

## **INSTITUTIONAL ECONOMICS AT THE CROSSROADS: A VIEW FROM RUSSIA**

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### **Abstract**

*On the base of the brief outlook of history of the origin and development of institutional economics, the main theoretical-methodological changes with details applied to the current stage of development, supplemented by the events taking place in the field of evolutionary economics, are discussed. More precisely, the purpose of the article is to identify new phenomena and trends occurring in modern institutional (evolutionary) economics during recent decades with special emphasis on the Russian experience. Add to this that the line between the new phenomena observed in this field and possible trends of development is shaky, because not all events at the crossroads can get the trends, and moreover, we cannot exclude the possibility of trends that by subjective or objective reasons have not been identified and/or foreseen before. The article also presents some considerations on the formation of an institutional policy in Russia.*

**Key Words:** *Institutional Economics, Mainstream Economics, Crossroads, Changes, Phenomena, Trends, Russia.*

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### **1. Introduction**

Institutional economics, the emergence of which can be attributed to the XIX, and its golden age to the XX century traditionally has focused its attention on the role of institutions, understood by different authors in their own way in the adoption of the economic agents of any decisions relating to their activities. In the course of development – in the long run initially inhomogeneous – the science and complexity of economic life, which requires its explanation, there were new branches in the tree of institutionalism. Thus in the earlier stages of its development the main focus was on institutions as a set of rules and regulations; let us remember the names of T. Veblen, W. Mitchell, J. Commons. That, now called *old*, institutionalism as a whole has remained on the periphery of mainstream economic thought, getting off at the time of the World War II almost to nothing, so that after it, at 1960 – 70 s, newly reborn – now as the *new* institutionalism. Over time, however, it has been clear that not everything in the new institutionalism is really new: some scholars, such as G. Hodgson or the followers of the Austrian school, have to continue the line of the old institutionalism, albeit under new conditions, others have gone on with the neoclassical convergence, which has become by this time a highly formalized science which has

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taken due to the use of rigorous mathematical apparatus a dominant position – largely explained besides purely intra-scientific logic of development also by political and ideological considerations – in modern economics. This has led to *neo-institutionalism*, which focuses on the interaction of concentrated formal and informal norms, on the types of economic organizations, the types of behavior of economic agents, the role of state and market, property rights, transaction costs. The most prominent representatives of this trend are R. Coase, D. North, and O. Williamson.

Such a division is somewhat arbitrary in the sense that it is not always possible to identify economists as belonging to a particular institutional direction. Thus, some economists of heterodox direction, convinced that the dominance of neo-liberalism in the modern economy pushed back in its development entire regions of the world and that it is time to remember a Schumpeterian capitalism's construction of increasing return in a real innovation sector, united under the banner of the current, known as the *other canon* (see, e.g. Reinert, 2007). Their ideological inspiration is not the Scotsman Adam Smith, it is the Italian Antonio Serra, whose theory of economic development (1613) based on the synergy of industrial division of labor and increasing returns continued to be a classic until the end of the XIX century. The followers of Serra were the American Alexander Hamilton, the German Friedrich List, the Russian Finance Minister Sergei Witte, the Austrians Joseph Schumpeter and Karl Polanyi, the Swede Gunnar Myrdal, the Japanese K. Akamatsu, the Polish M. Kalecki, etc.

Warn against the primitive view of the development of institutional economics as a dynamic oscillatory process, where the struggle of ideas is deployed in the spectrum of only two poles. It would be possible, for example, to consider a *divine* (it does not matter what it is called – the pole, god, nature, the higher mind, or noosphere, though perhaps both) representation of the place and role of institutions in the world today. Such an understanding of the institutional structure of the world economy, where the top of the hierarchy is the noosphere (hardly distinguished from the divine principle) and at the foot – the enterprises (with their organically moral-ethical and reasonably higher standings defining their objective functions) takes A. A. Zarnadze (2011).

In reference to 'divine' let us note that religious thinking among economists – even if they are not aware of it – is quite common. Economists, as writes Robert Nelson in the preface to his eloquently titled book *Economics as Religion*, think of themselves as scientists, but they are likely the theologians. Their closest predecessors are not scientists such as A. Einstein or I. Newton; rather, they are the heirs of T. Aquinas and M. Luther (Nelson, 2001, p. xv). The reason for such behavior of economists is as follows: being embedded in a specific economic culture they cultivate an economic way of thinking, which "is simply taken for granted as the correct way of thinking – the best means of access the genuine knowledge about the world". Moreover, the economics profession "is the priesthood of a powerful secular religion – or more accurately a set of secular religions, as they have been developed in the theories of leading schools of economics of the modern age". In sum, beneath the economists' formal theorizing surface, they "are engaged in an act of delivering religious messages", such as (if correctly understood) "the promises of the true path to a salvation' following "along a route of economic progress" (Ibid, p. xx).

In a sense, a middle position between the poles took place the supporters of a system approach to the economy and its institutional structure. The aiming at the system coverage of the events keeps them wittingly or unwittingly from the temptation to fall into one of the extremes of modern economics ramifications. The Russian followers of system and institutional economic studies are grouped, in particular, in the scientific school led by G. Kleiner at the Central Economics & Mathematics Institute (Russian Academy of Sciences), State University of Management, and Financial University under the Government of the Russian Federation (see, e.g. Kleiner, 2004, 2008).

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Such is the brief history of the origin and development of institutional economics, details of which applied to the current stage of development, supplemented by the events taking place in the field of evolutionary economics, is the subject of this article. More precisely, our purpose is to identify new phenomena and trends of the modern institutional economics. It should be remembered that the line between the new phenomena observed in the institutional (evolutionary) economics and possible trends of development is shaky, because not all events that occurred at the crossroads can get the trends, and moreover, we cannot exclude the possibility of trends that by subjective or objective reasons have not been identified and/or foreseen before (Yerznkyan, 2011).

## **2. New Phenomena**

**2.1** The appearance of controversial interpretive views on the nature of differences related to institutional economics (and broadly – its various ramifications, as well as the rest of heterodoxy) and the current economic mainstream (orthodoxy, neo-classical in its traditional base or inertia).

Learning, for example, the T. Lawson (2005) methodological basis of economics shows that he holds the distinction of heterodox and mainstream approaches to economics not at the deep, ontological level, but at the relatively superficial level of their “concerns or questions of interest” in considering the certain problems. The opposite view is held by G. Hodgson, according to which such an explanation, first of all, is “unconvincing” and, secondly, it “ignores the specific ontological outlook of a ‘Veblenian’ branch of institutional and evolutionary economics that focuses on algorithms and rule systems” (Hodgson, 2006, p. 213).

The very idea of the interpreted object in the various scientific and theoretical approaches depends strongly on the theoretical and methodological platform of a researcher’s scientific area. For example, the likely close socio-economists and representatives of economic sociology use different approaches in the analysis of economic phenomena, including those associated with the institutional theme,: the former develop an approach based on a synthesis of the elements of economic theory and sociology, while the latter use purely sociological approaches. Another example, political economy approaches to the institutions: the language, and therefore the world’s understanding of the representatives of the new political economy, differs significantly from that of the representatives of the traditional political economy. Subsequently, it is interesting to note that as a result of market-oriented reforms many chairs of political economy at Russian universities retrained in the chairs of economic theory – and this last seal is present, more or less, till now. It is expressed often in the bias at the side of one of the areas of economic thought, in spite of the fact that modern economics incorporates many of the complementary and at times alternative, or competing, or conflicting directions and branches. Same modern Institutional Economics in its new institutional version is much closer to the neoclassical than the old institutionalism of Veblen, Commons, Mitchell and others.

**2.2** Strengthening the demarcation of economists, including supporters of institutional theory, not so much due to the presence of internal (paradigms, schools, currents) causes, rather as a result of external to science reasons (ideology, politics). The consequence of replacing the actual logic of the scientific development by pseudo-scientific interest of scholars in the pursuit of pushing ahead certain ideas is increasing the degree of their own – free or involuntary – partisanship.

**2.2.1** *Free partisanship.* An example of such free-style bias, particularly in the Russian reality, is represented by many of the officially recognized by [and endowed with] the power supporters of the predominant in mainstream neoclassical economic paradigm, which has become ‘a guide to action’ for the freely engaged group of people for the Russian economy.

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They are defending their being true not at the open scientific debate, but mostly by silencing or ridiculing their opponents positions based on the axioms and assumptions that differ from the ones of neoclassical economics. And this occurs when many anomalous facts refute the fundamental axioms of orthodoxy, “including the conditions of optimal economic behavior leading to the market equilibrium establishment”. But the problem [for science, since for the country it is sheer misfortune] is precisely that “the equilibrium in real economic systems having been in a state of permanent change is never reached”, and it “calls into question the adequacy of the provisions of the classical economic theory” to modern socio-economic realities (Yerznkyan, 2009, p. 201). A specification of this example is rough and over-mythologized privatization activity of A. Chubais, who was mainly responsible for its implementation in the 1990 s’ Russia. He masked his intentions at first by references to economic theory, allegedly promising to bring a multitude of efficient owners, but after a while in 2000s acknowledged that it was a mere ideological maneuver.

As a theoretical cover for their political, ideological action, Russian reformers have often led the Coase theorem, although it “could not and was not used by the authors of privatization as the only justification of his actions without further analysis and a significant number of refinements” (Andreff, 2003, p. 124). It is known that an increasing number of economists, including Ronald Coase himself (1988, 1994), argue that such an approach to externality problems is misrepresented by standard formulations of the theorem. Despite the fact that Coase’s ideas are now discussed in virtually every undergraduate microeconomics textbook, Coase et al. believe that, “to a considerable extent, what is taught in the textbooks is the [externality] theory as it existed before Coase” (Friedman, 1991).

Leaving aside the controversial by itself viability of the Coase theorem, which includes such flaws that when you try to prove the theorem, it becomes inevitably either a tautology or a false statement (Cooter, 1987), let us point out the methodological vices inherent in many supporters of both orthodox and institutional economics. It is “in the erroneous interpretation of the *possibility* of effective redistribution of property rights as a *necessary* phenomenon, which must *necessarily be realized*” (Yerznkyan, 2005). The substitution of concepts reflecting the *modal nature* of the theorem can be expressed according to B. Yerznkyan (2005) as follows: the ability of private agents to *achieve effective results* in their work provided a clear definition of property rights by legislators and contractual obligations and judicial authorities monitor compliance with them is treated as the results *will be achieved* and even more – *they would have been achieved*. This is evident from the following redefinition of the Coase theorem: government aimed at creating a market economy must first issue an effective legal system which clearly defines property rights that are protected and easily exchanged; however, even if the government makes a mistake with the initial distribution of property rights, according to the Coase theorem, private agents will correct this mistake in the process of free exchange, enclosing the relevant private contracts (Rapaczynski, 1996, p. 89).

This kind of the economic prerequisites substitution for achieving political goals was coined as *opportunistic ignorance* by 1974 Nobel Laureate Gunnar Myrdal. A separate question, to be added, is a character – intentional or unpremeditated – of the manifestation of mentioned ignorance. Reinert (2007) gives an example of the dual, depending from situation, approach: the assumption of increasing returns as a method of increasing the wealth has been heavily used by politicians in order to coerce voters in the direction of the European Economic Union at 1986, while for the establishment of trade with Africa the theory of Ricardo, denying the existence of increasing returns, is more suitable.

**2.2.2 Involuntary partisanship.** An example of such an unintentional engagement is Yegor Gaidar, who seemed to sincerely believe in the infallibility of the neoclassical postulates and the existence of immutable economic laws, based on which he, as an architect of the controversial shock therapy reforms in Russia, attempted to build a [alphabetical] market economy [in an

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absolutely not alphabetical country]. Spellbound, in all probability, impeccable internal logic of standard economics, he did not realize that the paradigm, as Thomas Kuhn wrote, lacked conceptual tools for explaining social problems, not to mention their decision.

**2.2.3 Forced partisanship.** Examples of such a *volens-nolens* bias are different, and they have both a subjective and an objective dimension. Thus, the need for a publication in journals from the Russian official list of Higher Attestation Commission causes interested in this persons to meet their requirements, but it is a double edged sword, and this applies not only to Russia - in fact, this practice is nothing more than borrowing (Frey, 2003, 2009). This is the so-called '*Publication Impossibility Theorem System*' (PITS). To further their careers, academic economists are required to publish in refereed journals, but for the vast majority this is impossible because there are few slots open in such journals. Choosing between one's ideas and academic success is similar, to a certain extent, to prostitution (Frey, 2003).

Bruno Frey (2009) describes it in the following way: on the one hand, they are involved in binding activities related to teaching, scientific supervising of the thesis, informing and consulting the public, participating in the activities of the university administration. On the other hand, they certainly should publish their works in accordance with the standard principle '*publish or perish*' or a more rigid version of this principle '*publishes in A-journals or perish*'. Both types of activities are costly, time-consuming, and associated with considerable psychological stress and emotions. The situation in question is taken from life: many Western universities impose strict requirements for applicants for the post of professor, linking the possibility of receiving the availability of publications in the journals of the highest category (A-journals). Access to these journals (according to unwritten rules, there are five – *The American Economic Review, Econometrica, Journal of Political Economy, Quarterly Journal of Economics, and The Review of Economic Studies*) is extremely difficult: among the lucky ones are the dominating scientific community in the U.S. and especially the scientists of the most prestigious universities (*Harvard, MIT, Princeton, Yale, Berkeley, Stanford*). And the case is not only the quality of publications. The result is a dilemma: do concomitant scientist activities (lecturing, etc.) and get published in less prestigious (but not objectively worse) journals or to throw all the strength to overcome the barrier of the prestigious magazine. In other words, scientists are going to have to choose one of two motivational mechanisms: whether to give preference to the mechanism of *internal* incentives (to follow their vocation), or guide the decision-making mechanisms of the *external* motivation (to succeed, excel). As a result, there emerge traditional for economy effects of unwanted, adverse selection, complete or partial displacement, when externally motivated individuals generally ignore or leave behind internally motivated individuals (Yerznkyan, 2010a, 2010b).

**2.3 Simplicity** (complicated in an abstract space of mathematical exercises) versus *relevance* (of real-world economic processes). It is one of the main items in the methodological opposition of the neoclassical economics and traditional institutionalism. Following B. Seligman (1962), the abstractly formalized and overloaded math approach of economic orthodoxy to the reflection of economic realities has, in addition to the undoubted advantages and analytical capabilities, also a reverse side – restriction of knowledge of public links, relations, social background of the implementation of economic processes. In fact, the economy is inherently a social science, designed to explore how people act in a complex environment. With models, you can probably reveal some features of this complex reality, but the models will be meaningful only if they contribute to the solution of pressing social and economic problems.

In a sense, this inability to solve the urgent problems or even ask, in a scientific manner, the vital questions, is associated with a crisis of economic theory (Polterovich, 1998) or a methodological crisis, which many Russian economists agree with. However, I believe that it would be more correct to say that the deductive (taken from the head) constructs of – voluntary or involuntary – supporters of neoclassical theory do not correspond to the problems that need solving, many of which find their expression (but not the solution) in the inductive (based on

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experience) descriptions of followers of institutional (in its various manifestations) economics. This discrepancy is due to the ongoing/growing gap between the actual observed (*individual*) institutional facts and explanatory base of standard (*general*) representations of the economic world order.

**2.4** Revising or correcting their views of the representatives of modern institutional economics of various kinds.

Institutional economics as a science is not static, resulting in the observed from time to time change in the attitudes of scientists themselves to the underlying assumptions and principles and, as a side effect, the impression of *frivolous* nature of science itself. In principle, however, a reassessment of own views is normal, and there may be various reasons – objective (the logic of science, the emergence of new circumstances, in-depth understanding of the phenomena, etc.), subjective (personality of the scholar, its evolution, etc.), and possibly other, although the line between them may be fuzzy. Here are a few examples.

**2.4.1** In a work from 1990, Douglass North notes that earlier (1973) he (with participation of Robert Thomas) “made the determinant of economic performance and relative price changes the source of institutional change” (North, 1990, p. 7). The rationale was the fact that “changes in relative prices create incentives to construct more efficient institutions”. On this basis, “the persistence of inefficient institutions”, such as in Spain, “was a result of fiscal needs of rulers that led to shortened time horizons and therefore a disparity between private incentives and social welfare. Such an anomaly did not fit into a theoretical framework (Ibid, p. 7). However, eight years later (North, 1981) he abandoned the efficiency view of institutions and suggested that “rulers devised property rights in their own interests and transaction costs resulted in typically property rights prevailing” (North, 1990, p. 7). This change of view allowed him to give a different explanation for the “widespread existence of property rights throughout history and in the present that did not produce economic growth” (Ibid, p.7).

**2.4.2** Recently Geoffrey Hodgson (2011) informed colleagues with the intention to replace the concept of *reconstitutive downward causation* for a more accurate term – *reconstitutive downward effects*. The *first* concept was used for the explanation of the fact of the interdependence of institutions and their inherent relations of causality (Hodgson, 2003, 2004). It means that social laws or forces can overturn the principles governing the operation of human mental and physical activity at the level of the individual (Hodgson, 2011). Causal processes by themselves in different directions, as to the reason that they, being related to social structures, not limiting themselves to the limits and constraints on behavior, also affect and alter the fundamental quality of individuals, their capabilities and inclinations. When a higher hierarchical level impacts on the lower level, there is a specific and clear case of *downward causation*. Institutions in this case are particular social structures, endowed with such fundamentally important, long and widely current downward causation in relation to individuals (Hodgson, 2004. p. 188). The *second* concept: a causal explanation of the relationship is strained, because there is no causality as such, and therefore should be replaced by ‘causation’ more neutral term ‘effects’.

**2.4.3** Complex relationships on the nature of institutional change, their dynamics and evolution: Darwin or Lamarck? Who is preferred? Whose theory is better suited to explain the economic development? This topic continued to draw attention to G. Hodgson, as his recently published (jointly with T. Knudsen) works on evolutionary economics are often misinterpreted (Hodgson, Knudsen, 2006, 2010). Here are two examples of strictly wrong statements: on the one hand, he states that “following Nelson and Winter (1982) – with the notable, but for me difficult to understand exception of Hodgson and Knudsen (2006) – most of most of evolutionary economists appear to agree that in this sense, socioeconomic evolution is indeed partly Lamarckian” (Pelikan, 2011). On the other hand, he states that “cultural evolution, like biological evolution, is strictly non-Lamarckian” (Mesoudi, 2011, p. 44). The reason for this discrepancy lies in the fact

that Hodgson and Knudsen “admit the possibility of processes where the acquired characters of an interacted (social phenotype) can affect its replicators (social genotypes)” (Hodgson, 2011). This, however, does not mean that these processes can be described as Lamarckian. The reasons are as follows: (i) Lamarckism and Darwinism are not rivals, and (ii) if social evolution were Lamarckian then it also would have to be Darwinian (Hodgson, Knudsen, 2006, 2010).

**2.5 Increased attention to the financial sector due to the global financial and economic crisis.**

It manifests itself in a renewed interest in long-wave dynamics of economic and institutional development. The uncontrolled growth of the financial sector really was a catalyst for the crisis. But was it the cause, and to what extent was the crisis unexpected? For Carlota Perez (2002) complex, contradictory relationships between the manufacturing and financial sectors do not carry anything mysterious, as she observed crises for about seven decades, more or less regularly. All this is well within her techno-economic paradigm of the four phases of development of capital flows from the financial sector in production and vice versa - depending on the phase of development. And they are as follows: in the *first phase* is a techno-economic divide, when the implementation of the technological revolution is accompanied by the departure of older industries and unemployment. The *second phase* is a time of financial bubble, which is characteristic of intensive funding of the revolution, ‘tiff’ in the system, polarization, ‘gold-plated century’. Further, the *third phase* Perez calls the ‘golden age’, and it is characterized by intensive growth, positive external effects, high employment and productivity. And, finally, a *fourth phase* marks a social and political split (latest goods and industries, market saturation and technological aging, frustration vs. constancy).

Here I would like to focus on one fact. Speaking of financial bubbles, and emphasizing their wave (referring to the K-wave) nature, unorthodox economists often overlook the fact that the growth of the financial sector depends not only on the wave nature of economic development. In today's world financial sector is the basis of transaction sector, whose dynamics, in the first place, is an indicator of place in the economy and society, institutional change, and secondly – the determinant of the dynamics of nation-states and global socio-economic system in general (Yerznkyan, B., Yerznkyan, M., 2009). In this case, it is important to note that 150 years ago the share transaction sector in the U.S. economy was about a quarter of GNP, about 50 years ago it crossed the half, and then – at the time of the crisis – it was nearly three-quarters. A similar pattern, with variations, inexplicable characteristics of national economies, was also observed in other countries. Therefore, to explain the nearly 150-year growth of the financial component of the transaction sector only by Kondratieff dynamics would be wrong, and this fact should not be ignored.

**2.6 Increased attention to issues of power.**

V. Dementiev (2004), analyzing the problem of power in institutional economics, compares different approaches to the study of the phenomenon of power found in a variety of economic concepts. Emphasizing the weak elaboration of a problem of power in modern economic theory, including its unorthodox ramifications, he shows *inter alia* the methodological limitations of transactions costs approach to the analysis of problems of power and argues the need for incorporating inequality of economic agents and limited voluntary transactions in the conditions of behavioral model. Of particular importance is the fact that they are justified by the need to incorporate issues of power in the subject of economic analysis.

B. Yerznkyan (2006) examines the phenomenon of power through institutional (transactional) analysis of the relationship between government and business, and reveals the specifics of ‘contractual’ relationship between them at an example of the Russian fuel and energy complex, where the players are, on the one hand, the government (state), on the other – respectively the oil, gas and energy companies. They play a dynamic contractual play, i.e. they make some series

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of agreements concerning rent-distribution amongst them. To model this game, the author uses the simple contractual scheme of O. Williamson (1985). By the asymmetry of the distribution of power relations the State (Government-player) can impose on Oil-, Gas- and Energy-players to their will and, this is important, selectively, largely depending on the degree of loyalty to the players and their willingness to share power with the natural rent.

A. Oleinik (2011, p. 19) develops the idea of presenting the power of the scheme, as he calls it, "from the dyad to the triad". Neoclassical economics addresses issues of power, except in the context of market power, as the ability of seller or buyer to influence prices, folding in the market. At the same time, "political scientists and sociologists, for whom the study of the problem of power is not located on the periphery of a research program, understand the power of another way: they put it in the context of interaction between people". Power, in their view, is reduced to the ability of one entity to impose its will on another in spite of its possible resistance, resulting in changes of the last order of preference (Weber, 1968, p. 53).

In order to understand the specifics of the triad of power itself, the emergence of a third party in the transaction between market participants is not so important, and moreover, it is trivial, if we recall the various treatments of the transaction given by John Commons (1934). It is also pertinent to recall the work, which is considered as a unit of socio-economic analysis of the triad, 'economy - society - state'. Such an approach, systemic by its very nature, initially assumes the existence of a third party in the majority of transactions. For example, G. Kleiner (2008), considering a similar triad, requires the state (government) to perform functions that are not subject to any economic or social actors. Among them: the *function of integration* (including the production of some public goods in a lack of interest in the subjects of the market due to the free-rider problem), the *function of institutional management* ('cultivation' and the borrowing institution as a special type of public goods), *benchmarking function* (impact on the preference order of economic and social actors), etc. And yet the specifics of the triad model of power in the understanding of Oleinik (2011, p. 24) is somewhat different, and in it the difference between a dyad and triad "is not so much quantitative as it is qualitative in nature: if the power dyad is the basic element of the political or economic power, the triad of power creates the preconditions for their combination". It is important to stress that "the triad of power embodies the key configuration of relations between state and business in the post-Soviet context".

**2.7 Drawing attention to the implementation of *institutional synthesis*.** From an institutional point of view the problem of economic science, is not only to make a prediction, understand the system of relationships, but also to make recommendations to justify the prescriptions of the changes in policy, human behavior, social consciousness (Yerznkyan, Gyurjyan, 2011). Economic problems are not important in themselves and in their relationship with social, political, ethical, and legal problems. Therefore, the meaning of the institutional approach is not to limit the analysis of economic categories and processes in a pure form, and include in the analysis of institutions to take into account non-economic factors. Moreover, it should not be limited to the analysis and it should also pay closer attention to what might be called *institutional synthesis*.

In this connection it is worth recalling that one of the last works of Academician D. S. Lvov and his colleagues (2007) was the features of the institutional theory and the requirements for the similar textbook. Based on the fact that the properties of the social world represented in the theory as a set of necessary and sufficient conditions for existence and development of the human race in its diversity, it was shown that this approach is broader and deeper than an approach developed in the traditional textbooks on institutional economics. According to them, academic discipline and its teaching should focus on subjects, which are usually ignored or inadequately covered in standard textbooks. Among them: institutional practices; historical logic; the latest achievements of the institutional theory; the normative (in addition to the positive) nature of the theory; the complementary nature of the old and new institutional economics; building a fair society; construction of a homogeneous (in terms of achieving justice) community;



efficient institutions which constitute a just society; the principle of methodological pluralism; the different behaviors and institutional structures; alternative arrangements and inter-firm interactions' governance structure; the institutional image of the company; justification of the possibility and need for modernization of complementary institutions (Ibid., 2007, pp. 12-17). To this list it could be added that key moments in the theory of institutions are, primarily, the consideration of the economy as a subsystem of a broader, social, systems, and secondly – the normative character of institutional economics.

**2.8** Drawing attention to the implementation of institutional policies and institutional management.

In connection with the requirement of normative character of the theory let us make one important reservation. L. von Mises is known to be categorical in his assertion that normative science does not exist. Any “scientific treatment of the problems of value judgments must take into full account the fact that these judgments are subjective and changing. *Science seeks to know what is*, and to formulate existential propositions describing the universe as it is. With regard to judgments of value it cannot assert more than that they are uttered by some people, and inquire what the effects of action guided by them must be. Any step beyond these limits is tantamount to substituting a personal judgment of value for knowledge of reality *Science* and our organized body of knowledge *teach only what is, not what ought to be*” - emphasis added. – B. Y. (Mises, 2007, pp. 35-36).

In a sense, this is true, but in circumstances of the need for global social change, including the innovative orientation, relying on the evolutionary nature of institutional change is not reasonable. Hence the need for implementing the revolutionary changes that can be done only through the implementation of the *teleological approach*, including the implementation of *governmental/state institutional policy*. In the broadest sense, such a policy can be defined in terms of measures undertaken by the state, its action on the formation of new, removal of old or transformation of existing proprietary, labor, financial, social and economic institutions. Its purpose should be the formation and operation of adequate and effective institutional infrastructure to restore and develop the state system of Russia, or any country in need of institutional design, such as, say, Montenegro or Armenia. At the same time, management of institutions should be aimed at improving the property relations, the promotion of enterprises transition to modern forms of business organization, the development of competition between market players, etc.

Institutional policy involves the formation of the legal and institutional environment, corresponding market principles and objectives of industrial policy, the statement of the order and conduct rules – the same for all entities. This policy should cover the reform of the enterprises in accordance with modern economic structure, development and comprehensive support to small businesses, forming large competitive corporate and holding entities (in particular, the financial and industrial groups), implementation of measures for the transition of state-owned enterprises to private ownership (privatization), or vice versa (nationalization), the legal establishment and support of new market institutions. Institutional policy tools may include: a variety of licenses, regulations, rule-making, building effective organizational and economic structures, the transformation of property relations, maintenance of market processes with relevant legal framework, development of legal basis for establishment, operation and liquidation of enterprises, including through bankruptcy. It is also important to note that the state policy in the sphere of institutions should be aimed not only at maintaining the normal functioning of institutions, but also at their renewal and modernization, in case this is an objective need of the society.

The effectiveness of institutional policy, especially in regards to solving the tasks of modernization and innovation development, depends on, at a minimum, two circumstances. *First*, there is need in choice of appropriate governance aimed at achieving the goals of knowledge-based innovative economy (Yerznkyan, 2008). *Second*, to create a real, not doomed to

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fail, policy the specificity of predominant in Russia form of business functioning should be taken into account. It is about the so-called *business po ponyatiyam* (literally, business on notions). "A theoretical analogue of such way of doing business is an economy of local networks with personal and continuous relations between their participants based on the informal, mafia-type norms of behavior. While acting according to these norms, agents conduct themselves in the institutional frameworks of the locally shared notions that indicate acceptability of what they ought to do and what is right and/or wrong and thus the notions shape participants' actions. In short, notions are the essence, specific code of ethics, forming the regulative, unwritten and informal institution – locally acting not in geographical sense, but by nature, although widely diffused in a modern Russian economy" (Yerznkyan, Gassner, 2010, p. 143).

### 3. Trends in the Development

Trends indicate the direction in which a theory is developing and, as institutional economics resides yet (?) in the periphery (!) of dominated in the world economic thought, it is useful to preface a trends review by an outlook of orthodoxy steps – if any – towards institutionalism (heterodoxy).

**3.1** Trends according to scheme '*mainstream* → *institutionalism*', including theoretical developments in the mainstream, pushing it toward the institutional (and evolutionary) economics (Hodgson, 2007, pp. 8-11). According to a Russian economist Oleg Ananin, there are two trends in today's mainstream: a 'classic' trend, which is partly preserved in the Walrasian version of mainstream, and 'theoretical' one, revived in the private theorizing in the spirit of the Chicago School, or 'empirical economics'. Representatives of the latter used "neo-classical tools for the analysis of different institutional structures or explanations of some economic institutions", develop theories of property rights, agency relationships, transactions costs, etc. These and other movements from the mainstream to the institutionalism, being "partial and conditional, tied to them with the behavioral, institutional and other prerequisites, laid down in them", are not able to give a holistic view of any economy (Ananin, 2005, pp. 195, 197).

**3.2** Trends according to scheme '*institutionalism* → *mainstream (neo-classics)*', including theoretical constructs of institutional economics, incorporated (gradually, implicitly?) in the framework of mainstream, neoclassical, in fact, economics (Hodgson, 2007, pp. 12-14). It is rather reverse movement of institutional economics.

**3.3** Trends according to scheme '*institutionalism* → *new (different from neo-classics) mainstream*'; some evidences one can find in (Hodgson, 2007). It is movement in right (though, who knows?) direction.

**3.4** Trends in compliance with the *internal logic* of the development of institutional economics.

**3.4.1** Algorithm/automation of institutions according to scheme '*rules* → *prescriptions* → *algorithms* → *automata*'.

One of the major systemic vices is the hyperbolization of the concept of market economy and the market itself. Williamson, a representative himself and, in many respects, the creator of the new institutional economics, in his famous *Markets and Hierarchies* work has put forward the thesis that "*in the beginning there were markets*" (Williamson, 1975, p. 20). Subsequently, the market building continues through the efforts of individuals, together with this form and hierarchies/firms. Criterion of success of these forms of organization of economic activity is minimizing the transaction costs of interaction.

Hodgson leads counter-arguments based on the fact that, in reality, markets include social norms and practices, institutionalized exchange relations and networks that require further

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explanation (Hodgson, 2003). His conclusion is directly opposed to the approval of Williamson, namely, “markets are not an institution-free beginning” (Hodgson, 2007, p. 12). Such an understanding is not unique. It is sufficient to refer, agreeing with him, to the opinion of V. G. Grebennikov (2001, p. 41): “Theoretically impossible to reconstruct the social system of interaction between individuals, if a pattern of behavior of each of them has not laid at the outset special reasons action defined by reflexive norms”. We call attention to one important fact: in spite of these opposing views of Williamson and Hodgson, both of them talk about the market in the plural, whereas in the neoclassical models either figures one market or, even whether many of them, *de facto* they all boil down to essentially one big market. Such an interpretation, which facilitates the construction of equilibrium models, is at the same time, a gross distortion of reality caused by the intrinsic defect of the grounds of neoclassical methodology.

Recognition of the market dependence from institutions, as well as from activity of individuals, is equivalent to a certain extent to the recognition of the existence and the possibility of constructing the, what I call, *institutional reality* – social reality with congenital institutional fabric. As shown by achievement of experimental economics “markets have to be treated not as the abstract and universal ether of human interaction but as *designed systems of rules*” - emphasis added. – B. Y. (Hodgson, 2007, p. 10). It is worth to pay attention to two key points: first, the impossibility of designing “a laboratory resource allocation experiment without designing an institution in all its details” (Smith, 1982, p. 923); second, challenging the idea that the abstract market is a universal forum of human interaction, free from any specific rules (McMillan, 2002).

Consideration of these points leads to the idea of markets as not just simply rules, but as the algorithms and, in a stronger and more systematic form, as the [market] automata, *markomata* (Mirowski, 2010).

**3.4.2** Emphasis on innovation development of institutions and innovative institutional changes.

Institutions of innovation development of economy need not so much an evolutionary, but a revolutionary way of institutional development through nurturing, designing, and/or borrowing of social and economic institutions. The decisive condition for the implementation of the revolutionary scenario of institutional development is state intervention, political will, understanding *how* and *what* should be done to upgrade the institutional system, to improve it and bring it into conformity with the tasks of modernization and innovation development. It is especially important to be aware of the limitations of the development in the sense that not all institutions can be congruent with the existing institutional framework, especially in its informal part. Hence the demand for institutional innovation: they must be implemented so as to permit their ‘natural’ roots in the tissue-established formal rules and existing for centuries informal norms.

Creating the institutional prerequisites for stimulating innovation development occurs at a slow pace and creates the risk of impossibility of achieving the goals of modernization and innovation programs. Cause for concern is the imperfection of the institutional systems (legal and informal), existing in quite a few economies in transition, and lack of interest of those responsible for implementation of innovative economic development programs, the successful performance of assigned tasks, as well as the virtual absence of mechanisms to overcome the negative behavior of the administrative apparatus.

V. Draskovic and M. Draskovic (2009b) explain the *raison d’etre* of drawing attention to this subject in the following manner: an effective anti-crisis policy – in terms of global and local financial and economic crisis – can be worked out only based on an innovative-institutional nature of the changes. Though I am not quite sure whether “global crisis represents a *unique possibility* (emphasis added – B. Y.) to create qualitatively different and better developmental approach to economic policy”, but the idea of “proper implementation”, which “can secure a stable economic growth”, (V. Draskovic, M. Draskovic, 2009b, p. 51) seems reasonable and attracti-

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ve. And of course, one should completely agree with their opinion that such an implementation must include “a complicated and difficult process of fundamental civil and economic changes (innovations) and not cosmetic retouches” and that “it is necessary to overcome a rhetoric and interest sayings about successfulness of neoliberal economic doctrine” (Ibid., p. 51). In sum, *all we need* [as true and consistent supporters of institutionalism] is *substitution* of “the outdated and hazardous market fundamentalism” with ‘*institutional fundamentalism*’ (Rodrik et al., 2004) [as for me, in its soft version, for any fundamentalism is potentially dangerous – B.Y.] and with enormous doses of some of Keynesian medicaments (V. Draskovic, M. Draskovic, 2009b, p. 51).

Sharing this belief, let us offer, as a theoretical and methodological base of innovation development, a socio-economic doctrine, initiated and formulated by Dmitry S. Lvov for needs of Russia (2002). The reason is as such: every country has its own peculiarities due *inter alia* to institutional – inertial by its nature – system. According to this, the development of institutional support for innovation development of the national economy must be based on the impossibility to follow standard strategic steps in the reform of the socio-economic system in terms of market dogmatism.

Of fundamental importance for the construction of innovative development strategies is *heterogeneous nature of the economy*, its inherent *institutional difference*, particularly in terms of market device, – whether it is at the nano, micro, meso or macro-level. A synonym for the transfer of ideas is the concept of *multiplicity* – for explaining the presence of multiple social groups and strata, *social clusters* in terms of Valery L. Makarov (2010), as well as for explaining the need for non-standard approach to ensure the growth of institutional innovation capacity of any economy, including Russian. However, it should be borne in mind that the multiplicity (heterogeneity), which is “the world is governed”, is not a panacea, since it not only can promote “cultural and technological change”, but also lead to dissociation of the people, destabilizing the political situation and even “to national and religious wars” (Weber et al, 2009, p. 28).

### 3.5 Contradictory trends

3.5.1. Continuing development of topics of interest to enhance the availability/distribution of power relations between interacting economic agents should be the idea to revive interest in the concept of managerial transaction of Commons.

And, indeed, such an interest is observed, especially in the last writings of Oleinik. Moreover, such statements have been present earlier. Among them: (i) the criticism by Jack Knight (1992) of supporters of the new institutionalism for their neglect of the importance of distribution and power aspects of the analysis of the origin and development of institutions; (ii) an appeal of T. Haavelmo (1987) to the study of individuals, not as immersed in a vacuum robots, but as subjects reacting to the rules and regulations; (iii) a new approach of Masahiko Aoki (2003) to institutional analysis, where there are not only individuals, but also a set of inherited by history institutions; (iv) a concept of *institutional man* of G. Kleiner (2004) as opposed to *economic man* and with actions that are determined rather by institutions than neoclassical axioms; (v) a similar concept of B. Yerznkyan (2000) of the *institutional man*, who is a player governed by institutions rather than reason/emotion, whose thinking and acting are predetermined by formal and informal institutions, and behavior, be it bounded rational or emotional or however, is principally relative, for there is no possibility to separate his nature from the institutional framework in which he is embedded.

There is yes another, and quite stable, trend – due to the inertia of thinking of economists educated in the spirit of or continuing to stay under the neo-classical dogmas and for whom management transactions are somewhere in the back of mind. Such an attitude to the transaction, reducible solely to the market ones, leaves at best a place for the treatment of power as not-

hing more than market power. In other words, the movement towards institutional economics strengthening '*institutionalisms* → *institutionalisms*' is braked – consciously (perhaps in good faith) or unintentionally (which is likely) – through inclusion of anti-institutional mechanism '*institutionalisms* → *mainstream (neo-classics)*'.

**3.5.2** An above-mentioned line of transforming institutions into a kind of algorithms/automata by enhancing their formalized description and/or regulations is at odds with a line such as moving away from the formal aspect of institutional analysis, even presented in an elegant model package, with a view to a deeper understanding of the mental structures underlying the institutional foundation. Moreover, the case is not even the models themselves, or rather, not so much the models, rather the inertia of the very institutions as formal rules and informal norms and, moreover, algorithms/automata compared to ideas and thoughts that faster institutions with questionable relevance. It is appropriate to quote Nietzsche (*Human, All Too Human*): "The overthrow of beliefs is not immediately followed by the overthrow of institutions; rather, the new beliefs live for a long time in the now desolate and eerie house of their predecessors, which they themselves preserve, because of the housing shortage". Focusing on the deep foundations of institutional and evolutionary economics cannot fail to interest in the moral, ethical aspects, without which it is hardly possible to adequately understand the nature of institutions (Hodgson, 2011). The problem is not only to complement the rules and norms of behavior by 'moral dimension', it is necessary to change the installation on understanding the human's place and role in society.

**3.5.3** The tendency to develop a consistent language of institutional economics gets on with the opposite tendency to enhance the language and, therefore, cognitive disengagement, such as above-mentioned difference between the language of old and new political economists who continue disjoint coexistence in the modern world of institutional economical thought.

**3.6** A variety of forms of *institutional construction* and ways to achieve the desired goals. Appeal to the institutions in terms of construction stems from a desire to make an analogy with the construction. We should distinguish between an object (what must be constructed) from the way the [institutional] building will be built.

**3.6.1** In theoretical terms, there are a range of possible solutions.

*First*, an institutional system can be partially or completely destructed and then re-constructed. In construction, such things are often observed: the destruction of the Temple of Christ the Savior in Moscow in the Stalin era caused by ideological motives and its re-construction with a change in the dominant ideology half a century later, the destruction of the hotel Moscow – instead of reconstruction – in the post-soviet times caused by economic (and possibly other) considerations and its following re-construction. Similarly, the destruction of the institutional market-oriented system of Tsarist Russia in 1917 and an attempt to re-construct it on the wreckage of the Soviet planned system in 1987 and subsequent years Or destruction of traditional in Russia rural communes (*obshchina*, or *Gemeinschaft*, as to Tonnies) and a clumsy and bloody attempt to recreate them in the 1930s in the form of collective farms (*kolkhoz*), even though many people might have disagreed with it. In this series we should mention thus still unrealized dream of Alexander Solzhenitsyn on institution-building from the bottom – in a revival of the *zemstvo* – a form of local government, well-established in the 19th century Russia, and clearly the most suitable for implementation in 21st century.

*Second*, we can talk about the institutional, in terms of Kleiner (2004), designing, prosthetics, borrowing, or about a system of intermediary institutions (Polterovich, 2001) designed to play a role similar to the scaffolding needed during construction and then being liquidated.

**3.6.2** In practical terms, different solutions are possible too (from 'weak' to 'strong'). *Firstly*, it is a [weak] attempt to amend (just as a supplement and not as a revision of) to the pro-

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visions of the Washington Consensus, after recognizing its failure. Scholars were seeking to somehow save it by making a set of additional provisions.

The composition of the original set of prescriptions of Washington Consensus included: a) fiscal discipline, b) reorientation of public expenditures, c) tax reform, d) interest rate liberalization, e) unified and competitive exchange rates, f) trade liberalization, g) openness to DFI, h) privatization, i) deregulation, j) secure property rights. To save or upgrade these prescriptions, it was proposed to supplement them with another 10 items (Rodrik, 2003), k) corporate governance, l) anti-corruption, m) flexible labor markets, n) adherence to WTO disciplines, o) adherence to international financial codes and standards, p) prudent capital-account opening, q) non-intermediate exchange rate regimes, r) independent central banks/inflation targeting, s) social safety nets, t) targeted poverty reduction.

*Secondly*, it is the [strong] willingness to build an institutional system desirable for national economy without regard to the requirements/recommendations of the Washington Consensus. The clearest example of non-standard institutionalization, with all the pros and cons, demonstrates China through implementation of its own practice of reform. However, I would like to recall the unrealized possibilities that have been, with regard to Russia, lost not because of the theoretical inconsistency of a number of proposals, given by many heterodox economists, but as a result of persistent refusal to follow a course that differed from the neo-liberal – theoretically questionable and almost destructive – course, prescribed by Washington.

The practice of following the way that is the only true one has solid theoretical grounds shared by many, both Western and Eastern, social scientists. In Russia, for example, political economy of Marxism-Leninism changed by, more (economically) or less (ideologically), powerful neo-classical liberalisms – the only, as to present-day, true doctrine. For such practice A. Giddens (1984) uses a term of *evolutionary determinism* which serves for presentation of such ideas about social change, according to which a certain type of society has the only one way forward. Societies, in the absence in them of the characteristics of a general model of development, are underdeveloped; this means that they are lagging behind in their development.

This commitment to 'the only one true way' of development, theoretical and ideological foundation of which is the *institutional monism*, is the basis of neo-liberal economic policy, dominating in the modern world, including Russia, Montenegro, Armenia and many other countries,. The antidote for the harmful actions of the institutional monism may be *institutional pluralism*, based not on abstract dogma, but on the account of the institutional characteristics of national economies and the choice of non-trivial ways to develop. This view is in the base of a hypothesis "that the immediate overcoming of all quasi-institutional monism forms (among which is neo-liberalism), which have dogmatic, totalitarian and anti-development character, is necessary, since it is the condition for application of real and pluralistic institutionalization as the only reasonable alternative in creating economic politics and economy development" (V. Draskovic, M. Draskovic, 2009a, p. 21). Such pluralism implies recognition of the priority of *institutional innovations*, without which it is impossible to imagine the institutional modernization of the economy and society (Yerznkyan, 2009). Associated with that are the hopes to overcome the gap between the formally established economic institutions and the economic behavior in practice, which is far from standard norms (V. Draskovic, M. Draskovic, 2009b, p. 48).

We conclude the theme with words of D. S. Lvov about liberal government economists who ignore in their quest to be scientific as possible, "the fundamental principle of existence. They are a priori inclined to think that their views on the transformation of Russia's economy are not only in the true common sense, but also conform to standard notions of liberal Western economists". And further, "having turned economic theory into science-in-itself, radical reformers have forgotten (think quite deliberately) that the economist should also be a philosopher, psychologist, historian, jurist, geographer, and mathematician as well". Traditionally, the econo-

mic research focuses on areas of production and circulation, but for a true understanding of occurring events not less important are the following from them forms of “human behavior and interaction between different segments of the population” because “goods and services are significantly associated with people who have them created or manage them”. Only when the economic relationships, interlinks that are emerging between people, “economists can avoid commodity fetishism (a term carefully forgotten by our liberal adherents of the market) and come to an understanding of economic life as a social service” (Lvov, 2008, pp. 111-112).

#### **4. Conclusion: Implications for institutional practice**

The aforementioned changes in the development of institutional economics in the form of the proposed for consideration list of new phenomena and trends are an attempt to capture the most significant (observed, analyzed, invented) theoretical and applied aspects of institutional economics being nowadays on the crossroads of its further development without claims to completeness of coverage. The purpose of this paper was rather a monitoring and analysis of phenomena, including wearing the trends rather than their classification. In the center of attention were not only institutional, but also some evolutionary aspects, which despite their proximity are, strictly speaking, different.

Shifts in institutional economics, interesting from a purely scientific point of view, are important not merely as such, but also (and perhaps primarily) for institutional practices, for the implementation of institutional reforms aimed at developing the socio-oriented, market-opportunities-using, and finally moral-values-based economy. Identified, as phenomenon and trends, changes are a kind of ‘information for reflection’ that leads us to conclusions, among which an important place occupy those which focus on national economy’s innovative restructuring. Here are some examples of these implications with a focus on institutional support / maintenance alleged or proposed to implement the processes of modernization and innovation development of the socio-economic system.

*First*, the institutional support for innovative development of Russia's economy involves the creation – in particular, by ‘growing’, design or drawing – of relevant system of institutions, primarily, of a formal nature, compatible with the system of informal institutions capable of ensuring the efficient growth of its innovative potential. In general, socio-economic institutions are diverse and varied therefore they can be classified in various ways, taking into account their spatial, temporal, and hierarchical distribution.

*Secondly*, it seems appropriate for theoretical and methodological plan to combine the idea of technological heterogeneity of the economy, expressed in the concept of technological structures, with the idea of institutional heterogeneity and corresponding idea of institutional structures. In spite of them complementing one another, between the dynamics of institutional and technological structures there is a *temporary mismatch* caused by the inertia of the institutional system. It is important to add that there is a *logical contradiction* between the need to create institutional conditions for the ‘growing’ of a new technological system, which involves *advancing* the time of institutional support, and the peculiar way of *institutional lag* in comparison with the dynamics of the technological lifestyle.

*Third*, the effectiveness of the institutional system has a negative effect that the institutions that define the general rules of the game, replaced in practice by institutional, in its essence, but also private rules, agreements – such as ‘contracting’ between government and business. In terms of permanent institutional trap, in which resides the Russian (and not only) economy, and consolidation of the status of the country, albeit informal, raw power there are serious concerns for believing that talk about the need for innovative development become no more than rhetoric.

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*Fourth*, institutional support for innovation development is impossible without a purposeful, focused on innovation, *institutional policy*. Its determination is possible through the measures taken by the state, its action on the formation of new, removal of old and / or transformation of existing proprietary, labor, financial, social and economic institutions. The objective of state institutional policy should be the formation and operation of adequate and effective institutional infrastructures that create the framework conditions for the deployment of innovative processes at all levels of the institutional structure of the Russian socio-economic system.

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