



Munich Personal RePEc Archive

# **Power – property core of economic development: the cases of Russia and South Korea**

Pyastolov, S.M. and Shitenkova, E.V.

National Research University Higher School of Economics, National Chengchi University

2012

Online at <https://mpra.ub.uni-muenchen.de/44452/>

MPRA Paper No. 44452, posted 18 Feb 2013 13:04 UTC

Pyastolov S.M.<sup>1</sup>

Shitenkova E.V.<sup>2</sup>

## **Power – property core of economic development: the cases of Russia and South Korea<sup>3</sup>**

### **Abstract**

The paper argues that some peculiarities of national development strategies may be described and explained with the help of the power – property concept which is used as a complement to the Economic Freedom surveys methodology. A cluster analysis approach is used to reveal the discrepancies in development strategies of Russia and of South Korea. The paper claims that factors which influence those discrepancies are mostly institutional and cultural attributes that concern the power – property phenomenon.

*Key words:* economic development, Russia, South Korea, power – property

**JEL classification:** O21, O53, P52

### **Introduction**

It is now obvious that the economic growth sustainability is highly determined by political institutions. Such institutions are commonly property rights, contract enforcement, competition and macroeconomic stability. D. Acemoglu et al. argue that “there is convincing empirical support for the hypothesis that differences in economic institutions, rather than geography or culture, cause differences in incomes per-capita” (Acemoglu et al. 2005, p. 402). Cross-country analyses implemented by these and other authors prove that “better economic institutions, have higher average incomes” (Acemoglu et al. 2005, p. 403). Political institutions allocate de jure political power, while groups with greater economic might typically possess greater de facto political power.

Institutions are determined as collective choices of the society in neoclassical economic theories (Demsetz 1967; Buchanan 1980; Acemoglu et al. 2005), and their importance is due to their economic consequences. H. Demsetz found out that property rights and economic behavior are related (Demsetz 1967), S.J. Grossman and J. E. Stiglitz formally proved the impossibility of informationally efficient markets (Grossman, Stiglitz 1980), so one has to apply to institutions for explanation of behavioral patterns under conditions of imperfect information. D. North considers institutions to be “carriers of history”, and another North’s thesis deserves attention –

---

<sup>1</sup> Professor of economics, National Research University Higher School of Economics; Senior research fellow, Russian Academy of Sciences, Research Institute for Scientific Information on Public Sciences; piasts@mail.ru

<sup>2</sup> PhD student in the National Chengchi University, Department of Diplomacy, Taiwan.

<sup>3</sup> Published as: Pyastolov S.M., Shitenkova E.V. Power – property core of economic development: the cases of Russia and South Korea// JOURNAL OF ECONOMIC REGULATION (Вопросы регулирования экономики). Том 3, № 4. 2012, с. 93-108.

the one which states that institutions are constructions that are kept and growing in people's minds (North 1990), or rather it is the fourth proposition from the set of five propositions about institutional change: "Perceptions are derived from the mental constructs of the players" (North 1993).

Another concept which forms the framework of this study is that of a hierarchy of institutions. This concept comes out naturally if one adopts a proposition of a correlation between economic and political institutions and that political power is the source and the driver of the formation of economic institutions'. Acemoglu et al. above all distinguish between two components of political power: de-jure (institutional) and de facto political power (Acemoglu et al. 2005, p. 392-393).

Those problems are revealed and discussed in the following sections of this article: 1) the phenomenon and the theory of power – property are presented in the first section; 2) the case of South Korea is regarded in the second section; 3) in the third section the results of Economic Freedom Comparative Study are presented; then a discussion and a conclusion follow.

### **1. Power-property**

Political power by some definitions is closely connected with property. The concept of "Power-property" was originally coined in historical and sociological studies (Nureev 2002). The most common type of behavior under conditions of power – property is rent – seeking and G. Tullock has written about it and states that: "A complete history of the phenomenon would have to begin by discussing Egyptians and Babylonians thousands of years ago" (Tullock 2003).

Power-Property is defined as property of a type when the access to resources and political power is determined by the place in the state's hierarchy.

These two forms of property systems have their own competitive advantages and can compete with each other; the advantages may occur especially under changing economic conditions. Power – property is a socio - official form of property where property rights subjects are state officials, while private owners of resources and, households are subjects in a private property system. Target functions of the subjects differ substantially in the two property systems: one is a maximization of differences between renting and distribution activities and the other is a maximization of the net present value of property and capital flows.

Then there are also different property competences and the character of competences' distribution among the subjects. In a power – property system competences are dispersed among all the subjects, and they are realized in the form of service, people are driven by an administrative control and coercion. Alternatively, in a private property system, people are motivated by individual incentives for welfare growth.

Guarantors of property rights are special administrative and punitive organs of central and local power and guarantee mechanisms are usually scarce under power – property conditions. Officials pander property rights dispersion for the sake of renting. The most common way of problem solving is to complain of a violation to an official of a higher position. But this would most probably result in a return of your complaint paper to the official who is responsible for the violation of rights. Thus one may conclude that it would be better to organize interpersonal relations with the said official, possibly with the help of a bribe.

Unfortunately, quite often the cost of a bribe would be less than the costs of knowledge, information, will, social capital and that is needed for solving problems by legal means. Power-property systems minimize transaction costs, and provide mechanisms for greivances to be addressed through community conventions rather than through law enforcement agencies and thus create stability. While the successes of developed countries in the contemporary economy should inspire people in countries with power – property traditions to change the system, this would not happen so easily in the case of Russia and some of the other countries.

Another trend in the institutional studies of property rights systems is an investigation of a problem of endogenous creation of a stable property rights system (Grossman, Stiglitz 1980; Dixit 2004). One formally proved conclusion in this area is on “the impossibility of informationally efficient markets” (Grossman, Stiglitz 1980). The reasons might be numerous but among the most often cited are poverty traps, rent-seeking, and redistribution conflicts. Geographical and cultural factors are also in question.

P. Rosenstein-Rodan after considering problems of industrialization in Eastern and South-Eastern Europe draw attention of the academy to spillovers effects, multiple equilibria, underdevelopment traps (Rosenstein-Rodan 1943). Such phenomena according to experts’ conclusion lead to multiple Pareto-ranked equilibria. “As a consequence a country can get stuck in a Pareto inferior equilibrium, associated with poverty, but getting out of such a trap necessitates coordinated activities that the market cannot deliver” (Acemoglu et al. 2005, p. 398).

One of the lower ranked Pareto equilibria examples, i.e. local poverty traps among farming households in China was given by K. Hoff (Hoff 2000). She also reviewed a group of theories that explain the problems of low ranked Pareto equilibria by the coordination difficulties, which in turn are caused by an asymmetric accumulation of knowledge, physical and human capital, and by institutions’ poor quality. Hoff showed how modern economic theory broadened our view of the sources of spillovers that could lead to “traps” with low innovation and inefficient institutions (Hoff 2000)

Thus qualified personnel are needed in order to develop high technologies. But as soon as high technologies are not used in the national production sphere there is no demand for qualified personnel and they do not train them. The efforts of many economic agents are to be coordinated in order to break this “vicious cycle”.

“While under the older theory, “all” one had to do to ensure development was transfer enough capital and remove government-imposed distortions, under the new theories, “all” one has to do is to induce a movement out of the old equilibrium, sufficiently far, and in the right direction, that the economy will be “attracted” to the “good” equilibrium. While this may require fewer resources, it may require more skill. Some policies could lead the economy to an even worse equilibrium” (Hoff 2000, p. 29).

“Rent-Seeking” is one of the institutional traps distinctive under power – property systems’ conditions and it is explained by Investopedia as the following: “When a company, organization or individual uses their resources to obtain an economic gain from others without reciprocating any benefits back to society through wealth creation... An example of rent-seeking is when a company lobbies the government for loan subsidies, grants or tariff protection. These activities don't create any benefit for society, they just redistribute resources from the taxpayers to the special-interest group”<sup>4</sup>. This of course is less than a broad scientific definition and we should offer a more detailed review of the concept.

The positive theory of rent – seeking describes processes of seeking and protection of economic rent by economic subjects with the help of political efforts, which cost less than alternative means. According to liberal theory concepts the fact of existence of rent itself is the main driving force of rent-seeking because it creates stimuli for seeking the most profitable variants of an allocation of resources. However, rent can be augmented and the profit can be maximized by different means and some of them may lead to negative consequences for a society.

When economic subjects are yearning for rent and this leads to a growth of a society’s wellbeing it is called profit-seeking, and when this leads to a loss of wellbeing it is called rent-seeking. In the last case the expenses of such an activity are considered to be a pure loss for society. The most unwanted losses are deformations of the national economy infrastructure and an ineffective allocation of resources.

The theoretical approaches to rent-seeking in the Chicago school of economics and the Virginia School of Public Choice are usually emphasized. In the first case such scientists as G.Becker, B. Gardner, K.Salhofer etc. are named, and in the second case – J.Buchanan, A.Krueger, G. Tullock and their colleagues. As a result of generalizing the differences between

---

<sup>4</sup> <http://www.investopedia.com/>

the two theoretical approaches we can define several differences in the formulation of the core hypotheses: the Virginia school claims that the ineffectiveness of interactions between the state and pressure groups should be explained by the competitive character of rent – seeking; on the other hand, the Chicago school claims that rent-seeking behavior becomes effective because of the non-competitive character of rent – seeking. Thus the conclusions differ in a sense that a “Virginia school state” is unable to execute an effective income redistribution policy; and a “Chicago school state” should look for an optimal combination of income redistribution policy instruments.

Another challenge for theoreticians is the situation of an economic system’s transformation when it changes modes of economic regulation, i.e. from a power-property system to a market economy. Such a change means that besides new limitations, new privileged positions should appear. Thus rent-seeking activities would be intensified. Such a phenomenon is recognized as “transition rent” (Polterovich 2001).

Since rent incomes might be very high it would be quite profitable to put all the available resources into rent-seeking and this would lead to a situation where large amounts of production and human resources are taken away from the real production sphere. These were the characteristics of the Russian price and foreign trade liberalization period, which started in 1992. World prices for oil and non ferrous metals were sometimes 10 or even 100 times higher than national prices. So the rent, which previously belonged mostly to the state, became an object for competition. The reaction of prices lasted for several years and there was a period when control over foreign trade flow was so attractive that all other investment alternatives were negligible. So those people who had certain administrative positions or were lucky enough to be at the right place at the right time managed to get large amounts of speculative value.

The phenomenon of the domination of redistribution activities over production and entrepreneurial activities was revealed in more depth during the privatization processes in Russia. Another example could be the USA: the abrupt democratization caused an institutional trap in the first half of the 19th century (Knot, Miller 1987; Polterovich 2001). As experts claim nowadays the privatization in Russia should follow a commercialization, which should have begun from small and medium size enterprises and all these processes should be correlated with price stabilization. Such an approach was demonstrated in Poland where only 11% of formerly state owned enterprises were privatized in the first couple of years of the reformation period, and a privatization of medium size enterprises was postponed for 5-6 years.

After the abrupt privatization in Russia during the first two years of the reforms 62,5% of all the enterprises had become private property. It is now known that a 40% fall in GDP would follow this privatization and about 30% of the population found themselves below the poverty

level. This also contributed to a poverty trap phenomenon. The rent-seeking concept explains that the reforms of the social sphere, of the taxation along with the economic system generated new redistribution possibilities and this was a cause of rent-seeking processes.

This model of rent-seeking behavior was, in a sense, completed with the formulation of the “grabbing-hand model” by T. Frye and A. Shleifer for Russia, in contrast to the “helping-hand model” that had been developed in a variety of forms found in Central and Eastern Europe and China (Frye, Shleifer 1997). Besides the inertia of the economic system (i.e. power-property heritage) experts name other shortages that occurred during the Russian reforms of the 1990s: a wrong sequence of events during the reforms; shortages of social and of industrial policies, i.e. insufficient compensation for the “losers”; an improper strategy of institutional construction; “shock therapy” (it took more than 70 years for the USA to get out from a corruption trap after quick democratization in the 1830s (Knott, Miller 1987)).

Unfortunately, it often happens that reforms result not only in institutions’ modernization but also become an instrument of redistribution, which exhausts society’s production forces. They create an illusion of a “catch up development” while the country is trapped at the same level or even falls behind its previous position and, - behind developed economies.

Few countries, which managed to break through their institutional traps demonstrated examples of effectively simulating economic growth and institutional reforms. Among them are – France after the WWII, Taiwan, Japan, South Korea.

## **2. The case of South Korea**

Acemoglu et al. claim that “institutions matter” and use the South Korea case as a “quasi-natural experiment” in history (the other case is the colonization of much of the world by European powers starting in the fifteenth century (Acemoglu et al. 2005)). The fact is that after the Japanese Emperor Hirohito announced the Japanese surrender on August 15, 1945, the Northern area of Korea became the Democratic People’s Republic of Korea, and the South became a democratic state - the Republic of Korea. These two countries adopted different sets of institutions. South Korea established a system of private property and market mechanisms were used in the interest of economic development. North Korea took the models of the Chinese Revolution and of the Soviet command economy where the main goals were justice, security, paternalism provided by state ownership of land, and natural and capital resources.

The preliminary conditions of this “experiment” were those that North and South Korea had the same culture and history. “In fact, Korea exhibited an unparalleled degree of ethnic,

linguistic, cultural, geographic and economic homogeneity”<sup>5</sup>. Moreover despite some differences in economic potential due to a more advanced industrialization in the North both parts of Korea had approximately the same income per capita at the time of separation (Maddison 2001). Despite the equal conditions at the beginning in 2000-s per capita income in South Korea was more than \$16,000 while it was only \$1,000 in North Korea.

There is one thing that deserves special attention in the case of South Korea: the power property phenomenon in the national context. When general Park Chung-hee came to power as a result of a quiet *coup d'état* in 1961 he was actually a dictator<sup>6</sup>. But he was also the father of the nation widely known for his asceticism and modesty (and he was also the father of the reforms).

The basic ideas of reforms and the result of the Korean regime efforts were the creation of the export-focused economy, formation of the large companies with world level of competitiveness.

Park did not have a possibility to privatize anything, the country just had almost no valuable assets as an inheritance and it was necessary to create all anew.

Thus president Park had to find and allocate within the country the most talented people who practically had not had business experience before. The economy's development has begun with the light industry development which exported its production successfully although it was labour-consuming but demanded low skilled workers. Then the entrepreneurial experience received in this area in the seventies was applied in the heavy industry formation, and also in highly technological areas of electronics and home appliances.

The president Park did not avoid methods of mobilization economy and managed to realize them excellently. There were five year plans for development in the country as well as in the USSR. As a result South Korea has increased the gross national product from 1962 till 1989 (less than for 30 years) from \$2,3 billion to \$205 billion, the mid-annual income per capita - from \$87 to \$4830, economy grew with average annual rates about 8 %.

R. Wade claims that successes of South Korea, Taiwan, and Japan were achieved due to a market-oriented development strategy, and one that placed particular emphasis on incentives to export (“export-led growth”); moreover in the case of Taiwan it does not even fit the free-market model (Wade 2004). According to Wade's opinion interventions were a success in East Asia because they were made together with other supportive policies and fulfilled a “disciplining” function with respect to the distribution of rents. Thus national economy peculiarities and subsequent theories are being called for.

---

<sup>5</sup> For more details: Handbook of economic growth, p. 405

<sup>6</sup> In 1963 Park Chung-hee officially won on presidential election and has legalized the power.



The economic reforms in South Korea caused a substantial change in corporate governance which was influenced by an American style of management although (and this used to be a common feature for other countries of East Asia) this resulted in neither convergence nor rejection, but under external pressures an American style of interferences inspired searches for convenient ways of interactions between the managers, state officials, shareholders and other local actors (Ahmadjian 2004). Experts describe these processes as characterized by global pressures on local institutions among which are paternalism, tolerance for power inequalities and uncertainties, traditions' appreciation and preferences for long term solutions.

Changes in corporate relations and corporate governance routines have been in a certain sense successive: Japanese management practices had settled themselves in Korea during the colonization period and at the postwar period. Business groups were influential in both economies. But Korea's *chaebol* and Japan's *keiretsu* differ in some aspects, specifically, in the structure of ownership and control methods first of all. Although shareholders are usually family members and downsizing is hardly possible in either system, Korean management has a less cooperative relationship with employees than its Japanese colleagues.

Japan was the first in Asia to introduce corporate laws imported from the United States and South Korea followed. Those laws altered somehow patterns of corporate ownership, boards of directors' structures, and processes of decision making. A new wave of corporate governance reforms started in the 1990-s and "shareholder value" became a newly appointed goal. The reforms were urgent for both countries because global economy strategies demanded transparency.

The IMF and the World Bank demanded from the South Korean government drastic reforms in corporate structure and business practices in accordance with a so-called "global standard" because they considered that a malfunctioning corporate governance system had been the major cause of the 1997 crisis. Among the measures the South Korea government and the IMF agreed upon were: increase of the maximum share level for foreign ownership of listed firms from 26% to 55% by the end of 1998; liberalization of FDI; increase of transparency by means of independent audits, mandated complete disclosure and consolidated financial statements; upgrade of accounting principles; charges against managers of troubled corporations and financial institutions that had received public funds; liberalization of M&A by foreigners and foreign exchange transactions. Other certain measures recommended by the World Bank were implemented and economic and institutional landscapes have changed<sup>7</sup> quite visibly. Of the 30

---

<sup>7</sup> Besides other events under the presidency of Kim Young-sam former President Chun Doo-hwan and Roh Tae-woo were arrested on charges of corruption and treason, but later pardoned with the advice of then President-elect Kim Dae-jung.

biggest *chaebols*, 16 have been shut down or downsized radically. The companies which survived such were Samsung Group and LG barely resemble their former selves. Of the 2100 financial institutions cluttering the banking industry in 1998, only 1600 now remain. And only half of 24 major city banks.

A broader view and a more complex approach to “non economic” factors of development may be found in the Economic Freedom conception elaborated by the Fraser institute and another version is given by the Heritage foundation. For the first iteration we have chosen a commonly accepted cluster named BRIC (Brazil, Russia, India, China) and a group of countries from the region that South Korea belongs to: Japan, Taiwan besides South Korea herself. According to the Fraser institute observations (presented on fig. 1) we may note that two clusters of countries could be distinguished as (1) “free market” and (2) “not quite free”<sup>8</sup> economies.

South Korea belongs to the cluster of “free market” economies along with Japan, Taiwan and the cohort of developed countries. Russia belongs to the second cluster of countries which are striving for economic freedom (EF). An encouraging fact is that the regression coefficient in the formula for Russia is positive and a bit higher than the same coefficient for South Korea and this might mean that Russia has a chance to join the first cluster in a future.

An opposite example is South Africa with its EF index slowing down. Along with other facts this has made some experts say that BRIC is now changing into BRICS<sup>9</sup>.

### **3. Economic Freedom Comparative Study**

In this section we use comparisons of Economic Freedom data on various countries in order to formulate our version of a cluster description with probable development trends for Russia and for perspectives of its relations with South Korea and other countries of the region.

According to the Heritage Foundation data up to 2011 South Korea demonstrates “a well-functioning modern legal framework” that properly protects private property rights in the country. The rule of law is effective, and the judicial system is efficient. Although protection of intellectual property rights needs to be improved and corruption remains a substantial cause for concern (2012 Index of Economic Freedom). The country’s economic freedom score is 69.9, and this provides the 31st place in the 2012 Index calculated by the Heritage Foundation<sup>10</sup>.

---

<sup>8</sup> This is not an official classification and there are some differences between methodic approaches. For example South Korea is ranked as “moderately free” in Heritage Foundation 2012 Report with 69.9 at 31-th place and at the same time the Frazer institute puts this country at the 30-th place with 7.3 (2012 Index).

<sup>9</sup> BRICS is a recently coined name for a cluster which includes Brazil, Russia, India, China, South Africa – cluster of developing countries with similar characteristics which are to be discussed further.

<sup>10</sup> One has to note that Heritage Foundation Economic Freedom Index of a certain year indicates the values measured in previous year.

Entrepreneurial activities, innovation, business formation, and operating rules develop within a competitive regulatory framework. South Korea now has a dynamic labor market, but there are still lingering regulatory routines, and slowly acting trade unions to add to business transaction costs. The national markets are becoming increasingly open to foreign investors and the investment regime has become more transparent. A notable transformation is observed in the financial sector which now may provide a reliable level of transparency. Banks and non-bank financial institutions have been in the most part recapitalized, but their effectiveness is still in question as of 2010. Other evidences represented by the Fraser Institute let us calculate a positive trend for South Korea's Economic Freedom (fig. 1) that obviously supports conclusions made by the Heritage Foundation.

Russia finds itself far away from South Korea's position: as the 144th in all the sample of the 2012 Index with an overall economic freedom score of 50.5 (by the Heritage Foundation's version). This means that the rule of law is not clearly seen across the country. Law enforcement and protection of property rights (including intellectual property rights) still remain weak. Corruption is a problem up to now.

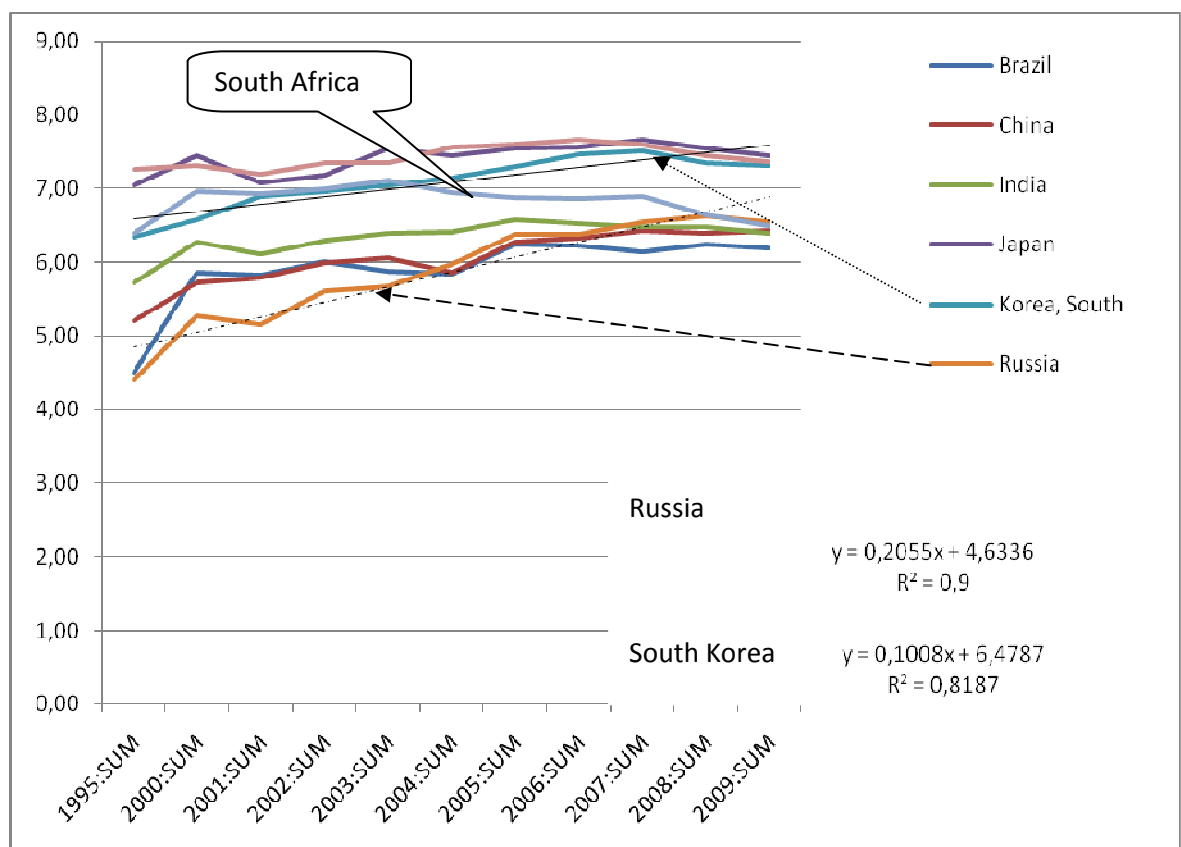


Fig. 1. Dynamics of Economic Freedom Index (Fraser Institute version) in the sample of countries.

Source: Adapted from "Fraser Index of the economic freedom of the world" (2012).

The business environment has improved only in a few aspects, and business transactions costs are rather high. Bureaucratic obstacles and inconsistent enforcement of regulations creates considerable uncertainty and affect entrepreneurship. The revised labor code does not support employment growth and a better performance. Real economic growth has been detected only in the oil and gas sector, the investment framework remains inefficient.

These description features for the two economies are taken from the Heritage Foundation website<sup>11</sup> and some experts claim that this source is quite reliable because it uses at the most part such variables which are controlled by the government administrators (Heckelman 2000). But others would prefer data from the Fraser Institute for it is a better fit for “academic contexts” (Berggren 2003; de Haan, Lundstrom and Sturm 2006). In fact there are still discussions on the quality of these two indexes and we may agree with H.Gurgul and L.Lach that some of the variables choices and calculation methods are “inconclusive or plain contradictory” (Gurgul, Lach 2012)<sup>12</sup>. But the matter is that we are not going to concentrate on methodology of these two indexes’ econometrics. The data shall be used in order to find some hints for where to look for possible analogy between the chosen countries development strategies and potentialities breakdown. For this purpose we shall pay attention to the Fraser Index first.

“Fraser Index of the economic freedom of the world” includes 5 areas: (1) Size of Government: Expenditures, Taxes, and Enterprises; (2) Legal Structure and Security of Property Rights; (3) Access to Sound Money; (4) Freedom to Trade Internationally; (5) Regulation of Credit, Labor, and Business (Fraser Index 2012). Those 5 areas offer refers the values of 42 variables which can serve for further surveys.

As IEF reports in the 1-st area Russia is “in line” with the most countries of the chosen group with China in the bottom and South Africa’s trend declining. Actually the government put much effort in order to overcome the 2008-09 global crisis effects and in particular it spent large financial reserves spent to compensate the losses although this does not seem to be sufficient for revitalization of the economic growth rates at pre-crisis levels.

The data demonstrates that South Korea reached the level of the 1-st cluster in areas 2 and 3 of the EF at the beginning of the XXI century. Russia in 2009 has managed to get almost to the point where South Korea was in 1995. Property rights and the regulation of the acquisition of property are formally defined in Russian law but they are not however consistently and adequately implemented, especially against state intervention. B. Stiftung and the Center for Applied Policy Research at Munich University also report about market concentrations tolerated by the Russian state, especially in the “natural” monopolies, such as natural gas and railroads

---

<sup>11</sup> [www.heritage.org](http://www.heritage.org).

<sup>12</sup> We also have to add that some versions of the Economic Freedom Index calculations methods were changed in various years and this can bias the results so one has to be careful about the version used in the study.

(BTI Russia Country Report 2010). The situation in the area 3 is improving for Russia. State regulation of the banking sector seems by and large to be adequate. Banks have been forced to adopt international standards, though at a slower pace than originally planned. But Russian banks are not yet able to compete internationally. The financial crisis negatively affected comparatively small Russian banking sector. Assets and credit business are both likely to decline.

In the area of “Freedom to Trade Internationally” many countries showed instability so Russia is not alone in the declining trend for A4EF: one can see for example that Japan is also falling almost with the same rate during the period of 2001-2009. South Korea and Russia in area 5 - Regulation of Credit, Labor, and Business, both demonstrate almost the same rate but a little lag. Nonetheless Russian state economic policy remains skewed in favor of politically influential large corporations, especially state-owned ones. The state has increased its ownership in the economy and has in a number of economic sectors which are deemed to be of strategic relevance discriminated against private, and especially foreign, investors. The informal sector amounted to 30% to 50% of GDP in the late 1990s. According to the Russian government, its size has been reduced considerably with the economic reforms. However, independent empirical studies are not available (BTI Russia Country Report 2010).

After having examined particular EF indexes we implemented a cluster analysis with STATISTICA 10 as an instrument. The results for the chosen 8 countries in respect for the aggregate indicators for the 5 Fraser EF areas are presented on fig. 2.

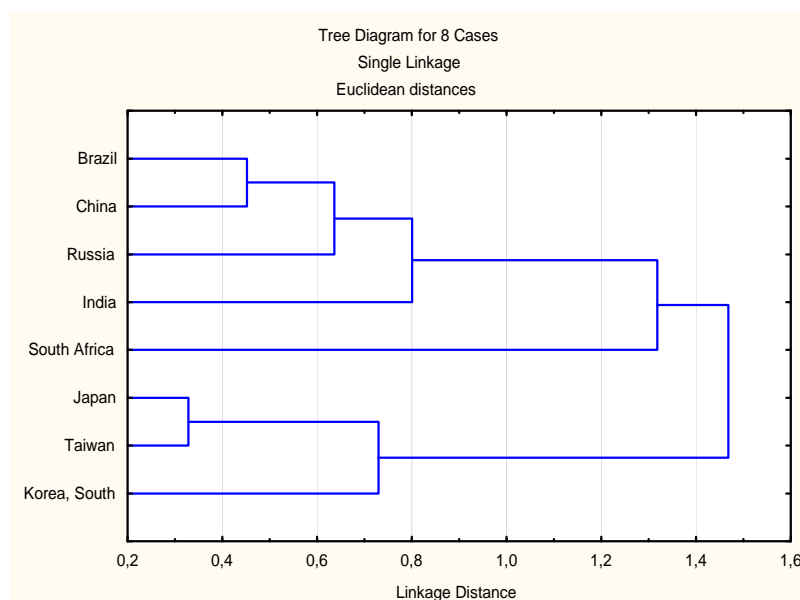


Fig. 2. Cluster analysis results for the chosen group on the Fraser EFW aggregate index.  
 Source: Adapted from “Fraser Index of the economic freedom of the world” (EFW 2012).

One may see that Russia stays comparatively far from South Korea in the space of the Fraser EFW aggregate index parameters. It is grouped with Brazil and China (which form a pair themselves), then India joins this cluster on a higher hierarchy level, and then South Africa does the same. South Korea comes to meet this hierarchical composition from the other side of the scale after joining Japan and Taiwan which have formed a cluster pair of their own.

In order to check the results we took the similar data from the Heritage Foundation database. The “overall score” in the Index of Economic Freedom (IEF) estimated by the Heritage Foundation consists of 10 broad factors for construction of which statistics from organizations like the World Bank, the International Monetary Fund and the Economist Intelligence Unit are used. These factors are: Business Freedom; Trade Freedom; Monetary Freedom; Government Size/Spending; Fiscal Freedom; Property Rights; Investment Freedom; Financial Freedom; Freedom from Corruption; Labor Freedom<sup>13</sup>.

These 10 factors served as variables in the cluster analysis performed with STATISTICA 10 and where 54 countries were the cases. Along with the 8 countries from the previous sample developed countries from various parts of the world were added to make the environment for the chosen ones. In order to check post-soviet specificities countries from former Soviet Union and Eastern Socialist bloc were sampled besides Russia.

The cluster analysis of the IEF indices demonstrates that there is rather large Euclidian distance between Russia and South Korea (actually it equals 87.5). Mean for Russia is 50.5, standard deviation 21.7; mean for South Korea is 69.9, standard deviation 12.1. The nearest neighbors of Russia in the IEF dimension are Tajikistan (distance between Russia and the country 32.8), China (47.8), Indonesia (48.7), a Moldova (35.8) is a neighbor from a higher level group, Ukraine (36.3) stays one more step higher where they meet Belarus (39.3). And only one more step further they meet South Korea (87.5) and Taiwan (91.7). India stays 51.1 points from Russia and 54.6 from South Africa. Japan stays closer to South Korea (distance between South Korea and the country 54.3) than to Russia (95.6). The same is for other developed countries, for example: Germany (54.9; 118.7)<sup>14</sup>, Norway (57.5; 113.5), Sweden (84.4; 14.7), United Kingdom (66.7; 125.9), and United States (51.2; 106.6).

Thus the cluster analyses of Economic Freedom parameters have created only a vague representation of what the case of South Korea economic miracle can contribute to a strategy of Russian national economy development. It is quite clear that Russia should do its best in order to improve the situation in the sphere of “Freedom from Corruption” first of all because it is in the worst position. Another urgent area is “Property Rights” and the situation here is a little better

---

<sup>13</sup> [http://en.wikipedia.org/wiki/Index\\_of\\_Economic\\_Freedom](http://en.wikipedia.org/wiki/Index_of_Economic_Freedom).

<sup>14</sup> In brackets - distance between South Korea and the country; distance between Russia and the country.

than in China. As far as one can see the Russian government understands the problem and its importance, it is trying to break the situation. But all the efforts implemented during the first two periods of V. Putin's presidency and the period of D. Medvedev have not changed the national economic system significantly (although it has been declared to have become a market economy) so that one could say that there is a hope for political and social stability and welfare growth. There is no doubt that Russian governments are trying to use all the resources that they can see but there is a question whether all the potentialities are seen. What was it that South Korea could find some times ago and managed to realize and what is missing in the philosophy of economic development in Russia?

#### **4. Discussion**

Actually it is rather difficult to construct a certain solid explanation for a national economic system development when quite a few parameters are regarded and one cannot distinguish between more and less significant parameters with a reliable degree of accuracy. Nonetheless we suppose that the power – property concept should be useful in this occasion. An analysis of the history of South Korean reforms through the lens of power – property concept may help to create an understanding of the development processes.

One can agree that with the establishment of the regime of general Park Chung-hee conditions for power – property started to be created. As we remember from the above: “the fact of existence of rent itself is the main driving force of rent-seeking”. But as long as there had been very little tradition of redistribution and rent-seeking those capital flows were channeled for the benefit of the whole society. Such processes Young and Krugman recognized also as an “accumulation of resources” (Young 1994; Krugman 1994). It is in fact a sort of simplification because the power – property is a valuable asset by itself (when it generates profit-seeking) although there is a danger of misusing it or it may be privatized by clans (when rent-seeking would prevail).

Another important thing which concerns this phenomenon is that the power – property institutes are the most effective in a time of crisis and while the situation is becoming more stable and an economy has reached the point of a world level competitiveness the “economic freedom” with its “rule of law” and other components should replace them.

But the inertia of “human action” and high incentives for power – proprietors hinder these processes and new law enforcement mechanisms should be created. It is painful for many economic actors (former South Korean President Chun Doo-Hwan and Roh Tae-Woo who were charged of corruption and treason know this quite well) especially for the groups of big interests.

Here one can see that Korean government managed to “induce a movement out of the old equilibrium... and in the right direction” (Hoff 2000, p. 29).

And this has not been only once when the Korean government induced a change in economic development. Technically it was the shift in industrial policy from export promotion to support for heavy industry and the chemical industry in 1973. And when it happened after such a policy implementation that the chaebols (family-owned business conglomerates) dominated the Korean industries too heavily there was a new turn in economic policy towards economic freedom at the end of 1990-s.

Unfortunately for Russia they have not yet overcome the institutional inertia and the national economy is caught in various institutional traps: the country is “stuck in a Pareto inferior equilibrium”. Some expert suggest that the experience of South Korean successful development should be implemented in Russia but the peculiarities of power – property and developmental phenomena are so diverse and often unexpected that this made some researchers admit that every developing country seems to have a development theory and a strategy of its own.

### **Conclusion**

The economic and innovative competitiveness is obviously one of the major goals in national development strategies. But the task of programming such strategies is rather complex and regulation methods based on a choice of a set of indicators are not efficient enough. Cluster analyses may serve as complements to a development programming methodology. Presumably a country from a cluster can use certain indicators of the cluster’s leader as reference points in order to formulate and adjust its development strategy.

South Korea is regarded by some russian experts to be an encouraging example for Russia because it has demonstrated an impressive economic and social transformation from a dictatorship into a developed country<sup>15</sup>. So South Korea might be regarded as a probable perspective for Russia in its attempts of modernization and competition with the best world economies, but the problem for an administrator is whether there is a cluster which both countries belong to, which of this cluster characteristics should be modernization priorities. In other words: what has helped South Korea to overcome the command economy inertia – the feature common for the history both of Russia and of South Korea - and are there similar resources in Russia nowadays?

---

<sup>15</sup> Zhuravskaya E. and S. Guriev even have found out that after some econometric adjustments Russia mimics year-to-year Korea’s Gross Domestic Product per capita (GDP pc) growth as of eleven years ago (Guriev, Zhuravskaya 2010).



An answer to this question offered in this article is that there are no “visible” obstacles for Russian economy’s development, as the Economic Freedom and macroeconomic indices trends are encouraging. But some “invisible” factors do not let Russia to overcome the watershed between the clusters which this country and South Korea belong to. The paper argues that those factors are mostly institutional and cultural attributes that concern the power – property phenomenon. A quantification of subsequent parameters and more detailed analyses will be an object for further studies.

## References

- Acemoglu D., Johnson S., Robinson J. (2005) Institutions as a fundamental cause of long-run growth. Handbook of Economic Growth Volume 1A. Edited by Philippe Aghion and Steven N. Durlauf. 2005. Chapter 6
- Ahmadjian C. L., Song J. (2004) Corporate Governance Reform in Japan and South Korea: Two Paths of Globalization. APEC Study Center Columbia Business School, Discussion Paper No. 23.
- Berggren N. (2003). The Benefits of Economic Freedom: A Survey, The Independent Review. N 8. PP. 193-211.
- BTI 2010. Russia Country Report. Bertelsmann Stiftung and the Center for Applied Policy Research (C•A•P). Munich University. <http://www.bertelsmann-transformation-index.de>
- Buchanan J. M. (1980) Rent Seeking and profit seeking. Toward a theory of the rent seeking society. Eds. by J. M. Buchanan, R. Tollison, G. Tullock. College Station: Texas A&M University.
- De Haan J., Lundstrom S., Sturm J.E. (2006) Market-oriented institutions and policies and economic growth: A critical survey. *Journal of Economic Surveys*. N. 20. PP. 157-191.
- Demsetz H. (1967) Toward a Theory of Property Rights. *The American Economic Review*, Vol. 57, No. 2, Papers and Proceedings of the Seventy-ninth Annual Meeting of the American Economic Association. (May, 1967), pp. 347-359.
- Dixit A. (2004) *Lawlessness and Economics*. Princeton University Press.
- Fraser Index of the economic freedom of the world (2012). <http://www.freetheworld.com/reports.html>
- Frye T., Shleifer A. (1997) The Invisible Hand and the Grabbing Hand // *The American Economic Review*. Vol. 87. No. 2. Papers and Proceedings of the Hundred and Fourth Annual Meeting of the American Economic Association. P. 354–358.
- Grossman S.J., Stiglitz J. E. (1980) On the Impossibility of Informationally Efficient Markets. *The American Economic Review*. Vol. 70. No. 3. PP. 393 - 408.
- Guriev S., Zhuravskaya E. (2010) Why Russia is Not South Korea. *Journal of International Affairs*. Spring/Summer 2010. PP. 125 – 139.
- Gurgul H., Lach L. (2012) “The nexus between economic freedom and growth: Evidence from CEE countries in transition”. MPRA Paper No. 37434, posted 18. March 2012. Online at <http://mpa.ub.uni-muenchen.de/37434/>. Last accessed: 08.07.2012.

- Heckelman J. (2000). Economic freedom and economic growth: A short-run causal investigation, *Journal of Applied Economics*. N 3. PP. 71–91.
- Hoff K. (2000) Beyond Rosenstein-Rodan: The modern Theory of Coordination Problems in Development. *Proceedings of the Annual World Bank Conference on Development Economics*. Washington DC: World Bank, 145-188.
- Knott J.H., G.J. Miller (1987) *Reforming Bureaucracy. The Politics of Institutional Choice*. Prentice-Hall, Englewood Cliffs, New Jersey. 290 pp.
- Krueger A.O. (1974) The Political Economy of Rent-Seeking Society // *American Economic Review*. Vol.64.N 3. PP. 291 – 303.
- Krugman P. (1994) The Myth of Asia's Miracle. *Foreign Affairs*. Vol.73, Iss. 6. PP. 62 – 79.
- Maddison A. (2001) *The World Economy: A Millennial Perspective*. OECD Publishing.
- North D.C. (1990) *Institutions, Institutional Change, and Economic Performance*. Cambridge: Cambridge University Press/
- North, D.C. (1993) Five Propositions about institutional change. Washington University, St. Louis. <http://129.3.20.41/eps/eh/papers/9309/9309001.pdf>
- Nureev R. (2002) Power-property in postsoviet Russia as a path dependence problem. [http://kodeks.econ.pu.ru/files/5a\\_1134066202.pdf](http://kodeks.econ.pu.ru/files/5a_1134066202.pdf)
- Polterovich V. (2001) Rent seeking, tax policy, and economic growth. Working paper #2001/025. Moscow, New Economic School.
- Rodrik D. (2005) Growth Strategies. chap. 14 in *Handbook of Economic Growth*, eds. Aghion P. and Durlauf S., 1st ed., vol. 1, pp. 967-1014.
- Rosenstein-Rodan P. (1943) Problems of industrialization in Eastern and South-Eastern Europe. *Economic Journal* 53, pp. 202-211.
- Salhofer K. (1998) Promotion of the agricultural sector and political power in Austria - a revision / K. Salhofer, M. Hofreither, F. Sinabell. Wien: Universitet fur Bodenkultur.
- Tullock G. (2003) The origin rent-seeking concept. *International Journal of Business and Economics*, Vol.2 (1), pp.1-8.
- Wade R. (2004) *Governing the Market: Economic Theory and the Role of Government in East Asian Industrialization*. Princeton, N.J.: Princeton University Press.
- Young A. (1994) Lessons from the east Asian NICs: A contrarian view. *European Economic Review: Papers and Proceedings*, 38 (1), 104-128.
- 2012 Index of Economic Freedom. [www.heritage.org](http://www.heritage.org)