



THE MIDDLE-INCOME TRAP: THE CASE OF RUSSIA AND KOREA

Ravshan Ulugov

Tashkent State University of Economics

Master

ravshanulugov@gmail.com

<https://doi.org/10.5281/zenodo.7862054>

The essence, origin and consequences of the middle-income trap concept are scientifically based. The reasons for falling into this trap are considered in the case of Russia and Korea, and ways to overcome it are analyzed.

Key words: Macroeconomics, Middle income trap, Russia, Korea.

The need for a new growth model for Russia became clear immediately after the 2008-2009 crisis. The pre-crisis sources of growth—a low base, idle capacities, the reforms of the 1990s and early 2000s, and the rapid rise in oil prices in the 2000s—were exhausted just in time for the crisis. The post-crisis recovery ended in 2012. Further growth required new sources of growth—the denationalization of the economy, improving the quality of political and legal institutions, fighting corruption, and attracting foreign investment. Without them, the Russian economy was doomed to stagnation in the "70-80 scenario"¹ or, in other words, doomed to fall into the "middle income trap".

A middle-income trap is a situation where the institutions that have fueled rapid growth in a transitioning low- to middle-income country become a brake on further development. World Bank economists Indermit Gil and Homi Karas first described this problem as applied to Asian economies in the mid-2000s.² The Russian middle-income trap began to be discussed already in 2012, and in January 2014 both the then Prime Minister Dmitry Medvedev and his first deputy Igor Shuvalov recognized this problem.³ After three years of recovery at a rate of more than 4% per year, Russian GDP growth slowed to 1.8% in 2013 and to 0.7% in 2014. Over the next 6 years, GDP grew by only 1.7% (or by 0.28% per year). Contrast with rapid growth in 1999–2008 (when GDP grew by an average of 7% per year) is especially noticeable against the background of the recovery and growth of the world economy.

¹ Guriev S. Crisis can make the Soviet Union out of Russia 1970-80. / S. Guriev, O. Tsyvinsky // Vedomosti. - 2010. - 19 Jan. Access mode: <https://www.vedomosti.ru/opinion/articles/2010/01/19/krizis-mozhet-sdelat-iz-rossii-sovetskij-soyuz-1970-80-gg>

² Gill, Indermit, Homi Kharas, and others. An East Asian Renaissance: Ideas for Economic Growth // World Bank. - Washington, DC, 2007.

³ Chakarov I. Russia is threatened by the middle income trap, which will slow down the growth of the economy / I. Chakarov // Vedomosti. - 2012. - 15 Feb.





How one falls into the middle income trap and how one can get out of it is best illustrated by the example of South Korea. In the early 1960s Korea was a poor country with no natural resources. In his book *The Quest for Growth*, the well-known economist William Easterly wrote that during these years, Ghana was more likely to be considered the leader of economic development.⁴ However, due to cheap labor and government support for investment in export industries, Korea has built a successful industry. Investments were driven by financial and industrial groups, “chaebols” (from the Korean “che” - wealth / finance and “pain” - group), which used special mechanisms of state support and protection from foreign competition. Since investment in technology imports, rather than innovation, played a key role during the low-to-middle-income transition, the chaebol-based growth model was quite successful. As GDP and household incomes grew, this growth model, which required cheap labor, lost its advantages. By the mid-1990s, factor productivity in Korean industry had stopped growing.

Crisis of 1997–1998 proved the unviability of the growth model based on chaebols. Its bankruptcy opened a window of opportunity for competitive reforms. Some chaebols have been restructured, some closed, and restrictions on foreign investors and independent companies (non-chaebol members) have been lifted. The result of this was the resumption of productivity growth and the transformation of the industrial economy into an innovative one.⁵ Korea has shown how to break out of the middle income trap.

Why is Russia not Korea? In a 2010 paper, Ekaterina Zhuravskaya and I showed that the level and dynamics of Russia's GDP per capita were similar to those of Korea, with a lag of 11 years.⁶ However, already in 2010 we said that in order to repeat the Korean innovation miracle, Russia needed Korean radical reforms - competition instead of oligarchs, equal conditions for foreign investment and the fight against corruption. Korea was lucky - the crisis of 1997-1998. formed a consensus in society regarding the need for such reforms. Without it, collusion between chaebol leaders and the political elite would have led to continued stagnation in productivity and hence an inevitable slowdown in income growth. Unfortunately, this is exactly what happened in Russia, which missed the opportunity to use the crisis of 2008-2009. to start a new round of reforms and

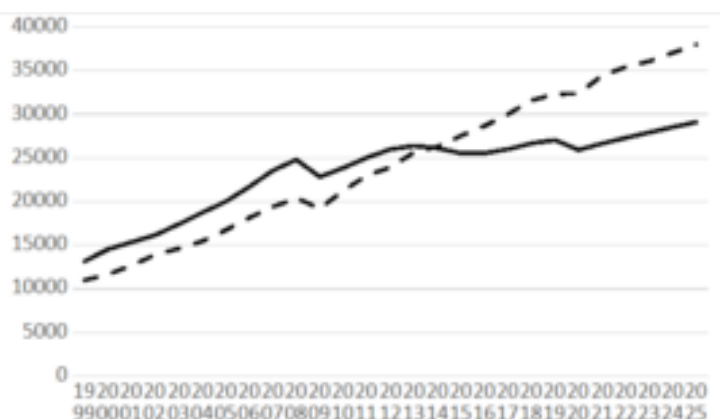
⁴ Easterly W. In Search of Growth. Adventures and misadventures of economists in the tropics // transl. from English. V. Sonkina. — Moscow, 2006.

⁵ Aghion Ph. Chaebols and Firm Dynamics in Korea / Ph. Aghion, S. Guriev, K. Jo. Bank of Korea WP 2021-7. - 2021. - 5 March. Mode Access : <https://ssrn.com/abstract=3798087>

⁶ Guriev S. Why Russia is not South Korea / S. Guriev, E. Zhuravskaya // Journal of International Affairs. - 2010. - 63.2. P. 125–139. Access mode: <https://jia.sipa.columbia.edu/why-russia-not-south-korea>



find new sources of growth. The result is clearly visible in **Fig.1** The analogies between Russia and Korea, which were so obvious before the crisis (1997-1998 in Korea and 2008-2009 in Russia), completely disappeared after the crisis: Korea found new sources of growth, while the stagnation we predicted began in Russia.



Rice. 1. GDP per capita at purchasing power parity in 2017 dollars⁷

The solid line is Russia. The dotted line is Korea (with a lag of 11 years).

The explanation for this stagnation is the typical logic of the middle income trap. The political and business elites seek to protect the sources of rent extraction. They know exactly what reforms are needed to boost growth, but they know that these reforms will make them less likely to retain control over politics and the economy.

In itself, the desire of the elites to stay in power at the cost of economic stagnation is not surprising. It is interesting how successfully they manage to do this. The Russian regime is one of the most prominent informational autocracies.⁸ Through an expensive and well-thought-out propaganda campaign, the Kremlin has so far managed to convince the majority of the population that stagnation is the best thing Russians can hope for. Representatives of the dissenting minority were either co-opted or repressed. Despite the lack of income growth and the apparent failure to deliver on his 2012 and 2018 election promises, Vladimir Putin remains popular.

Unfortunately, this political balance is incompatible with economic growth. Breaking out of the middle income trap requires rapid development of the knowledge-based services sector and its exports. This requires a modern financial sector, protection of competition, the rule of law and overcoming

⁷ Source : IMF (World Economic Outlook, October 2020).

⁸ Guriev S. Informational Autocrats / S. Guriev, D. Treisman // Journal of Economic Perspectives. - 2019. - 33 (4). — R. _ 100–127. Mode Access : <https://www.aeaweb.org/articles?id=10.1257/jep.33.4.1>

isolation from the global economy. But such changes are contrary to the interests of the ruling elite, which needs control over the economy and relies on the government-friendly oligarchs. The geopolitical confrontation with the West helps create a propaganda narrative and explain to the population why incomes are not growing. Corruption is a key barrier to investment and economic growth, but it is also the main way to govern and co-opt elites.

The recipes for resuming economic growth in Russia are well known — they were described in the Gref Program (Program for the Socio-Economic Development of the Russian Federation for the period 2000–2010), the Long-Term Development Concept 2020 (approved in 2008), the Strategy –2020” (final version published in March 2012), May 2012 and 2018 Decrees. These recipes include building an open and competitive economy, a modern legal system, a competitive financial system, protecting property rights, developing non-commodity exports and attracting foreign investment, reforming education and healthcare, fighting corruption, deregulation and privatization.

These reforms directly contradict the interests of the ruling elite, but all international experience suggests that without them, Russia cannot be expected to break out of the middle income trap and become a wealthy country. There are many examples of countries that have been able to move from low to middle income without building modern political institutions. But examples of the transition from middle to high income in non-democratic countries are exceptions, namely Singapore and the Middle Eastern oil monarchies.⁹ Singapore Prime Minister Lee Kuan Yew, however, led an uncompromising fight against corruption and relied on attracting foreign investment, and the oil wealth of the Middle Eastern monarchies is an order of magnitude higher than that of Russia per capita. Therefore, without political changes, there is no reason to expect an acceleration of economic growth in Russia

References:

1. Guriev S. Crisis can make the Soviet Union out of Russia 1970-80. / S. Guriev, O. Tsyvinsky // Vedomosti. - 2010. - 19 Jan. Access mode: <https://www.vedomosti.ru/opinion/articles/2010/01/19/krizis-mozhet-sdelat-iz-rossii-sovetskij-soyuz-1970-80-gg>
2. Gill, Indermit, Homi Kharas, and others. An East Asian Renaissance: Ideas for Economic Growth // World Bank. -Washington, DC, 2007.

⁹ Treisman D. Economic development and democracy: predispositions and triggers / D. Treisman // Annual Review of Political Science. - 2020. - 23.1. — R. _ 241–257.





3. Chakarov I. Russia is threatened by the middle income trap, which will slow down the growth of the economy / I. Chakarov // Vedomosti. - 2012. - 15 Feb.
4. Easterly W. In Search of Growth. Adventures and misadventures of economists in the tropics // transl. from English. V. Sonkina. — Moscow, 2006.
5. Aghion Ph. Chaebols and Firm Dynamics in Korea / Ph. Aghion, S. Guriev, K. Jo. Bank of Korea WP 2021-7. - 2021. - 5 March. Mode Access : <https://ssrn.com/abstract=3798087>
6. Guriev S. Why Russia is not South Korea / S. Guriev, E. Zhuravskaya // Journal of International Affairs. - 2010. - 63.2. P. 125–139. Access mode: <https://jia.sipa.columbia.edu/why-russia-not-south-korea>
7. Guriev S. Informational Autocrats / S. Guriev, D. Treisman // Journal of Economic Perspectives. - 2019. - 33 (4). — R. _ 100–127. Mode Access : <https://www.aeaweb.org/articles?id=10.1257/jep.33.4.1>
8. Treisman D. Economic development and democracy: predispositions and triggers / D. Treisman // Annual Review of Political Science. - 2020. - 23.1. — R. _ 241–257.

