

Coase on Posner on Coase - Comment

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Coase on Posner on Coase

Comment

by

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After reading Richard POSNER's [1993] paper I felt that I could not remain silent. When the conference was over Rudolf Richter asked me to write up my remarks for this journal. I have therefore reconstructed what I said from my notes. What one says in an oral presentation is not always appropriate in print but on this occasion I felt obliged to comply with Richter's request.

My first reaction on reading Posner's paper was one of amusement. It recalled to my mind Miss Elliott's description of Alfred Marshall's lectures on Henry George. She said that Marshall reminded her of a boa-constrictor that slobbered over its victim before swallowing it (MARSHALL [1947, 35]). In saying this, I had no intention of equating Posner with Marshall, still less with any kind of snake, although I must confess that the wicked thought did flicker through my mind as I studied his paper with more care and ceased to be amused. POSNER [1993, 79] says that the first part of his paper describes "the conception of the field [the new institutional economics] held by Ronald Coase." Reading this part of his paper recalled to my mind Horace Walpole's opening remarks in his book on King Richard the Third: "So incompetent has the generality of historians been for the province they have undertaken, that it is almost a question, whether, if the dead of past ages could revive, they would be able to reconnoitre the events of their own times, as transmitted to us by ignorance and misrepresentation" (WALPOLE [1768, 1]). I have only one foot through the door but should the final yank come before this piece is published, Horace Walpole's words would apply exactly to Posner's highly inaccurate account of my views. I cannot discuss all of his misstatements but I will give some examples of the more serious of them.

POSNER [1993, 75] states that I "want to go back to the earlier, simpler, looser, nonmathematical theory of Adam Smith." This is the opposite of the truth. I do *not* want to go back to the earlier, simpler, looser, nonmathematical theory of Adam Smith. I want to see us develop an economic theory similar to that found in the natural sciences. Contrary to what Posner says, I have argued that we are too tied to Adam Smith. As I have said, economics since Adam Smith can be seen as "little more than a vast mopping-up operation in which economists have filled in the gaps, corrected the errors and refined the analysis of the *Wealth of Nations*" (COASE [1977, 312]). This reflects well on Smith but

less well on us. Harold DEMSETZ [1988] has argued, a view that I strongly endorsed in my Nobel Memorial Prize lecture, that a major task of economists since the publication of the *Wealth of Nations* has been to formalize Adam Smith's theory of the "invisible hand." As he rightly says, what has been produced is a theory of a system with extreme decentralization (COASE [1992, 713]). It is a very incomplete theory. I want to move on from Adam Smith, not go back to him.

POSNER [1993, 76] also refers to my "dislike of abstraction." This is wrong. It is true that I said, in my Warren Nutter lecture, that the assumptions of our theory should be realistic. "[R]ealism in assumptions forces us to analyse the world that exists, not some imaginary world that does not" (COASE [1988, 65]). But I go on to say: "It is, of course, true that our assumption should not be completely realistic. There are factors we leave out because we do not know how to handle them. There are others we exclude because we do not feel the benefits of a more complete theory would be worth the costs involved in including them. Their inclusion might, for example, greatly complicate the analysis without giving us greater understanding about what is going on. Again, assumptions about other factors do not need to be realistic because they are completely irrelevant. If we wish to show that enforcement of a minimum wage will lead to unemployment among less productive workers, it is unnecessary to be accurate about the exact way in which capital gains are taxed. There are good reasons why the assumptions of one's theories should not be completely realistic, but this does not mean that we should lose touch with reality" (COASE [1988, 65–66]). As this quotation indicates, I do not dislike abstraction. But the right degree of abstraction depends on the problem that is being analysed. What I object to is mindless abstraction or the kind of abstraction which does not help us to understand the working of the economic system. My aim is to bring into existence an economic theory which is solidly based. How Posner came to interpret my position as being anti-theoretical I cannot imagine. It is certainly untrue.

There is much in Posner's paper with which I disagree such as his assertion that I object to econometric studies (POSNER [1993, 79]). In fact, much of my early work was econometric. But it would be inappropriate to go through Posner's paper point by point. However, I must refer to something to which he returns towards the end of his paper. He finds "puzzling" my rejection of the concept of "rational utility maximization" which he calls a "cornerstone of neoclassical theory" and that I make my starting point that for groups of human beings in most circumstances a higher relative price leads to a reduction in the amount demanded (POSNER [1993, 85]). It would take too long to explain why I regard the concept of "rational utility maximization" as meaningless. But Posner goes on to argue that the assumption that a lower price leads to a greater amount demanded implies a rational maximizing of utility. This is incorrect. Gary BECKER [1976] has shown that, even if people are not rational, one would expect a higher price to lead to a reduction in the amount demanded.

There is one passage on which I did not comment at the conference but I feel that I should now. POSNER [1993, 81] questions how much recent research on contractual arrangements owes "to the ideas of Williamson or even for that matter of Coase." I will not comment on the reference to me. But the reference to Williamson seems to me ungenerous. My discussions with researchers in this field has made it clear to me that Williamson's influence has been immense. In a real sense, transaction cost economics, through his writing and teaching, is his creation. Posner objects to some concepts espoused by Williamson such as "bounded rationality." I also have reservations about this concept as I do to any economic concept that includes the word "rational." I was also doubtful about the validity of Williamson's treatment of "opportunism" as a significant rationale for vertical integration (not, of course, as an explanation of other contractual arrangements). But these are differences that will be cleared up by further discussion and, above all, by more empirical work. Whatever the result, Williamson's basic approach will be unaffected.

At the conference I expressed my astonishment that Posner, writing about my views, had not bothered to ask me what they were and I quoted the saying from the *Wallet of Kai Lung*: "It is a mark of insincerity of purpose to spend one's time looking for the Sacred Emperor in the low-class tea-shops" (as quoted by GUILLEBAUD [1937, 21]). I have since concluded that this does Posner an injustice. The trouble with Posner, to use a phrase of Frank Knight's, is not with what he doesn't know but with what he knows that "ain't so."

It was customary at this conference, after criticising a paper, to express one's admiration for the work of the author. I am happy to do the same. I greatly admire the writings of Richard Posner, but not always.

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