Introduction

Claude Ménard

The research program in ‘new institutional economics’ is expanding and deepening rapidly. In its expansion in the traditional domain of economics, it provides new insights and offers powerful explanations of central issues such as modes of coordination, the integration and disintegration of firms, contractual incompleteness, organizational arrangements, market structures and factors of growth. It is also extending into new terrain, from legal studies to political science and anthropology. Even more importantly, the new institutional economics approach is deepening. Concepts are becoming better defined, models are being progressively developed, and empirical tests are multiplying rapidly and successfully.

The chapters collected in this book illustrate and substantiate several dimensions of this research program. These chapters are at the frontier of the field, selected to present ideas and areas under exploration, and without the intention of covering all aspects of current research.1

Part I deals with the foundations of new institutional economics, and it includes three very special contributions. Ronald Coase emphasizes the interdependence among the productivity of an economic system, the costs of exchange, and the institutions that make specialization possible. Douglass North explores further some major characteristics of institutions, particularly their dependence on how choices are aggregated in political markets, how informal constraints and norms contribute to shape them, how the resulting rules are enforced, and why changes are so difficult to explain. It is precisely this problem of institutional change that Masahiko Aoki explores with the help of game theory. Many contributors to new institutional economics are skeptical about the utility of game theory in developing our research program. Aoki’s chapter shows how helpful this approach can be in delineating much better some fundamental concepts (for example, ‘institutions’) and in analysing more rigorously some major issues (for example, what Aoki calls the ‘reconfiguration’ of institutions).

Part II of the book is a Homage to Ronald Coase. It is a collection of papers that were delivered on the occasion of the presentation by the University of Paris (Panthéon-Sorbonne) of an honorary degree to Coase, who is
also the first president of the International Society for New Institutional Economics. Contributors to this part (Douglass C. North, Lars Werin, Oliver Williamson and Claude Ménard) emphasize different aspects of the complex and dense works of Ronald Coase, from the microanalytics to the macro-dimensions of institutions, and they suggest further developments and new dimensions to explore. Together, they provide complementary insights on the many facets of research instigated by Coase. Part II ends with a complete bibliography of Coase’s work that he himself provided.

Part III raises controversial issues and contains conflicting views about the sources of growth. In a provocative and stimulating chapter, Harold Demsetz challenges the emphasis on institutions in the explanation of growth, and develops the idea that ‘North’s chain of causation’ should be reversed, with non-institutional factors such as technology and natural endowment the determinants of changes in institutional arrangements. Philip Keefer and Mary Shirley move in the opposite direction, showing that countries with good institutional scores and weak macroeconomic policy have higher growth rates than countries with good macropolicies and weak institutions. Their conclusion, using a comparison between Ghana and China, is that formal institutions (such as political systems with checks and balances) and, even more importantly, informal institutions, are the sesame to economic development. Stanley Engerman, Stephen Haber and Kenneth Sokoloff provide a sort of blend of these views. Through a careful examination of the differentials in growth rates and income levels in the Americas, they show the role of factors endowment in the modeling of social relationships (for example, slavery) and of institutions, but also the reverse effect of institutions on the formation of human capital and on the dynamics of sustained growth.

Part IV brings us into more microanalytics views, with very original developments on trust, distrust and corruption. Margaret Levi proposes provocative ideas on the positive results of distrust. She argues for the importance of building defenses in the form of institutional arrangements that safeguard property rights and that ensure minimal peace among economic actors among whom distrust is often rational. She concludes that ‘healthy skepticism’ is important to democracy, in that it provides incentives for building institutions that ensure ‘good defenses’ and that lower transaction costs. Jean Ensminger also discusses the role of trust and distrust, but in a very different setting. An anthropologist who has worked in Kenya for several years, she reports on her pioneering work in experimental economics. Using preliminary results from four games played in different villages, she suggests two important results: (a) the strong concern for fairness in these traditional societies is identical to what the same games reveal in the most developed economies; and (b) there may be significant differences between sedentarists and nomads, with more trust and more fair-minded behavior among the former because of the exist-
ence of more formal institutions. This analysis surely challenges the traditional view of the goodness of human beings in their ‘natural’ state. The third chapter in this part, by Lee Alston and Kyle Kaufmann, raises the issue of trust and distrust in a context in which formal institutions do not provide adequate guarantees. Analysing why black renters paid more than their white counterparts in the US South in the 1920s, they suggest that black cash renters had to pay a premium in exchange for protection from influential Whites in the hostile environment (for Blacks) of the American post-bellum South. This would be a typical case in which informal institutions, in this case, paternalism, had to substitute for the failing formal institutions. Joshua Charap and Christian Harm bring us the opposite point of view, arguing that formal institutions, and particularly political ones, are fundamentally based on corruption, understood as the result of predatory behavior, so that the elimination of corruption in some instances could lead to anarchy rather than efficiency. This is a controversial view, indeed, and one that leaves open the question raised by one of their referees of ‘how the [authors’] hypotheses square with modern democratic institutions where predatory behavior is not a realistic assumption’.

Part V also deals with problems that are partially related to trust and distrust, that is, enforcement issues. Yoram Barzel discusses the forms of third-party enforcement that develop when self-enforcement is not enough to provide guarantees to transactors. He makes a very useful distinction between forms that develop in the context of a long-term relationship and those that tend to prevail in situations with no enduring direct relationship. In the latter, enforcers will have incentives to impose costs by inflicting harm on parties who fail to fulfill their commitments. This necessary ‘violence’ could provide some positive rationale for the role of the state, an interpretation that can be compared to the darker view proposed by Charap and Harm. Claude Ménard’s chapter is also concerned with enforcement issues, particularly when self-enforcement fails. But his approach puts more emphasis on the micro level, particularly on the relationship between procedures of enforcement that will be implemented and the type of governance structures to which they relate. Using the analytical apparatus of transaction cost economics, the author suggests that asset specificity, as an attribute of transactions, connects contracts to governance structures, while uncertainty is the factor that links the latter to enforcement procedures. He also examines self-enforcement and credible commitment, and private and public ordering. Jose Garibaldi-Fernandez goes further in the analysis of public enforcement by examining the impact on how people organize and interpret transactions, of legal traditions and their administrative settings. In examining divergence among interpretations of civil law in Western Europe and Latin America, he also shows how much enforcement depends on the organization of courts, and can
influence choices of transactions, such as forms of credit. John Drobak’s chapter closes this section with an examination of the role of rules of thumb in the enforcement of contracts by the legal system. The case of Carnival Cruise Lines, Inc. versus Shute, that Drobak examines, illustrates how bounded rationality matters in the interpretation of contractual arrangements by parties and in conflict resolution by the courts.

The chapters assembled in Part VI present different facets of the organization of transactions across different arrangements, from integrated firms and quasi-integrated networks to cooperatives and regulated markets. Behind the variety of these arrangements, all the chapters show the interaction between institutions and modes of organization. Alberto Fernández, Benito Arruñada and Manuel González present a careful examination of the quasi-integration and hybrid arrangements in the less-than-truckload industry. Comparing the fragmented Spanish trucking industry to the much more concentrated American market, they show the impact of institutional factors such as labor and tax regulations on transaction costs and, consequently, on the shaping of a market structure. This is exactly what the chapter by Jean-Michel Glachant and Dominique Finon is about. Looking at electricity markets that organize very similar transactions, they examine why the ongoing reforms of electricity systems in the European Union do not converge towards the emergence of similar arrangements. Their explanation combines the analysis of what they call ‘internal institutional characteristics’, that is, characteristics of transactions in the electricity industry that delineate the set of possible arrangements, and the analysis of institutional environments that model the decisions made on regulation and the regulatory body, on the restructuration of the industry, and on the allocation of property rights. Their conclusion emphasizes the importance of the political regime in the design of reforms in the electricity sector. Michael Cook and Constantine Iliopoulos also deal with issues of property rights, but in a very different context. They analyse how a new generation of cooperatives emerged in the 1990s, which developed a structure of property rights that better overcomes the traditional problems of opportunism and underinvestment that have plagued cooperatives. Their empirical test shows the key roles, in the comparative success of these new arrangements, of membership policies designed to allow a better control over supply; and of marketing agreements between cooperatives and their members, designed to improve commitments of members to delivering specific quantities. The final chapter in this section, by Didier Chabaud, explores the possibility of using the standard analytical apparatus of transaction cost economics, which usually serves to explain the tradeoff among different governance structures, in order to understand another type of arrangement. Building on Koike’s distinction among operational, intellectual and relational skills to substantiate the concept of human asset specificity, and on the place of temporal specificity in the production process of the automobile
industry, he proposes a typology of the organization of work in that sector that partially confirms previous studies. He takes a further step in differentiating modes of work organization according to the strength of their hierarchical relationships. Future research will be needed to determine the validity of this typology for other industries.

Finally, Part VII discusses issues related to *models and measures*. Both aspects are of particular importance since it has so often been argued that new institutional economics remains unable to meet the technical standards of mainstream economics. In their chapter, Alexandra Benham and Lee Benham deal directly with the problem of empirical estimation of transaction costs. They identify several of the difficulties involved and they provide a rich set of examples of the variability in costs of exchange for the same transaction, depending on the institutional setting. Stéphane Saussier adds a significant piece to the already large set of econometric tests in transaction cost economics by comparing the propositions from this theory to those derived from incomplete contract theory. Using an extensive set of contracts, he analyses the tradeoff between the *ex ante* incentive function of contracts, designed to induce specific investments, and the search for *ex post* adaptability. His conclusion is that the latter prevails; this suggests a strong advantage of transaction cost economics over incomplete contract theory when it comes to empirical testing. Eric Brousseau and M’hand Fares develop more systematically the comparison between these two approaches, from a theoretical standpoint. Their chapter emphasizes what they consider to be some major differences between these explanations of the incompleteness of most contracts. They give special attention to the role of unverifiability, with the resulting difficulty of enforcement of contracts by a third party, in incomplete contract theory (or theories), and to the role of radical uncertainty, with the resulting development of organizational arrangements to prevent or reduce the risk of opportunism, in transaction cost theory. In the chapter closing this book, Pieter Ruys, René van den Brink and Radislav Semenov propose a further step in the analysis of governance systems, by developing a model that incorporates a complex set of cultural values. Their main goal is to show that formal tools can be designed to describe these cultural dimensions, and that the integration of cultural characteristics, as developed by the seminal work of Hofstede, has a significant effect on the concepts of ‘organization’ and ‘equilibrium’. From a methodological standpoint, their effort mirrors that of Aoki: they are looking explicitly at the possibilities of building a bridge between neoclassical economics and neoinstitutional economics, and they do so by modeling some fundamental intuitions provided by the latter. We can expect more research in this direction in the future.

This summary suggests the richness of the chapters assembled here. The arrangement in parts is mine, and other combinations would be possible.
Notwithstanding the diversity of disciplines, the degree of abstraction and formalization, the presence (or absence) and the importance of empirical content, there are an amazing number of complementarities. The network of relationships among such different contributors and domains demonstrates that a new, coherent and consistent perspective is emerging in economics, a perspective focussed on the analysis of institutions and of their impact on the organization of economic activities. The research program that Ronald Coase initiated is well on its way.

NOTES

1. This book is based on a selection of contributions presented at the second annual Conference of the International Society for New Institutional Economics (ISNIE), held in Paris in September 1998. Selection criteria for chapters presented here include their quality, their originality, their direct connection to the central theme of the book, and their exclusivity (with the exception of that by Ronald Coase, none has been published before). All but a few were submitted to a refereeing process, and most were rewritten with very significant changes.

2. This ceremony was held the day before the opening of the ISNIE Conference, on which this book is based. The International Society for New Institutional Economics came into being in September 1997. The idea of a network of researchers active in the field of new institutional economics had been maturing over several years, through discussions involving Ronald Coase, Douglass North, Oliver Williamson and several people in St. Louis, Berkeley, Ann Arbor, Washington and Paris. Informal meetings were held in 1995–96, and an electronic letter of information was circulated from 1995. In 1997, a workshop organized at Washington University (St. Louis) turned into a conference with over 200 participants from over 20 different countries. The ISNIE was established at that meeting.