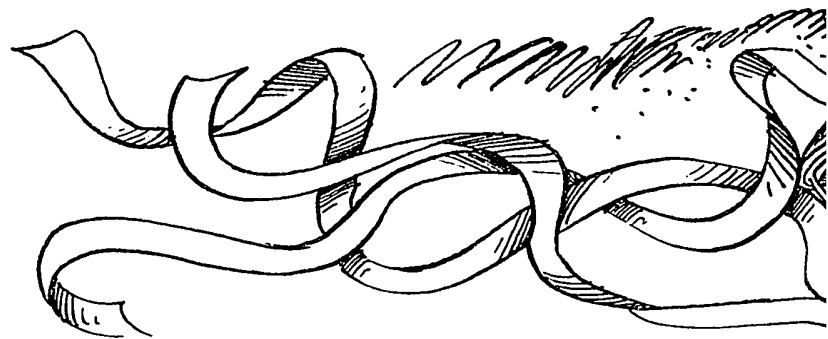


The Nation



For a Common-Sense Economist, A Nobel – And an Impact in the Law

By PETER PASSELL

WHEN people think about what economists do, they are likely to conjure nightmarish equations and computer simulations and all manner of indigestible Greek-letter salad. For the most part, they are right.

But exceptions are often more interesting than the rules. And few are as interesting as the work of Ronald H. Coase, the 81-year-old retired University of Chicago Law School professor who last week won the Nobel prize for economics. His ideas have swept through-legal scholarship like a fresh breeze. It is likely — some would argue, inevitable — that the Coasian way of thinking will influence policies ranging from access to transplant organs to the control of corporations.

Mr. Coase (whose name rhymes with dose) has made a career asking basic questions about the minuet of the markets — how people organize to advance their economic interests, and when government is needed to choreograph the dance. And what a career: his penetrating yet disarmingly simple answers have become the stuff of myth to a generation of scholars more at home in multivariate regression analysis than in English.

For a sample of vintage Coase, consider his 1974 article on lighthouses. For decades, textbooks used the lighthouse as an example of a “public good,” a service that private markets could not deliver efficiently because there was no practical way to exclude consumers who refused to pay.

But the British-born Mr. Coase noted that lighthouses began as private enterprises in Britain, and that the system worked well. For in spite of the “free rider” problem, enough people who profited from the ship traffic through British ports were willing to support the lighthouses because they did not trust government to provide adequate service on its own. New Yorkers may note that what worked in Britain also works closer to home: hundreds of city block associations now pay for the extra protection the city’s police department cannot or will not provide.

Mr. Coase reserved his broadest brush for an analysis of why business companies exist. Companies, he argued, are really contractual hierarchies that shelter collections of workers from the uncertainties and costs of relying on markets to meet their needs. When a professional wants a letter typed, she can hand it to her secretary rather than looking for typists on the street or in the Yellow

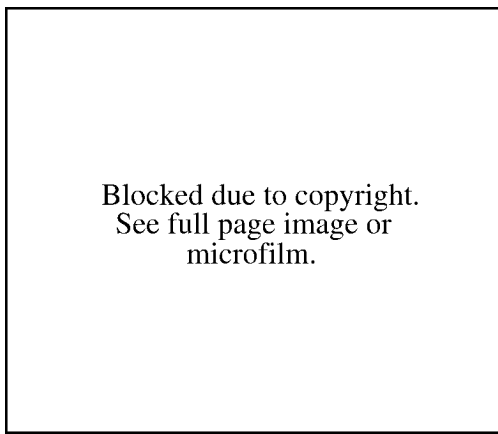
one of his disciples, Oliver Williamson of the University of California at Berkeley, may yet win his own Nobel prize for extensions of the framework.

For all its impact, however, Mr. Coase’s theory of the firm must take a back seat to his 1960 article, “The Problem of Social Cost.” When first submitted to the University of Chicago’s Journal of Law and Economics, it evoked the wrath of the entire economics department, which was then home to giants including the future Nobel prize winners Milton Friedman and George Stigler. But in a famous seminar, Mr. Coase converted them one by one. Thirty years later it has probably become the single most cited article in modern economics.

Again, the point is simple. It had long been the conventional wisdom that markets generating “externalities” — costs not borne by producers — would inevitably be wasteful without a little help from government. If, for example, soot from a factory chimney ruined the paint on neighboring houses, some sort of tax or regulation would be needed to get the factory to take account of the soot damage in choosing a lowest-cost method of production.

Mr. Coase was skeptical. If the damage created by the soot exceeded the cost of curtailing it, why couldn’t the homeowners bribe the factory to clean up its act? In a world where the practical problems of making deals (what economists call the transactions costs) were tiny, he concluded, government would not be needed to insure least-cost solutions to problems of externalities.

By the same logic, of course, pigs could fly if only they had wings. But as Guido Calabresi, dean of the Yale Law School, points out, Mr. Coase was not trying to make a practical case for keeping government out of regulating pollution. Rather, he was arguing the true source of market failure is not the externalities but the transactions costs that prevent waste-reducing deals. For purposes of clearer analysis, he was separating the problem of coping with the nuisance from the question of who was at fault. In a Coasian world of “causal agnosticism,” Mr. Calabresi says, one could as easily speak of the



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Ronald H. Coase

Associated Press.

Pages. And when a typist wants to sell his skills, he can trade flexibility, independence and perhaps a higher income for a guaranteed salary.

Businesses grow, Mr. Coase concluded, to the point that the costs of internal sources of inefficiency — the myriad conflicts between individual workers’ interests and that of the organization as a whole — equal the costs of coping with the endless headaches of buying and selling what you need, when you need it. This may not seem an earth-shaking insight. But his ideas lurk behind serious analyses of contemporary business issues ranging from corporate control to workplace discrimination. Indeed, they have proved so fruitful that

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A 1960 article enraged scholars, but is now probably the single most cited work in modern economics.

paint getting in the way of the soot as the soot getting in the way of the paint.

Michael E. Levine, the dean of Yale’s School of Management, offers an example of the way such analysis can change established legal thinking. In a hoary Minnesota case often cited in law texts, a Great Lakes steamer tied up at the nearest wharf to avoid sinking in a storm. The dock was badly damaged, and the owner sued to cover the repair costs.

At the time (1910), the court floundered its way through a logical thicket of assigning liability where common sense said no one

was truly at fault. If Mr. Coase had been on the bench, however, he might well have focused on the next accident rather than the last.

A Coasian scholar would want to give both the owners of docks and the owners of boats the incentives to minimize the total damage to life and property. And that probably would have meant billing the boat owner, who was in the better position to weigh the risks.

The Coasian way of thinking, Mr. Calabresi says, offers opportunities for analyzing questions in everything from bankruptcy to environmental law. Even novel legal issues, like balancing the wishes of grieving families against society’s interest in making body organs available for transplant, give way easily to Mr. Coase’s brand of analysis. Such Coasian techniques have found a firm niche in legal scholarship.

But Richard A. Posner, a Federal appeals court judge and disciple of the Nobel prize winner from his days as a University of Chicago Law professor, thinks the best is yet to come. “Ideas filter gradually into the real law,” he said; “It will be another generation” before the shock waves fully penetrate the system.