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Introduction to the Ronald H. Coase memorial issue

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Abstract. This is an introduction to the twelve essays in the special memorial issue in honor of Ronald Coase. It includes a brief account of Coase's long life and some of its many achievements. Coase's distinctive, worldly and empirically-grounded approach to economics is highlighted, claiming that it has yielded major theoretical and policy insights. This introduction concludes with a summary of the contributions of the twelve essays.

Ronald Coase was born in Willesden in London, UK in December 1910, the son of a post office telegraphist. After obtaining a scholarship, he was educated at Kilburn Grammar school. In 1929, he began to study commerce at the London School of Economics. The LSE Bachelor of Commerce degree focused on the real world problems of business, much like students on MBA programs today, and this practical orientation informed Coase's subsequent research. In 1931, a seminar by Arnold Plant introduced him to Adam Smith's invisible hand, which Coase (1992) later described as 'a revelation'. Coase was a great admirer of Smith, as we can see from his writings on Smith's work (Coase, 1976, 1977). He took to heart Smith's view of the workings of market economies and of man in society.

Coase studied with Plant in the 1930s at a time of great intellectual foment, when economists were debating the role of state intervention in developed capitalist economies suffering high unemployment, and the merits or demerits of economic planning, both in theory and in Soviet practice. Plant was opposed to

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schemes to coordinate production through planning, which at that time many saw as solutions to the Great Depression. Yet, despite his admiration for Plant, the youthful Coase was already questioning authority. As he later put it, 'Plant argued that competition would provide all the coordination needed. Yet we had in economics a factor of production, management, whose function is to coordinate' (Coase, 1993). Why do we need management, he wondered, if the pricing system provided all the coordination necessary?

Coase was contemplating these questions when he finished his course work towards his BA and was awarded a Cassel Travelling Scholarship, enabling him to travel in the United States in 1931–1932. After a year of fieldwork meeting with businessmen and investigating US industrial integration, Coase concluded that coordination by management arose because there are costs to using the pricing mechanism, ideas which formed the core of his seminal article on 'The Nature of the Firm' (1937). Coase's subsequent writings confirm that this trip also shaped his views about the importance of in-depth investigation of the facts through fieldwork and archival research. Coase practiced what he preached. For example, for his research on British public utilities and lighthouses, he painstakingly assembled a large array of company reports, parliamentary papers, trade journals, court cases, etc. from libraries, governments and company archives. He did the same for his study of what he called 'the political economy of public broadcasting' in the UK, US and Canada. (Coase's large collection of materials is available at the Special Collection of the University of Chicago.) For his paper on payola (Coase, 1979), he spent two summers in Los Angeles interviewing musicians, DJs and radio station managers.[1]

Upon his graduation from the LSE, Coase got a job as an assistant lecturer at the Dundee School of Economics and Commerce and began 'to read the literature of economics – Adam Smith, Babbage, Jevons, Wicksteed, Knight' (Coase, 1995). Edward Chamberlin's *Theory of Monopolistic Competition* (1933) and Joan Robinson's *Economics of Imperfect Competition* (1933) also influenced Coase, as did his discussions with Ronald Fowler and the work of Henry Schultz on deriving statistical demand schedules. Between 1934 and 1935, Coase was an assistant lecturer at the University of Liverpool before returning to the London School of Economics in 1935. After six years in the government statistical offices during the war, he returned to the LSE and worked on pricing issues, particularly under monopolies. In 1951, Coase moved to the United States, spurred by an 'admiration for American economics' (particularly for the work of Frank Knight, George Stigler and Henry Schultz), coupled with 'a lack of faith in the future of

1 Much later, although unable to travel to post-reform China, he did the next best thing, inviting Chinese scholars to visit the University of Chicago (for example, Sheng Hong). He also remained in close contact with scholars in China (such as Steven Cheung), and instigated (and financed) two conferences (in 2008 and 2010) that brought the Chinese scholars, local and central government officials, and business people that he most wanted to interview to Chicago. See Coase and Wang (2012) on modern China.

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socialist Britain' (Coase, 1995: 239–40). But he retained his British citizenship. In the USA, Coase taught at the Universities of Buffalo and Virginia; he moved in 1964 to the University of Chicago Law School where he became emeritus in 1981.

The views of other economists never influenced Coase as much as his studies of actual operations of businesses and government; as he put it: 'My views have always been driven by factual investigation' (Coase, 1997). For example, despite his admiration for Smith and Plant, Coase remained a socialist until his studies of British public utilities in the late 1930s heightened his awareness of the defects of government intervention (Coase, 1996).[2] His wartime experience working for the British government further prompted him to question the faith many economists placed in government's ability to correct market failures.

Early in his career, Coase believed that economists should consider the practical effects of alternative policy recommendations. For example, in 'The Marginal Cost Controversy', Coase (1946) discussed the practical drawbacks to setting prices based on marginal costs and using government subsidies to cover the losses that result when marginal costs are less than average costs. To determine the subsidy, proponents of marginal cost pricing suggested that 'the Government should estimate for each individual consumer ... whether he would buy the product and also what location he would prefer, if he had to pay the total cost' (Coase, 1946: 174–175). If this estimated demand covered the enterprise's total cost, the government would give a subsidy equal to the difference between total costs and receipts from consumers. Coase argued that this approach would cause 'great inefficiency'. Since consumers were not asked to pay total costs, there would be little information to estimate how much they would be willing to pay, quite apart from the political pressures to influence the subsidies. Moreover, the subsidies would redistribute income to consumers of products facing decreasing marginal cost, and raise prices above marginal costs for products subject to taxation. He later asked why marginal cost pricing policies had received such widespread support in economics (Coase, 1988b: 19), and concluded that such support was the result of economists applying 'blackboard economics'.

These early studies reflect the tenor of all of Coase's work: study the real world, ask the questions no one is asking, get the facts, consider the alternatives, and do work that transforms the way we see problems. Coase went on to produce a

2 Coase later described his continued embrace of socialism, even after adopting many of Arnold Plant's positions about the disadvantages of ill-conceived government interventions, as 'inconsistent', but 'not unusual at the time' (Coase, 1996:106). Coase noted that Calabresi (1991: 1212) had 'ascribed my introduction into economic analysis of the costs of using the pricing system (transaction costs) in "The Nature of the Firm" as coming about because of my Socialist beliefs at that time. It is very difficult to know where one's ideas come from but for all I know he may well be right' (Coase, 1996: 106). He added: 'my socialist sympathies gradually fell away ...' as a result of his research on public utilities while at London School of Economics in the latter half of the 1930s. That research '... made me aware of the defects of government operation of these industries'. (Ibid.)

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number of influential works, including and 'The Problem of Social Cost' (1960), which suggests that well-defined property rights could overcome the problems of externalities. Coase is also often referred to as the 'father' of reform in the policy for allocation of the electromagnetic spectrum, based on his article 'The Federal Communications Commission' (1959). Another example of his concern to build economics on empirical facts is found in his 1974 essay on 'The Lighthouse in Economics'.

Coase tirelessly reminded his fellow economists that their job was to address the real world: mathematical models would be useful for the discipline only insofar as they aided practical engagement. Coase (1975: 30–31) broadly applauded Alfred Marshall's cautious attitude to mathematics in economics, and quoted Pigou's (1925: 84) report that Marshall had warned that 'excessive reliance' on mathematics 'might lead us astray in pursuit of intellectual toys, imaginary problems not conforming to the conditions of real life'. Coase (1988a: 24) regretted that: 'when economists find that they are unable to analyze what is happening in the real world, they invent an imaginary world which they are capable of handling'. Coase (1988b: 185) joked: 'In 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'.

While Coase repeatedly emphasized the primary importance of empirically-oriented enquiry over unrealistic models, he also understood astutely that empirical research had to be framed and driven by theoretical questions. Coase (1982: 13–14) argued that 'quantitative studies in economics are explorations with the aid of a theory'. Instead of facts speaking for themselves, proponents of rival theories try to use quantitative studies 'to make their point in a particularly persuasive form'.

In 1991, the Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel was awarded to Coase 'for his discovery and clarification of the significance of transaction costs and property rights for the institutional structure and functioning of the economy'. Coase died in Chicago on 2 September 2013, at the age of 102.

This memorial issue contains twelve further essays.[3] Williamson (2014) reflects on Coase's life and work, noting in particular his seminal editorship of the *Journal of Law and Economics* and his role in co-founding the International Society for New Institutional Economics (ISNIE).[4] Shirley *et al.* (2014) give an overview of Coase's contribution to economics, stressing its originality and massive influence.

3 The essays in this issue were submitted in response to invitations by the editors of this journal and to an open call for additional submissions. Neither Ménard, Shirley nor Wang were involved in the selection, revision, acceptance or editing of these papers.

4 Shortly before his death in 2013, Coase also accepted an invitation to be an Honorary President of the World Interdisciplinary Network for Institutional Research (WINIR).

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Further essays focus on Coase's key contributions, particularly his early work on the theory of the firm and his seminal essay on social cost (Coase, 1937, 1960). Addressing Coase's enduring contribution to our understanding of the firm, Loasby (2014) gives a fresh interpretation, underling the role of knowledge and the nature of institutions, which offers challenging insights concerning the scope of economics. Likewise probing Coase's analysis of institutions, Pagano *et al.* (2014) argue that while Coase rightly saw the creation of institutions as costly, he downplayed the possibility of complementarities and overlooked the meta-institutions concomitant with institutional change. Miceli (2014) also addresses the problem of institutional (or organizational) choice. Addressing the boundaries between firms, markets and law, he develops a unified framework that reveals the relative advantages and disadvantages of market exchange, court ordering and internal governance. Rossi (2014) revisits the institutional structure of production posed in Coase's (1937) paper and in much subsequent work in transaction cost economics. From the point of view of subjective cardinal value theory, transaction costs may be insufficient to explain institutions. He explores the further implications of his argument for competition theory and the socialist planning debate.

A number of papers here address Coase's (1960) path-breaking essay on social cost. Frischmann and Marciano (2014) explore the meaning and implications of this paper, arguing that many ignored Coase's call for a new approach and his sustained use of legal cases to illustrate his arguments. Frischmann and Marciano propose that the economics profession interpreted Coase's seminal article exactly the opposite of what he had intended. It was Stigler (1966), not Coase, who invented the term 'Coase theorem'. Medema (2014) argues that, circa the 1970s, the Coase theorem had no settled meaning or content, instead, that meaning and content was created in differing ways by the modeling choices of scholars who attempted to grapple with issues laid out by Coase (1960). But from a fresh perspective, with clear definitions and logical arguments, Allen (2014) argues that the Coase theorem is coherent, logical and unrefuted.

Foss and Foss (2014) place Coase's work on property rights within a broad tradition including Armen Alchian, Yoram Barzel, Steven Cheung, Harold Demsetz and others. They contrast this genre with the influential work on property rights by Oliver Hart and others, which they see as narrower and more restrictive. They argue for a richer approach, building on the Coasian tradition. Bertrand (2014) focuses on the figure of the judge in Coase's economics. She notes that while Coase depicts judges as motivated to improve efficiency, he treats regulators as fallible and possibly swayed by vested interests. She explores reasons for this apparent inconsistency. In the final paper, Lemstra *et al.* (2014) consider Coase's (1959) important work on radio spectrum trading. Outlining its basic assumptions and methodology, they compare with the theoretical and policy framework developed by the earlier institutional economist John R. Commons.

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