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International Journal of Applied Business and Economic Research

ISSN : 0972-7302

available at <http://www.serialsjournal.com>

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Volume 15 • Number 15 • 2017

Institutional Analysis of Public Administration System

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Abstract: Most developed countries has successfully made a transition to full-fledged market relations. For quite a long period, Russia is trying not to be late. From one point of view there are obvious successes, from other hand we see destroying feedbacks. Recognizing the need for a balanced approach, we propose to consider those failures that led to particularly serious distortions in economic relations, deformations, destructive consequences, and dysfunctions in public administration. Dysfunction of public administration system in the economy is a disorder of the public administration of the economy, which leads to adverse consequences. Institutional analysis aims to assess the quality of the organizational, legal, administrative, political components of the institutional environment. Thus, we would like to assess the individual elements of the institutional environment, in the formation of which the public administration in the economy plays an essential role and whose quality has the strongest impact.

Keywords: institutional analysis, public administration, dysfunctions of public administration system, competition, state, institute.

JEL: D2, H1, O2

INTRODUCTION

Nowadays we can observe a discussion in academic and political communities on where free market relations end and state regulation of economy begins and on the scope of state involvement in economy. During economic growth, state interference becomes the object of severe criticism, while in times of recession and crisis the majority of citizens and business expect miracles from state regulation and urge the government to intervene in certain economic mechanisms and relations and stabilize an economic life.

The state machine responds to these demands and eagerly intervenes in the economic relations; however, it does not always step back in times of economic growth under accusations of excessive economic regulation from previously welcoming business and citizens.

Following to the American researcher Robert Higgs, exactly to his book “Crisis and Leviathan: Critical Episodes in the Growth of American Government” (1987), we can see a centenary statistical trend and proves that the government always strengthens its role in the economy during crisis and hardly ever reduces its interference during the transition to economic growth. Because of this gradual state intervention, increase the efficiency in various sectors of the US national economy declines. After several complete economic cycles, this consequently leads to excessive growth of state intervention in the economy, which becomes one of the reasons of the next crisis.

This expansion of the Government activity (e.g. interference in the sectors of national economy where private bodies have operated previously) and its inefficient self-organization if compared to the natural market one during the current economic crisis.

METHODOLOGY

Following to the lecture of Joseph Stiglitz during the Nobel Prize in Economics receipt, he considered the interconnection of state, market and non-market institutions and emphasized that several reasons were given against state interference in market relations after the growing theoretical understanding of ineffectiveness of markets with imperfect information. However, the analysis revealed that incentives and constraints related to state activities differ from those operating in the private sector. Therefore, even if the state and the private sector confront the same information constraints, in the first case welfare can be increased. Based on this analysis the speaker concluded that market mechanism could be efficient only under very certain circumstances. Thus, it is possible to avoid dysfunctions in sustainable economic system development if state institutions, market and non-market institutions are combined.

In general, it should be emphasized that mistakes of development model choice, current system of governance and its impact on the control object, lack of professional skills in social and economic processes management background of all dysfunctions. Management failures in the development process lead to dissatisfaction of public demands and consequently to the aggravation of social problems. As Robert Merton pointed out, “tensions accumulated in the social structure as a result of dysfunction ... will eventually lead to the institutional collapse and profound social changes” (1949).

From the evolution theory, perspective dysfunctional tendencies are an integral part of development process. It is essential to minimize the time gap between the dysfunction detection and the solution of system unbalance. Dysfunction can be avoided through timely cause-and-effect analysis of economic system unbalance. A number of factors currently determines dysfunctions inherent in the real economic system of Russia.

We have already attempted to classify public administration dysfunctions by areas of government bodies' activity and types of government services in the researches of Silvestrov, Zeldner, Osipov (2015). The current economic situation in the country and external factors needs to add another classification related to decision-making. Thus, the administrative reform of 2004 was designed to divide the functions of ministries and to separate legislative functions (remaining by the ministries), state functions execution

(agencies) and supervision functions (service and supervisions). The major idea was not only to get rid of redundant and excessive functions, but also to transform the ministries into strategic decision-making bodies and make those responsible for reforms in the relevant areas of public administration and economic system. Over the time, some agencies were eliminated (i.g. the Federal Agency for Agriculture), new ministries and departments were created. As a result, the number of government bodies increased greatly rather than declined, which had led to bureaucracy growth, its effectiveness reduction and increase of its maintenance costs. Economic crisis and unfavorable external environment require more efficient fund spending, and hence optimization of the public administration system. If we consider the international practices, for example, the experience of the USA we can assume this country had faced the problem of economy bureaucratization as well. The US economy allows leveling major bureaucratic problems, thus the increase of public administration economic efficiency is directly related to the reduction of redundant functions and the following decline of excessive number of public employees and government bodies. We should remind a very ingenious affirmation of Gurcharan Das (2013): “India grows at night while the government sleeps”.

In addition, it has currently become the problem for ministries to have no opportunities to bear responsibility for strategic decisions aimed at overcoming economic crisis and external negative effects. It becomes clear that the regime of “manual economy management” despite its effectiveness during rapid economic growth does not work in terms of the economic crisis, when expectation of commands and short-term issues solution leads to aggravation of negative consequences for the economy.

RESULTS

We can acknowledge there is no body in the country that could be responsible to coordinate the government actions in terms of development and implementation of necessary reforms. The ministries are overloaded with current issues and this leads to a reluctance to elaborate and enforce necessary structural economic reforms. Previously the Center of Reforms under the Government of the Russian Federation was the strategic body. Currently there is no such body in Russia and the President has to manage a special meeting with the ministers (namely, A. Kudrin, G. Gref and others) to understand the needs to be done to launch the anti-crisis plan in terms of falling oil prices and strengthening of economic sanctions.

It is obvious that such occasional consultations will not lead to serious elaboration of reform projects; therefore, it is necessary to reestablish the permanent state body under the President of the Russian Federation, constantly and systematically engaged in development and coordination of structural reforms implementation. Currently, the most common public administration dysfunctions is the premature reforms and steps that lead to degradation. For example, a severe increase in tax burden (social expenditures) for individual entrepreneurs has led to closure of 1.5 million enterprises or their transfer to the shadow economy.

Now the Parliament considers a reduction of social expenditures from 30% to 14% and the Russian Government develops the new programs to support small and medium-sized business. Why undertake actions that lead to the closure of every third individual entrepreneur? Then the government try to create the programs to save the remaining ones by budget funding. Obviously, the reason is the lack of elaboration of these change and its consequences forecast, as well as departmental interests. Systematic development of the structural reforms and their implementation as well as immediate adjustment in the case of system errors are needed. It has become more typical for modern reforms where the main victims are the vulnerable

groups and small business. As F. Fukuyama notes it is typical not only for Russia, "...heavier tax burden will be laid on those who could oppose it the least" (2011). It is necessary to refer here to the International Monetary Fund report, which empirically proves that economy grows when the income of the poor is growing. If the income of the wealthiest 20% of the population increases by 1%, the GDP reduces by 0.1%, but when the revenues of the least affluent 20% of the population grow by the same 1%, the country's GDP increases by 0.4%. The report was based on results of four – year studies in 150 countries.

What are the costs and consequences of such false actions? These is a reduction of tax revenues and suppression of entrepreneurial initiative during economic crisis, as well as decline of effective demand, because the least wealthy citizens and small business tend to spend money quickly.

The second important systemic dysfunction that has surfaced during economic crisis is personnel policy in the public administration bodies. Manual economy management does not need creative initiative and innovative-minded employees, only executors are needed.

The competent executors are certainly necessary, however development of solutions is an equally or even more important task as external environment requires immediate reaction to changes and it will not wait for the bureaucratic machine to turn towards it. The consequence of such personnel policy is an obvious delay in the decision-making. The Government intends to change an education policy and start educating a new class of public servants who can elaborate and make strategic decisions. However, under monopolization of civil servants training system based on one Russian high school (RANEPA) the result is unlikely to be reached (RANEPA supports the anti-monopolies fight only in unimportant areas, but severely reject it in the areas of their direct interest).

The next strategic dysfunction is a creation of financial system where is no place for the real economy as a recipient of financial resources; it acts only as a donor. (see Exhibit 1, 2).

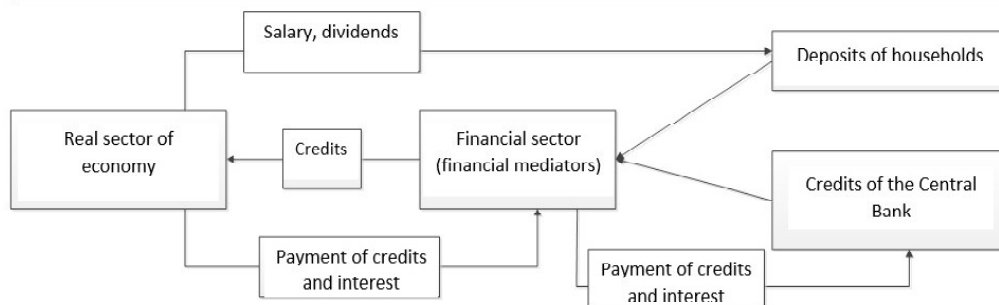


Exhibit 1 – Scheme of financial resources movement (theory)

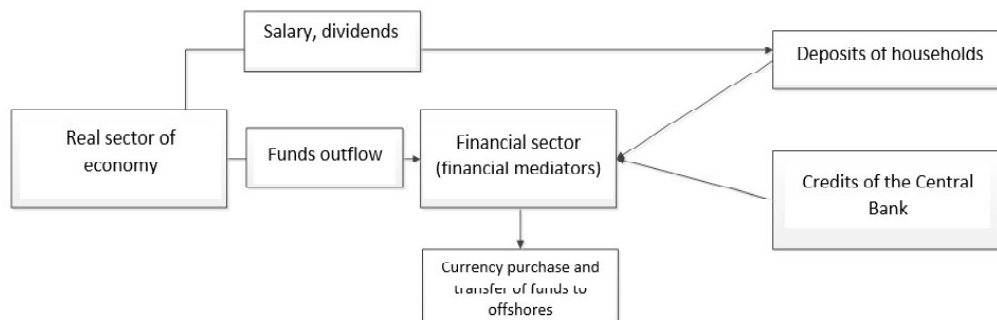


Exhibit 2 – Scheme of financial resources movement (Russian and Chinese practices)

The chart clearly shows that the current economic model where the financial mediators accumulate financial resources not only from the Central Bank (credits) and population (deposits) but also from the real sector (investments in the private capital). Instead of financing real economy, the financial sector withdraws funds and directs them either into currency speculations, or to the offshores. After that, the funds are partially re-exported to the country, but already as foreign investments.

This economic system is typical not only for Russia but also for China. To prove this statement it is sufficient to look at the Russia's largest corporations system of financing, including state participation.

The main problem is that the actions of state corporations distort the principles of market economy in many areas where they were the key players, which results in systemic dysfunctions. Unlike private companies that maximize profit, state corporations maximize performance indicators, which they receive from the government above.

For example, "Gazprom" is building economically inefficient gas pipelines rather than establishing customer relations. The funds spent on construction of the "Northern Stream" and "Southern Stream" could be used to create the gas liquefaction plants network and for supplies diversification. "Rosneft" demands RUB 300 billion up to 2.4 trillion from the National Welfare Fund and other funds for development of new deposits. However, if the deposits are profitable resources for their development can be attracted on the market. If deposits are unprofitable then it makes no sense to develop them until new production technologies appear. It can be related to many infrastructure projects of the Russian Railways, Olympic and football construction projects, etc. Management that maximizes cost for shareholders would have never invested in such projects.

Instead of profit maximization, the companies raise the natural indices imposed by the state (e.g. linear meters, developed deposits, energy security, tons of iron and steel and so on). It may be gradually degrade to a full-fledged revival of the planned economy and further suppression of entrepreneurial initiative.

We argue that corporations are not to blame for this situation. It is a dysfunction of the public administration. It has led to a system where funds withdrawal from the country is more profitable than investment. Here we face an important state administration system's dysfunction - institutional dysfunction of public administration system.

Finally, the decision-making strategy in the public administration system should be changed from "patching holes model" to project management, which results in identification of priority issues and solution tools with account of strategic decision-making. The development of priority areas should be entrusted to the body, which is responsible for elaboration and implementation of the structural reforms.

DISCUSSION

R. Higgs proves that a certain internal or external, real or imaginary "crisis", which may even be caused or provoked by the actions of the state, is used to launch new programs designed to mitigate or eliminate its effects. These always include expansion of state authority and its interference into areas that have previously been out of its competence (1987).

The Government constantly faces a dilemma: either to admit to its citizens that it is ineffective or to continue the economic policy of state regulation strengthening for "overcoming crisis consequences"

which has been generated by the government regulation itself. The Italian scientist Vilfredo Pareto wrote: “In October 1921 the government can choose one of the two ways to cope with the current crisis: to leave it all to the laws of economy or to intervene and start managing social and economic processes. It chose the second path” (1984).

Further Pareto named this choice “ultimately only exacerbates evil”. Firstly, the government can be seen to take the “second way”. Obviously, the choice is determined by the desire to win parliamentary or presidential elections. Instinctively people understand that if the economy resides into crisis, it is necessary to use manual management of economic processes. People are unable to understand that this could be a false path, despite some historical examples of the developed countries.

However, a state intervention in economy also occurs for other reasons. A prominent American scholar of strategic management issues I. Ansoff states that “satisfied customers ... directly doubt the company activities and require stronger state control over its actions” (1984). Thus, in the second half of the XX century the customer rights protection movement began in the United States. It resulted in establishment of more serious state control over the business actions. It is interesting that Russia has to embark on ideas of consumerism, as the increasing competition between manufacturers will force them to seek new ways for product marketing, further goods differentiation and etc.

Let us consider a very special product - public services. Many researches have been devoted to this issue. The Nobel Prize in Economics winner, American professor Joseph Stiglitz, makes the most notable one. He poses a question: “How the economic role of the state has grown over the last 50 years?” (1977). The fact of the state’s role increase is not even disputed. Arguing with some Russian economists who believe that the state has distanced itself from problem’s solution and insufficiently regulates economic relations, J. Stiglitz wrote “...in the former Soviet Union and the Soviet bloc ... the major share of economic activity accounted for the state” (1977). J. Le Grand advocates a more liberal way and proves the need to introduce competitive market mechanisms in the sphere of public services (2007).

It turns out that while economists disagree in assessing the state role in the economy, they agree that the state has increased its role in economic relations by complication and strengthening of government regulation. However, this has not lead to overcoming crisis effects in the economy or to increasing consumer satisfaction level in public goods. To sum up, a state regulation in some historical moments (e.g. during the Great Depression in the United States) contributes to neutralization of negative consequences for the broader population, but at the same time restrains an economic development and leads to the economic crisis (e.g. 1960-1970 in the US and Western Europe, the economic crisis of 2008-2009). Thus, it is possible the appeal to the state intervention, but its long-term effects are not as pleasant as could have been expected. Moreover, not all economists consider government intervention in the economy, especially in the United States during the Great Depression, as salvation. Some sources claim that the US recovery from deep recession has occurred not due to the right government actions but rather in spite of it (Rothbard, 2000).

It is obvious that a product or public service is good when it meets the needs and requirements of its consumers. In practice, costs of a product or a public service are the criteria for assessing of their quality. However, as we highlighted above, that the consumer values the characteristics of a product or a public service, friendliness of personnel or civil servants, courtesy, speed of demand satisfaction (speed of fulfilling consumer wishes) and obtained result.

The latter idea is particularly important in the healthcare and education. Indicated sectors are traditionally under the broad state regulation (from strict criteria and licensing in the US to almost complete nationalization in Russia). Does this mean that nationalization leads to better quality of consumer needs/wishes satisfaction? Judging by the state of healthcare and education sectors in Russia it obviously does not. Therefore, there needs to be a balance between state regulation and free market to satisfy consumer demands. Consequently, both sides of this “conflict of interests” should be balanced in influence or participation in the economy.

The state role in the past 50 years has been increased however; the economic crises are becoming deeper and longer. We believe that the time has come to change this stereotype and to stop encouraging the government to strengthen its already extensive interference in the economy, to provide an opportunity for competition as a basic market relations mechanism. If business wants to overcome crisis then it should participate rather than expect help from the government. The cost of state interference will be increased by government regulation and taxation during the period of prosperity that will put pressure on business. Business should be more responsive to consumer needs, improve a service quality and try to maximize consumer satisfaction level. However, this recommendation is inapplicable to the large state corporations, since their only interest is to strengthen influence on decision-makers and receive additional budget allocations for megaprojects.

A prominent economist Friedrich von Hayek in his famous article “Competition as a Discovery Procedure” wrote the following on the necessity to change the government role: “... strange as it may seem at first glance, the high growth rate sometimes speaks not so much of good policy now rather than of bad policy in the past. Consequently, in the countries with already high development level there is no reason to expect an equally significant growth, comparable with the countries where effective resources use have been hampered by legal and institutional barriers for a long time” (2002).

Thus, a high economic growth achieved by favorable external environment (due to high prices for natural resources) does not testify the success of state economic policy, but rather a deterrence of economic development by state economic management.

The change of state role in economic relations can occur in several directions. Some of them are already at the preliminary stage in Russia, namely, the launch of anti-corruption actions, the continuation of a difficult and long-lasting reform to reduce administrative barriers in the economy, the introduction of financial ombudsman institute to protect business against the illegal actions of the public authorities.

CONCLUSION

It is necessary to continue reforms aimed at changing the role of the state, to abandon direct intervention in the economic processes and so-called “manual control” of economic relations.

The American specialist in a field of competition and competitiveness of national economies, M. Porter distinguishes the following factors as determinants of the modern national economy competitiveness. On the one hand, it is the quality of national producers, on the other hand the quality of political and economic environment in a country (1998).

Therefore, the value of such comparative advantages as natural resources, climate conditions, as well as benefits acquired during previous development, such as technology level, production experience,

significantly reduces under the modern conditions. However, the importance of such competitiveness factor as institutional structure of the state increases greatly.

The consumer's dollar voting highlights the goods and services which most completely satisfy the needs. Meeting consumer needs is the prerequisite for business creation, prosperity and competitiveness in the modern world. Satisfaction quality or level of consumer needs satisfaction are prevailing. The higher the satisfaction quality or level, the greater the competitiveness of businesses and of national economy in general.

It seems obvious that a satisfied customer is the basis of prosperity of any business. However, in business practice standardization of procedures, clichés have substituted the contents. Business becomes mechanistic, inanimate and customers feel it, as it is often uncomfortable to buy products in the way established by the seller (methods of selling goods are uncomfortable for the customer).

The consumer suffers the consequences of the shift of importance, as he lacks high quality food, housing, healthcare, education, roads, etc., as well as qualitative public services. In such system, the consumer opinion does not matter. It results in a growth of social discontent with authorities of all levels, increase of dissent and unrest, social appeals to the government to "rein in the overweening business".

The faster the federal authorities will understand the need to change the state role in economic processes regulation, the greater the chances that Russia will be able to build a competitive economy based on innovation and knowledge, and the faster the Russian citizens - consumers will have the opportunity and access to qualitative products and public services.

In addition, the result of such government role alteration is the mutual antagonism of business and state that will not allow either of the parties to aggravate negative consequences of a new economic crisis, and might even help to level these consequences for the weakest side of the "triangle" - citizen and consumer. We do not want to give the reader the impression that we reject the state as an institution, we will quote a prominent libertarian economist Ludwig von Mises: "The state itself is not evil; it is a necessary and wholesome institution which is essential for development and preservation of sustainable social cooperation and civilization" (1978). At the same time, public authorities should change their interaction with business and society for the benefit of all the three communities, since the state can be either a strong partner of business and society, or the oppressor of the latter (Zeldner, 2010).

By establishing interdictions the state authorities force business to follow the path outlined by the state policy and thus compel business to act in the interests of society and the state (for example in medicines production). The state and business are doomed to coexist.

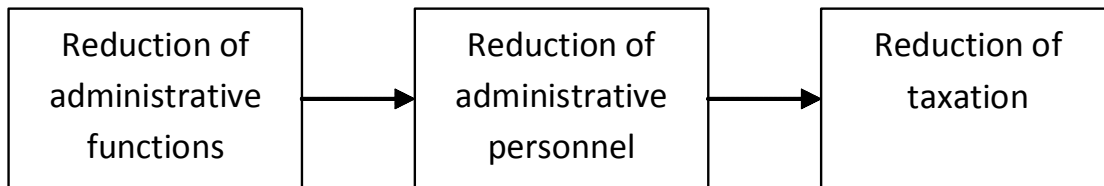
St. Augustine of Hippo wrote: "In the absence of justice, what means state for the large bandit gangs; bandit gangs themselves are nothing else than the miniature state ... they are a community of people, administrated by the leader authority, bound by mutual agreement and divide trophies by voluntarily set law" (2013). In addition, Marcus Tullius Cicero specified, that many harmful and destructive decisions of peoples "... deserve the name of the law no more than decisions made by majority of the bandits" (1995). Thus, even in ancient times, scholars have pointed out that the state should be fair and otherwise the state became a bandit gang in relation to the subordinates.

Let us consider the problem of business taxation. Firstly, tax is a statutory way of partial income takeoff from business and people in favor of the state. Taxes as costs slightly harm the economy of large

companies, but are deadly for small business. Therefore, in competitive struggle large corporations are interested in state policy of tax increase, since it eliminates competition from small business.

This is another argument to reduce the state role in economy in general and in cluster policy in particular. Government regulation leads to industry monopolization and cartelization, which results in higher prices and limited production, competition and progress, as can be seen on the case of rail and air transport regulation, oil and gas extraction and public services (Rothbard, 2006). It should be noted that Finland, Sweden and some other countries have achieved leadership in competitiveness through clustering. Formation of market-oriented clusters in Russia will allow public authorities and local governments to promote innovative development of business entities” (Osipov, 2012). Why state authorities should encourage innovative development? Why not to assign it to the market? Moreover, how public authorities will do it without commitment? The state is often considered a genius that is able to solve all problems, while the state is a group of ordinary people, only worried about keeping their position. This activity motivation is the most typical for the current stage of the Russian economy and democracy development. Lack of responsibility for decisions makers, rigid power vertical, low level of education and culture of public officials undermine the possibilities of the state to regulate and, moreover to stimulate anything. It is necessary to give business an opportunity to decide whom to encourage, where to invest and what to produce under the market rules. When the state creates various barriers and obstacles for business, it gives root to corruption (Osipov, Skryl, 2016). After all, corruption is in its essence simply a method to overcome barriers of the state authorities. A simple and effective way to fight corruption is to remove excessive state economic processes regulation. The degree of construction process over-regulation in Moscow has led to the exile of small business from construction in the city, as it takes about 5 years only to conform initial permits. No small business will survive in such conditions. In addition, no bureaucrat is interested in development, improvement or promotion. These factors together prove the need to reduce government involvement in economic relations.

A radical reduction of regulation is likely to bring the dismissal of officials at all levels, and hence the cost of public administration will be curtailed (including salaries of fired officials, office buildings, equipment and other expenses). A reduction of government spending will allow to cutting of tax levies significantly. This tax levies reduction will stop the flawed practice of wealth redistribution in favor of the inefficient administration and will guarantee money for an efficient private entrepreneur.



Scheme 1: Logical succession of economic stimulation measures

Undoubtedly, the implementation of this program will require the revival of administrative reform of 2004, when the study of public functions has been started but sunken into oblivion.

A mass redistribution of the national income through taxation system leads to decrease of resource use efficiency (from simple negligence and mismanagement to corruption), while the entrepreneur will

find a more effective application of taxes levied as his actions are guided by the invisible hand of the market.

An increase of budget efficiency will automatically lead to expansion of business activity, job creation and finally to economic growth. In addition, reduction of taxes and simplification of tax administration results in significant improvement of investment climate. A taxation reduction is possible under budget balance maintenance, i.e. at least the lack of budget deficit.

This is possible under conditions of planned reduction of budget spending only; we suppose it means reduction of public administration expenditures, administrative apparatus, transfer of the majority of state functions to private commercial organizations (Osipov, Skryl, Nevskaya, Shavina, 2016). This will not only create new areas of business activity, but also expand the ground for economic growth through deregulation. Here the sphere for B-2-B services business will appear which will effectively function exactly based on value chain management.

The development of cluster system as a system-forming factor in innovation and technology involves modernization of the real sector of economy and increase of its competitiveness at different levels. With such approach, clusters become the leading economic growth points.

One of the most effective mechanism to create models of public service delivery is a “model of voice”. A.Hirschman characterized it, as «a model of voice is an attempt to change an undesirable state of affairs by means of individual or collective call to the immediate management, or to higher authorities able to influence the management; or by different types of actions and protest, including mobilization of public opinion (1970)

We convince that power distribution should happen on not only industry and competencies basis, but also based on macroeconomic planning horizon - tactical and strategic management. To execute the second task, we consider it is necessary to call upon a new management body as an over-ministerial institution in management system.

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