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INTRODUCTION

Introduction to the Oliver E. Williamson memorial issue

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Abstract
Oliver E. Williamson, who died on May 21, 2020 at the age of 87, was one of the most influential social scientists of modern times. In 2009, he was co-recipient of the Nobel Prize in Economics. As of mid-October 2021, he had been cited an astonishing 317,838 times according to Google Scholar. His measured influence outdistances that of even his fellow Nobel Laureates Elinor Ostrom (230,667), Douglass C. North (187,577) and Ronald H. Coase (123,686). This special issue of the *Journal of Institutional Economics* brings together a distinguished roster of scholars to remember Williamson, to elucidate some of his key ideas and influences, and to extend the reach of his ideas to new arenas.

Key words: Antitrust; capabilities; relational contracts; transaction costs; vertical integration

Oliver E. Williamson, who died on May 21, 2020 at the age of 87, was one of the most influential social scientists of modern times. In 2009, he was co-recipient of the Nobel Prize in Economics. As of mid-October 2021, he had been cited an astonishing 317,838 times according to Google Scholar. His measured influence outdistances that of even his fellow Nobel Laureates Elinor Ostrom (230,667), Douglass C. North (187,577), and Ronald H. Coase (123,686). This special issue brings together a distinguished roster of scholars to remember Williamson, to elucidate some of his key ideas and influences, and to extend the reach of his ideas to new arenas.

Williamson was a major influence on my own work from the very beginning. I started reading him in graduate school. And I first met him when he agreed to be part of a set of two conferences I organized early in my career. I had been struck by the potential synergies among a number of streams of mildly heterodox thought, and the conferences were an attempt to create a dialogue among some leading figures of what – taking advantage of a term Williamson (1975: 1) had invented – I presumed to call the New Institutional Economics. The result was a collected volume to which Williamson contributed a chapter (Langlois, 1986).[1] In the ensuing years, I was fortunate to interact with Williamson at a variety of conferences and seminars, and he continues to influence my work.

I need not recount Williamson's life and academic contributions in detail here, as two papers in this special issue do just that. In 'Oliver Williamson: a Hero's Journey on the Merits', Mahoney and Nickerson (2021) provide a detailed intellectual (and to some extent personal) biography, drawing on Williamson's own unpublished memoir. They cast Williamson's career as a journey filled with challenges and triumphs, one that greatly enriched the study of institutions and organizations. Mahoney and Nickerson also point to the institutions that Williamson himself built, including the legion of graduate students he has left behind. In 'Commemorating Oliver Williamson, a Founding Father of Transaction Cost Economics', Sent and Kroese (2021) also examine Williamson's intellectual

[1]The other chapter authors were Stephen C. Littlechild, Brian J. Loasby, Ronald A. Heiner, Andrew Schotter, Richard R. Nelson, Gerald P. O'Driscoll, Jr., and Axel Leijonhufvud. I provided an introduction and a methodological piece to which I refer below.

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biography. They trace his evolution from an interest in the economics of vertical integration to his development of the field of Transaction Cost Economics. Eventually, they suggest, Williamson would come to situate himself within the broader arena of institutional economics.

These biographers agree on the fundamental importance to Williamson's intellectual trajectory of his graduate training with the interdisciplinary and often iconoclastic Carnegie School of Herbert Simon, Richard, Cyert, James March, and others. In his dissertation, Williamson provided what was essentially an economic spin on the Carnegie School approach, producing what would become one of the central documents of the so-called managerial theory of the firm (Williamson, 1964). It has been cited 36,312 times.

A crucial episode in Williamson's early career was his tenure in 1966–1967 at the US Department of Justice, where he served as Special Economic Assistant to Donald F. Turner, the second head of the Antitrust Division under Lyndon Johnson. A Ph.D. economist as well as a Harvard law professor, Turner was at that time a proponent of the so-called Structure-Conduct-Performance paradigm, which saw economic organization narrowly through the lens of the formal price theory that had been developing over the course of the 20th century (Hovenkamp, 2005). Williamson was struck by the Division's inclination to dismiss as anticompetitive, without any careful economic analysis, most kinds of complex contracting between firms. This included the ongoing, and ultimately successful, suit against bicycle maker Schwinn for assigning exclusive territories to its franchised distributors, even though it was evident to all that the same conduct would have been perfectly legal had Schwinn been vertically integrated into distribution.[2] Williamson would later brand this attitude 'the inhospitality tradition' (Williamson, 1983: 292). In the 1960s, he complained, industrial-organization economists were working with 'a black box theory of the firm and a plain vanilla theory of markets' (Williamson, 2009: 12).

Williamson's tenure at the Justice department set him on the path of attempting precisely what he thought the Antitrust Division had not been doing – thinking hard about the economics of alternative ways of governing economic transactions. He turned to the work of Coase (1937), which he had read as a graduate student, and began elaborating what he called Transaction Cost Economics. In 1975, he published *Markets and Hierarchies: Analysis and Antitrust Implications* (cited 48,451 times). Here, like Coase, he cast markets and hierarchies (i.e. internal organization within a firm) as alternative governance structures. Which governance structure we observe will depend on which offers lower costs, especially including transaction costs, under specific circumstances; and transaction costs will in turn depend on the prevailing level of uncertainty, the frequency with which transactions recur, and the presence or absence of highly specific assets. Ten years later, Williamson produced what is arguably his magnum opus, *The Economic Institutions of Capitalism* (cited 55,544 times). In that volume, he elaborated on his comparative framework, though the role of highly specific assets would come to take on a far greater salience.

Williamson has never been without his critics. In 'The Labor-managed Firm, Oliver Williamson, and Me', Gregory Dow (2021) recounts his long-running friendly debate with Williamson about the economics of the labor-managed firm, initiated when he and Williamson were colleagues at Yale in the 1980s. In part, this is a disagreement about the details of the comparative assessment of the costs of the capital-managed firm versus those of the labor-managed firm. Among other things, Dow believed, Williamson underestimated the costs of hierarchical management. More significantly, Dow pointed to a fundamental methodological issue. Williamson's comparative-institutional approach asserts that the organizational structure we observe is whichever alternative represents a lower sum of production and transaction costs. Yet Williamson did not offer an analysis of how such an optimization takes place. He did not provide an account of why it is that what we observe must be optimal. Perhaps, Dow argued, we observe very few labor-managed firms in capital-intensive industries in

[2]*United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967). Williamson (1985 :183–189) excoriates the *Schwinn* decision in detail.

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developed countries not because that organizational form is relatively less efficient but because a 'market failure' prevents it from arising.[3]

At more-or-less the same time, I made similar points about the methodology of comparative-institutional analysis (Langlois, 1984, 1986), though I took the argument in a different direction. It seemed to me (and still seems to me) that we cannot pronounce on the relative optimality of observed organizational forms without embedding the analysis within an evolutionary framework of the sort advocated by Nelson and Winter (1982). An evolutionary perspective immediately draws our attention away from a side-by-side comparison of fully formed ideal types – though that remains a crucial tool in the organizational kit bag – and toward the nitty-gritty historical processes in which organizational forms arise and die. In *Markets and Hierarchies*, Williamson announced that 'in the beginning there were markets', which he meant not as an anthropological claim but as methodological injunction to compare the ideal type of fully formed markets with the ideal types of alternative institutional structures. In historical reality, however, in the beginning there very often weren't markets; and the absence (or underdevelopment) of markets is frequently a better explanation for vertical integration than anything having to do with the properties of ideal markets. Both markets and firms are institutions that are costly to create, giving rise to what I call dynamic transaction costs (Langlois, 1992).[4]

In 'Oliver Williamson and the Strategic Theory of the Firm', Argyres and Zenger (2021) concur that 'Williamson pushed the presence and origins of heterogeneous capabilities into the background and simply asked how firms (or the economy) should efficiently organize specific exchanges, using a logic that was quite independent of these existing heterogeneous capabilities'. At first glance, this makes Transaction Cost Economics seem less than relevant to the field of strategic management, which seeks to understand how managers can create and assemble capabilities in a way that gains competitive advantage. For Williamson, the unit of analysis is the transaction; in strategic management, the units of analysis are capabilities (Richardson, 1972) or resources (Penrose, 1959). Yet, Argyres and Zenger argue, one of the key concepts in Williamson's work is crucial to strategy: the phenomenon of asset specificity. For Williamson, assets that are highly specialized to a transaction generate contractual hazards – the threat that one of the parties might attempt to 'hold up' the other party in order to extract more rents – which militate in favor of vertical integration. Argyres and Zenger generalize this idea to any capabilities that are uniquely complementary to the bundle of capabilities that a firm possesses or wants to assemble. As in situations of holdup, such highly complementary assets can be sources of rents – of competitive advantage. In the end, strategy is a complex process of assembling uniquely complementary capabilities.

Whereas for Argyres and Zenger, the holdup phenomenon offers a source of conceptual inspiration, for many others it has been a target of criticism. From the very beginning, many authors have taken aim at Williamson's assumption of 'opportunism' – 'self-interest seeking

[3]It is not correct to say that labor-managed firms are rare in general. As Henry Hansmann (1996) pointed out, they are abundant in the service sector – law offices, medical practices, consultancies. In all those cases, human capital is both the crucial factor and the factor most costly to monitor; so human capital assumes the residual rights of control. Hansmann believes that in industries in which non-human capital is equally as or more important than human capital, capital providers will assume the residual control rights because the use of financial capital is more costly to monitor than is routine human labor. Williamson (1985: 323) makes essentially the same argument.

[4]Dynamic transaction costs are the costs of persuading, teaching, negotiating with, and coordinating with others who hold relevant capabilities. They are the costs of not having the capabilities you need when you need them. Dynamic transaction costs can arise within firms not just in markets. Workers often create new firms – spinoffs (Klepper, 2016) – when the costs of persuading, teaching, negotiating with, and coordinating with others are high within an existing firm. Williamson's response to the idea of dynamic transaction costs was that his approach was already adequately dynamic, in the sense that it is a two-period analysis (Williamson, 1999). The signing of a contract represents a Fundamental Transformation – more on this idea soon – between the pre-contract period and the post-contact period. As my long-ago mentor Fritz Machlup famously quipped, 'Dynamics is my theory; statics is the other fellow's theory' (Machlup, 1963: 24).

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with guile' – which underpins the analysis of holdup and asset specificity.[5] (This is very much a typical economist's assumption; and, as Sent and Kroese note, Williamson was always ultimately an economist.) The specter of opportunism implies to many the necessity of 'hard' incentive mechanisms to prevent inefficient behavior associated with the threat of holdup. Many, including Williamson himself, have suggested that perhaps there might also be 'softer' mechanisms available. In 'Integrating Variable Risk Preferences, Trust, and Transaction Cost Economics – 25 Years On: Reflections in Memory of Oliver Williamson', McMackin *et al.* (2021) focus in on one such mechanism, trust. In 'Atmosphere, Private Ordering and Industrial Pluralism: Williamson's Evolving Science of Organization', Chassagnon (2021) explores another mechanism, atmosphere. This latter is a concept that Williamson himself adumbrated in a couple of pages of *Markets and Hierarchies* but never returned to, though he had always hoped to do so (Williamson, 2007). As Chassagnon notes, however, the notion of atmosphere has largely been overtaken in the literature today by the idea of relational contracts.

Williamson had begun writing about relational contracts as early as 1979 (Williamson, 1979). In 'Deals That Start When You Sign Them', Robert Gibbons (2021), one of the foremost theoreticians of relational contracts, defines such contracts as 'a shared understanding of the parties' roles in and rewards from collaborating together (an understanding so rooted in the details of the parties' relationship that it cannot be enforced by a court)'. Gibbons traces the history of his, and to a large extent the profession's, formal modeling of relational contracts from early principal-agent formulations to property-rights models to a concern with problems of adaptation.

Williamson famously divided contacting into *ex ante* and *ex post* periods: the signing of the contract creates a Fundamental Transformation. Property rights models (Grossman and Hart, 1986) concern themselves with the allocation of ownership rights, in the face of contractual incompleteness and potential holdup problems, before the contract is signed; but those models 'vaporize *ex post* maladaptation' – they assume no inefficiencies or contractual difficulties once the ink is dry. Inspired, he tells us, by a brief stroll with Williamson atop the medieval walls of Lucca, Italy, Gibbons began thinking about the role of relational contracts after not before the Fundamental Transformation.[6] Although he initially understood the process of *ex post* adaptation in terms of formal models of governance, he eventually came to believe that ultimately relational contracts are ways of solving the 'clarity problem'. In real-life situations, contracting parties cannot foresee, and thus cannot explicitly agree upon, the nature and meaning of future states of the world. The relational contracts to which they must resort are in the end frameworks of learning that help them slowly develop shared, often tacit, 'cultural' understandings of the deal they made when they signed the contract.

In 'Adaptation, Adjudication, and Private Ordering: Contractual Relations through the Williamson Lens', Scott Masten (2021), another prominent student of contracting, picks up many of the same threads in Williamson's work. Like Gibbons, he emphasizes Williamson's 'process orientation', in which 'the main dimension along which contracts vary is the extent to which contract adjustments are effected through court ordering versus private ordering'. Relational contracts are a form of private ordering – the participants develop their own mechanisms of adjudication and dispute resolution rather than resorting to the formal legal system. Williamson rejected the assumption – which he derided as 'legal centralism' – that courts are reliably able to resolve all disputes in a sophisticated and low-cost way. As a result, 'contracts do not so much define the terms of trade as establish the procedures and alter the threat points from which parties compete over the division of transactional surpluses'. Perhaps counterintuitively, it is typically vague contracts, not those with precise terms, that are 'invitations for court ordering', since courts are more likely to defer to explicit contract terms. And,

[5]There is no need to trawl through this literature here; but see Hodgson (2004). As early as my 1984 paper (Langlois, 1984), I too questioned whether the assumption of opportunism was necessary to explain vertical integration or the existence of firms. I also talked about what I called 'imperfect structural knowledge', by which I meant something very like what Gibbons (2021) calls the 'clarity problem'.

[6]I too attended that conference and strolled the walls of Lucca, though, sadly, I received no similar bolt of inspiration.

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perhaps counterintuitively, it is frequently the vaguer and more-difficult-to-administer terms that elicit the stronger incentives for cooperation.

In turning his attention to the economics of contracting, Williamson 'must get full credit for having embedded the Coasean intuition in a model capturing the richness of arrangements that characterize modern market economies'. So writes Claude Ménard (2021) in 'Hybrids: Where Are We?' Like Coase, Williamson in his early work analyzed what are really two polar cases: vertically integrated firms on the one hand and spontaneous spot markets on the other. Perhaps influenced by Macneil (1974), however, by the late 1970s he had turned his attention to 'intermediate' forms of governance – essentially the various kinds of complex inter-firm contracting that had been so thoughtlessly dismissed by the 1960s Antitrust Division. For many scholars, these contractual arrangements are too diverse, specialized, and idiosyncratic to fit under a single theoretical umbrella. Ménard has long been associated with the idea that they might in fact be grouped together and analyzed systematically as 'hybrid' organizations. In this essay, Ménard brings us up to date on thinking about hybrids. He suggests that most hybrids can be arranged along two dimensions: the extent to which decision rights are decentralized and the extent to which property rights are centralized.

In 'From Hierarchies to Markets and Partially Back Again in Electricity: Responding to Decarbonization and Security of Supply Goals', Paul Joskow (2021) vividly illustrates the application of Williamson's ideas, including the importance of hybrid forms of governance. Over the past 25 years or more, electricity generation – a sector abundant with contractual hazards arising from complex interdependencies and high fixed costs – has transitioned in significant part from a system of regulated vertically integrated monopolies to a system based on engineered markets. As governments are mandating 'deep decarbonization' and a transformation from large-scale fossil-fuel generation to highly volatile wind and solar power, those institutional arrangements are undergoing rapid change. Joskow argues that we are witnessing a transition back in the direction of hierarchical governance. That governance is not taking the form of full vertical integration and central planning but continues to involve elements of competition, including 'competition for the market'. Purchased-power agreements – contracts between generators and what are often large corporations or universities as well as governments – are arising to link buyers and sellers in long-term arrangements that partake of some of the character of vertical integration.

Taken together, the essays in this special issue honor Oliver Williamson in what is surely the most appropriate way – by taking his ideas seriously and extending them in new and exciting ways.

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