The Transformation in the Thought of Ronald Coase around the 1970s

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Abstract
This paper investigates the transformation in the thought of Ronald Coase, one of the founders of the economic perspective of new institutional economics (NIE). Mainstream economists assimilated the ideas presented in Coase’s two seminal articles—‘The Nature of the Firm’ (1937) and ‘The Problem of Social Cost’ (1960)—to a remarkable extent. However, Coase, in his main book, The Firm, the Market, and the Law (1988), criticised them for failing to understand his true meaning. The present paper attempts to understand the reasons for this misunderstanding. Further, it attempts to explain why Coase’s work on economic thoughts and methodologies, which is collated mostly in Essays on Economics and Economists (1994), has been given relatively less attention. For this purpose, the present paper analyses the development of Coasean economics in relation to mainstream economics and examines the transformation in Coase’s thought that occurred around the 1970s. At that time, concurrent with the establishment of NIE as a field, Coase focused on the dynamic factors of institutional structure and the human nature of economic agents. A critical reading of Coase’s works reveals that a possible cause of the aforementioned misunderstanding and lack of attention is his excessive emphasis on the consistency of his research history and on its compatibility with mainstream economics. The present paper shows that Coase, in the process of persuading mainstream economists to incorporate his ideas, actually had to reject the core of neoclassical theory in order to pursue his initial goal of institutional analysis.

I. Introduction
This paper investigates the transformation in the thought of Ronald Coase, one of the founders of new institutional economics (NIE). As a long-time editor of the Journal of Law and Economics, from 1964 to 1982, and the founding president of the International Society for New Institutional Economics, from 1996 to 1997, he contributed substantially to the institutional building of NIE as a distinct research area. Furthermore, he introduced the concepts of transaction costs and property rights into formal economic analysis in his articles “The Nature of the Firm” (1937) and “The Problem of Social Cost” (1960). In 1991, he received the Nobel Prize in economics “for his discovery and clarification of the significance of transaction costs and property rights for the
I. Introduction

institutional structure and functioning of the economy” (Nobel Prize Organization 1991). The major areas of NIE, such as transaction cost economics, economics of property rights, and law and economics, owe much of their development to Coase’s original ideas. Coase’s contribution to NIE is unquestionable.

However, when it comes to his relationship to neoclassical or mainstream economics, his remarks seem ambivalent to some extent. On the one hand, Coase is a promoter rather than a detractor of mainstream economics, emphasizing the compatibility of his ideas with mainstream economics. In his main book, *The Firm, the Market, and the Law* (1988), he advanced that “it is not necessary to abandon standard economic theory, but it does mean incorporating transaction costs into the analysis” (Coase 1988, p. 30). On the other hand, within the same book, he expressed great disappointment at how mainstream economics actually absorbed his ideas, claiming that “[m]y point of view has not in general commanded assent, nor has my argument, for the most part, been understood” (ibid., p. 1). Contrary to Coase’s intentions, the extensive discussion on his ideas in journals had concentrated on the “Coase Theorem,” which results in a world of zero transaction costs (ibid., p. 15).

How could such a gap occur between Coase’s thought and mainstream economics? If Coase’s claim that NIE is an expanded version of mainstream economics is wholly consistent, from start to finish, mainstream economists could narrow the gap just by improving on Coase’s ideas. However, in his efforts to confront the problems of institutional structure, and to persuade mainstream economists to do so, the relationship between Coase’s thought and mainstream economics is not so simple and one-dimensional. Coase seems to harbor continuous and discontinuous aspects within the development of his own thought. According to his reminiscent lecture, he did not have a clear goal until recently, and the emergence of his ideas at each stage was not part of a grand scheme (Coase 1995, p. 228). Rather, Coase had gradually added building blocks to his theoretical construction. Therefore, the development of his ideas may have enough room for reinterpretation and reevaluation.

In this sense, this article agrees with Medema, the editor of *Coasean Economics*, in that we have to assess “the development of, tensions within, and prospects for Coasean Economics—those aspects of economic analysis that have evolved out of Coase’s path-breaking work” (Medema ed. 1998, p. xi). This paper is organized as
I. Introduction

follows. In the next section, the development of Coasean economics from the 1930s to the 1990s is reviewed in relation to the neoclassical theoretical core, with a focus on Coase’s continuous and discontinuous aspects. Section 3 deals with Coase’s work during the period in order to reveal the beginning of Coase’s transformation around the 1970s. Section 4 concludes the paper.

II. Coase’s Theoretical Development from the 1930s to the 1990s

In this section, the development of Coase’s theory from the 1930s to the 1990s is reviewed in order to reevaluate the continuity of his theory. First, Coase’s two earlier articles, “The Nature of the Firm” (1937) and “The Problem of Social Cost” (1960), are reviewed in relation to neoclassical economics. Second, his integrative work, The Firm, the Market, and the Law (1988), and “Accounting and the Theory of the Firm” (1990) and other articles of the 1990s are reviewed and contrasted to his earlier work. Third, the continuous and discontinuous aspects in the development of Coase’s thought are identified.


It is well known that NIE derives in part from Coase’s seminal article of 1937, in which he questions the raison d’être of the firm. However, in order to capture the whole of his institutional thought, we need to understand this theory of the firm in conjunction with that of costs, both developed in the same period. Although Coase is well known as a prominent Chicago economist today, his institutional theory of the firm and costs took shape at the LSE in the 1930s, where he was as a student in the Department of Commerce from 1929 to 1931. After an absence of four years, he was appointed an assistant lecturer at the LSE in 1935. It was this institution, especially his supervisor Arnold Plant, and its academic discourse—LSE cost theory, in particular—that influenced Coase’s comparative institutional perspective, one which inseparably relates institutional structures to actual institutional costs (transaction and organizing costs).

In “The Nature of the Firm” (1937), Coase aimed to obtain “a definition of a firm ... which is not only realistic in that it corresponds to what is meant by a firm in the real world, but is tractable by two of the most powerful instruments of economic analysis developed by Marshall, the idea of the margin and that of substitution, together
giving the idea of substitution at the margin” (Coase 1937, pp. 386–387; emphases added). According to his self-evaluation, he derived such a definition. On the one hand, the definition is realistic in that it reflects the direction and the legal relationship between employer (entrepreneur) and employee (factor of production) (ibid., p. 404).

On the other hand, the definition is also tractable or manageable in that the size and boundary of a firm is determined at the margin, where the costs of organizing within the firm will be equal to either the costs of organizing in another firm or the costs of using the price mechanism (ibid.).

Thus, at least in the 1930s, his theory of the firm was a static analysis, focusing on the equilibrium of the firm and the market. While he recognized that the dynamic factors were also important and that an investigation of their effect on marketing and organizing costs would enable us to explain why firms get larger or smaller, he did not formally develop such “a theory of moving equilibrium” (ibid., p. 405). Therefore, Coase’s theory of the firm in 1937 is compatible with neoclassical economics. Although Coase’s idea of transaction costs, as often maintained, opened the neoclassical “black box” of the firm, his theory of the firm still had the neoclassical marginalist feature and deepened the neoclassical analysis of resource allocation, instead of requiring a completely different approach from neoclassical economics.

Coase’s theory of social costs also encouraged the neoclassical research program. Coase moved to the United States in 1951 and wrote “The Problem of Social Cost” (1960) before moving to the University of Chicago in 1964. In the paper, he argued that “[i]t is always possible to modify by transactions on the market the initial legal delimitation of rights” and “if such market transactions are costless, such a rearrangement of rights will always take place if it would lead to an increase in the value of production” (Coase 1960, p. 15). In other words, if the transaction cost is zero, that is, markets are ideally universal and efficient, the initial arrangements of property rights do not matter and the Pareto-efficient allocation of resources will be voluntarily realized by transactions between interested parties. This part of his reasoning was named the “Coase Theorem” by Stigler (1966, p. 113). This worked to the advantage of Chicago economics, which promotes free transactions in the market rather than government intervention.

In this sense, Coase’s arguments definitely had some elements that could be used
to defend and expand the neoclassical economic approach. How can we understand this relationship between neoclassical and new institutional economics? Eggertsson explained the development of NIE (neoinstitutional economics, in his terminology) from neoclassical economics based on Lakatos’ methodology of scientific research programs (Lakatos 1970), defining the former as a modification of the protective belt of neoclassical economics by introducing information and transaction costs and the constraints of property rights, while the microeconomic paradigm comprises stable preference, rational choice, and equilibrium structures of interaction (Eggertsson 1990, pp. 5–6). Coase’s concepts of transaction costs and property rights mostly worked as part of the protective belt of the neoclassical research program rather than its refutations. Therefore, mainstream economists may well have made much of the neoclassical facets of Coase’s ideas in their piecemeal way of work. However, those facets are only a part of Coase’s economics, from the viewpoint of later development of his theory.

2. Coase’s Theoretical Systematization in 1988 and the 1990s

In his main book, The Firm, the Market, and the Law (1988), Coase sought to reassert his previously proposed ideas more clearly and systematically. The book largely consists of his previously published articles, including “The Nature of the Firm” (1937) and “The Problem of Social Cost” (1960), but includes two newly written articles as well. The purpose of the book was “to persuade [his] fellow economists to change the way they analyze a number of important questions in micro-economics” (Coase 1988, p. vii). Even as late as 1988, mainstream economics did not achieve what Coase had in mind. He observes that as a result of the divorce of theory from its subject matter, entities in modern economics, such as consumers, firms, and markets, all lack substance (ibid., p. 3). Specifically, his criticism and clarification can be summarized as follows.

First, contrary to his marginalist theoretical stance in the 1930s, Coase criticizes the neoclassical behavioral assumption that cements normal price theory:

The analysis is held together by the assumption that consumers maximize utility (a nonexistent entity which plays a part similar, I suspect, to that of ether in the old physics) and by the assumption that producers have as their aim to maximize profit or net income (for which there is a good deal more evidence) (ibid., p. 2).

In fact, the rational utility maximizer of economic theory bears no resemblance to
ordinary individuals (*ibid.*). He envisages that the study of sociobiology will eventually illuminate the whole picture of human nature (*ibid.*, p. 4), but at the moment we must be satisfied with limited knowledge:

In the meantime . . . we must be content with the knowledge that for groups of human beings, in almost all circumstances, a higher (relative) price for anything will lead to a reduction in the amount demanded. This does not only refer to a money price but to price in its widest sense (*ibid.*, pp. 4–5).

Here, he seems to suppose that we had better try to understand the general tendencies of groups of human beings, rather than presuppose invalid and unrealistic views of individual human beings. According to Coase, a generalization of such knowledge is sufficient to constitute price theory; therefore, the assumption that economic agents are rational utility maximizers is unnecessary and sterile (*ibid.*, pp. 3–5).

Second, Coase objects to the treatment of institutions in mainstream economics, specifically the firm, the market, and the law:

In mainstream economic theory, the firm and the market are, for the most part, assumed to exist and are not themselves the subject of investigation” and “the crucial role of the law in determining the activities carried out by the firm and in the market has been largely ignored” (*ibid.*, p. 5).

Coase applies the same perspective as his theory of the firm of the 1930s to both the firm and the market, calling into question not just the price mechanism but also the internal institutions in the market:

Markets are institutions that exist to facilitate exchange, that is, they exist in order to reduce the cost of carrying out exchange transactions. In an economic theory which assumes that transaction costs are nonexistent, markets have no function to perform . . . And when economists do speak of market structure, it has nothing to do with the market as an institution but refers to such things as the number of firms, product differentiation, and the like, the influence of the social institutions which facilitate exchange being completely ignored (*ibid.*, pp. 7–8).

According to Coase, the provision of a market as an institution is ordinarily the result of entrepreneurial activities to reduce transaction costs (*ibid.*, pp. 8–9). For example, commodity and stock exchanges in the modern economy are usually organized by a group of traders, and are markets where transactions are highly regulated by their rules,
II. Coase's Theoretical Development

apart from any government regulation (ibid.).

Third, and in relation to the first and the second point, Coase emphasized the importance of transaction costs, which he had argued in the previous articles.

I showed in “The Nature of the Firm” that, in the absence of transaction costs, there is no economic basis for the existence of the firm. What I showed in “The Problem of Social Cost” was that, in the absence of transaction costs, it does not matter what the law is ... In such a world the institutions which make up the economic system have neither substance nor purpose (ibid., p. 14).

Moreover, as Coase stated, “when there are no costs of making transactions, it costs nothing to speed them up, so that eternity can be experienced in a split second” (ibid., p. 15). Nevertheless, the extensive discussion on his ideas in journals had concentrated on the “Coase Theorem,” which results in a world of zero transaction costs. He analyzed the reason of this concentration as follows:

The world of zero transaction costs, to which the Coase Theorem applies, is the world of modern economic analysis, and economists therefore feel quite comfortable handling the intellectual problems it poses, remote from the real world though they may be (ibid.).

Instead, he emphasized the need to introduce positive transaction costs into economic analysis in order to study the real world. Otherwise, economic theory would be impoverished, since “so much that happens in the economic system is designed either to reduce transaction costs or to make possible what their existence prevents” (ibid., p. 30).

Furthermore, in “Accounting and the Theory of the Firm” (1990), Coase advanced his investigation of the dynamic factors that determine its performance and size, which he had suspended in the 1937 article. Coase emphasizes the role of accounting systems within the firm in relation to the decentralization of decision-making:

In a firm, men also make decisions independently of those that others are making (there is delegation of responsibility and all decisions are not the product of a single mind) and when people in a firm use its resources, they often need to be given some figure representing their costs, so as to be able to compare it with receipts. Since using a resource denies its use to others, the figure for cost should represent what it would yield elsewhere in the business (Coase 1990, p. 11).
Given multiple individual decision-makers within a firm, an accounting system is not optional but has a substantive and crucial role; it moderates the problems of information and uncertainty in recognizing cost. Furthermore, he states that the performance of the accounting system differs between transactions and between firms, which consequently affects the performance of the firm itself.

Doing this [accounting calculation] is, no doubt, more difficult in some circumstances than in others—and we need to know what these circumstances are. When it is difficult, because of the particular activities or combination of activities in which the firm is engaged, the costs of organizing will be greater—either more mistakes will be made or additional costs will be incurred to avoid making them. As a result, the activities which we find firms undertaking must be influenced to some degree by their effect on the efficiency with which the accounting system operates (ibid., p. 12).

Coase, therefore, concludes that the theory of the accounting system is part of the theory of the firm (ibid.). In this view, the role of intra-firm differences for determining the institutional structure of production would become huge. Because once most production is carried out within firms and most transactions are not between factors, but between firms, the dominant factor determining the institutional structure of production will, in general, no longer be transaction costs but the relative costs of different firms in organizing particular activities (ibid., p. 11). This argument opens Coase’s theory of the firm to the dynamic analysis of institutional structural changes, which he did not develop in the 1930s.

In the late 1990s, Coase explicitly suggested that, for a performance analysis of economic systems, economics needs to be a dynamic rather than a static theory. His interest was drawn toward the internal structures of the economy and of social institutions:

Apart from the formalization of the theory, the way we look at the working of the economic system has been extraordinarily static over the years. Economists often take pride in the fact that Charles Darwin came to his theory of evolution as a result of reading Thomas Malthus and Adam Smith. But contrast the developments in biology since Darwin with what has happened in economics since Adam Smith. Biology has been transformed. Biologists now have a detailed understanding of the complicated structures that govern the functioning of living organisms. I believe that one day we will have similar triumphs in economics. But it will not be easy (Coase 1998, p. 73).
In this regard, it can be said that Coase was interested in a dynamic change or the interrelated structure of institutions rather than a static institutional equilibrium. As Coase indicates, discovering all the factors that determine the relative coordination costs (transaction and organizing costs) of even a single firm is no simple task. However, we cannot confine our analysis to what happens within a single firm:

The costs of coordination within a firm and the level of transaction costs that it faces are affected by its ability to purchase inputs from other firms, and their ability to supply these inputs depends in part on their costs of coordination and the level of transaction costs that they face, which are similarly affected by what these are in still other firms. What we are dealing with is a complex interrelated structure (Coase 1995, p. 245; emphasis added).

Of course, in addition to firms, we have to take into account numerous other institutions that affect these coordination costs:

Add to this the influence of the laws, of the social system, and of the culture, as well as the effects of technological changes such as the digital revolution with its dramatic fall in information costs (a major component of transaction costs), and you have a complicated set of interrelationships the nature of which will take much dedicated work over a long period to discover (Coase 1998, p. 73; emphasis added).

These tasks promptly suggest the desirability and necessity of dynamic analysis of institutions, especially of their complicated interrelations, which cannot be reduced to any single unit or used to examine its influence in isolation.

3. Continuous and Discontinuous Aspects in Coase’s Theory from the 1930s to the 1990s

Compared to Coase’s theory in 1937 and 1960, his systematization in 1988 and the 1990s is remarkable in two facets. In the 1930s, Coase’s theory of institutions still represented a static analysis, sharing the assumptions of formal neoclassical analysis, including its marginalist principle of profit maximization. In contrast, in his 1988 work, as well as in the 1990s, Coase himself opposed the assumption of rational maximizers and was more interested in dynamic changes of institutional structures in the real world. His strong concern with business practices and realistic theories at the time would gradually drive him from a pro-neoclassical to an anti-neoclassical stance. These are discontinuous aspects in the development of Coase’s theory.1
II. Coase’s Theoretical Development

What, then, are the continuous aspects? It might be Coase’s comparative institutional perspective that is consistently based on cost theory. As Coase indicates, he was working on both accounting and the theory of the firm in the 1930s (Coase 1990, p. 3). He describes the complicated relationship among markets, firms, and decision-makers within the economic system from the perspective of an institutional (as well as non-institutional) cost and revenue network. Following the price system of the market and the internal accounting system within the firm, which reflect the opportunity costs of resources, businessmen make decisions based on costs and receipts, realizing the maximum value of used resources as a whole. In this sense, we can see that even after 1988, Coase’s theory was still in line with his theories of costs and the firm during the 1930s.

Thus, Coase did not change his fundamental perspective. In fact, he diverged from the core of neoclassical economics in order to retain his perspective. Indeed, to persuade mainstream economists to pay attention to economic institutions, Coase emphasized the compatibility of his proposition with mainstream economics. However, that strategy led them to focus solely on the compatible aspects of Coase’s theoretical proposition but almost neglect the rest, which was more crucial to Coase’s institutional perspective. What, then, was Coase’s turning point between the 1930s and the 1990s? Further, why does he fail to see the need to abandon neoclassical economics though he criticizes its theoretical core?

III. Coase’s Transformation around the 1970s

In the previous section, I showed that Coase’s theory departed from his previous pro-neoclassical stance, at some point before his systematic proposition in 1988. In this section, I try to identify the beginning of this transformation of Coase’s view in his work on Adam Smith in the 1970s. Coase’s methodology is also examined to consider why he does not abandon mainstream economics, while at the same time criticizing the neoclassical behavioral assumption and promoting his original way of looking at human nature and institutional structure.

1. Adam Smith’s Influence on Coase’s View of Man

It seems to be during the 1970s that Coase changed, or at least sharpened, his attitude
toward the core of neoclassical theory. As far as I know, the first time Coase questioned the assumption of rational maximizers was when he argued Adam Smith’s view of man in *The Wealth of Nations* and *The Theory of Moral Sentiments*:

> It is wrong to believe, as is commonly done, that Adam Smith had as his view of man an abstraction, an ‘economic man,’ rationally pursuing his self-interest in a single-minded way. Adam Smith would not have thought it sensible to treat man as a rational utility-maximiser. He thinks of man as he actually is—dominated, it is true, by self-love but not without some concern for others, able to reason but not necessarily in such a way as to reach the right conclusion, seeing the outcomes of his actions but through a veil of self-delusion (Coase 1976, pp. 545–546).

Thus, Coase highly appreciates Smith for his well-balanced and realistic view of human nature. In a discussion with Ghiselin (1978), who advocated synthesizing economics and biology into one discipline, Coase reargued the related topic. Objecting to Ghiselin, Coase opposed the use of biological analogies in economics. Instead, he believed that sociobiology would provide a comprehensive view of man’s nature, on the basis of which modern utility theory could be improved (Coase 1978, p. 244; 1988, p. 4).

> Human nature is here seen as the product of evolution over a long period and is genetically determined. The structure of human nature includes learning rules, and what is particularly important in economics, the way in which we translate experience into expectations. Human nature is what it is because it contributed to human survival in the conditions in which human beings developed . . . (Coase 1978, p. 244; emphases added).

As he rightly argues, because human beings are, not analogically but factually, the products of long-term evolution, we can learn an enormous amount from sociobiology about what determines human behavior. It is interesting that Coase refers to rule learning and expectation as inherent in the nature of human beings. This means that human nature is deeply intertwined with the human use of institutions. Invoking Adam Smith, he deduces the consequence of the sociobiological approach:

> This [sociobiological] approach downplays the rational element in human behavior. . . .

Thus, as Adam Smith said in 1759 [*The Theory of Moral Sentiments*] when discussing self-preservation and the propagation of the species (both essential to survival), they are so important that they have not been “entrusted to the slow and
III. Coase’s Transformation

uncertain determinations of our reason” but to “original and immediate instincts” (ibid., pp. 244–245; emphasis added).

Thus, Coase acknowledges the role of instinct as well as reason in human behavior and implies that the former looms larger in long-term evolution. It seems reasonable that Coase would have incorporated these considerations into his institutional analysis. However, to my knowledge, he has not thus far developed such an approach. At any rate, it is conceivable that these considerations of human nature prompted his break from neoclassical views of mankind as rational utility maximizers.

2. Coasean Methodology


In particular, Coase’s article “Economics and Contiguous Discipline” (1977) importantly deals with the scope of economics. In the article, Coase considers the problem of what determines the boundaries between disciplines and proposes that they are determined by competition:

The practitioners in a given discipline extend or narrow the range of the questions that they attempt to answer according to whether they find it profitable to do so, and this is determined, in part by the success or failure of the practitioners in other disciplines in answering the same questions (Coase 1977, p. 482).

In general, if economists find advantages in other disciplines, they move into them; if not, they abandon these fields. In the short term, economists’ advantages may lie in their common technique of analysis, theory, or approach to the subject, but in the long run, the dominant factor of the economic profession is their common subject (ibid., pp. 484–485). In other words, the subject determines the theory used, not the other way around.

Coase observes that current economists who are moving more and more into
other disciplines (such as politics, sociology, and so on) will gradually be displaced from their new fields, to the extent that this movement is based on a technique or approach and not on subject matter (ibid., p. 483–485). Therefore, Coase opposes Becker and Posner’s so-called economic imperialism:

I take it to be the view of Becker and Posner that the decisive advantage which economists possess in handling social problems is their theory of, or approach to, human behaviour, the treatment of man as a rational, utility-maximizer. . . . But . . . [i]n these different fields, the purposes which men seek to achieve will not be the same, the degree of consistency in behaviour need not be the same and, in particular, the institutional framework within which the choices are made are quite different (ibid., p. 488).

Instead, Coase suggests that an understanding of these various purposes and the character of the institutional framework requires specialized knowledge within a particular discipline and that an appropriate theory of social systems needs to deal with their specific inter-relationships (ibid.). Thus, he opposes the versatility of economics as a science of choice, as derived from Robbins’ definition of the subject (ibid., pp. 487–488), and insists, “[t]o say that people maximize utility tells us nothing about the purposes for which they engage in economic activity and leaves us without any insight into why people do what they do” (ibid., p. 488).

The reason for Coase’s rejection of rational utility maximizers could also be understood in terms of his criticism of the use of unrealistic assumptions. In the 1981 G. Warren Nutter Lecture in Political Economy, “How Should Economists Choose?”, he questions how economists select the theories they espouse and finds Friedman’s methodology (Friedman 1953) unsatisfactory (Coase 1988a, p. 16). Instead, he asserts the significance of realistic assumptions:

The view that the worth of a theory is to be judged solely by the extent and accuracy of its predictions seems to me wrong. Of course, any theory has implications . . . But a theory is not like an airline or bus timetable. We are not interested simply in the accuracy of its predictions. A theory also serves as a base for thinking. It helps us to understand what is going on by enabling us to organize our thoughts. (ibid., p. 64)

For him, a theory that provides insight into the operations of a system but predicts weakly is preferable to a theory that predicts accurately but provides little insight (ibid.).
Thus, he advocates a realistic methodology, arguing that “realism in our assumptions is needed if our theories are ever to help us understand why the system works in the way it does” (ibid., p. 65). Of course, he knows that our assumptions should not be completely realistic in that we may exclude some factors if they are completely irrelevant, or if their inclusion would not be worth the costs involved in including them (due to greater complexity). However, “this does not mean that we should lose touch with reality” (ibid.).

3. Coase’s Evaluation of Mainstream Economics

Coase is an economist who has always struggled with the relation between reality and theory. On the one hand, he has never lost his interest in business problems and actual institutions, which led him to object to the mainstream economics that floats in the air:

Mainstream economics, as one sees it in the journals and the textbooks and in the courses taught in economics departments has become more and more abstract over time, and although it purports otherwise, it is in fact little concerned with what happens in the real world (Coase 1998, p. 72).

On the other hand, even though he criticized the old institutional economics, he has never lessened the role of theoretical deliberation and has never merely assembled facts:

[O]ld institutional economics ... [of] ... John R. Commons, Wesley Mitchell, and those associated with them were men of great intellectual stature, but they were anti-theoretical, and without a theory to bind together their collection of facts, they had very little that they were able to pass on (ibid.).

Therefore, Coase has tried to achieve economic theory based on facts in the real world, as is seen in his realistic and tractable definition of the firm in his 1937 article. Then, why didn’t Coase abandon mainstream economics? In the article, “The New Institutional Economics” (1984), he argues:

[N]othing is perfect and we should not abandon an old theory in favor of a new one merely because the old has defects but because we believe the new to be better. If we think, ... that the New Institutional Economics should replace the existing approach of economists, it is necessary to specify in what ways it is preferable (Coase 1984, p. 229)

Then, he argues that modern institutional economists’ dissatisfaction is not with basic economic theory, but with how it is used by most economists (ibid., p. 230). Even for
Coase himself, the dissatisfaction with mainstream economics is not unreserved:

I have said that to a large extent modern institutional economists use standard economic theory. Nor do I think that it is wrong for them to do so. But there is one respect in which I hold a heretical view. Most economists make the assumption that man is a rational utility maximiser. This seems to me both unnecessary and misleading. I have said that in modern institutional economics we should start with real institutions. Let us also start with man as he is (ibid., p. 231).

Therefore, Coase thinks that new institutional economics, the modified version of standard economic theory, could just survive without the assumption of rational maximizers and serve to analyze the working of economic institutions. Although his rejection of the core of neoclassical theory implies that he refutes the neoclassical research program, he does not employ such a view of mainstream economics.

Then, how do we describe Coase’s own stance? For example, in contrast to the views of Stigler, Becker, and Posner, Coase himself refers to his own view as “an unmodern Chicago view” in that he believes that people’s behaviors are more irrational within the family and as consumers than they are in firms (Hazlett 1997, p. 42).

Because Frank Knight was at Chicago, and I was brought up more on Knight than I was on any of the others. And my views were quite consistent with what he says. They’re not consistent with what George Stigler, Gary Becker, and Richard Posner say. Posner condemns me because I don’t think people maximize utility (ibid.).

In this regard, Coase clearly departs from economic imperialism at Chicago. Or, Coase has criticized the traditional policy analysis of mainstream economics as “black-board economics” (e.g., Coase 1984, p. 230; Coase 1988, pp. 28–30; Coase 1992, p. 714; Coase 1995, p. 239). By this term, he means any economic argument that neglects actual institutions and assumes ideal economic systems:

The majority of economists . . . paint a picture of an ideal economic system, and then, comparing it with what they observe (or think they observe), they prescribe what is necessary to reach this ideal state without much consideration for how this could be done. The analysis is carried out with great ingenuity but it floats in the air. It is, as I have phrased it, “blackboard economics.” There is little investigation of how the economy actually operates . . . (Coase 1988, pp. 28–29).

Instead, Coase has sustained his interest in actual institutions and always tried to begin
with them, which has often been called “Coasean economics.” However, in a recent interview, Coase himself mentioned that he dislikes the term “Coasean economics” and prefers to call it “right economics”:

The bad or wrong economics is what I called the “blackboard economics.” It does not study the real world economy. Instead, its efforts are on an imaginary world that exists only in the mind of economists, for example, the zero-transaction cost world. Ideas and imaginations are terribly important in economic research or any pursuit of science. But the subject of study has to be real (Wang 2011).

Coase is saying that what he thinks is “right” economics should not be ascribed to his peculiar opinion, but to the general requirement of any economics. Anyway, his perspective has now moved far from the very core of neoclassical economic analysis as a result of his pursuing institutional problems. Therefore, we now have to emphasize the different rather than common aspects between neoclassical and Coasean economics in order to propagate his true vision of institutional economic analysis.

IV. Conclusion

The purpose of this paper was to reveal the causes of mainstream economists’ misunderstanding of Coase and their lack of attention to Coase’s work on methodology. To this end, I analyzed the development of Coasean economics in relation to mainstream economics from the 1930s and identified the transformation in Coase’s thought around the 1970s.

In Section 1, I argued that while Coase’s ideas, such as transaction costs and property rights, are assimilated into mainstream economics, Coase is not satisfied with how mainstream economics has actually assimilated those ideas. Further, it is implied that Coase’s research history has enough room for reinterpretation and reevaluation, since there seem to be both continuous and discontinuous aspects within the development of Coase’s own thought.

Therefore, in Section 2, I reviewed the development of Coasean economics from the 1930s to the 1990s in relation to the core of neoclassical theory. It was shown that Coase’s earlier works, “The Nature of the Firm” (1937) and “The Problem of Social Cost” (1960), are compatible with static neoclassical economic analyses of optimizing agents, whereas his later integrative work, The Firm, the Market, and the Law (1988),
and articles from the 1990s made much of the human nature of economic agents and the dynamics of institutional structures. In addition to these discontinuous aspects, I pointed out Coase’s comparative institutional perspective based on cost theory as the continuous aspect in his thought from the 1930s until today.

In Section 3, I showed that Coase’s transformation in his thought was identified in the 1970s. At the time, his reconsideration of Adam Smith’s contribution led him to depart from the neoclassical view of economic agents. I also showed that why Coase opposes rational utility maximizers, in terms of Coase’s methodology from the 1970s: his emphasis on the institutional framework of behavior and the realism in assumptions. Lastly, I reviewed Coase’s evaluation of mainstream economics and his own economics and considered why he does not abandon mainstream economics.

In order to persuade mainstream economists to take economic institutions into consideration, Coase has emphasized the consistency and importance of his idea of transaction costs for his comparative institutional perspective. As a result, mainstream economists have focused solely on the compatible aspects of Coase’s theoretical proposition and relatively disregarded the aspects that oppose their theoretical assumptions. For the same reason, Coase’s methodology included in Essays on Economics and Economists (1994), which supports his opposition to rational maximizers, has also been disregarded. However, it seems that those neglected aspects were, in fact, more critical to Coase’s perspective to human nature and institutional structures. Certainly, Coase himself sees that mainstream economics can be modified to survive without rational maximizing agents. However, if we are to understand Coase’s true vision of institutional economic analysis, we have to emphasize the different rather than common aspects between neoclassical and Coasean economics. This would lead to fruitful discussion on the varieties and tensions within the NIE perspective.

Notes

1 In Mikami (2011), I argued that Coase’s views on economic agents and institutional structures lead to evolutionary economics, but I did not pay enough attention to their absence in the earlier stages of Coase’s thought.
References


119–121.


—— (2011), “Interview with Professor Ronald Coase,” conducted on 28-29 December 2010,