THE STATE AND THE BUSINESS: INTERESTS AND INSTITUTES

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Abstract: *Relations between governors and economic units have always attracted attention of economists, politicians, sociologists… This article reviews most prominent approaches to this problem developed by economists in the past centuries. Their variety is shown according to an increasing complexity of approaches. As the system of economic knowledge penetrated deeper and deeper into the issue, views changed from simple Adam Smith's viewpoint according to which interests of entrepreneurs and the state were very close, to ones introducing more details and more players into the analysis, like the Marxian class approach, Coase's agents approach and modern Game Theory based auction approaches. The final part of the article develops the concept of "balance of powers" between the private and the public sectors in order to minimize costs of economic regulation which can be achieved through considering certain characteristics of every state and people.*

Абстракт: *Взаимоотношения бизнеса и государства — тема, всегда интересовавшая экономистов, политологов, социологов… В данной статье рассматриваются основные, сформировавшиеся на сегодняшний день, подходы к анализу данной проблемы. По мере углубления знаний об экономике, взгляды исследователей эволюционировали от простого подхода Адама Смита, видевшего в интересах предпринимателей и государства много общего, к более сложным концепциям, учитывающим большее количество деталей и игроков, таким как классовая теория Маркса, теория агентских взаимоотношений, разрабатываемая последователями Рональда Коуза, современные подходы, основанные на теории игр. В последней части статьи рассматривается подход, основанный на поиске баланса сил между государственным и частным сектором, минимизирующего издержки экономического регулирования, достижение которого возможно при учете особенностей отдельного государства и его населения.*

Key words: *Regulatory capture, special interest politics, economics of regulation, protection, alliances, trade policy, collective action.*

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Relationships between business and state — is a really wide issue with long history and multiple points of view on it. Should the state control business of some companies or its treatment to all commercial enterprises must be the same? Or it is the business who takes control over state bureaucrats and uses them for its own purposes? There's no certain answer to these questions. Lack of confidence and consent is present both among officials and among private companies on how to protect their interests.

This article explores most prominent approaches analyzing the issue of business-government relationships which formed to the date. Major progress in this direction has been achieved with development of the modern neoinstitutional theories. Still, economists had been interested in this problem for a very long time before. It was yet Adam Smith who pointed at importance of property rights protection for development of trade and entrepreneurship. In one of the most fundamental works in Economics he wrote: "In all countries where there is tolerable security [of property], every man of common understanding will endeavour to employ whatever stock he can command in procuring either present enjoyment or future profit. … In those unfortunate countries, indeed, where men are continually afraid of the violence of their superiors, they frequently bury and conceal a great part of their stock, in order to have it always at hand to carry with them to some place of safety"[1]

Hence a state which cares about its citizens welfare, must think about such aspects of entrepreneurs activity as safety, good law and contract enforcement and other principles which are meant by the term "property rights". And for a long period of time economists insisted that the role of the state must be reduced to protecting these rights and avoiding interference of governmental structures into the business of separate companies. This idea rested on a belief in the ability of market forces to solve all problems facing them. But with development of capitalism its problems grew bigger and bigger. Large unions of entrepreneurs captured whole markets and pushed prices up at the expense of the rest of society and the state. The latter was forced to seek methods of control over such unions. Smith was right, saying that: "It is to prevent this reduction of price, and consequently of wages and profit, by restraining that free competition which would most certainly occasion it, that all corporations, and the greater part of corporation laws, have been established"[2]. So the inner meaning of corporation is in cooperation between a number of producers, who put their inputs together in order to control rate of production and maintain high prices. And it was only geographical remoteness that could by Smiths opinion, owing to its nature prevent such unions from appearance. Making up a corporation is quite possible in one town, but, he wrote: "the inhabitants of the country, dispersed in distant places, cannot easily combine together. They have not only never been incorporated, but the corporation spirit never has prevailed among them"[3].

Rapid growth of corporations based on stock capital which took place in the 2-nd half of the XIX century and continued in the beginning of the XX century, covering both continents. This demonstrated to the public that the natural barriers analyzed by Adam Smith were not sufficient to prevent market monopolization. By the end of the XIX century the share of property belonging to corporations was estimated by different authors within a wide range from 20 to 80 percent[4]. Contemporaries of this process quite reasonably feared that integrity of the individual as the unit of society within the state was seriously impaired and now he had to be content with a role of hired worker. Soon corporations started transforming into even larger combinations like syndicates and trusts, making it finally clear that monopolization can't stop itself without government intervention. The state now faced a hard dilemma which John Clark called "a choice between the devil of private monopoly and the deep sea of state socialism".[5]

The USA were the first country to introduce new legislative barriers to monopolies and this shaped in the Sherman Anti-Trust Act which was suggested to the Congress by senator Sherman in 1890. According to the law any activity limiting free trade was declared illegal and could be suited. For a long time this act was used predominantly against trusts and cartels, until in 1914 it was replaced by the Clayton act, which more specifically determined the subject of prosecution and limited activities of monopolies. By doing this the state officially recognized the menace to its safety and market efficiency, coming from too large joint ventures, and took actions to avoid their appearance in future. But what could be the basic reasons for such unions, preventing competition and establishing monopoly?

1 Smith Adam, An inquiry into the Nature and Causes of the Wealth of Nations, Chicago, IL:University of Chicagp Press, 1776 (1976), book 2, Ch.1
2 Ibid, book 1, Ch 10
3 Ibid.
4 Davis, John, Corporations, Ontario, Batoche Books, 2001 p. 7
5 Clark John Bates, Clark John Maurice, The Control of Trusts, New York, A.M. Kelley, 1971, p. 7

Karl Marx was one of the first who answered this question. He insisted that the processes of competition and capital accumulation lead to its concentration and centralization and result in an opposite substance — monopoly. What's more, K Marx (like V. Lenin and others later), linked together economic power of monopolized capital and it's influence on the state structures within the theory of class conflict. This point of view had strong influence on at least one generation of economists and especially radical ones. This dimension of economic theories became later well known as Marxian theories. Still, this view of the state as an instrument in hands of capitalists class, faced a number of serious objections. The first group of objections was based on the facts that a big proportion of government expenditures is spent in the interests of the entire society including socially insignificant layers of population by means of social programs and programs devoted to small and medium business. Another objection was that the class of capitalists cannot be always viewed as a singular matter, but rather it presents a mass of smaller groups which tend to conflict with one another - companies and brunches.

1. Interest groups

Obviously to find the key reasons of problems arising one had to look more deeply into the structure of class itself than the theory of classes could do. A more consistent approach implied that the capitalists class should be split into groups which with two necessary characteristics: capability and interest in influencing state politics. Such groups were called "interest groups". Economists adopted this term from political scientists, who, in turn, seem to have borrowed its meaning from biologists. It is definitely political science where group represents main unit of analysis and where adequate views could be taken from. The first to introduce this term in economics was Arthur Bentley. Studying external influence on the procedure of passing a law, he wrote: "If a law is in question, we find that our statement of it in terms of the groups of men it affects — the group or set of groups directly insisting on it, those directly opposing it, and those more indirectly concerned in it — is much more complete than any statement in terms of self interest, theories, or ideals".[6] The main difficulty in viewing this interaction is making sure that certain individual is engaged in one particular group activity. In fact human interests and interests of groups to which he pretends to belong to, may be different and this makes it very difficult to predict future behavior of such member. Still groups which form in politics and represent parties, seem to Bentley the case of stability and exact members' self-identification. This can be explained by influence of ideology — a system of easily seen ideals and goals inherent to political forces. Perhaps in the days of Arthur Bentleys living this was really the case: parties were built predominantly with orientation on ideology and other preset principles. But one century later we cannot be quite confident judging people by their party belonging, because political systems of the majority of countries put ideological framework to the background today.

Another important aspect of groups mentioned by Bentley is presence of mutual interest, a joint direction of activity that consolidates group members. However this "interest" should be viewed not just as a "psychological feeling" or desire, but as a completed action that can be verified empirically and let one judge of men drawn into this action as a single interest group. "There is no way to find it except by observation" — he writes.

Contouring some classes (like Marxists theories did) or groups (like Bentley suggested) out from the society, was attended with some difficulties too. The main direction of critics rests on lack of attention to the role of separate individual and leadership in these concepts. The second argument is based on underestimation of the integrating role of the state which represents interests of the entire people as a group. And though Bentley operates with countries as groups exemplifying re-

6 Arthur F. Bentley, The Process of Government: A Study of Social Pressures, Chicago: University of Chicago Press, 1908, p. 200

lationships between the peoples of Russia and Japan during the Rissian-Japan war, his major point is that "the society itself is nothing other than the complex of the groups that compose it".[7]

Meanwhile it is exactly existence of common interest or in other words, "state benefit" that lets appear and survive the substance called the state. According to another American political scientist, David Truman: "We cannot account for such a system by adding up in some fashion the National Association of Manufacturers, the Congress of Industrial Organizations, the American Farm Bureau Federation, the American Legion, and other groups that come to mind when "lobbies" and "pressure groups" are mentioned. Even if the political parties are added to the list, the result could properly be designated as "a view which seems hardly compatible with the relative stability of the political system".[8] In fact one can hardly find groups which would lobby such entities like constitutionalism, civil liberties, representative responsibility. Each of these institutes is a good for the whole nation and every citizen apart. Consequently, the state must be taken as a group too, which also has its own interests and goals.

If one goes on developing group approach, he should recognize that companies can also be viewed as a special kind of groups: they have labor force hired which consists of people — members and they have common goal too. Presence of common goal (interest) in turn gives us an idea, that a company may also belong to the class of interest groups, which influence other groups and the entire state too. Political scientists explain quite easily why groups are created — their common cause is used to be the search of power and control. But economists lacked such transparence in their minds as it was rather difficult to see some economic reasons for group creation. Obviously More often their models prompted that competition and free trade could bring mush more benefits to independent producers and the whole society. Explanation of this required a somewhat more precise definition of motives standing behind members of the group called "firm".

2. Theory of the Firm

This problem was solved with appearance of a new direction in economic thought which was called the "new institutional theory". Its first step concluded in setting aside some strict conditions adherent to the classic theory. Among them — predetermined consumer behavior, rationality in maximizing benefits, acting in a perfect market with full information about prices and so on. By giving up these restrictions economic theory became less accurate (like physics or mathematics are), but began to pretend on being closer to the real life.[9] The new theory suggested that there are no perfect markets, individuals are not always rational and information is not available to everyone (contains asymmetry). It turns out that behavior of a person who doesn't possess all the necessary information, is determined by the two new dimensions: uncertainty and risk. And these two categories according to neoinstitutionalists give the key to understanding: where do interest groups (including corporations and the state) come from. The first such explanation has been given by Frank Knight. In his book "Risk Uncertainty and Profit" he wrote: "When uncertainty is present and the task of deciding what to do and how to do it takes the ascendancy over that of execution, the internal organization of the productive groups is no longer a matter of indifference or a mechanical detail. Centralization of this deciding and controlling function is imperative, a process of "cephalization", such as has taken place in the evolution of organic life, is inevitable, and for the same reasons as in the case of biological evolution"[10] (it's remarkable,

7 i bid p. 222

8 Truman David B. The Governmental Process: Political Interests and Public Opinion, New York: Alfred A. Knopf, 1958

9 See also: Avtonomov V. S. Human in a mirror of economic science (an outline of the western economic thought) M. Nauka, 1993. ch. 8, 9

10 Knight, Frank H, Risk, Uncertainty, and Profit, Boston, MA: Hart, Schaffner & Marx; Houghton Mifflin Company, 1921. Part III, Ch. IX

how often economists refer to the theory of evolution).

The idea that the origins of company-building lay in the necessity of centralization of control and management, has been developed further in studies of Ronald Coase.[11] In his article "Nature of the firm" he insists that the key role of entrepreneur is to take the costs of setting up contract relationships in those cases when market mechanisms are too costly for doing that. In this way the natural borders of the firm form where the costs of doing operations within the firm equal the costs of doing the same operations by virtue of market trade.

It is remarkable that authoritarian power obtained by an entrepreneur itself can also be viewed as a sort of market relationships. To do this one has only to give some wider determination of what is the meaning of term contract. The new institutional theory means by contract not just a legal document but more widely — any kind of trade which results in a property rights exchange. So, for example, relationships between company stuff members or a chief and his subordinates can also be viewed in terms of contracts. Michael Jensen and William Meckling were the first to give a picture of a firm as a nexus of contracts. According to them "most of organizations are simply legal fictions which serve as a nexus for contracting relationships among individuals".[12] The main difference between contracts inside and outside the firm is contained in durability and stability of the former. Consequently since contracts are negotiated between individuals acting on their own, each of them seeks personal benefits, but to the extent these benefits are determined by the firms affairs, this makes them work for the joint welfare.

If we recognize that a person hired by a firm does in fact follow his own interest, we will have to answer another important question: how to provide him with the right motivation for doing the necessary work. The answer is given by the theory of agency relationships which explores various aspects of implementing a contract by all of its parties: a principal (an ordering side) and an agent (an executor). Within a firm the former side takes responsibility over functions of remuneration and control, whereas the latter answers for implementation of a task, given a certain promise of compensation. Agency relationships are well exemplified by a contract between the firm owner and its hired managers. Large firms with many shareholders have to pass over leadership in the company to a third party — managers who are chosen at the stockholders' meeting. But because managers hold their positions for a long time and have a full access to the company inside information, they obtain a real control over the firm as distinct from the shareholders who lose such control. This idea is elaborated by Eugene Fama: "The firm is just the set of contracts covering the way inputs are joined to create outputs and the way receipts from outputs are shared among inputs. In this "nexus of contracts" perspective, ownership of the firm is an irrelevant concept. Dispelling the tenacious notion that a firm is owned by its security holders is important because it is a step toward understanding that control over a firm's decisions is not necessarily the province of security holders. The second step is setting aside the equally tenacious role in the firm usually attributed to the entrepreneur".[13] This thesis of Fama stands quite instantly from ideas of his predecessors — Frank Knight and Joseph Schumpeter who paid much attention to the entrepreneurs role as a party taking all the risk and adopting innovative ideas. Still, this point of view also looks out to be reasonable if we bear in mind that such substances as risk and ideas are pertain to tradable goods. The first one is sold by means of securities and the second – as patents.

Firm structure is interesting for us so far as it has much in common with the structure of state bureaucracy. And our purpose is to

11 Coase, Ronald H. The Nature of the Firm // Economica, 4 (1937); pp. 386-405

12 Michael Jensen, William Meckling, Theory of the firm: managerial behaviour, agency costs, and ownership structure, The Journal of Financial Economics, 3 (1976): 305-60

13 Fama, Eugene F. Agency Problems and the Theory of the Firm. The Journal of Political Economy, Vol. 88, No. 2. (Apr., 1980), p. 290

show the same nature of both institutes — the private and the common. For example, If we look at how information is disseminated within a firm between its owners — stockholders and its hired managers who control the business process and collect all necessary information about it, we can see that it is certainly uneven. The same can be said about uneven distribution of information between the population which with some reservations represents stockholders of the state (say "stateholders"), and the government, which manages the economy and controls most information flows. Informational asymmetry can be found within the government too. It is expressed in different knowledge owned by the legislative and the executive powers.[14] Both, the firm and the state, have similar mechanisms of decision making and their fulfillment control. Writing about agency relationships M. Jensen and W. Meckling argue that they take place in either sectors — the private and the state: "The problem of inducing an "agent" as if he were maximizing the "principal's" welfare is quite general. It exists in all organizations and in all cooperative efforts — at every level of management in firms, in universities, in mutual companies, in cooperatives, in governmental authorities and bureaus …".[15]

Of course, one cannot speak about total equivalence between the state and the firm. There's such an important aspect of the State like a monopoly on some of its services: a citizen cannot chose whether to pay taxes or not to pay. Also, unlike firms, government structures don't have any certain criteria of assessment of their work quality. But these differences don't displace the notion of the general nature of the two sectors.

Further development of the theory of agency relationships has put a new question: how should the state be treated: like a principal conducting economic policy on his own or as an agent who acts on behalf of all economic system powers which dictate him what balance policy should be done. So If we assume that the state and the firm have a common nature, why cannot we think of their relationships in terms of contracts and transactions?

At the beginning this idea embraced only chains between the state and its nation as a whole. The so called common choice theory analyzed the process of elections as achieving an agreement between the power holders and the citizens. One of the theory brunches called "direct democracy" explored voting results on the matter of specific policy choice. Voting was supposed to have a direct effect on the elections results and consequently determine the policy choice. The simplest case of this effect can be presented by a Wolfgang Mayers[16] model. This model assumes given voters' preferences influence on the choice of import tariff stakes. The result of such voting appears to be coincident to the choice of the median voter. In other words, the resulting tariff would be such that the number of people thinking that it must be higher is equal to those who want to bring it down.

But this model is more or less adequate only in various democracies and appears much less appropriate for all the other kinds of states. Moreover, soon researchers stated that there are other factors influencing state politics except elections process. Factors like campaign fees, agitation for certain candidates, subsidizing particular policy after it has been chosen and other methods by which a minority is capable of influencing a majority, also attracted attention of scientists. All this required more diligent analysis of activity of single interest groups which possess the ability to influence the politics of the State. Thus economists once again came to an idea born by political scientists that politics results are dependent on lobbying by interest groups.

14 See also. также Atkinson A., Stiglitz J.. Lectures on public economics: Textbook / transl. from Engl. Eds. L. Lubimov. — M.: Aspect press, 1995. c.404, 421

15 Michael Jensen, William Meckling, Theory of the firm: managerial behaviour, agency costs, and ownership structure, The Joutnal of Financial Economics, 3 (1976): 305-60.

16 Mayer, Wolfgang, Endogenous Tariff Protection // The American Economic Review, Vol. 74, No. 5. (Dec., 1984), pp. 970-985

3. Theory of economic regulation

A cornerstone contribution to the building of the theory of lobbying was made by Joseph Stigler and his article "The Theory of Economic Regulation".[17] This one represented further elaboration of ideas of political scientists concerning the process called "state capture" — when state regulating agencies come to be captured by interested market players. But unlike the political theory of capture, the theory of economic regulation had a better framework, could be more easily verified and by words of Richard Posner[18], looked more like a theory. The theory introduced by Stigler laid a new foundation for study of state economic policy as endogenous one, or in other words, formed according to the interests of inner economic system factors.

In his work Stigler researched major government regulation mechanisms which are at the disposal of business representatives. He insists that this ability rests on the right of the state to coerce other economic agents. This includes taxation, setting tariffs, changing economy rules, moving economic resources and so on. By influencing these institutes interested groups may change them for their interest.

Among the most frequently used methods of exercising power by business there is direct financing or subsidizing. The governments motivation in this case is usually represented as a vital necessity of the specific industry for the whole nation, or any other plausible excuse. Quite often interest-free loans, warranties, development funds can serve as proxies to a simple subsidy. Subsidizing is also a useful mean of industrial policy intended to accelerate growth in some specific brunches. But such subsidies are of limited interest to companies, because it's difficult to find criteria of choosing the right channel of financing. Without such criteria subsidy-seekers will quickly find themselves among other interested groups, seeking budgetary financing and resources will be dissipated.

The case with limiting competitors' access to subsidies is closely related to limiting their access to the market. And gaining such control can also be achieved by virtue of state politics. In order to obtain monopoly surplus, companies can pursue introducing special regulating rules which will burden growth of newcomers. Excess limitations on banks' minimum equity capital can represent an example of such tactics. On the one hand this measure increases stability of the whole financial system, but on the other, it leads to oppressing competition and favors existing market players. Obligatory licensing (with limits on total number of licenses given), granting patens, permissions for dumping pricing, etc. are among other kinds of barriers to entry established by the state. Application of these barriers is quite difficult to reveal and makes practical estimation of entire losses to society very complicated or even impossible. According to H. Demsetz "the valuation process must necessarily be one that is rich in intuition and faith, and poor in discernable measurements".[19]

One more instrument which is often applied by the firms seeking governments assistance are measures affecting competitors who carry on their business in adjacent markets — producers of substitutes and complements. Determination of substituting goods strongly depends on what are conventional borders of a market (brunch) and how they are set. For example, a company whose product is threatened by a substitute, may try to negotiate legislators on passing special standards for the whole brunch, restricting opponents production.

Production of complements on the other hand is worth promotion and this can also be done with assistance from the state. This takes place in case of airlines, whose owners are interested in developing neighbor markets: hotels, taxi parks, tourism agencies and so on.

And the last — fourth sort of economic

17 Stigler George J. The Theory of Economic Regulation // Bell Journal of Economics, 1971, №2, p. 3-21

18 Posner Richard A., Theories of Economic Regulation // The Bell Journal of Economics and Management Science > Vol. 5, No. 2 (Autumn, 1974), pp. 335-358

19 Demsetz Harold. Barriers to Entry // American Economic Review, 1982, №1 p. 47-57

regulation studied by Stigler: fixing prices by the state. This measure provokes competitors from dumping, but still doesn't guarantee stable income rates, because competition may shift from prices to other product qualities.

Certainly the interested party has to compensate the decision–making agencies for their services. This can be done either by transfer of some economic resources or by providing extra votes during an election campaign. Both ways of remuneration may take various forms. The former may shape into rather obvious campaign contributions or less transparent methods like employing members of the political parties.[20] The latter may need votes of the interested company own stuff or its engagement into an agitation process for the right candidate.

The larger is the business run by a seeker of politics assistance, the larger expenses he has to bear and the larger are the costs of its implementation to the rest society, which cause protest of other businessmen. But size is not the only determinant of costs — there is also requirement of such vital factor like good contacts presence. That is why smaller companies tend sometimes to be more favored by politicians and hold more political capital than their larger colleagues.

The main contribution made by the "theory of economic regulation" comes to introducing market framework to relationships between businessmen and politicians and expressing them in terms of supply and demand. After this economists could apply their old ideas in politics — theories of agency relationships, theories of cartels, theory of auctions and others.

In fact Interest groups resemble cartels in many aspects of their activity. Both of these kinds of organizations have the same final goal — profiting from increased prices. And again, the first who wrote about this was Adam Smith, who believed that regulation by the state is the key reason for forming monopolies. Since then a reverse pattern became clear too: monopolies can be organized for the purpose of seeking economic regulation. Main expenses carried by cartels and interest groups are also similar. Their hardest task is joining up interests of all participants of an organization and avoiding appearance of free-riders who will benefit from the monopoly surplus without carrying its political expenses. And like cartels, interest groups have the same favoring conditions for creation. They are formed easier when their number quantity is limited and every member himself pretends to be large enough. Inelastic import market demand curve also tends to strengthen interest groups in their intentions.

There are also differences between the two mentioned theories present. In practice cartels are not necessarily regulation seekers and vice versa, companies involved in politics don't not always possess some monopoly power. This is stipulated by the fact that both of the instruments — a cartel and a lobby are alternative to each other in reaching their goals and have different costs. This is illustrated by an example of farmers who are too numerous to create a monopoly but find it much easier to seek governments support, using their voting power for this purpose.

Stiglers theory helped to explain how does function exchange between business and political leaders. Still, it didn't answer the question of what must be the final equilibrium of benefits obtained from regulatory intervention, what sort of benefits (or losses) they would be and how does the interest coordination happen. All these questions had to be explored and answered by other researchers. A significant progress at this direction was achieved with penetration of the game theory methods into economics. This caused appearance of a great deal of papers devoted to various models of endogenously formed economic policy.[21] So far as politics mechanism was deemed as a market structure, its analysis involved another theory born in the 1970s

20 This is one of the reasons why there are so many layers working for the American political system

21 A rather detailed review of pepers on this issue can be found in article of Elhanan Helpman (in D.M. Kneps and K.F.Wallis(eds.), Advances in Economics and Econometrics: Theory and Applications. (New York: Cambridge University Press),1997, p. 19-45);
See also Gene M. Grossman and Elhanan Helpman, Special Interest Politics, The MIT Press, Cambridge, Massachusetts 2001

— theory of auctions. A few words about this theory are in the next section.

4. Politics and auctions

Theoretical analysis of relationships between private companies and the state evolved from simplicity to complexity. At first economists were interested primarily in mechanisms of public-private trade relationships. Since State often displays different kinds of assets for sale, it has to use auctions for property transfer in hands of a private partner. Auction allows to resolve two problems: finding the right possessor, who would value the purchased asset most of all, and second — maximizing budgetary revenues. Of course, auctions aren't associated with the state business only — in general all stock market trade can be defined as a huge auction, where the buyer is chosen by the highest price criteria. State also participates in stock market and thus uses auctions (e.g. when it sells securities). So the auction theory was created to resolve, how the gains from auctions are dispensed. Its theorists paid major attention to simple auctions with a single indivisible good. Paul Milgrom, and Robert Weber describe four key types of such auctions in their article "Theory of auctions and competitive bidding".[22] An "English" auction, where the auctioneers price is increasing together with bid prices called, unless the final largest bid remains. A "Dutch" auction takes place when an auctioneer gradually decreases his price until there appears somebody ready to pay it. "First price" and "Second price" auctions are also distinguished by authors as those where the sell price is determined by the buyer himself and where price is set according to the bid of the next to last pretender correspondingly.

Primarily only trade was the domain application of the auction theory models, because market price making mechanism best corresponded to theorists concepts. But since economic regulation had been qualified as a kind of market relationships, the theory of auctions pretended on being involved into this new sphere.

A somewhat better models of endogenously determined politics appeared after Douglas Bernheim and Michael Whinston described in their 1986' article[23] a new approach to analyzing auction algorithms. Their "menu auction" approach consisted of formalizing rules of a special kind of auction in which several bidders were suggesting their prices for a number of goods sold by a single auctioneer-agent. This auctioneer being aware of all bids available tended to maximize his own benefit. This model takes advantage of describing multiple goods (or services) for sale at once and takes account of possible interactions between the auction participants. Later on such concepts were categorized as common agency models because in contrast to previous theories they studied relationships between a multitude of principals and a single agent.

Bernheim and Whinstons theory covered a wide range of issues such as distribution of construction contracts, serving several customers in a restaurant by a waiter, a secretary whose duty is assisting several university professors and other sorts of practical application. A political dimension of the theory also deserved special attention.

In 1994 Gene Grossman and Elhanan Helpman published their famous "Protection for sale"[24] paper, in which they applied ideas of Bernheim and Whinston to analysis of influence of separate interest groups (authors call them individuals) on governments decisions on tariff stakes and subsidy volumes. There are two main factors taken into account by the model: an individual factor which implies benefit of each group from its strategy of behavior and a collective factor — how will the other groups react to this strategy. The process of group formation is outside the framework of the model — it considers only that not

22 Milgrom P., Weber R. A theory of auctions and competitive bidding // Econometrica. 1982. No 5. p. 1089-1122

23 Douglas B. Bernheim; Michael D. Whinston. Menu Auctions, Resource Allocation, and Economic Influence // The Quarterly Journal of Economics. 1986 No. 1. p. 1-32

24 Gene Grossman, Elhanan Helpman, Protection For Sale // American Economic Review Vol. 84, 1994, p. 833-850

every individual participates in some lobby and consequently only part of the economy can be represented by interest groups. So the task of modeler confines to finding optimum equilibrium in which there exists balance of every side: representatives of interest groups, society as a whole and government, whose destiny strongly depends on social welfare.

Accordingly the ratio of the ultimate dollar received from lobbyists to the number of votes lost during elections becomes a key moment of the model. The process of determining the resulting policy goes as follows: at start the government collects information about the payments provided by every interest group for each action planned. And after this it proceeds with setting the rates of tariffs and subsidies which would maximize its own benefit in terms of contributions and votes.

The Nash equilibrium[25] which is used for calculating the final set of decisions, requires four conditions to be fulfilled.[26]

- Lobby payment functions must be positive and stay within borders of their ability to pay.
- The government adheres its welfare-maximization principle.
- The sum of welfare of the government and every separate interested representative is also maximized. This is necessary because otherwise lobbyists might decide to use some other remuneration strategy which would provide such maximization.
- The range of strategies maximizing the governments welfare includes such one which would receive no payment from any lobbyist. This is proved by contradiction: if there wasn't such a decision available, some lobbyist would be able to decrease his payment schedule without alteration of the final equilibrium, because by doing so he might have improved his own position, attaining the same benefit at a lower price.

Analyzing various combinations of interest groups and governments interrelationships, authors came to several conclusions. First, companies' influence on government and consequent level of tariffs are higher in brunches where lobbying is present by fact and import demand elasticity is lower. Second, in brunches with organized lobby groups protectionism level is negatively correlated to imports market share. On the other hand, economy sectors without lobby tend to obtain protection with imports expansion.

Empirical approbation of the model results was undertaken by other researchers — Goldbe and Maggi[27] on a sample data of protection in several brunches of the American economy of 1983. It gave a general confirmation to the model results including notion of high correlation of imports growth and protectionism level in nonorganized politically brunches. Moreover Goldby and Maggy managed to estimate how the government weighs social welfare and interest groups' contributions. This ratio equaled 0.98 : 0.02 correspondingly and was generally supported by an established opinion of free trade paradigm predominance among politics in the USA — the country whose total level of tariff protection equals 13%.

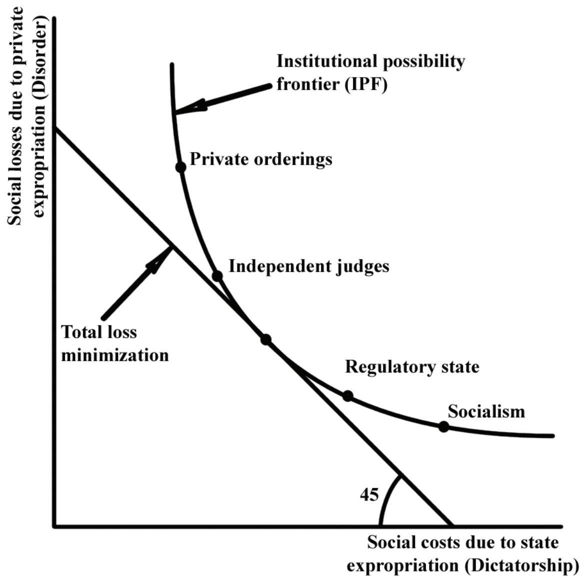
However other researchers reasonably insist that this parameter cannot be validated quantitatively. And this refers not only to Grossman and Helpman model, but to all models which attempt to establish correlations basing on statistics of contributions to candidates election funds. In practice as it was said earlier, monetary ways of remuneration are not very spread, and especially this is true for ones covered by official statistics. This lets one suppose that the real weigh of interest group influence on politics is much higher than the 2% mentioned. Still this fact doesn't diminish the importance of Goldby and Maggy results whose main achievement concluded in giving practical attestation of a purely mathematical interpretation of government intervention

25 Nash equilibrium is achieved in game when no player is able to improve his position somehow, given that behavior of other players is known beforehand.

26 Sufficiency and necessity of these conditions are proved in B. Douglas Bernheim; Michael D. Whinston. Menu Auctions, Resource Allocation, and Economic Influence // The Quarterly Journal of Economics. 1986 No. 1. p. 10

27 Pinelopi Koujianou Goldbe, Giovanni Maggi, Protection for Sale: An Empirical Investigation // American Economic Review, Vol. 89, No. 5., 1999, p. 1135-1155.

Plot 1. Institutes in coordinates Dictatorship — Disorder



Source: Simeon Djankov, Edward Glaeser, Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer. The New Comparative Economics // Journal of Comparative Economics. 2003. V. 31. №4. P. 595-619.

driven by external business interests.

Thus we know that the economic regulation is driven by the forces of demand and supply and their combination is shaped through reconciliation of claims of all interested sides. But how can one determine the optimum level of state intervention which would harmonize with interests of every national interest on the one hand and wouldn't hamper the country economic growth. Different economists, politicians, philosophers present different versions of where the state regulation must be limited and different countries have diverse levels of this limit. The multitude of variants of proportion of the public and the state sectors of economy in the world shows that there's no certainly known place and role of state in this system and each country defines it basing on its own historically formed distinctions. A huge number of factors affecting activity of state institutions leave little chance to give definite interpretation to it, estimate effectiveness or build interstate comparisons. Still economists try to disengage from some restrictions and make comparative analysis of state politics effectiveness to answer this question.

5. Disorder or dictatorship: what's efficient?

Estimation of the costs of economic regulation undertaken by the government is one of ways in which this analysis can be held. These costs express in various manners. One of the ways is measuring the lost potential of economic growth what is caused by the low quality of existing institutes. Multiple imperfections of the modern market economies such as shadow sector of economy (black market), corruption, lack of investments, capital flight, breach of contracts and violation of rights of workers and minority stockholders can be mentioned here. All these and other examples of unsatisfactory institution development are measurable and show the potential of institutional improvement. Authors of the article "The New Comparative Economics"[28] suggest that government intervention into economy should be measured as some sort of balance of the two opposite categories: order and disorder. Disor-

28 Simeon Djankov, Edward Glaeser, Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer. The New Comparative Economics // Journal of Comparative Economics. 2003. V. 31. №4. P. 595-619

der and associated with it absence of regulation imply big possibility of violation of property rights, assassination, robbery, contract breach, monopoly pricing and so on. Corruption and hidden menaces are also manifestations of disorder and lack of regulation. On the other hand, abundant order caused by excess regulation is a synonym of dictatorship and also has its costs. Shortages of dictatorship are well known and they include disorder too. This is another – higher class of disorder caused by the state which is also able to deprive, initiate burdensome taxation, restrict entrepreneurs freedom. Corruption is also possible here but as opposite to the case of disorder it changes its character. In a weak state bribery is targeted on achieving preferences and in case of overregulation briber pretends rather to avoid some regulation from the state.

Every state has to make a choice of a number of alternatives, each of which assumes some level of disorder in a country and simultaneously some dictatorship present too. If somebody tried to estimate the social costs caused by choosing one of the alternatives in a co-ordinate scale of disorder and dictatorship, he might find out that some of them are more effective in terms of total costs than the other. The next step to do is see what is to be done to move from one alternative to another in order to minimize the costs. To make it more clear lets see the described connection of disorder and dictatorship on a plot. The plot 1 shows the co-ordinates with social costs of dictatorship along the horizontal axis and social costs of disorder along the vertical axis. Two curves represented on the plot have the following meaning. The first one back sloped under 45 degrees corresponds to a set of positions having equal total social costs from both parameters of state intervention. Extent of the curve from the origin point is determined by another important variable — civic capital. Authors understand by it citizens' ability to communicate and settle disputes. The less is this ability developed in a society, the higher are the costs of enforcing contract fulfillment and the further from zero is the isocost curve position.

The other curve forms the frontier of institutional possibilities — a zone of instruments and institutes of regulation available to the state. Every decision of policymakers concerning introduction of extra regulation or diminishing it is represented by movement along this curve. Obviously, when the level of disorder is high, some not very large portion of regulation is enough to bring social costs down. However after chaos is defeated, further order improvement will require more and more regulation and social costs caused by it. It's clear that there's no way to destroy every manifestation of disorder (in any way there will remain corruption and nepotism) — this is why the curve is concave.

In the long run government is able to do more than simply modify ratio of regulation and disorder — it can influence both parameters at the same time diminishing the total costs from them. Step by step stabilization leads to building long perspective relationships between market agents and this system becomes self-regulating. Market players become guided not only by external state regulation policies, but also through necessity of keeping reputation before their partners. This is how costs of disorder can decrease and reduce necessity of economic regulation.

Position and slope of the institutional possibilities frontier depend on individual characteristics of the state system, its population mentality, and even on the dominating religion in the country.

The plot presents an optimum level of economic regulation by the state which is located in a zone of tangency of the fixed costs curve and the institutional possibilities curve. And this is the point where the social costs of different combinations of government regulation would be minimized. Lets see what are these combinations.

The first one takes place when the state absolutely abdicates responsibility for economic regulation allowing economic agents manage their relations themselves. Keeping business reputation becomes the main self-regulation incentive in this situation. This interdependence is a matter of very long repeats of business cycle. Market discipline is almost free from such shortages like bureaucratism and corruption, though it is to a large extent subject to the risk of market failures — situations in which market regulation is not sufficient like ones of monopoly forming or maintenance of contract enforcement discipline.

The second way, alternative to government intervention is practice of private suits and legal processes. Chamber of Commerce and trade associations also settle economic disputes founding on the existing legal base without resorting to services of state agencies. This approach is immanent to views of libertarians, though it is also not free from costs. Absolute court independence from pressure groups is quite rare, not to say impossible. Moreover, judges can be bribed, replaced or persuaded by a good command of professional lawyers. There are different ways of interpreting legislation what often leads to ambiguous judgment giving.

When carrying out court orders doesn't seem to work, stronger means of regulation are required and the state may resort to the third alternative: direct interference in economic processes. Public regulation can be more adequate than legal process for the reason that officials are better informed about economic problems within their jurisdiction and have ability to perfect legislation. Still going from courts to bureaucrats represents a shift along the institutional possibilities frontier towards dictatorship. Little by little state departments tend to transform into independent agents with their own economic interests which wouldn't necessarily be the same as interests of the whole society. They become exposed to influence of interest group and potentially can be "captured". Consequently regulation by the state should take place when market discipline and court decrees are insufficient and shouldn't in all other cases.

At last, the extreme case also available to the state represents total subordination of regulated objects to state control — transforming it into property of the state. This measure allows no place for appearance of disorder inherent to market system. Though it needs large expenses (and social costs) for maintenance of the control system and financing state property.

In practice different countries use various combinations of forms of institutional architecture listed above. And the key factors determining their choice are human ability to stable relationships and transaction costs. Their difference reflects uneven distribution of the civic capital among nations and defines their growth capacities.

To underline the discussion we should notice that growth and economic development (the latter embraces the former) cannot be unambiguously interpreted as a domain target of the national government. Economic theorists like philosophers, politicians and other scientists feel difficulties in giving a certain explanation of what is development. In this article is made an attempt to show that there can be no unique determinant of development results for every nation since they are stipulated by specific country inner factors among which the inner power balance plays the dominating role. Economic models haven't yet achieved sufficient accuracy to predict the resulting economic policy. The largest progress in this direction concerned only approximate determination of main game players and game rules. And it may take long time till people would be able to predict results of this game. One of the points of view on this issue says: newer — because any prediction plays just a role of one more model factor.

Conclusion

The main trend in views of economists on state and capital relationships in the last decades can be described as setting equal rights between them. On its way the progress of Economics adopted ideas of political scientists and biologists, leading to more profound understanding of such terms like market and transaction. By Introduction of the political market into the system of traditional markets, theory moved forward to explain the driving forces of decision making on the firm and state levels. This in turn lets us see what should be the state like in order to correspond the requirements of transparency and efficiency, necessary for survival in the modern competitive world.

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ГОСУДАРСТВО И БИЗНЕС: ИНТЕРЕСЫ И ИНСТИТУТЫ

Заключение: *В течение последних десятилетий взгляды экономистов на взаимоотношения частного и государственного секторов развивались в направлении установления равноправия между ними. Экономическая наука в ходе своего развития заимствовала идеи политологии и биологии, что выразилось в расширении смысла таких понятий как рынок и сделка. Дополняя систему традиционных рынков политическим рынком, теория сделала новый шаг в сторону объяснения причин, движущих принятием экономических решений на уровне отдельной фирмы и целого государства. Это, в свою очередь, дает возможность лучше понять, каким должно быть само государство, чтобы соответствовать критериям открытости и эффективности, которые необходимы сегодня для поддержания конкурентоспособности национальных экономик.*