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ABSTRACT

Kim, Byung-Yeon, Choi, Syngjoo, Lee, Jungmin, Lee, Sokbae, and Choi, Kyunghui—Do Institutions Affect Social Preferences? Evidence from Divided Korea

The division of Korea is a historic social experiment that randomly assigned *ex ante* identical individuals into two different economic and political institutions. About 70 years after the division, we sample Koreans who were born and raised in the two different parts of Korea to study whether institutions affect social preferences. We find that those from North Korea behave in a less self-interested manner and support the market economy and democracy less than those from South Korea. A follow-up study shows that social preferences did not change considerably in two years. We check robustness against sample selection and potential confounding factors such as income differences. Our findings indicate that preferences are rooted in institutions. *Journal of Comparative Economics* 000 (2016) 1–24. Seoul National University, Korea; Columbia University, United States, and Institute for Fiscal Studies, United Kingdom; Hanyang University Contemporary Korea Studies Institute, Korea.

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1. Introduction

The world has witnessed the division of Korea into North and South in 1945 and its subsequent institutional divergence—to a market economy and democracy in South Korea and to a socialist economy and Communist dictatorship in North Korea—throughout the Cold War and up to the present day. Korea's partition at the 38th parallel holds particular interest because it was a historic social experiment that randomly assigned *ex ante* identical individuals into two economic and political institutions, signified as “the Korean experiment” by [Acemoglu et al. \(2005\)](#). The two Koreas were homogeneous

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prior to the division, which was made as a result of the Cold War and independent of ordinary Koreans' preferences, and there has been little mobility and communication between the two populations since the division.

The main hypothesis of this paper is that North and South Koreans have become different in their preferences owing to their life experiences under their different institutions. Understanding whether institutions affect preferences, and, if they do, how institutions affect preferences is difficult because institutions are endogenously selected by citizens and because institutions and preferences coevolve (Aghion et al. (2010); Tabellini (2008)). The Korean experiment offers a unique opportunity to investigate the impact of institutions on individual preferences. About 70 years after the division, we sample Koreans who were born and raised in the two different parts of Korea to study whether institutions affect social preferences. We employ standard laboratory experiments to elicit social preferences and ask survey questions to measure attitudes toward economic and political institutions.

The most challenging task in our study is to recruit those who were born and raised in North Korea, more accurately, those who hold preferences that were likely to be shaped under North Korean institutions. Given that it is impossible to access the general population of North Korea, arguably the most reclusive country in the world, we use the strategy of target group recruitment to overcome the practical limitation by recruiting three distinct groups of North Korean refugees who settled in South Korea. The first group, which we refer to as *North Korean newcomers*, consists of those who arrived in South Korea on average less than a year prior to our study. Since they had relatively little time to experience South Korean society, they are likely to maintain North Korean social norms. In other words, they should provide a hole in the wall through which we can take the best glance at ordinary residents in North Korea. The second group, which we call *North Korean students*, comprises those who have stayed on average for five years in South Korea. This group is on average younger than the first group and is comprised of students enrolled in universities in South Korea at the time of the study. The first two groups of North Koreans have differential degrees of exposure to South Korean institutions in terms of their length of stay and the second group's education in South Korea. The third group, called *North Korean returning newcomers*, is a subgroup of North Korean newcomers whom we followed about two years later. By comparing their behavior when they were initially studied with that after two years in South Korea, we can examine the malleability of individual preferences over a two-year horizon.¹ We recruited South Korean (SK) college students as a counterpart to North Korean (NK) subjects. We deliberately chose college students as SK subjects to ensure that the results for SK students be comparable to previous findings in the literature that used samples of college students in developed countries.

We employ modified dictator and trust games to measure distributional preferences, trust, and trustworthiness. We employ the "standard" games for the purpose of facilitating the comparison of our results, especially those for NK subjects, who have never been studied before, with the accumulated findings in the literature using the same games. Specifically, we conducted the following three experiments: (i) the *other-other allocation game* in which an endowment is divided between two anonymous opponents; (ii) the *dictator game* in which an endowment is divided between the decision maker and an anonymous receiver (based on Andreoni and Miller (2002)); and (iii) the *trust game* (based on Berg et al. (1995)) in which the receiver has a chance to return a part of money received from the sender. One important feature of our design is that subjects are informed of the group identity of their partners, which is defined by their birth country. Every subject played the three games twice sequentially: once with an NK opponent and once with an SK opponent. This design enables us to measure each dimension of social preferences directed toward in-group and out-group members. In addition, we ask a large number of survey questions to collect rich information about individual characteristics. In particular, we measure attitudes toward the market economy and democracy among others. The main findings of the paper can be summarized as follows:

- We find a sharp disparity in distributional preferences between NK and SK subjects. NK subjects, both newcomers and students, are less self-interested than SK subjects irrespective of the group identity of their partner.
- A follow-up study of returning newcomers shows that there is a significant disparity between NK and SK subjects, which indicates that distributional preferences did not achieve parity in two years.
- There is a considerable gap in preferences for economic and political institutions between NK and SK subjects. NK subjects exhibit less support for the market economy and democracy than SK subjects.

The aforementioned results are robust after controlling for demographic characteristics and various potential confounding factors such as income prospects, risk aversion and national identity. We also find significant differences between NK and SK subjects in their behavior in the trust game. However, after controlling for distributional preferences, the differences become small and insignificant. We conclude that institutions affect distributional preference, while they do not affect trust and trustworthiness.

Some important caveats in our paper are (i) the issue of sample selection: that is, NK refugees are a selected sample of the NK population and the SK subjects consist of university students, and (ii) the NK refugees are on average much poorer than the SK subjects. To deal with the former concern, we look into the representativeness of our NK refugee sample as well as the external validity of our SK student sample. Furthermore, for the second concern, we examine the potential bias coming from substantial income differences between the SK and NK subjects. We provide evidence that the differences in giving behavior between the NK and SK subjects are not simply an artifact of our sampling choice, nor from income differences.

¹ It is not common to conduct follow-up experimental studies tracking the same individuals. One notable exception is Meier and Sprenger (2010), who tracked subjects' credit card debt one year after the experiments measuring time preferences.

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