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# Democratization and the Politics Behind Korean E-Government

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**Abstract**

Korea has become the world E-government leader, employing ICTs to improve the openness, transparency, and accountability of government operations, yielding $1 billion in annual savings. E-government legislation would not have been possible though, without Korea's prior democratization, which altered incentives facing politicians, making it riskier and more costly to abuse public office for private gain, while rewarding leaders for introducing reforms to reign in bureaucratic corruption and more effectively deliver public goods to constituents.

This study demonstrates the constraining effect of democracy on corruption through objective, comparative statics analysis of industrial policy corruption and through examination of perception polls and experience surveys of corruption before and after the democratic transition. Application of process tracing techniques reveals that E-government was introduced as part of a broader democratically-motivated drive within Korea to reduce corruption and improve government policy performance.



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**Democratization and the Politics Behind Korean E-Government**

Korea has become the world E-government leader. E-government has improved the openness, transparency, and accountability of Korean government operations, saving an estimated $1 billion annually from the government budget. What explains Korea's successful utilization of ICTs? What are the politics behind the introduction of E-government to Korea?

E-government, defined by the OECD as 'the use of ICTs, and particularly the Internet, as a tool to achieve better government' (OECD, 2003) would not have been possible without Korea's prior democratization. In fact, E-government was introduced as part of a broader trend in Korean democracy to reign in bureaucratic corruption, allowing government to more effectively deliver public goods to constituents, and stop officials from using office for private enriching activities.

Democratization in Korea shifted the incentives of politicians and firms, cutting corruption, and yielding reforms to improve governance and further reduce graft. Democratic political competition expanded the size of the winning coalition, heightened transparency, increased accountability to the electorate, and multiplied the number of veto points required for a corrupt deal, making it more expensive and dangerous for political leaders to exchange favors with the business elite. The democratic system of checks and balances also preserved property rights, blocking any attempt by politicians to extort bribes by threatening to seize assets.

The evidence, consisting of perception polls, experience surveys, and objective measures of illicit rents convincingly demonstrates that democracy has reduced corruption in Korea. A comparison of the Dictator Chun Doo Hwan's Industrial Rationalization with the 1999-2001

Big Deal democratic restructuring measures reveals a far greater scale of corrupt rent exchange under the Chun dictatorship. Chun's industrial rationalization doled out rents to elite supporters in return for bribes and loyalty. In contrast, greater transparency, accountability through political competition, and more numerous veto points raised the costs and risks of exchanging rents for bribes under democratic corporate restructuring programs. Minimal financial assistance was allocated only in return for the recipient's implementation of burden sharing 'self rescue' measures, while property rights were respected.

With corruption less attractive, democratic political leaders introduced further reforms to reduce corruption through bank reform and establishment of an anti-corruption agency and through improved governance with measures such as E-government.

The article first explores the theoretical debate over democratization and corruption, arguing that the overall effect of democratic competition is to deter bribe taking. Next, the article briefly examines the survey evidence indicating a reduction in corruption with democratization and compares industrial restructuring programs under authoritarian and democratic rule, revealing sharp declines in transactive and extortive corruption. Finally the article explores how shifting incentives led democratic politicians to introduce E-government measures to further improve government effectiveness and reduce graft.

## Theories of Corruption and Democratization

Institutionalist scholars disagree over whether democratization increases or decreases corruption. Those arguing in favor of increased corruption contend that democratic diffusion of authority allows numerous players, including members of the legislature, central ministries, and local government, to demand bribes for government services driving up the bribe price and multiplying individual acts of corruption (Johnston, 2005). Elections are claimed to heighten uncertainty, leading to short term oriented bribe taking. Some advocates of the 'developmental state' explanation for East Asian development (Amsden, 1989) similarly argue that democratization increases opportunity for politicians and lower level officials to abuse for personal ends the policy tools that had autonomous bureaucrats had previously employed to deliver economic development (Kang, 2002).

These views ignore the critical democratic element of competition, however, which provides a strong incentive to minimize bribes, since corrupt leaders face the real prospect of exposure and defeat in the next election. Under competitive conditions, the more deals required to secure favors, the greater the likelihood of exposure and punishment, and the higher the costs of engaging in corruption. Democratic governments are also designed to be transparent, and include a free press to better hold leaders accountable, further increasing likelihood of detection. Maintaining power also requires democratic politicians to reward supporters within their ruling coalition, which can encompass a majority of the populace. Allocating private goods, by buying votes, thus becomes a less effective means for democratic leaders to secure support, relative to provision of public goods (Root, 1994).

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

Democratic diffusion of authority through multiple veto points also serves to protect the judiciary from political interference, helping to preserve the rule of law and protect private property rights from threats of extortion.

**Evidence of Lower Corruption in Democratic Korea**

Evidence indicates that democratization in Korea led to both a reduction in perceived and actual rates of corruption. Popular perceptions of Korean corruption have gradually improved with democratization but not without fluctuation. The Korean Transparency International Corruption Perception Index (CPI) score initially showed a rise in corruption from 3.93 CPI (1980 to 1985) under the Chun dictatorship to 3.5 under early democracy (1988 to 1992) (0 most corrupt to 10 least corrupt). Perceived corruption levels improved briefly with heavy sentences meted out to former presidents Roh Tae-woo and Chun Doo-hwan for corruption in 1995 and 1996, but declined again with the involvement of scores of politicians, high officials and Kim Hyun-chul, son of sitting President Kim Young Sam, in the 1997 Hanbo scandal. Perceptions of Korean corruption improved with good governance reforms introduced under the progressive administrations of Kim Dae-jung and Roh Moo-hyeon, but only after twelve years of democracy, slightly declining in the first two years of the conservative Lee Myung-bak government.

**Figure 1: Korean Corruption Perception Index**

Even the perception surveys recording progress understate the improvement in corruption under Korean democracy. Factors unrelated to the actual incidence of corruption,[1] particularly the media,[2] influence perceptions, since few directly experience corruption. More media stories on corruption primes the issue in memory,[3] leading individuals to overestimate its frequency. Press freedom with democratization leads to a sharp rise in corruption stories, and this impacts popular perception. In Korea, for instance, following abrogation of the authoritarian Basic Press Law with democratization the number of articles per year mentioning the word "corruption" (*bujeung bupeh, bujeung biri, or biri*) in the leading daily newspaper, the Chosun Ilbo, rocketed upward from 6 and 7 in 1986 and 1987, respectively, to 999 in 1993,[4] contributing to the deterioration in Korea's CPI from 3.93 to 3.5.

Experience surveys imply an even greater decline in corruption with democratization. Those most likely to participate were least likely to perceive graft. Whereas 51.6% of the public viewed Korean society as corrupt in October 2010 only 10.5% of government officials felt this way (Anti-Corruption and Civil Rights Commission, 2010) TI's Global Corruption Barometer also reported a decline in the percentage of Koreans reporting giving bribes from 6% in 2004 to 2% in 2010, well below the OECD average of 8.7%.

To transcend media generated bias in popular perceptions of corruption, I employ an objective means to measure corruption, which TI defines as "the misuse of public power for

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[1] Abramo (2005) discovered that perceptions of corruption more closely followed opinions on a variety of other matters than any firsthand knowledge of corruption. According to the 2010 global corruption barometer 2% of Koreans and 2% of Finns reported paying bribes for government services (Global Corruption Barometer), yet Finland recorded a 9.2 on the CPI to Korea's 5.4.

[2] Miller, Godeland & Koshechnkina (2002) found that media reports play a stronger role than experience in shaping respondents views of corruption. In his Polish Election Survey, 21% cited gossip, and 47% the media as sources for views about official corruption.

[3] Priming information increases its cognitive availability, which Nisbett & Ross (1980) define as "accessibility in the processes of perception, memory or construction from imagination."

[4] An increase in corruption stories is sufficient to influence its perceived rate, regardless of the level of rents or the guilt or innocence of the defendant, which may take several years to determine.

private gain." I focus on elite, or Grand corruption, which must be resolved prior to low level bureaucratic corruption, if overall corruption levels are to be reduced. Two types of Grand corruption are examined: 'Transactive' corruption involving an exchange of government provided rents (returns above market level) for either bribes or loyalty, and 'Predatory' corruption in which private property rights are threatened to induce bribes.

The article adopts a comparative statics approach, searching for the illicit exchange of rents for private favors and threats to property rights in large-scale industrial restructuring programs involving massive government allocation of assets and capital, both before and after democratization. Chun Doo-hwan's authoritarian Industrial Rationalization program is compared to democratic corporate restructuring under Kim Dae-jung.

To qualify as a case of transactive corruption, the office holder must maximize private gain by exchanging rents, in the form of assets or capital, at below market prices, usually in return for bribes or political loyalty. Rents are a necessary, insufficient condition for transactive corruption and are measured by comparing the purchase price to the market's estimation of target firm value, comparing the firm's market value before and after the public release of takeover terms to gauge the amount of government financial assistance. Rents are corrupt if provided to maximize the private gain of the office holder in exchange for bribes or loyalty. Rents are not corrupt if recipient firms are required to fulfill transparent criteria designed to further the public interest, for instance, by exporting, or cutting costs and repaying debt through asset and affiliate sales to help stabilize the financial system.

Predatory corruption involves credibly threatening property rights to generate 'protection money' and can be observed in cases where the property rights of large contributors are protected, while those of political enemies or low bribers are violated.

Application of these measurement techniques reveals that the Korean dictator Chun Doo-hwan (1981-1987), with a polity score of –8, corruptly manipulated the Industrial Rationalization measure, doling out private property confiscated from political enemies and low interest loans at no cost to firms that had offered him the most bribes and were linked by family ties to members of his ruling elite. The complete lack of accountability and transparency of Chun's rule, along with his monopoly control over policy and motivation to provide payoffs to supporters[5] provided ideal conditions for corruption, allowing Chun to amass at least $1.24 billion in bribes from the corporate sector while in office.[6]

In contrast, in democratic restructuring programs, monitoring by the press, civic organizations and the opposition parties in the National Assembly, and greater accountability to the electorate, precluded the Kim Dae-jung governments from corruptly exploiting the 'Big Deal' industrial restructuring program. Only limited financial assistance was provided to firms willing to shoulder most of the restructuring burden. The Kim government also protected private property rights. Firms controlled whether or not to swap affiliates, and trades were conducted at fair market value.

**Table 1: Estimating Rents in the Chun Industrial Rationalization**

The Chun regime provided 7 trillion won (9 billion in 1986 US dollars) in Industrial Rationalization financial assistance through postponed repayment of principal and interest,

[5] Chun testified that he provided the members of his party with $25 million annually for over seven years ("Investigation of Chun's," 1996).
[6] At an average exchange rate for 1980–88 of 767 won per dollar ("Chun gathered," 1996).

principal write-offs, and new low interest loans to 57 firms designated to take over others.[7] Another 21 'self rescue' firms were granted assistance in return for implementing financial improvement plans.

Takeover terms, purchase prices, and share values reveal the extent of Chun's rent transfer through Industrial Rationalization financial assistance. Four of seven largest arranged acquisitions transpired without a purchase price, representing an immediate gain of up to $40 million. In contrast to the common tendency for acquiring firm share values to slide, industrial rationalization firm values all rose appreciably above their respective industry indices immediately following the public release of takeover terms.

**The Chun Industrial Rationalization: Winners, Losers, Financial Support & Rent**

Five key measures of financial performance reveal no relation between financial performance and receipt of rents, despite Chun regime claims to have channeled financial assistance to well-managed firms to take over non-viable operations. In fact, target firms outperformed firms designated to take them over in four of the five largest cases. Daewoo, which Chun had selected to take over Kyungnam, responded to rumors that it would participate in the industrial rationalization by issuing a Korean Stock Exchange public disclosure denying that it had become a rationalization takeover **target,** or had entered into non-payment ("Daewoo disclosure says," 1985).

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

Chun's record of receipts for bribes, previously sealed National Assembly material released to the author under the Korean Freedom of Information Act,[8] reveals that the largest industrial rationalization rent recipients had also shouldered the greatest political contribution burdens, overall and within their respective industries. Many large rent recipients were linked by marriage to Chun's elite, notably, Daelim and Daewoo, both widely rumored to be verging on bankruptcy (Chaebol and Chaebol Families, 1992).

Firm owners who lost property rights in the industrial rationalization, on the other hand, were those who had provided the least bribes to Chun or who had opposition links. For instance, Chun deprived opposition leader Yoon Suk-min of ownership of the Daehan Sunjoo Shipping firm as punishment for perceived disloyalty. Yoon had won election to the 11th National Assembly, assuming the Vice Presidency of the Korean Nationalist Party (*Hankuk Kukmin-dang*), one of the two moderate opposition parties tolerated by the Chun regime.

Yoon's marriage ties to former Chairman of the Joint Chiefs of Staff and Assemblyman Moon Hyung-tay soured relations with the Chun regime following the Jung Reh-hyuk anonymous letter incident. Moon re-ignited a long-standing feud by sending an anonymous letter to Democratic Justice Party headquarters and the press containing evidence that National Assembly Speaker Jung, a key Chun ally, had amassed up to 17.8 billion won by speculating in real estate, forcing Jung's dismissal ten days later. Chun retaliated against Moon and the Yoon family, with a tax investigation of Daehan Sunjoo, where Moon's son in law and Yoon's younger brother, Suk-jae, was President. The investigation called into question government

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[8] With assistance from the People's Solidarity for Participatory Democracy, I filed a freedom of information request with the National Assembly Administrative Affairs Office on May 19, 1998 for sealed documents detailing the exchange of bribes under the Fifth Republic, under the newly passed Korean Freedom of Information Act. Various ministries provided the documents to National Assembly members participating in the 150th General Assembly's closed-session 38th Special Inquiry into Corruption, held in 1988. These sources are listed in the references as *Korean Freedom of Information Act Requested Material.*

commitment to Daehan Sunjoo, triggering panic among secondary financial lenders which called back 100 billion *won* (“The Life and death, 1993). The Chun government then demanded Yoon’s resignation from the National Assembly and from the Kukmin Party to manage Daehan Sunjoo as a condition for 10 billion won in rescue funds. Yoon further damaged relations by calling for Chun’s removal as head of the ruling Democratic Justice Party. Chun then struck back, seizing Daehan Sunjoo and using the KCIA to twice seize and interrogate Yoon.

Chun also deprived Yang Jung Moe of ownership of Korea’s seventh largest Korean *chaebol* conglomerate, the Kukje group, overriding the self-rescue plan designed by the group’s main bank Korea First Bank, as punishment for Yang’s lackluster support and minimal financial contributions. Yang earned Chun’s wrath by refusing to campaign in his home community of Pusan for Chun during the 12$^{th}$ National Assembly Election, and by committing a number of symbolic affronts to the President, including a late arrival to Chun’s important dinner party. Most importantly, Yang contributed very little to Chun in bribes, far less than groups of comparable size, and openly complained of bribe demands by resigning as Director of the Pusan Branch of Chun’s Saemaul Movement and by turning away Chun’s Ilhae Foundation representative, contributing just 10% of contributions from similarly sized *chaebol*. Chun responded by removing Kukje from Yang’s ownership (“The Life and death,” 1993).

**Table 2: Industrial Rationalization Acquisitions: Financial Performance vs. Bribes & Family Ties**

Chun allocated rents, then, to advance personal goals of amassing bribes and securing loyalty from political backers, undercutting the stated policy objectives of strengthening industrial performance by rewarding well managed firms. Press censorship ensured that Chun's crimes remained hidden until after he fell from power.

**Falling Corruption under Democracy**

Chun's manipulation of the Industrial Rationalization to reward cronies with rents, by reallocating assets and writing off loans, contrasts with the absence of rents in democratic restructuring programs. Democratic institutional features, principally monitoring by the press, civic organizations and the opposition parties in the National Assembly, and greater accountability to the electorate, precluded the Kim Dae-jung government from corruptly exploiting the 'Big Deal' industrial restructuring program. Only limited financial assistance was provided to firms willing to shoulder most of the restructuring burden. The Kim government also upheld the property rights of Big Deal participants, who voluntarily negotiated merger and acquisition deals in order to attain government financial incentives. Unlike Chun's rationalization, firms were rewarded with above market premiums in return for selling ownership and management rights.

South Korea rapidly democratized following transition to civilian rule in 1987 with free and fair elections, universal adult suffrage, civil liberties, multiparty competition, and a free press and rated an 8 out of 10 according to the polity index.

The largest democratic government industrial restructuring, Kim Dae-jung's Big Deal program following the 1998 currency crisis, was largely designed and implemented through a transparent process including opposition lawmakers, the press, and civil society groups, and produced a similar outcome: limited financial assistance highly conditioned on burden sharing. The Kim restructuring was to assist key industries suffering from excess capacity, stagnant profits, and onerous debt burden. The Big Deal corporate restructuring plan evolved from a five-point restructuring accord reached between President-elect Kim Dae-jung and four of the top five *Chaebol* leaders in January 1998, under which the Kim government promised financial assistance to *Chaebol* that merged or swapped core affiliates, purportedly to improve productivity by reducing over-lapping and excess capacity and supply to concentrate each *chaebol*'s production within three to five core sectors.

Under Korean democracy, the National Assembly and courts upheld property rights and checked any attempts by the executive to employ state coercion for personal gain by engaging in corruption through extortion. Access to court receivership, largely denied under Chun, allowed owners of reasonably healthy firms to protect their property rights from government imposed credit cut-off or loan recall. *Chaebol* owners also had recourse to the National Assembly, which had frequently intervened in economic policy making under democratic Korea. If their property rights were at stake, *chaebol* owners could expect some support from friendly assemblymen, particularly those from the pro-business opposition Grand National Party which had received many of their contributions.

Initially, the Kim administration was more concerned with strengthening overseas confidence in the Korean economy in the aftermath of a national economic emergency, the IMF currency crisis, than with upholding private property rights. Opposition from the *chaebol*'s peak organization, the Federation of Korean Industry (FKI), the opposition Grand National Party, and the availability of court receivership in an independent bankruptcy court impeded any Kim government attempts to force a swap.

After conceding to a *chaebol* demand for secret negotiations, the Kim government entrusted minority party ULD Chairman Park Tay Joon with brokering secret negotiations over a government proposed three-way exchange between Samsung, L.G., and Hyundai to strengthen industry leaders, but this too collapsed under assault from the *chaebol*/ GNP alliance. The government agreed to make any *chaebol* swaps completely voluntary and further conceded to business/opposition party demands to remove any sectoral limitations *chaebol* selections. The final Big Deal selections therefore reflected *chaebol* preferences to discard loss making affiliates, including firms outside the government-designated set of eligible industries, and excluding affiliates within the government bracket. The *chaebol* further blocked Kim government efforts to expedite agreement over management and ownership shares, determined the pace of ownership and management settlements in six of the seven deals and their full control over property rights.

Unable to determine the ownership or management within newly merged firms, the Kim government had little opportunity to take bribes in return for providing financial assistance. Not surprisingly, therefore, despite promises of financial support, none of the Big Deal participating firms received substantial government support. Moreover, the prices paid in takeovers were often above market value. The few firms that received financial assistance had first to engage in extended negotiations and contribute large sums through the sale of affiliates or real estate, or inducement of foreign capital.

Unlike Chun's Industrial Rationalization, firms in only three of the five major swaps received assistance, too little to affect their share value, and only in return for implementation of rigorous 'self rescue' measures to share the restructuring burden by disposing of redundant facilities and manpower, attracting foreign capital and repaying debt. Without favors there can be no transactive corruption, and that proved true in the Big Deal.

In open and extended negotiations, the *Chaebol* received far less government financial assistance than they initially sought and were forced to cover most restructuring costs. The Kim government responded with a 1.3 trillion won ($967.7 million) counter offer to a 20 trillion won October 1998 *Chaebol* request, rejecting three of four proposed swaps, and demanding more self rehabilitation capital improvement measures.[9] In December, a committee of twenty-five creditors again rejected *Chaebol* resubmissions in the semi-conductor, ship engine, and power generator sectors, and promised future support to the aircraft and rolling stock deals only in return for more self-rehabilitation measures and foreign investment, providing only short term loan postponement to the petrochemical merger, and limited support to the petroleum refining deal in return for attracting foreign investment.

Despite Big Deal firm success trimming debt, selling off assets, and implementing layoffs, two of the five deals still failed to receive assistance after two years of negotiations, either due to collapse (in petrochemicals), or popular opposition to perceived favoritism (semiconductors), while in two others (aircraft and rolling stock), the meager support was too insignificant to increase share value during announcement of the deals or disclosure of assistance terms. Unlike the typical free assumption of shares, several hundred billion won debt write-off, and forty year combined deferment and repayment terms exchanged for bribes and support through Chun's Industrial Rationalization, amounting to hundreds of millions of dollars in rents, firms participating in the democratic Kim government's Big Deal, were lucky to receive one, three, and five year deferments, and instead of debt write-offs, had to cede ownership and management control through debt-equity swaps. The only firm to record any appreciable gain in share value through Big Deal financial assistance, Hanhwa Energy, conceded ownership, while

[9] The *Chaebol* requested debt-to-equity swaps, debt write-offs, deferment of debt repayment at privileged rates, infusion of fresh capital, and tax reductions.

the Hyundai affiliates which took over firms in the semiconductors and petroleum refining deals, paid 22% and 87% above market price, respectively, and received so little debt relief that their share values collapsed to under 10% within two years.[10]

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

**Table 3: Limited Rents in the Big Deal**

During Hyundai's purchase of LG Semiconductor, the active, vocal role of the opposition GNP in the National Assembly ensured a fair deal. When Hyundai refused to compromise over the purchase price, the GNP used the National Assembly Interpellation on Economic and Social affairs to allege government favoritism towards Hyundai, and called for cessation of government intervention in the Big Deals. The Kim government responded to GNP Representative Paek Seung-Hong's threat to investigate the Big Deals in public hearings under the next government with a tougher line towards Hyundai ("Opposition and ruling," 1999). FSC chairman Lee Hun-jai called for more Hyundai concessions ("if Hyundai really wants the deal, then it should make a more reasonable offer to the seller") ("Impending agreement, 1999), and the FKI, too, strongly

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

urged a Hyundai compromise. Four days later, Hyundai raised its offer from 1.2 trillion to 2.56 trillion won, well above market value, sealing the deal ("Agreement Reached Over," 1999).

The Big Deal, then, upheld property rights by ensuring that *chaebol* retained full control over swaps and takeovers. Inability of the government to threaten private assets prevented any attempt at extortion. Preventing the government from determining the ownership or management composition of newly merged firms also removed opportunities to take bribes in return for providing financial assistance. The limited amount of financial support in the Big Deal demonstrated the absence of transactive corruption as well.

Further research corroborates the finding of a reduction in bribes for loans with democratization. The price of long-term bank loans in Korea has long been fixed at a favorable rate by the government. When faced with a financially troubled borrower with poor credit, therefore, a profit-maximizing bank should attempt to minimize loss by persuading the firm to dispose of assets to repay loans or increase paid-in capital, similar to the 'self-rescue' plans pushed by the Kim government through the Big Deal corporate restructuring program. Cases in which banks reward poor performers with further loans, attract suspicion as possible instances of corruption.[11] In a smoothly functioning financial market, loss generating, debt-ridden, risky borrowers lack the necessary credit to access low interest, long-term loans. Not only does this type of borrowing represent a rent transfer, it also diverges from the bank's objective to maximize return from its loan. This study examines financially troubled *Chaebol* with over 800% debt/capital ratio, and identifies four possible bank-lending responses: tough, punitive, lenient, and favored (see Table 8). With a tough response, the most economically rational

[11] The Hanbo group, the 14th largest Chaebol in 1995, received \$4.5 billion in bank loans to construct the Tangjin Steel plant despite a 1892% debt capital ratio and \$116 million in losses in the first half of 1996. It was later revealed that Hanbo's head Chung Tai-soo secured the loans with \$5 million in bribes distributed to up to 35 politicians and bureaucrats (Schopf, 2001).

strategy, the bank called back loans while the *Chaebol* increased capital. Under a punitive response, the bank cut lending to *Chaebol* that lowered capital. In lenient cases, the bank expanded lending to *Chaebol* that raised capital. Finally, in cases of suspected favoritism, the bank extended more loans despite a *chaebol*'s capital reduction. Cases of favoritism here serve as proxies for 'suspect rents,' since they represent a bank providing a market rate loan to an extremely risky customer, unlikely to repay. To control for overall fluctuation in the Korean financial market, which would lead all firms to increase or decrease capital and all banks to extend or reduce loans, this study examines relative variation between the case studies (those over 800% debt/capital ratio) and the top 30 average. A capital increase is therefore calculated as one greater than the top 30 average and a capital reduction is below that average. The study reveals, with absolute and relative measures of long-term loan response and with annual and two-year rolling average loan calculations (because long-term loans overlap annual financial statements), that the transition to democracy brought a shift from favored to tough responses. The change was particularly evident when relative measures are made of the top 30 *Chaebol*. While toughness, the strictest and most economically appropriate response, rose from 13% of all cases under Chun Doo-hwan to 41% under the democratic governments, suspected favoritism fell from 40% to 21%. The misallocation of low interest loans to unqualified risky borrowers and the absence of any other transparent criteria to justify so much rent transfer or to manage its allocation suggests the existence of 'suspect rents' and indicates the likely existence of corruption.

**Table 4: Appropriateness of Government and Bank Response to *Chaebol* in Trouble**

**Korean E-Government Reform**

As the evidence demonstrates, Korean democracy achieved remarkable progress in reducing the rampant extortive and transactive corruption that characterized the Chun authoritarian regime’s industrial rationalization. Higher political risks and institutional checks under democracy deterred politicians from taking bribes for protection or favors, and offered attractive incentives to introduce legislative reform to cut corruption and improve government effectiveness. Democratic politicians introduced legislation to create E-government and the Korea Independent Commission Against Corruption (KICAC), as well as bank management reform to reduce bank corruption, in the hopes of increasing constituent support following scandal.

The Kim Young-sam administration introduced bank management reform in January 1997 to cut bank lending corruption, like that of the Chun Industrial Rationalization, following the Chun and Roh corruption trial. Powerful new boards of directors provided shareholders with a mechanism to restrain and control the bank president, who had previously sought to satisfy politicians with favorable loans in return for a desirable position upon retirement. The new boards were delegated authority to monitor and set management goals; select the president; approve of loans, budget, mergers, and settlement of accounts; set salaries of employees, including the president; and were required to report back to the shareholders. In 1999, President Kim Dae-Jung bolstered management reform, by requiring Korean banks to fill two-thirds of the boards with non-permanent members, creating 129 new positions (“How the bank,” 1999 and "Non-permanent members," 1999). With control over management, shareholders introduced CRMs to boost profits and raise lending transparency. Whereas connections to the bank president had been essential to secure a loan, under the CRM two-thirds of a committee comprising financial specialists were required to set loan conditions, based on credit rating. Increased transparency in the lending process thus discouraged political interference.

After a spate of scandals involving government provision of licenses and law enforcement corruption dampened ruling party support in the June 2001 National Assembly elections, President Kim Dae-jung responded with a strong incentive to introduce anti-corruption reform and pushed e-government policies to improve government performance.

The Kim government responded by enacting the Anti-Corruption Act in July 2001, establishing the Korea Independent Commission Against Corruption (KICAC), an anti-corruption agency under official Presidential control, to refer corruption reports to law-enforcement authorities for investigation, while protecting the anonymity of whistleblowers. KICAC launched educational campaigns with civic groups such as the People's Solidarity for Participatory Democracy and Citizens' Coalition for Economic Justice to break tolerance for corruption and uproot its cultural, social and institutional foundation. New legislation also required rigorous enforcement of the 'Ten Observances of Officials,' disciplining officials accepting gifts or entertainment, or holding a second job paying over 30% of their annual salary. The National Assembly Act also granted itself authority to order the BAI to conduct audits.

The Kim government then pushed E-government policies as part of an overall plan to improve government performance, reduce bureaucratic dysfunction and cut corruption. E-government can improve government function by delivering services and information online, increasing government accountability to the citizenry. E-government increases government transparency by openly disseminating policy and budget information, and offers citizens direct input into the design and implementation of policy through online surveys and suggestion boxes.

The result is greater accountability and lower corruption as government agencies respond with desired services (Scott, 2006). Internet delivery can also improve the usability and effectiveness of government services, by organizing information and services on the web according to the needs of different user groups, and by allowing citizens to seek information at their own convenience (West, 2004 and Welch, Hinnant & Moon, 2005).[12]

Kim Dae-jung's policies helped to transform Korea into the world E-government leader, ranked by the UN atop 190 nations in terms of "E-Government Development" and "E Participation" in its 2010 Global E-Government Survey. E-government helped cut corruption by enabling the Korean government to operate with greater openness, transparency, and accountability. The Kim government laid the foundation for e-government systems by building a high speed internet network to link 20 million citizens (half the population), digitalizing government business, including patents, customs and tax forms, and by developing software and content for government websites. The Ministry of Information and Communication carried out e-government plans through the 2000 "Government for Citizens (G4C) project requiring all central and local government agencies to operate websites.

Korean government websites improved the efficiency of service provision by cutting response times and costs. Up to 650 services were provided online, enabling citizens to file civil petitions and gain online access to essential documents such as national registry certificates and land registers. By 2006, the Korean government relied on the internet to procure up to 99.6% of goods ($46.7 billion annually), and receive 82.6% of taxes. Online transactions cut government procurement time down from half a day to one minute, and provided citizens with guaranteed responses to website inquiries within 24 hours. Individual citizens, businesses, Koreans living

[12] Ho (2002) reports that e-government in the U.S. led public managers to focus more on user satisfaction, control and flexibility in service delivery.

abroad and foreigners could all access public services at their convenience. E-government saved $1 billion from the government budget, cut government personnel by 9,000 and saved the economy $16 billion through the 'E-Procurement', 'E-Trade' and 'E-Construction' programs (Korea E-Government Website).

Korean government websites also increased government accountability, by providing citizens with information about budget use and policy making. Citizens were able to monitor every government decision or opinion, which was now recorded in e-document cards. Online forums served as a civil participation portal, allowing citizens to request desired services or complain about the poor performance of local government officials.

Democratization, then, was a necessary condition for the successful introduction of E-government in Korea. By expanding the size of the winning coalition, heightening transparency, increasing accountability to the electorate, and multiplying the number of veto points required for a corrupt deal, democracy increased the costs and risks for political leaders to exchange favors with the business elite and provided electoral incentives to instead more effectively deliver public goods to constituents. Introduced as part of a broader trend in Korean democracy to reign in bureaucratic corruption, E-government has succeeded in improving the openness, transparency, and accountability of Korean government operations.

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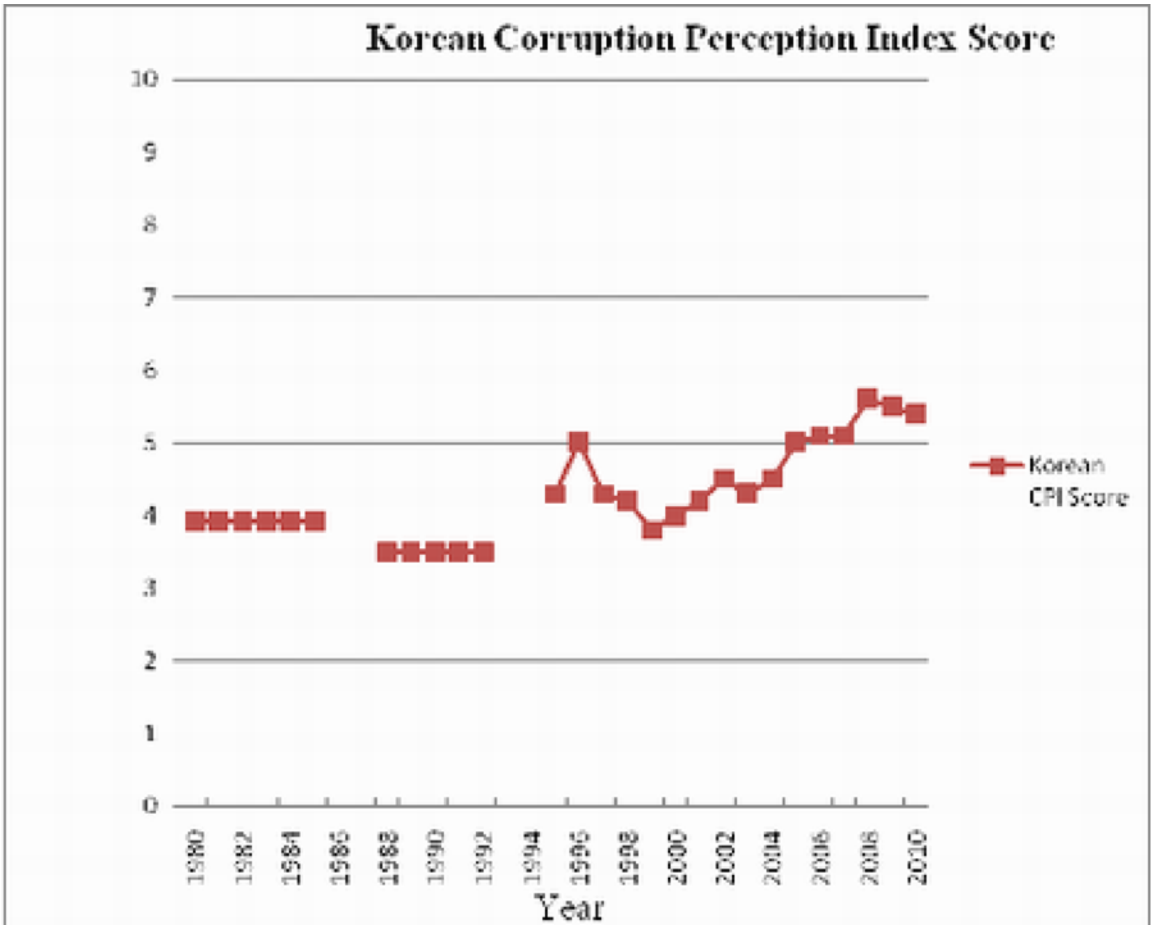
## Tables and Figures

**Figure 1: Korean Corruption Perception Index**




**(10 is least corrupt, 0 is most corrupt)**

Sources: Transparency International Corruption Perception Index - http://www.transparency.org/policy_research/surveys_indices/cpi

**Table 1: Estimating Rents in the Chun Industrial Rationalization**

| Acquiring Group / Target Group | Debt Terms: Years deferred/ Years repayment/ Interest rate | Take Over Price (Per Share) | Post Support Market Share value* | Gain from Target | Gain from Own Share Rise | Total Gain |
|---|---|---|---|---|---|---|
| **Dongkuk** / **Union Steel** | 229 million credit guarantee<br>Write off | 2,517 Won | 4,120 Won | $22 million | Not publicly traded | $22 million+ |
| **Hanil** / **Kukje Commerce** | $218.8 million: Write off<br>$218.8 million: 15/15<br>$263.2 million: 12/10<br>$70.3 million: 10/10/10%<br>New loans | 1 Won | 821 Won | $43.09 million | $47.3 million | $90.4 million |
| **Kukdong** / **Kukje Commerce** | $165 million: Write off<br>$74 million: 15/ 5<br>$90.8 million: 15/10<br>$64.85 million: 10/10/10%<br>New Loans | 80 Won | 821 Won | $8.133 million | $9.367 million | $17.5 million |
| **Hanjin** / **Daehan Sunjoo** | $494.7 million: Write off<br>$438.8 million: 15/15<br>$235 million: 5/5/5%<br>New Loans | 419 Won | 860 Won | $15.403 million | Not publicly traded | $15.403 million + |
| **Ssangyong** / **Namkwang** | $169.7 million: Write off<br>$169.5 million: 15/10<br>$62.6 million: 10/10<br>New Loans | Free | 1,690 Won | $27.699 million | Not publicly traded | $27.699 million + |
| **Daelim** / **Samho** | $340.7 million: 10/15<br>$48.1 million: 3/0<br>$34.4 million: 20/0<br>$111.7 million: 10/10/10%<br>New Loans | Free | 1,590 Won | $42.297 million | $558.778 million | $601 million |
| **Daewoo** / **Kyungnam** | $554 million: 15/15<br>$235 million: 12/5/10%<br>New Loans | 1/100 Won | 1,695 Won | $33.149 million | $269.916 million | $303 million |

***Average value two weeks following support**

Sources:

Debt terms from Government of the Republic of Korea (MOF) 1988, p. 323 *FOI Request Materials*, gains calculated from *KSE Data Base*, bribes per asset data from *FOI requested material*, direct political contribution data from (Government of Korea, High Court 1996), financial statistics from (*Annual Analysis of Firms*, various years).

**Table 2: Industrial Rationalization Acquisitions**
**Financial Performance vs. Bribes & Family Ties**

| **Acquiring Firm** / **Target Firm** | **Industry** | **Financial Performance Rankings 1979 -1984**** | | | | | **Corrupt Political Factors** | |
|---|---|---|---|---|---|---|---|---|
| | | **Sales/Assets** | **Profit/Financial Cost** | **Earnings/Assets** | *Current Ratio* | **Debt/Assets** | **Elite Ties** | *Bribe Per* **Asset** |
| Dongkuk | Steel | 45 | 73 | 82 | 91 | 64 | 4 Ministers<br>1 Ambassador | .021<br>(1st Overall) |
| ***Union** | | **18** | **27** | **27** | **54** | **9** | | .0007 |
| Hanil | Textiles | 22 | 67 | 78 | **33** | 67 | 2 KMA Presidents<br>Roh Tae Woo<br>NA DJP Member | .038<br>(3rd Overall) |
| ***Kukje** | Shoes | 40 | **40** | **20** | 60 | **40** | | .0007 |
| Hanjin | Shipping | 57 | 100 | 100 | 100 | 100 | 1 Minister | .01331<br>(1st in Industry) |
| ***Daehan Sunjoo** | | 29 | 71 | 71 | 57 | 86 | | 0 |
| Ssangyong | Construction | 86 | 89 | 89 | **11**<br>(81) | **57**<br>(83) | | .00426<br>(8th of 40 in Industry) |
| ***Namkwang** | | **54** | **48** | **49** | 84 | 68 | | 0 |
| **Daelim** *** | Construction | **32** | **70** | **76** | **78** | **24** | Brother-NA Chairman<br>Chun's Brother employed by group | .00497<br>(9th of 40 in Industry) |
| Samho | | 65<br>(45) | 81 | 84 | 81<br>(62) | 78 | | 0 |
| Daewoo | Construction | *** See Note** | | | | | Brother is Deputy Prime Minister Roh Tae Woo | .00475<br>(13th of 40 in industry) |
| ***Kyungnam** | | 76 | 67 | 77 | 40 | 78 | | 0.00016<br>(bottom of industry) |
| Kukdong | Construction | 5 | 3 | 5 | 11 | 5 | | .027<br>(2nd Overall) |

***Top Performer
**Financial Performance Rankings Refers to Percentage of industry firms above the firm

*Daewoo Corporation, a trading firm, also contained the group's smaller construction operations. In mid-February 1985, rumors of Daewoo's collapse led to a 20% fall in share value and prompted the group to issue a disclosure denying that Daewoo had become a target of Chun's industrial rationalization program, or entered into nonpayment. (*Chosun Ilbo* 1985).
Statistics in parenthesis are group, rather than firm, statistics

Source: Bribes per asset data from *FOI requested material*, direct political contribution data from (Government of Korea, High Court 1996), financial statistics from (*Annual Analysis of Firms*, various years). Family tie data from (*Chaebol and Chaebol Families* 1992).

**Table 3. Limited Rents in the Big Deal**
***(% Increase or Decrease in firm share value at time of Public Disclosure)***

| Industry | Type of Deal | Financial Aid | Self Rescue Measures | Value of Firm shares Vs. KOSPI & Industry Index | Response to News of Deal | Response to Release of Aid Terms |
|---|---|---|---|---|---|---|
| Semi-conductors | Hyundai takeover of LG | None | None | Hyundai | 1.6 | None |
| | | | | LG | 4.5 | |
| | | | | KOSPI | -1 | |
| | | | | Industry | -5.4 | |
| Rolling Stock | Merger of Hyundai, Hanjin Daewoo | Temporary low interest rate on 153.7 Bill. Won | None | Hyundai | 0.3 | -13.57 |
| | | | | Hanjin | -2.91 | 2.2 |
| | | | | KOSPI | -1 | 14.61 |
| | | | | Industry | 3.37 | -12.31 |
| Aircraft | Merger of Samsung Daewoo Hyundai | 75 Bill. Won debt equity swap 374.4 Bill.Won repayment postponed | 100.2 Bill. Won Capital infusion Factory sold 500 workers (15%) cut | Samsung | -2.4 | 18.4 |
| | | | | KOSPI | -1 | 17 |
| | | | | Industry | 0 | 18.4 |
| Petroleum Refining | Hyundai takeover of Hanhwa | 5yr defer/ 5yr repayment on 1.2 Trill. won ($990 mill) | $500 Mill. in foreign capital | Hanhwa Energy | -20.56 | 28.38 |
| | | | | KOSPI | -1 | 8.73 |
| | | | | Industry | 3.42 | 0 |
| Petro-chemicals | Merger of Hyundai & Samsung | Firms not publicly traded and deal collapses | | | | |

Note: Share response calculated from one week before event to two weeks following the event.

Source: *KSE Data Base.*
KOSPI is the Korea Composite Stock Price Index

**Table 4: Appropriateness of Government and Bank Response to Chaebol in Trouble**

| | Annual | | | | Two-Year Rolling Avg. | | | |
|---|---|---|---|---|---|---|---|---|
| | Tough | Punitive | Lenient | Favoritism | Tough | Punitive | Lenient | Favoritism |
| **Chun regime (1984/85–1987/88)** | | | | | | | | |
| Number of cases | 3 | 8 | 3 | 4 | 2 | 3 | 4 | 6 |
| Percentage of cases | 17 | 44 | 17 | 22 | 13 | 20 | 27 | 40 |
| **Democratic governments (1988/89–2004/05)** | | | | | | | | |
| Number of cases | 20 | 10 | 9 | 6 | 14 | 2 | 11 | 7 |
| Percentage of cases | 44 | 22 | 20 | 13 | 41 | 6 | 32 | 21 |

SOURCES: Statistics were gathered from condensed, combined financial and cash flow statements from (MERI 1985-1992 editions) and (NIMA, 1994-2000 editions).

NOTES:
Total capital and debt statistics for each group were gathered from Table 3.1, "Table of Primary Indicators," present in both of the aforementioned publications.
Statistics for long-term loans, with maturity of over one year, predominantly from banks, were selected to approximate bank debt and gathered from each group's condensed financial and cash flow statements. Because the maturity of long-term loans exceeded the financial accounting year, this article calculated two year rolling averages of long-term loans for groups that appeared in consecutive years in the top 30 list. Annual rates of change were then calculated per group and the relative rate of change was calculated by comparing each group's rate with that of the top 30 average. Because of groups having dissolved or falling from the top 30 list, more cases were present with the single year as opposed to two-year rolling average calculation of long-term loans. Note that the table is of relative measures. However, the overall study does show the same trend for both relative and absolute measures.