1 Editors’ introduction

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Since its emergence in the 1970s, the transaction cost approach to firms, contracts, and economic organization has become one of the most important, influential, and exciting fields in law, economics, and organization theory. On applied topics such as vertical integration, the structure of networks and alliances, franchise contracting, the multinational firm, parts of antitrust analysis, marketing channels, and more, transaction cost economics (TCE) has become a dominant, if not the mainstream, perspective.

The transaction cost approach has its roots in the classic papers by Coase in 1937 and 1960, which articulated the concepts of transaction costs and property rights, and took form with the theories of the firm offered by Williamson (1971, 1979), Alchian and Demsetz (1972), and Klein et al. (1978), which introduced monitoring costs, relationship-specific investments (or ‘asset specificity’), and particular notions of governance and organizational mechanisms into the literature. TCE is expressed most strongly in Williamson’s books Markets and Hierarchies (1975), The Economic Institutions of Capitalism (1985), and The Mechanisms of Governance (1996), though important contributions come from other diverse sources. As described in the pages that follow, TCE has other important antecedents, core concepts, applications, extensions, and critiques. This volume aims to introduce the novice, and to inform the specialist, about TCE’s fundamental elements, about recent controversies and new developments, and about the place of TCE in the larger legal, economic, and managerial literatures on organizations and institutions. It does not attempt to provide a comprehensive overview of the field, a task performed well in recent survey papers and volumes such as Williamson (2000), Ménard and Shirley (2005), Brousseau and Glachant (2008) and in many contemporary textbooks on industrial organization, managerial economics, and business strategy.

We were both exposed to TCE in our graduate training and have been closely associated with the field ever since. Klein studied under Williamson at Berkeley in the late 1980s and early 1990s, eventually receiving his PhD under Williamson’s supervision and focusing on the performance effects of organizational form. Sykuta was trained directly by Douglass North, and indirectly by Ronald Coase (via Lee Benham and others) at Washington.
University, St Louis, where he wrote his PhD dissertation on the effects of market and government institutions on contracting practices and industry organization. We have both been active members of the International Society for New Institutional Economics (ISNIE), the academic organization founded by Coase, North, Williamson, and others in 1998, and we jointly direct the Contracting and Organizations Research Institute (CORI) at the University of Missouri. CORI is an interdepartmental, interdisciplinary research institute focused on empirical research on contracts and business organization, inspired (and supported) by Coase and his belief that research on contracts is hampered by a lack of data. CORI maintains a digital archive of over 600,000 contracts available to the research and practitioner communities, designed to facilitate research to better understand how contracts are structured, how they are used and enforced, and what purposes they serve.

TCE, and the new institutional economics more generally, are particularly important at the University of Missouri. We take turns teaching a required PhD course, ‘Economics of Institutions and Organizations’, in the Division of Applied Social Sciences, we organize seminar and working paper series on contracting and organizations, and we supervise many graduate students working in this area. We also maintain strong ties with institutions and organizations around the world focusing on transaction costs and related issues such as the Centre d’Analyse Théorique des Organisations et des Marchés (ATOM) in Paris, the Centre for Strategic Management and Globalization (SMG) in Copenhagen, PENSA in São Paulo, and others.

As we were preparing the manuscript for publication, in the Fall of 2009, we learned that Williamson had been awarded the 2009 Nobel Prize in economics (shared with Elinor Ostrom). The Nobel citation recognized Williamson for ‘develop[ing] a theory where business firms serve as structures for conflict resolution’. Williamson’s and Ostrom’s contributions ‘have advanced economic governance research from the fringe to the forefront of scientific attention’ (The Royal Swedish Academy of Sciences, 2009). Indeed, the transaction cost approach, which focuses on the benefits and costs of alternative institutions of governance, has become part of the mainstream of economics and management research. Coase, the most influential figure in the economic theory of the firm, received the Nobel Prize in 1991, and North was recognized (along with Robert Fogel) in 1993, giving the New Institutional Economics, of which TCE is a part, three Nobel Prizes. We are delighted that the study of transactions, and economic governance more generally, is now acknowledged as a core element of social science research and policy.

At the same time, the reaction among economists to Williamson’s Nobel
Prize highlighted a continuing tension about the role and place of TCE, narrowly defined, within the more general field of organizational economics. The day of the Nobel announcement, Steven Levitt (2009) wrote, in his ‘Freakonomics’ blog:

When I was a graduate student at MIT back in the early 1990s, there was a Nobel Prize betting pool every year. Three years in a row, Oliver Williamson was my choice. At the time, his research was viewed as a hip, iconoclastic contribution to economics – something that was talked about by economists, but that students were not actually trying to emulate (and probably would have been actively discouraged from had they tried to do so). What’s interesting is that in the ensuing 15 years, it seems to me that economists have talked less and less about Williamson’s research, at least in the circles in which I run. I suspect most assistant professors of economics have barely heard of him. Yet I suspect the older generation of economists will applaud this choice.

Levitt’s comments allude to the fact that the field of organizational economics, including the theory of the firm, has become increasingly formal, mainstream, and ‘neoclassical’, in a way that Williamson’s work has never been. In particular, much (though by no means all) of the recent theoretical work in the theory of the firm has followed the ‘incomplete contracting’ approach associated with Oliver Hart (Grossman and Hart, 1986; Hart and Moore, 1990; Hart, 1995; Tirole, 1999; Baker et al., 2002). The seminar papers by Coase (1937), Williamson (1971, 1979), Alchian and Demsetz (1972), and Klein et al. (1978) are seen by many economists as inspirational, suggestive, perhaps speculative pieces that provided the basic ideas of the modern theory of the firm but in an informal, ‘loose’, conjectural style that runs against the grain of modern, mainstream theoretical analysis. Just as graduate students in economics no longer read Smith, Ricardo, Marx, Keynes, and Hayek – whatever they need to know about markets is in Debreu (1959), presumably – few of them read Coase or Williamson to learn about organizations. Those wishing to learn more about firms are probably encouraged to study some of the latest incomplete-contracting models.

While we respect and admire the formal contracting literature, we agree with Williamson (2000) that these models do not, by any means, capture all the essential and useful features of TCE. We think TCE stands on its own, and is not merely a preliminary step toward some other theory, though we agree with Coase and Williamson that there is much more work to do. As Williamson (2000, p. 595) notes, ‘we are still very ignorant about institutions’. Interestingly, TCE is still highly influential in the strategic management field, as evidenced by the collaborative volume, Economic Institutions of Strategy, produced by a group of Williamson’s former students (Nickerson and Silverman, 2009). Several of the chapters in this
volume explore the applications of TCE to various topics in strategy and management.

The chapters in this work are organized into five sections: an introductory set, a section on precursors and influences, one on fundamental concepts, another on applications, and a final section on alternatives and critiques. The authors, established scholars in economics, management, law, and related disciplines, come from a variety of backgrounds and take different perspectives on TCE. All share the view, however, that the transaction cost perspective offers important, and typically unique, insight into key organizational, managerial, and social issues of our day.

When Coase visited the University of Missouri in 2002, he spoke of the need to ‘revolutionize economics’ through the careful, systematic study of contractual relationships and contract documents. TCE may or may not be revolutionary, but it stands with other important fields, movements, or approaches within economics and related disciplines as both a challenge to orthodoxy and an extension, elaboration, and advance upon the strongest elements of that tradition. Williamson (1996, p. 13) describes the development of TCE as ‘modest, slow, molecular, definitive’. We hope the chapters in this volume will not only inform, but also challenge the reader to continue this development.

References


