STEVEN G. MEDEMA (ed.) (1997). *Coasean Economics: Law and Economics and the New Institutional Economics*. Boston, MA: Kluwer Academic Publishers. 274 pp., $115.00

Maynard Keynes's valedictory to *The General Theory*, appealing to the vanity of all scholars, argued that, in the long run, ideas trump interest. But Keynes found, upon visiting Roosevelt's Brain Trust, that his own ideas were nearly unrecognizable, ruefully quipping: "I am no Keynesian." As with Keynes, Ronald Coase is no Coasean, or so this collection of essays wishes to argue.

Ronald Coase, of course, is best known for two seminal articles, those his Nobel citation instances: "The Nature of the Firm" (1937) and "The Problem of Social Cost" (1960). Many economists would be hard pressed to name a third. Measured by citation, both of these papers have been hugely influential, though, as with Keynes, perhaps not in the way their author intended. In Coase (1988), which republishes the two famous papers, Coase laments that his work is more cited than used. "My argument," he says querulously, "has not been understood."

Coase's argument is this: gains from trade, transacted in or out of markets, are not obtained costlessly—transacting requires costly search, bargaining, and enforcement. Coase applies the argument counterfactually, in industrial organization and in welfare economics. In a world of no transactions costs—the world of neoclassical price theory—the firm (*qua* hierarchical organization) has no economic purpose and neither, by the same logic, does liability law have an economic purpose. Since we observe firms and externalities, there is *prima facie* evidence for the existence of transactions costs.

The present collection began life as an anniversary celebration of "The Problem of Social Cost" (PSC) and, though there are three eclectic papers by Richard Langlois, Geoffrey Hodgson and Peter Boettke on the theory of the firm, and Oliver Williamson's previously published proposal for adding organization theory to law and economics, the book retains its original emphasis. It suffers from the usual flaws of the conference-volume genre—a certain lack of cohesion, a title that promises more than thirteen papers can deliver, and less than vigilant copy editing ("Coase" morphs into "Coast" at one point). But there are compensating rewards once the reader acquires the theme, which may be put as follows: to reclaim the real Coase from mainstream economics, which has cast him as the ersatz "Coase" of the famously misnamed "Coase" Theorem.

The ideas behind what came to be known as the Coase Theorem join transactions costs to two related themes in the Coasean *oeuvre*—the efficacy of government interventions and of economists' methods, respectively. First, economists in the Pigovian tradition regard policy makers as sufficiently well-informed and well-intended to remedy market failures, while Coase insists that government cures can be worse than market diseases. Second, mainstream economists practice "blackboard economics," a theory-tropic method that blinds economists to transactions costs and to the difficulties of successful government intervention, while Coase insists on an economics which is empirically grounded and alert to differences among alternative institutional arrangements.

Now, the Theorem itself. One common formulation is this: when transactions costs are zero, resources are used efficiently, regardless of the initial assignment of legal entitlements. If smokers value air more than breathers then there will be smoke, whether or not smokers

are legally liable for harms. If breathers value air more than smokers, then air will be clear even with smokers's rights.

Most readers will know that the Coase Theorem, as Paul Samuelson once sniffed, is not a theorem at all, that George Stigler, not Coase, is responsible for the name, and that Coase never wrote down an authoritative formulation, so that the above is just one among a family of like versions. Some readers will know of the potential complications introduced by wealth effects, endowment effects, and informational asymmetries. These and other issues are surveyed in Martin Zelder's able and exhaustive account of the Coase Theorem's tortuous doctrinal history.

A more serious misunderstanding is the common notion that Coase somehow endorsed the never-never land assumption of zero transactions costs, i.e., the word "since" can be substituted for the word "when" in our formulation. Nothing could be further from the truth, Coase vigorously argued, and this is the starting point for the two fine papers by Warren Samuels and Steven Medema, and Deidre McCloskey. As McCloskey puts it, PSC was not meant to show that we live in the best of all possible worlds, but, on the contrary that if we did, there would be no need for policy. There is no "problem" of social cost when it always equals private cost.

Since, Coase insists, we live in a world of pervasive and high transactions costs, there is a rationale for policy—it may well matter which party is assigned property rights over air. McCloskey tartly suggests that the "Coase" Theorem is best read as Stigler in Panglossian mode. The real Coase is left to wonder how the author of "The Nature of the Firm" could be mistaken for a proponent of zero transactions costs.

Samuels and Medema are also persuasive that Coase, his Chicago credentials notwithstanding, is best seen as a policy pragmatist who believes that the appropriate (read: lower cost) institutional choice—market versus government—can be determined only by comparative, case-by-case, cost-benefit analysis. But this reading leads to a puzzle, namely: if Coase is institutionally agnostic in principle, that is, he rejects a general theoretical presumption in favor of markets, in practice he is free-market libertarian, on one occasion unable to cite a *single* instance of successful regulation. Why?

First, while markets may fail in the presence of high transactions costs, it doesn't follow that government remedies can do better. The institutional choice among social arrangements is a choice among imperfect alternatives. Here Coase is interpreted as a precursor to Lancaster and Lipsey's Theory of Second Best. Thus, the anti-interventionist spirit of PSC is not that the "Coase" Theorem shows that markets will bargain away externalities and other market failures, but that successful intervention requires more information than even well-intended governments are likely to have.

Second, if Coase regularly agreed with his Chicago colleagues on their policy positions, he did so for rather different reasons. Coase's Hayekian emphasis on the epistemological challenges that interveners face, is closely connected to his criticism of mainstream economists' reliance on "blackboard economics." The regulator's problem looks trivial on the blackboard—set the natural monopolist's price to marginal cost, and cover fixed costs by subsidy. But, Coase rejoins, taxation to finance the subsidy will be distortionary and, more important, the analysis begs the question of how successfully the regulator

can estimate the firm's cost and demand functions. The idea of marginal cost pricing is "logically impeccable" Coase concedes. But to fail to consider what real governments can do, is to fall prey to what Richard Posner has called the socialist pitfalls of high theory.

Coase objects not to intervention *per se*, but to intervention rationalized solely by "blackboard" considerations. His 1974 paper, "The Lighthouse in Economics" (reprinted in Coase 1988) shows that lighthouses—economics' stock example of a public good—were routinely privately supplied in 19th-century England. Coase's empirical approach derives its force not because it somehow rejects the idea of market failure, but because it so pointedly shows that purely "blackboard" exercises can lead to egregious empirical lapses. The paper by Richard Zerbe, Jr. and Medema pursues this line of thought by arguing that Coase's method is Marshallian, part of the British tradition, with its emphasis on understanding, induction, empiricism, and prudence with respect to mathematics.

Readers of a Constitutional bent—who might agree that the proper role for welfare economics is the consideration of alternative institutional arrangements, not merely the determination of optimal allocations in a given institutional setting—will be familiar with a tension that lies at the heart of Coase's normative enterprise. Coase advocates choosing social arrangements so as to minimize social costs, roughly defined as transactions costs plus allocative inefficiency. The catch, as Robert Ellickson has argued, is that the injunction "minimize social costs" cannot help a society decide how to confer fundamental entitlements because the costs and benefits upon which the analysis depends come into existence only after those entitlements have already been conferred. Thus, there is a tension between Coase's normative approach and his comparative institutional approach; the former requires that some version of the latter already exists. Samuels and Medema refer to this as the "circularity problem."

Coase's methodological distinctiveness—prose not algebraic expression, empirical though not quantitative investigation, logical but not purely deductive thinking—may help explain why his work has been more influential in Law than in Economics. Coase wanted it the other way around. He says he never intended to influence legal scholarship. Neil Duxbury's note speculates on the reasons for Coase's influence in law schools, highlighting a crucial, if overshadowed argument in PSC.

The argument is that externalities are reciprocally caused. Nuisance and tort law traditionally assigns liability for harms by assessing (proximate) cause—railroad sparks *cause* fires in nearby crops, so railroads should be liable. Coase insists that, but for flammable crops planted close to the rail bed, there is no externality—it takes two to tort. And if "cause" is not dispositive, the door is open to other criteria for deciding whom is to bear social costs. Enter efficiency, the thin edge of the economic incursion into legal scholarship.

Less methodologically inclined readers will perhaps be put off by this volume's emphasis, which considers Coase's economics, rather than practicing it. Only Victor Goldberg's paper—an interesting consideration of the railroad sparks-crops history and a related puzzle—is an instance of the latter. But Coase's economics cannot be understood—nor can the misunderstandings documented in this volume—without refer-

ence to his ideas about the institutional structure of knowledge production within economics itself.

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Reference

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