AN EXPLANATION FOR THE END OF POLITICAL BANK ROBBERY IN THE REPUBLIC OF KOREA

The T + T Model

James C. Schopf

Many statist accounts of development, especially that which has occurred in East Asia, emphasize the autonomous role of the bureaucracy. Civil servants in these accounts are often assumed to give plan-rational guidance to economic forces. This argument fits nicely with the claims of some strong-state advocates that the messiness, conflict, and jockeying for position characteristic of democratic politics do disrupt the efficient contributions to development that a state-led or *dirigiste* system makes possible. This article, however, argues to the contrary, in favor of a different theoretical analysis to which comparative examination of Korean regimes gives some empirical confirmation. In Korea, authoritarian leaderships extracted funds and rewarded political supporters by using banks and bureaucracies to coddle inefficient but favored firms with close ties. Under a more democratic regime, it was harder, more expensive, and above all, more dangerous for firms and politicians to act in a similar way. Because of the wider diffusion of political power, attempts to procure favoritism required bribing a larger and more diverse set of politicians. Meanwhile, transparency and accountability increased because this wider exposure made the transactions known to

James C. Schopf is a Ph.D. candidate in the Department of Political Science, University of California, San Diego. He is currently Visiting Lecturer at the School of Public Policy and Management, Korean Development Institute, Seoul. The author is grateful to David Lumsdaine, Stephan Haggard, General Secretary Won Soon Park of the People's Solidarity for Participatory Democracy, Hae Gohn Kwack at the Millennium Democratic Party, and the National Assembly Administrative Affairs Office.

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more people, and uncensored reports and democratic processes provided for greater scrutiny.

The uncurbed exchange of rents during dictator Chun Doo Hwan's rule (1980–88) with Korea's Kukdong, Dongkook, and Hanil groups contrasts with later smaller scale, unsuccessful dealings between the Hanbo group and a multitude of politicians under more democratic governments from 1988. Furthermore, analysis of government responses to troubled *chaebol* in the two periods–from 1984, the earliest year for which data is available, to 1988 and 1989 to 1998–offers additional and more systematic support for the contention that the more rational government response occurred in the democratic period. Following on three bank scandals, democratic politicians also introduced bank management reforms that granted shareholders control over management, further decreasing political influence in lending.

The upshot of these findings is that they demonstrate the need to augment some versions of state-led development theory. Clearly, state-led development theory, from Chalmers Johnson to Alice Amsden, has extended scholarly understanding of Korean and other newly industrialized countries' industrial advancement. While establishing an effective bureaucracy, as President Park Chung-Hee did, contributed to Korea's economic development, it was not determinative. A leader, in wielding a competent bureaucracy, has a range of policy options. Bureaucrats do not make decisions for political leaders. As shown below, careful examination of evidence released under Korea's new Freedom of Information Act underscores that President Chun Doo-hwan–through his Industrial Rationalization Program, the foremost government industrial intervention of the 1980s–did not use the effective economic bureaucracy available to him simply to implement plan-rational industrial policy.[1] Instead, Chun selected firms to receive rents and used the bureaucracy to advise these politically motivated decisions, thus foregoing maximization of efficiency and basing his decisions not on firms' economic performance so much as on the owners' political contributions and family ties.

1. With assistance from the People's Solidarity for Participatory Democracy (PSPD), I filed a freedom of information request with the National Assembly Administrative Affairs Office on May 19, 1998, under the newly passed Korean Freedom of Information Act. My request covered several hundred thousand pages of sealed documents detailing the exchange of bribes under the Fifth Republic that had been provided by various ministries to National Assembly members participating in the 150th General Assembly's closed-session 38th Special Inquiry into Corruption, held in 1988. Following an initial rejection, I appealed on July 13 with assistance from the PSPD, and in August the National Assembly's Freedom of Information Deliberative Committee granted my request. The information released to me came as the first application of the Korean Freedom of Information Act for classified National Assembly Documents. Materials I received under this request will be noted as "FOI request materials."

Determining the likelihood of political leaders exchanging rents leads one to examine the political institutions that constrain leaders and not merely the bureaucratic agencies under their control. At its heart, this article develops an analytical model drawing on well-known theories relating to two aspects of political institutions: transaction costs and transparencies, here called the T + T model. Where the transaction costs of corrupt exchange are low and the concealment of corrupt exchange possible, because of an opaque environment, the model predicts a large exchange of favors between the political leader and heads of business. In accordance with the model, the institution of dictatorship, with its low T + T, allowed Chun Doo-Hwan to efficiently amass an enormous amount of bribes from the corporate sector ($1.24 billion, at the average exchange rate for 1980–88 of 767 won per dollar).[2]

Under democratic institutions, however, a much larger political elite had a share in controlling decisions that affect economic rents. Getting favors from banks now required involvement of numerous politicians, including many from the opposition party. This expansion thus raised the costs and risks of detection. Democracy increased transparency and transaction costs, which reduced payoffs from bank-based corruption for political and business elites. Under democratic government, the ruling party introduced a substantive bank management reform that deterred much bank-based corruption. Two big bank corruption scandals, products of higher transparency and transaction costs under the new democratic institutions, were needed to warn elites of the dangers. That, in turn, meant political leaders had less to lose by introducing reform.

The State-Led Development Argument

The conventional account of Korean development ignores the mammoth exchange of favors that had been endemic to government/business relations under Korean dictatorial regimes. Chalmers Johnson formulated the theory of state-led development, explaining how government economic intervention fostered Japanese developmental success. Johnson argues that an autonomous, powerful bureaucratic Ministry of International Trade and Industry (MITI) propelled Japan's industrial transformation by channeling investment to strategic industries. This pilot ministry practiced administrative guidance of the private sector by first establishing production goals for strategic industries and then inducing firms to fulfill them through financial and tax incentives, infrastructural development, and import protection or exemption from import duties. Legislative and judicial branches were mere safety valves for

2. "Chun Gathered 950 billion won" (in Korean), *Joongang ilbo,* January 13, 1996.

irate groups, leaving MITI the autonomy to focus strictly upon economic development.[3]

Scholars such as Alice Amsden have applied Johnson's approach to Korea. Amsden argues that the Korean government manipulated various economic mechanisms (control over commercial banks, licensing, price controls, and restrictions on capital) to guide business toward economically beneficial results. She argued that in exchange for subsidies, the state placed performance standards on private enterprise that penalized the poor performers and rewarded only the good ones.[4] Jung-en Woo agrees that the Korean state rewarded solid economic performance: "The mercantilist state [was] rewarding the *chaebol*, which it deemed the most fit agent to carry out the state's purpose."[5]

But the core of the state-led approach in which benign Korean bureaucrats controlled policy making primarily through the banks, distributing rents to reward economically sound performance, has important theoretical flaws. David Kang points out that the approach often fails to examine the politics behind the autonomous and insulated bureaucracy. He further points out that the concept itself contains contradictions, because bureaucracies are hierarchically ordered organizations established to serve political superiors' purposes.[6] Damaging empirical evidence bears this out. Material first released under Korea's new Freedom of Information law pertaining to the 1980s' Industrial Rationalization program shows patterns that diverge from the state-led model. The program, which defined the major episode of government industrial policy under the Chun government, involved 78 firms in 13 different industries from shipbuilding to textiles. The single largest case of restructuring involved dissolving and reselling the 23 subsidiaries of the Kukje Group. The documents show that Chun overruled bank decisions and channeled financial subsidies to groups who had family ties or made large financial contributions, not to the best performers. Chun did shape the firms' incentives, but he did so by inducing contributions, not by improving performance.

If one supposes the Chun regime possessed an autonomous bureaucracy, one might expect that increased oversight by the National Assembly, a product of democratic transition, would increasingly politicize the policy-making process and channel rent to politically favored firms. In fact, bank lending

3. Chalmers A. Johnson, *MITI and the Japanese Miracle: The Growth of Industrial Policy, 1925–1975* (Stanford, California: Stanford University Press, 1982).

4. Alice H. Amsden, *Asia's Next Giant: South Korea and Late Industrialization* (New York: Oxford University Press, 1989).

5. Jung-en Woo, *Race to the Swift* (New York: Columbia University Press, 1991), p. 175.

6. David C. Kang, "Korean and Taiwanese Development and the New Institutional Economics," *International Organization* 49:3 (Summer 1995), pp. 555–87.

moved away from favoritism, a trend culminating with bank management reform. Why did bank-based corruption decline from large-scale exchange under Chun's dictatorial rule, while powerful bank boards of directors under democracy allowed bank shareholders to wrest control of the bank away from political influence?

A Transaction-Costs-and-Transparency Theory of Corruption: The T + T Model

A theory of corruption explaining the exchange of rent between political leaders and business elites can provide some answers. Political leaders possess independent interests derived from institutional power, which they seek to further. As Douglass North contends, leaders seek to maximize revenue in return for the protection they offer as discriminating monopolists.[7] Leaders are motivated by survival to secure revenue as well. Authoritarian leaders, as Philip Roeder points out, are accountable to and must reward the elite supporters within their ruling coalition.[8] Chun testified that he provided the members of his party with $25 million annually for over seven years.[9] Owners of large *chaebol* business groups also seek to increase wealth, whether through market competition or by using kickbacks to obtain rents from political leaders.

Two factors chiefly condition the exchange of favors between political leaders and the business elite: transaction costs of rent seeking and the likelihood and severity of the penalties if they are detected, which in turn derives from the transparency of the transaction environment. As North argues, the transaction costs of obtaining rents constrain the degree to which leaders can secure revenue. Where the transaction costs of creating, monitoring, and enforcing the exchange of favors are low and political penalty unlikely, because of low levels of transparency, fertile conditions for corruption obtain. When transaction costs are higher and the environment much more transparent, corruption becomes less lucrative for the political leadership and for business.

As Korean institutions shifted from dictatorship toward democracy, the costs for the corrupt use of banks rose and the benefits fell for rulers and business, leading in turn to a decline in bank corruption. Democratization gave the National Assembly a larger policy role, allowed more political actors to participate, and liberated the press. Each change drove up the transac-

7. Douglass C. North, *Structure and Change in Economic History* (New York: Norton, 1981).

8. Philip G. Roeder, *Red Sunset: The Failure of Soviet Politics* (Princeton, N.J.: Princeton University Press, 1993).

9. "Investigation of Chun's Use of Slush Funds" (in Korean), *Joongang ilbo,* February 5, 1996.

tion costs of corrupt exchange and heightened transparency, raising the political risks to *chaebol* and the president and his party.

Annual government inspections gave Assembly members the authority to interrogate bank presidents and their corporate clientele. Bank presidents thus became accountable to a variety of political masters, depriving the president's party of its political monopoly. Members of the opposition had to be bought off before a political leader could get kickbacks for low-interest loan schemes. The annual inspections allowed opposition Assembly members to acquire knowledge of others' political use of the banks and gave them the option of blowing the whistle if not provided with sufficient payoffs themselves. Increased freedom of the press under democracy could be used to mobilize public support for investigations the ruling party tried to curtail.

Besides heightening transparency, Assembly oversight of banks drove up the transaction costs for business attempting to secure low-interest loans for kickbacks. Hilton Root observes that under a parliamentary regime, a firm seeking to obtain particularistic returns must undertake many more bargains, leading to higher transaction costs and a lower potential net return.[10] Such high costs of corruption under Korean democracy were evident in the Hanbo bank scandal in which Chung Tai-Woo had to strike separate deals with 35 government officials and politicians to get low-interest loans.[11]

Indeed, bank lending patterns under democracy demonstrate both reduced favoritism and tougher lending terms from the banks to the leading *chaebol*. After two major bank corruption scandals involved three Korean presidencies–with the last inflicting heavy damage upon an incumbent president–the higher costs of corrupt exchange under democracy became clear to political leaders, who consequently had less to lose by foregoing their political influence over banks. Bank management reform gave powerful new boards of directors representing shareholders more control over the bank presidents and policies. Korean banks then introduced profit-maximizing reforms, such as credit risk management (CRM) systems. These made political interference and influence in bank lending decisions difficult, effectively closing the era of political bank robbery.

The Exchange of Rent under Chun Doo-Hwan

As predicted by the model, low transparency and transaction costs of corruption allowed Chun Doo-Hwan to reward political contributors with ample

10. Hilton L. Root, *The Fountain of Privilege: Political Foundations of Markets in Old Regime France and England* (Berkeley: University of California Press, 1994), p. 54.

11. "A Megaton Bomb, the Circulation of the Second List" (in Korean), *Joongang ilbo,* April 16, 1997.

rents channeled through the banks in return for kickbacks. Chun alone made crucial policy decisions, as revealed in the largest industrial rationalization case, the Kukje dissolution. He allowed only a few others–his bodyguards, the heads of the Korea Central Intelligence Agency, the National Tax Office, and economic ministers–to be involved in the amassing of a considerable sum of bribes and personally oversaw contributions, instructing underlings never to receive funds, as "I will do it for you."[12]

While relying partly upon intimidation and coercion to secure bribes, Chun also rewarded large *chaebol* contributors. Through the Industrial Rationalization program in the mid-1990s, Chun designated favored *chaebol* (those that had provided bribes or with family ties) to define the terms of takeovers and obtain tens of millions of dollars in rents through compensatory low-interest loans. In the largest of the rationalization cases, the Kukje Group, accounting for 23 of the 73 targeted firms, was dissolved by Chun and allocated, along with loan subsidies, to Chun's three largest per/asset bribe Chaebol contributors: Hanil, Kukdong, and Dongkook.

The Dissolution of the Kukje Group

Like the founders of the Samsung, Hyundai, Gumho, and Shin Donga groups, Kukje group founder Yang Te-Jin first accumulated capital through the rice trade, establishing a rice mill in 1940. He then diversified into rubber manufacturing in 1948 and shoes, in short supply following the Korean War, to become Korea's first shoe exporter in 1962. Through takeovers, mergers, and the establishment of new firms, Kukje expanded rapidly: into textiles in 1971, shipping and metals in 1972, paper in 1973, securities in 1974, trade in 1975, and steel and electronics in 1977. Kukje's assets multiplied 28 times in 10 years to make it Korea's seventh largest *chaebol* by 1983, with sales of $2.4 billion, assets of $1.85 billion, $900 million in exports, and 38,800 employees.[13]

In the 1980s, a cyclical downturn in core industries combined with a short-term credit crunch dealt the group a financial setback. The second oil shock led to stagnation and excess competition in the major industries (shoes and textiles) in which Kukje's firms produced and a sharp contraction in Middle East construction orders. Kukje firms in the trade, construction, machinery, textile, and shipping sectors all recorded losses. The group continued to ex-

12. "Corruption Styles of the Fifth and Sixth Republics" (in Korean), *Chosun ilbo*, February 17, 1997. Chun accumulated twice as much in bribes as did his successor Roh Tae-Woo (950 billion won versus the latter's 460 billion won), according to the prosecutor. See "Confirmation of Political Contributions from Firms," ibid., January 12, 1996.

13. Management Efficiency Research Institute (MERI), *Korea's Fifty Largest Chaebol* (Seoul: MERI, 1985), p. 85.

pand investment, however, spending $299 million in construction of a new headquarters, hotels, a golf course, and manufacturing plants in Australia.[14]

In the spring of 1984, Kwon Chul-Hyun, the second largest shareholder and previous owner of Kukje group affiliate Union Steel, filed six court cases to reassert management rights and win $6.7 million in compensation for the firm's loan guarantees to Kukje affiliates. Regulations in 1984, which eliminated further Wonmae loans, in combination with the threat posed by Kwon's lawsuit, drove short-term lenders to recall $3.2 million from Kukje in November and December of 1984. Kukje's October 1984 financial statements indicated, however, that only $169 million of $2.1 billion in total debt were Wonmae loans, compared to $1.29 billion in long-term bank loans, a higher percentage than the 34.5% average of the top 30 *chaebol* in 1984.[15]

With Kukje unable to repay $53 million on December 27, 1984, a consortium of banks led by Kukje's main bank, Korea First Bank (KFB), stepped in. They supplied $188 million in emergency loans through to January 8, 1985, and another $116 million by February 18.[16] On February 13, the day following the National Assembly election, KFB's president Lee Pil-Sun announced the introduction of a standard bank fund management program under which core Kukje firms would continue operation. Contrary to market expectations that Kukje would dispose of non-core businesses and unused real estate, eight days later the government announced the transfer of core firms to Hanil Synthetic Nylon and Kukdong Construction. Lee charged that the dissolution was unavoidable, due to "incompetent management, excessive debt/asset ratio, and clan management under the son-in-laws of owner Yang Jung-Moe,"[17] while Finance Minister Kim Mahn-Jeh claimed to have selected Hanil and Kukdong for their solid financial structure and competent management. Lee and Kim, who both claimed a role in the decision, argued that supplying funds to Yang was like "pouring water into a bottomless vase."[18] State-led development proponents support the interpretation that bureaucrats made responsible decisions guided by economic rationale. But, is this in fact what happened?

14. Government of the Republic of Korea, Ministry of Finance (MOF), *Reorganization of Infeasible Firms,* a compilation of documents from the MOF, Bank of Korea (BOK), Bank Supervisory Board, and main banks, in National Assembly, *Fifth Republic Corruption Hearings*, July 1988, p. 323, FOI request materials.

15. "Union Steel Purchase Contract Is Invalid" (in Korean), *Joongang ilbo*, July 25, 1984; "Kukje Group: Murder Victim or Self Destruction?" (in Korean), *Wolgan joongang* [Joongang monthly magazine] (May 1988), p. 286; and MERI, *Korea's Fifty Largest Chaebol*.

16. "Kukje Group Dissolution Drama" (in Korean), *Nehweh kyungjae,* July 30, 1993.

17. "Why the Kukje Group Is to Be Reorganized" (in Korean), *Hankook kyungjae*, February 22, 1985.

18. "Kukje Group Dissolution Unconstitutional" (in Korean), *Joongang kyungjae*, July 30, 1993.

The Policy-Making Process under Chun

The true pattern of economic policy making under President Chun emerged during Yang Jung-Moe's 1993 Constitutional Court case, placing Chun at the center of crucial policy and bank lending decisions. In the final hour, Chun had overruled a KFB self-rescue normalization plan that had, like the previous Hysoung and Gumho self-rescue restructurings, been negotiated with the target group. The Constitutional Court's head judge Choe Kyu-Kwang ruled that "in the third party takeover process, the Government ignored the bank's independently established normalization proposal, and arbitrarily selected the Kukje Group's total dissolution, forcing the main bank to acquiesce."[19]

Despite President Lee's announcement of the KFB group's dissolution, the bank had been denied any input. The head of the MOF's Financial Bureau, Kang Hyun-Wook, revealed that he had "received a direct order from the Minister of Finance Kim Mahn-Jeh to write the [Kukje Dissolution] announcement, and to borrow KFB President Lee's signature." The "Kukje Normalization Plan" announced by Lee was in fact an MOF document.[20] The finance minister had failed even to consult with any of the banks from February 7 until the announcement.

Immediately prior to the implementation of the self-rescue plan prepared by KFB and Kukje on February 5, officers from the Blue House and the MOF met in a secret all-night session in a south Seoul Hotel room, concocting a rival plan to dissolve the group, titled "An Emergency Instruction from the Blue House to the Ministry of Finance" on February 6.[21] According to the general prosecutor, the following day, Kim Mahn-Jeh presented the scheme to Chun (titled "Plan B") requiring the group's dissolution and transfer to third parties, along with an alternate Plan A that called for the preservation of Kukje Commerce and the sale of other group affiliates. The prosecutor reported that "following the President's decision, Plan B was selected and implemented."[22] Head Judge Choe outlined the implementation of Plan B: "Minister Kim Mahn-Jeh received President Chun's order on February 7 to dissolve the Kukje Group, and on February 11 they selected the takeover

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19. *Constitutional Lawsuit Concerning an Infringement of Property Rights Through Execution of Government Authority: Yang Jung Moe vs. Ministry of Finance* (hereafter *Yang vs. MOF Ruling*), Constitutional Court Ruling 89 Hunma 31, Third Public Report, July 29, 1993.

20. "The Life and Death of the Kukje Group" (in Korean), *Shin Donga* [Shin Donga monthly magazine] (September 1993), p. 507.

21. Ibid.

22. The MOF document, *Kukje Group's Present Condition and Policy*, included in the July 29, 1993, Constitutional Court decision, documented the Blue House's approval of Plan B on February 7.

firms. Chun then ordered KFB's Lee on February 13th to assume Yang's authority over assets and stock."[23]

Kang Hyun-Wook then testified that mid-level managers at the MOF, normally in charge of supervising self-rescue plans, had been excluded from the Kukje decision. Officers from both the KFB and the MOF reported to the general prosecutor "that we had neither led nor carried out" the Kukje dissolution.[24] Indeed, only eight individuals even received Chun's order to dissolve Kukje: the head economic secretary at the Blue House, the minister of finance as well as the vice-minister and his assistant secretary, the financial bureau head and his assistant, the head of the Bank Supervisory Board, and KFB's president.[25]

The Recipients of the Dissolved Kukje Group

Chun also intervened in the selection of Hanil, Kukdong, and Dongkook to take over the core Kukje firms. Examination of the textile, construction, and steel industries reveals that with the possible exception of Kukdong, these firms were far from top performers. They were, however, the three largest per asset contributors to Chun.

The Dongkook Steel Group. On February 11, Minister Kim presented a plan to President Chun calling for Hanil Synthetic Nylon to take over Kukje Commerce's shoe division, Kukdong Construction, to absorb Kukje Commerce's construction division, and for shareholder Kwon Chul-Hyun to take control of Union Steel. President Chun left the plan intact, except for the disposition of Union Steel, which he turned over to major contributor Dongkook Steel.

A producer of iron reinforcement bar, Dongkook Steel flourished with the booming demand for apartments in the late 1960s and early 1970s, controlling 80% of the re-bar market. The firm's growth stagnated as new competitors, notably Inchon Steel, Kangwon Industries, and Gumho Industries, entered iron manufacturing. Following the second oil shock in 1980, the four largest Dongkook firms recorded losses, with the group losing $3.35 million. The Dongkook group's capital/profit and sales/profit ratios placed it in the lower ranks of the top 50 *chaebol* in 1983, as Dongkook dropped in total sales from 19th to 24th by 1983.[26] Consequently, the government's choice of Dongkook surprised industry experts, especially since the MOF had designated shareholder and former owner Kwon Chul-Hyun to take over Union. When the transfer to Dongkook became evident on March 11, Kwon passed petitions to the relevant government ministries as well as Kukje's and

23. *Yang vs. MOF Ruling.*
24. "The Life and Death," p. 507.
25. "Kukje Group Dissolution."
26. MERI, *Korea's Fifty Largest Chaebol*, p. 162.

Union's main banks, protesting the handover to the smaller and inferior Dongkook. Despite support from Union Steel's labor union, the MOF rebuffed Kwon and the court rejected his temporary stock transfer motion on March 13.

Union Steel and Pusan Pipe, another firm considered by the MOF for takeover, outperformed Dongkook in every financial category. Among the 11 largest steel producers in the six years prior to the dissolution, Union and Pusan outperformed Dongkook in terms of liquidity (sales/asset ratio, 2nd and 1st vs. 5th and current ratio, 6th and 4th vs. 9th), profitability (profit/financial cost 3rd and 4th vs. 6th and earnings/asset 3rd and 4th vs. 6th) and stability (debt/asset, 3rd and 2nd vs. 7th), making it unlikely for Dongkook to have been any rational bureaucrat's first choice.[27]

The terms provided to the takeover group rested upon results of the on-site inspection of the target group, invariably a source of friction between the new and old owners. The Chun government mandated that takeovers proceed according to the "takeover first, settle accounts later" principle, which granted the new ownership control of management and an opportunity to manipulate on-site inspections to lower the purchase price. New owners countered that banks acted as a check against under-valuation of assets and inflation of debt. As Chun's rejection of KFB's normalization plan demonstrated, however, banks followed the orders of political leadership, more closely resembling bureaucratic agencies than independent actors. Examination of conflicting asset claims is a daunting task, even for accounting specialists in Korea. To determine if favors were provided, this article examines the market's estimation of firm value before and after the public release of takeover terms. Market capitalization (the price multiplied by the number of shares) is employed to measure firm value. Relevant industry indexes are then utilized to control for alternate sources of share price variation. Increases in firm value are attributed to the provision of financial support only in cases where the firm's share prices diverged from the industry index.

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

Although the government neither postponed nor excused Union Steel's repayment of debt, Dongkook profited from the exemption of most of a $229

27. Ratios computed based on data from *Annual Analysis of Firms* (in Korean) (Seoul: Maeil Kyungjae Publications), and MOF, *Reorganization*. Data were also gathered from some of the several hundred financial statements included in the *Fifth Republic Corruption Special Hearings* documents provided to the author under the FOI Act.

million credit guarantee provided by Union to Kukje Commerce at a February 1984 meeting of Union Steel's main stockholders.[28] Barring government intervention, Kukje Commerce's entrance into non-payment would have ensured conversion of the payment guarantee into actual debt liabilities, swelling Union's $206.4 million debt. The exemptions and deferred repayment provided to Kukje Commerce, which lowered its debt, also reduced Union's payment guarantees, raising the firm's value. No variation in share price could be discerned, however, because of government suspension of trading of Union's shares from February 15, 1985, at the fixed price of 1,250 won. Not surprisingly, Union's share prices jumped with the resumption of trading on October 22, 1986. Furthermore, in July and September the government had selectively leaked incomplete takeover term reports that were particularly relevant to Union's debt payment guarantees. Initial news reports on June 27, though, failed to mention Union's debt guarantees and a subsequent release on September 22 considerably underreported the financial favors provided in the Kukje Commerce takeover.[29] The true extent of financial support only emerged later in audit reports.

Union's 1986 financial statement, released one month early on January 31, 1987, showed Kukje Commerce's payment guarantee to be $48.4 million. Two weeks later, Kukje Commerce's financial statement reported the guarantee at $23.2 million. The market became gradually aware of the drop in Union's payment guarantee that came between the inaccurate reports in September and the release of the January financial reports, as accountants made rough financial estimates at the end of the year. Union's management also had ample incentive to leak the good news of reduced payment guarantees during the December formulation of the financial statement. Responding to September reports of financial support to Kukje Commerce and December leaks, Union's share price soared upward from 1,692 won to 3,875 won from the October 22 resumption of trading to the January 31, 1987, release of Union's 1986 financial statement.[30] This was a 129% rise, three times the Korean steel industry share index's rise of 45.1% from 293.58 to 425.97 over

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28. "Union Steel's Guarantee to Kukje to Be Resolved" (in Korean), *Joongang Ilbo Economist*, February 20, 1986.

29. "Four Kukje Affiliates to Be Reorganized" (in Korean), *Donga ilbo,* June 27, 1986. In Hanil's takeover of Kukje Commerce, for instance, the *Donga ilbo* and *Maekyung* newspapers reported rumors on September 22, 1986, that banks would write off $121 million of Kukje Commerce Debt, and provide deferment of repayment for another $121 million, when the true extent of support was an exemption of $218.8 million, and deferment of $481.9 million.

30. For financial statements, see Ahnkwon Accounting, "Union Steel Audit Report," Seoul, January 31, 1987; and Chungwoon Accounting, "Kukje Commerce Audit Report," Seoul, February 12, 1987. For the market response, *Securities* and *Stock Market*, the biannual and daily publications of the Association of Korean Publicly Traded Company's Public Information Research Institute, provide insight. Publications of the Korea Stock Exchange (KSE), they can be

the same period, Union's share price continued to surge to 4,120 won with the February 12 disclosure of the $23.2 million figure in Kukje Commerce's financial statement, reaching 4,500 won two weeks later.

Dongkook paid an average of 2,517 won per share to take over 54.3% of Union's 19 million shares. Dongkook's official 2,785 won per share purchase of 8,517,680 shares was augmented by Seoul Credit Bank's peculiar off-market sale through securities firms of 1.8 million shares at 1,250 won per share, following suspension of trading in February, 1985.[31] The reduction in payment guarantees raised Union Steel's value, providing Dongkook with a return of $24.76 million, far greater than the $2.31 million Dongkook would have gained had Union's shares followed the industry index.[32] Dongkook Steel shares were not publicly traded, so other gains could not be calculated.

Dongkook likely would have paid less if not for persistent protest from Union Steel's workers and legal action from former owner Kwon. Following Dongkook's initial June 30, 1985, on-site inspection, Union's workers demonstrated at the Pusan factory and corporate headquarters, launched a legal challenge to Dongkook's asset valuation, and placed notices in the leading daily newspapers, alleging that Dongkook managers had downgraded assets from A to C level and temporarily shut off machinery for reclassification as discarded property. Responding to labor unrest and Kwon's February 1986 lawsuit, the government directed Seoul Credit Bank to reassess Union's assets from March to June 1986, dispatching a management team from Pohang Steel in August. A Union Steel department head remarked, "if we [the labor union] had not raised the issue, Dongkook likely would have taken over the company at the first onsite inspection price of 1,700 won per share."[33]

The Hanil Synthetic Fiber Group. The favorable terms provided to Hanil Synthetic to take over the trade and shoe divisions and real estate affiliates of the parent firm, Kukje Commerce, stunned industry observers. Hanil had suffered from the decline in the Korean textile industry in the early 1980s and the government had revoked Hanil's general trading company license during a period when the group fell from 20th among *chaebol* in sales to 27th in 1983.[34] Furthermore, Hanil's financial performance had been poor. The

found in KSE, *KSE Data Base* (Seoul: KSE, July 1996), CD-ROM. The *Data Base* also includes data regarding Union's share price surge.

31. For the official won per share price, see MOF, *Reorganization*, p. 333. For the off-market trade information, see "Union Steel's Guarantee to Kukje to Be Resolved."

32. *KSE Data Base*. At the rate of the steel industry index, during the same period, Union's share price would have risen from 1,692 won to 2,702 won.

33. "Empty Firm, Union Steel, the Unfolding Drama," *Shin Donga* (November 1988), p. 540.

34. MERI, *Korea's Fifty Largest Chaebol*, p. 171.

group's parent firm ranked near the bottom of the nine largest fiber producers in profitability (seventh in earnings/assets and sixth in profit/financial cost) and in stability (sixth in debt/assets) in the six years prior to Kukje's dissolution.[35] Taekwang Industrial, for instance, outperformed Hanil in each financial category.

On December 30, 1986, Hanil Nylon took over 43,379,000 shares (55.86%) of Kukje Commerce at one won per share.[36] Erroneous reports of Hanil's takeover terms first leaked to the press on September 22, 1986, with the true scale of financial support only revealed on February 12, 1987, in Kukje Commerce's 1986 financial statement.[37] Kukje Commerce's banks wrote off half of the estimated $450 million in debt over assets ($218.8 million) and provided Hanil with a 15-year deferment of principal and 15-year installed repayment without interest on $218.8 million, and 12-year deferment of principal and 10-year installed repayment on $263.2 million. The banks also loaned Hanil $70.3 million, with a 10-year deferment and 10-year repayment, at 10% interest.[38]

The stock Hanil purchased had traded at an average of 400 won per share the year prior to the dissolution.[39] Reflecting the generous takeover terms, Kukje Commerce shares resumed trading on February 6, 1987, at 821 won.[40] This was timed to coincide with the release of the firm's financial statement, containing accurate terms of takeover and financial assistance. During the next two years, Kukje Commerce's share price fluctuated between 700 and 900 won. At 821 won per share, Hanil received a windfall of $43.092 million. In contrast to the generally observed decline in a takeover firm's share value, Hanil stock skyrocketed from 1,880 won one week prior to the release of accurate takeover terms on February 12, to 3,000 won just over two weeks later, double the rise in the Korean textile share index.[41] Hanil increased in

35. Data compiled from *Annual Analysis of Firms*; and MOF, *Reorganization*. Some of the financial statements that were part of documents from the 1988 National Assembly Special Inquiry into Fifth Republic Corruption released in response to the author's FOI request were also consulted.

36. *Sales and Purchase Contract for Kukje Affiliate's Issued Shares,* KFB document, National Assembly, 1988 Investigation into Fifth Republic, December 30, 1986, FOI request material. Kukje Commerce's trade division's assets totaled $787 million with debt of $1.2 billion. MOF, *Reorganization*, p. 328.

37. "Reorganized but Not Normalized," *Donga ilbo*, September 22, 1986; and Chungwoon Accounting, *Kukje Commerce Audit Report*.

38. MOF, *Reorganization*, p. 324.

39. Korea First Bank document, *Sales and Purchase Contract for Kukje Affiliate's Issued Shares*, National Assembly, 1988 Investigation into Fifth Republic, December 30, 1986, FOI request material.

40. *KSE Data Base*.

41. Ibid. The Korean textile share index rose from 487.6 on February 4 to 637.17 on March 4, an increase of 30.7%, compared to a 59.6% rise in the price of Hanil's shares.

value by $97.57 million, or $47.303 million greater than if its shares had mirrored the industry index. By taking over Kukje Commerce, Hanil gained a total of $90.4 million.

The Kukdong Construction Group. Chun's selection of Kukdong to take over Kukje Commerce's construction division was most economically rational of the three cases. Kukdong's financial performance ranked in the top half of the 37 largest construction firms in the five years prior to the takeover: seventh in profit/ financial cost, third in current ratio, fourth in debt/assets, 12th in earnings/asset, and 18th in sales/assets.[42]

Unlike other cases, the government released a generally accurate account of the terms of Kukdong's takeover to the press on June 27, 1986. The *Donga ilbo* subsequently reported, out of $330 million in debt over assets, a 10-year deferment and 15-year repayment for $169.4 million in debt, a $169.4 million debt exemption, and $60.5 million in new loans.[43] In fact, the banks wrote off $165 million, and for the remaining debt balance of $165 million, Kukdong received a 15-year postponement of repayment on $74 million, with five-year installed repayment, and a 15-year postponement and 10-year installed repayment on $90.8 million.[44] The banks actually lent an additional $64.85 million to Kukdong, with a 10-year deferment and 10-year installed repayment period, at the concessionary interest rate of 10% per year. Kukdong purchased 14.2%, 11 million shares of Kukje Commerce's Construction section at a price of 80 won per share for a total of only $99,435, far below Kukje's yearly average of 400 won prior to dissolution.[45]

Kukje Commerce stock resumed trading on February 6, 1987, at 821 won, yielding Kukdong a profit of $9.862 million. Kukdong's share price climbed from 515 won one week prior to the announcement to 910 won two weeks later. With 19.6 million shares, Kukdong's value rose by $9.367 million, $7.657 million beyond the 14% rise in the Korean construction index.[46] Net gains to Kukdong then totaled $17.5 million.

Rewarding Political Contributors through Industrial Policy

Why did Chun select Hanil, Dongkook, and Kukdong to take over the Kukje subsidiaries? Part of the answer can be found in political contributions (see

42. Data compiled from *Annual Analysis of Firms*; MOF, *Reorganization*; and *KSE Data Base*.

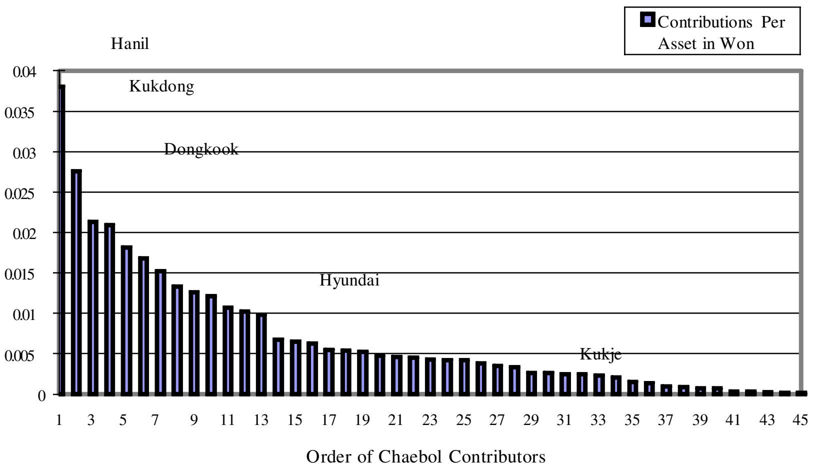
43. "Four Kukje Affiliates to Be Reorganized."

44. MOF, *Reorganization*, p. 338.

45. Soon Woo Lee, *After the Reorganization* (in Korean) (Seoul: Junkwon Shijang Jipjoong Tamgu, 1994), p. 72; and *KSE Data Base*.

46. Kukdong's share price rose by 77% ($9.367 million) from June 14 to July 4, compared to a 14% ($1.709 million) rise in the Korean construction index. See *KSE Data Base*.

FIGURE 1 *Order of Chaebol Contributors to Chun*



SOURCES: Bribes per asset data are from the National Tax Office, *Confirmation of the Record of the Tax Treatment of Political Donations*, prepared in February 1989, FOI request material; and Blue House, *New Village Movement Donation List*, prepared in February 1989, FOI request material. For direct political contribution data, see Government of Korea, High Court, *Chun Doo Hwan Trial Documents*, December 16, 1996.

NOTE: In terms of contributions per asset, Hanil ranked 1st with .0381, Kukdong 2nd with .0276, Dongkook 3rd with .0213, Hyundai 17th with .0055, and Kukje 39th with .0007.

Fig. 1). The list of *chaebol* political contributions, released to the author under Korea's first Freedom of Information Act, reveals a startling finding: the top three contributors per asset were the three recipients of Kukje Group firms: Hanil, Kukdong, and Dongkook. Their order and scale of contribution corresponds to the level of favors received from Chun. The three respectively provided eight, five, and four times as many contributions per asset as Hyundai, the largest *chaebol*.

Bribes were reinforced by family ties. The owner of the largest per asset contributor, Hanil's Kim Han-Soo, had forged a strong bond with Chun's inner circle. Kim's second and fourth sons married the daughters of two Korean Military Academy (KMA) presidents, Choi Nam-Sun and Kim Bok-Dong, from the mainstay of Chun's support, the KMA's 11th graduating class. Kim Bok-Dong's brother-in-law was right-hand man Roh Tae-Woo, and Hanil Kim's son-in-law, Lee Jae-woo, was also an assemblyman in Chun's Democratic Justice Party.

The Transition to Democracy and the Hanbo Bribery Scandal

The National Assembly's more active policy-making role, coupled with a press unleashed through the democratic transformation, heightened transparency and drove up the transaction costs of bank-based corruption. The most notable case of political bank bribery under Korean democracy, the Hanbo scandal, highlighted the higher penalty risk confronting the elite that took bribes in return for subsidized loans. While ex-President Chun faced penalty only upon departing office, Hanbo damaged an incumbent president and his party.

The National Assembly's annual investigation of the government raised transparency by allowing opposition Assembly members to interrogate bank presidents and the heads of client firms. As a consequence, democratic bribery rackets, such as that operated by Hanbo, now had to include opposition politicians. For the right payoff, these opposition members could use intimate knowledge of corruption to damage the ruling party. The Hanbo case also demonstrated the difficulty in containing a scandal once news reached the democratic press; it exposed the increase in transaction costs for rents under democracy. Hanbo revealed the higher transaction costs for rents under democracy, as well. With more political leaders influencing lending decisions, Hanbo's owner had to find and bribe 35 office holders.[47]

Hanbo's Financial Woes

Owner Chung Tai-Soo, a low-ranking tax official for 23 years, established the Hanbo group's parent firm, Hanbo Construction, in 1974. With 24 affiliates, Hanbo ranked 14th in total assets and 18th in turnover among *chaebol* at the end of 1995, producing in the steel, construction, energy, and pharmaceuticals sectors. Hanbo's rapid rise was due in part to Chung's success at securing government rent, unveiled in subsequent bribery trials.

At the end of 1996, Hanbo confronted financial crisis as the company was engaged in the final stages of construction of the world's fifth largest steel plant on three million square meters of reclaimed land in Tangjin. A one-and-a-half-year delay doubled costs to $7.4 billion, and secondary lenders, sensing Hanbo's trouble, cut off fresh loans. Initially, banks supplied emergency funds of $468 million in 1996 and $258 million in January 1997, but on January 23, 1997, Hanbo creditor banks declared insolvent two group affiliates that had failed to honor $9.6 million in promissory bills. Hanbo credi-

47. “Hanbo's Reach: The Unsolvable Mystery” (in Korean), *Hankuk kyungjae*, January 28, 1997.

tors initiated fund management, taking control of Chung Tai-Soo's shares, and selected Pohang Iron & Steel to manage Hanbo until the firm's sale.[48]

Hanbo Steel's rapidly deteriorating finances and soaring low-interest bank debt suggested that bribes had been exchanged for loans. During construction of Tangjin, Hanbo Steel's debt/capital ratio shot upward from 348% in 1993 to 1,892% in 1996, as the firm recorded losses of $116 million the first half of 1996. While Hanbo's secondary financial loans remained constant, bank debt soared, from $447 million (1992), to $1.9 billion (1994), $3.2 billion (1995), and $4.5 billion out of $6.4 billion of total debt in 1996, contrary to a pattern of normal lending to a troubled firm. Such favoritism produced the lowest interest rate among top 30 *chaebol* during construction of Tangjin in 1994 (6.67%) and 1995 (7%), and second lowest in 1993 (7.3%).[49]

Investigations by the general prosecutor and National Assembly revealed that Hanbo loans defied normal procedure. Creditors had provided $1.42 billion in 1994 and $2.8 billion in 1995 exceeding collateral.[50] Park Il-yong, head of KFB's credit management, testified at the National Assembly that while "working-level officials generally determine corporate lending, for Hanbo, the bank head offered loans." KFB loaned to Hanbo in 1993, despite opposition from credit managers, as top bank officials forged credit clearance documents and used trust accounts.[51] KFB's president Ryoo Shee-Yul even admitted failing to investigate Hanbo's business prospects, despite insolvency in 1995.

Higher Transaction Costs with Bribing the Assembly

In contrast to Chun's monopolized control of bribes, Hanbo's Chung Tai-Soo dispersed funds widely, to the Assembly's Finance Committee and bank presidents for low-interest loans and to opposition politicians to prevent Hanbo's inclusion in the annual Assembly government inspection.

Most bribes ($4.65 million) went to secure low-interest loans. In 1995 and 1996, Chung supplied $1.29 million to Kim Young-Sam's top aide, Representative Hong In-Kil, who introduced Chung's son, president of Hanbo Steel, to President Kim's economic advisors Han Lee-hun and Lee Suk-chae.

48. "Acceleration of Effects in the Steel Industry" (in Korean), *Joongang ilbo*, January 26, 1997; "Hanbo Steel's Non-payment" (in Korean), *Hankuk kyungjae*, January 24, 1997; "Hanbo's Reach," ibid.; and "Hanbo's Bankruptcy" (in Korean), *Maeil kyungjae*, January 24, 1997.

49. "Hanbo's Reach"; and MERI, *Korea's Top Fifty Chaebol*, Table 4-19, p. 76, for years 1993 and 1994 in the 1995 and 1996 editions, respectively, and from p. 108 for 1995 in the 1997 edition.

50. National Assembly, Special Investigative Committee (SIC), *Hearings on the Hanbo Incident, Questioning of Chung Tae Soo*, 183rd sess., April 8, 1997.

51. Ibid., April 17, 1997.

Hong requested loans from Han, who appealed to the Korea Development Bank's (KDB) president Kim Shi-hyung and KFB's president Lee Chul-soo. In return they supplied $348.8 million and $258.4 million, respectively, to Hanbo in 1995 without collateral.[52]

Following Lee Suk-chae's November 1996 appointment as presidential economic advisor, Hong asked Lee to request a loan from Chohung Bank's president Woo Chan-mok, who subsequently provided $129 million to Hanbo on December 3.[53] To further grease the wheels, Chung provided $2.26 million in 1995 and 1996 to three bank presidents, $496,800 to seven members of the National Assembly's Finance and Economy Committee (to phone KDB in 1996), and $491,000 to eight high-ranking politicians from President Kim's Minju faction. Finally, Chung provided $543,000 to nine powerful opposition (National Congress for New Politics, NCNP) assembly members to ward off questioning related to the Tangjin plant and Hanbo's financial troubles during the 1994, 1995, and 1996 Assembly investigations.[54]

Higher Transparency Leads to Whistle Blowing and Ruling Party Losses

The democratic National Assembly's expansive policy role raised transparency within the ruling elite, elevating the risk of rent exchange. Key opposition assembly members on the finance committee and inspection committees could blow the whistle in return for the right payoff. Once news reached the free press, a corruption scandal would be hard for the ruling party to contain.

Opposition leaders had taken Chung Tai-Soo's bribes since 1994. They knew that Chung had been imprisoned in the 1991 Suso land bribery scandal and indicted in 1995, laundering $77,520 for President Roh. Yet, the opposition waited until conditions were prime with Hanbo's entry into bank fund management in January 1997 just prior to the next presidential election before blowing the whistle. The day following the announcement of bank fund management, January 26, NCNP head Kim Dae-Jung publicly declared Hanbo to be “the worst corruption case of the Kim Young-sam administration,” calling for investigation of the president.[55] Kim Dae-Jung and Kim Jong-Pil likely reasoned that collateral damage to their parties was well worth imparting greater loss on the ruling party.

52. “New Facts about Hanbo Favoritism” (in Korean), *Joongang ilbo*, March 18, 1997.

53. Seoul Local Court, *Criminal Proceedings in the Main Court, Hanbo Corruption Case, First Hearing,* March 17, 1997.

54. Bribe figures compiled from SIC, *Hearings on the Hanbo Incident*, February 20 and April 7–May 1, 1997.

55. “Kim Young Sam Is Responsible, Says Kim Dae Jung” (in Korean), *Hankuk ilbo*, January 26, 1997.

The Hanbo scandal weakened President Kim Young-Sam, crippling his powerful Minju faction. Investigations revealed that Kim's son Hyun-Chul received millions of dollars in kickbacks for government contracts while managing his father's campaign finances,[56] thus discrediting elder Kim's reputation. Most importantly, the Hanbo crisis prevented the Minju faction from fielding a strong presidential candidate, eliminating powerful contenders Choi Hyung-woo and Kim Deog-ryong. The ruling New Korea Party therefore selected as chairman Representative Lee Hoi-chang, a non-Minju faction member opposed by President Kim, who supported independent candidate and Minju member Rhee In-Jeh. Rhee took 19% of the December vote away from Lee, including 30% from South Kyungsang and Pusan, Kim Young Sam's home province and NKP stronghold. These results enabled opposition leader Kim Dae-Jung to seize the presidency with only 39.7% of the vote to 38.2% for Lee.[57] The opposition took advantage of the Hanbo case to inflict a painful blow on the ruling party that split it from its core faction prior to the election.

As with the Roh and Chun scandals, Hanbo developed its own momentum with the opposition and ruling parties as well as Chung leaking names to the press, thus forcing the general prosecutor to expand the investigation ever further. The Kim government's initial attempts to save the Minju faction from further scrutiny by confining inquiry to the four most guilty lawmakers fell through after newspapers revealed 20 additional lawmakers from the "Chung Tai-soo list." Kim then yielded to public pressure, appointing a new general prosecutor to examine all 35 on the list.

The Drop in Bank Corruption: The End of Political Bank Robbery

The T + T model predicts that under democracy greater transparency and higher transaction costs will produce a drop in the exchange of bribes for low-interest loans. To test the hypothesis, this study seeks to ascertain the degree to which banks lent according to economic, as opposed to political, criteria. When faced with a financially troubled borrower, 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. Cases like Hanbo, where banks reward poor performers with further loans, attract suspicion as possible instances of bribery.

This research examines financially troubled *chaebol* with over 800% debt/capital ratio, and identifies four bank lending responses: tough, punitive, lenient, and favored (see Table 1). With a tough response, the bank called back

56. "Kim Ki Sup's Warrant" (in Korean), *Hankuk ilbo*, May 19, 1997.
57. "The Choice of 1997, Kim Dae Jung" (in Korean), *Munwha ilbo*, December 19, 1997.

TABLE 1 *Appropriateness of Government and Bank Response to* Chaebol *in Trouble*

	Annual				*Two-Year Rolling Avg.*			
	A	*B*	*C*	*D*	*A*	*B*	*C*	*D*
Chun regime (1984/85–1987/88)								
No. of cases	3	8	3	4	2	3	4	6
Percentage of cases	17	44	17	22	13	20	27	40
Democratic governments (1988/89–1997/98)								
No. of cases	15	8	4	5	11	2	6	6
Percentage of cases	47	25	13	16	44	8	24	24

SOURCES: Statistics were gathered from condensed, combined financial and cash flow statements from MERI, *Analysis of Financial Statements: Fifty Major Business Groups in Korea* (Seoul: MERI, 1985–1992 editions); and New Industry Management Academy (NIMA), *Financial Analysis of Korea's 30 Largest Chaebol* (Seoul: NIMA, 1994–2000 editions). 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.

NOTE: A = tough, B = punitive, C = lenient, and D = favoritism. 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.

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 favoritism, such as Hanbo, the bank extended more loans despite a *chaebol*'s capital reduction.

To control for overall fluctuation in the Korean financial market, which led 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 revealed, 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 and lenient to tough and punitive responses. The change was particularly evident when relative measures are made of the top 30 *chaebol*. Toughness, the strictest and most economically appropriate response, rose from 13% of all cases under Chun Doo-Hwan to 44% under the democratic governments.

As the T + T model predicts, the shift to democracy altered payoffs to politicians and the business community. With bank-based corruption risky, politicians had less to lose by foregoing political influence through management reform, introduced following the Chun and Roh trial and accelerated with the Hanbo scandal. The powerful new boards of directors provided shareholders with a mechanism to wrest bank management control away from political influence. Prior to reform, shareholders had no agency with which to restrain the bank president, who often sought to satisfy politicians in return for a desirable position upon retirement. With authority to override loan decisions, and no credit rating system, bank presidents could offer illicit loans with relative impunity.

Despite calls by the Bank Supervisory Board and MOF in May 1993, April and June 1994, and May 1996 for bank president accountability to shareholders, the Kim Young-Sam government introduced reform only in 1996, following the Roh and Chun scandals. Reform legislation, which established boards of directors with key positions held by non-permanent shareholder representatives, took effect only in January 1997. The 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. Major shareholders at Hanmi Bank–the Bank of America, Samsung, and Daewoo–immediately demonstrated the new board's power, rejecting the government's candidate for president in favor of an in-house candidate, Kim Jin-Man. 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.[58]

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.

58. "How the Bank Board Has Changed" (in Korean), *Joongang Ilbo Economist*, February 2, 1999; and "Non-Permanent Members of the Board" (in Korean), *Newsmaker* (weekly magazine), March 11, 1999.

The Korean government still influences management through non-permanent board members at three city banks where it is majority shareholder (Chohung 80%, Hanbit 75%, and Seoul 100%). The remaining city banks are nearly completely privately owned, however. The increased presence at Korean banks of foreigner shareholders that lack ties (e.g., family, school, or regional) to the political elite will likely further reinforce the board's authority. Foreigners already own over 20% of seven Korean city banks and are majority shareholders at three. So, decision-making at Korean banks, like the Korean government, has become increasingly transparent.

Korea experienced a noticeable drop in bank-based corruption from the dictatorial Chun regime, where low-interest bank loans were exchanged for bribes, to the democratic Kim Dae-Jung government, which severed the link between political leaders and bank presidents through bank management reform. The statist logic would lead one to believe that democratic politicization under a more active National Assembly would produce unsound economic policy. In fact, as the Kukje case and the fall in bank-lending favoritism demonstrate, the opposite trend is evident. An institutional theoretical perspective, focusing upon the transaction costs and transparency of the exchange environment, best explains the drop in political bank robbery and the timing of bank management reform. It was the introduction of democratic institutions that brought an end to Korean political bank robbery.