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INFLUENCE OF ADMINISTRATIVE REGULATION ON THE EFFICIENCY OF BUSINESS ACTIVITIES IN THE REGION¹

The article discusses the theoretical issues of the formation of the administrative regulation mechanisms for business entities. The necessity of the further development of theoretical and methodological base and the application tools for the design of business environment is proved. This can stimulate the growth of business and investment activity in the Russian regions and municipalities. The authors identify two types of government structures influence on the business entities, differentiated by the nature of the targeting impact on the economic activity of business structures – the administrative pressure and administrative assistance. It is suggested that in practice, high cost implications for compliance with all regulation requirements as well as sanctions for the violation of these requirements create preconditions for the development of informal interaction between entrepreneurs and the representatives of regulatory bodies. Therefore, businessmen try to minimize the costs associated with the implementation of formal administrative requirements, rules and regulations by personal arrangements. A mathematical model for the assessment of the informal interaction between business entities and certain officials of control supervisory authorities is proposed. It allows to determine the range of benefits for economic entities from avoiding the implementation of administrative norms, requirements and rules. It is concluded that unreasonably high level of costs for the implementation of formal administrative requirements rules and regulations by business entities composes the economic basis for the reproduction of informal relations. This determines mutual benefits for a number of entrepreneurs and a part of bureaucracy from various schemes of informal interaction.

Keywords: administrative control, business entities, business, administrative costs, informal interaction, administrative pressure, business environment, power structures, control and supervision activities, excessive formal administrative requirements

Introduction

Nowadays, Russia has been working on improving the system of state regulation of business activities and reducing the administrative pressure on business entities. Vigorous development of business regulation at federal level practically involves the reduction of administrative pressure on business². The administrative reforms optimizing the system of providing state and municipal services to business entities are in progress, the Institute of regulatory impact assessment and expertise of normative legal acts is working hard and successfully at the moment. The ASI project "National entrepreneurial initiative on the improvement of investment climate in Russia» started and currently 11 roadmaps in various areas related to improving the investment and business climate in the regions are being realized. The main objective of this ambitious project is eliminating the administrative barriers for small and medium enterprises and, therefore, reducing administrative costs.

However, despite the efforts made by government such as administrative reforming, the implementation of measures as part of the national entrepreneurial initiatives, etc. the business environment of our country in general remains quite aggressive, and institutional support continues to be characterized by their instability, "mobility" and inconvenience [1, 2]. As an example, we can tell that every year there are about 22 thousand of normative-legal acts to be introduced and many of them affect the business activity³. Moreover the real impact parameters of the state (municipal) authorities on entrepreneurship [3] remain uncertain [4, 5] and vary greatly across the regions [6], as evidenced

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² Reducing the barriers at the federal legislation level, pronounced by V. V. Putin at the meeting of ASI SB on the 14th of January, 2016: I would like to repeat: many barriers in Federal legislation were taken away and now it is very important or ensure correct use of already approved norms at local level, and develop the best practices of interaction with entrepreneurs for all the country. Retrieved from: <http://www.kremlin.ru/events/president/news/51167> (date of access: 21.01.16).

³ About measures of developing small and medium business in the Russian Federation. Report of the State Council of the Russian Federation. Retrieved from: <http://new.opora.ru/images/files/Doklad%20k%20gossovetu.compressed.pdf> (date of access: 12.01.16).

by the data of the National rating of investment climate in the subjects of the Russian Federation, its results show that the regions with comparable socio-economic potential and a similar configuration of the state-political system, seriously differ by the parameters of the investment climate and by indicators of the efficiency of business environment institutions (Table 1).

In our opinion, such differentiation of regions by business activity conditions in formally the same institutional space is explained by spatial specific characteristics of the institutional configuration of the regional business environment. However, we believe that the institutional configuration of the regional business environment is a set of interrelated and interacting basic and additional regional formal and informal institutions determining the business relations, organized and structured in a certain hierarchy combinations defining together the rules and restrictions of economic behavior and affecting the payments pattern [7] of business entities within a regionally spatial business system. In general we can talk about a regional format of the institutional business environment, including a set of political, social, legal rules, and informal norms [8, 9], determining the business relations in the region, and their interpretation and application in business practices with the emerging nature of interaction between basic and complementary regional institutions and stakeholders [10].

Table 1

PFA regions within the National rating of investment climate in subjects of The Russian Federation for 2015

No.	Region	Rating of the region in national rating of investment climate in subjects of the Russian Federation	Rating of regulatory environment*	Rating of institutes for business	Rating of infrastructure and resource	Rating of small business support
1	Tatarstan	1	A	A	A	B
2	Ulyanovsk	5	B	A	C	C
3	Chuvashiya	9	A	C	B	B
4	Penza	11	D	A	C	A
5	Mordovia	24	B	A	C	D
6	Kirov	25	B	C	C	B
7	Mari EL	29	C	A	C	D
8	Bashkortostan	40	B	D	B	D
9	Udmurt	43	C	B	D	B
10	Samara	45	E	B	C	B
11	Nizhny Novgorod	46	D	B	D	B
12	Saratov	50	B	C	E	C
13	Orenburg	53	C	D	B	D
14	Perm Krai	56	D	C	C	C

* A — the best mark, E — the worst mark

Source: National rating of investment climate in subjects of the Russian Federation // <http://www.investinregions.ru/rating>.

Therefore, we should state that, at the regional level, the rules of the game generated at the Federal level taking into account the stakeholders' interests [10] are interpreted and applied differently by various participants of economic cooperation, seeking to improve their usefulness. It is this feature that leads to significant differences [11] in parameters of the administrative control of business activity observed in Russian regions.

However, the methodological approaches to define the parameters of administrative pressure, its structure and evaluation have not been worked out yet. All these facts complicate a right estimation of the parameters of administrative impact on business entities and, accordingly, development of solutions to reduce administrative pressure on business.

Research methods

In our work, we define the administrative control of business activities is a process of targeted influence of power structures on carrying out business activities aimed at creating conditions for business entities functioning, ensuring the connection of the state or public interests (or public utility) and business community (or commercial profitability) [6, 12].

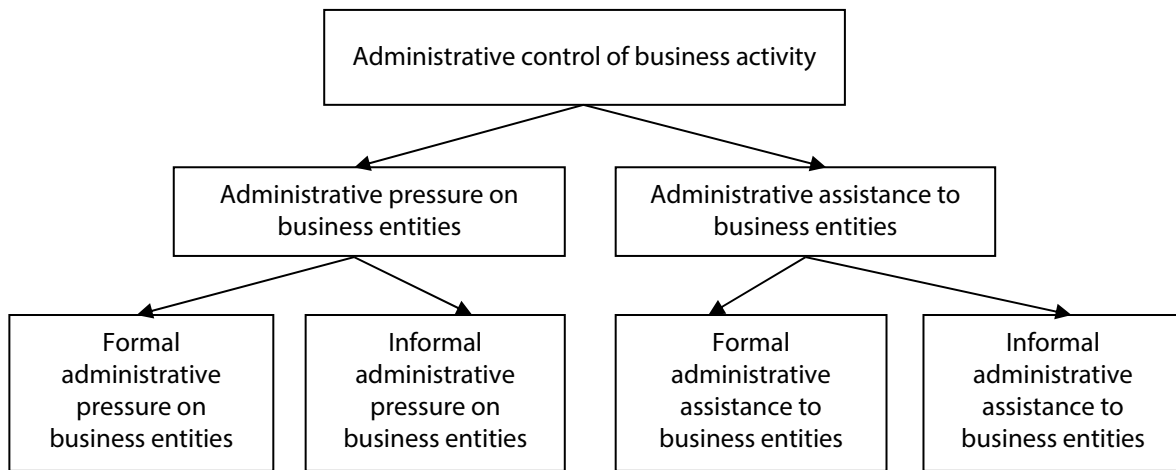


Fig. 1. Scheme of administrative control of business activity

The first peculiarity of our approach is our distinguishing two kinds of targeted influence of power structures on business entities in the system of administrative regulation of business, differentiated by the nature of the impact on economic business activity. The first power structures' impacting to be called administrative pressure on business entities and the second one is administrative assistance to business entities. The characteristic feature of administrative pressure is the increase in economic or non-production costs [13]. In this administrative assistance, we can see the impact of power structures on business entities by economic benefits of the business (for example, different types of state support) [14].

The second peculiarity of our approach is distinguishing formal and informal components in both types of administrative influence, and it allows us to assess the total impact of formal and informal institutions on the development of economic agents' activity in the regional business environment [6, 15] (Fig. 1).

In this paper, the research is based on the analysis and assessment of administrative pressure impact on the efficiency of economic business activities. The proposed approach is a further development of our research where we carried out a refinement of some concepts.

Thus, taking into account further scientific studies we propose a revised definition of "administrative pressure on business entities", defined as a totality of formal and informal requirements, standards, rules, and their use, regulating and governing parameters of economic activity of business entities established and supported by state (municipal) power in a certain area, and this implementation increasing non-productive or transaction costs of doing the business [16–18]. Thus, it is necessary to speak not only about administrative pressure on business, but also about its potential, that is, the possible range of negative impacts on businesses from the authorities.

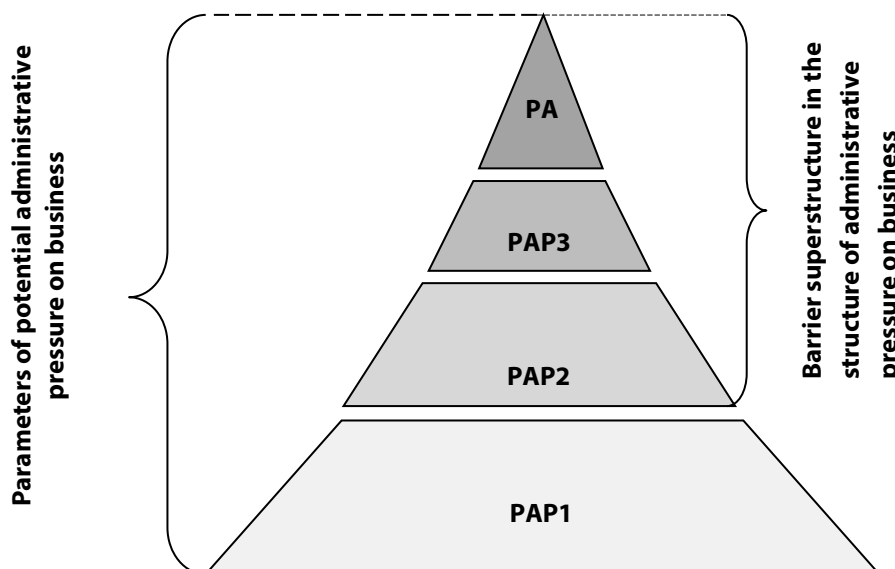


Fig. 2. Structure of potential administrative pressure (PAP) on business entities

Schematically, the potential administrative pressure on business entities is shown in Figure 2.

A brief description of the elements of potential administrative pressure on business entities is given in Table 2.

Table 2

Brief description of the elements of potential administrative pressure on business entities

Index of structural element	Description of structural element		
PAP1	Formal administrative requirements, norms and rules, regulating the functioning of business entities (administrative regulating minimum), protecting the interests of business, society and government, expressed as follows:		
	For business	For society	For state
	protecting the interests of economic entities in ensuring the business environment that allows obtaining a sufficient amount of business income (freedom of enterprise (including equal access to resources), property rights protection, protection against unfair competition, etc.)	— high quality of products and services and their safety (prevention of the infliction of life and health harm); — protecting the consumers' rights; — creating new jobs; — social guarantees for employees; — observing the environmental protection standards	— compliance with legislation by business; — sufficient amount of tax revenues to the budgets at different levels, allowing the state to fulfill its obligations to society; — competitiveness of domestic products in international markets (competitive state economy)
PAP2	Excessive formal administrative requirements, norms and rules governing the parameters of enterprise entities functioning not having an integrated significant positive effects on all the parameters specified in the element <i>PAP1</i> but significantly increasing administrative costs for businessmen. These rules and regulations may be imposed but not limited to normative legal acts after passing the procedure of regulatory impact assessment (RIA)		
PAP3	Violations of legal regulations by officials in realizing the formal procedures of administrative regulation (delays in public services or carrying out supervisory activities (administrative paperwork), the requirement of additional documents, etc.)		
PAP4	Additional informal administrative requirements, rules and regulations imposed by authorities on employers (informal agreement, various forms of corruption relations, "forced charity")		

Thus, the total capacity of administrative pressure on business entities (*TCAP*) is calculated as follows:

$$TCAP = PAP1 + PAP2 + PAP3 + PAP4.$$

The elements *PAP2*, *PAP3*, *PAP4* together form the structure of administrative barriers in entrepreneurial activity.

Moreover, we believe that the elements *PAP3*, *PAP4* largely characterize the specificity of the institutional set of regional business environment, identifying regional variations by the parameters of administrative pressure on business entities observed in national business practices.

Further, by the use of this presented approach, it is also possible to represent the structure of business expenses on the implementation of total administrative requirements, norms and rules (Fig. 3, Table 3).

According to our principle the total costs of business entities on carrying-out of administrative requirements, norms and rules (*TAC*) should be calculated as follows:

$$TAC = AC1 + AC2 + AC3 + AC4 + AC5 + AC6.$$

At the same time, the sum of $AC3 + AC4 + AC5 + AC6$ represents the monetary costs to overcome the administrative barriers.

Surveys show that entrepreneurs are currently experiencing the growth of total formal administrative pressure on business, what has an extremely negative impact on economic activities of business and, primarily, for small and medium enterprises [19].

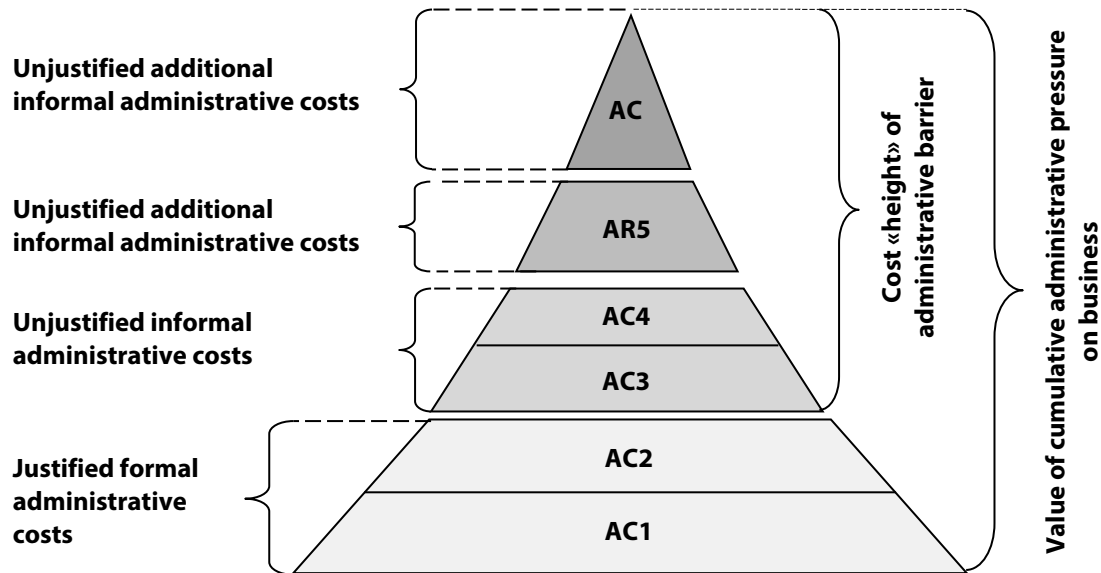


Fig. 3. Structure of business expenses on implementing total administrative requirements, norms and rules

Table 3

Elements of the structure of business expenses on implementing total administrative requirements, norms and rules

Index of administrative cost element	Description of the element of administrative expenses		
AC1	Administrative costs of the business, based on the implementation of formal administrative requirements, norms and rules governing the parameters of functioning of enterprise structures (at least a reasonable administrative regulation), which provide comprehensive protection of interests of business, society and government that can be expressed in the following effects:		
	On business	On society	On state
	protecting the interests of economic entities from the viewpoint of ensuring a business environment that allows businesses to obtain a sufficient amount of business income (freedom of enterprise (including equal access to resources), protection of property rights, protection against unfair competition, etc.)	— high quality of products and services and their safety (prevention of the infliction of life and health harm); — protecting the consumers' rights; — creating new jobs; — social guarantees for employees; — observing the environmental protection standards	— compliance with legislation by business; — sufficient amount of tax revenues to the budgets at different levels, allowing the state to effectively fulfill its obligations to society; — competitiveness of domestic products in international markets (competitive state economy)
AC2	Administrative costs of business associated with the sanctions for the violations of formal administrative requirements, norms and rules that regulate the parameters of functioning of enterprise structures (at least a reasonable administrative regulation), which provide comprehensive protection of interests of business, society and government, the results of a control and Supervisory activities of the authorities.		
AC3	Administrative costs of the business, based on the implementation of formal excessive administrative requirements, norms and rules regulating the functioning parameters of business structures that are not integrated have a significant positive impact on all elements PAD1 (these rules and regulations may be imposed, including normative-legal acts that have passed the procedure of regulatory impact assessment (RIA)).		
AC4	Administrative costs of business associated with the sanctions for the violations of formal excessive administrative requirements, norms and rules regulating the functioning parameters of business structures that are not integrated have a significant positive impact on all elements PAD1		

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Index of administrative cost element	Description of the element of administrative expenses
AC5	Administrative costs of business due to violation of the law by officials in the implementation of formal procedures of administrative regulation of activity of business entities (delays in the provision of public services or Supervisory activities (administrative paperwork), the requirement of additional documents).
AC6	Administrative costs of the business, based on the implementation of additional informal administrative requirements, norms and rules imposed by authorities are the employers (informal agreement, various forms of corrupt relations, "forced charity").

So, according to sociologic survey ordered by the Commissioner for the President of the Russian Federation on protection of entrepreneurs' rights from the 9th to 27th of February, 2015 in 83 regions of the Russian Federation with 4149 people, more than half of respondents (51.8 %) said that the administrative pressure increased in the last year. It is rather interesting to mention the fact that one in three businessmen spend more than 20 % of revenue on it, and one in four – from 10 to 20 %. According to estimates of the Ministry of Economic Development of Russia, the total volume of formal costs of business entities for carrying-out of administrative requirements, norms and rules in 10 areas of state regulation (labor and employment, sanitary and epidemiological safety, technical regulation, pension system, migration legislation, social insurance, registration and accounting of real estate objects, state and municipal purchasing, consumer rights protection, tourism) as of 2013 amounted to 789 billion rubles (Fig. 4).

From the point of view of the costs on carrying-out of formal administrative requirements, norms and rules, the situation with introducing the control on waste products seems to be very significant. According to Federal law dd. 24th June, 1998 no. 89-FZ "On production and consumption wastes" the individual businessmen and legal entities conducting waste management activities are obliged to record generated, disposed of, neutralized, transferred to others or received and also placed wastes in

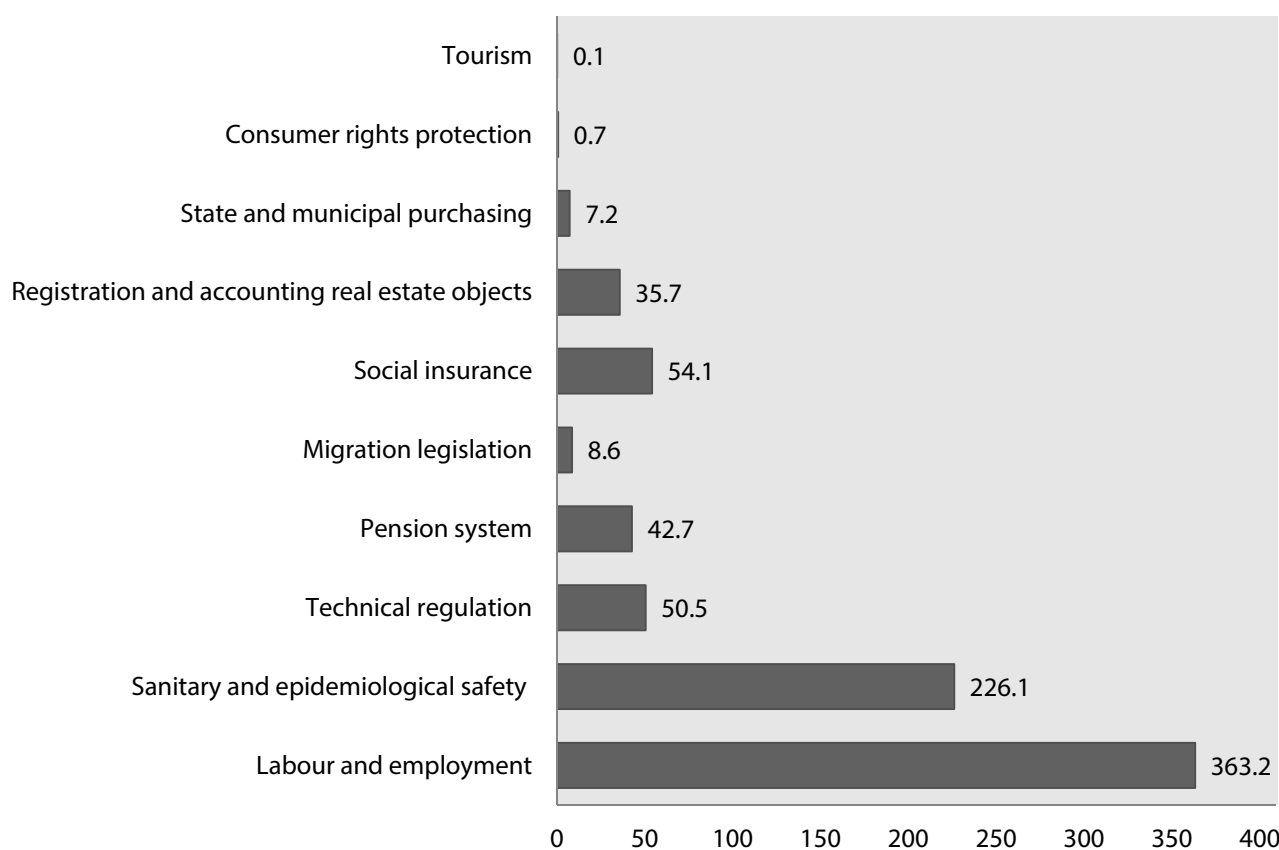


Fig. 4. Formal costs of business entities on carrying-out of administrative requirements, norms and rules in 10 areas of state regulation (bn rubles)

accordance with established procedure. Production and consumption wastes can exist in any economic activity; therefore, almost all business entities are required to keep records of this waste. As for the order of Russian Ministry of Nature dd. September 1, 2011 no. 721 "On approval of accounting in waste management", the accounting shall be made for all types of wastes of I-IV hazard classes, formed, used, neutralized, transferred to others or received from third persons, and also placed by a legal entity and individual entrepreneur for a reference period. All the data recorded in waste management are to be kept in soft form. If there is impossible to do it in electronic format all the data shall be registered in writing. An authorized person should be responsible to maintain these records. Based on the data made by Ministry of economic development of the Russian Federation, if all the entrepreneurs had fulfilled the requirements, their corresponding one-time costs only for equipment to measure the amount of waste made up 359.2 billion rubles, and annual staff costs for accounting—630.6 billion rubles. According to NISSE research public catering enterprises spend 11–25 billion rubles per year on these requirements on wastes management accounting.

Model

In general, it should be noted that the amount of formal administrative requirements to business entities is quite high. At the same time, the research investigate that in practice entrepreneurs prefer to carry a lower amount of administrative costs, due to the fact that many requirements being binding under the law in force are either not implemented or implemented formally because of their burdensomeness for business.

A huge amount of administrative requirements to the business activities associated with high costs on their implementation negatively affects the economic activities [20]. In this case, if the violations of the norms of administrative regulation to be revealed by control and supervisory bodies the business entity may be subject to serious financial penalties in volume rather financially sensitive for an individual business.

In such circumstances, we can see the development of informal interaction institutes connecting the entrepreneurs and the representatives of the regulatory bodies. There the businessmen are trying to minimize their costs on carrying-out of formal administrative requirements, norms and rules by personal arrangements, "drifting" and "payoffs". Thus, according to the NISSE study an average commercial enterprise operating in public catering system spends 20–80 thousand rubles on such "payoffs" working with Russian Federal Consumer Rights Protection and Human Health Control Service, for fire supervision by EVERCOM—40–100 thousand rubles and for licensed bodies (for dealing with alcoholic products)—25–80 thousand rubles.

Including various schemes of informal arrangements of interaction between a business entity with a supervisory body the model of expected income for evading from carrying-out of the formal administrative requirements, norms and rules regulating and governing the parameters of business activity, in the case of detecting such an evasion is presented in the form of the utility function:

$$U(D_r, a, P_n, w, R, q, k) = (1 - P_n) [D_r \cdot a \cdot q(1 - w) - R \cdot D_r] + P_n [D_r \cdot a \cdot q(1 - w) + w \cdot D_r \cdot a \cdot q - R \cdot D_r - k \cdot D_r], \quad (1)$$

where P_n is the probability of detecting and subsequent punishment of the entrepreneur who uses informal agreements, rel. units; D_r —disposable income of the entrepreneur, cost units; R —“payoff” value to reduce the costs of carrying-out of formal administrative requirements, rules and regulations governing and regulating the parameters of doing business, rel. units; q —penalty rate for failure to comply with formal administrative requirements, rules and regulations governing and regulating the parameters of doing business, rel. units; w —coefficient of penalty rate decrease as a result of informal agreements in the interaction of the entrepreneur with an official, rel. units; a —the level of formal administrative requirements, rules and regulations governing and regulating the parameters of costs on doing the business (excluding fiscal fees), rel. units; k —factor of penalties applied to the owner for the fact of informal agreements with supervisory officials, rel. units.

The economic interpretation of model (1) is in estimating the potential income of the owner dealing informally with a supervising official to lower the formal administrative requirements, rules and regulations governing and regulating the parameters of doing the business. This income includes the sum of the possible shortfall of formal administrative regulations and rules, which can be obtained

with probability $(1 - P_n)$, when the fact of informal interaction is not detected, and the amount can be obtained with probability P_n , if the fact of informal interactions is discovered and the entrepreneur has to fulfil administrative requirements in full, paying the appropriate penalty, and generally being liable in accordance with applicable law.

Taking the first derivative of the function (1) by disposable income D_r and equating it to zero after the corresponding transformations we have:

$$\frac{dU}{dD_r} = -(1 - P_n) \cdot a \cdot q \cdot (1 - w) - P_n \cdot R - P_n \cdot a \cdot q + R \cdot P_n + k = 0, \tag{2}$$

$$P_n = \frac{a \cdot q \cdot (1 - w) + k}{a \cdot q \cdot w}, \tag{3}$$

$$w = \frac{a \cdot q - k}{a \cdot q \cdot 1 - P_n}, \tag{4}$$

$$a = \frac{k}{q \cdot (P_n \cdot w - w + 1)}. \tag{5}$$

Based on formulas (3–5) it is possible to determine the parameters of the function when the potential income from evading the formal administrative requirements, rules and regulations governing and regulating the parameters of doing the business equals zero. It represents the dual balance between the interests of the entrepreneur as a subject of business focused on maximizing the profits, and as a subject being forced to carry-out of the administrative requirements and pay the statutory and additional payments imposed on economic and this entrepreneur stays "indifferent."

Here the entrepreneur rationally accepts the application of "payoff" strategy from the officials carrying out supervisory activities under the condition of

$$U(D_r, a, P_n, w, R, q, k) > 0.$$

As a result, it is possible to calculate the parameters of the probability P_n , the coefficient of penalty rate decrease w and the level of formal administrative requirements, rules and regulations governing and regulating the parameters of costs on doing the business a for a position of indifference. An example of the calculation is presented in Table 4.

Table 4

Values penalty rate decrease as a result of informal agreement of the i -th business entity with a supervisory

official, for the function $w = \frac{a \cdot q - k}{a \cdot q \cdot 1 - P_n}$, where $q = 0.5, k = 1$

P_n	a							
	0.3	0.4	0.5	0.6	0.7	0.8	0.9	1
0	0.33	0.50	0.60	0.67	0.71	0.75	0.78	0.80
0.1	0.37	0.56	0.67	0.74	0.79	0.83	0.86	0.89
0.2	0.42	0.63	0.75	0.83	0.89	0.94	0.97	1.00
0.3	0.48	0.71	0.86	0.95	—	—	—	—
0.4	0.56	0.83	1.00	—	—	—	—	—
0.5	0.67	1.00	—	—	—	—	—	—

Discussion of results

As it was shown in this presented article, very often the component of the informal interaction of business entities with the authorities is not considered in analyzing the parameters of administrative regulation of business and evaluating its effectiveness. Meanwhile, in the regional systems of business development, the interpretation and application of formal rules by interacting economic agents are influenced by informal institutions and it creates differentiation in real conditions for business activities in different regions. Omitting this factor reveals the situation when state interventions aimed at improving the administrative regulation of business often gives only formal changes in business

environment (the fact to be traced by positive dynamics of Russia's positions in Doing Business ranking), and meanwhile the real practice of business entities demonstrates serious institutional problems in the business environment, preventing the development of the full business potential of Russian regions [6].

Sum it up so far, we should note the following scientific results.

1. Many actual parameters of the administrative regulation of business activity as administrative support and administrative pressure (considering the ratio of formal and informal component) were element-wise structured and systematized, including the regional distribution, and this allows us to determine measures of creating a favorable institutional environment for business for the most problem elements in the structure of administrative pressure on business structure and significantly improve their efficiency.

2. It was determined that due to the formation of administrative pressure parameters *PAP1* and *PAP2* primarily at the Federal level the impact of regional authorities on these parameters is limited. Therefore, in practice of reducing the administrative pressure, particular attention should be paid to parameters *PAP3* and *PAP4* in the structure of administrative impact on business, due to the fact the regional authorities have the greatest opportunity to optimize and reduce the administrative pressure on business entities by generating the most efficient institutional configuration of the regional business environment.

3. It was proved that the economic basis for the reproduction of informal relations in the process of administrative regulation of business activities is a relatively high level of costs of business entities for carrying-out of the formal administrative requirements, norms and rules giving the mutual profitability for a number of the entrepreneurs and the bureaucracy, regulatory bodies concluding informal arrangements on obtaining and providing other informal services for the underestimation of the costs of following the administrative requirements, norms and rules.

4. The mathematical model of assessing the parameter of the informal interaction of the entrepreneur and supervisory official is given and it allows calculating the profitability of using these informal relationships and determining the permitted limits of administrative pressure on businesses.

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