

Economic Theory

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**INSTITUTIONAL CONDITIONALITY
OF THE ENDOGENIZATION
OF ECONOMIC DEVELOPMENT**

Abstract

At the end of the XXth century, in the countries of the former socialist camp, the capitalist reforms of the fundamental content of the principles of ensuring the right to liberty were carried out, including the economic one, that was realized in accordance with the existence and protection of the rights for a private property. This choice was made because there was a fundamental desire to overcome the dependence on the leadership of the political sovereign, which, in fact, ensured the receipt of «rents» through the implementation of a centralized management system on a planning and distribution basis, restraining the desire to gain freedom by providing opportunities for self-realization. In place of the ideology of the political «sovereign», the new ways of human activity coordination had to come, based on the principles of the ideology of liberalism. At the initial stages of reforms, the problems of institutionalization of activity of both the state and business, remained out of attention, since freedom was «above all».

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Capitalism, that develops without control and restrictions, is guided by a single criterion – by the private interest of the strongest and remains hostile to any form of public interest of the majority. At the same time, the development of the social institutions requires the formation of an institutional space for the implementation of the civic initiatives and the protection of freedoms from the manifestations of power and the weakly controlled monopoly organized business in the limitation of the civic activity. For this reason, in the process of development of society, the state should establish the long-term social mechanisms not only to consolidate the new spirit of capitalization and further economic growth, but also development through the social mechanisms of the social space that will not break, but will stabilize the society on the basis of the social values.

Key words:

State, private institutions, capitalism, liberal reforms, social institutions, social space.

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Given Locke's definition of what civil society «... not only preceded (the state – *V. H.*), but it had actually created the state in a deliberate attempt to defend itself both internally against disturbances of the peace and externally against all comers» (Martin van Creveld, p. 225–226), and considering that «For all that he held the state as the idea (in particular. – *V. H.*) Hegel had never regarded it as the *sole* ideal, on the contrary, he had always insisted on the need for strong private institutions to maintain themselves balancing both each other and the state so as to make liberty possible» (Martin van Creveld, p. 250)¹, as regards the debts, there appears a basis for an organic unity of freedom and private property. In the capitalist mode of production, there is a lot of necessary conditions for the accumulation of private property, for independence and, at the same time, opportunities for self-realization. In these conditions, even «...Small shareholders, savers who do not want their 'money to lie idle' ... thus belong to the group of capitalists by the same token as the big property-owners... In its

¹ Besides, for Hegel's views on civil society see [2, p. 141–147, 161–175].

broadest sense, the capitalist group thus encompasses all those who possess a property income» (Boltansky, Chiapello, p. 38). But this is far from being the only characteristic feature of capitalism. In its basis, first of all, are the processes of commodification, due to which capitalism is able even to «... commodify desire – especially the desire for liberation – and hence to recuperate and supervise it» (Boltansky, Chiapello, p. 731).

Under capitalism, not all the population belongs to the capitalist group, but at the same time it retains the ability keep friendly relations even in spite of the desire for freedom, which is the exact reason why «... contrary to prognoses regularly heralding its collapse, capitalism has not only survived, but ceaselessly extended its empire, it is because it could rely on a number of shared representations – capable of guiding action – and justifications, which present it as an acceptable and even desirable order of things: the only possible order, or the best of all possible orders» (Boltansky, Chiapello, p. 45), and even in the current conditions of mass precariatization of the able-bodied population, which is basically alienated both from the state and from business. This means that important and necessary is the new question about the legitimacy of such type of freedom, which, in our opinion will be spreading in the world of relations (for details see 6). According to Luc Boltansky and Eve Chiapello, under the influence of criticism, capitalism changed its ideology over time, and even the fact that it is capable of commodifying even the desire for freedom (which apparently undermines even the foundations of such a system) is justified, in particular, in the introduction capitalist reforms in the countries of the former socialist camp. At the end of the twentieth century, the reforms were carried out in accordance with the fundamental methodological provision regarding the principles of ensuring the right to freedom whose implementation is related to the right to private property. This was due to fact that the driving force in the emergence of the reform ideology of the XXth century was a fundamental desire to overcome the dependence on the political «sovereign», who provided a system of centralized control, which was fundamental in reducing the opportunities for self-realization. The ideology of the political «sovereign» was to be replaced by a dominating liberalistic ideology involving certain institutional constraints to coordinate human activities. It should be noted that, at the initial stages of the reforms, the problems of the institutionalization of state and business remained largely ignored. The ideology of liberalism is dominated by the contractual system that operates at all levels of the functioning of the economy, where the right of private property is exercised in relation to the activities of a private businessman who owns one or another asset. This, on the one hand, and on the other hand, the state, both shape and ensure the operation of the contractual system, which is, in its essence, a rather complex mechanism. Take, for example, the works that describe the US contract system (Fedorovych, Patron, Zavarukhin, p.926).

The institutional limitations of the mode of production (which was new for us at that time was), was a necessary condition (along with the above mentioned one) for a successful transition, since it is well known that a capitalism develop-

ing without any control or restrictions is only ruled by a single criterion of the private interest of the strongest ones and remains hostile to any form of common interest (Callon, 1989).

Actually this was exactly the case in Ukraine (which will be discussed further in this paper). And now let us follow the logic of the implementation of the so-called transitive reforms whose main ideology was de-politization of social life, first of all via privatization, in order to sever the ties between heads of the enterprises and politicians (Boychko, Schleifer, Vishny, 1995). Meanwhile, as shown in an article (Heyets, p. 3–17, 2017), the first reform package failed to attain a desired success, which «...takes place and spreads most naturally under a specific type of economic institution ...» (Asemoglu, p. 41). The reason was that, at the first stage of the reform, no so called inclusive institutions were created. Given the fact that inclusive institutions are «...institutions that provide incentives and opportunities for innovation and economic activity for a broad cross-section of society», and «...are defined by two characteristics: first, a pluralistic, broad-based distribution of political power... and second, sufficient state centralization...» (Asemoglu, p. 41), in Ukrainian realities, the indicated signs of inclusiveness in the institutionalization of the economic space were not present. At the same time, in Ukrainian economy, certain «extractive» institutions appeared, which «...are characterized by insecure property rights for the majority... lack of freedom directed at extracting resources from the majority for the benefit of a narrow elite; a playing field tilted to favor the elite often thanks to entry barriers into businesses and occupations; and a general lack of opportunities and public services for most... Precisely because extractive institutions involve the enrichment of a small group at the expense of the rest, the rest will sometimes rise up» (Asemoglu, p. 41–43), which does not correspond to the above described spirit (ideology) of the reforms that were to be implemented.

In Ukrainian realities, capitalism developed not only without any control on the part of the state or civil institutions, but also with the direct participation of the state establishment in the interests of the strongest and most agile players. And, to satisfy common interests and at the same time to protect themselves from the uprising of others, those players produced numerous declarations regarding «people's» privatization, social obligations of the state, and other similar «obligations». Surprisingly enough, such declarations were positively perceived by the people, which further deepened paternalistic sentiments regarding the role of the state. While, in reality, the state lost control of property and lost the ability to redistribute resources to meet people's needs. The revolutionary events in Ukraine in 2004 and 2013–2014 were a vivid proof of the formation and functioning of the extractive institutions operating in the interests of the strongest whose «hostile» activities were the target of the massive protests.

The institutional transformation, which were expected to change the form of ownership by means of massive privatization, completed that task, but, in the first stage of reforms, that was almost all that was actually done. That is why, in

reality, the right to freedom was not secured, since ownership was ineffective in the absence of inclusive institutions while the dominant role of political expediency was preserved in the interests of a narrow circle of political and administrative elites. At the same time, «... The formal features of the institutional environment—the laws, polity, judiciary, bureaucracy...» which are «...crucial...» and «...a growth industry...» (Williamson, Oliver, p. 595–613) failed to meet the new system of the dominance of private property, which formed the basis for personal freedom. Therefore, no appropriate institutional framework was created to ensure a long run sustainable growth. The right of property, whose behavioral characteristics are determined by the law, is at the same time a result of certain cognitive abilities and cultural and religious preferences of the country's population. The latter factors are essentially development resources, since both the old and the new institutional theories, as is known, recognize that «institutions matter». At the same time, for the conditions of today's Ukraine, as well as for many other transitional economies, this statement is of particular importance, since in countries with a similar economy (and in Ukraine, in particular), as a result of the transformational changes that began in the 90's of the twentieth century. According to Oliver Williamson (the founder of the new institutional economic doctrine), a «window of opportunity» was opened (Williamson, Oliver, 2000).

In Ukraine, the first level of social analysis, as in other countries, is dominated by customs, traditions, codes of conduct, etc., which can be classified as what O. Williamson calls informal constraints. During the transitional period, the shift in those informal constraints was not a gradual process (as is historically usual), but a jump-like event. For Ukraine, the new restrictions opened up a series of opportunities, which could have created new formalized rules involving a wide range of rights from constitutional rights for life and freedom to the formal codification of the right of property. However, for most people, the new opportunities appeared to be purely formal, and it was mainly the above mentioned uncontrolled strongest players who were able to make a full use of them. That stratum turned out to be the new dominating social group who replaced the Communist Party and the administrative nomenclature of the past. They took control of the administrative and often political power, and violated the generally accepted social rules by imposing their own ones, where the common interest of society and the state narrowed to catastrophic proportions, which eventually led to the situation that Ukraine began to lose territory, that is, became incapable of protecting its integrity. If we rely on Locke's definition of who and how created the state, then a legitimate question arises about the role of civil society in the formation and preservation of the Ukrainian state. In the following publications on this topic, we will try to answer this question both in the theoretical and in the practical sense.

The window of opportunity for development, which arose as a result of deep transformational changes, became unique due to intentions to implement a wide range of reforms both in economic terms and in deep social transformations

in the triad of society-state-economy, which was characteristic not only for Ukraine (Heyets, 2015).

However, in reality, this widely open window of opportunity was far from what was expected, since the depoliticization of economic life through privatization and the realization of the right of people for freedom (related with property rights) is a necessary, as already stated above, but still insufficient condition for ensuring effective property rights and other rights and freedoms, or proper distribution of power and its transparency, which are the fundamentals of democracy. Much of this is due to the institutions of the state that «...to avoid tyranny, it was still necessary that government should be based on Law... but such as man... himself made for himself and wrote down in accordance with the kind of community he had in mind... As had already been the case with Hobbes, from now on law, good or bad, was simply that which the state enacted and put on the books in due form.» (Martin van Creveld, p. 227, 2006). At the same time, “no individual, no country, no people, no history of a people, no state is like any other. Therefore, the true, the beautiful and the good are not the same for all of them. Everything is suffocated if one’s own way is not sought, and if another nation is blindly taken as a model.» (cited in 1, p. 240–241). Under such conditions, Ukraine faced, on the one hand, the need for reforms with exogenously set coordinates (involving, in particular, the right of ownership), and, on the other hand, the need to exercise the right to property, which should be protected by some new mechanism determined by the new state, where the laws, judicial authorities, and bureaucracy are organized into appropriate institutions that really matter and are a «growth industry». This country now should have independent courts, which in reality are still absent after more than 25 years of reforms. In addition, many necessary authorities of the state administration are still missing. This means that, due to market failures, (that should be minimized by the state, which, according to L. Boltanski and E. Chiapello, is a kind of device that cleans up after capitalism, the apparently market oriented Ukrainian economy is actually functioning in accordance with quasi-market laws (Heyets, p. 4–17, 2015). This was accompanied by a global trend, according to which, instead of or alongside the former centralized system that largely failed to timely implement the necessary reforms, decentralization began to intensively gain ground – by expanding horizontal relations among the population and between the population and the government due to the new communicative opportunities (supported, in particular, by ICT technologies). This means that hierarchical (and mostly administrative) networks that formerly existed in Ukraine, now, as in the rest of the world, are being replaced by distributed networks with multiple types of contacts. All that greatly enhances the organizational complexity, which in turn expands the «blind spot», since, as is well known, the population has a cognitive ability to identify causal relationships and respond to them (Goldin, Kutarin, p. 226-227, 2016). The authors point out in the same work that organizational complexity increases their number and variety, which serves as a catalyst for creativity and the emergence of new ideas. However, in the centuries-old history of development, complex organiza-

tion has often remained beyond the limits of human understanding both in terms of social phenomena and processes, and in the material world.

As expected, organizational complexity has begun to rapidly grow both in Ukrainian society and economy, since, in the window of development opportunities, as a result of the deep nature of transformations and against the background of weaker hierarchy of the previous institutional space, the declared inter-related triad (that includes the right to life, the right to freedom and the right to property) generates a diversity in the institutional organization. At the same time, the population's cognitive ability failed to recognize the effect of internal and external forces due to their largely contradictory and complex nature. This resulted in rapid socio-economic changes that violated the terms of the agreement existing in the previous social system that used to compensate for the low capacity of the state authorities institutions to generate new institutions in response to the ongoing processes. This did not allow realizing the new opportunities opened up in the window of reforms, and created new threats that began to materialize one after another against the background of intensive polarization between wealth and poverty. In addition, in the light of the state's institutional weakness, according to Nobel Prize laureate O. Williamson, there appears (and intensifies in the conditions of uncertainty) *people's propensity* to opportunistic *behavior* when they *tend to use cunning and deceit*, in spite of the norms of morality (Oliver, Williamson, p. 44–52). As a result, people ignore restrictions, especially if we consider that there are sufficient opportunities for this due to the institutional weakness or even absence of inclusive institutions and active action of new and powerful extractive institutions. Nobel Prize Winner J. Akerlof argues that, under certain conditions, on the one hand, opportunistic behavior is observed in the markets and, on the other hand, opportunism as limited rationality extends to the relationship between *man and the state* (George A. Akerlof, p. 488–500, Aug, 1970).

As is well known, the institutions opposing to *opportunism* include the following:

- community traditions;
- formal rules and laws;
- unformal rules;
- «acumen» (Ausin, p. 142, 2017).

At the same time, it should be noted that «acumen» can lead either to opportunism, or to original decisions, which, in our opinion, happens seldom or *not so often*, if a person faces a complex organization that is either substantially changing or growing against the backdrop of major shifts in the social, socio-economic and humanitarian spheres, which is the case in Ukraine. Under such conditions, it may become impossible to observe the existing laws (which in

many cases are simply missing), which threatens the stability of both society and state.

In society, according to Mansour Olson, social activity may strongly depend on the activity of social groups with *big* and *small* interest, and the mechanism of its action is *the theory of collective action* of these groups. If the actions of those groups are the sum of their mutual trust, in case of their high level, the scale of trust based social activity corresponds to an economic upsurge (Olson, p. 174, 1995). Against the background of the existing high level of mistrust in Ukraine, in particular to the institutions of the state, one should not expect a long-term economic upsurge in this country (Heyets, p. 15–30, 2017).

In the course of the reforms, we began to minimize the activities of the authoritarian state, but the connections between groups and individuals did not weaken, but intensified, with signs of increased chaos, as the institutional constraints of the past system disappeared, and the new inclusive ones were either absent or extractive.

All that led to the distribution and redistribution of property and budgets in favor of certain aggressive groups. The restrictions on distributive activities of individual groups disappeared, and the aggressiveness of those groups could no longer be restrained by the state. In this context, it is important to remember that, according to Hernando de Soto, private property is unproductive when it is illegal or semi-legal, (Ernando de Soto, p. 272, 2004) that, actually was confirmed in Ukraine.

As a result, firstly, Ukraine's economy has undergone an extraordinary recession, which during 25 years of reform was never overcome. Secondly, there was no desirable advancement towards the elitism of Ukrainian society, which would provide the majority of the population with largely equal opportunities as to management and access to material goods. Not only failed the members of Ukrainian society to advance in the above mentioned direction, but an enrichment of a small «elite» group took place as a result of uncontrolled access to resources. Thirdly, in Ukrainian realities, power has been often obtained and then exercised by incompetent or low competent people, since, according to a study carried out by the Institute of Sociology of the National Academy of Sciences of Ukraine, in 1996, only 12.0% of poll respondents had sufficient modern political and a mere 9.7% had sufficient economic knowledge (Castells, p. 543–544, 2016). Earlier academic surveys on the topic are not available, although these data indicate that during the first stages of reforms, the population had a rather high shortage of knowledge necessary to successfully launch activities that ensure individual independence on the basis of commoditization. Given the construction of the new spirit of capitalism via «its entrenchment in enduring mechanisms» (Boltansky, Chiapello, p. 873, 2011), in order to ensure the inclusion of increasingly wider range of people in the processes of capital accumulation, expanding the processes of commoditization, in order to maintain social compro-

mise and hence stability in the country, it is important to simultaneously ensure the formation and development of so-called new format social institutions, since the old ones are mainly either already destroyed, or often, due to their dysfunctionality, not suitable for performing their functions according to the requirements of time.

We proceed from the assumption that social institutions are a form of institutionalization of the social space in which there are stable social norms formed on the one hand based on the traditional social values laid down primarily in culture, customs, traditions, and religion, and on the other – in the environment of non-state civic initiatives that can be both normalized or formed in the network space. Thanks to them, society should be consolidated and the alienation the opportunistic behavior of the general population from the state and from business should be overcome. Actually, in this way (through the institutionalization of the public space via the formatting of social institutions), it is possible to overcome opportunism and limited rationality in people's behavior, as has been said above, referring to the opinion of J. Akerlof. And it is exactly in this way that those conditions that motivate opportunistic behavior towards the market and the state should be overcome. New social institutions are the basis for overcoming both the social exclusion and the antagonism between society and state, which in turn provides a basis for further development of democracy not only in terms of the functioning of its representative principles through participation in elections, but also in terms of overcoming excessive technologization and manipulations in the election process. The development of social institutions requires the formation of an institutional space and its legislative filling, which opens opportunities, on the one hand, for the implementation of civil initiatives, and on the other – for protection from those authorities who try to limit civic activities. Thus, in the society, the state will lay long-term social mechanisms aimed not only at consolidating the new spirit of capitalization and further economic growth, but also at developing, through the above mentioned social mechanisms mentioned above, the so-called social space, which would not loosen but stabilize the society on the basis of the social values inherent in the people of our country. In this way, we not only will become even freer over time, but we will preserve, and not lose, our traditional values. And paradoxically, but a key role on that path should be played by the state that, for its own development, should carry out so-called social construction, not only by creating proper conditions for but also by directly participating in the formation and development of social institutions to improve the society's social structure, despite the natural dialectical contradictions between the personality and the state (which often include a key for their solution in their basis). The key factor in this process, along with the accumulation of necessary political and economic knowledge, will be the use of the above mentioned informal constraints that arose at the first level of social analysis in accordance with the traditions associated with the deep historical consciousness that together constitute the «cultural code», which, according to J. Alexander, determines or forms, in the end, the course of political processes in the country (Alexander J., 2013), especially if

we consider that «... a majority of citizens in the world (by the way, in Ukraine as well – V. H.) do not trust their governments or their parliaments, and an even larger group of citizens despise politicians and political parties, and think that their government does not represent the will of the people.» Strange as it may seem, but «...This includes advanced democracies, as numerous surveys show that public trust in government and political institutions has substantially decreased in the past three decades»(Castells, p. 318, 2016). Taking into account these research results, in terms of the formation of sufficient conditions for the success of development, it is necessary to elaborate state rules and laws – first and foremost in accordance with the community's traditions, which will fill with a the new content the development of the institutional space on the basis of political trust towards its inclusiveness and thus overcome corruption, whose level, according to M. Castells, is the most significant predictor of political trust. A prerequisite for the success of such a development path is, first and foremost, the nation's potential embodied in socio-cultural determinants with inherent features of the national character (Gontmakher et al., p. 175–200)², which together constitute the nation's cultural code of the nation. A proper development leads to equality in the relations between the state, business and the voters, which is a basis for the success of both economic activities and reforms. In addition, research by R.Putnam has shown that civic participation and interpersonal trust promote social and political trust, which is closely correlated with each other (Putnam, 2000). In our opinion, the necessary result is achieved on the basis of political and economic competition, since the latter forms a basis for the institutional conditionality, or, as is sometimes argued, a necessary pressure on «activists», who ensure the accumulation of capital, in order to prevent, on the one hand, the formation of a new medieval age with its inequality in many aspects, or any other crisis of democracy, because of the «... growing distance between belief in political institutions and desire for political action that constitutes the crisis of democracy» (Castells, p. 318, 2016).

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² In more detail, for a characteristic of a successful model, for example the Swedish one, and its social conditions for modern economic development, see [22, p. 175–200].

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