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Towards a New Economic Theory of State

The present report gives the authors' approach to constructing a new economic theory of modern state, the theory of patronized goods and a general concept of mixed economy failures being its two important components. This approach is based on the original interpretation of a term 'irrationality' and proposes a more general definition of 'paternalism', revealing negative consequences of their present interpretation.

Along with the other failures of the mixed economy, the authors describe its special case – 'paternalist failure'; that may be considered a combination of failures in social choice and irrational government bureaucrats' activities. Five types of bureaucratic irrationalities: Vjazemsky law, dilettantism, 'cashier effect', Parkinson law and government officers' 'rent seeking' behavior, generating bureaucrats' (officers') failure.

The authors show that in contrast to the market failures, generating government activities, paternalist failures require the other responses, demanding different activities, — democratic procedures for creating paternalist lines and the introduction of the procedures limiting bureaucratic tyranny.

Keywords: patronized goods, merit goods, market failures, paternalism, government failures, bureaucrats' failures, bureaucracy.

JEL Classification: C70, C72, D5, D6, D7, H41, Z28.

Introduction

Considering a model of modern state let us examine the links between the theory of patronized goods and the concept of mixed economy failures (*Rubinstein, 2017*) summarizing social and merit goods, including the idea of libertarian and asymmetric paternalism — these are the theoretical constructions considering paternalist activities of a government. Let us remind a definition of a term 'patronized goods' — these are the goods and services, a consumption of which the government regulates — increases or decreases — at its choice or preference. At this point we find the connections between the theory of patronized goods and merit goods, libertarian and asymmetric paternalism. But besides the general we can find the specific features.

Considering the current people behavior, we think their activities are

subjectively rational at any circumstances, including the situations described by Musgrave, as well as later outlined by the behaviorist economists.

But if we estimate their behavior as irrational, one should not create special constructions with several utility functions for each individual to explain their behavior (*Margolis, 1982; Sunstein, Thaler, 2003*). Such a construction, as it is well known, includes a weakly approved assumption that a government knows the individual ‘genuine preferences’. The theory of patronized goods rejects on principle this shabby provision being fairly criticized (*Kapelushnikov, 2013, p. 40*).

Its basic feature does not deny a phenomenon of dual preferences, but gives another understanding of its nature. The question is about the presence of the two points for the estimate — each having its own preferences. From this assumption the theory of patronized goods proposed another understanding of dual preferences’ phenomenon.

The basic idea of the theory of patronized goods is to treat individual behavior from “the subjective point – as a goal to which an active person aims because he considers it rational” (*Mises, 2005, p. 24*). Alongside, the theory of patronized goods assumes the presence of an independent source of estimate — that is namely the carrier of normative standard. From the point of this ‘outside observer’, individual behavior may only be estimated as irrational or limited rational.

As a matter of fact we can observe the same situation in macroeconomics, where, as the new Keynesians consider, the economic agents act subjectively, trying to optimize one’s behavior in time. Moreover, as compared to meritorics and behavioral economics, government paternalism is based on some individual “genuine preferences”, — the economic regulation in macroeconomics is based on an idea to accelerate return to a full use of resources or to a reduction of balanced economy biases.

Considering all this, “pater” stimulates the changes in economic agents’ behavior. One can easily see that government understanding how to correct their behavior has the same nature as its “knowledge” of individual “genuine preferences”. In both cases government-pater manipulates behavior of the economic agents.

In other words, paternalism in any form means imposing the “pater” settings on members of a specific community of individuals – it may be a household, a company, a social group, which behavior and/or institutional media (where one acts), is considered ineffective. Concerning this, the nature of paternalism is tightly connected with and even conditioned by the failures of mixed economy – namely the periodic disproportions between the real results and the normative idea of individual well-being and society as integrity.

1. Social interest and paternalist failures

One of the basic features of the economic theory in progress is the assumption of a concept of economic socio-dynamics and the theory of patronized goods concerning the interest of society — if any, — which cannot be reduced to the interests of the economic agents (*Grinberg, Rubinstein, 2005, 2013; Rubinstein, 2013*). This important methodological statement contradicts the basic neoclassical statement — methodological individualism.

At the same time a more detailed analysis of this contradiction allows us to identify a conditional character of this assumption. The point is that a reduction of social interest to the interests of individuals is based on an important latent assumption. By default, we find here a hypothesis of *the perfect institutional environment* – some analogous of A. Smith’s ‘invisible hand’ — an environment, where the rational individuals are acting. In this case the interests of individuals cooperating with the other actors and perfect institutions reach harmony and transform into an integral social interest.

A situation changes radically if we cannot confirm this hypothesis. In these circumstances it is no longer possible to insist that self-interests of acting individuals are transformed into the summarized interest of a society as an integrity. As a matter of fact these very circumstances approved the introduction of a term “unreducible social interest” (*Grinberg, Rubinstein, 2005*).

We need stressing that in the real world there are no perfect institutional conditions, where self-regulating mechanisms would work without mistakes, continuously harmonizing the interests of social and

economic agents. That is why we can discuss the other nature of social interest and consider a ‘government play-maker’ as an autonomous market actor, using his resources for achieving the goals, he declares on behalf of society.

In this context we can think of the two versions of social interest. In one case there is a market coordination of individual behavior, in this process their aggregate interest is shaped, and in another case — there is an autonomous social interest that would not be reduced to the individual preferences. We shall think of two parallel processes, about the two lines of creating social interests. At the same time the theory of patronized goods analyzes two lines – the market (economic) and political. Within the political line normative interests and corresponding settings are generated by the institutes of the political system, they define the nature and substance of government paternalism (*Rubinstein, 2013, p. 18–19*).

Considering the political line and the government with its normative interest, one should not forget about Boudon verdict. So R. Boudon stressed that these assumptions are valid only if an individual is able to act in institutional environment, allowing him to make collective decisions (*Boudon, 1979*). Some institutional system allowing an individual to make decisions on behalf of society is an obvious condition for government designing normative settings.

The collective decisions on behalf of the government generated by the political line should be considered as a result of a discourse determined by the current institutions and the elite interests, capable to bring closer as well as to distance from the real social needs (*Tikhonova, 2013, p. 41–43; Urnov, 2014, p. 26*). There is a valid note: “the political process has its own logic; in many cases it does not match with common logic of optimizing economic mechanisms” (*Radigin, Entov2012, p. 26*), — and it is true.

In the recent past dominated the concept of “charity state”, which activity was driven exclusively to the realization of social interests. But in the second half of the twentieth century a new logo is playing a more important role — the thesis of shifting the political decisions towards the interests of ruling elites (*Stigler, 1971*). In the same context one should consider that government paternalism is not always directed to the “pater care” of the people’s well-being according to the initial interpretation of

this idea — even in the origin (*Alson, 2006*). In other words: the political line actualizes the interests, approved only by elite.

Merely their assumptions become the normative social interests as a result of corresponding collective decisions. Whatever the mechanisms of creating the social interest — whether these are personal decisions of a group leader, or voting of all the society members, or a coalition decision — the interest is always determined in the form of pater assumption “as it should be”. For all this the decisions made depend on the level of society development, its political system, the government rules and regulations. That is why the decisions suffer defects, namely — wrong public choice, bureaucratic tyranny, risk to loose social well-being (*Melnik, 2015, p. 16; Gorodetsky, 2016, p. 430*).

It is worthwhile stressing that a parliament party (in coalition), formulating the normative assumptions (within the political line), possessing the necessary majority of votes, is able to vote practically for any decision in favor of the party interests (*Polterovich, Popov, 2007; Hillman, 2009*). And the point is not whether the parliament is representative and how its work is organized. The principal component is a procedure of making decisions and its basic institutes (*Melnik, 2015, p. 18*).

Related to this, one can formulate the fundamental contradiction of the modern political process. On the one hand, any democratic system is built on the majority domination, on the other hand — subordination to the majority would recently turn into “following the majority”¹.

“Many of those, who support democratic institutions, — wrote L. von Mises — would ignore these ideas... The arguments they propose in support for freedom and democracy, are infected with the collectivist mistakes. Their doctrines are likely misinterpretations, than a support to genuine liberalism. In their opinion the majority is always right only because it is able to crash any opposition. The majority is a dictator power

¹ «It is not difficult to resist against and influence of one villain, but many of them are rushing down the slope headlong, then not to jump into the stream is a sign of noble soul and wise mind, educated by courage» (cit. from (*Kovelman, 1996, p. 65*)). These modern sound words, so elegantly formulated, belong to Philo Alexandrinus — a philosopher in I BC, who in his writings had combined the Jewish tradition with the Greek culture.

of the most member-intensive party. Such a liberalism — namely pseudo-liberalism — is an opposition to liberal doctrine” (*Mises, 2005, p. 144*). Democratization of the collective decisions, search of the institutional mechanisms, limiting the majority power, are the key tasks of modern political science and the theory of social choice.

From the end of the twentieth century this theme has begun getting popularity in researchers. Among them was J.-J. Laffont; he stressed that “despite a domineering view of social interests – as a decisive goal in choosing the way for economic development, — intervention of the theory of interest groups, making a special accent on its influence on political decisions, is still expanding” (*Laffont, 2007, p. 23*). Analyzing this tendency, he points at an ‘authentic adviser’ in the ruling party, who proposes a program of activities aimed at increasing his advantages in a particular economic and political situation (*Laffont, 2007, p. 22*).

At the same time it would be a mistake to think of the unique possible choice; it is always in the field of normative decisions, where the target guidelines of the parliamentary majority are playing the main role. At the same time society (according to Laffont) comes into a collision with political tyranny in determining pater assumptions that is fraught with false decisions.

If a problem of “pater” pattern setting is hold back or by default is set to increase social well-being in the concepts of public goods, merit goods and new paternalism, as well as in the Keynesians doctrine, then in the theory of the mixed economy failures this question is of prime importance and is thoroughly examined through the optics of collective decisions taken by the parliament. The parliament by itself may be considered as integrity of advisers’ to the political parties, representing the interests of relative groups of voters.

Such an approach is the basis for using Arrow’s theorem “on the impossibility” to an integrity of authentic advisers. It allows making a following conclusion: it is impossible to coordinate the parliament parties’ interests. It is necessary to notice that the real political practice of the democratic governments demonstrate the general rule: every parliament would evolve towards a collective dictator (according to Mises) in form of

a party-in-power or the parties' coalition, which, as a rule, possesses the necessary majority of votes for making decisions.

Moreover, parliament voting would produce "paternalist" assumptions, not related to the needs and priorities of a society, ignoring the preferences of small parties, as well as the interests of their many million voters. This outcome may be applied to any procedures of the collective decisions, about which wrote Boudon and against which warned Mises, provoking distrust to paternalism and the government activities in the majority of economists and politicians².

In these circumstances a doctrine of charity-state is obviously not correct. Let us examine the fact, that the consequences of assumption not corresponding with the needs of society, may be the decline in well-being, explaining one of the mixed economy failures — "*paternalist failure*".

It is necessary to stress, that paternalism in any government system would lead to the strong government, which would, as a rule, drift to "Leviathan". At the same time the negative consequences of government paternalism may strengthen because of improper bureaucrats' activities, at the same time generating "government failures"³, provoking the very special type of paternalist failure — "*bureaucrats' failure*"⁴.

2. Bureaucrats' failure

According to the well-known principles of behavioral economy and alongside Max Weber traditions (*Weber, 1994, p. 57—58, 345*) we shall further understand "*bureaucrats' failure*" as the *irrational activities of bureaucrats*. Let us analyze the behavior of government officers⁵ whose

² Let us mention the writings of the representatives of Virginia school of political economy Ch. Rowely and M. Vachris; they showed up as the opponents to «free electors' choice» (*Rowely, Vachris, 1993, 2004; Rowely, 1997*).

³ The government dysfunctions may mean excessive government interference, as well as lack of its necessary activity (*Crosier, 1997, p. 699*).

⁴ We can find descriptions of similar «government failures», as contrasted to «market failures», in a number of publications. For example, in (*Krueger, 1990; Tullock et al., 2002; Winston, 2006; Radigin, Entov, 2012*).

⁵ Officer here is an executive manager within a system of public administration.

activities do not always correspond with the assumptions of its strict orientation to the implementation of representative and executive power — that is one of the key problems of the general theory of the mixed economy failures.

2.1. Irrationality of bureaucracy

At the same time there are no ideal conditions for the bureaucrats — each in his place — to act without mistakes. The standard theory does not give enough explanations to this phenomenon, giving reasons for analyzing the behavior peculiarities of bureaucracy. The examination of different government service concepts (*Obolonsky, 2000; Vassilenko, 2001*) gives the ground for affirmation, that here one would find the methodological assumptions, based on rational behavior principle, but this time — specially for the bureaucrats.

According to this principle, every government officer would choose the best variant for his activities optimizing not only his own, but a social well-being as well. In other words any bureaucrat would seek maximizing his utility function within the given limits, making up his position functions. All the rest would be provided by the institutional system of the government rule, aimed at harmonizing social interests with government officer providing maximum closing the gap between the executive power decisions and the government assumptions, formed within the frames of a political system.

If a system of government rules and regulations fails and generates the wrong decisions causing losses in social well-being, these failures are explained by the government dysfunctions — the failures of the system itself that need to be reformed — and/or irrational individual activities of the government officers. Not diving too deep into this subject, we stress the most important point — the effective system of government administration is driven by *rational* behavior of the bureaucrats. At the same time their activities are rational only in case when they are able to choose those lines that would mostly respond to their preferences – within the available variants.

At the same time, reminding Blaug, let us note that even in the activities of government bureaucrats “it is impossible to exclude the

behavior driven by immediate impulse, a habit ... or even by the forgetfulness” (Blaug, 2004, p. 351) that allows proposing the possibility of choosing not the best variant leading to the loss in social well-being. Let us add that — as in the case of economic agents’ “behavior failure” (Gorodetsky, Rubinstein, 2017) — there is a lot of evidences revealing the failure of rationality principle in bureaucrats’ behavior (Zinchenko, 2002).

If the economic theory, providing the government interference in individual behavior, explains it by individual irrational activities and pater drive to push economic agents to choose some “genuine preferences”, — we shall observe a completely different situation about irrational government bureaucrats’ behavior. “Genuine preferences” in this case is not a hypothesis. On the contrary: every government officer — according to his professional functions — is assigned what to do in order to implement government decisions. So here comes the question: why and how bureaucrat’s irrational activities are generated? — the activities leading to “bureaucrats’ failure”.

The analysis of different concepts and practices of government gives us a possibility to forward a hypothesis about several types of irrationality of the government officers, stipulated by *objective imbalanced interests* of the government — the interests, these bureaucrats are called to implement, as well as their personal interests as individuals. This imbalance, to our mind, reveals the negative aspects of government administration system, leading to the government failures, braking economic growth and the losses in social well-being. Let us discuss this hypothesis, having distinguished a number of institutional reasons of irrational bureaucrats’ behavior without giving a full description of the nature and types of “bureaucrats’ failures”.

2.2. *Vjazemsky law*

Analyzing not always a rational behavior of bureaucracy let us look at another fact — in many cases this behavior is driven by institutional environment: specific acts, current norms and regulations. At the same time many analytics note the “genuine character” of any bureaucratic system — that is an excessive number of various instructions at different levels of executive power, often impossible to be implemented (Dolfsma, 2013).

Let us point at inflexible legal and normative acts concerning economic activities, undue tendency of a government (as certain administrations) to unify its establishing norms without concerning different specifications of various branches and forms of (economic and social) activity.

Let us analyze an example of the Russian Federal Act on the contract system concerning provisions, works and services for the government and municipal needs. This Federal Act sustaining the competition (between the service companies') requires open tenders in every sphere — in providing resources for the offices, as well as for inviting the famous tenor for opera performance in the Bolshoi Theater.

Last years the procedure of such unification follows practically all the government acts, regulating the activities of legal bodies in Russia without concern of a particular branch or sphere. And as it usually happens, nobody is trying to respect the given norms. It looks like this has become a common practice and a special feature of the Russian system of management.

Let us remind the known moto of Peter Andreevich Vjazemsky: “severe Russian laws are moderated by the failure to its implementation”. This institutional feature provokes many types of bureaucrats' irrational behavior, with its inevitable consequences — bureaucrats' failures.

2.3. Dilettantism and a capture of “the others’” competences

Let us observe some specific circumstances provoking irrationality of bureaucracy. First of all — and like the famous Lester Salamon analysis (*Salamon, 1987*) — it is necessary to point to dilettantism of the clerks. The thing is that people without necessary professional competences, knowledge and skills are appointed to managerial positions at different levels in modern government — proceeded from their affiliation to the particular political elite (*political principle*). Let us also add nepotism (*clan principle*). The nominations to the high positions in the executive institutions also give a way to the practice of “one’s own” people (*clan (or nepotism) principle*).

No doubt we cannot exclude the situations when these methods would still provide nominating the professionals with the necessary characteristics. But in cases a dilettante occupies boss chair, our hypothesis

would be considered funded, at the same time ” bureaucrats’ failure” is becoming inevitable. Incompetent officer is unable to exercise his duties. Making mistakes in the necessary decisions he would in fact substitute the rational behavior — by acting “from general assumptions”.

Let us distinguish another type of irrational bureaucrats’ behavior which reaffirms our hypothesis. Let us turn to irrational behavior of government officers, willing to extend the frontiers of their influence and rule beyond the frames of their competences. This phenomenon called “cashier syndrome”⁶ is well known and is widely discussed in literature (*Zverev, 1992, p. 91; Chesnokov, 2000, p. 161—171*). Moreover this syndrome is seen in individual officer and at the administration level.

The same situation can be traced in takeover of outside competences by the Finance ministry. The concentration of the most economy management functions in this Ministry has narrowed its ability to influence economic development of the country by the due Ministry of economic development. Concerning the basic function of the Finance ministry — to rule and regulate the budget policy — its jump beyond the functions would increase the risks of irrelevant strategic decisions running contrary to the tasks of economic growth.

Another example of a takeover of «the others’» (outside) competencies is the activities of Federal Agency for Scientific Organizations (FASO, Russia) that goes far beyond material provision of the scientific organizations. This situation requires a more detailed analysis, but it looks like that this Agency with a thousand man-power managerial staff, was able to grab “the second key” to the Russian Academy of Sciences. This situation has dramatically reduced the ability of the Russian Academy of Sciences to influence the process of scientific research and scientific development of the country.

Apparently a more frequently observed situation of an outcome beyond ones competences can be observed at the individual level. “Bureaucratic tyranny” was analyzed in many publications — (*Smirnov, 2009;*

⁶ Describing similar situation, one usually think that nobody wants to be “just a cashier” — everyone who is handing out cash, would like to decide by himself, whom to, what for and how much money to hand out.

Obolonsky, 2011) — are the typical ones. We stress again that in many cases this tyranny is caused by the attempts of an individual bureaucrat (administrator) to extend the personal power.

In all the similar cases such a “privatization of authorities” limits the legitimate opportunities of the other citizens, so increasing the risks of failure to execute the tasks settled by the government. The bureaucrats’ tendency to broaden their authorities comes out in another situation that may be attributed to the third type of irrational behavior.

2.4. Parkinson law and self-interest of the bureaucrats

We should deal here with the opposite trend — a transfer of some competences to a lower, but a reporting-up level; and artificial complication of management structures. Cyril Parkinson gave support to the truth of this hypothesis saying: “a bureaucrat multiplies his subordinates, meaning he would shift his responsibilities onto their shoulders” (*Parkinson, 1957*).

According to Parkinson law a number of bureaucrats is increasing. Parkinson proposed a formula: $X = (2S^m + L) / N$, where S is a number of office workers hiring up the subordinates, L — a number of years in work; m — a number of hours in processing the material, N — a number of the necessary office workers; X — a number of the new office workers hired in one year (*Parkinson, 1957*).

Despite the constant call to decrease management stuff — the Russian administration reforms did not stop uncontrolled growth of a number of government officers and a bureaucratic burden on the economy. Increasing the authorities’ power and promotion, a bureaucrat increases dilettantism and a number of ineffective management decisions. These circumstances decrease the ability to react flexibly to the new challenges and solve economic development problems (*Vassilenko, 2001*).

Bureaucrats’ drive to concentrate the power authorities and approach a budget pie would lead to the illegitimate capture of the “outside” (others’) functions unusual for the specific institutions and organs. The penetration of executive power into the practice and authorities of local administration runs along the same lines.

The three investigated types of irrational behavior could be most frequently found in a situation with the fourth factor of a bureaucrats' irrational behavior — their motive to increase personal well-being in all the possible forms. At the same time a balanced government system providing managers' interests (in case of perfect professional functioning), as well as management activities would increase well-being of the bureaucrats' (officers') and the society.

The circumstances of real life differ from theoretical constructions; personal bureaucrat interest does not meet the demands of government service and his job descriptions. History and modern practice do not know many situations when the systems of government regulation, economic stimulation measures and ethnic norms, fixed in the corresponding normative acts, based on specific and general legislation, would provide balance of interests. On the contrary in most cases the analytics find self-interest and rent-seeking behavior of the bureaucrats, meaning the desire to profit from their position (*Krueger, 1990; Tullock et al., 2002; Winston, 2006*), that generates high corruption potential.

2.5. About the system of government administration

Five discussed types of irrationality of bureaucracy do not reveal all the reasons of “bureaucrats' failure”. Further investigation is necessary here; its results would give us an integrated picture of behavior of this group of individuals that fundamentally differs from the behavior of economic agents by contents and aims of their activities — the later are fixed by “the other people” — they shape up their job responsibilities. Here we always find a conflict between personal interests of the bureaucrats and the interests of society.

It is necessary to note that temperature of a conflict depends not only on the design of a system of government administration, but on the civil culture of a certain society at a certain stage of development. Modern research reveals the links between institutions, economic decisions and culture (*Putnam, 1993; Alesina, Giuliano, 2016*). So it is necessary to learn the factors directly influencing bureaucrats' behavior. The measured characteristics — such as “general trust”, “general morality” and “job behavior” (*Alesina, Giuliano, 2016, p. 91—93, 97—99*), — would

determine honesty, responsibility and faith of the bureaucrats, that define their rational behavior.

K. Arrow puts it like this: “One can surely assert that a considerable portion of economic backwardness in the world may be explained by the lack of mutual; trust“(Arrow, 1972, p. 35). Similar investigations should become, to our mind, a part of every project of institutional modernization, and first and foremost of the administrative reform directed to the creation of a government system of administration, providing lower risks of “bureaucrats’ failure”. “Paternalist failures” alongside with the institutional, distribution and behavioral ones would allow to analyze them from the common grounds — namely as special cases within the general theory of mixed economy failures where the government acts as pater (Gorodetsky, Rubinstein, 2017, p. 32). Paternalist failure clearly shows that government activities are accompanied with the risks of making wrong decisions enforced by undue practices.

It is necessary to pay special attention to the fact that “pater” itself is not able to eliminate the failure of pater-government as compared to the standard mixed economy failures that would be removed by the government activities. It is the same odd to believe that Munchausen would draw himself from the swamp by his hair. And only the third participant of economic relations — a civil society (civil activity and self-organization if the citizens) — is able to create institutional environment, capable of lowering the risks of wrong decisions, and providing social control within the system of government administration (table 1).

Table 1. Mixed economy failures

Mixed economy failures	Government activities	
Institutional failure	Pareto-ineffective balance (monopoly, externalities, information asymmetry etc.)	Paternalist activities of the government aimed at changing the institutional environment respecting freedom of consumer choice

Distribution failure	Pareto-effective balance with unacceptable wealth distribution	Paternalist activities of the government aimed at changing the budget limitations of individuals (redistribution) respecting freedom of consumer choice
Behavior failure	Individual irrational behavior	Paternalist activities of the government aimed at changing the consumer choice
Paternalist failure	Failures of social choice	Civil activities aimed at democratization of social choice and lowering the risks of irrational bureaucrats' behavior
	Irrational bureaucrats' behavior	

Thus, if the standard market failures — institutional, distributional and behavioral — cause government activities, the paternalist failure, being the immediate consequence of this activity, demands quite different actions — the actions directed to demonopolization of creating normative assumptions, introduction of the procedures limiting the bureaucratic tyranny, lowering the risk of the “bureaucrats’ failures” as well as the associated losses in well-being.

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