populace (Kristof, 1995, 1), but he undeniably laid the foundations for the country's economic progress and for the dominant role that the *chaebol* would play in exports and in the production of domestic goods and infrastructure. The political-economic structure analyzed

here was not exclusive to Park Chung-Hee's rule; the foundations for its central planning were in some way laid down by his predecessor, Syngman Rhee, and was continued by his successor, Chun Doo-Hwan. However, I will largely focus on his administration (1961-1979) as the Korean developmental model is most strongly associated with him.

The latter bookend of 1997, on the other hand, bore far more negative ramifications for Korea's economic stability, in the form of the East Asian financial crisis (also known as the IMF crisis in Korea). Besides the negative socioeconomic consequences for the general population, the financial crisis bore significant ramifications for Korea's economic framework, largely as a result of the IMF's intervention, which attached conditions to its financial bailout, designed to cater to foreign investors: "The promise of overcoming the crisis and stabilizing the financial market with the help of foreign investment...the social costs of the reforms were justified by citing the need to regain investors' confidence." (Kalinowski and Cho, 2009, 229).

The IMF-imposed conditions included a reduction in direct state intervention in the economy and, most dramatically, a near complete opening of the Korean financial system to foreign investment. As a result of the bailout, South Korea went from being one of the most financially closed off countries to one of the most open in just a couple of years. From the 1960's to the early 1990's, Korea's economic template was designed to accommodate the needs of the *chaebol*, whereas after the crisis its economy was redirected towards the needs of foreign investors, which represented a complete sea change from the model that fueled Korea's rapid growth during the 20th century (Kalinowski and Cho, 2009, 228-229). This thesis focuses on the period preceding the 1997 financial crisis because that year represents an end of an era; Korea's tremendous streak of economic growth came to an end, and its *chaebol*-centric model was reformed according to external forces.

In particular, the South Korean experience during this time can be roughly characterized as a *dirigiste* model, if one accepts a very general definition of *dirigisme*: "proponents have argued that a rational and autonomous bureaucracy dedicated to development, organised and led the phenomenal

economic growth process...the key distinguishing criterion of a dirigiste state is the presence of developmentally committed state leadership" (Park, 2004, 96-98). Given this broad definition, *dirigisme* essentially refers to any state where the government takes an assertive approach to development. However, it is a useful term here both for comparing Korea's case to other states in the region and for contrasting Korea's pre and post-crisis economic models.

I chose the case of South Korea during the 20<sup>th</sup> century for two reasons. Firstly, in 2016, president Park Geun-Hye (daughter of the aforementioned Park Chung-Hee) was impeached due to allegations of corruption and misuse of public office. This is quite interesting, as it demonstrated that the phenomenon of corruption in Korea continues to be a major problem, especially after one considers that more Korean presidents have been convicted or accused of corruption than those who have not. In addition, corruption continues to be a major point of contention in social discourse: "The South Korean public had a particular antipathy toward...political corruption and serious political scandals in the past. The corrupt practices of politicians and high officials have generated an atmosphere of resentment, frustration, and distrust for many years" (Kim, 2008, 156). Yet, despite the persistence of corruption and its ensuing scandals, Korea continues to witness high economic growth in comparison to its peers in the OECD, achieving persistent growth rates of around 3% from 2012-2016 (OECD, 2016).

Secondly, the experience of South Korea poses some interesting problems and challenges to the way that development theory is conceived and applied to real cases. In many ways, the model in place in South Korea before 1997 opposes the free-market, open to foreign investment model that the IMF and the World Bank promote. This idea, combined with the previous observation of corruption's persistence, led me to question that if Korea experience high growth through this kind of *dirigiste* model, and if corruption has accompanied this growth throughout the period in question, then is it possible that this corruption actually played some role in Korea's economic development? This

question then led me to this analysis of rent-seeking and economic development in 20<sup>th</sup> century South Korea.

Approximately forty-nine secondary sources were used to compose this analysis, which run the gamut from official indices of corruption from Transparency International, to articles concerned with the theoretical aspects of rent-seeking as well as case studies of Korea's economic planning model. Secondary sources were chosen based on their ability to focus on theoretical aspects of rent-seeking and economic development. In addition, most of the secondary sources used in this analysis focus either on Korea's specific context and steps towards development, the theoretical aspects of rent-seeking, or the conceptualization of corruption in general. Almost all sources were found either directly in The University of Iowa libraries or through the university's InfoHawk+ search system, which provides access to many different academic journals.

This analysis relies primarily upon qualitative sociological or political-economic approaches, rather than pure economic ones. This is a potential shortfall of the analysis, as it may be the case that there are important trends or patterns in Korea's economic growth which can only be recognized through quantitative models. In addition, this analysis does not compare Korea's case to other East Asian Tigers or other *dirigiste* states, many of which experienced similar patterns of growth in similar circumstances. It may be possible that important factors or trends that are not noted here would be illuminated through a comparative analysis.

### Defining the Terms:

Throughout this project, several terms will be used repeatedly which deserve some specification early on. Most importantly, I distinguish between rents, rent-seeking, and political corruption. Rent-seeking and political corruption have a complex relationship, as not all rent-seeking is corrupt behavior, and the impact of rents and of rent-seeking on economic development are distinct as well. The former distinction is crucial, because corruption is generally regarded as a

serious detriment to economic growth that can hinder the distribution of public wealth: “There are several channels through which corruption hinders economic development. They include reduced domestic investment, reduced foreign direct investment, overblown government expenditure...towards less efficient public projects that have more scope for manipulations and bribe-taking opportunities” (Wei, 1999, 24). In this paper, I argue that corruption is not always harmful. First, I argue that how these terms are defined determines their impact on economy and society. Secondly, I argue that corruption’s effects are dependent on its economic context.

When scholars or organizations like the World Bank use the term corruption, they are referring to a broad set of behaviors that can occur in markedly different environments, and the differences in these environments are very important. Oftentimes, analysis of the institutional or democratic context of corruption is more fruitful than attempts to quantify the level of corruption. The way that corruption is manifested often indicates deeper problems within society and institutions (Johnston, 2005, 2-3).

For example, there are important distinctions between political, or grand, and bureaucratic, or petty, corruption. The former refers to behavior of elites, such as politicians or ministers creating legislation or extending a grant in favor of a group that gave them a bribe, whereas the latter refers to behavior that an ordinary citizen might encounter during interactions with low-level public officials (Holmes, 2015, 10). Even though the intent of the corrupt actor is roughly the same, the scope of corruption that occurs through these channels is very different. This analysis of Korea is focused on the former, which as will be shown can occur in a context that does not hinder economic growth.

In this analysis, I focus on the effects of rent-seeking in elite groups on economic development. However, I will also use the term political corruption to refer to interactions between government and *chaebol* officials in Korea, because rent-seeking encompasses a wide array of activities (and even entire professions). Rent-seeking is “the pursuit of ‘private returns [that] come from the redistribution of wealth from others and not from wealth creation’...an activity can be defined as rent seeking if it is

an activity that yields a private return but is at best zero sum" (Seekam, 2017, 600). This definition generally describes the behavior in question much more accurately, but it is often impossible to disentangle rent-seeking behavior from corrupt behavior. Political corruption at its core is the acquisition of private returns through public mechanisms, without setting new growth production in place. These two definitions reveal that the two concepts are closely intertwined, to the point that they are the same thing much of the time. Therefore, I will be using the two terms interchangeably but will specify activity as rent-seeking when the difference in definitions makes a key distinction, particularly when discussing the kinds of political-economic structures that explicitly involve rent transfers.

Like rent-seeking and corruption, rents can differ in how broadly they are conceived, but on a basic level rents describe 'excess incomes'; a person receives a rent if they earn an income higher than the minimum they would have received in their next-best opportunity. For example, these may be realized as extra income received as a result of politically organized transfers (such as subsidies or tax benefits) or the income advantage that comes from owning precious assets, such as natural resources or specialized knowledge. Some rents do hamper economic growth, but some are essential for development and are irremovable from any economy (Khan, 2000, 21).

According to this definition, rents can either represent the pernicious acquisition of personal wealth by political elites, or they can be the incentives (i.e., in the form of tax breaks or direct subsidies) for already growth-producing entities to keep doing so. While understanding the differences between subcategories of rents is important to reveal the impact that rents can have on economic development, that is not the focus of this analysis. However, the notion of rents and their distribution is central to rent-seeking networks and, as such, will be analyzed in this paper.

Finally, my definition of entails bribes and kickbacks, the effects of which are of major interest to scholars. As evidenced by the 2016 conviction of Lee Jae-Yong, vice president of Samsung, for bribes paid out for political interests, bribery and kickbacks persist as a major dilemma of South

Korea's political landscape. Certainly, high-profile bribery cases such as this damage the government's reputation amongst its citizens and can magnify general mistrust of government institutions, which is a social cost of political corruption that cannot necessarily be quantified.

The explicit effects of these two forces on economic growth and productivity are somewhat murky, but to begin analyzing them, a proper definition of the two terms is necessary. Bribery refers to a financial compensation of public officials in exchange for preferential services or treatment. These may be petty amounts, as in situations where average citizens must pay bribes to low-level public officials for certain services, or they could be much larger amounts paid during nontransparent negotiations for, say, large infrastructure projects (Zhang and Vargas-Hernandez, 2015, xv). Thus, bribery refers to any extralegal, one-way transfer of wealth, and is often synonymous with the term corruption itself.

Kickbacks, on the other hand, are: "a form of negotiated bribery in which a commission is paid to a public official in power as a reward for rendering a government contract or fund...varies from other kinds of bribes in that there is implied collusion between the two parties of the illegal exchange, rather than one party extorting the bribe" (Zhang and Vargas-Hernandez, 2015, xvi). This definition is crucial for the framework of rent-seeking and patron-client networks detailed in the following section. This is because the collusion between the two parties involved in a kickback deal implies a certain level of trust and a power relationship that makes continued dealings within the network possible.

### Rents and Rent-Seeking

It is important to distinguish rents themselves from the process of rent-seeking, as the differences between them determine their effect on development. This distinction exists because the term 'rents' can refer to a wide array of possible transfers within an economy, with distinct consequences for economic performance. Rent-seeking, on the other hand, refers to a range of

activities within a socioeconomic system meant to gain or preserve extra incomes: “rent-seeking can be broadly interpreted as activities which seek to create, maintain or change the rights and institutions on which particular rents are based... almost all institutional change involves creating or destroying rents and almost all distributive conflicts can be described as conflicts where one or both sides are seeking rents” (Khan, 2000, 5-6). In this way, rent-seeking encompasses a diverse array of behaviors both legal and illegal. The end economic effects of rent-seeking depends on whether or not the benefactors of the rents have an obligation or incentive to utilize the rents gained for productive ends.

In other words, the benefit of the rents acquired (in terms of their ability to create economic production) has to outweigh the productivity costs that went into the rent-seeking process. Of course, this does not take into consideration the characteristics of different rents, but the assumption is that the effects of different kinds of rents bears consequences which do not have to do with the process by which they were acquired. This outline of the process of rent-seeking, of course, is very general, so the end consequence of the rent-seeking process is dependent on circumstance.

Likewise, different kinds of rent transfers can have positive or negative effects depending on what constraints are in place in the economic system. As stated previously, the term rents covers an array of supplementary incomes which can be acquired through a variety of different means. Most salient to the case presented in this analysis are rents acquired through political mechanisms, or, more accurately, through transfers coordinated by political mechanisms. These kinds of transfers can be very powerful, and often serve to convert public resources are converted into private and vice-versa. This is the foundation for how assets of the middle and upper classes are built up in developed countries, but they can be even more important in developing countries where asset accumulation has yet to begin (Khan, 2000, 60).

However, this kind of rent transfer is often not fair; in developing countries, rent transfers from the poor (in the form of labor) to the rich (the owner of the store, factory, etc.) are very common.

This is despite the fact that the poor would presumably value those rents more than the rich. In addition, a transfer of rents implies an explicit social cost as well: “[rent-seeking] actually reduces overall social wealth. It is important to recognize that theft is not merely zero-sum...it is actually negative sum because of the opportunity cost of the resources the thief uses to be a criminal that otherwise could be used for productive activity” (Zywicki, 2016, 80-81). The question of rent-seeking’s harm on the economy is not so much about the misallocation of the rent itself, but rather the resources that were used in its transfer. In order for rent-seeking to not impact the economy in a negative way, the rent must be utilized in a way that outweighs the opportunity cost that came with its allocation.

The objective of this analysis is to demonstrate the effect of rent-seeking on Korea’s economic development. The problem that is assumed to be inherent in rent-seeking is that actors waste public resources by continually seeking additional rents. However, the end result of rent-seeking by certain actors could plausibly benefit the economy in the long term. The assumption that returns earned from rent-seeking represent wasted resources ignores the importance of these returns for stimulating entrepreneurial activity. By continuously seeking rents, certain actors are creating a process of resource allocation that can ensure further growth. Assuming that returns from rent-seeking are constitute waste ignores the fact that profits earned from rent-seeking drive further market activity (Pasour Jr, 1987, 125-126). It is true that rents produced by workers might end up in the coffers of bureaucrats or corporate tycoons at any given time, but this is only considering the short-term impact of rent-seeking. The long-term result of the actor’s rent-seeking *could be* positive if the end product further incentivizes economic productivity, as that actor might only be able to engage in production if they already have funds which were acquired through rent-seeking means.

In addition, the activities that the term rent-seeking encompasses are broad enough that it includes transfers which are the basic elements of any market structure: “the profit-seeking activity of the butcher and the baker ensures results beneficial to all members of the community. Only through

such activity do markets work in getting resources allocated efficiently among competing uses” (Buchanan et al., 1980, 4). If rent-seeking is such a basic element of a market, then it can be reasoned that its occurrence should not be considered a negative force in it of itself. Rather, as this analysis emphasizes, the effects of rent-seeking should be considered within the confines of the institution that surrounds it. The behavior described above may be beneficial given the market structure that it is taking place in, but it might produce negative consequences if within a different set of institutions. Whether or not rent-seeking produces social waste or a social surplus is not so much dependent on the choice to transfer rents, but rather on the institutional structure that changes its effects (Buchanan et al., 1980, 4).

So how does a government, which is working to facilitate these transfers, make sure that they are both economically and politically viable? The government must make sure that the recipients of these transfers have an imperative to use them towards productive ends, instead of stashing them away in offshore bank accounts (Khan, 2000, 37-39). This management of rent-seeking behavior is central for a nation’s economic development. The transfer of rents from the poor to the rich is one of the central mechanisms of capitalist production, so how well those transfers are managed, along with how the rents are used by the receiving parties, can be the difference between a rapidly developing economy and a kleptocratic state. This idea is being used as an assumption underlying this analysis. Since Korea developed very rapidly between 1961 and 1997, the state must have been able to successfully navigate these constraints which have been outlined above.

## The Korean Experience:

### Basics of the State-Chaebol Relationship

The state-*chaebol* relationship in Korea is a prime example of rent transfers used for productive means. This relationship is sometimes referred to in the literature as Korea Inc.’, with the *chaebol*

largely being created by the state in pursuit of national interests. Alternatively, it is sometimes depicted as a form of crony capitalism, where the state was captured by the *chaebol*, which were primarily interested in the acquisition of rents and not in economic development. While the state-*chaebol* relationship was indeed very close, it is incorrect to claim that one was a captive of the other. Rather, the relationship was that of a continuous negotiation dependent on the political and economic circumstances. Park Chung-Hee had the ability to discipline the *chaebol*, but accepted their autonomy as long as they accepted his economic vision and did not get involved in partisan politics (Kim and Park, 2011, 265-266). While characterizing the state-*chaebol* relationship as 'Korea Inc.' is useful for capturing the broad vision of national development that the two parties had, it is not useful for describing the mechanisms by which economic development occurred through this relationship.

It is important to note that during this early developmental stage of the 1960's, the *chaebol* had not yet become the economic powerhouses that they are today. The *chaebol's* rise to global prominence was primarily achieved through their transition to heavy and chemical industries (HCI) after the 1970's, after the relationship between Park Chung-Hee's administration and the *chaebol* had already been established for some time. Since the *chaebol* had not yet produced much growth, they lacked leverage in negotiations with the government, which prevented them from engaging in political opposition with Park Chung-Hee's government (Hwang, 1996, 309). While the *chaebol* understood that they were the instruments by which the government's path of national development would be achieved, the fact that they had not yet proven their potential for development meant that they were not able to leverage their importance for rent-seeking early on in the relationship.

Park Chung-Hee had an ambitious plan for the nation, and the economic growth that he desired outmatched the expectations that most had for South Korea: "setting his sights on goals that far exceeded what most at the time thought the country's small economy was capable of achieving...the strategy of development Park chose had to be one of high risk, high payoff, and high cost" (Kim, 2011, 201-202). In order to get the *chaebol* to take on the risks of creating growth and

infrastructure, Park Chung-Hee had to provide certain guarantees for their financial safety if they were to take on this path that his administration demanded of them. Park assured the *chaebol* that the government would rescue them if they faltered financially, and promised a blank check to match the risk that they were taking on.

In this way, the *chaebol's* fulfillment of the requested economic growth was contingent upon rent-seeking. It was through financial subsidies, tariff protections, and tax privileges that the development projects that Park outlined became desirable for the *chaebol* (Kim, 2011, 202). It is through these government-provided avenues of rent-seeking that industrial production and infrastructure creation became desirable activities for the *chaebol* to pursue. Therefore, opportunities for rent-seeking in Korea were used as incentives for corporations to create economic growth, despite the inherent risks in creating growth during the short timeframe that was asked of them.

#### Rent-Seeking Networks:

The nature of how political and economic elites interact with each other on a transactional basis is crucial for ascertaining how political corruption can either bolster or hinder economic development. Therefore, understanding the characteristics of the networks in which rents are distributed is important for modeling the economic decision-making process.

To develop a framework for understanding how rent-seeking networks operated in Korea and how they are related to corruption, it is necessary to discuss the structure and nature of patron-client networks. The term patron-client network describes a set of relationships which often overlap with corruption, but are in fact distinct processes. Entry into these networks is typically more limited than general market transactions *or* from general corrupt activity. These exchanges involve a patron and a number of clients, who are distinguished from another by level of status and/or power. Importantly, the ratio of patrons to clients and the collective bargaining power of the latter (or how well-organized and cooperative they are with each other) can have an important effect on the effectiveness of these

networks. The relative power of patrons and clients determines the type of payoff that either might receive; for example, if the patron is powerful and the client is weak the patron is likely to demand the maximum possible transfer of rents (in this case, a bribe), whereas if the patron is politically weak the client may be offering only political support in the transfer (Khan, 1998, 22-24).

Here, it is necessary to describe the relationship between rents, rent-seeking, and patron-client networks. As stated before, rents are essentially an abstract representation of that exceeds what would have been received from production alone. Therefore, a rent-seeking network is a social organization of actors intent on receiving financial returns from wealth/property distribution *rather* than its creation. In addition, a patron-client network is a form of rent-seeking network that is closer to describing the actual situation in a political system, rather than just being a theoretical framework. Within a patron-client network, rents are allotted from a source (patron) to receiver(s) (clients). The size of rents that the client receives is dependent on two things: the relative status of the patron and the client, and the level of cooperation between different clients who are seeking rents from the same client (Khan, 1998, 23).

This relationship structure is how governments and business officials interact with each other, regardless of corrupt activity, and when many of these relationships are happening simultaneously the aggregate effect can be very powerful. In particular, how well organized the clients are and how centralized the set of patrons are is very important for discerning the efficaciousness of these networks. To take an extreme example, if all the patrons in the network are members of the same political party/organization and have a shared agenda, but all the clients are coming from disparate organizations and have little communication with one another, then the patrons will probably be able to extract the maximum possible rents from the clients. But if the clients are in communication with each other and form a coalition, then there is going to be a more equitable distribution of how rents and political rights are transferred between the groups.

The question of which specific patron-client relationships that continue and are maximized over time is actually quite simple. The longevity of a patron-client relationship is dependent on the ability of the client to pay dividends: “Rents are maximized *over time* if growth is maximized. This is simply saying that the economic ability of investors to pay bribes is proportional to the productivity of the investor...the most productive entrepreneurs are favoured and the less productive ones are weeded out” (Khan, 1998, 32). This point is central to understanding how corruption can positively affect economic development. Even the most self-interested and uninformed bureaucrat is likely to bestow favor upon clients that are the most economically productive, simply because those clients are more likely to be able pay to bribes. As growth goes up, the scale of rent-transfers to the political class increases, as there are simply more rents that are being created. This is not to suggest that corruption naturally accompanies economic development, but rather that in a developmental state that is working, i.e. that is producing growth, bribes and extralegal rent-transfers are likely to be maximized as growth is maximized, primarily out of the self-interest of patrons in the patron-client networks outlined above.

#### Rent-Seeking of the Chaebol:

As stated previously, rent-seeking is not inherently corruption, and the legally mandated forms of rent-seeking that the Park administration provided are common procedures in most economies: “lobbying of government for beneficial treatment, be it protection from competition or the payment of subsidies, is rent-seeking. Expenditure on advertising is rent-seeking and so is arguing for tariffs to protect infant industries. These activities are rife in most economies” (Hindriks and Myles, 2013, 388). While these official avenues existed in Korea, rent-seeking converged with political corruption due to the ability of the state bureaucrat and the *chaebol* officials to create deals and opportunities for rent-seeking through personal relations, rather than through legal channels. Since these *chaebol* had personal connections to individuals who were embedded within the highest levels

of government decision-making, they were able to tailor their economic proposals in line with exactly what the administration desired, and therefore firms with these personal connections had a significant advantage in earning rents relative to firms without those relationships (Kang, 2002, 107).

This narrowing of the *chaebol's* choices was further bolstered by the government's control of the financial sector. One of the most important components of the state-*chaebol* relationship was the state's control of private access to capital. As private banking was essentially banned during this period, the government's complete control over the financial sector ensured that the *chaebol* followed the government's dictates (Lee, 2008, 440). This control of financial resources was of primary importance to the Korean developmental model: "scholars studying the classical Korean developmental state agree is the centrality of state control of finance to the entire system...the capacity of the state to manage a relatively closed national financial system in collusion with private sector insiders was also critical to the effectiveness of the Korean...developmental states (Pirie, 2008, 4). Without its firm grip on scarce financial resources, the government would not have been able to push firms into the network of rent-seeking that it had contrived.

An odd concept emerges due to the government's financial control over the *chaebol*, in that they were held financially accountable to the same government that guaranteed them financial support in the case of failure. Since the government guaranteed to the *chaebol* that they would be rescued if their ventures failed, the capital that would be lost in that situation would have come from the government anyway. So in a way, the *chaebol* had great freedom in pursuing business ventures despite their limited freedom in capital acquisition. Therefore, the *chaebol* faced little actual risk as long as their ventures stayed within the purview of the government's network and economic priorities.

So, the central government both controlled the *chaebol's* access to capital and structured their opportunities for rent-seeking in a way that was strictly in line with the prerogatives for economic development that had been set forth. In addition, the ability of the *chaebol* to obtain the rents they

desired was dependent upon their ability to pay bribes to government officials. Thus, it can be seen that while the *chaebol* were private entities, their ability to function was wholly tangled with the objectives of the central government. This meant that once the *chaebol* were producing growth, their importance to the government grew to the extent that they were irreplaceable, and “the chaebols became integral to a growing alliance between official power and family / corporate wealth. By the 1980s political and economic power and interests were virtually unified” (Johnston, 2005, 106).

Since access to credit and to contracts was dependent on payments to government officials, engaging in corrupt behavior seemed the logical choice for the *chaebol*, as the prospects of not engaging in it were significantly negative. *Chaebol* leaders who did not pay bribes to officials had to seek financial backing in far riskier ways, and were also targeted by hostile and arbitrary litigation by the government. Falling out of favor with the government spelled a real risk of business failure. At the same time, *chaebol* that did produce growth and exports were further rewarded with access to rents (Johnston, 2005, 107). So while private firms that did not engage in rent-seeking were indirectly penalized for doing so, *chaebol* that did play the game were rewarded with further opportunities for rent-seeking. This guarantee came with the understanding that they would continue to receive rents as long as their endeavors continued produce economic growth (Gilson and Milhaupt, 2011, 247).

This confirms the argument that rents are maximized as growth is maximized, thus favoring the most productive rent-seekers. On the part of the government, there was an incentive to grant contracts to firms that were the most productive, and most likely to continue paying bribes. On the part of the *chaebol*, there was an incentive to use the capital earned for productive means in order to continue earning rents.

In addition, the *chaebol* had their position ensured in part because of the lack of other entrepreneurial actors in Korea at the time. This meant that it was preferable for the government to maintain its relationship with the *chaebol*, rather than invest in new economic players (Gilson and Milhaupt, 2011, 248). The context here is crucial; since Korea was in the first stages of its development

at the time, there was really no alternative for the government to turn to in order to initiate growth. While the Park government could have conceivably nationalized some industries in order to have control, it is important to keep in mind that the Park Chung-Hee administration (and its ally of the United States) were preoccupied with containing communism: “anti-communism became the core of dominant political ideologies, overriding all other political ideologies. Both civilian dictatorship in the 1950s and military regime in the 1960s and 1970s had consistently mobilized the strong anti-communist sentiment” (Shin, 2017, 2). Therefore, there was a significant incentive for the Park Chung-Hee administration to keep the potential for growth within the hands of the private sector, in order to avoid any actions that could have been conceived as socialist or communist in nature.

The control of political, financial, and human resources was not only consolidated into the Korean government’s hands, but even further centralized into a single government ‘pilot’ agency, the Economic Planning Board (EPB). This agency had the predominate control over budgetary decisions and its key members often became managers of other ministries as well. This centralization of decision-making power meant that it could be both coherent and managed by individuals with expertise. As the state selectively appointed the highest achievers of bureaucratic exams into agencies like the EPB, the government had much power in the distribution of human capital as well. (Evans, 2012, 58). This concentration of political, financial, and human capital-in a nation where capital was quite scarce-meant that the state, and specifically the EPB (the state’s apparatus of economic planning) had firm control over any of the domestic ability to plan economic development.

While this system became entrenched and high rates of growth were first achieved during the Park Chung-Hee presidency, some of the foundation for this system was laid out by the administration of South Korea’s first president, Syngman Rhee. The export-led development that occurred in Korea was nonexistent under Rhee, but the policy-planning decisions that he made echoed the system that Park had put forth a decade later: “he implemented an import substitution industrialization (ISI) strategy, nationalized the banks, and seized property owned by the Japanese.

Such policies created rent-scraping opportunities, which Rhee sold off to private and political interests in return for political and financial support” (Wedeman, 1997, 466). Rhee, an unpopular strongman who resigned after widespread protests, was never able to consolidate the kind of support that Park did. However, Rhee created the precedent of providing rent-seeking avenues to private interests in order to shore up continued political support.

As said earlier, the distribution of this capital was dependent on the ability of firms to contribute to national development as well as their willingness to contribute to political officials. This practice was continued by Park’s successors Chun Doo-Hwan and Roh Tae-Woo, who forced firms to pay commissions and kickbacks to members of the ruling Democratic Justice Party (Wedeman, 1997, 466-467). Thus, while this system was prominent during Park’s rule, it was not specific to his presidency. Rather, this practice was an inextricable part of Korea’s early developmental state, and provided the avenue for ensuring that production from the private sector would accompany the regimes’ political survival.

#### Conceptualizing This Argument:

This continued practice is also where the intersection of rent-seeking and political corruption in Korea becomes most evident. When considering how these two phenomena are intertwined, it can be concluded that economic growth (which inherently involves some rent-seeking) is more likely to occur along with persistent corruption if there are incentives for rent-seekers to not extract the rents earned from outside of the economic system. It is not only important how rents are distributed, but the way in which earned rents are invested is vital for rent-seeking’s consequences on economic growth. If rents earned are simply siphoned off to foreign bank accounts or are consumed on, say, luxury goods, then the economy will certainly suffer a net loss in capital resources. If, however, a significant portion of rents earned are invested domestically, there may be a decrease in efficiency or some portion of the earnings might be consumed by the corrupt officials, but the loss in capital will

be not be absolute, and net growth in the economy will be far more likely than if all of the rents are siphoned out of the system (Wedeman, 1997, 460).

By definition, the authority of elites and bureaucrats in a newly-created state and economy has not been established, and any comprehensive legislation concerning the allocation of newly-created wealth is likely to be viewed with doubt and suspicion by the general population, particularly in cases where corruption is already widespread and faith in bureaucracy is low. In addition, there are likely to be special interests and lobbying on behalf of patrons inside rent-transfer networks that would further complicate the process of dictating how newly-created wealth is distributed (Khan, 1998, 16). It is therefore possible to argue that rent-seeking and corruption should not be considered deviant, harmful behavior; rather, they are normal or even inevitable behaviors for newly-developed political systems, that need to be managed or phased out as the political class gains acceptance. This argument does not imply that such behaviors are not harmful or deviant; rather, I argue that they should be judged within the difficult context of newly-created legal systems.

In a developing country, networks of rent transfers are often extralegal almost by necessity: "The rights which underpin the emergence of these classes are by definition new and not widely perceived to be legitimate...many decisions made by states concerning the allocation of these critical rights cannot easily be made through strictly legal frameworks simply because a transparent allocative rule is often impossible to agree on" (Khan, 1998, 16). Transfers of rents through corrupt means may still be more wasteful than those that occur through legally-mandated channels, but this inefficiency may simply be unavoidable in a context where legitimate channels for rent-seeking would take a long time to develop and gain legitimacy.

The tenuous status of elites and the political class in developing countries influences one of the central components of this analysis, which is that political corruption and extensive rent-seeking should not be viewed as deviant behavior in developing states. Rather, this kind of corruption should

be viewed as a particular set of behaviors inside networks or institutions that can have different kinds of effects in the aggregate depending on their qualities.

More specifically, if many actors within an institution are already engaging in corrupt behavior, there may be significant pressure upon other actors within that institution to engage in corrupt behavior even if they had not been doing so otherwise. This view of political corruption characterizes a neo-institutionalist approach to corruption, whereby the behavior of individuals within an institution is determined *endogenously* by the common behaviors of other individuals within that sphere, and not exogenously by citizens outside of the institution. (Hellman, 2017, 147). Whether or not a politician decides to engage in corrupt behavior is determined by their perception and experience with the frequency of corrupt behavior by other individuals within that sphere. In this way, corruption can become institutionalized by a set of informal practices and behaviors which gradually shape the behavior of individuals within the institution, which contradicts the traditional perception of corruption as deviant behavior (Hellman, 2017, 148).

This is not to suggest that this neo-institutionalist approach should be used as a universal approach to conceptualizing corruption. After all, in a well-established democracy with fewer degrees of separation between politicians and citizens, corrupt activity *is* deviant behavior. Rather, this way of conceptualizing corruption makes sense for the Korean case or other examples of developmental states. South Korea, at least until 1988, was firmly undemocratic, and the general population's exposure to the government's activity or of their ability to influence the behavior of political actors was very limited. Therefore, characterizing the decision of actors in question whether or not to engage in corrupt behavior as being exogenously determined does not make any sense.

Moreover, as corrupt activity becomes commonplace on an institutional level, its perceived risk on the individual level decreases. In this way, the development of corruption in the political environment is kind of a vicious cycle; as corrupt activity becomes more commonplace, the probability of suffering consequences from that behavior lowers, and the opportunity cost of

engaging in corrupt activity if the actor was not doing so already increases. However, to apply this view of to the Korean case, it must come with the caveat that the institution in question includes both government and *chaebol* officials, as the behavior of the *chaebol* officials played a key role in shaping the behavior of government officials and vice-versa.

In addition to this definition of rent-seeking networks, Hellman introduces a way of organizing corruption (at least in newly-emerged states, such as those in East and Southeast Asia) into four different categories: elite cartels, oligarchs/clans, official moguls, and influence markets. These categories are predicated upon two factors and their temporal relationship, specifically when mass suffrage was introduced and the concentration/fragmentation of the political marketplace (Hellman, 2017, 150-151). This categorization is based on a limited set of variables, but the 'elite cartel' type helps one understand how rent-seeking manifests itself in the South Korean case.

It is worth remembering that institutions in Korea during this time period had only been around for 30-40 years and, their political legitimacy had not yet been established. As a result, political elites had to consolidate power in order to ensure their own security: "Political regimes have been in place for shorter periods of time, and institutions are weaker...Political parties have shallow roots-often embodying contending elite...the core function of Elite Cartel corruption is to protect, as well as to enrich, networks of higher-level elites" (Johnston, 2005, 89). Although personal and mutual enrichment played a role in the structure of these rent-seeking networks, such networks of elites had to be well-organized and able to preserve their positions before they could focus on their rent-seeking endeavors.

In addition, the perceived level of corruption in these kinds of states may not be actually aligned with the reality: "Factors unrelated to the actual incidence of corruption, particularly the media, influence perceptions, since few directly experience corruption. More media stories on corruption primes the issue in memory, leading individuals to overestimate its frequency" (Schopf, 2012, 641). While there may be high-profile cases of corruption that get a lot of media attention in elite

cartel states, most citizens are not actually confronted with corrupt officials in everyday life. This means that the perceived levels of corruption could be either inflated or deflated. On one hand, if citizens are not dealing with corruption in their lives but there are high-level government/*chaebol* officials engaging in corruption frequently, then the perception of corruption could plausibly be downplaying corruption's true prevalence. On the other hand, however, the high-profile nature of corruption cases in the public eye could plausibly lead individuals to overestimate corruption's true prevalence.

Instead of pervasive, low-level bureaucratic corruption, there are fewer but larger incidents of graft inside these elites networks, which has two important effects. Firstly, it means that elite cartel structures in political networks can accompany rapid economic development, because of their cohesion and centralization. Second, it means that political opposition in the government can often simply be the actors that are excluded from the elite cartel network (Johnston, 2005, 90). Additionally, this kind of network structure reveals a qualitative difference that indices of perceived levels of corruption can not necessarily indicate. If the corrupt activity is only occurring inside a network of elites, average citizens are not exposed or induced into that activity, which could potentially mean that the perceived level of corruption in that society is going to be significantly lower than in a state with a higher frequency of minor bureaucratic corruption, even if the net level of illegitimate rent transfer is the same or higher.

Moreover, a few large cases of bribery within elite networks is much more efficient than many smaller ones, and the total cost in productivity (usage of resources) is going to be lower when there are a smaller number of actors. This is because a small group of actors with access to rents can cooperate with the other actors in the system to lower the cost of acquiring them. In addition, they have a more secure claim to rents and will not have to spend as many resources protecting them than if they were in a larger and more open market (Kang, 2002, 182-183). So from the rent-seeking

perspective, it is much less harmful to the economy if entry into the rent-seeking game is more restricted and limited to larger transactions, rather than being open to many smaller players.

Indeed, the central government's ability to restrict bribery and other rent-seeking activity in its own organs is important in regards to the effect of rent-seeking on economic growth. If many separate government organizations and their petty officials can enter into rent-seeking and demand bribes independently, it will greatly magnify the amount of separate bribes that a buyer must pay in order to get their objective through the required government channels. In other words, when entry into the rent-seeking network is free or very low, it will drive up the cumulative cost of bribes significantly (Shleifer and Vishny, 1993, 606-615).

This argument explains how the ability of the top levels of government to enforce who can enter into rent-seeking networks can keep down rent-seeking's net cost. Without strong enforcement from the top, unscrupulous bureaucrats can act independently, so "the absence of authoritarian central coordination allows numerous actors an opportunity to act as independent monopolists in the provision of government services, driving up the price of bribes and individual acts of corruption" (Schopf, 2012, 638).

Limiting access to rents to only large actors like the *chaebol* was a deliberate strategy of Park Chung-Hee's government; in fact, it can be conceptualized as the primary feature of Korea's developmental state. The state and the *chaebol* constituted the entirety of the elites of South Korea, and the collusion between these two parties, in the form of 'political funds for economic favors', was intimately connected with the concentration of power in the executive administration. With this system, it was much easier for Park to control the nation's capitalist production through a few large proxies rather than many small ones, and it was easier for his own administration to extract funds from economic actors for the same reason (Park, 2004, 100-101).

Given this, it is easy to see why the development of small business firms in Korea was severely hindered during the 20<sup>th</sup> century (Park, 2004, 101). The government's developmental model hinged

upon its ability to constrain rent-seeking and ensure that economic actors would cooperate with them through this system of bribes and kickbacks for economic favors. Much criticism can be levied against the Korean government for its support of this oligopolistic style of economic production, but it should be understood that this was a vitally important feature of Korea's developmental model from the 1950's to the late 1980's. Rent-seeking was the mechanism by which the government ensured its ability to direct the large economic actors and to limit the access of new ones into the patron-client system outlined above.

### Corruption and Economic Development:

There are competing notions as to how political corruption should be conceived in terms of its effects on economic growth and development, with some contending that it should always be thought of as a net negative force on economies, while others state that it can be neutral or even positive for development in some instances. Studies that suggest that corruption is bad for economies reflects the prevailing conviction amongst intergovernmental organizations such as the World Bank and the IMF. Moreover, many scholars contend that corruption can be detrimental to the well-being of an economy. According to them, political corruption reduces the flow of direct foreign investment into a country because it is associated with unreliability, insecure property rights, and mismanagement by the bureaucracy. In addition, countries with high levels of political corruption may have public works which are lower in quality yet higher in cost than expected, and carry a perception that political maneuvering was used to win contracts or advantages (Funderburk, 2012, 2).

In short, the primary issue that I am addressing is how the typical perception of corruption's negative effects on economic development can be reconciled with the experience of Korea and the other East Asian Tigers during the 20<sup>th</sup> century. Going with the neo-institutionalist approach outlined earlier, I am arguing that corruption must be conceptualized in accordance with the economic and political circumstances of the case before any judgements are made. In addition, discussions about

corruption and its effects often center around morality: “Often ‘corruption’ is related to acting in opposition to what is considered morally good or right...In other words, it is equal to violating what is considered to be in line with relevant moral values and norms, equal to the violation of integrity” (Huberts, 2010, 147).

Questioning the morality of corruption is perhaps appropriate for judging its effects on society, but this analysis is exclusively focusing on its effects on economic development, so corruption’s morality is not relevant. In addition, any question of morality presupposes some kind of normative values system, which has no place in an objective analysis. Rather, the analysis must focus on the objective impact of the institutional framework where corruption is taking place on economic development.

Many anticorruption efforts in countries are predicated upon the principal-agent theory; that there is a conflict of interest between principals, conceptualized as the collective citizenry or public interest, and agents, who are assumed to have a preference for corrupt transactions and have more information or private motivations that would encourage such corrupt behavior. Therefore, anti-corruption efforts based upon this model dictate that the responsibility is on the principal to diminish the motivations of the agent to engage in corrupt behavior, and that there needs to be actors willing to hold other actors accountable for corruption (Person, Rothstein, and Teorell, 2012, 452-455). This modelling of corrupt behavior assumes that there is a motive on the part of the principal to mitigate the corrupt behavior of the actor, and it does not address the actual motives or incentives for individuals to engage in corrupt behavior. In addition, this model operates on a key assumption: “the principal-agent model thus always rests on the assumption that the principal will take on the role of controlling corruption” (Person, Rothstein and Teorell, 2012, 452).

The problem that is revealed by this model is a kind of prisoner’s dilemma; an actor (a member of the political administration in Korea’s case) may well have an incentive or interest in mitigating corrupt behavior, but they cannot trust the other actors to do so as well: “whether or not an action is

rational...is rather determined by the social context. It may certainly be rational to choose non-cooperation if one has reason to believe that the others are not going to participate" (Rothstein et al., 2005, 13). This strikes to the core of the argument in this analysis; in order to understand how corruption accompanied Korea's economic growth, corruption must not be thought of as singular individuals acting out of self-interest, but rather as actors who are making decisions in relation with the decisions of other actors in the system. This then leads to an issue where if all the actors are engaging in corruption, there is serious risk to any one actor that chooses to not be corrupt, as they cannot trust that any of the other actors will do the same (Person, Rothstein and Teorell, 2012, 457).

This dilemma is further compounded by the fact that corrupt activity, such as bribery, can become institutionalized within a system of actors, such as a political party. Oftentimes, political actors involved in corrupt exchanges must reveal their activity to and act in accordance with their party, as they rely upon the other members of the institution for political support. If corruption is already widespread, political parties can both monitor its members' activities and lay out 'rules' for engaging in bribery, which are then applied to the public administration as a whole. This has some important effects. Firstly, political parties can frame corruption as normal or expected activity, which thereby reduces the risks of developing the relations and information necessary for widespread bribery. Secondly, it weakens the ability of any actor in the public administration to leave the system and engage in behavior that is not corrupt (Porta, Vanucci and Nelken, 2012, 31).

If political corruption can become entrenched in this way, then it would seem that any anticorruption effort in this kind of environment that treats corruption as deviant or abhorrent behavior is going to be immediately ineffective: "insofar as corruption is the expected behavior in a particular society, we should expect the key instruments to curb corruption...to be largely ineffective since there will simply be no actors that have an incentive to enforce them" (Person, Rothstein and Teorell, 2012, 450-451). Theorizing an ideal way to manage or mitigate political corruption is not the

objective of the analysis, but the problem that this presents is indicative of how political corruption should be viewed within its context.

If bribery is entrenched and controlled within political parties, then an attempt to measure or mitigate corruption's effects is going to be counterproductive. Rather, an analysis that focuses on the motives for political groups that utilize corruption can more effectively diagnose corruption's potential problems. In Korea's case, where political corruption and rent-seeking fulfill the elite cartel typology, the purpose of corruption is often to amass influence and to outmatch and insulate the group's advantages from competitors.

Indeed, this kind of context may have extensive anticorruption efforts (as has always been the case in Korea's modern history), but those leading the efforts may simply be doing so to punish their political rivals (Johnston, 2005, 90). So while it is true that corruption can become an institutionalized behavior, it may only be institutionalized within a component of the political system as a tool to gain advantage over rival components. This is exactly the situation that occurred in Korea during the 20<sup>th</sup> century. Political parties under the rule of Park Chung-Hee, Chun Doo-Hwan, etc. had a distinct advantage in being able to seek rents from the *chaebol*, as they used bribery and kickbacks in order to maintain their prioritized relationship.

One of the primary points of interest for sociologists or political scientists concerned with the effects of political corruption is its effect on foreign direct investment, or FDI. Certainly, FDI is very important for building economic growth, particularly in newly formed or underdeveloped states, and the typical argument is that political corruption discourages FDI because it makes the country seem unstable or that investors' funds will be utilized poorly or inefficiently. I would argue that this distinction is not relevant to Korea before the East Asian financial crisis, because the country's leadership was not concerned with attracting FDI or having open financial markets.

Moreover, Korea's political and financial system during the Park Chung-Hee era was not designed to accommodate large influxes of foreign capital for investment, as the economic directive

during this period was oriented outwards: “[South Korea] had, by the mid-1960s, begun to orient its trade policies toward export-oriented industrialization (EOI). Korea also maintained high import barriers and heavily restricted direct foreign investment” (Kang, 2002, 48). In addition, while the Korean government began to gradually encourage some foreign investment during and after the 1960’s, it was generally discouraged in the sectors that were protected by the import-substitution program out of fear that foreign firms would begin to dominate the economy’s production. This was further compounded by the fact that the Korean government wanted to channel its limited capital into nascent industries based within South Korea (Kim and Hwang, 2007, 268). It is important to note that the sectors that were part of the import-substitution program were the infant industries of *chaebol* like Samsung and Hyundai, so this was certainly not a minor portion of the economy.

As stated at the beginning of this thesis, one of the primary changes that the IMF made to Korean economic policies in the 1997 bailout was a near complete opening of Korea’s financial markets to foreign investors, which suggests that Korea’s financial markets had not been very open to foreign investment before. Certainly, South Korea received and benefited tremendously from unilateral aid from the United States, as it was one of the five largest recipients of US aid during the period of 1946-1980, receiving nearly \$12 billion in aid from 1946 to 1980, enough to cover virtually of the central government’s expenditures (Kang, 2002, 43-45). It is important to keep in mind, however, that much of this aid was meant for purposes of national security and containing North Korea, and not to jump-start economic development.

The difficulty of quantifying social cost of political corruption notwithstanding, many scholars argue that political corruption is prominently associated with negative social and economic consequences for the state as a whole, but oftentimes these claims are targeted towards states which are underdeveloped, or which despite possessing the adequate qualifications (an educated work force, established industrial base, etc.) still do not achieve the economic growth rates that are desired. In these kinds of situations, corruption is often an easy culprit to diagnose as a primary cause of

economic underperformance, but the identification of the effects of political corruption becomes far murkier when the state in question is achieving satisfactory or high rates of economic growth. Even amongst countries like the East Asian tigers, which all achieved remarkably high growth rates during the 20<sup>th</sup> century, high-level corruption amongst political/corporate elites is still blamed for deficiencies in the potential economic growth that they could have achieved: “systemic corruption can introduce inefficiencies that reduce competitiveness. It may limit the number of bidders, favor those with inside connections over the most efficient candidates, limit the information available to participants, and introduce added transactions costs” (Rose-Ackerman, 1999, 30).

This is a broad claim about the impact of grand corruption, but it is consistent with many other critiques of high-level rent-seeking network-such as the patron-client model I outlined earlier-and in fact serves as an exemplar of the most common criticisms of political corruption in developmental states. This proposition of Rose-Ackerman is generally correct and matches the Korean case well. However, the way that these factors are manifested in coordination with all of the other factors in the end result (i.e. the GDP growth) is not necessarily correct. It is true that pervasive rent-seeking within the top-level networks of political elites can reduce efficiency and can exclude the most economically effective actors, but the benefits of this kind of closed-off transactional system can outweigh the drawbacks if occurring in the proper circumstances, such as South Korea. This is because not all rent-seeking networks are the same. The quantity of clients, along with their level of organization and collective bargaining power influence how efficiently clients can extract rents from patrons.

In addition, the institution in which rent-seeking occurs has important effects on the efficiency of the process. The rules of the institution may prevent certain groups of clients from entering the rent-seeking game in the first place, and the level of fragmentation amongst patrons within the network influences the magnitude of the bribes that they are able to extract, as well as the amount of political support that they can guarantee from the clients. In simpler terms, the relative level of power

between the patrons and clients is critical for determining the efficiency of the economic payoffs that occur (Khan, 1998, 16-26).

### Effects of Democratization:

Korea made the transition to democracy in 1988 after the peaceful resignation of the dictator Chun Doo-Hwan and the placement of Roh Tae-Woo, the nation's first civilian president (Diamond and Shin, 2000, 7). This transition from an authoritarian and oligopolistic style of government to a true democracy bore significant implications for the rent-seeking system that had been in place. While democracy may have granted political rights to many citizens, it opened up opportunities for rent-seeking to many more people at the same time: "the spread of democracy and markets-though central to controlling corruption in the long run-has increased both the opportunities for graft and the likelihood of exposure" (Leiken, 1996, 58). Democracy resulted in a dramatic increase in actors entering into the rent-seeking networks, but this created a large problem for the Korean developmental state, as Korea was able to maintain high levels of economic growth precisely because of the limited access to rents that the government had enforced.

While the country was a dictatorship, the state had greater control over who could enter the bureaucracy and thus could coordinate its efforts in balancing the *chaebol's* ability to extract rents. But after democratization, the number of political actors greatly increased, and this in turn affected the ability of the Korean government to coordinate its objectives: "democratisation, which purportedly transferred authority from autonomous government bureaucrats, responsible for guiding Korean economic development, to politically motivated politicians and lower level officials" (Schopf, 2012, 638).

This can be made sense of in a conceptual sense when one considers the nature of democracy itself. In the most basic sense, democracy translates to an ability for a large portion of the population to participate in the political system. Therefore, in a newly created democracy where a system of

checks and balances has not been laid out, there is both an increased access to the political system and to public funds. This means that there will be more rents overall and that there is an increased incentive for individuals to seek rents in the first place (Mohtadi and Roe, 2003, 447). There will always be opportunistic actors within a state, so when the ability to seek rents is opened up to more actors there will be more rent-seeking that takes place.

However, this accentuation of corruption in early democracy winds down once the democracy matures: “competition among a larger number of rent seekers reduces returns per rent seeker. Simultaneously, the higher transparency of mature democracies raises costs to rent seekers. Both forces act to reduce aggregate rents in mature democracies even as the number of rent-seekers is larger” (Mohtadi and Roe, 2003, 447). So, while the early years of democracy may invite opportunistic actors into the system, the increasing number of rent-seekers as well as the accompanying scrutiny upon rent-seeking lowers the net amount of rents that any single actor can acquire.

Moreover, this concept presents an issue for actors who are already within the political system. Once the network of rent transactions is opened up to more players, actors within it must spend more resources in order to protect their own place within the network: “the absence of authoritarian central coordination allows numerous actors an opportunity to act as independent monopolists in the provision of government services, driving up the price of bribes and individual acts of corruption” (Schopf, 2012, 638). Without a strong autocrat at the top of government who can set the entire bureaucracy in line, lower level actors have more autonomy in setting the price of bribes being asked towards clients. This then decreases the efficiency within the government, since now every official can get away with setting higher and higher prices for bribes.

Like this, democratization in Korea dispersed the state’s objectives over a larger array of political officials who had to worry about their own political survival rather than having their positions ensured by the state. This then affected the state’s ability to counteract the rent-seeking demands of the *chaebol*. As more politicians were able to enter into the rent-seeking networks and

began to compete for political support, the supply side of the rent-seeking endeavor was greatly magnified, while the demand side (the *chaebol*) remained the same. This meant that the state no longer had an organized structure to balance the demands of the *chaebol*, and so the state's role was significantly weakened (Kang, 2002, 151-153).

The Korean state during the mid-late 20<sup>th</sup> century functioned because the government was able to control and direct the activity of the *chaebol* into a path that matched its goal for national development, and this required the government to be able to curtail the self-interested activities of its own bureaucrats. After democratization, the number of political actors greatly increased, and shifted the locus of control away from the government. This is not necessarily to say that the *chaebol* were able to grab power from the government, but rather that the relative power of the *chaebol* increased as a result of the decreased coherency of the central government. This can be related back to the patron-client structure detailed earlier in this analysis. Democratization results in a substantial increase in the amount of clients, while the level of patrons roughly stays the same. Therefore, the relative power of each patron is going to decrease while the opposite happens on the client side.

The early years of democracy during the presidency of Kim Young-Sam (1993-1998) were marked by the passing of legislation aimed at reigning in the power of the *chaebol*. Much of this legislation, such as the new Five-Year Economic Development Plan and the Revisions of the Fair Trade Act, was meant to remove the *chaebol's* traditional leadership and make their decision-making processes more democratic (Kim, 2000, 173). Something that has not been mentioned in this analysis so far is that to this day, most *chaebol* executives and management are family-run organizations, and the present-day management are usually the descendants of the companies' founders. So when one talks of Hyundai or Samsung, they are to a large degree speaking of the Chung family and Lee family, respectively.

This has a significant impact on the way that the *chaebol* are perceived in public discourse. For example, the intermarriage and interconnectedness of *chaebol* families is a popular subject in the

Korean news media, and influences the popular perception that all of the families are tightly centralized and interconnected through family ties (Han, 2008, 1-2). This influences the effort to reform the *chaebol*, as the popular perception that they are corrupt and sealed off from the rest of the society pushed the government to attempt to reform their structure.

However, much of the legislation that the Kim Young-Sam administration passed did little to mitigate the *chaebol's* power, as many of those that were recklessly expanded their businesses into riskier sectors. The IMF and other organizations argue that the failure of these attempts to regulate the conglomerates was one of the primary factors that led to the financial crisis of 1997 (Kim, 2000, 178). Importantly, several of the *chaebol* that expanded in spite of this regulation either collapsed or were absorbed into other conglomerates as a result of the financial crisis.

#### East Asian Financial Crisis:

It is in large part because of the weakened role of the state and the corresponding strengthening of the *chaebol's* power that led to Korea's increasingly risky financial situation, which resulted in its vulnerability to the East Asian financial crisis of 1997. Starting in Thailand with the massive devaluation of the *baht*, the crisis quickly spread across Southeast and East Asia. In Korea, the crisis began with the default of the Hanbo steel corporation, the first of several Korean corporations to fall victim to their own financial overextension. This was caused by the practice of many *chaebol* of having a very high ratio of debt to equity, which was made possible by the government's aforementioned guarantee of financial protection (Tabb, 1998, 26-27). Over the decades preceding the crisis, the *chaebol* never changed their financial structure or their relationship to government banks despite the years of high economic growth. Rather, they continued to cement their reliance upon government subsidization: "many of the industrial conglomerates (the chaebols) have ratios of debt to equity in excess of 6 to 1...instead of confronting the necessity to rationalise...Korea

used government guarantees to sanction a continued flow of borrowing to bridge the financial deficits" (Bird and Milne, 1999, 425-426).

Not only had the government and the *chaebol* failed to alter the latter's financial reliance upon the former, several *chaebol* actually continued to expand and overstretch their nonexistent financial resources during the years of the crisis. Hyundai and Daewoo (the latter of which collapsed due to insolvency) continued to expand their automobile manufacturing despite that sector's global oversupply, and Samsung made claims of wanting to expand into the auto industry while Kia Motors went to the government for a bailout (Tabb, 1998, 29-30). It can be seen that the *chaebol* continued to expand, either in ignorance of their acute indebtedness or with the expectation that the government would continue to bail them out of their insolvency.

In addition, the *chaebol's* persistent expansion into unfamiliar industries only inflamed the existing structural problems in the financial system. The government's strategy of using the banks and credit allocation as its tool for crafting policy, in coordination with the mutual assurance of safety between the government, banks, and *chaebol*, had been in place since the 1960's. However, this strategy resulted in a banking system that was unable to independently judge the *chaebol's* increasingly risky decisions, and so was highly vulnerable to external shocks like the one that occurred in 1997 (Mo and Moon, 1999, 153). The government's usage of the banks as the mechanism of control over the *chaebol* ensured that the latter would adhere to the economic plan of the former. This worked quite well in Korea's insulated, state-dictated development model through the late 20<sup>th</sup> century. For this strategy to work, however, it also meant that the banks could not function as independent actors, and had no discretion in dictating the distribution of credit. In other words, the banks' primary function as independent creditors was subsumed under the government's need to constrain the *chaebol*, and this left the system as a whole vulnerable to external shocks.

How, then, are these structural flaws in Korea related to rent-seeking and democratization? As mentioned earlier, Korea's transition to democracy resulted in a shift of the balance of power between

the government and the *chaebol*. The increase in individual politicians who all now had to contend for political support meant that these politicians still needed funds from somewhere: "The state increasingly wanted to reduce both the size and the influence of the chaebol, but each individual politician had a private incentive to retain collusive ties for purposes of fund raising" (Kang, 2002, 154).

Even though Korea's democratic administrations sought to reign in the power of the *chaebol* as a collective, individuals within the political system were still reliant upon rents from the *chaebol* for their own political survival. Through democratization, businesses faced increased demands from politicians, and president Roh Tae-Woo himself received \$367 million from various *chaebol*. Naturally, this resulted in the *chaebol's* increased leverage over the governmental decision-making process (Moran, 1999, 573-574).

Despite the newfound democratic governments' proposed commitment to economic reform, the needs of individual politicians to raise funds for their own campaigns necessitated the continuation of the same rent-seeking relationships that had defined the previous authoritarian administrations. It can be concluded that democratization reinforced the preexisting rent-seeking relationship, but also transferred power over to the *chaebol*: "liberalization can provide new opportunities for large firms to buy favorable policy. Whereas measures to rein in the chaebol remain popular politically, because of government-business ties such policies were unsustainable even after 1997" (Kang, 2002, 164).

What can be seen here is a disconnect between the proclaimed goals of the government as a whole and the self-interest of its individual constituents. The Kim Young-Sam government during the early 1990's may have made earnest proclamations of economic reform, but the need for political funds brought on by democratization created the opposite result. Instead of reigning in the *chaebol*, democratization actually strengthened their position in the decision-making process by granting them more influence among individual politicians. This, combined with the overextended financial

system was in large part responsible for Korea's susceptibility to the financial crisis of 1997 (Moran, 1999, 574).

### Conclusion:

The goal of this analysis was to present a logical progression of modern Korea's development and rise to economic prominence, as well as to demonstrate how political corruption and extensive rent-seeking can serve as a component of this kind of development. In no way is this argument meant to claim that corruption is a good thing for development or that it should be described in any kind of normative language. Rather, as this analysis has argued, rent-seeking networks may be inextricably connected with the political and economic system in developing countries. Rent-seeking networks diminished the need for bureaucracy and made the quick turnaround of economic decision-making possible.

In addition, the negative effects of widespread rent-seeking were largely negated by the economic benefits of the direct government-*chaebol* relationship and the mutual goal that they shared. While the arrangement of this rent-seeking relationship was primarily determined by circumstance, much of the economic decision-making was guided by a well-conceived goal: "Park and the chaebol were united by the vision of pulling South Korea and its people out of their absolute poverty...For Park the chaebol were indispensable for his political project...for the chaebol Park was indispensable for their growth into a corporate empire" (Kim and Park, 2011, 267).

In summary, my argument is that the government was able to offer opportunities for rent-seeking to the *chaebol* as an incentive to produce industry and economic growth. At the same time, the government was able to constrain the *chaebol* into obeying its economic directive through its control of capital and its promise of fiscal protection. In addition, rent-seeking on the government end was constrained because of the high cost required to enter into the rent-seeking network, which minimized rent-seeking's negative effects. However, the balance of this system was irreparably

altered after Korea democratized: “‘too much’ democracy in combination with a still collusive business-government relationship resulted in increasingly ineffectual policy-making” (Kang, 2002, 153-154). In other words, Korea’s rapid transition to democracy resulted in a kind of dissonance with the preexisting governmental system, which was not able to cope with the increased demands for rents coming from the business sector and from the new entries within its own ranks.

Most of the literature around development in Korea contends that corruption or rent-seeking either did not have an overtly negative effect or that its negative effect was mitigated by the country’s stellar economic performance between the 1960’s and 1990’s. My argument goes further, in that it argues that corruption did in fact aid economic development in Korea during this time. Moreover, it is based upon a theoretical framework that posits that rent-seeking can occur along with economic development if there are incentives for individuals within the system to use rents earned for economically productive purposes. However, I would also argue that the framework itself should not be considered without the accompanying socioeconomic and political circumstances, as it only applies to contexts where entry into rent-seeking networks is limited and where there remains a significant amount of potential for development.

The experience of South Korea during the late 20<sup>th</sup> century is often cited as a glowing success story, or even as a miracle of economic development. Korea’s experience, while unique in certain aspects, such as the government’s control of the financial sector, bears many similarities with the other East Asian Tigers during this time period. An analysis that focuses on comparing Korea and the other Tigers could further reveal how rent-seeking can incentivize economic growth, or pose further complexities to this hypothesis. In addition, I think that a deeper analysis of the structure and management of various *chaebol* would further elucidate how this rent-seeking relationship produced consistent growth through the 20<sup>th</sup> century.

Finally, this analysis only hints at the changes that occurred to Korea’s economic paradigm following the East Asian financial crisis. How these rent-seeking networks have adapted to the

reforms forced upon Korea, and how they have been manifested in economic growth in the past two decades, would be a fascinating subject for analysis. Not only would this answer questions regarding the efficacy of Korea's political and economic structure, it would also add to the ongoing discussion as to how large of a role the state should have in dictating national development.

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