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THE COSTS AND PROSPECTS OF REFORMS IN RUSSIA: AN INSTITUTIONAL APPROACH*

Summary

The high price that Russia has to pay for the market and democratic reforms has become a commonplace both in the speeches of political opposition and in the government statements. However, they rarely point to more than just obvious facts of economic decay, deep stratification of society and non-payment crisis. It stays unclear, whether all these various indicators could be "reduced to a common denominator". The *nature* of costs that occur in the process of reforming society is not discussed. Are these costs of a subjective nature – an indication of tactical errors in the policy of reforms – or are there objective reasons for the costs of reforms that are independent of the personalities of politicians?

Кључне речи: democratic reforms, costs of reforms, personalities of politicians

1. *Shadow economy as a source for market institutions?*

Neo-institutional theory which has recently begun to attract substantial attention conceives of economic and social problems as being a consequence of replacing old institutions with the new ones. One of the most notable representatives of new institutionalism -- Douglass North,

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* This article summarizes and further develops the ideas previously discussed in the article А. Олейник, «Иждержки и перспективы реформ в России: институциональный подход» // *Мировая экономика и международные отношения*, №12, 1997, №1, 1998 and the essay with the same title published by Магистр (Москва) in 1997 in a series of publications selected by Open Society Institute-Russia.

explains the success story of some nations and the continuing stagnation of others through the differences in their institutional structures. For example, the industrial revolution of the 19th century in England was, according to North, preceded by the "institutional" one, that had legalized the institution of copyright in science and engineering (North 1981 p. 159). Can the institutional analysis offer a clue to understanding the problems and prospects of contemporary Russian society?

Before answering this question, we should specify the terms. According to North, institutions are defined as a set of rules, enforcement characteristics and patterns of behavior that structure and facilitate human interaction. In other words, the informal principles of solving everyday problems in a certain community can be considered institutions together with the Civil Law and other written rules. In fact, we talk about different types of institutions: *formal* (the norms and regulations that exist in written form -- such as the Constitution and other legislature) and *informal* (such as categories of common regulations). While the first are based on legal sanctions, the second employ means of social control: damaging a reputation, ostracizing, etc.

In fact, these two types of institutions relate as two consecutive stages of the development of institutional system. In this sense, the evolution of the early medieval arbitration tribunal is quite revealing (Milgrom, North and Weingast 1990). In the 12-13th centuries European trade was concentrated at regional fairs that provided goods for local markets. A community of merchants that had a long-term interest in the region and, usually, knew each other personally formed around each fair. The most respected and credible of them were elected to perform arbitration functions in case a conflict occurred. Initially, the institution of arbitration tribunals was informal: the decision was based on arbiter's personal reputation and his affiliation with one or another community of merchants. As trade developed and the number of deals between representatives of the different trade communities increased, a need appeared for an arbitration institution that would not be dependent on any of local communities and personalized relationships. It became clear that social sanctions and personal reputation were no longer sufficient to successfully settle a conflict, and the "Law Merchant" (*Lex Mercatoria*) and arbiters non-related to any particular community were brought to life (Ibid., pp. 4-5).

In this context, the question about the existence of informal market institutions in Russia becomes particularly interesting. Indeed, if such institutions have already existed in the framework of the command system, one only needs skillfully to stimulate and support their transformation into formal ones. For example, H. de Soto in his analysis of informal institutions of Peru concludes of their effectiveness and opts for their instant legalization. "The shadow sector of the economy initiated -- through the spontaneous origination of non-legalized norms -- a transformation of

the existing status quo that demonstrated for legal institutions the way for their development, provided that they are eager to adapt to the new situation and once again become of use to society" (de Soto 1995, p. 302).

The shadow economy existed in so called "socialist countries" as well. Moreover, the shadow market used to be a significant factor of stability: the unavoidable production non-equilibrium and the resulting commodity deficit were at least softened by the regular recourse to informal quasi-market strategies by all economic agents, including state-owned enterprises. "Demand that can not be provided for by the "first economy" creates an all-absorbing market for the "shadow" economic activities" (Andreff 1993, pp. 210-215). As a result a diversity of informal institutions appeared, ranging from those of the "black" market to the institutions of the "gray" market (for example, the so called "pushers", *tolkachi*, commandeered employees who provided state-owned enterprises with resources in deficit).

The significance of these institutions allowed some researchers to describe the whole socialist system as an "administrative" market, transpierced by vertical ("planned") and horizontal bargaining (Naishul 1992, p. 70; Timofeev 1993, pp. 195, 230). But would the legalization of the informal institutions, inherited from socialist economy, be sufficient to build an effective institutional market system? In order to answer this question we will

1. compare the basic norms of informal institutions with the ones traditionally attributed to the "ideal type" of market institution;
2. analyze the factors of transformation of an informal institution into a formal one, which does not simply imply an articulation of the existing features of everyday regulations in a written form.

Indeed, informal institutions are locally determined and personalized: their functioning depends on efficiency of social sanctions. At the same time, formal institutions make use of impersonal interactions and transform local community into a broader society based on a system of impersonal exchanges. That is why each norm of common law could not be automatically transferred to be employed by society "at large", this process necessitates a series of deep changes in the structure of the norm. While discussing the development of the Law in the late Ottoman empire (1870-1877), B. Badie concludes that this process did not imply any change in the nature of traditional norms, they had simply been "codified" (Badie 1992, p.197). As a result, the written in this way Law appeared very unsuitable for interactions between partners who do not know personally each other.

2. *The ethics of market behavior: the ideal type.*

Let us compare the norms of market behavior that exist in informal Russian institutions with the concept of the ideal type of a market convention, as defined by such representatives of institutionalist thought as French "conventionalists" Luc Boltanski and Laurent Thévenot. The first norm of market convention presupposes the existence of the lowest necessary level of *mutual trust* between the economic agents. Not only complicated market transactions but even the simplest ones can not be implemented without such trust.

For example, this trust serves as a basis for all elementary deals involving the advance payment or, in other words, transactions involving time delays in fulfilling obligations. Let us analyze the simplest model with two interacting parties: the Seller and the Buyer. The Seller faces two options:

1. to advance payment in the hope of getting merchandise, or
2. refuse from entering the transaction.

Upon receiving the advance payment the Seller, in his turn, makes his choice between fulfilling his obligations and pocketing the money. Game theory offers the following model for such situation (Kreps 1991, pp. 103-104):

Table 1. "A trust game"

		SELLER	
		Fulfills the contract (p)	Pockets the money ($1-p$)
BUYER	Makes an advance payment	10, 10 N_1	-5, 15
	Doesn't make an advance payment	0, 0	0, 0 N_2

where (-5), 10, 15 - are unit values for conventional benefits for each party in all possible cases (for instance, expressed in dollars). We may emphasize that in this case there is no dominant strategy (the strategy that provide the maximum benefit regardless of the actions of a partner). Nor could the single Nash equilibrium be achieved: there are two issues resulting from the "best responses" of each player.

Now let us bring in an additional variable p , which represents the Buyer-estimated probability of the fact that the Seller fulfills the contract. Accordingly, the Buyer's estimation of deceit equals $(1-p)$. Then, the estimated utility of making an advance payment can be calculated as:

$$EU_{\text{advancing}} = 10p + (-5)(1-p) = 15p - 5,$$

while the estimated utility of not advancing a payment:

$$EU_{\text{not advancing}} = 0p + 0(1-p) = 0.$$

Hence, the Buyer will advance a payment only provided that $15p - 5 > 0$. In other words, the equation $p = 1/3$ represents the minimum necessary level of the Buyer's trust in the Seller. J. Coleman (1990, p.99-100) generalizes these results in a formula allowing to calculate the minimally required level of trust taking into consideration the conditions of a transaction: $p/1-p > L/G$, where L is the potential loss (-5 in our case) and G – the potential gain (10 in our case). Empirical data confirms the high level of trust existing in the countries with full-fledged market. The percentage of people who give a positive answer to the standard question: "Do you think the people around you could be trusted?" varies from 50-60 in Italy to 85-90 in Germany, France, Great Britain and Denmark (Inglehart 1990, p. 35; quoted in Patrushev 1996, p. 43).

The next norm requires *mutual sympathy* between the market subjects. The sympathy, in A. Smith's understanding, helps one party to correlate its interests with the interests of the other and allows a party to take a detached view on itself (Boltanski and Thévenot 1991, p. 77). The actual sympathy provides the transition to the higher level of interaction that is based on *empathy*, the human ability to put him or herself in a partner's shoes and encounter an interaction through his eyes (Monroe 1994, p. 884). It should be noted, that empathy serves as a basis for any legitimately organized marketing strategy and promotion of new products.

Another element of market convention is connected to the standards of *utilitarianism*, that presupposes a correlation between human productive activities and their aggregate pleasures. A utilitarian sees the world as a whole complex of actual and potential means to achieve certain goals. Weber wrote that goal-oriented rational action of the individual is based on "the expectation of certain behavior of external objects and other people, and the utilization of such expectation in capacity of "conditions" and "means" of achieving rationally formulated and considered goals" (Weber 1990, p. 628). In other words, market mechanisms work only provided all the norms of rational behavior are followed; if not so, the problems of profit and utility maximization become meaningless. At the same time, a global market equilibrium is only possible if all the economic subjects take these problems into account.

Finally, there is a norm that synthesizes all these sympathy and rational behavior requirements. Here we are talking about a special, interpretive type of rationality. The concept of *interpretive rationality* implies (Livet and Thévenot 1994, p.157):

1. the ability to predict the actions of other parties in a transaction, and
2. the ability to convey to them your intentions and, thus, facilitate the prediction of your actions.

It should be noted, that both of these abilities may be manifested even when the direct communication and agreement on a coordinated strategy are not possible.

For this reason the economic agents revealing an interpretive rationality are capable of solving problems that usually lead conventional instrumental rationality into the dead-end of, for instance, what is conventionally called the "prisoners' dilemma." The prisoners' dilemma models the behavior of two persons that have been accused of committing the same crime and put in a separate cells. Each of them has two different strategies to follow: either to blame it all on the other or to plead not guilty. If both of them plead not guilty, they both are sentenced to short-term imprisonment; if each of them blames it on the other, they are sentenced to long-term imprisonment. Finally, if one blames it on the other and the other pleads not guilty, the first one is set free while the second one gets the maximum penalty. The paradox is that the only rational strategy for both of them implies blaming one another which obviously results in long-term imprisonment. Only an interpretive rationality can re-establish mutual trust and therefore provide a solution for prisoners' dilemma. Here we find some interdependence between different norms of market convention: trust may lead to sympathy, sympathy -- to empathy, and empathy, in its turn, is connected to a complex of norms of rational behavior, while interpretive rationality decisively contributes to trust-based relationship. Thus, we can conclude that internal stability and coordination are characteristic of market convention.

3. The ethics of market behavior: Russian reality

With the "ideal type" of market convention described, we can now turn to the analysis of the informally institutionalized norms of quasi-market behavior that have been existed in the USSR post-communist Russia. In our analysis, we will predominantly rely on a series surveys recently conducted by a group of researchers from the Institute of Comparative Political Studies (Russian Academy of Sciences) and the Moscow State University*. The sample consisted of 450 respondents from three regions of the Russian Federation in late 1995, 850 respondents from 6 regions in 1998 and 1310 respondents from 8 regions in 1999. The survey demonstrates that the level of trust is critically low in contemporary Russia: only about 32% of the respondents gave a positive answer to the question on whether they can trust the people around them (compare with the lowest necessary level of 33,3%, calculated in Paragraph 2, see Table 2). Trust was not considered relevant among the actual basic prin-

* S. Patrushev, A. Khlopin, E. Gvozdeva and author of the present article.

principles of Russian society nowadays (only 28% of the respondents mentioned in 1999 trust – 8th rank of 12 basic values – while 72,6% - 1st rank – named profit), and among the principles on which Russian society *should* be built (trust occupies the 5th of 12 positions). Respondents didn't consider trust a typical feature of Western society either: it occupies (in 1995) the 15th of 19 positions, i.e. it was put among the most atypical ones^{**}.

Table 2. "Level of trust in Russia"

<i>% of those who can trust:</i>	<i>1995</i>	<i>1998</i>	<i>1999</i>
The people around them (<i>impersonal trust</i>)	31,5	N/A	32,1
The State (<i>institutional trust</i>)	N/A	9	3,4

In the same time we can not state that in Russian society norms of trust are not present as such. For example, the trust is mentioned as the most important factor structuring the relationships within the family (86%, cf. utility was named only by 49,3% in 1999). There is a very simple explanation for such a contradiction: trust is so much personalized that trust-based relationships are limited to a circle of well-acquainted people, and, namely, to a circle of relatives. The closest relationships exist between relatives, and it is relatives who would be included into the circle of everyday personal contacts provided the respondents could choose it themselves. Now it becomes clear, why the institution of the family gained the major grade of trust among the respondents: family was named by 70% (in 1995), friends – by 48%, while the first de-personalized institution, the Church, - by 21%. By the way, such "privatization" of social life and limitation of social and economic contacts to the framework of the family were also characteristic of Soviet society in 70's and 80's (Shlapentokh 1989, pp.156, 165).

In other words, norms of trust do exist in Russian society, but they are personalized and localized. That is why the only possible market transactions are local ones or the ones based on a preliminary acquaintance of the parties. A radical deficit of trust was demonstrated during the crisis of the inter-bank loan market in September-October of 1995 (and in autumn 1998). As a result of the lack of trust between the market operators, the total volume of deals had reached zero point and it was only the

^{**} The dynamics of the basic values during the second half of 90s is considered in more details in Oleinik A., "Changes in the Organization of Everyday Life in the Wake of Financial Crisis", in Segbers K. (editor), "*Explaining Post-Soviet Patchworks*", Aldershot: Ashgate, 2001, Vol.2 "Pathways from the past to the global". In particular, we propose an analysis of impact of the recent financial crisis (August 1998) on the level of trust.

formation of local "bank clubs" that made it possible to keep the trust-based relations between the members (Commerçant, n°34, 1995, p. 58-63). In conclusion, it should be noted that while the existing norms of trust do not contradict the requirements of market convention they are obviously insufficient. Such insufficiency could only be compensated for by formal institutions based on the norms of a trustworthy relationship.

The answers to the questions concerning the respondents' readiness to fulfill the obligations and comprehend someone else's point of view indicated the lack of yet other elements of market convention -- sympathy and empathy. In this context, the answer to the question concerning the reasons to fulfill obligations is quite illuminating. Only 30% of the respondents were respectful of the rights of other people, 15% considered that they would be treated in the same way in response (the results of 1995 survey). At the same time 60% fulfilled their obligations out of a sense of responsibility, in other words, they based their behavior on an absolute imperative that did not imply any attempt to look at themselves through the eyes of a partner. (It should be noted that the percentage may exceed 100% in total, because it was possible to give more than one version of an answer). It also occurred that the overwhelming majority of the respondents (63%) in order to resolve any complicated problem preferred to rely on the decisions made by several strong and experienced people. Even friends were less valued for being respectful of someone else's opinion (the 9th position of 12), than for honesty, kindness and sense of humor -- qualities that actually require much less positive effort.

However, the results of the study should not be interpreted denying the existence of empathy norms as such. They do exist, but in extremely personalized and localized forms: for example, 35,4% of the respondents in the case of an emergency would have counted on help from their relatives, while 32% counted only on themselves; 40,5% had recently received help from their relatives, another 29% -- from their friends, and only 14% had not recently seen any help from "their people" (the results of 1995 survey). In other words, the respondents considered their closest relatives and friends to be capable of sharing their problems and counted on their assistance. The farther one found oneself from the circle of relatives and friends, the more the level of moral responsibility decreased. It reached its maximum in relation to children, then, in diminishing order, it applied to husband (wife), enterprise, country and other people's actions.

Personalization of sympathy and empathy-based relationships, the lack of formal and de-personalized standards, may exclude even the simplest polite interest in the problems of one's neighbor. Total indifference towards the faceless "environment" may come together with an impudent intrusion into the private life of a neighbor and result in the denial of his right to privacy as such. The threat of aggression into the private sphere, be it from one's close relative, one's enterprise or "one's people," takes

Russian society back to a situation of communal collectivism and mechanical solidarity: the situation in which individuality simply dissolves (Khlopin 1996, pp.30-33). Let us once again stress that the personalization of relationships has a rather destructive influence upon the norms of sympathy. Such an influence can only be overcome by the development of the institutions of formal law, that would dislocate sympathy (that would assume the form of a legal reciprocity and mutual readiness to execute commitments) and guarantee the inviolability of the basic rights of the individual.

The situation with norms of rational behavior in Russian society is not any less complicated. Historical analysis reveals types of action different from the goal-rational one. For example, A. Akhieser, analyzing simple and developed forms of utilitarianism, concludes that in Russia a simple one that implies a striving for the image or level of consumption that is already present in society dominates over a developed one (Akhieser 1991, v.1, p. 124). In contrast to a developed form, such striving for a certain result has nothing to do with productive human activities as such. It should be noted, that the features of simple utilitarianism have a lot in common with the "demonstration effect" that is characteristic of Third World countries: there is a striving for modern consumption without a change in predominant norms and way of life (Obershall 1993, pp. 129-130).

Similarly, joint ventures in Russia do not strive for production goals but create and support systems of personalized relationships (Morozov 1991, vol.1, p. 107). Sociological studies on managers of Russian enterprises in late 80-s have demonstrated the predomination of the moral-ethical type over the pragmatic one, which is current in Japan and the USA (Ibid., pp. 82-85). In the 90-s, studies showed the same tendency: Russian entrepreneurs are predominantly motivated by values. These factors make value-rational action more pervasive than traditional, affective or goal-rational (Radaev 1994, p. 92).

The prevalence of types of social action of non-goal-rational type is proved by the results of our survey in Russia. The majority of the respondents are affective in their relationships with people: they would rather not stay in contact with a useful but annoying character. Curiously, such results at first sight contradict the rational behavior of the respondents during elections: the majority would definitely not vote for a sympathetic but politically unsuitable candidate. However, a more precise view shows that such behavior proves to be of the same value-rational type: only 33% (1995) of the respondents concerned themselves with the political program of the candidate. The rest either behaved in a limited rational way and paid attention only to the information that corresponded to their value orientation (5,2%) or concerned themselves with no political program whatsoever and made their choice in accordance with their own value hierarchy (42%).

However, one should not conclude that each element of the predominant type of behavior contradicts the corresponding one of the "ideal type". Assuming that Weber's four basic types of behavior exist in the framework of some continuum, the transition from one to another proves to be quite possible: from the affective type to the value-rational, then to the traditional and finally to the goal-rational one. Between these types of behavior, there are several intermediate stages that differ both in the complexity of procedure of the decision-making and in the number of factors taken into consideration (Tsimburski 1995).

Thus, in Russian society the predominant informal norms of behavior are radically insufficient for the implementation of market transactions. Trust and sympathy-based relationships are personalized and localized, and the prospects for their development are closely connected with the organization of formal institutions. The goal-rational type of behavior is subordinated to the value-rational type. It should be noted, that according to the interdependence of the norms of market convention, the lack of anyone of them would put into question the prospects of market development as such. That is why it is so important to analyze the problems that occur when formalizing the existing quasi-market norms in an attempt to produce an impulse for their development.

4. The problems of legalization of quasi-market institutions

The first and the simplest strategy of the market reform implies a simple articulation of informal norms in the form of a written law. That is what the proposals of H. de Soto (1995, pp. 303-304) and V. Naishul (1992, p. 81) amount to. According to these proposals, in order to implement such strategy one should simply codify two categories of informal norms: socially good ones (for market and democracy) should be legalized by formal institutions, while inefficient or socially dangerous ones should be considered criminal (Kolesnikov 1994, p. 102).

However, the disadvantage of the simplicity of such legalization procedure is, primarily, that the information the state can use to define the norms worth legalizing is limited. It may be helpful to recall an argument, supplied by Frederich Von. Hayek. Though admitting that the state should be authorized to define the general framework for economic activities and set up formal regulations, he was very careful in relation to the ability of the central organ to collect all the information necessary to make the right decision (Hayek 1992, pp. 43, 61-62). And even though this problem can be solved through organizing several regional legal zones and creating a precedent-based legalization mechanism (Naishul 1994, p. 189), the "direct" legalization has a second and the more substantial obstacle to overcome: in order to meet the requirements of society "at large", informal norms should undergo qualitative changes.

The transition from the localized and personalized norm to a de-personalized regulation implies an *interpretation* of the content of the norm that should from now on meet the criterion of coordination within society "at large" (Akhieser 1991, vol. 1, p. 71). For example, were the norm "close people are friends in any circumstances" legalized, it could not serve as a basis for the de-personalized interactions between people, even if a majority of people agree to this. This norm implies the existence or formation of the tight circle of acquaintances and thus, the disintegration of society which "crumbles" into local communities and groups. The *interpretation* means much more than a simple extrapolation of the principles of informal norms and writing them down as a law. Listing the norms that have proved to be efficient in ensuring human interaction and are commonly used at a local level is, mathematically speaking, the necessary but insufficient condition of successful institutional reforms. One needs to interpret these norms according to the requirements of society "at large".

What are the specific requirements of society "at large?" The norm must fulfill the integrative function, i.e. serve as a link between various social groups and local communities. Here originates the possibility of resolving inter-group conflicts through applying a norm that is acknowledged by each of the parties. In other words, the norm is considered not an absolute determinant of behavior in this or that situation, but a procedure for resolving conflicts caused by the diversified interpretation of the behavior of the partners (Thévenot 1993, p. 13-14). It should be noted that the institutionalization of norms, defined in this way, does not contradict the principles of free choice and rational behavior. On the contrary, the implementation of norms helps to coordinate one's actions with others, regardless of how distant they are, and, thus, to achieve the certain goals.

The interpretation of actions on the basis of formal regulation implies the synthetic and compromising nature of this regulation. Formal regulation must provide the possibility of finding a compromise between the requirements of various informal norms; simple legalization of one or of several informal norms would only lead to general uncertainty in relations and interactions and thus, to a multiplication of conflicts. In its turn, institutionalization by means of compromise implies the availability of a special culture of mediating quality. This *mediation culture* tends to resolve all conflicts through the search for the "middle" (intermediate course), a synthesis of contradicting requirements and behavior imperatives. The opposite to that, the *inversionary type of culture*, excludes the possibility of compromise and implies a permanent oscillation from the one extreme to another (Akhieser 1991, vol. 1, p. 40). The permanent attempts to replace the law with one of local norms and, thus, build society

"at large" on the basis of the principles of one social group are deeply characteristic of the inversionary type of culture.

Historical analysis of the development of Russian society reveals a number of features relating to a society with the inversionary type of culture. A. Akhieser calls such a type of culture "manichean", or a striking example of the inversionary logic. Consequently, the transition from informal to formal regulations seems problematic for Russia: society permanently waves between one local norm and another, unable to find a compromise. The attitude of respondents to the statement: "Real solutions are not found in discussion, but thanks to the will and skill of several strong and experienced people" is quite illustrative. The overwhelming majority of the respondents (63,2%, 1995) agreed with the statement and, thus, confirmed the lack of the mediation culture.

Summing up, we may conclude that the premises for the evolutionary development of market institutions in Russia are insufficient. The predominant informal norms do not meet the requirements of the "ideal" type of market convention. The development of existing norms towards the "ideal" type (de-personalization of trust and empathy and transition from the value-rational to the goal-rational type of behavior) implies their formalization. However, the prospects of the legalization of such norms by formal institutions are very much in question because of the predominance of the inversionary type of culture that denies the possibility of a compromise between local norms. Are market and democratic types of institutional reforms of any meaningful significance in such a situation?

5. The strategy of institutional reforms, initiated from "above"

The admission of the insufficiency of premises for the evolution of market institutions combined with the intention of building a civilized market in Russia, assumes the form of a *teleological strategy of market reforms*. In contrast to the genetic approach that takes into account the existing social norms, the tendencies in their development and limitations, the teleological approach sees as a starting ground not an actual, but a desirable situation -- in our case a civilized market with an aggregate of formal market institutions (Andreff 1993, pp. 11-12). This desirable situation is projected on society, pushing the actual tendencies off the scene. The "enlightened monarch's" conception of the ideal society as well as the social institutions that have shown themselves to advantage in other countries can both be reproduced as the desirable situation. In the second case we can talk about the import of institutions resembling the import of goods or the import of capital.

In the case of the evolution of informal norms the most difficult part consists in interpreting them and reconsidering formal regulations; in the case of importing institutions, on the contrary, changing the formal

regulations proves to be the easiest and the most transient step. It only takes to choose which institutions to import and acquaint oneself with the basic written regulations. This is the way in which the principles of the Declaration of Human Rights, originally formulated during the period of the French Revolution, made their way to the Constitutions of other countries. Later, the norms of the US Bill of Rights were reproduced in the same way.

The same thing happens with the export of market institutions. We can observe the reproduction of either the Anglo-Saxon type of property institutions that implies a division into separate spheres of competence, or the institutions that are characteristic of the countries of continental Europe and imply proprietary rights as "absolute and indivisible" (Kapelushnikov 1990, pp. 10-11). Correspondingly, the legislation regulating bank activity in different countries is either based on the German bank legislation that allows the bank capital to participate in the joint-stock companies, or implements the American one that limit such participation.

The history of Russia offers many examples of the import of institutions: from the enforced institutionalization of Christianity or, being more precise, its formal ceremonies, to the reforms of Peter the Great. The reforms of Peter the Great represent the first attempt at a complex institutional transformation of Russian society according to the Western European standards. Persuaded of the depravity of the outdated but still dominant norms, Peter the Great tried to replace them with formal regulations that proved to be effective in European countries (Morozov 1991, vol. 3, pp. 148-186). The new formal regulations were installed from "above," and the legalization of informal ones was thus excluded. However, there were times after World War II, when Russia (the USSR) exported institutions rather than imported them. This meant, for instance, that the institutionalization of planned production, the reforms of the banking and social system in Eastern European countries were implemented according to Soviet patterns (Douglass 1972).

The market reforms of the 90s are mainly based on the strategy of import of social and economic institutions. In the first place it refers to the contradiction between the insufficiency of the existing premises for the civilized market and the urgent necessity to find a substitute for the insolvent institutions of the planned economy. Consequently, Russia had to renege from implementation of the norms of the common law, for example, in privatization policy (Naishul 1992, p.77). Rapid privatization and relocation of property in prejudice to its former informal owners (ministries-"bureaus" or enterprise directorate) displayed the intention to institutionalize effective Western standards of proprietary system.

Interestingly, the predomination of the import-oriented strategy of the reforms, is clearly understood at the level of mass conscience. The respondents in the first place admit the American influence on the course of

reforms, then the Western European and only after that mention Russian or Slavonic influences. Such influence is obvious not only in the political sphere -- the import of such institutions as the President, Parliament or the idea of separating power -- but in economy as well. Among the most vivid examples, we can mention the anti-monopoly regulations, the legislation regulating bank activities as well as audit and accounting standards.

At first sight, the strategy of import of institutions is a non-risky strategy. First of all, no efforts are spent to develop informal norms. For example, if the problem is that the empathy norms work only on a local level, they can be replaced with standards of reciprocal behavior from the Declaration of the Human Rights. In the second place, the market of institutions -- as any other market -- offers an opportunity to choose the most effective one: if the American banking system does not meet expectations, all it takes is to turn to the German model (that, for instance, may be implemented within the framework of Industrial-Financial groups, *FPG*). Thirdly, import duties can be neglected as soon as neither international nor national copyright regulations for the institutional innovations exist. This allows to reproduce this or that formal institution without any concern for compensation for the country-innovator.

Since we deal with the first type the costs of market reforms, the import costs are worth more detailed analysis. These are the elements of *formal institutions import costs (I)*:

(I₁) The cost of technical assistance from the countries -- institutional "donors"(consultations, the exchange of experience and information). Costs of this nature can easily be calculated and are represented in American or European financial reports. In some cases, the (I₁) costs assume the form of loans from the exporting countries.

(I₂) The costs of training bureaucrats and functionaries who will be employed in the new institutional structures. This types of costs are partially represented in the (I₁) accounts (international training and seminars).

(I₃) The costs of lobbying the new regulations in legislative organs. In authoritarian countries these costs are minimal provided the head of State personally defines the imported institutions. Where the regulations must pass the legislative procedure, the (I₃) cost may exceed (I₁) and (I₂) taken together. This is demonstrated in the case of the Credit Union Regulation, the elaboration of which was financed by CUNA Mutual Insurance, the American Credit Union Association and the Canadian cooperative bank Desjardins.

(I₄) The costs of providing information about the change of the formal institutions: the costs of printing and distributing new versions of regulations and the information campaign costs.

But is the cost of institutional import limited to the mentioned above elements? Can the development of informal norms be replaced by the enforced

institutionalization of the formal regulations that proved to be efficient in the framework of a different institutional system? Indeed, the counter-reforms that were conducted straight after Peter the Great left unchanged only the institutional innovations that could accommodate the former way of life. Our main hypothesis implies the possible nonconformity of informal norms in relation to the requirements of the new legal regulations enforced from "above". Only the totalitarian state, that appropriated the right to intrude into any aspect of people's everyday life and privacy, can prevent the origination of such nonconformity. However, we hope that the totalitarian type of market is of no real significance for Russia.

Generally speaking, once the new regulations are institutionalized events can develop in two different directions. First: the new regulations do not contradict the informal norms that dominate the society. In other words, the premises for the evolution exist, but such evolution is inhibited by the reasons of various origin and one only needs to accelerate the natural processes. For example, despite all the difference between English and French history, both countries have had in existence the norms of solidarity and mutual aid embodied in trade guilds and other corporate bodies (Thompson 1988; Touraine 1984, pp. 105, 108). Consequently, democratic institutions based on standards of reciprocal behavior became appropriate for both countries, regardless of which country first established this or that institution. Once the vectors of the development of informal norms and formal institutions concord in orientation, and society is highly capable of interpreting new norms, no nonconformity of informal institutions occurs. This minimizes the maintenance costs of the new institutions. Obviously, apart from the "start-up costs" (the cost of import of formal institutions), resources are also needed to maintain the legal system. The cost of production of social goods (coordination of interactions, predictability, general social stability along with low transaction costs) includes the cost of the bureaucratic system that is responsible for supervision and implementation of legal sanctions. Here originate the *formal institutions submission costs (S)*, that are covered by the economic subjects themselves:

(S₁) The costs of access to the formal institutions: registration, licensing and authorization costs (de Soto 1995, p. 178).

(S₂) The cost of restarting business in the framework of the new legal system: taxes and accounting reports (Ibid., p. 187).

Provided the vectors of development of informal norms and formal institutions concord (in other words, they are *congruent*), the total cost of the institutional reforms reads: $T_1 = I + S = I_1 + I_2 + I_3 + I_4 + S_1 + S_2$, and the T_1 costs per one economic subject are minimal. The I costs are minimal provided new formal norms are easily perceived both by functionaries and people. The S costs are minimal because the formal institutions corre-

spond to the interests of the majority of economic subjects and the total cost is distributed among the large number of subjects.




6. *The costs of bridging the gap between formal and informal institutions*

The second possible way of development after legalization of the new regulations may be followed if the new regulations contradict the predominant informal norms. When analyzing the practice of legalizing the norms of the American Constitution within the tribes of Indians according to the Indian Reorganization Act in the 30-s, S. Cornell and J.P. Kalt noticed two types of tribe. The tribes of the first type (e.g., the Apache) passed on to a higher level of economic and social development, while the other (e.g., the Sioux) ended up in an even deeper crisis. The authors conclude that in the tribes of the first type, the traditional mechanism of power was somehow similar to that of democratic institutions (Cornell and Kalt 1995, pp. 411-412). The tribes in which the informal norms contradicted the requirements of the Constitution such as an electoral system, individual freedom and the rationalization of behavior, fell into crisis (Ibid, pp.414-417).

In the same way, H. de Soto elaborates on the contradiction between the principles of Spanish mercantilism that served as a basis for the formal institutions in Peru and quasi-liberal principles that in his vision are implied by informal institutions (de Soto 1995, pp. 248-253).

The gap between informal norms and formal regulations causes the seemingly paradoxical situation when nobody benefits from following the requirements of potentially more efficient formal regulations (to set aside the reverse situation in Peru, that originates from the colonial practice of enforcing institutions taken from the mother country). Let us take the place of the individual that seeks to optimize relations with his surroundings, in other words, to concert his actions with others. The individual realizes that the majority of people act in accordance with informal norms despite the fact of the existence of the formal regulations that are potentially more efficient and provide better coordination. We will not compare the efficiency of social and legal sanctions, assuming them identical from this respect. Then, the option of following informal norms and formal regulations may be presented as:

Table 3. "A coordination game"

		PARTNER	
		informal (p)	formal (1-p)
INDIVIDUAL	Informal	1, 1 N_1 	0, 0 
	Formal	0, 0	2, 2 N_2 

where "formal" means a strategy of following formal regulations, "informal"-- a strategy of following informal norms; (1, 1) -- benefits of each party in case of their both choosing informal norms, (2, 2) -- benefits of each party in case of choosing more effective formal regulations, (0, 0) -- zero benefits in case of choosing different norms so, that no coordination of transactions is achieved; finally, p -- represents the probability of the fact that the partner will follow the norms of informal institutions. As we assumed, $0 < p < 1$.

Then, the estimated utility of choosing informal norms can be calculated as: $EU_{\text{informal}} = p + 0(1-p) = p$; and the estimated utility of choosing formal ones: $EU_{\text{formal}} = 0p + 2(1-p)$. The maximization of the estimated utility implies that the individual will follow informal norms provided that $p > 2-2p$ or $p > 2/3$, in other words, more than 66% of people follow informal norms. This, obviously corresponds to the conditions of the problem. The implementation of informal norms becomes an Evolutionarily Stable Strategy: if the majority of people choose to follow it, no optional strategy can pass natural selection, regardless to how effective it is (Smith 1982, p. 10). The losses of those who chose to follow formal regulations equal to: $L = 2-2p - p = 2-3p$. Let us one more time stress this paradoxical situation: the losses originate from choosing regulations that are potentially more effective (for example, market convention in comparison with quasi-market informal norms).

In this context, the need to determine the depth of the gap between informal norms and formal regulations becomes essential. The more their requirements contradict each other, the more people will try to ignore enforced regulations. S. Cornell and J. Kalt propose to define the depth of the gap taking into account 4 parameters: the structure of relations of power (according to informal norms and formal institutions); the responsibilities of power structures; the place of organs of authority in the social structure; and sources of power (Cornell and Kalt 1995, pp.405-406). However this approach in analysis is mainly applicable to political institutions. The comparison of basic norms in each sphere of activity seems to be more prospective. For example, the depth of the gap between formal market institutions and quasi-market informal norms in Russia can be determined by 3 parameters: the level of trust between the economic subjects; the ability of the economic subject to feel sympathy and empathy; and the degree of their behavior rationality.

All three mentioned parameters show a substantial gap: the requirement to trust only close and familiar people implies distrusting society "at large." The same can be concluded of sympathy. The requirements relating to the value-rational behavior substantially differ from those of the goal-rational type. The differences may be better illustrated by using G. Simon's conception of bounded rationality (Simon 1978, pp. 10-12). The individual with a bounded rationality is unable

1. to gather all the information that is necessary for making a decision in a certain situation;
2. to process the gathered information in a proper way.

And it is namely values that determine the amount of gathered information as well as the choice of the goals and means for their achievement. The existence of such gap substantially increases the cost of institutional reforms. Apart from "start-up costs" (I) and bureaucracy maintenance costs (S), here occurs the specific cost of bridging the gap between institutions (G). Even the costs (S) are much higher than in cases where the vectors of the development of informal norms and formal regulations agree: as soon as people follow formal regulations only provided it is impossible to escape from legal sanctions, the bureaucracy maintenance costs are carried by less economic subjects. This implies a heavier tax burden (S2) for each of them. In other words, the gap prevents economic subject from saving money due to the large number of tax-payers.

The (G) costs include:

(G1) The transaction costs that occur as a consequence of the coexistence of informal and legal principles of coordination. In contrast to production costs, transaction costs are equivalent to the coefficient of friction within the economic system (Williamson 1985, pp. 18-19). General uncertainty about the behavior of the partner who may follow either informal norms or formal regulations increases. The risk of opportunistic behavior, i.e. deviation from the initial agreement by one of the parties in prejudice of the other increases as well. Indeed, if the economic subject follows formal regulations, the partner's reference to any of informal norms (or vice versa) will be considered an opportunistic act (Thévenot 1989, pp. 150-151).

(G2) This element represents the formal regulations expansion costs. Enforced replacement of informal norms with unwelcome formal institutions causes an increase in supervision costs. If no gap exists, the State in certain situations may simply implement the appropriate informal norms. In our case, the State has to embed formal regulations and closely observe economic subjects. This happens, for example, when the moral norms are substituted for specific regulations that in the case of non-compliance with their requirements implement legal sanctions. In Soviet society, non-compliance with the norms of predominant labor ethics resulted in the growth of the ideological apparatus and an increase in the number of communist party functionaries and propagandists (Shlapentokh 1989, pp. 106, 108). People's reluctance to participate in formally organized social life has transformed the ideological supervision into a profession (Ibid., pp. 116-119). Therefore, the increase in the number of bureaucrats in comparison with that of the total population highlights the gap and increases the (G2) costs. For example, during the reign of Peter the Great,

the number of bureaucrats grew three times faster than the total population (Akhieser 1991, vol. 1., c. 137).

(G3) Illegality costs originate in a situation when both interacting parties choose the same -- informal -- norms to follow. In this case the requirements of the law are, at the best, ignored, or, at the worst, violated (the last situation becomes specifically actual if the articles of the law fully contradict the requirements of informal norms).

Illegality costs consist of:

(G3.1) The cost of escaping from the sanctions implied by legal regulations in the case of their violation (de Soto 1995, pp. 191-192). It comprises the cost of consultations on avoiding taxation, the cost of a double accounting systems and bribes as well as the cost of lost opportunities in business, advertising etc.

(G3.2) The unavoidable transfer of a part of net profit in favor of legal institutions (Ibid., pp. 194-195). Despite the fact that legal establishments are "put aside" and none of their services is used in the course of interaction, a part of the profit of each economic subject is paid out in the form of an "inflation tax" or of other indirect taxes. For example, while the cigarette vendor may not have been registered, he pays the indirect access tax when buying from a wholesaler anyway. As a result, the "informal" economic subjects that gain no support from legal institutions, pay the State a part of their profit.

(G3.3) The cost of limiting transactions to a circle of well acquainted people. Informal norms are based on the application of social sanctions that are only valid within local groups and communities. Potentially more beneficial transactions initiated from elsewhere are not considered, simply because in this case deceit or opportunistic behavior are highly probable. The minimization of risks maximizes the probability of missing favorable opportunities. This is illustrated by Russian enterprises that prefer to hold on to old, Soviet-time links to certain suppliers, customers and banks. In 1994, 70-80% of enterprises favored the former ties (Dolgopiatova 1995, pp. 172-173), and the communication between their directors was organized according to the specific corporate ethics of directorate (Kharkhordine 1994, p. 29).

(G3.4) The costs of subordination to informal institutions. The role of formal institutions in providing interactions is taken over by informal i.e. the Mafia structures that implement not the law but informal norms. For example, the Mafia provides trust in cases when this can not be done by the State and the parties of an interaction do not know each other (Gambetta 1988, pp. 128-130). If a conflict occurs, the Mafia fulfills an arbitration function, preserves informal proprietary rights and prevents interaction from intrusion by "non-organized" criminal elements (Podlesskikh and Tereshonok 1995, pp. 191-193, 203-205). The Mafia charges for its services, and thus supports its apparatus that serves as an

alternative for state institutions. There are two reasons why Mafia services are expensive: firstly, the regional principle of the Mafia organization limits the number of deals and makes it impossible to save on the bases of large scale operations. Secondly, the fact that the Mafia is well informed about the conditions of informal interactions allows it to conduct a discriminating monopolist policy and "enter the deal" rather than to use standard "tariffs" (Gambetta 1988, pp. 136-137).

(G3.5) The cost connected with personalization and temporary character of informal regulations. Informal norms are usually sufficient to provide short-term and middle-term transactions of the buy-sell type. Neither informal norms nor the Mafia can guarantee long-term protection of interests, for example, in the case of long-term investment. Personalization of relations – meaning their limitation to participants' lifetime or to that of their closest relatives – as well as their localization prevents from the capitalization and the resale of resources. The same situation applies to complicated financial market transactions, the procedures of risk sharing etc. (Olson 1992, p. 65). This means that only comparatively elementary and short-term deals are possible within the framework of informal norms.

(G4) Costs that are internalized by economic agents. The coexistence of two different normative systems gives rise to a situation where the individual has to demonstrate an affiliation with formal regulations on the one hand and implement informal norms in his daily life on the other. Here we observe the problem of "double mentality," i.e. "public demonstration of adherence towards socially predominant ideals and norms that may not correspond to inner individual beliefs and even contradict actual behavior" (Khlopin 1994, p. 51). In such conditions the preservation of the individual "self" can only be provided by

1. mediation culture and
2. formal guarantees of the inviolability of the private sphere, in fact, the only place where the individual can stay himself.

However, the results of sociological survey testify to the fact that 84,4% (1999) of respondents do not count on any legal protection in their interactions with the State. 60% of respondents would like to implement their rights but are sure that they would not be allowed to do so. As a result, the danger of losing one's self as well as the rate of mental illness increases (it would be appropriate to recall the bright interpretation of A. Bek's novel "The Promotion", offered by G. Popov in his review published by "Science and Life" magazine in late 80-s).

The total cost of institutional reforms in the case of society with the gap between formal regulations and informal norms can be presented as:

$$T2=I+S+D=I1+I2+I3+I4+S1+S2+G1+G2+G3.1+G3.2+G3.3+G3.4+G3.5+G4,$$

where the I4 and S2 costs substantially exceed the costs of the same type in the case of a concordance of the vectors of informal norms and formal regulations. According to our vision, the second type of reformation is characteristic of contemporary Russian society. Thus, the economic subjects have to carry all of T2 expenditures, which may be separately calculated for each of them as well as on a macroscopic level. However, when turning from macro to micro analysis, a minor correction in approach is required: for an economic subject taken separately the I1, I2, I3 and G2 costs express in growth of the S1 and S2 costs. The proposed methodology can offer an interpretation for the majority of indicators of social and economic decay. For example, the recession of production can be caused by the G1, G3.3 (mutual non-payments and the high cost of searching for a new partner) and G3.5 costs (investment crisis: the fact that banks lose the interest in the "real sector" of economy, among other possible reasons, may be originated by the lack of legal instruments of pay-back control and loan usage supervision).

7. The search for a way to concord the vectors of the development of formal regulations and informal norms: Is there a way out of the crisis?

Is it possible to reduce the cost of transition to market economy, in other words, can institutional reforms in Russia turn to the first variant of development? The first variant implies the search for new countries – institutional exporters. Until recently, as has been shown, institutions have been exported mainly from the USA. At the same time, not American but Western European experience is considered by respondents to be the most helpful one for Russia (the American experience occupies the fourth place after Russian (2) and Slavonic (3)). In practice it means that more attention should be paid to the French, German and Scandinavian institutional systems. Institutions that exist in these countries may better correspond to the predominant informal norms in Russia. However, the answers to the next part of the questionnaire made us doubt the success of a simple import of institutions regardless of how well such institutions might be chosen. The majority of the respondents (51,1%, 1999) tend to state that Russia has its own distinctive way to develop, while only 44,5% vote for using foreign experience. Most probably, a successful strategy of institutional reforms would mean something more than just an appropriate choice of institutions to import. For example, it may be required to create a national market model that will substantially differ from the classic Western model based on market convention. As one of the features of this new model we may have to accept the localization of market transactions in the framework of existing social networks. In this aspect, the Russian market may have much in common with the corporate capitalism of countries of South-Eastern Asia (Granovetter 1994, pp. 87-88).

The lack of efficiency in the allocation of resources (resources fall into the possession of agents that belong to a definite social structure and are capable of optimal utilization of resources) is partially compensated for by its high adaptive efficiency, i.e. the ability to function in a situation with an uncertain and rapidly changing environment. The necessity to quickly "recombine" property in case the new circumstances occur leads to "erosion" of proprietary rights within social structures and gives priority to informal proprietary rights (Stark 1996). In the same way, the implementation of existing communal norms of behavior provided the successful establishment of the local agricultural markets in China (Hermann-Pillath 1994, pp. 232-234). The creation of national market model leads one back to the idea of the institutionalization of informal norms, however imperfect they may seem in comparison with classical market institutions. In this case, the problem of the lack of a mediation culture can be solved through localization of formal norms.

However, there exists one more variant of institutional reforms that implies the establishment of a market the features of which are very close to these of the classic one. Such approach is based on attempts to change informal norms through reforming formal institutions. In this case, formal institutions do not instantly establish an effective market, but initiate the transformation of informal norms. Here we are talking about using feedback in the interaction between formal institutions and informal norms. As an analysis shows, the development of the illegal institutions of drugs market is determined by dynamics of the legal institutions that supervise this sphere of market (Turvani 1994). The dynamics of illegal institutions in this case depends on the dynamics of legal ones, and here originates the opportunity to influence the evolution of informal norms.

In order to verify this hypothesis we studied the norms followed by prisoners in their everyday life. Our survey consisted in written questioning among the prisoners in 43 penitentiary institutions of 10 regions of Russia (1310 respondents, in period from 1996 till 2001) and a series of focused interviews (41 respondents). The situation registered by our survey was formed after the new legislation on keeping convicts came in force. Unfortunately, the lack of information on the same topics for the period before such legislation will only allow us to guess the direction in which informal norms evolved (though our assumptions have been partially confirmed by focused interviews with convicts sentenced to long-term imprisonment). The survey indicated, that the liberalization of imprisonment conditions, assuming the prisoners' right to information, meetings and scheduled meal provided for the liberalization of predominant informal norms. Though the trust-based relationships between the convicts have been still personalized (only 13,7% of the respondents trusted people), some of the answers testified to the progress even in

comparison with the informal norms that predominate the relationships of criminals outside prison.

A dialogue and search for an equilibrium of interests as the means for resolving conflicts were mentioned most frequently (31,2%), while only 19,9% intend to use force. While in prison, the orientation on compromise and respect for other people's interests prevails over other requirements to friends: responsibility for one's words and actions was mentioned by 43,8% of respondents, respect for other people's opinions – by 20,4%. In comparison with that after dismissal, solidarity in prison is understood more rationally: 28,5% took solidarity as confidence in reciprocal assistance from those who have been assisted today. On the contrary, solidarity after dismissal would be judged as an absolute value that does not depend on any concrete circumstances.

The attitude of the convicts to the institution of informal authority/leadership is most illuminating. The more tolerant attitude of the administration of the prison to those leaders that do not deny cooperation in any form, changed the convicts' requirements to informal authorities and even initiated the development of the institution of informal leadership towards depersonalization: fairness represents the second of 14 requirements to informal leader (the common sense – the first), the respect to opinions of others – the fifth. To compare with strength – the 9th, and the denial of any contacts with administration that shared 11-13 positions. Provided that the evolution of informal norms will continue in this direction, informal leaders have chances to start fulfilling the functions of common arbiters or even arbitration tribunal (the depersonalized institution). Indeed, while the convicts' relationships with their surroundings were still of an affective nature – 58% of the respondents would rather not keep relationships with helpful but annoying fellowman, -- the attitude to an informal leader was depersonalized: 57% of the respondents were ready to admit the authority of an unpleasant person!

This helps to understand why the convicts trusted the procedures of decision-making that is in the informal leader's competence: while only 30% of free people thought that they actually executed their right to participate in country governing, 43% of the convicts thought that they could influence the decisions made within their environment. 30,3% of the convicts stated that such decisions either corresponded to or did not contradict their own interests. In the list of institutions which gained the trust of the convicts, the institution of informal leadership was put on the third position after the institutions of the family and the Church.

These facts were mentioned not in order to praise the institution of informal authority or norms that are followed by convicts*. We can presume that more representative audience might have supplied different data. However, our basic thesis that emphasizes the possibility to influence informal norms through changes of formal regulations has been verified. Undoubtedly, though this scheme of the development of institutional reforms allows to avoid the costs that occur in the case of institutional gap, it represents the most complicated and long one. There is a need to gradually, by tests and errors approach modify legal institutions in order to provide the development of quasi-market norms towards market convention. And then, after a certain period of time, it will become possible to begin legalizing informal norms. Such a strategy of institutional reforms seems to have more prospects in the sense of achieving the ultimate goal, i.e. the establishing of efficient market and reducing of the costs of reforms.

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ТРОШКОВИ И ПЕРСПЕКТИВЕ РЕФОРМИ У РУСИЈИ: ИНСТИТУЦИОНАЛНИ ПРИСТУП

Резиме

Висока цена коју је Русија морала да плати за тржишне и демократске реформе постала је опште место како у говорима политичара опозиције ако и у саопштењима власти. У сваком случају оне ретко указују на више од очигледне чињенице економског пропадања, дубоке стратификације друштва и кризе неплаћања. Свеједно, остаје нејасно да ли ови разни индикатори могу бити "сведени на заједнички именитељ". *Природа* цене која се појављује у процесу реформисања друштва се не дискутује. Да ли су ови трошкови субјективне природе – индикација тактичких грешака у политици реформи – или постоје објективни разлози цене реформи који су независни од личности политичара?

Кључне речи: демократске реформе, цена реформи, личности политичара