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Patronized Goods Before and After.  
A Historical-Theoretical Analysis

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## **Patronized Goods Before and After: A Historical-Theoretical Analysis**

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### **Abstract:**

From the perspective of contemporary knowledge, this paper presents a review and critical analysis of the concept of economic sociodynamics and its continuity in theories of patronized goods, the humanitarian sector of the economy, the state and public administration developed over the last 25 years. The presence in these theoretical constructs of a common logic, based on the premise that public interest cannot be reduced to individual preferences, allows us to consider this concept and its heritage as a complex of ideas that expand the boundaries of economic analysis. The study also showed that several theoretical results obtained in the period 2000-2025 may have a more general scientific basis, relying on the achievements of modern philosophy and sociology, which led to the author's introduction of the principle of methodological relativism into scientific circulation, which "equalizes" the interests of individuals and the autonomous interests of the state. A significant part of the work is devoted to results that were not found in the initial versions of these theories. This concerns the proof of the need to return to a strict dichotomy (according to Samuelson) in the definition of public goods and the introduction of the category of "normative public goods," whose properties of non-excludability and non-rivalry are acquired in the process of targeted actions by the state, in the extreme case of the policy of amortization of private goods and services. The new results also include the construction of an equilibrium model for patronized goods, an important consequence of which is the justification of an alternative exegesis of the "Harberger triangle," which has become theoretical proof of the rehabilitation of the category of budget subsidies and the basis for its parametric model. The concluding part of the work presents a fundamentally new direction of research, continuing the general line and logic of the KES, in which relativistic methodology and the existence of autonomous state interest made it possible to define a more general content of the category of the state and introduce its new paradigm in the form of a metasystem "political power–economy–civil society," including the measurement of the social structure of the state and its balance, which have led to a new approach to the theory of public administration.

### **Keywords:**

methodological relativism, patronized goods, budget subsidy, state, power, economy, civil society, public administration



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## INTRODUCTION

It all began with the “Concept of Economic Sociodynamics” (CES), which was first published in the Russian Economic Journal in February 1997 (*Grinberg, Rubinstein, 1997*). In the summer of that year, the CES was presented at a seminar in Moscow with the participation of specialists from the Vienna Institute for Advanced Studies, the Faculty of Economics of the University of Marburg, and scientists from the Economic Institutes of the Russian Academy of Sciences. Numerous recommendations from the participants in this discussion prompted the authors to continue their work, the results of which were reflected in Russian and foreign publications (*Grinberg, Rubinstein, 1998; Grinberg, Rubinstein, 1999*). The first edition of the monograph “Economic Sociodynamics” in 2000 is considered to be the date of birth of CES (*Grinberg, Rubinstein, 2000*).

The presentation of the updated version of Economic Sociodynamics took place in January 2001 at the University of California, where, at the invitation of Michael Intriligator, a corresponding report was presented at the famous Marshak Colloquium (*Grinberg, Rubinstein, 2001*). Subsequent meetings and several truly worldview discussions with prominent American scientists—Richard Masgrave and Kenneth Arrow—marked the prospects for the further development of CES. Interest in it from foreign colleagues prompted Springer to offer the authors a reprint of Economic Sociodynamics, which was published in a revised and expanded English-language version in Germany and the United States (*Grinberg, Rubinstein, 2005, 2010*).

Memories of research and the trajectory of the formation of ideas and approaches present in CES while still in its infancy, that is, in the period “BEFORE” the creation of the Theory of Patronized goods (*Rubinstein, 2018, 2024*), and which received “AFTER”

and as a result the corresponding development in the form of a new scientific direction, gave rise to my desire to look at this history from the perspective of modern knowledge. The aim of this work is not to reminisce about past achievements or even meetings with prominent foreign scientists. It is an attempt to look at the path traveled through the lens of the present time and today's perception of the basic provisions concerning public goods, the humanitarian sector, and the economic theory of the state.

With this in mind, the structure of this work is divided into four parts, which present a review and critical analysis of the main provisions of theories of Patronized Goods and the Humanitarian sector, as well as economic theory of the state and public administration. The specific order in which these parts of the work are presented should be noted. It is determined not so much by general economic logic as by the desire to trace the “biography” of my research. This order of presentation made it possible to evaluate the results of many years of research from the perspective of contemporary knowledge and to formulate what had not been discovered in previous works.

# I

## ON THE SHOULDERS OF GIANTS

Economic theory has interpreted state activity in different ways, and by the end of the 19th century, two trends had emerged in the interpretation of its primary cause – the public interest. The German tradition, postulating the interest of society as such (*holism*), recognized the category of "collective needs" as the fundamental basis of the famous "German financial science". The English tradition, on the contrary, denied the very possibility of the existence of public interests other than the aggregate of individual preferences (*individualism*)<sup>1</sup>. Becoming the antithesis of holism in the 20th century, methodological individualism took a firm place in the mainstream of economic theory.

### 1.1. The English tradition

Its foundation, as is well known, is based on Adam Smith's classical political economy, with its inherent individualism and internal economic mechanism of the "invisible hand" (*Smith, 1776*). The final stage in the evolution of classical political economy is represented in the works of J. S. Mill, who, defending the concept of individual freedom as opposed to unlimited state control, made a significant contribution to the philosophy of liberalism (*Mill, 2006*).

It should be noted that within the framework of this tradition, following and as a result of the marginalist revolution, many difficult issues were successfully resolved, including the problems of public goods, which, despite their special properties, as has been shown, are produced to satisfy individual demand (*Samuelson, 1954*). This led to

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<sup>1</sup> It is worth noting the fair observation made by V. Avtonomov, who points out the presence in classical political economy (*Ricardo, Marx*) of the interests of a number of social groups (classes) that differ from the aggregate of individual preferences.

the development of the well-known Wicksell-Lindahl equilibrium model for public goods, a feature of which is the procedure of "vertical summation" (*Wicksell, 1896; Lindahl, 1919*).

At the same time, it is clear today that within the framework of the positivist approach, one of the main issues related to the existence of the social utility function ensuring Pareto efficient equilibrium remained unresolved. In attempts to resolve it, for example, in the development of Abram Bergson's social welfare function, the conclusion was reached that social utility is determined by a combination of individual preferences, in which value attitudes act as weights (*Bergson, 1938*). I would add that the Pareto efficiency criterion also contains value judgements (*Blau, 2004, pp. 207-210*).

In other words, research has shown that the internal mechanism of the "invisible hand" alone, without any exogenous conditions, cannot ensure optimal equilibrium, turning the function of social (public) utility *de facto* into a *normative* criterion that generates the existence of a multitude of possible optima. In the current situation, the question of social utility has transformed into a problem of public choice. But here, researchers encountered a certain setback.

After Kenneth Arrow's famous work proving the impossibility of reconciling individual preferences, in which he summarized the "Condorcet paradox" (*Arrow, 1951*), it became clear that the problem of cyclicality had not disappeared. Numerous attempts to circumvent the "dictator condition" and overcome the phenomenon of cyclicality in the process of rational social choice, based on the use of various voting procedures, i.e., options for its organization, did not yield any particular results. As was later shown, social choice "must be preceded by a social choice about how to make that choice" (*Nekipelov, 2023, 2024*). As a result, economists' attitude towards the social utility function has inevitably changed. It became clear that it only makes sense to discuss it from the standpoint of its normative content, which, generally speaking, is not very different from the holistic ideas' characteristic of the German alternative.

## 1.2. The German tradition

In this direction of economic thought, the main emphasis was placed on the needs of society as such. Here we can highlight a number of economists of the late 19th and early 20th centuries: Friedrich Herman (*Herman, 1870*), Albert Schaffle (*Schaffle, 1873*) and Carl Menger (*Menger, 1923*). Despite the well-known differences in their views, the main point on which they agreed was the emphasis on the interests inherent in society as a whole.

Schaffle, for example, writes about the existence of social needs "that cannot be met by individual members of society" (*Schaffle, 1873, p. 113*). According to Menger, "not only human individuals, who make up their associations, but also these associations themselves have their own nature and, therefore, the need to preserve their essence and develop—these are common needs that should not be confused with the needs of their individual members or even with the needs of all members taken together" (*Menger, 1923, p. 8*). Menger's words became one of the most important confirmations of the worldview paradigm of the CES, which originates from the well-known thesis that the whole can have its own special properties, different from the properties of its parts. However, one should not forget the criticism of the category of "common needs," which mainly referred to the relationship between the whole and its parts. As Horst Jecht noted, "the bearer of this need is always an individual person and never a social community taken as a whole, which, unlike the individual, lacks a living Centre capable of experiencing emotions" (*Jecht, 1928, p. 62*).

This anthropological thesis remained in the arsenal of a number of authors for a long time. Thus, one of the most authoritative researchers of public interests, Richard Musgrave, did not want to go beyond obvious oversimplification: "...since a group of people as such cannot speak, the question arises as to who is capable of expressing the feelings of this group" (*Musgrave, 1959, p. 87*). Klaus Schmidt makes the same argument in slightly different words, noting that "a community (collective) with needs is a mystical organ" (*Schmidt, 1964, p. 337*). Paul Samuelson expresses a similar opinion:

"I do not assume the existence of a mystical collective mind that allows one to enjoy the use of collective consumer goods" (*Samuelson, 1954, p. 387*).

Time has passed, and from the perspective of modern knowledge, such arguments no longer seem so convincing. As relationships between people become more complex, institutions themselves can generate specific interests for individual communities and society as a whole. With this in mind, it is worth paying attention to the opinion of Helmut Ritschl, who, while recognizing the existence of the interests of society as such, emphasizes the phenomenon of their individualization (*Ritschl, 1925*). This position is close to the thesis that a group of people can generate common needs, which are experienced not by society as a whole, but by individuals, and only to the extent that they have a sense of community.

It is precisely this interpretation of public interests that has become widespread in mainstream economic theory. It should also be noted that Ritschl's thesis, which is consistent with Friedrich Hayek's concepts of "distributed knowledge" (*Hayek, 2001, pp. 51–71, 89–101*) and Jean-Jacques Laffon's concept of the "authentic adviser" to the ruling party (*Laffon, 2007, pp. 22–23*), does not reject the existence of public interests as such.

### **1.3. Philosophical concepts**

The twentieth century changed a lot. The former arguments "for" and "against" relating to the English and German traditions, as well as the debate "individualism vs. holism," have lost their relevance. With this in mind, a quarter of a century later, it makes sense to consider the concept of economic sociodynamics through the prism of a multidisciplinary approach and more subtle reasoning characteristic of contemporary philosophy, which divides and complements the behavior of individuals and society as a whole.

As a non-isolated example, I will cite the research of Canadian philosopher and cultural theorist Charles Taylor. Demonstrating one of the possible ways of developing a methodology for social analysis, he identified what he called (*Taylor, 1989; Taylor, 2001*), which, unlike public goods, are not intended for individual consumption by their very nature. However, the main point of Taylor's work, in my opinion, is not even the

result, but the argumentation with which he substantiates it. We are talking about a completely different direction of analysis, based on the methodology of the Austrian philosopher Ludwig Wittgenstein, who enriched contemporary philosophy with the categories of thought and language (*Wittgenstein, 1994, 2008*), and the research of one of the founders of semiotics, the Swiss Ferdinand de Saussure, who demonstrated the fundamental differences and cyclical connection between language and speech (*Saussure, 2000, 2009*).

Using Wittgenstein's concept of "a background space of meanings existing outside the minds of individuals" and extending it to human relations in society, Taylor not only strengthened the arguments in favor of the complementarity of institutions and individual activities, but, more importantly, introduced the phenomenon of "common understanding" into scientific discourse - the existence of a "background basis of practices, institutions and representations" immanent in society as a social whole (*Taylor, 2001, p. 12*).<sup>2</sup>

This approach made it possible to go beyond methodological individualism and created a philosophical basis for viewing society as a bearer of special properties and even needs that can be satisfied by "indivisible social goods." By naming the phenomenon of "common understanding" as culture and applying F. de Saussure's approach to a broad class of social phenomena, Taylor identified its sole bearer – society as such.

#### **1.4. Sociological motives**

So, individualism or holism? I will start with methodological individualism. The history of this principle is not that long. And although, as Mark Blaug writes, "the very expression 'methodological individualism' was apparently introduced by Schumpeter in 1908 г. (*Blaug, 2004, p. 100*), it is still not worth starting this story with the 20th century. It is not about the term, but about the concept.

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<sup>2</sup> Illustrating the ideas of L. Wittgenstein, C. Taylor quotes the following words: "Thoughts imply and require a background space of meanings in order to be the thoughts that they are" (*Taylor, 2001, p. 10*). I would like to note the ideological similarity of this remark to Hayek's concept of "diffuse knowledge" (*Hayek, 2001*) and the process of its manifestation (*Nonaka, Takeuchi, 1995*).

Even without mentioning Jeremy Bentham, the founder of utilitarianism, and his follower John Stuart Mill, with his thesis that "by uniting in society, people do not become something else" (*Mill, 1914, p. 798*), it is impossible to ignore Knut Wicksell. He is credited with the thesis that expresses the essence of methodological individualism: "if the utility for each individual citizen is zero, then the total utility for all members of society will be zero and nothing else" (*Wicksell, 1958, pp. 72–118*). However, the absolutization of this principle, like Wicksell's thesis itself, raises certain doubts<sup>3</sup>.

In general, I would like to make an a posteriori comment on the debate between individualism and holism. Based on contemporary theory and the associated interdisciplinary approach, it should be noted that there are two questions at stake here. First, how are public interests related to the interests of the individuals who make up society, and can we always assume that such a connection exists? Second, can there be an objectively neutral criterion for determining the "correctness" of one of the alternative methodologies arising from different economic contexts?

These questions did not arise today or even yesterday, bringing the researcher back to the debate on individualism and holism, which unfolded with particular force in the 20th century, arousing corresponding interest among representatives of theoretical sociology. One of its features is that critics of holism have, not entirely reasonably, begun to derive methodological individualism from the fact that society consists of people, their ideas that social institutions are created by individuals, and that social wholes are only hypothetical abstractions (*Kincaid, 1998, p. 295*).

However, this approach was not supported by everyone. "People do not create society," writes British sociologist Roy Bhaskar, "because it always exists before them and is a necessary condition for their activity" (*Bhaskar, 1989, p.36*). Gradually, the main vector of the discussion shifted to a less radical perception of individualism.

Swiss professor Benno Verlen emphasizes that "methodological individualism does not mean denying the existence of collectivities and institutions. According to a

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<sup>3</sup> Strictly speaking, this thesis of Wicksell cannot serve as a sufficient basis for denying social utility, because with non-zero utilities "for each individual citizen," social utility may differ from any combination of them.

number of authors, it does not require agreeing with the assertion that society is nothing more than the sum of the individuals who belong to it, or that society can be reduced to individual psychology and explained in its terms" (*Verlen, 1993, p.22-51; Verlen, 2002*). Similar positions were held by the Israeli philosopher Joseph Agassi, who interpreted methodological individualism in neutral and even conciliatory tones (*Agassi, 1960, 1973*). All this points to the formation of a certain compromise.

Thus, Anthony Giddens, on the one hand, considers methodological individualism as opposed to structural sociology, but on the other hand, comes to the conclusion that structural sociology and methodological individualism are not alternatives, such that by rejecting one, we accept the other (*Giddens, 1984, 2001*). Roy Bhaskar continues this line of thought, believing that social relations are compatible with both individualistic and collectivist theories (*Bhaskar, 1991*).

Raymond Boudon, a representative of French sociology, holds roughly the same views, emphasizing that methodological individualism is a necessary but not sufficient prerequisite for the study of society, which requires the mandatory consideration of macro-sociological phenomena (*Boudon, 1988; Boudon, 1999*). At the same time, he positions himself closer to the "Centre," stipulating that "the assimilation of a group to an individual is legitimate only when the group is organized and clearly endowed with institutional forms that allow it to make collective decisions" (*Boudon, 1979*).

In this context, it is useful to draw attention to the works of Michel Crozier and Alain Touraine, a distinctive feature of which is the recognition of the duality of social life, where social structures and individual Behaviour act as equal and complementary elements of the surrounding reality (*Crozier, 1993, pp. 35-43; Touraine, 2005*). Methodologically, the research approaches of M. Crozier and A. Touraine correspond well with those of E. Giddens and R. Bhaskar and are, in fact, based on a synthesis of micro- and macro-sociological approaches, combining holism and individualism without forcing a choice of primary basis.

As a conclusion to this brief analysis, it can be said that the philosophical concepts and results of theoretical sociology outlined above seem to indicate that the

authors of the studies presented have a common answer to the second question formulated above. Judging by all appearances, the logic and results of their reasoning are based on an internal assumption that there is no objective criterion for choosing the "right" methodology. Without requiring adherence to either the English or German tradition, the modern understanding of the Behaviour of individuals and the state, and their interactions in society, creates serious prerequisites for ending the "individualism vs. holism" debate. We are talking about the introduction of a new principle into economic theory, one that "equalizes" individual preferences and the interests of the state, which I have deemed it possible to call *methodological relativism*. Here, a brief digression is necessary.

### **1.5. Relativist methodology**

The theoretical description of "relativist methodology" is not a simple task<sup>4</sup> , if only because the category of "relativism" itself does not represent a single philosophical concept. It is not one but several relatively different doctrines, united mainly by what they reject — absolutism, universalism and monism — rather than what they support. Looking at the history of relativism, starting with Protagoras, Aristotle and Plato, then Montaigne, Kant, Nietzsche, and contemporary philosophers of the 20th and 21st centuries, it is not difficult to see the intertwining of fundamentally different positions. And as Irish philosopher Maria Baghramian notes in her work "The Many Faces of Relativism," participants in discussions on relativism do not have "clear ideas about what exactly they are discussing" (*Baghramian, 2004, p.1*). While not entirely agreeing with such a harsh verdict, I will highlight four relatively independent and not greatly overlapping types of relativism that have had the greatest influence in academic circles in recent decades.

*Cultural relativism*, which has largely determined the ethical and political views of many researchers. Its key position is the proposition that there can be no culturally neutral criteria for determining the correct choice between conflicting assertions arising

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<sup>4</sup> I would like to point out that most dictionary entries on relativism focus on *the relativity and conventionality* of the content of knowledge, simplifying and narrowing this branch of philosophical thought with its rich and long history.

in *different* cultural contexts. A distinctive feature of cultural relativism is its division into moral and cognitive relativism (*Westermarck, 1912; Baghramian, 2004*).

*Conceptual relativism* is, on the one hand, narrower and, on the other hand, a more general form of relativism, referring to conceptual schemes, scientific paradigms or methodologies. Apart from the general position that there are no universal criteria for deciding which conceptual scheme is more appropriate, its fundamental feature is that the human mind plays an active role in shaping "reality" (*Putnam, 1987*). This also applies to contexts that shape alternative statements.

*Social constructivism* is another form of relativism, the content of which is based on the assertion that different social conditions determine the construction of different "worlds" and that there is no neutral criterion for judging which of them is more useful. The constructivist approach, in particular, relativizes scientific knowledge to the extent that it asserts that different social and conceptual conditions can lead to the construction of different systems of knowledge. These are "contextually specific constructions that bear the imprint of situational conditioning and the structure of interests in the process of their creation" (*Knorr-Cetina, 1984, p.226*).

*Postmodernism*, which also has relativistic features, in its extreme form postulates that truth is not an objective property independent of reason that can be identified, but is created through social interactions (*Rorty, 1982, p. 5*). Moreover, according to French philosopher Michel Foucault, all claims to knowledge and truth are disguised power relations. Since the 1980s, postmodernism has become the dominant theoretical approach in theoretical sociology, social anthropology, and cultural studies.

What, in my opinion, unites the various forms of relativism and, most importantly, why have several of the tenets of this philosophical doctrine become an important stage in my many years of research into economic methodologies based on individualism and holism? A quarter of a century later, and as a result of a more detailed acquaintance with the philosophical literature on relativism, I realized *the sufficiency* of two principles that are very close to me. The point is that there can be no objectively neutral criteria for choosing between conflicting alternatives and that these

alternatives themselves arise in different contexts — in our case, the English and German traditions, in the formation of which the human mind plays a major role ( ). In this sense, the "artificiality" of the concepts of individualism and holism determines their equality.

The use of these two principles in summarizing the discussion on individualism and holism reveals the main idea of the first part of this work. I would like to make one more comment. On the one hand, the analysis presented aims at justifying the legitimacy and even expediency of introducing the principle of methodological relativism. On the other hand, I consider its application in economic analysis to be one of the new results of my research, which took shape in the process of studying the development of the CES and her heritage through the "magnifying glass" of modern knowledge.

It should also be emphasized that, while losing their status as "the only correct ones," individualism and holism retain their meaning and significance, but only within certain contexts and, I would like to stress, within strict limitations on the use of the relevant methodologies. Thus, the principle of methodological individualism remains the basis for the economic analysis of a multitude of private goods and services that have exclusively individual utility. The analysis of a set of goods that have only social utility, for example, "indivisible social goods" (according to Taylor), requires a holistic methodology. This conclusion also applies to *relativist methodology*, the use of which is also subject to limitations related to the ability of the relevant goods and services to satisfy the needs of individuals and the state — the presence of individual and social utility in these goods.

Given the use of this methodology, it is appropriate to discuss the creation of a new approach to studying that part of the economy where the state participates in financing the production of goods and services. But the issue is not only, and not even primarily, about public finance. Methodological relativism is, in essence, a "bridge" between the space of the positivist concept of Marginalism and the normative interests (attitudes) of society, providing an opportunity for a theoretical description of the phenomenon of "public guardianship" of goods and services that have individual and social utility.

## II THEORY OF PATRONIZED GOODS

The identification of a class of patronized goods, based on the anti-monistic position on the existence of societal interests *that cannot be reduced* to individual preferences, and relativistic methodology, led to a new stage in the development of this concept. Discussing the motives for identifying patronized goods, I will quote Richard Masgrave on his intention to "implant the public sector into the body of theoretical analysis"<sup>5</sup>. I pursued roughly the same goal, but not in the limited space of the public sector, but in relation to any goods and services that have individual and social utility and are under the care of the state.

### **2.1. Features of patronized goods**

In every historical era and in many countries, there have been various types of patronized goods: for example, "bread and circuses" in ancient times, food ration cards during the Second World War, and tropical fruits in Scandinavian countries today. It is not difficult to name many other examples, and many researchers wonder why the state spends considerable funds on financing scientific research, education and healthcare services, and works of art.

More than a quarter of a century ago, I asked myself the same question. Reflecting on this topic, I raised it in conversations with leading Russian and foreign scientists – A. Nekipelov, N. Petrakov, V. Polterovich, V. Baumol, M. Blau, M. Intrilligator, R. Masgrave, B. Felderer, K. Arrow, and many other specialists<sup>6</sup>. Their answers, which

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<sup>5</sup> The full translation of R. Masgrave's review is published in my book *The Birth of Theory: Conversations with Famous Economists* (Rubinstein, 2010).

<sup>6</sup> Conversations with most of them are published in the aforementioned book *The Birth of Theory: Conversations with Famous Economists* (Rubinstein, 2010).

were always interesting and deserved close attention, but were nevertheless predominantly private in nature, prompted me to seek a common understanding of this phenomenon. I would also like to note that, as a subject of research for many economists, patronized goods, in one form or another, are included in various theoretical constructs.

In preparing this report, I have concluded that there have been no significant changes in this segment of theoretical economics. As before, state intervention in situations of "market failure" is commonplace, including due to the existence of monopolies, negative and positive externalities<sup>7</sup>, information asymmetry, etc. It is obvious that products that generate market failures and trigger government action aimed at eliminating them can be classified as patronized goods, but it is also clear that the entire range of these special goods and services cannot be reduced to the shortcomings of the market economy.

Another attempt to answer the question posed is related to the identification and theoretical description of one of the varieties of "patronized goods" - public goods whose special properties (non-excludability and non-rivalry) determine the motivation for state activity. These circumstances, in fact, prompt the state to take on the provision of public goods. However, even in this case, the broadest interpretation of public goods does not allow other types of patronized goods to be "squeezed" into this group, such as budgetary products such as educational services or social security.

Almost the same situation is characteristic of merit goods, which, according to Musgrave, include goods and services for which the demand from individuals differs from the demand of society, corresponding to its normative settings (*Musgrave, 1959, 1996*). The goal of patronized is to correct individuals' behavior towards their "correct" choice (*Musgrave, 1974, p. 10*). It is not difficult to find examples of different meritorious goods, but it is impossible to describe all types of patronized goods using only merit goods theory. Suffice it to mention innovative products and the results of the 'Schumpeterian economy' that ensure stable economic growth (*Nelson, Winter, 2002*).

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<sup>7</sup> Including the products of "Baumolian economics," where, with positive externalities, production costs grow faster than the prices of the final product (*Baumol, Bowen, 1966*).

## 2.2. On the "new merit goods theory"

It must be said that merit goods theory has never gained widespread acceptance within the mainstream. One of the arguments against this concept was the fair criticism that the state does not know the 'true preferences' of the individuals it seeks to serve. It seems to me that this is indeed the Achilles' heel of merit goods theory, which its creator, Richard Masgrave, positioned as one of the directions of standard theory based on methodological individualism.

From a relativist point of view, the argument of James Buchanan, who believed that individuals should be considered as the only and even "exclusive source of evaluation," does not seem convincing. In the same vein are J. Head's attempts to reconcile merit goods theory with methodological individualism and the analysis of M. Tietzel and K. Müller, who dispute Head, and even Musgrave's own merit goods theory assumes of the existence of two systems of individual preferences. And no matter how researchers arrange their hierarchy (*Thaler, Shefrin, 1981*), the discussion always revolves around the duality of preferences, around the *true* and *false* preferences of individuals.

In other words, the belief that any social need can be represented as a transition from false to true individual preferences gives rise to a much more "sinful" assumption that individuals do not have a single utility function. In this situation, actual preferences always turn out to be false, while true preferences have an exclusively "reflective character" (*Brennan, Lomasky, 1983*) and the state "can only have vague ideas" about them (*Schmidt, 1988, p. 384*). That is when we must turn back and accept that individuals are not the "exclusive source of assessments." For in order to understand which individual preferences are distorted, we need to have another source of assessments. Obviously, this closes the circle with a very unpleasant logical loop.

Based on the current understanding, I can say that the negative aspects of merit goods theory are largely related not to the concept itself, but to the previous interpretation of this theory, to attempts at its strictly individualistic justification, a tradition established by Masgrave himself. I think today we can say that the initial dilemma he formulated between false and true preferences of individuals is, in essence, itself false. Following

Pareto's relativistic statement, I will repeat that each person is the best judge of their own well-being. In this sense, the preferences of individuals are always true. And as one of the principles of Roman private law states, desire cannot be considered unjust - "*volenti non fit iniuria*".

After many conversations with Musgrave and, over the years, I have become convinced that the merit goods theory of this outstanding economist is linked to a completely different problem, conditioned by the very nature of state activity. I proceed from the assumption that, in accordance with methodological relativism, the state has its own autonomous interest, which cannot be represented as a market aggregate of individual preferences.

In this sense, relativistic methodology creates good preconditions for the formation of a "New Theory of Merit Goods" (*Rubinstein, 2024a* ). The fact is that the institutional environment does not always allow individuals to "see" the benefits of consuming certain goods and services, generating public interest that is realized through *the meritisation of private goods*. Here, too, a small digression is necessary.

### **2.3. Public goods: dichotomy VS continuum.**

I will cite two well-known statements that characterize substantively different contexts. David Hume pointed out that "two neighbors may agree to drain a field, but a thousand people cannot do so, as each will try to shift the entire burden onto others" (*Musgrave, 1996 , p.145; Hume, 2020*). Joseph Schumpeter identified a different phenomenon: "...we do not mean the same thing when we talk about 'public good', simply because our cultural views, on which the public good should be based, differ hopelessly in each specific case" (*Schumpeter, 2001*).

These formulations by thinkers from different eras reflect fundamentally different approaches to the definition of public goods. In the first case, their characteristics are *the peculiarities of the consumption* of collective goods (according to Hume). In the second case, it is a question of *the characteristics of the understanding* of the very category of these goods, its dependence on "cultural views" (according to Schumpeter).

The classic definition of public goods (*Samuelson, 1954, p. 387*) identifies two main characteristics: a clear dichotomy between public and private goods, and the simultaneous consumption of these special goods by more than one individual. Musgrave, focusing on public finance issues, rejected this dichotomy and refused to accept the principle of simultaneous consumption of public goods. Moreover, since the introduction of the property of non-rivalry into scientific discourse (*Musgrave 1983, p. 151, note 48*), the very concepts of "rivalry" and "non-rivalry" have become variable, ranging from complete rivalry to complete non-rivalry.

As a result, in contrast to Samuelson's definition, the continuum principle has become widespread in the mainstream (*Musgrave, 1959, 1969*)<sup>8</sup>. And I am forced to conclude that, unfortunately, there is no unambiguity in the definition of public goods. Believing that the properties of non-excludability and non-rivalry can manifest themselves to varying degrees and that there is no clear boundary between private and public goods, several economists admit the possibility of the existence of different types of public goods, in the form of their peculiar "centaurs".

These are *purely public goods* that satisfy two conditions: non-excludability and non-rivalry in consumption (*Stiglitz, 1997, p. 121*), or, in another version, when "both properties are highly inherent" (*Jacobson, 2000, p. 41*), and *mixed public goods*, when "at least one of the properties is moderately expressed" (*Jacobson, 1996, p. 42*). Using the category of "pure public goods" that satisfy the two properties mentioned above, Stiglitz and Atkinson also note that "many goods have one or the other property to varying degrees" (*Stiglitz, 1997, p. 124; Atkinson, Stiglitz, 1995, p. 654*). There is also the concept of *quasi-public goods*, which "are at least partly public in nature" (*Blau, 1994, p. 550*).

I believe that "pure" and various types of "mixed goods" are not an achievement of economic theory but rather indicate its "concessions" due to a number of unresolved issues. Based on the theory of patronized goods, which relies on relativist methodology

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<sup>8</sup> M. Pickard presented a special report entitled "Fifty Years After Samuelson's 'Pure Theory of Public Expenditure': Where Do We Stand?" at the 58th Congress of the International Institute of Public Finance (Helsinki, 26-29 August 2002). For more details, see: (*Rubinstein, 2024a*)

and meritocracy, we can look at the discussion between Samuelson and Masgrave regarding the dichotomy and continuum of public goods and services from a different perspective.

I will begin by saying that, depending on regulatory settings driven by the state's desire to expand access to relevant goods and services, the degree of meritisation may increase. It is worth highlighting the extreme case when the state, seeking to maximize the consumption of certain goods, creates *special conditions* to ensure their full accessibility. In this situation, the goods and services in question are transformed into '*normative public goods*' (Rubinstein, 2024 a).

Using the proposed definition, it should be emphasized that, unlike classical public goods, which are indivisible by nature and initially possess the properties of non-excludability and non-rivalry in consumption, normative public goods, while remaining divisible, acquire these properties as a result of meritorious actions by the state aimed at achieving the relevant goals of society, as formed by the political system. In general terms, this process can be represented as a sequential chain of meritisation of initially private goods (Fig. 1).

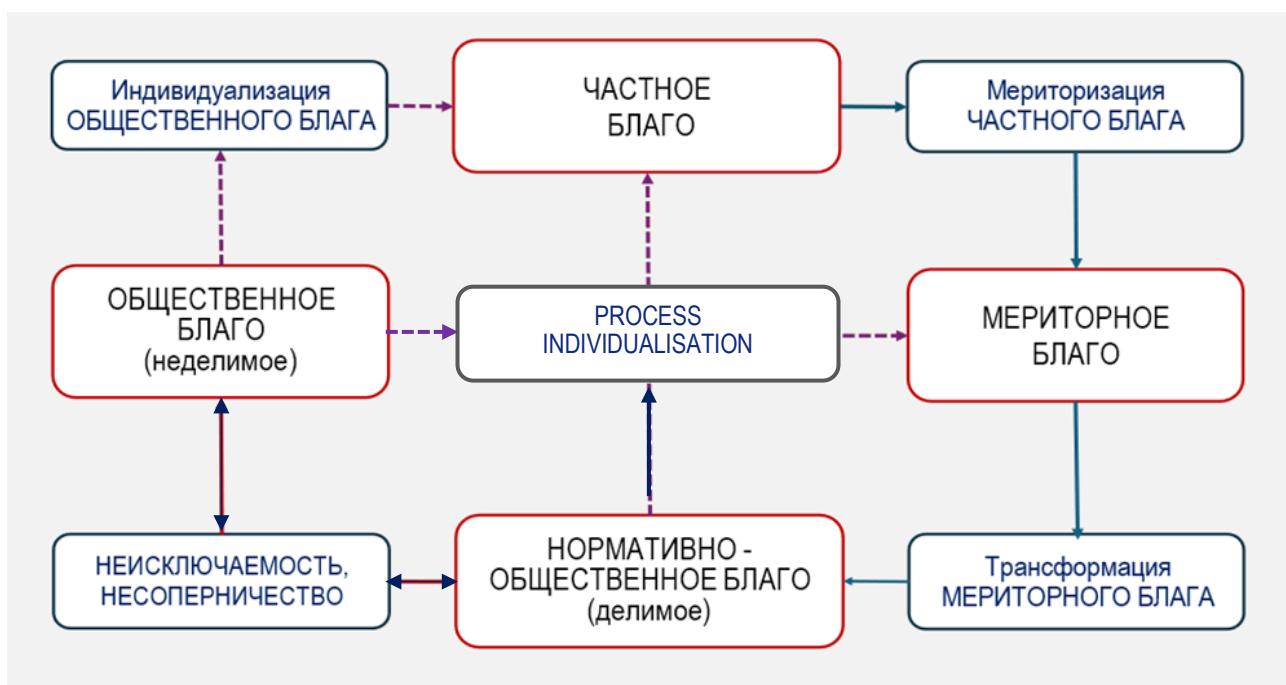


Fig. 1. General scheme of the transformation of goods

Merit-based, normative-social and classical social goods are transformed into ordinary private goods as a result of the loss of their social utility and the cessation of

state funding. As for the individualization of public goods, and conversely, the transformation of normative-social goods into classical social goods, special measures need to be taken here.

A description of the general transformation process allows us to assert that the entire range of goods and services can be divided into four groups: *private, merit, normative-public, and classical public goods*. It is also easy to understand that in this case, the questionable practice of distinguishing between different types of mixed goods and services disappears. They are fully included in the group of meritorious goods, which are divisible and have individual and social utility. Private and merit goods are complemented by classical public and normative public goods with inherent or acquired properties of non-excludability and non-rivalry in consumption. I also attribute this important conclusion, which makes certain adjustments to the theory of public goods, to the new research results.

#### **2.4. Equilibrium model for patronized goods**

It should be noted that relativistic methodology, among other things, became a platform for the theoretical description of the possibility of combining neoclassical positivism with the normative interests of the state by constructing an appropriate equilibrium model that considers the individual and social utility of the patronized goods. Without repeating the calculations that were first presented in the justification of this model (Rubinstein, 2009b), I will indicate two different interests in the form of utility functions  $U_I$  and  $U_N$ . One of them represents a market aggregate of individual preferences, transformed by the invisible hand mechanism into the interest of the "mega-individual":  $U_I = f(U^1, U^2, \dots, U^n)$ , where  $U^i$  is the utility function of the  $i$ -th individual. The other is the normative interest  $U^i$  - formed within the boundaries and through the political system.

At the same time, any normative interest  $U_N$  can be expressed without limiting generality as the state's need to increase the production of a certain good  $G$  in relation to the value that corresponds to the standard market equilibrium, i.e., the equality of supply and individual demand for this good. In other words, interest  $U_N$  manifests itself in the

form of additional demand by the state for the same patronized good  $G$ , which is the object of public care.

When interest  $U_{(N)}$  is realized, i.e. when goods  $G$  are produced and consumed in volume  $G_N$ , two results are observed: along with the satisfaction of individuals' needs, the interests of their aggregate as a whole are also achieved. This means that the total volume of the patronized good enters simultaneously in equal amounts into the market aggregate of the utility functions of the mega-individual and the utility function of the state. Without the consumption of good  $G$  by individuals, the normative interest of the state cannot be satisfied, and the more it is realized, the more individuals receive.

As was proven in a 2009 article, the patronized good  $G$  in this case exhibits two well-known properties: non-excludability and non-rivalry. In other words, it becomes a public good that the mega-individual and the state consume jointly and in equal quantities. The general conclusion can be formulated in *the following important lemma*. "If individuals from a set  $N$  have preferences  $U^1, U^2, \dots U^n$  with regard to a private good  $G$ , and their interest in the mega-individual  $U_I = f(U^1, U^2, \dots U^n)$  complements the normative interest of the state  $U_N$  in relation to the same good, then the good  $G$  itself acquires a certain duality: while remaining a private good for individuals from set  $N$ , it acts as a public good for the bearers of interests  $U_I(G)$  and  $U_N(G)$ " (Rubinstein, 2024a, p. 192).

When considering the balance between the interests of individuals and the state, it is not difficult to understand that building an appropriate model involves determining the total demand for the patronized good. At the same time, it is obvious that the heterogeneity of the interests of the mega-individual and the state does not allow for a simple summation of the consumption volumes of the patronized good by the participants in this pair. *The lemma* above suggests a way out of this situation. It directly implies the possibility of modifying the well-known Vickzel-Lindahl equilibrium model for public goods with its characteristic *vertical summation* of demand functions (Lindahl, 1967), but applying it to the entire class of patronized goods.

In this case, without repeating the entire course of theoretical reasoning, I will emphasise the main point: the volume of the patronized good  $G_N$  and the price  $P_N$  set by the

state, at which it pays for the achievement of its interest  $U_N$ , depend on the price  $P_I$  at which the mega-individual is willing to purchase this total volume of the given good. It is easy to see that such a modification of the basic model does not change the general conclusion: aggregate demand in this model is determined by *vertically* summing the demand curves of the mega-individual and the state, and the Pareto-efficient equilibrium for this pair of players, who have personal interests in the patronized good  $G(N)$ , is realized in the form of a Vickrey-Lindahl equilibrium.

This conclusion provides the basis for the following conclusion. The emergence of the normative interest of the state  $U_N$  relation to any private good  $G$ , which individuals purchased in different quantities but at a single price  $p^i$  generates a mutation of this good and leads to an inversion of its equilibrium prices and quantities: the mega-individual and the state purchase the good that has become a public good for them in equal quantities  $G_N$ , but at different prices  $P^I$  и  $P_N$ .

It should also be emphasized that in the proposed modification of the Wicksell-Lindahl model (Rubinstein, 2024a, pp. 190–195), equilibrium prices have different natures. The personalized price of a mega-individual  $P^I$  is based on the marginal individual utility of a private good  $G$ ; the price paid by the state  $P_N$  also corresponds to the marginal, but now social, utility of the patronized good  $G$  and reflects that part of the state's budgetary resources that is spent on the realization of the social interest  $U(N)$ . In other words, equilibrium is achieved when marginal costs are equal to the sum of the marginal individual and marginal social utility of goods:

$$MC_R = MU_I + MUs. \quad (1)$$

## 2.5. Excesses of the "Harberger triangle"

One of the main instruments for the meritisation of private goods and services (in general, patronized goods) is budget subsidies, the methodology and practice of determining which has remained virtually unchanged. It would not be an exaggeration to say that, in mainstream economic theory, subsidies remain an undefined category, while in the practice of government agencies that finance patronized goods, the term "support" is used, which carries connotations of charity that are not characteristic of

the state. This is facilitated by the "Harberger triangle," a, which is "stuck" in the model of equilibrium of private goods and is interpreted as "pure losses" (Harberger, 1964; James, 1999).

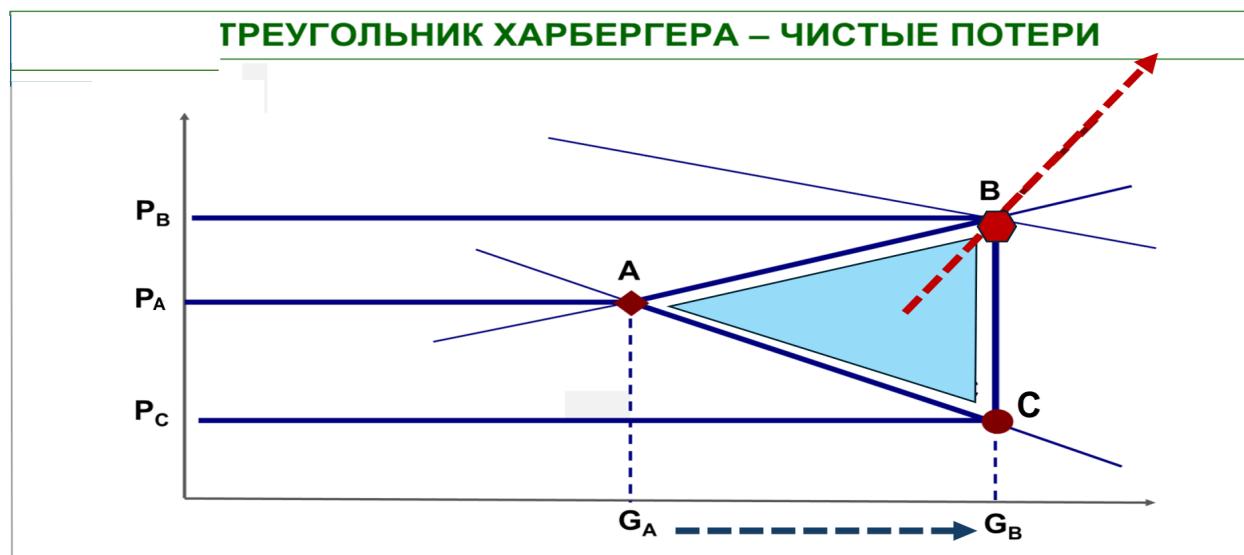


Fig. 2. "Harberger triangle"

This exegesis is based on the use of a standard model of private goods equilibrium (Fig. 2). In this model, the producers' gain from subsidizing the growth in the volume of production of goods is equal to the area of the quadrilateral  $\{P_A, P_B, B, A\}$ ; the consumers' gain from the reduction in prices when subsidizing the growth in the volume of production of goods is equal to the area of the quadrilateral  $\{P_A, A, C, P_C\}$ . The difference between budget expenditures  $\{P_C, C, B, P_B\}$  and the total gains of producers and consumers is equal to the area of the triangle  $\{A, B, C\}$ , which is usually interpreted as "net losses."

This verdict raises several theoretical questions. I will formulate some of them. What are the economic reasons for providing subsidies to producers of certain goods and services? For what reasons, excluding charity, which is not characteristic of the state, do the state spend budget funds? If we assume that the reasons for such expenditure lie in the normative interests of the state, can they be reflected in the neoclassical equilibrium model? If such interests exist and are related to the desire to increase the availability of certain goods, then in this case they must correspond to certain needs of the state, which determines their social utility.

However, as has been shown, such goods and services must belong to one of the groups of meritorious, normative-social, or classical public goods, to which the equilibrium model for private goods and services that have no social utility cannot be applied. This conclusion leads one to think about the fallacy of the widespread interpretation of the "Harberger triangle." In the current situation, Herberger's exegesis resembles the well-known search for a cat in a dark room that is not there.

For a correct interpretation of the 'Harberger triangle,' it is necessary, in accordance with relativistic methodology, to use the equilibrium model for patronized goods that, by definition, have individual and social utility and thus consider the interests of the state, to which the budget subsidy is directly linked (Fig. 3).

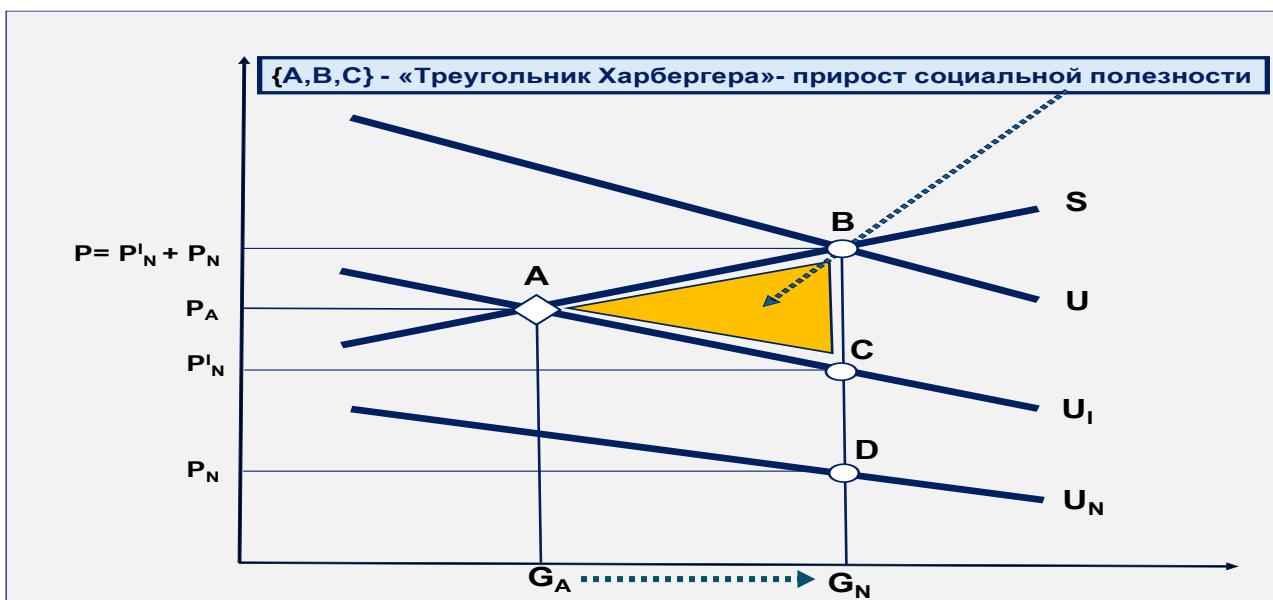


Fig. 3. Vickrey-Lindahl equilibrium for a patronized good

Analysis of this equilibrium model shows that the area of the "Harberger triangle", equal to the difference between the area of the rectangle  $\{P^I_N, C, B, P\}$  - the amount of the budget subsidy, and the sum of the areas of the rectangles representing consumer gains  $\{P^I_N, C, A, P_A\}$  and producers  $\{P_A, A, B, P\}$ , as a result of the increased volume of production of patronized goods from  $G_A$  to  $G_N$ , represents the return on investment in patronized goods – the increase in their social utility, which the model successfully reveals.

It so happened that this new and important result of my research into the equilibrium model for patronized goods, including the justification of such a category as

consolidated income (*Rubinstein, 2022 , pp. 20-26*), which will be discussed further, overshadowed one of the most interesting consequences of this model, which is nothing less than *the theoretical rehabilitation* of the category of budget subsidies.

Although somewhat delayed, something happened that I had not anticipated: my research in economic theory happily converged with another area of my research at the Institute of Economics. This concerns the economics of science, education, culture, and healthcare. One of the main tasks here has always been to justify the amount of state funding in the form of grants, and later budget subsidies<sup>9</sup> . All attempts to solve this difficult task have constantly come up against the argument of "net losses" - the main argument of the neoclassical interpretation of state funding of "planned loss-making organizations"

Returning to the topic of "pure losses" and reflecting on the fundamentally new content of the "Harberger triangle" in the generalized equilibrium model for patronized goods led me to another conclusion: within the class of patronized goods, there is a special group of goods and services for which this problem is of paramount importance. These are goods and services produced in the fields of science, culture, education, and medicine. Thus, the economic theory of the humanitarian sector has become a "grandchild" continuation of the CES.

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<sup>9</sup> More than fifty years ago, Boris Yuryevich Sorochkin, head of the planning and finance department of the Ministry of Culture of the Russian Federation, pointed out this problem to me, then a final-year student of mechanical mathematics. I will always remember this wonderful and wise man, who effectively determined my scientific destiny. Moreover, it may seem implausible, but my subsequent research in the field of theoretical economics and sociology began with attempts to find a scientific solution to the problem of financing cultural goods.

### III

## THE HUMANITARIAN SECTOR OF THE ECONOMY

I will begin with the term "humanitarian sector" (*Rubinstein, 2004, 2019*), which includes a set of entities whose activities provide the bulk of the production of science, education, culture and medicine products. Its history began many years ago, when in 1937 the future creator of the theory of public finance Richard Musgrave, drawing on the German tradition, used the term "public economy" in his dissertation (*Musgrave, 1937*). And, as the author himself told me sixty years later, he considered the production of education and medicine to be part of the "public economy" along with other goods (*Rubinstein, 2009a, pp. 98-109; Rubinstein, 2010, pp. 89-97*). However, it turned out that the definition proposed in the 1937 work did not receive support from his colleagues. Generally speaking, even many years later, it is difficult to find a definition for a sector of the economy whose composition has constantly changed — from education, medicine, and social security to broader concepts including fundamental science, culture, sports, etc.

Against this backdrop, the monograph "The Humanitarian Sector of the Patriarchalistic State," published in 2023, became the first exposition of a general approach to its economy, developed in the process of developing the KES and the Theory of patronized goods using relativistic methodology. The synthesis of fragmented ideas about various types of intellectual activity became an important step in transforming purely intuitive thoughts about the genetic relationship between science, education, culture, and medicine into scientific facts.

### 3.1. Knowledge and the dilemma of public goods

It is impossible not to mention the motivation that prompted people in these seemingly very different fields to unite in one sector of activity. It took time and a lot of rethinking to see what now seems like a simple similarity in meaning. We're talking about *the creative nature of the work* of scientists, teachers, cultural workers and doctors, about their intellectual activity in understanding the world around them. The key word here is 'understanding', which is often associated only with science. However, this category, which is universal in nature, also applies to education, culture and medicine, where any achievements are based on experience, in which accumulated 'knowledge' is concentrated.

The issue of knowledge has been present in many studies since the mid-20th century (Hayek, 1945; Machlup, 1962, 1984; Maunoury, 1972; Foray, Mairesse, 1998; Foray, 2004; Ivanova, 2001, 2002; Milner, 2003, 2009). At the same time, the least studied aspects were theoretical ones, primarily the content of the category of knowledge itself, as well as the processes of its transformation into economic goods participating in market exchange.

Based on the works of Fritz Machlup, who mainly considered activities related to the production of knowledge (Machlup, 1966), I concluded that it would be expedient to take a broader view of the category of knowledge itself. This involves the use of the concept of "background space of meanings existing outside the minds of individuals" (Wittgenstein, 2008), which in this case was called "intellectual ether." Regarding the humanities sector, it can be concluded that the knowledge produced, which exists in the space of thoughts, feelings, language, symbols, meanings, etc., has the classic characteristics of intellectual goods.

This background space reflects accumulated knowledge and experience of intellectual activity. In accordance with the concept of "diffuse knowledge" (Hayek, 2001, pp. 51–71, 89–101), knowledge itself, as Dominique Foray noted, "... appears only when it is expressed and recorded, and when it becomes possible to assign ownership rights to it" (Foray, 2004, p. 9). I will emphasize the main point: in order for the results

of the intellectual activity of scientists, teachers, cultural figures and medical professionals to become knowledge, they must undergo a process of manifestation – *exteriorisation*, the transition from an implicit to an explicit state (Nonaka, Takeuchi, 1995).

In this regard, I will return to the category of knowledge, which by its nature is a public good with its well-known properties of non-excludability and non-rivalry. Based on the theory of public goods, a general statement can be formulated. First, the marginal costs of its use are zero, and knowledge itself has no positive price; Second, the absence of such a price discourages knowledge creators with uncertain prospects for compensation for their costs. In fact, this is where the dilemma of public goods manifests itself with its standard questions, caused by the contradiction between the interests of knowledge creators in any type of intellectual activity and society's interest in its dissemination. It is also clear that because of this, it is impossible to rely exclusively on the system of competitive markets (David, 1998), as indicated by the basic provisions of relativistic methodology.

### **3.2. Results and characteristics of creative work**

It should be emphasized that creative work and intellectual activity generate significantly *more* than the economy is currently able to detect. This assertion is usually justified by economic logic based on the 'Solow residual', part of which has been identified as human capital, which has gradually taken Centre stage in modern economic growth theory. It is not difficult to see that all types of intellectual activity in the humanities sector contribute to varying degrees to the formation of different types of human capital (Grossman, 1972; Farr, 2007; Bourdieu, 2011).

From the perspective of the theory of patronized goods, this effect can be viewed as a positive externality of the production and consumption of goods and services in the fields of science, culture, education, and medicine. In other words, when discussing the results of intellectual activity in the humanities sector, in addition to the creation of goods and services that are valued by the market, one should bear in mind its long-term consequences in the form of created and accumulated knowledge, and the formation and development of various forms of human capital.

Another circumstance characteristic of the modern understanding of intellectual activity should be noted. Creative work has long been the focus of attention of researchers in various sciences. Economists have also been considering it from different angles for a long time, including as a creator of knowledge and a participant in the processes of human capital formation. In addition to this, attention should be paid to its peculiarity of a different kind, which, surprisingly, economic science has almost been ignored.

Until recently, economic theory did not take into account a genetic feature of intellectual activity that distinguishes creative work from other types of work. This feature is the fundamental impossibility of replacing it with machines and equipment. I believe that it is for this reason that economic results in the humanities sector, in accordance with William Baumol's well-known theory, known as "cost disease," are doomed to zero or low productivity growth rates (*Baumol, Bowen, 1966*)<sup>10</sup>.

### **3.3. Financing of patronized goods**

Over the years, theoretical and empirical studies have been devoted to "cost disease," the results of which have become one of the foundations of modern economic theory (*Globerman, Book, 1974; Heilbrun, 2003; Ginsburgh, Throsby, 2006*). A conceptually new approach was laid down in Baumol's doctoral thesis and finally took shape in his well-known work on the problems of "unbalanced growth"<sup>11</sup>.

An important step in the development of this line of research was the identification of two parts of the economy: "stagnant (with low or zero rates of technological progress) and technologically progressive economic sectors" (*Baumol, 1967*). Of note is the renaissance of Baumol's theory in the new century and the expansion of its application to the fields of education (*Neck, Getzner, 2007*) and healthcare (*Pomp, Vujic, 2008*), as well as to other types of services (*Fernandez, Palazuelo, 2012*), as well as in macroeconomic research (*Nordhaus, 2008*).

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<sup>10</sup> See also: (*Rubinstein, 1987; Rubinstein, 1991; Baumol, Baumol, Rubinstein, 1991; Baumol, Baumol, Rubinstein, 1992; Rubinstein, 1997*)

<sup>11</sup> The dissertation "The Economics of Welfare and the Theory of the State" was defended by V. Baumol in 1949 at the London School of Economics and many years later was published by Harvard University Press (*Baumol, 1965*).

The justification of this pattern has made it possible to draw conclusions regarding compensation for the "lost income" of producers of patronized goods in the humanitarian sector (Rubinstein, Slavinskaya, Burakov, 2024). This refers to income that could have been generated if the nature of the activity had allowed for the introduction of technical advances, replacing creative Labour with machines and equipment, thereby ensuring productivity growth. The absence of such opportunities in intellectual activity generates the need for state intervention aimed at compensating for lost income in the form of budget subsidies. But what do these state expenditures represent, and what is the content of the category of budget financing?

Research in science, education, culture, and healthcare within the framework of relativistic methodology and the General Theory of patronized goods has created the preconditions for a fundamentally new approach to determining the economic content of budget subsidies and constructing an adequate model for them. This involves considering the state as a participant in market relations with its own utility function, the equilibrium for patronized goods with its characteristic mechanism of "vertical summation," and the direct links between government spending and external effects in the form of knowledge and human capital accumulation.

One of the results of the study of patronized goods in combination with the above-mentioned 'cost disease' led to the definition of a budget subsidy based on a modified equilibrium model for patronized goods. This means that the volume of supply and price must correspond to the aggregate demand for the patronized good, including both of its components. With this in mind, we can answer the question posed above about the content of the budget subsidy.

It should be assumed that it represents government expenditure aimed at compensating producers of patronized goods for lost income due to their social utility. Given that the market consists of individual actors who demand the patronized good and the state, which seeks to realize its own interests, equilibrium is achieved when production costs are equal to the sum of the revenue from market sales of this good and the budget subsidy - *the consolidated income* of the producers of the relevant goods.

This conclusion describes the conditions of equilibrium for goods and services in the humanitarian sector, including the production, reproduction, and accumulation of knowledge (Foray, 2004; Rubinstein, Chukovskaya, 2024a, 2024b), the formation of human capital, including that associated with "leisure and educational practices" (Bourdieu, 2001; Stebbins, 2017; Tikhonova, Latov, 2023) and a tendency towards health-preserving behavior (Grossman, 1972; Chubarova, 2023). At the same time, compensation for "lost income" ensuring the growth of total labor productivity – consolidated income per employee – allows us to speak of the "transfer" of the humanitarian sector to the group of effective sectors of the economy, the results of which determine the production of cared-for goods that have individual and social utility.

### 3.4. Full budget cycle

The diagram below illustrates not only the economic meaning of subsidies, but also demonstrates the entire budget cycle – from government expenditure in the form of budget subsidies aimed at compensating for the lost income of producers of patronized goods in the stagnant humanitarian sector of the economy, to tax revenues as a result of innovation and productivity growth in technologically advanced sectors, secured in part by the results of scientific, cultural, educational and medical activities in the form of accumulated knowledge and human capital (Fig. 4).

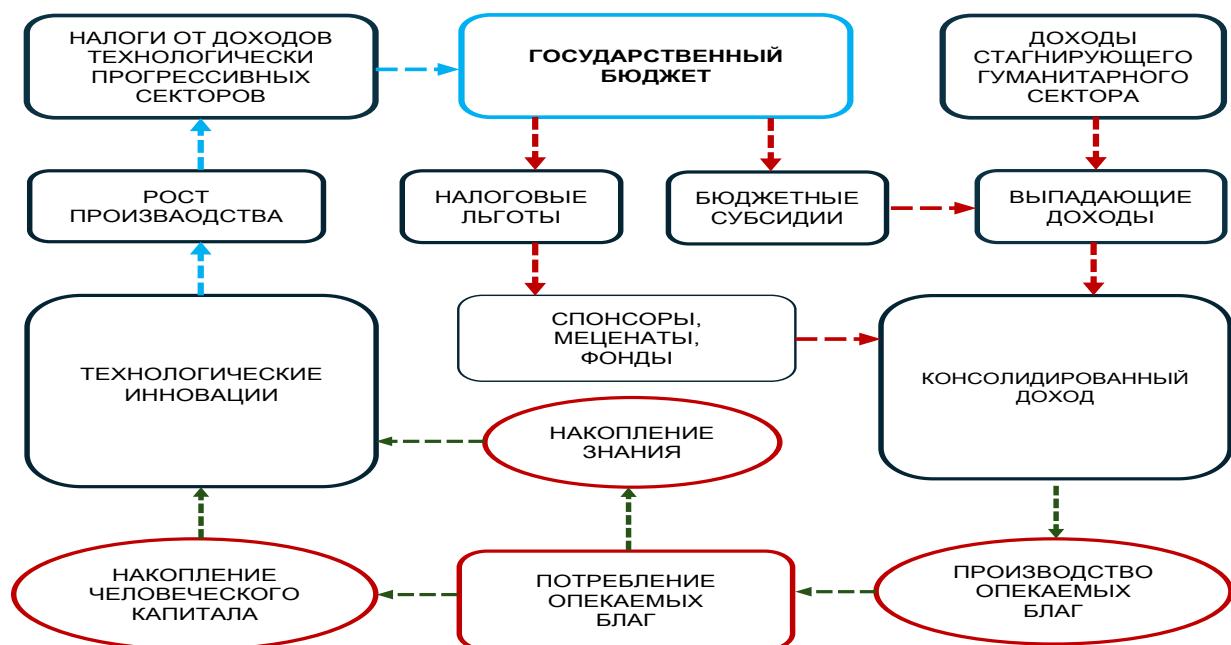


Fig. 4. Schematic diagram of the full budget cycle of expenditure on the production of patronized goods in the humanitarian sector

This diagram allows us to formulate a general conclusion that budget subsidies to producers of patronized goods in the humanitarian sector are state investments in technologically advanced sectors of the economy. To this we must add that the concept of consolidated income developed within the framework of the theory of the humanitarian sector has ensured the creation of a normative model of budget subsidies applicable to the production of patronized goods in the fields of science, culture, education and medicine (*Rubinstein, 2024a, pp. 253-262*).

In conclusion, it should be noted that issues of state intervention in market relations, apart from considering the positive effects of budgetary investments in patronized goods, almost always bring researchers back to the question of decisions related to mechanisms for choosing the direction of state spending. Given that it is known that this does not always contribute to an increase in public welfare (*Krueger, 1990; Buchanan, Musgrave, 2000; Zaostrovtshev, 2024*), one cannot lose sight of the negative consequences of decisions determined by the normative attitudes of political authorities<sup>12</sup>.

In this case, the "Harberger triangle" measures not only and not so much the financial results of such decisions as the "failures of the state" and the losses to civil society caused by them. It is quite obvious that the answers to the above question are closely related to the very category of the "state," to the place it occupies in the life of society, including the entire set of interactions between the authorities, the economy, and civil society.

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<sup>12</sup> Oleg Igorevich Ananyin drew my attention to the need to interpret the "Harberger triangle" in relation to normative decisions by the authorities in a personal conversation with me

## IV ECONOMIC THEORY OF THE STATE

This concluding part of the report, which covers research conducted between 2018 and 2024, will focus on the state, the processes of forming its interests as an independent market player, and the characteristics of state activities aimed at realising these interests. Despite the "hackneyed" nature of this topic, the monograph Economic Theory of the State: A New Paradigm of Paternalism, published in 2020, was probably the first systematic presentation of an approach developed from the perspective of the General Theory of patronized goods, based on relativist methodology.

It should be noted that the Institute of Economics' research in this area unexpectedly, but now seemingly quite naturally, touched upon theoretical issues of public administration related to defining the goals of the state and ensuring their achievement. This is a completely new topic, in which the theoretical aspects of public administration are closely linked to economic theory of the state.

### **4.1. The paternalistic state**

The paternalistic state is not the pinnacle of evolution. And although this type of statehood is observed in most countries, the substantive structure of the state attracts the constant attention of researchers in various fields of science. The main changes in this process are related to the very paradigm of paternalism. This refers to its semantic transformation: from the autocratic power characteristic of patriarchal paternalism and monarchy, as a system of relations based on the subordination of individuals to a paternal figure or dictator, to a more restrained perception of state intervention in the

choices of individuals, accompanied by a certain liberalization of paternalism itself (*Rubinstein, 2016, pp. 443-493*).

An example of the change in economists' attitudes towards paternalism can be seen in the concept of "libertarian paternalism" put forward by Richard Thaler at the beginning of the new century as the core of behavioural economics. There is no doubt that the previous paradigm of the state has clearly exhausted itself and we are witnessing the next stage of its evolution, characterized by the transformation of the welfare state into a paternalistic state (*Kapelyushnikov, 2013a, 2013b*). In this regard, I would like to quote Friedrich Hayek: "...the welfare state becomes a household state, in which paternalistic authority controls most of society's income and distributes it among people in the forms and amounts that it believes they need or deserve" (*Hayek, 2018*).

It makes sense to pay attention to another aspect of scientific discourse. The observed transformation of the content of paternalism is directly related to the recognition of the irrational behavior of individuals who harm their own well-being. Recognizing the possibility of irrational behavior is essentially equivalent to legitimizing paternalism. In this sense, both meritocratic and libertarian paternalism correspond to the basic tenets of the theory of patronized goods, which defines paternalism as an integral element of the existence of the state (*Rubinstein, 2024a*).

Theoretical analysis and historical research show that, under different conditions, the activities of a paternalistic state can have both positive and negative consequences. Moreover, shifts towards the negative are to a very large extent associated with a reduction in the field of public choice, caused by the "breakdown" of society's protective mechanisms. We are talking about civil society, its formation and development, the formation of self-organizing institutions that protect the rights of citizens and exert appropriate influence on political power.

The reasons for the failures of civil society lie in the well-known conflict between paternalistic state actions and the fundamental trend towards the development of democratic foundations in society, which even liberal states have been unable to implement sufficiently. At the same time, the explanations usually offered are one-sided,

focusing only on the actions of the authorities, without considering the evolutionary history of the state, including the formation, development and crises of its paternalistic form, which has changed many times (Fig. 5).

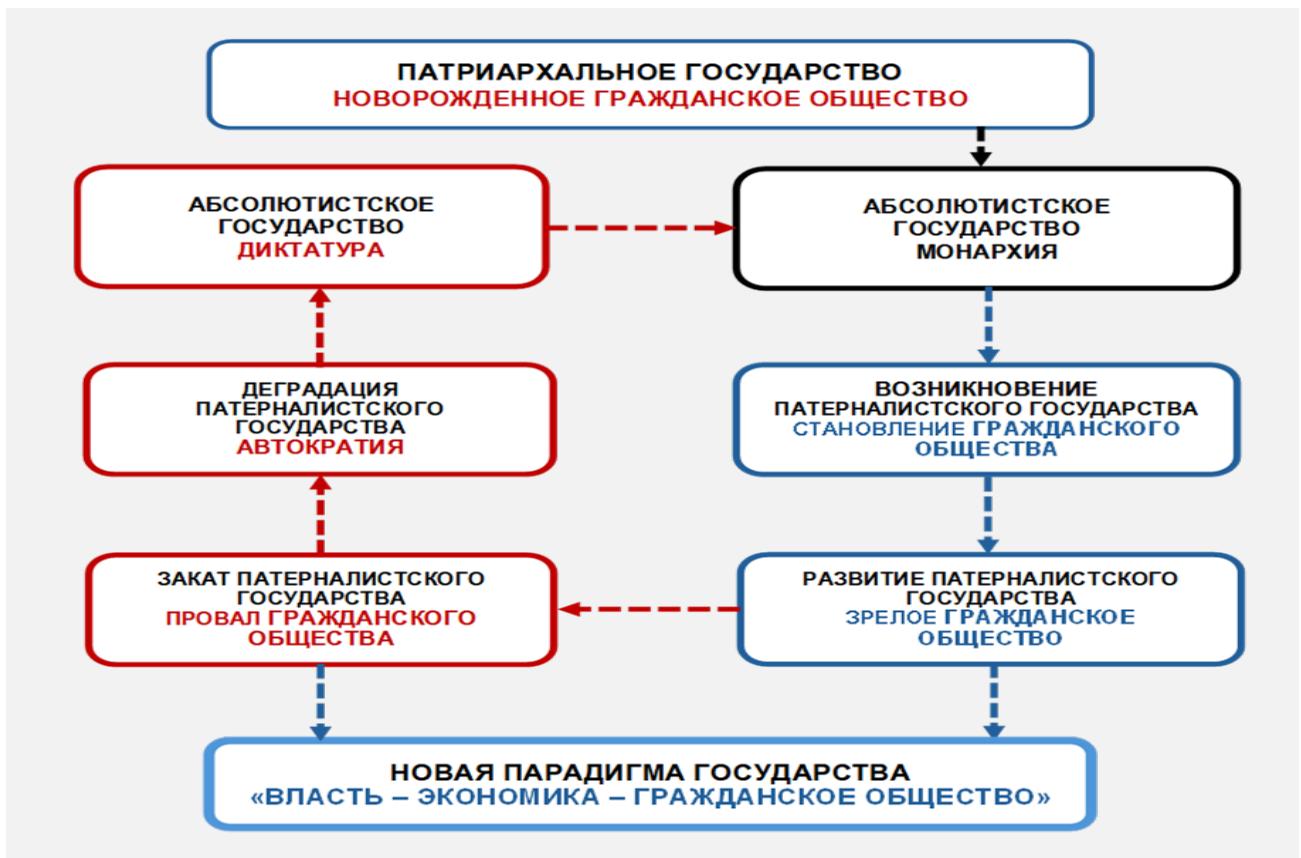


Fig. 5. Evolution of the State (general scheme)

It should also be emphasized that the modern paternalistic state differs from its patriarchal model in the collective nature of generating its interests and the possibilities for democratizing the very process of public choice (Rubinstein, Greenberg, Gorodetsky, 2022, p. 144). There is extensive literature on this topic, presenting various aspects of collective decisions, including public choice theory, whose origins are associated with the publications of David Black (Black, 1948a; 1948b). James Buchanan's first article on this issue was published at almost the same time (Buchanan, 1949), but the name "public choice" only became established in the 1960s, after the creation of the corresponding association and the journal *Public Choice*.

#### 4.2. Public choice and its flaws

Within the framework of this theoretical construct, an approach to the study of non-market decisions was presented, a distinctive feature of which was the democratic

procedures of parliamentary voting (*Buchanan, Tullock, 1962*). However, despite the democratization of the public choice procedure, it is noteworthy that a parliamentary party (coalition) with the necessary majority of votes is capable of accepting any normative settings and passing virtually all decisions that are in the interests of the party itself<sup>13</sup>.

Let me formulate the fundamental contradiction of the modern political process. On the one hand, any democratic system presupposes the supremacy of the majority, while on the other hand, submission to the majority often transforms into "deviation from the majority"<sup>14</sup>. By agreeing with the preferences of the "many" and following them, every parliamentarian risks missing the right choice. Even greater risks are faced by society as a whole, which may find itself outside the zone of effective decisions.

"Today, even many of those who support democratic institutions," wrote Mises, "ignore these ideas.... In their opinion, the majority is always right simply because it can crush any opposition; the power of the majority is the dictatorial power of the most numerous party... Such pseudo-liberalism is the opposite of liberal doctrine" (*Mises, 2005, p. 144*). I would like to emphasize that changing collective decision-making procedures and searching for institutional mechanisms that limit the power of the majority is one of the key tasks of economic and political theory.

At the beginning of this century, this area of research began to gain popularity. Among them are the works of French scholar Jean-Jacques Laffon, who drew attention to the fact that "despite the dominance in economics of the view of the public interest as decisive in choosing a path of development, the 'intervention' of interest group theory, which places particular emphasis on their influence in shaping political decisions, continues to expand" (*Lafon, 2007, p. 23*). Based on the importance of this theory, he introduced into his analysis the so-called "authentic advisor" to the ruling party, who proposes a

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<sup>13</sup> See, in particular, (*Polterovich, Popov, 2007; Polterovich, Popov, Tonis, 2008; Hillman, 2009*).

<sup>14</sup>"It is not difficult to resist the persuasion and influence of one villain, but when a multitude rushes down-hill with unstoppable momentum, not to be swept away by the flow is a sign of a noble soul and a mind trained in courage" (quoted from (*Kovelman, 1996, p. . 65*). These modern-sounding words, clothed in elegant form, belong to Philo of Alexandria, a philosopher of the 1st century AD who combined Jewish tradition with Greek culture in his scholarly works.

Programme of action that increases its benefits in a given economic and political situation (Lafon, 2007, p. 22).

This process has been particularly evident in Russia. "There has been a significant conflict of interest between society and the elites, resulting in the current deficit of institutions – public goods that serve the whole of society, not just its privileged section" (Polishchuk, 2013, p. 41). At the same time, parliament can be viewed, following Lafon, as a group of "authentic advisers" to political parties representing their interests. This approach provides a basis for generalizing Kenneth Arrow's well-known result in the form of a conclusion about the impossibility of reconciling the preferences of parliamentary parties, except in the case of a dictator, when everyone votes the same way as he does. The real political practice of democratic states demonstrates a general pattern: every parliament evolves towards the emergence of a "collective dictator" in the form of a ruling party or a party- al coalition that has the necessary majority of votes to make collective decisions.

It cannot be denied, therefore, that society quite often faces a situation where *public choice* is transformed into the monopolistic choice of the ruling party. In other words, democratic voting can give rise to paternalistic attitudes that are far from relevant to the priorities of society. Instead of reflecting the interests of various social groups, the use of the ruling party's normative attitudes often leads to a decline in overall welfare. This applies to any "collective decision-making" procedures that undermine the majority of economists' trust in paternalism and state activity (Stiglitz, 1997, pp. 14-15). A general thesis can be formulated: a paternalistic form of government can develop without the risk of degradation only if there are appropriate protective mechanisms that form the "immune system" of society, including self-organizing civil society institutions that are capable of preventing the wrong choice of goals and bureaucratic arbitrariness in their implementation (Fig. 5).

But what does the category of state mean? Having spent several decades studying mixed economies (Rubinstein, 2008, 2024; Greenberg, Rubinstein, 2013), I have come to the conclusion that there is no adequate understanding of the "state" and no

corresponding definition that would reflect not only "a sovereign form of public authority with an apparatus of governance and coercion to which the entire population of the country is subject," but also its direct links to the economy and civil society institutions. I would also like to note that neither modern science nor international law provides a universally accepted definition of the "state." Based on the theoretical research of the Institute of Economics in recent years<sup>15</sup>, I considered it possible to propose a *fundamentally new* definition. A state is a social entity created by a national or multi-national community in a specific territory and functioning in the form of a metasystem of "political power–economy–civil society" (*Rubinstein, 2024a, p. 388, 2024b, p. 197*).

From this definition, it follows directly that the interests of the state represent a combination of the interests of the authorities, the preferences of individuals formed by market mechanisms, and the interests of civil society. In other words, the market aggregate of individual preferences, corresponding to neoclassical theory, constitutes only part of the interests of the state, which coincides, in fact, with the basic assertion of the CES that its interests cannot be reduced to individual preferences.

#### **4.3. On the new paradigm of the state**

When discussing issues of state theory, I adhere to Friedrich von Hayek's concept of social order (*Hayek, 1973; Hayek, 1992, 2006*). In this context, I will also quote Richard Wagner, who, drawing on Hayek's ideas, defines the state as one of the manifestations of "an order that coordinates the actions of a multitude of participants pursuing different goals" (*Wagner, 2016, p. 90*). This order arises spontaneously "as a result of each of its elements balancing the forces acting on it and coordinating all its actions with each other" (*Hayek, 2006, p. 69*), ensuring the coordination of the Behaviour of individuals and their communities pursuing different goals.

I would like to note that even a superficial acquaintance with Hayek's Concept of Cultural Evolution leads to the conclusion that its most important provision is related

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<sup>15</sup> See, for example, Voeikov M. I., Pavlenko Yu. G., Kolganov A. I. State Paternalism and Civil Society (2023), ch. I. / Final report of a three-year study on the state assignment "The Evolutionary Theory of State Paternalism: Public Choice, Institutions and Civil Society" (*Scientific supervisor and editor of the report: Rubinstein A. Ya.*)

to the fundamental unattainability of the final point of evolution<sup>16</sup>. As Hayek himself writes, "the nature of this evolution is not linear; it developed through a process of constant trial and error, continuous 'experimentation' in areas where there was 'competition' between different types of order" (Hayek, 1992, p. 39).

It is clear that in the process of evolution, various elements of the metasystem "political power–economy–civil society" can exert greater or lesser influence. It can also be assumed that in all these cases, the degree of its balance, or, according to Hayek, the measure of "balancing the forces at work", will most likely not be the same. This is confirmed by economic theory, which points to the existence of market failures that generate increased government intervention in the economy. I would add to this the failures associated with the implementation of government regulations (Krueger, 1990; Stiglitz, 1997; Radygin, Entov, 2012), and failures of civil society due to "insufficient self-organization" (Salamon, 1987), which also cause corresponding changes in the balance of elements of the meta-system under consideration.

Two directions of development of the economic theory of the state can be identified. First and foremost, this involves studying the structure of the social organization of the state<sup>17</sup>, including identifying *the dominant* elements in this structure, i.e. the corresponding elements of the trial "political power-economy-civil society", whose predominant influence at a given point in time becomes the main reason for the formation or growth of overall imbalance. The absence of a dominant element in the structure of the social organization of the state indicates a certain "balancing of the forces at work". Conversely, the presence of a corresponding dominant element is essentially a criterion for the imbalance of social organization.

Identifying these dominant factors is no easy task, as various components of the metasystem may be responsible for such structural shifts. It all comes down to changes in their influence during the evolution of the state. Based on this, it is not difficult to

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<sup>16</sup> For more details, see: (Kapelyushnikov, 2024a, 2024b)

<sup>17</sup> The term "social organization structure" refers to the weight of the three elements of the "political power–economy–civil society" metasystem, reflecting the degree of influence of each of them. In a certain sense, this structure is analogous to "social order".

assume the existence of links between different types of imbalances in social organization caused by the dominant elements of the metasystem and the characteristics of state governance aimed at forming and implementing the interests of the state. Taking this hypothesis into account, three basic models of state governance can be identified, each of which is determined by *the dominant element* of the metasystem.

*The market model of governance*, formed because of the dominance of a competitive market with the weakening of the influence of political power, whose actions are limited to the functions of a "night watchman" associated with the elimination of market failures. The formation and implementation of public choice goals using mainly market mechanisms.

*A model of public governance* that arises as a result of the strengthening of the influence of self-governing civil society actors, which limits the actions of political power and determines the collective nature of decision-making on the formation and implementation of public choice goals, with the participation of civil society representatives at the federal, regional and municipal levels.

*An autocratic model of governance*, formed as a result of the strengthening of the influence of political power while restricting market freedoms, as well as civil rights and the activities of self-governing civil society actors, aimed at the formation and implementation of public choice goals in accordance only with the basic guidelines of the authorities.

It is obvious that each of these models of governance, corresponding to *extreme* cases of the structure of the social organization of the state, cannot be considered as a coordinated public choice, but is a spontaneous result of the evolution of the state, the nature of which (according to Hayek) is not straightforward. Its volatility reflects evolutionary shifts in the structure of social organization, expressed in the change or elimination of its dominant features, which determines the change in models of state governance. The evolutionary nature of such changes is extremely rarely manifested in the form of the abrupt formation of one of the dominant features, allowing for the presence

of signs of one or another model of state governance at different phases of this evolution.

I will also highlight another direction related to the consideration of Hayek's key thesis on "balancing the forces acting on the social order," but now from the perspective of economic dimensions. Solving problems of this kind involves, among other things, studying the consequences of failures: of the market, political power, and civil society, and their reflection in changes in the structure of social organization, taking into account a number of circumstances.

First, institutional decisions that contribute to the elimination of market failures as a result of restrictions on its freedoms are fraught with the redistribution of influence among elements of the metasystem in favor of the authorities and a change in the "balancing of forces." Second, another vector of evolution, associated with a reduction in the influence of the authorities as a result of the growth in the activity of self-governing civil society actors that limit the legislative and executive powers, also leads to a change in the "balance of forces," but in a different direction. Thirdly, the permanent conflict between each pair of elements in the triad of the aforementioned metasystem, and above all between political power and civil society institutions, often leads to the failure of "civil society" and the strengthening of political control.

## INSTEAD OF A CONCLUSION

A theoretical-historical analysis of the formation and development of the Theory of Protected Goods, its continuation in approaches to the study of the state and public administration, the humanitarian sector of the economy, and cultural activities themselves, has made it possible to rethink some of the results of research and build on the current state of theoretical economics. As some of the results of this analysis, I will formulate a number of meaningful conclusions.

1. It is possible to speak with some certainty about the existence of a common logic of theoretical constructs, based on a relativistic methodology that equalizes individual preferences and the interests of the state. This fact allows us to consider the Theory of Public Goods and its legacy as a set of ideas that expand the boundaries of economic analysis and have important practical significance for the performing arts.
2. Much has changed over the years, and economic science is becoming increasingly multidisciplinary, drawing on the results and methods of research in philosophy, sociology, political science, and social psychology, which has significantly expanded the arsenal of theoretical economics. In this sense, the analysis demonstrated a more rigorous and, most importantly, interesting scientific justification for a number of theoretical results based on philosophical and sociological research.
3. An overview of the theory of public goods and its legacy also yielded new results that were absent from the original version of these theories. Among them, we should first mention the relativistic methodology, a more rigorous content of the theory of public goods and the concept of “new meritocracy,” meritocracy policy and the definition of normative public goods, the construction of an equilibrium model for public

goods, a new interpretation of the “Harberger triangle,” and the theoretical rehabilitation of the category of budget subsidies, its parametric model, and the full budget cycle, including three exogenous sources of financial resources for the humanitarian sector of the economy.

4. The results of recent research devoted to the theory of the state and its evolution should be highlighted separately. The introduction of a new paradigm of the state in the form of an institutional metasystem “political power-economy-civil society,” including the definition of its social structure. This is a fundamentally new direction of research, in which methodological relativism and the existence of an autonomous interest of the state, irreducible to individual preferences, have made it possible to define a more general content of the state, which has led to a new approach to the theory of public administration with the distinction between the market model, the public administration model, and the autocratic model.

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