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## **Economic Behavior of Business Entities, Culture and Institutions: Specifics of their Interrelations in Conditions of Neo-Industrialization**

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**Abstract:**

*Goal of the research is to develop an approach for a system-value study of endogenous links between the economic behavior of business entities and ethic-cultural values and institutions.*

*Objectives are to develop an approach for a systematic and comprehensive interpretation of dynamic and endogenous relationships of behavioral, cultural-value and institutional variables; to clarify the specifics of the systemic relationships of culture and institutions; to determine the specifics of system-endogenous influence of ethic-cultural values and institutions on the economic efficiency of entrepreneurship; to study shifts in the distribution of personal incomes and contemporary problems caused by disfunctions related to culture, values and national specifics.*

*Central hypothesis of the research deals with the assumption that it is impossible to study the systemic links in the economic behavior emerging between business entities, culture and institutions at the required level using traditional approaches, mechanisms and methods in the dramatically changing economic reality.*

*Research methods: theoretical and methodological approach combining the methods of the interdisciplinary research theory: synergetic, complex systems, social constructivism, metaethics, multicultural modernization and structurally active methodology, as well as methods of theoretical and empirical research. The institutional basis of the empirical part of the analysis was comprised by the statistical data of many international organizations and the main findings of cross-cultural research on this topic published in scientific journals over 2001-2016.*

*The authors developed a theoretical and methodological approach that allows a system-holistic study of the endogenous links between behavioral, cultural-value and institutional variables, combining the individualistic and holistic methodology, as well as positive and normative approaches. The article proposes an approach for systematic study of endogenous links between the efficiency of business entities' economic activity and cultural-value*

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*variables. Using the example of the US economy, it was proved that the dis-functionality of the value-normative and institutional systems is the fundamental factor of the abnormal inequality of personal incomes and the problems caused by it.*

*Provisions and conclusions presented in the article enable a spacious approach to the problem and a deeper theoretical understanding of the relationship between culture and institutions, the composition and functions of the main structure-forming elements of the economic system and the national model, the role of cultural-value and institutional variables in economic efficiency of business entities.*

*The main provisions and conclusions of the paper can be used for further theoretical and empirical studies on this issue and in practice to develop strategic approaches and priorities that can increase the effectiveness of economic policy and business.*

*Relevance of research stems from the rise of a qualitatively new wave of global changes in the national economy caused by a shift in the nature and mechanisms of economic activities of business entities, the growing role of knowledge and innovation, culture and institutions in economic development; as well as the lack of appropriate theoretical and methodological approaches.*

**Keywords:** *economic behavior, business entities, institutions, actors, culture, ethics, neo-industrialization.*

**JEL Classification:** *O35, O38, O43, D01, D04, D31, D33*

## **1. Introduction**

At present moment, empirical research has clearly established and universally recognizes the importance of institutions for the economic activity of business entities. Empirical studies of culture are a relatively new field of economic science. Most papers aim to give a general idea of the role culture plays or its specific characteristics. Only in recent years, some empirical studies have been conducted which explore the relationship between culture and institutions and classify their impact on economic activity (Alesina and Giuliano, 2015; Pociovalisteanu and Thalassinos 2008). In addition, many empirical studies apply the anthropological approach to culture which underestimates its potential change and exaggerates the significance of certain characteristics for economic activity.

Theoretical and empirical studies describe the influence culture exerts on the economic activities of business entities through some of its significant characteristics. In this article, we consider ethical and value beliefs that form the core of the culture of each society as an example of such characteristics.

The paper attempts to combine the research findings on culture and institutions within the considered problem and to propose some umbrella-type concept within the economic theory which provides a systemic and holistic perspective of its solution and to establish the crucial theoretical aspects of the relationship between behavioral characteristics of actors and cultural-value and institutional characteristics of the economic system.

## **2. Literature Review**

Most conceptual theoretical and empirical studies involve the development of theoretical models and logical diagrams that analyze the exogenous links of economic behavior with culture and institutions in line with the methodology of individualism and positivism.

Methodological holistic concepts are often based on the rigid links of cultural values and institutions, and they practically neutralize the role of individual actions and maintain the exogenous interpretation of these relationships. Today, not all adherents of the new institutional economics fully rely on individualistic methodology, and not all representatives of traditional institutional economics adopt the principle of holism in their studies (Toboso, 2013). This leads to breaches in methodology and incomprehensive research results.

Today, the role of institutions is well established and generally recognized. Numerous recent studies have empirically shown that the culture characteristics significantly influence the development of the national economy and economic changes (Guiso *et al.*, 2006, 2009; Fernandez, 2008, 2011; Vinogradova, 2015; Setyawati *et al.*, 2017) innovation and knowledge management at the national and

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organizational levels (Couto and Vieira, 2004; King, 2007; Ang and Massingham, 2007; Kayworth and Leidner, 2004); results of economic activities of individuals and companies (Algan and Cahuc, 2014; Rustamova, 2013; Thalassinos and Pociovalisteanu, 2007; Hania *et al.*, 2007). At the same time, understanding of the interrelation mechanism between culture, institutions and economic behavior of business entities may vary significantly, which largely result from the application of alternative methodological approaches – individualism and holism.

The neoclassical school based on the methodology of individualism has taken the domineering position in economic science. Its competitiveness is since there is no clear alternative to the rational-maximizing model of the human (Lawson, 2013). Methodological individualism resulted in the emergence of numerous fragmentary models that cannot be combined within a universal concept (Harstad and Selten, 2013; Thalassinos and Dafnos, 2015). In the institutional modification of this methodology, individual action is associated with the institutionalized consciousness that considers the structural framework of rules and organization (Chavance, 2012). However, the methodology of individualism suggests that “institutions are part of the external environment of individual actors” (Boyer and Petersen, 2012).

Institutional versions of methodological holism recognize the key role of culture and institutions in interpreting economic processes since people act in accord with norms and values learned. The problem of institutional holism is associated with the exaggeration of the background role of culture and institutions, which creates an impression of the external predetermination of norms and values (Spiegler and Milberg, 2009; Turnbull, 2011).

In economic studies, the term “culture” has not been clearly defined yet, and many papers consider culture as a phenomenon expressed through values, preferences or beliefs (Guiso *et al.*, 2006; Hapsoro and Suryanto, 2017).

It is believed that the boundaries between culture and institutions are very vague; this leads to differences in classification of institutionalized forms of economic behavior among business entities (Buchanan *et al.*, 2014). In broad sense, there are the following basic types of institutions: mental – thinking stereotypes, values, cognitive patterns, etc; informal – customs, traditions, codes, etc; formal – laws, contracts, etc; functional – status roles and functions; structural – organized forms and models of transactions (Frolov, 2016). At the same time, A. Alesina and P. Giuliano draw attention to the fact that when describing measurements and studying papers on the interaction of culture and institutions, as a rule, culture is understood as values and beliefs, i.e. informal rules, whereas institutions are formal institutions (Alesina and Giuliano, 2015). This approach can be found in most empirical works, where authors attempt to differentiate between these two concepts.

North defines institutions as exogenously set formal rules and informal norms (North, 1990). In all modern versions of institutional individualism, institutions and

culture are exogenous variables. Spiegler, Milberg, and Greif, Kingston see institutional elements as exogenous to each subject and endogenous to the system (Spiegler and Milberg, 2009; Greif and Kingston, 2011). All new institutional theories are based on the theory of social constructivism since they view the creation of institutions as the result of social interaction between actors colliding with each other in certain fields or arenas. However, neither constructivism nor the theory of rational choice provides meaningful explanations or predictions of their behavior (March and Olsen, 2006; Fligstein and McAdam, 2012; Ostrom, 2007).

At present moment, a normative line of research has emerged at the intersection of economics and related social sciences studying ethics and culture (Sen, 2005; Mongin, 2006; Hausman and McPherso, 2006; Sayer, 2007; Kaplow and Shavell, 2007), as well as efficiency ethics (Staveren, 2009), ethical climate and national ethical capital (Parboteeah *et al.*, 2005; Schwartz and Weber, 2006), social responsibility of business and value-based management (Porter and Kramer, 2011; Malbasic and Break, 2012). There is active search for the conceptual core conducted within the framework of socioeconomics (Etzioni, 2003; Keizer, 2005; Hollingsworth and Müller, 2008; Boyer, 2008; Starr, 2009). Today, as Lal notes, many theoretical economists do not have a clear perspective of culture and economic development, but see them as something vague and confusing, whereas those involved in practical development of economic programs point out the importance of culture (Lal, 2007). Thus, it seems viable to develop a conceptual approach that would provide an accurate interpretation of the economic interaction behavior among business entities, culture and institutions.

### **3. Methodology**

Our research is based on the developed methodological approach which combines the methodology of individualism and holism. This approach allows us to expand the range of problems and to propose a systemic and holistic view which will enable the research on relationships in the behavior of actors, cultural and institutional variables in the national economy. The approach implies that this connection is endogenous and there are deep cause-and-effect mechanisms determining the formation and changes in economic relations and institutional practices, while the national economy is viewed as an open, complex, and dynamic system. At the same time, due to interinfluence and interdependence, actors pursue to build relationships of compromise, institutional forms and behavior models based on mutual evaluations of ethical-cultural and business characteristics, as well as resource potential for successful operation in changing structural conditions. The work also adopts interdisciplinary methodology combining the methods of the theory of synergetic and complex systems, sociocultural systems and multicultural modernization, social constructivism and communications, metaethics and the system-active concept; methods of theoretical and empirical research (abstract-logical, comparative-analytical, interpretation, typology, observation, grouping and

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generalization, statistical information, tabular and graphical forms of data representation).

#### **4. Results**

The article proposes a methodological approach, which, unlike traditional concepts, allowed us to view the national economy as a complex, multidimensional and dynamic system of value-rational interactions of heterogeneous actors. We expanded the range of problems researched and proposed a system-holistic view of the relationship between economic behavior and cultural values and institutions, the basis of which implies overcoming the dichotomy of positive and normative in the economy, individualism and holism. In addition to that, we identified the cultural-value and institutional levels of the factor space. In contrast to the limited rationalistic and moralistic concepts, we developed a deeper interpretation of the mechanisms describing the relationship between behavioral, cultural and institutional variables and the boundaries of their variations according to the proposition that their national characteristics are determined by the traditions of maintaining a specific system of value-ethical preferences.

It is proven that cultural values and norms have an economic component and in this sense, are an important part of the economic reality. We have developed a structural model of the national economy which, unlike traditional approaches, along with the institutional and instrumental system, includes a value-normative system. The research reveals the formation mechanism of endogenous links of economic efficiency with cultural-value and institutional variables, as well as defines the role of cultural-value and institutional variables in the formation of different types of situations, the causes of economic success and failure. The authors establish the influence of the change in cultural and value preferences on the distribution of personal incomes on the example of the USA and the emergence of economic problems caused by abnormal inequality, and the solution of this problem is proposed.

#### **5. Discussion**

##### ***5.1. Culture and institutions: Interconnection specifics***

Over the last decade, sociological, philosophical and culture-logical papers saw culture as a social code – a complex, historically developing system of supra-biological programs manifested in symbolic forms that are used to store, broadcast and generate knowledge and ideas about the world for solving practical problems and adapting to the material and social environment. The core of culture is formed by values that are the basis for actors' understanding each other and interaction. Individual beliefs acquired because of cultural transmission are gradually updated as experience is being gained, from generation to generation (Guiso *et al.*, 2008). At present moment, another view is emerging which is an alternative to positivistic vision of the economy, focused exclusively on the theory of rational choice; this

alternative of the “road of values” is opposed to the “road of choice” (Klamer, 2003). In contrast to the logic of rationally maximizing actors, the constructivist approach suggests the logic of communicative action, within the framework of which value-rational actors interact and their cultural-value perception of the world is determined by the way they understand it. Within this logic, institutionalization implies legitimation when the institutional order is perceived as justified, with its authoritative nature emphasized (Fligstein and McAdam, 2012).

When analyzing the actors’ behavior, one should proceed from the idea that there are two fundamental levels of the factor space. The first level acts as a cultural-value space or a sphere of human consciousness where symbolic ways of comprehending and evaluating reality are formed. The second level describes the institutional aspect of value-oriented interactions.

To clarify the mechanisms that ensure the creation of system-related norms and rules, and coordinate interests of different actors, one should reconsider the role of morality as a special way culture influences communicative practices. Today metaethical theories are divided into two groups: moral exclusivism based on the idea of the otherworldly nature of morality and its neutrality; on the other hand, moral inclusivism is becoming more popular, and it views morality as an integral element of the universal reality (Levin, 2013). In contrast to value-neutral and moralizing approaches, it is important to mention that ethical-cultural values in actors’ interactions are to perform their basic function, acting as a universal way of reconciling different interests. The moral principle assumes that only those norms that are beneficial to all whom they concern are effective and receive expert approval.

The mechanism of changes in cultural values and institutions reveals their complex relationship, relative autonomy and mutual influence. Institutions develop a system connection which signifies their rootedness in culture. Therefore, the same institutions in different structural conditions lead to different outcomes. “Economic institutions do not exist in vacuum, but in the context or, if you like, in the fabric and social and political structures, cultural forms and, of course, in the structure of self-consciousness: in the system of values, ideas, beliefs” (Berger, 1994).

There is a complex systemic relationship between the behavioral, cultural-value and institutional variables. When implementing sociocultural changes, it is important to choose a strategy that avoids their negative aspects and forms positive motives for all bearers of change.

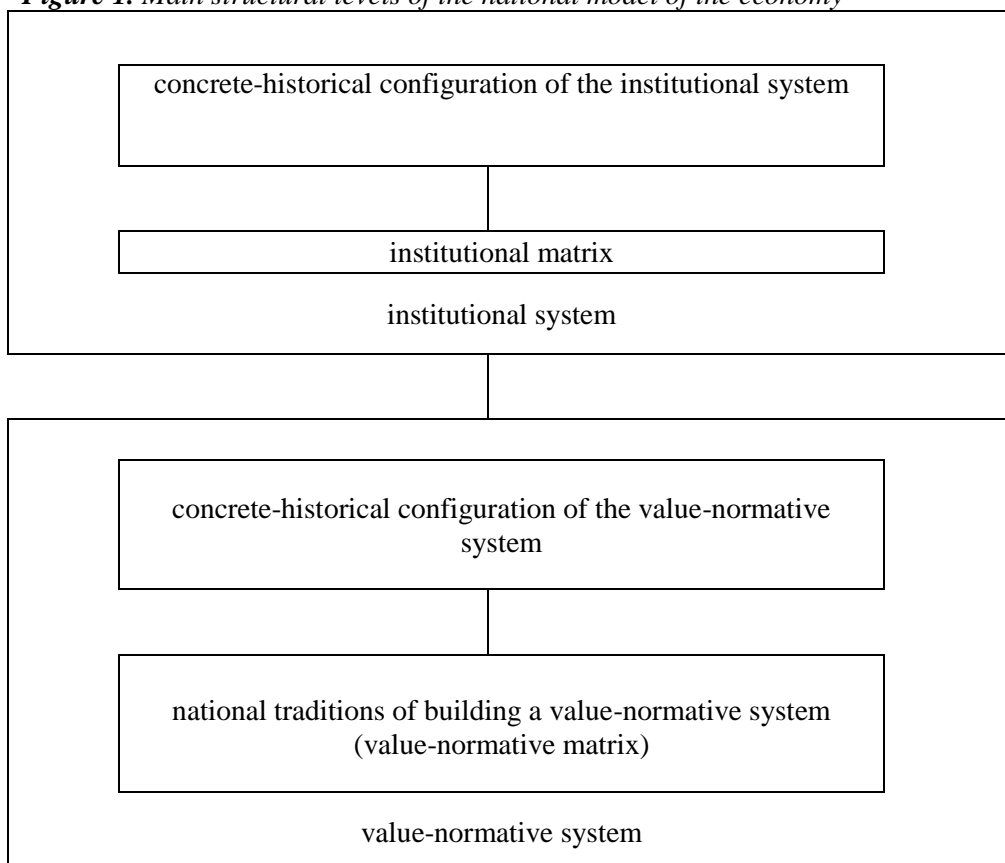
### ***5.2. Ethic-cultural norms and concepts as an integral part of economic reality***

Economic reality is part of social reality which includes economic culture, as well as relevant values, norms, rules, attitudes and practices.

Within the general economic system, the following phenomena arise during communicative practices: 1) the value-normative system that represents a goal-oriented, integrating and coordinating center; 2) the institutional-instrumental system that acts as a shell and includes subsystems – productive-technological, functional role-based, organizational-economic and others. At the same time, ethics should form the basis for the whole economic activity at all its levels (Carroll, 1996; Zsolnai, 2002; Seadlacek, 2011).

National specifics of the mechanism of interaction between behavioral, cultural-value and institutional variables form under the influence of the peculiarities of the structural conditions that emerge during the development of the national economy. They create the basis for the specificity of the configurations of cultural-value preferences, normative-value and institutional systems, which manifests itself in the specific features of economic culture and its individual forms (labor, entrepreneurial, organizational), value-ethical and institutional characteristics of business environment (Figure 1).

**Figure 1.** Main structural levels of the national model of the economy





Economic actors demonstrate both selfish and ethical-cultural aspirations. Such a combination determines the choice of goals and means to achieve them, which leads to various consequences (Etzioni, 2003; Sen, 2005; Sayer, 2007). Depending on the balance of negotiating forces, actors often try to “adjust” regulatory norms and practices to the positions they hold. Informal institutions can arise not only because of spontaneous or planned individual actions, but also partly stem from formal institutions, which they, in turn, are also capable of modifying (Smallbone and Welter, 2012).

The proposed approach to the analysis of the fundamental principles of building the economy implies the development of the systemic vision of it because the behavior of actors is not only goal-oriented, but also value-rational. It enables the transition to a new level of understanding the complexity of interrelationships of the universal and the local in cultural-value institutional variables, clarifying the general laws and features of the development of national economies.

### ***5.3 Cultural values and efficiency of economic activities of business entities***

In contrast to the value-neutral notions of efficiency, at present moment, researchers are actively developing theories that consider ethical aspects (poverty, environmental deterioration, etc.). Numerous publications are devoted to the criticism of Pareto-efficiency which allows unfair equilibrium if the Pareto-efficiency criterion is observed (Lutz, 1999; Schultz, 2001). At the same time, many versions of normative economic science that have been developed over decades remain unsatisfactory as they proceed from the dichotomy between normative and positive economic science. As Staveren notes, “the normative concept cannot capture the essence and is incapable of proving the inconsistency of the Pareto efficiency criterion... The concept of efficiency is ethical by its nature, not because it excludes justice... but because it includes values” (Staveren, 2009).

The endogenous mechanism of the link between economic efficiency with cultural values and norms is since the efficiency of distribution and use of resources in the economy directly depends on the ratio of private and common interests. The more balanced the value-ethical and institutional sphere of the economy, the more favorable are the conditions for the formation of mutually beneficial relations between all groups of actors and cumulative-synergetic effects in the economy. For example, there is a nonlinear relationship between equality and efficiency (Cornea, 2004). High and non-legitimate inequality hinders the growth of human and social capital, and reduces the level of general trust and support for institutional changes.

Therefore, since 2010 the Human Development Index (HDI), monitored by the UN, has been supplemented by inequality indicators. Today, researchers propose various ideas about the relationship between inequality and economic growth in the long historical perspective. For example, S. Kuznets pointed to the relationship that takes the form of an inverted U (Kuznets, 1955), T. Piketty claims the opposite (Piketty, 2014); B. Milanovic proves the existence of a cyclic type of communication within

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the framework of large economic cycles under the influence of three fundamental factors: technology, openness of the economy and state policy (Milanovic, 2016). However, many researchers believe that there are no universal laws in the long-term dynamics of inequality since all situations arising in national economies in different periods are unique. Therefore, these dynamics should be considered as episodes, rather than trends (Atkinson, 2015).

Trust is one of the most empirically researched ethical-cultural values and, as a rule, it does not depend on life experience (Uslaner, 2008). Trust influences the level of transaction costs, individual productivity and company's efficiency, innovation and economic development, the development of the financial sector and trade. A review of the impact of trust on various economic indicators is presented in the work of Y. Algan and P. Cahuc (Algan and Cahuc, 2014). In the institutional economy, the category of trust underlies "relationship" (implicit) contracts and in this capacity, acts as "social capital" (Graafland, 2007).

The analysis should be carried out not only from the perspective of statistical efficiency, but also dynamic productivity, taking into account the system-cumulative effects arising in the strategic perspective that lead to the accumulation of not only physical, but also human, intellectual and relationship capital, generation and spread of innovations, cyclo-temporal dependencies, and providing a rational balance between traditions and innovations, existing and new technical and economic structures (Blaug, 2001; Biryukov *et al.*, 2015).

Using a multi-level system of cultural values, actors of different levels of the economy: 1) develop assessment procedures, statistical and dynamic parameters of the effectiveness of economic activity; 2) evaluate the situation; 3) determine the range of permissible variations of economic practices and institutional variables.

#### ***5.4. Specifics of labor and capital income distribution in the conditions of neo-industrialization***

Most timely economic problems can be solved through the development of new mechanisms for regulating the income from labor and capital, if national traditions, the level and cyclical development of the economy are accounted for. The value components of culture dealing with income distribution are quite inert and there is a strong correlation between the preferences of the second generation of emigrants and the same preferences in the country of origin (Luttmer and Singhal, 2011). This kind of preferences is influenced by the political regime and macroeconomic shocks that affect people's beliefs (Giuliano and Spilimbergo, 2014).

Distribution of income between labor and capital is largely characterized by the inverse relationship of how well the economy is supplied with these resources. In developing countries with cheap labor, its capital-labor ratio is crucial for increasing labor productivity. Therefore, in the structure of these countries, the income from capital makes up the largest share. For instance, in the 2000s it accounted for 70% of

India's GDP, with 30% of labor incomes; due to the favorable investment climate, foreign direct investment (FDI) in the country increased by 45 times over 1995-2014 (UNCTAD, 2015).

In the 21<sup>st</sup> century income distribution trends are changing, which causes certain complications of the socio-economic situation. For instance, in the USA, the use of labor-saving technologies and the export of capital to countries with cheap labor resulted in a decrease in the GDP share of labor incomes from 60.9% in 2000 to 56.8% in 2014 (BEA, 2015).

The problems of modern economy are caused not by capitalism, but by the “ersatz capitalism”, based on the misappropriation of rent and ignorance of the interests of most of the population (Stiglitz, 2015). The incomes of the top managers of the largest companies in 1970 exceeded the average wages of their employees by 30 times, this figure estimating 300 times in the mid-2000s (Krugman, 2007). The reduction in the US and UK maximum tax rate on the incomes of top managers from 80-90% to 30-40% led to explosive growth of their incomes (Piketty, 2014).

Under these circumstances, many countries must change the focus of their tax system to effectively use savings and boost innovation. Currently, the EU countries are striving hard to achieve this goal. The EU has demonstrated a tendency to lower interest rates and raise value-added rates (Table 1). This helps to improve the business climate and limit excess consumption.

**Table 1.** Rates of profit tax and value added tax in EU countries, 2000-2015 (%) (EU, 2015)

| Country | Profit tax |      | Value-added tax* |      |
|---------|------------|------|------------------|------|
|         | 2000       | 2015 | 2000             | 2015 |
| Germany | 51.6       | 30.2 | 16/7             | 19/7 |
| The UK  | 30.0       | 20.0 | 17/5             | 20/5 |
| The EU  | 32.0       | 22.8 | 19.3             | 21.6 |

\* The numerator represents the standard rate, the denominator – the minimum.

At present moment, Anglo-Saxon school of economic science does not pay much attention to the issue of income distribution. R. Lucas points out the negative impact of scientific research in this area (Lucas, 2002). However, despite the resistance of conservatives, influential groups of politicians and economists, the problem of regulating income distribution will become the key one in economic policy and science in the foreseeable future (Klinov, 2016). To change income distribution practices, one should keep in mind that different groups should get a wider access to the resources of human capital accumulation, and it is necessary to create the

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environment conducive to structural changes, to intensify investment, business and work activities.

## **6. Conclusion**

The paper proposes a more universal system vision of the national economy which is considered as a complex, multidimensional and dynamic system. Within it, using cultural and value ideas about business abilities of partners and the trends of a changing environment, actors develop compromising forms and rules of interaction that allow them to succeed. It was shown that the economic system includes: 1) the value-normative subsystem; 2) economic-instrumental subsystems and corresponding institutions. The developed two-level model of the national economy allows a more meaningful interpretation of the systemic links of its factor space, the specifics of the links between behavioral, cultural-value and institutional variables.

The proposed methodology puts forth a new set of research problems through the paradigmatic reconsideration of theories based on the methodology of individualism and holism, the dichotomy of positive and normative in the economy. It is shown that the factor space includes the value-ethical and institutional levels, such a view providing a better understanding of the complex interrelationship between culture and institutions.

The main provisions and conclusions can be used for further theoretical, methodological and empirical research on the interrelationship of the economic behavior of various actors, ethical and cultural values and institutions. The main findings of the study can contribute to the development of practical recommendations for improving the efficiency of economic activity.

The developed theoretical-methodological approach allows a transition beyond traditional value-neutral and normative theories regarding the issues of economic efficiency of business. The paper reveals the influence of changes in cultural-value preferences on the distribution of income between labor and capital within a large cycle of the modern economy, using the example of the United States. The authors establish the economic problems caused by abnormal inequality and ways of solving them.

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