

The Firm, the Market, and the Law

By Ronald H. Coase

University of Chicago Press, 1988

For an economist who wrote relatively little, Ronald Coase's influence has been enormous. Still, his receipt of the 1991 Nobel Prize in economics is a strange and wonderful thing, though Coase has been a favorite "dark horse" candidate for several years. What's remarkable is how far Coase is from the stereotype of the modern academic economist. His long-time appointment at the University of Chicago is with the school of law; he reasons like a lawyer, producing long essays of simple argument, careful documentation, and proof by example rather than tortured mathematics; and his reputation among economists is based almost entirely on two journal articles, one more than 50 years old and the other so long that few people have read it all the way through.

In 1988 the University of Chicago Press issued a collection of Coase's papers as *The Firm, the Market, and the Law*. Included are the two famous ones—"The Nature of the Firm" (1937) and "The Problem of Social Cost" (1960)—along with the well-known pieces on marginal cost and the lighthouse, a 1972 survey of the field of industrial organization, and two new essays, "Notes on the Problem of Social Cost" and a lengthy introduction. It is a good representation of Coase's style and thought, and a useful tool for understanding two major forces in contemporary economics: the law and economics movement, and what has come to be known as the "New Institutional Economics."

Coase did not originate the economic analysis of law, which developed into a systematic program under Aaron Director at Chicago in the 1940s and 1950s, but his paper on social cost that produced the "Coase theorem" is the best-known achievement of law and economics. Coase's main contention—that as long as property rights are well defined, external effects can under certain conditions be bargained away, no matter who holds the specific property titles—has met with varying degrees of enthusiasm. Nonetheless he did provide a new framework for thinking about property and externalities that has become widely influential. (It is mostly forgotten that the second half of Coase's paper provides a set of guidelines for judges to settle such disputes when barriers to efficient bargaining do exist; the charge that Coase "ignores transaction costs" is hence unfounded.) In the companion essay "Notes on the Problem of Social Cost," Coase demonstrates his uncommon conviction that economics ought to be useful as well as true. Responding to a critic who defends a classical Pigovian tax plan as mathematically correct, though admittedly useless, Coase observes that "[i]n my youth it was said that what was too silly to be said may be sung. In modern economics it may be put into mathematics" (p. 185).

The other of Coase's legacies is the new theory of the firm or new institutional economics. It was Coase's "Nature of the Firm" that first urged economists to view the firm not as a set of demand and cost curves, but as an *organization*, with an internal structure guided by the same rules of human action that govern its external activities. This line of thought has finally developed into a

systematic research program, with the growth of the highly technical literature on information and incentives of the last 20 years or so, and the work of writers like Oliver E. Williamson and Douglass North.

We are lucky that Coase's main works are few enough to be collected into one small book (Hayek's collected works, by contrast, are projected at around 20 volumes). The publishers could actually have included a few more selections, but we needn't quibble. *The Firm, the Market, and the Law* does contain the core of Coase's contribution to economics, and he is without a doubt one of the most powerful and creative minds in the discipline.