Crony Capitalism in East Asia: Has Anything Changed?

Preliminary Draft Only

Conference on
East Asia a Decade after the Crisis
Australian National University
Canberra, July 20-21 2006

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Crony capitalism has long been seen as a prevalent phenomenon in many parts of East Asia and was widely viewed as a significant contributing factor (for some, the decisive factor) in the Asian economic crisis of 1997-98. Accordingly, curtailing crony capitalist practices was seen as an important step in the rehabilitation of crisis-afflicted economies. As we approach the ten year mark from the Asian economic crisis, what can we say about the prevalence of crony capitalism around the region? The question seems both straightforward and of obvious importance, and yet it proves to be a surprisingly elusive. Almost nothing is straightforward. Definitions are slippery, there is no established base for empirical comparison, and no well developed corpus of theory to guide expectations about change. The aim of this first draft paper is to clarify the key conceptual issues, to sketch the empirical outlines of what seems to be happening in key parts of the region and to propose some plausible explanatory arguments. It is, then, a self-consciously tentative draft – a brush clearing exercise – with much still to be done. The second draft of the paper will aim to deliver the empirical goods together with an integrated argument about change.

I Crony Capitalism – what are we talking about?

Crony capitalism is a slippery notion that lies at the interstices of a number of distinct areas of scholarly inquiry by political scientists and economists, including the political economy of development, corruption, corporate governance and democratization. The term derives – at least in the East Asian context – from the Philippines during the Marcos era. In terms of broader application, pre-crisis the term was employed mostly in the media and occasionally as a casual adjective in the scholarly literature about various parts of the region. Post-crisis, the term and topic have become more common in analytic work (in particular, Faccio 2006, Fisman 2001, Hutchcroft 1998, Jomo and Khan 2000, Haber 2002, Kang 2002, Kreuger 2002, Krugman 1998, Rodan 2004 ch 5, Wei 2001).

1 The primary partial exception to this was Kunio Yoshihara’s major study (1988) major study on “ersatz capitalism” in Southeast Asia, which argued that economic development in Southeast Asia’s industrialising economies would not proceed as it had in Japan and the west, as these countries had little in the way of a national technological base, had ineffective industrial policies and because of chauvinism against the Chinese immigrant commercial in class. But this was a substantially different from the critique of crony capitalism that emerged in the wake of the 1997-98 crisis.
In much of the contemporary literature, the term is used almost interchangeably with others such as corruption and rent-seeking. As David Kang (2002, fn 4) correctly observes, all these notions connote resource allocation decisions based on criteria other than pure market efficiency. And yet treating them as synonyms seems to conflate too much. While cronyism and corruption are certainly associated, not all corruption is cronyistic and not all cronyism is necessarily corrupt. And while cronyism can be viewed as a species of rent-seeking, but not all rent-seeking is cronyistic. The term cronyism is rarely defined formally, but it can best be understood as referring to a pattern of business-government relations in which select business people who are very close to key policymakers receive highly preferential treatment that enables them to capture spectacular profits – even to the point that they dominate the corporate landscape.

Unlike other forms of rent-seeking, cronyism rests upon a specific mode of interaction between business people and policymakers: the patron-client relationship. The pioneering work on patron-client relations in East Asia was undertaken several decades ago in Southeast Asia by Lande (1966), Scott (1977) and Crouch (1979). The main elements of the patron-client model were personalised, hierarchical and long-term relationships between a patron (say, a leader or a senior official) and a client (say, a business person). Patron-client relationships were conceived as a standard form of political representation across the developing world. But for present purposes, they can be viewed as the medium through which crony capitalism functions. Understanding nature of these relationships is key to interpreting the dynamics of change in the prevailing pattern of business-government relations in East Asia since 1998.

That these relationships were personalised underscores the fact that they were not available to all rent-seekers. These were not simply one-off transactions. The parties were usually connected by longstanding associations based on friendship, family links or some other bond of close trust. The long-term nature of these relationships was a critical feature and was powerfully influenced by political circumstances. Authoritarian or semi-democratic regimes increased the likelihood of leaders and associated policymakers being in power for extended periods. Thus the spectacular rise of the chaebol in post-war Korea took place during the Park and Chun regimes,
the rise of Daim Zainuddin far above most other Malaysian business people took place under Mahathir and similarly the ascendancy of the Salim group in Indonesia took place under Suharto. The political leader could count on his key business clients for support and, in particular, access to wholly discretionary financial resources – not just for personal consumption – but, more importantly, for political purposes (e.g. funds to distribute to political allies or funds to be deployed during managed electoral exercises in Korea or Thailand) and policy purposes (e.g. taking on a struggling state-owned steel mill in Indonesia). In return, the business person could count on his political patron for ongoing privileged access to financial and regulatory favours.

The rise of corporate empires on this basis around East Asia during the second half of the twentieth century has been charted by a range of scholars focusing on particular countries (inter alia, Robison, Hewison, Akira, Gomez, Manapat, Kim, Hutchcroft). Firms enjoying crony linkages have not operated in all sectors of the economy; their key corporate assets have been concentrated in less-traded and less-contested sectors. The reason for this is straightforward: the key to their commercial success lay in their ability to limit competition or gain unbeatable market advantage over others on the basis of regulatory favours. Firms not enjoying privileged access of this sort found their own lesser fortunes in less restricted markets where efficiency considerations had a greater bearing on outcomes.

By definition, not all firms enjoyed the crony privileges. Indeed, only a small number of business people were able to secure the ultimate privilege a patronage relationship with the top political leaders. Those that were fortunate enough to do so were typically the ones that experienced the most spectacular commercial success. Insight into the commercial importance of crony linkages can be gained from two distinct perspectives. One is through Fisman’s (2001) inspired quantitative analysis of the impact of major rumours about Suharto’s health on the share price of crony-linked firms listed on the Jakarta Stock Exchange – which showed a clear and very strong relationship. The other is through attempts to take the business model off-shore to other jurisdictions. In other national markets, try as they might, commercial success was usually harder because they could not secure the same level of preferential treatment, in turn, because they did not have the very close long-standing relationships with key decision-makers. Typically, because their core asset was the
relationship between the company head and the political leader, their most important
commercial operations tended to be concentrated in their home markets. The main
partial exception to this was investment back into China by Southeast Asian firms
whose patriarchs had themselves immigrated from China in earlier decades. The most
spectacular example of this Thailand’s Charoen Pokphand group, whose leader was
famed for his links to Deng Xiao Peng. But the wider pattern for Southeast Asian
Chinese business people investing back into China was for them to do so in the town
or region from which they (or in some cases, their fathers) had migrated several
decades earlier – and thus capitalise on family ties with people now in positions of
regional authority (Waldron).

Notwithstanding the vast wealth accumulated by corporate groups whose leaders had
close patron-client links with top decision-makers, an element of hierarchy always
remained in their relationships. Unless the political leader was himself in political
decline, the risk that he might impose serious sanctions persisted as illustrated
strikingly through the humbling of the Kukje group in Korea in the 1980s, the
Soeryadjaya family in Indonesia in the 1990s and Daim Zainuddin’s operations in
Malaysia after the financial crisis.

Cronyism and patron-client relationships are certainly strongly associated with East
Asia’s economic development, but I would argue there is nothing peculiarly East
Asian about cronyism or patron-client relations. In the wake of the Asian crisis, it has
been a focus of inquiry and concern in many parts of the world. In a significant recent
study on Latin America, Stephen Haber (2002, xii) offers the view that “…there is
perhaps no region of the world in which crony arrangements have been as
fundamental a feature of the economy as in Latin America.” Not only is common
across the developing world, significant instances come to light on a regular basis in
the advanced industrial democracies. The most spectacular recent reminders of this
have been the corporate and broader lobbying scandals in the United States (Krugman
2002, Sitglitz 2002). Recall too the example of Indonesian businessman James
Riady’s long-term relationship with Bill Clinton (Backman 2001). Or consider the
earlier careful scholarly analysis (Roberts 1990) of the negative effect of the death of
long-serving United States Senator, Henry Jackson, on the share price of firms
associated with him and the positive effect on the share price of firms associated with
his successor. There is nothing surprising in this; patron-client style relationships are for many purposes the ideal outcome for company executives wherever they are located, for they hold out the possibility of maximising rent-collection, given that it avoids all the costs of collective political action. In return for specific material or assistance to the political leader, the business person stands to capture benefits exclusively for his or her firm.

In principle, then, this is an extremely attractive model of government relations for firms everywhere. But in practice, of course, any hypothetical attractions of such relationships are conditional upon first their potential availability, and then up the potential dangers associated with exploiting such relationships. The potential for forging a long run political exchange relationship with a senior decision-maker is, on average, likely to be much greater in the sorts of authoritarian and semi-democratic environments that prevailed in East Asia for much of the latter part of the twentieth century. Top leaders and policymakers were typically in office for extended periods. This improved predictability and made long-term investments in a relationship feasible. Equally, to the extent that the conduct of these relationships not infrequently involved transactions that were either outrightly illegal or, at a minimum, were of a form that would be deeply embarrassing to both parties if it were exposed, an authoritarian or semi-democratic environment was conducive.

Why? Because with a more constrained media and a more constrained political opposition, the risks of detection and exposure are lower because of the weaker and less political independent policing and judicial systems. Simply put, patron-client relationships and crony capitalist practices are more likely to flourish in institutional environments where the prospects for longevity of tenure are high and where the risks of detection, apprehension and prosecution are low if one engages in illegal or otherwise compromising forms of political exchange. Cronyism exists in all polities because the potential gains from exchange relationships of this sort are so high, but it is much more common in developing and transitional countries because the institutional environment is so much more permissive.\(^2\) In the absence of intervening

\(^2\) Although focused on corruption rather than cronyism, Gerring and Thacker’s (2004) exhaustive survey usefully highlights the potential relevance of different configurations of political institutions. This is an angle I have yet to explore.
institutional variables, cronyism – as mediated through patron-client relationships – is the default pattern for business-government relations.

II  Post-crisis trends in East Asia – what are we measuring?
Specifying the empirical picture proves to be particularly problematic. How do we judge the extent to which cronyistic practices pervade the political economy of a country? Or, more specifically, how do we judge if these practices are becoming more prevalent or less prevalent? An earlier cluster of research (Anek 1992, MacIntyre 1991) – nearly two decades ago now – sought to show that clientelistic links between business and government were no longer the only significant channel for business representation, and that group-based sectoral action was beginning to emerge in Southeast Asia. That finding was not wrong, and yet – clearly – clientelism and cronyism remained defining parts of the political economy of these and other countries in the region.

Nobody would expect that cronyism has been substantially eliminated from the crisis-afflicted economies of East Asia. But can we say anything meaningful about the extent to which it has expanded or contracted in the period since 1997/98? The question is deceptively simple, and in a volume of this sort it demands an answer. Yet on what empirical basis do we answer it? What is the benchmark and how do we calibrate? Reviewing past literature – including some of the very best literature in the field – I find myself now stuck by how much of what we accepted in the past was largely based on assertion; wise and informed assertion to be sure and illustrated with some instructive examples, but assertion nonetheless. Simply put, the empirical basis for making statements about the extent of cronyism is problematic.

My current thinking is to take three different cuts on the subject, focusing on the five most crisis-affected countries: South Korea, Thailand, the Philippines, Malaysia and Indonesia. The first cut is a qualitative profile of what seem to be key dimensions: the extent of regulatory change and other anecdotal evidence of the fate of corporate empires with emblematic significance. The second cut is based on World Bank et al. survey data on perceptions about the extent to which there is progress on dimensions such as corruption, the rule of law and the quality of regulation. And the third cut is to look at - if possible – then and now measures of economic concentration in each
country. The logic and limitations of each of these windows on the subject are discussed further below.

The first window on the subject contains just stylised summaries for now, little more than thumbnail sketches. The careful work of fleshing these qualitative profiles through of primary and secondary sources remains to be done. These are my summary impressions, and for now I am keen to test them against the readings of the specialist country chapters as well as some of the other thematic chapters for the project.

Starting with South Korea, a number of developments would suggest there has been meaningful change introduced, particularly under Kim Dae Jung: prudential and other financial regulations have been tightened, tougher corporate governance rules have been put in place, there is increasing reliance on foreign capital, senior executives from a number of corporate groups engaging egregious practices have been prosecuted and some corporate empires have been broken up. This does not amount to root-and-branch change, but it certainly looks significant.

In Thailand, the extent of change seems marginal by comparison. Although there has been some tightening in financial regulations, most of the major corporate groups have come through intact – and in the landmark case of Thai Petrochemical Industries, creditors did not ultimately succeed in separating CEO Prachai Leophairatana from his/their company. More broadly, the overall climate of business-government relations under Thaksin appears more hospitable rather than less hospitable to cronyism.

In the Philippines, too, there seems to have been little significant improvement since 1997/98. The Philippines was of course less severely affected than the rest, so the pressures placed upon it were correspondingly lighter. But a synoptic survey of the corporate and regulatory environments does not indicate any major change. Neither the Estrada nor Arroyo administrations has demonstrated any credibility in tackling these issues.
Malaysia, by contrast, does appear to have experienced some meaningful change. Malaysia did a better job than most of the crisis-affected countries in enforcing the reasonable disposal of insolvent corporate assets acquired by the state at the height of the crisis. There has been some tightening of financial regulations and corporate governance regulations. Dr Mahathir forced out three of the most deeply entrenched crony business people – and previously three of his closest corporate allies (Daim Zainuddin, Tajudin Ramli and Halim Saad). That said, even as he did this, he was bringing on a new favourite entrepreneur, Syed Mokhtar al-Bukhary, with a highly diversified empire ranging from container ports to property to palm oil. Mahathir’s successor, Abdullah Badawi has maintained a steady rhetorical commitment to winding back crony business practices and has been willing to cancel some of the large national infrastructure projects that would have been devoured by crony businessmen and push to ease the application of systemic preferentialism in favour of Malays with infrastructure projects.

Indonesia is in some ways the most interesting case of the sample. To begin with the progress was deeply unimpressive. Through successive presidents post-Suharto – Habibie, Wahid and Megawati – very little progress was made on cleaning up the corporate environment. There was a strengthening of banking and financial regulations, but in terms of disposal of insolvent corporate assets that had been acquired by the state, the process was extremely protracted with the original owners not infrequently ending up back in control with taxpayers having picked up their earlier debt burden. And yet, there has been some change. First, those firms from the Suharto era who were effectively pure rentier firms (e.g. the firms of the Suharto children, Bob Hassan and Prajogo Pangestu) have managed to retain significant wealth, but their ability to generate future wealth has disappeared. And crony firms that also had significant business acumen – most notably, the Salim group – have retained their corporate assets, but are having to develop a new model for business operation that is less reliant on presidential patronage. Simply put, Suharto has not been replaced. And Indonesia’s most effective post-Suharto president – Susilo Bambang Yudhoyono – has made a strong public comment to wind back corruption and cronyism. Progress has been modest, including the arrest and prosecution of a number of senior officials and business people. The change is not as substantial as Korea, but nor is it trivial.
How do these summary descriptions compare with the evidence from data deriving from the opinion surveys of investor and institutional perceptions? Unfortunately perceptions about cronyism or the extent of clientelistic operations is not one of the specific variables surveyed. The nearest proxies among the many governance variables now tracked by the World Bank are: control of corruption, quality of regulation and rule of law. The five charts below, organised by country, summarise the story. This data is one of the very few sources of systematic comparison of numeric indices across the cases for the years from the crisis to the present. All data is from the Kaufmann et al Governance dataset. For ease of reading, Kaufmann’s -2.5 to +2.5 range has been converted to a 0 to 10 range, with 0 being the worst score and 10 the best.
The picture that emerges from this aggregate survey data is less differentiated. In some respects it echoes the evidence from the descriptive summaries, and in others it does not. The survey data affirms the view that there has been little improvement in the Philippines or Thailand, indeed overall the situation may have deteriorated. It also supports the view of Indonesia as initially drifting, and then beginning to make some progress off a low base. In the case of South Korea, the data is more muted, but is arguably consistent with progress under Kim Dae Jung. And in Malaysia, the survey data suggests no improvement or actual decline – which is in contrast to my descriptive summary of developments there. More broadly, the general picture to emerge from this data is of no gain since 1996 on these particular variables – if
anything net backsliding – across all of the cases, with the partial exception of
Indonesia (though again, this was off a low base after several years of deterioration).

Certainly these survey databases are widely used for large n studies, but how useful is
it for an exercise of this sort? What weight should be attached to it relative to the
other two types of evidence presented here?

The third cut at the gauging the extent of change is to seek comparative data on the
extent of economic concentration across these five economies now and immediately
pre-crisis. Economic concentration is here measured by the market capitalisation of
the top ten publicly listed firms as a percentage of total market capitalisation in that
country. Following our original definition, the logic here is that, other things equal,
very high levels of economic concentration are likely to be correlated with high levels
of cronyism – as cronyism involves a small number of favoured firms capturing
spectacular profits on the basis of heavily preferential treatment, and on this basis,
coming to dominate the corporate landscape. If economic concentration – as
measured here – has declined in the period since the crisis, it is possible that this
corresponds to some easing of cronyism.

*Still waiting on comparable data.*

**III Theory and Expectations**

If we step back from empirical evidence of any sort, a priori, what factors might we
expect to be drivers of change? What factors might be expected to inhibit or promote
the normal interest of business people in securing preferential treatment, if possible on
an enduring basis through a close tie to a key decision-maker? Here I sketch the bare
bones of five possible causal factors.

1. *Political institutions.* To the extent that there is at least
democratic contestation for control of government and a reasonable turnover in
ruling parties, this is likely to make patron-client relations more difficult to
sustain and, by extension, over time is likely to inhibit rather than promote
crony capitalism. With regular turn-over, and expectations of regular turn-
over, long term political exchange relationships become impractical.
Exchange has to take on a much short-term character and is susceptible to
ready reversal by the subsequent government. Indonesia provides a stark illustration of this logic. This is a basic enabling condition, from which other things may possibly follow.

2. **Coalitional basis of government.** If governments have a constituency base that is demanding reform, this will increase the likelihood of policy measures to inhibit cronyism. Korea provides an illustration of this with both the Kim Dae Jung and Roh Moo-hyun administrations, as does Malaysia under Badawi and Indonesia under Yudhoyono. Conversely, Thailand under Thaksin and the Philippines under Estrada provide examples of the opposite. In the short term, this is likely to a powerful causal driver and, itself, critical to any change in the configuration of large and small institutions.

3. **Legal Institutions.** To the extent the police, the prosecutorial administration, and the judicial system are resourced and encouraged to be more active rather than less active in apprehending and prosecuting cases of high-level collusion between corporate heads and policymakers, this is likely to have some deterrent effect on others. Korea and Indonesia provide partial illustrations of this, whereas Thailand provides an illustration of the same logic in reverse. Over the longer term, this is vital to any sustained diminution in the prevalence of cronyistic operations.

4. **Media activism.** To the extent the print and electronic media are more active rather than less in reporting stories of high-level cronyism on a persistent and vigorous basis, this will increase the risks to would-be participants. Again, Indonesia and Korea provide illustrations of this, as does Thaksin’s efforts to shut down media organisations critical of his operations. The Philippines provides an illustration of the limits of this factor on its own. Although the media’s impact can be constrained in many ways – notwithstanding new technologies (Rodan 2004) – it is a key enabling condition both for the operations of competitive elections as well as an independent and active legal system. Information drives the system.
5. *Exposure to global capital markets.* To the extent that firms are increasingly sensitive to the need to attract or retain foreign investors/creditors, this may make them more receptive to reforming corporate governance practices. Korea provides an illustration of this. But a plausible argument also runs in the other direction, as foreign investors may be just as focused on immediate profitability as their local counterparts and thus be just as keen on the benefits of a crony-style relationship, provided the risks associated with this can be managed. Examples of foreign firms being deeply embedded in long-term relationships in this way were common in pre-crisis Asia. And, of course, China provides powerful ongoing reminders of this.

As the mix of cross-cutting illustrations for these points suggest, none of them is sufficient to drive change alone. Combined, however, it does seem reasonable to suppose that significant movement in these variables will lead to change. Putting it the other way around, it is difficult to believe that a combination of these factors will not, over time, have the affect of making the establishment and maintenance of patron-client relationships significantly more difficult and more dangerous. And as a result – again, over time – it seems reasonable to infer that this in turn would make a less hospitable outcome for crony capitalism. But, note, that none of this implies convergence upon any particular model for business-government relations.

Even the tentative empirical evidence we have at hand thus far points to a diverse picture around the region and – at least in the short term – suggests some of these countries are trending in different directions. Indonesia, Korea and perhaps Malaysia in varying degrees appear to have been creating an environments that, at least for now, is less conducive to the classic “high cronyism” of the past when top level patron-client ties were a gateway to sustained tremendous wealth expansion. By contrast, Thailand and the Philippines appear to be just as conducive environments for cronyism as before, and if not, even more so.

Clearly electoral competition and government turn-over are only part of the story. As the divergent patters of these cases suggest, the coalitional basis of governments is critical: if governments are not driven by the core interests of their underlying base of support to promote and sustain policy reform in this area, it is unlikely to happen on
its own. And, equally, in the still longer term, the importance of the media and the legal system in raising the costs to patron-client relationships and cronyism comes through in these cases.

A remaining question with which I need to wrestle is how we should think about the possibility of a transfiguration or mutation of cronyism. If one accepts the essential causal logic about change over time laid out above, a question that still needs to be addressed is how we should understand any residual forms of personal relationships exchange relations that survive. If political turnover becomes normal and the need for short-termism in patron-client relationships becomes more widespread, this may imply not that cronyism goes away, but that it too mutates into a more short term form of personalised exchange. This may no longer be the pattern of the high-crony era, but wealth creation may nonetheless remain very sensitive to personalised and trust-based relationships with people in power – even if the fruits of these relationships have to be harvested within an electoral cycle.


