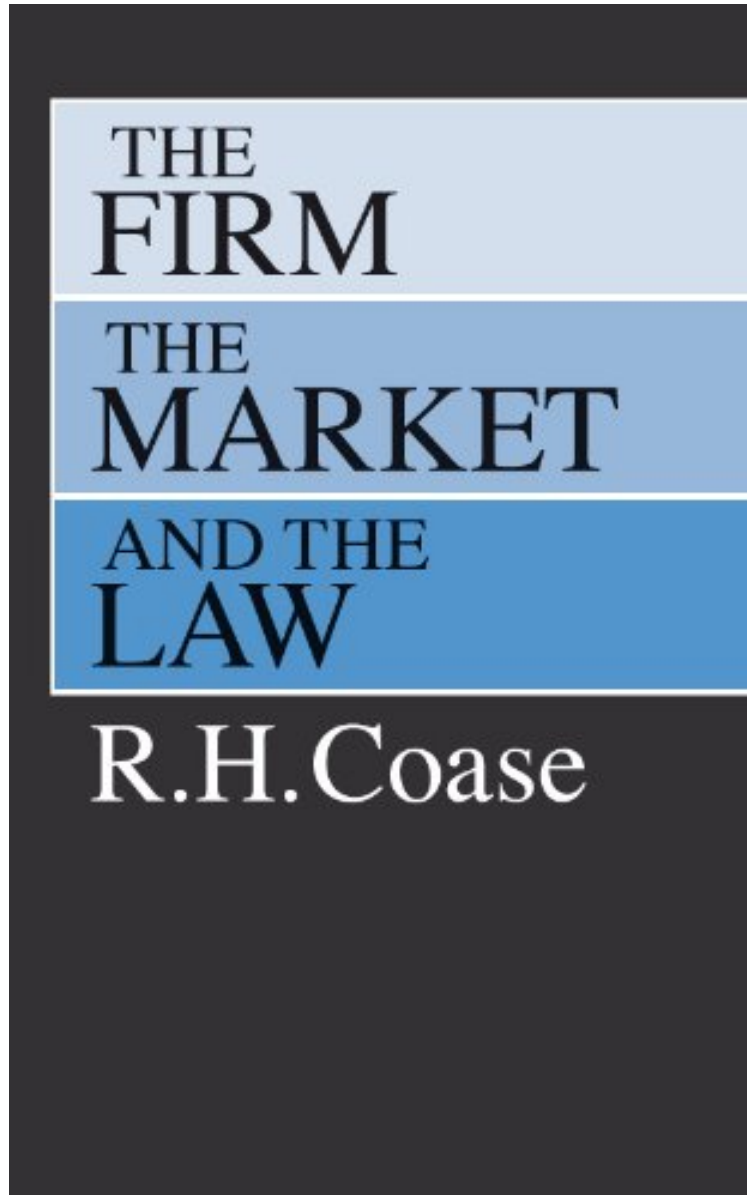


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## The Firm, the Market, and the Law

*R. H. Coase*

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**R. H. Coase : The Firm, the Market, and the Law** before purchasing it in order to gage whether or not it would be worth my time, and all praised The Firm, the Market, and the Law:

4 of 4 people found the following review helpful. The Brilliance of Ronald Coase...By James F. MuellerRonald Coase is a fantastic economist. He writes with great lucidity and a confidence which suggests to the reader that his arguments "fall into the category of truths which can be deemed self-evident" (page 1). Coase's principal aim in these essays is to

correct what he believes to be the flaws of mainstream economic theory. In the process of doing so, he asks some remarkably novel and challenging questions, but in the end fails to pursue them consistently, arriving at conclusions which employ the same assumptions by those whom he is trying to refute. The book consists of seven essays. Very briefly, the first essay is an introduction in which Coase describes his economic outlook while introducing the concepts contained in each of the following essays. The remaining six essays can be divided up as follows. Chapters two and three contain discussions of the firm. The second essay is the highly influential "The Nature of the Firm" essay while the third essay applies these arguments to a general research proposal on industrial organization. Chapter four and seven are essays which can be described as historical. Chapter four summarizes and contributes to the "marginal cost controversy." For those with little exposure to this issue, this essay can be passed over. Chapter seven is the famous "The Lighthouse in Economics" which challenges the public goods argument by showing that the lighthouse has historically been provided by private companies. The remaining two chapters contain arguments and notes on what has come to be called "The Coase Theorem." Chapter five is the actual essay "The Problem of Social Cost" and chapter six contains a series of replies to various criticisms that have been directed at the arguments presented in "The Problem of Social Cost" essay. Clearly, the best articles in this book are chapters two and five, "The Nature of the Firm" and "The Problem of Social Cost". As I mentioned earlier, Coase begins his analysis by asking a very novel and challenging question: If the price system works itself, as is conventionally taught, then why do we see firms? His answer is that there are costs to conducting transactions through the market. The two examples he gives in various forms are: 1. discovering what the relevant prices are, since outside equilibrium the relevant prices are not known. 2. The costs of negotiating and concluding contracts. To my disappointment, Coase inexplicably spends the rest of the essay extending the example of the costs of contractual arrangements. Now this is an important problem, but until the question of relevant prices is resolved, the problem of executing costly contracts seems to be almost insuperable because if we still have no way of discovering what the relevant prices are, then how can we measure the degree of costs involved in "negotiating and concluding contracts" (page 38)? I would have liked to see Coase concentrate his remarkable intellectual abilities on the first problem; namely, that of discovering what the relevant prices are. He mentions this problem just once, and then omits it from all subsequent discussions of costs and market transactions. I cannot make sense of this. This problem is carried into his other famous essay "The Problem of Social Cost". Now the economic analysis contained in this essay is both rigorous and logically consistent. Given certain prices, and given a world in which transaction costs are absent, it would seem superfluous to assign rights because they would simply be re-negotiated in a way which maximizes the social product. This world is a world of equilibrium, and in such a world we can presume that the relevant prices are known. What I like about this argument is that it demonstrates to the advocates of this model (equilibrium) that economists cannot simultaneously present theories of perfect competition and market failure. In a world of perfect competition, rights will be arranged in a way consistent with the maximization of the social product. It does not make any sense to speak of market failure in conditions of perfect equilibrium. We can use Coase's analysis and say to economists: "The nature of the choice is clear: [perfect competition] or [market failure]. What answer should be given is, of course, not clear unless we know the value of what is obtained as well as the value of what is sacrificed to obtain it" (page 96). But when Coase does admit the existence of transaction costs into the analysis, he falls into the same error of assuming that the relevant prices are still known in such a world. He writes: "In earlier sections, when dealing with the problem of the rearrangement of legal rights through the market, I argued that such a rearrangement would be made through the market whenever this would lead to an increase in the value of production. But this assumed costless market transactions. Once the costs of carrying out market transactions are taken into account, it is clear that such a rearrangement of rights will only be undertaken when the increase in the value of production consequent upon the rearrangement is greater than the costs which would be involved in bringing it about" (page 115). This argument, while laudable in its emphasis on transaction costs, still begs the question. We first must know what the relevant prices are before we can compare the relative advantages of alternative sets of rights. I think Coase's argument would be strengthened considerably once these considerations are brought into clearer light. To my knowledge, this observation has yet to be made. Before we can speak of transaction "costs", it behooves us to know, as Coase recognized, what the relevant prices are. We could not speak of cost without first solving this very important problem.

1 of 1 people found the following review helpful. Next only to Adam Smith's *Wealth of Nations* By De-Xing Guan Definitely the best book in economics since Adam Smith's *Wealth of Nations*. I believe the future of economics will be more promising if we would be more willingly to adopt the Smith/Coase framework to re-organize our thoughts than to be continuously stuck in the world without transaction costs, such as that in Walrasian perfect competition or in Chamberlinian monopolistic competition. Smith never proposed perfect competition. He did recognize the significance of the cost of using markets (see *Wealth of Nations*, Book I, Chapter VII). *The Firm, the Market, and the Law*, therefore, deepens the arguments of Smith, and makes clearer the interactions among the three most important institutions in human society: firm, market, and law. Any person who is interested in economics should read this book, and if this has been done before, then read it again!

0 of 0 people found the following review helpful. Classic work that forms the backbone of the case for Companies. By Customer Why do firms exist? Why are there companies instead of cottage industries? Why should the government

encourage or support the formation of firms and enforce laws that assist the firm as if it had rights? Dig down into things and you discover that it is the minimization of transaction costs that drives the formation and growth of firms and that when people lose sight of that truth, things can get dicey. This book is for someone with a decent grasp of economics. Not for the faint of heart. *The Firm* was written in the 1930's and has not lost anything over the years. The other two essays, *The Market* and *The Law* are good ancillary material.

Few other economists have been read and cited as often as R.H. Coase has been, even though, as he admits, "most economists have a different way of looking at economic problems and do not share my conception of the nature of our subject." Coase's particular interest has been that part of economic theory that deals with firms, industries, and markets—what is known as price theory or microeconomics. He has always urged his fellow economists to examine the foundations on which their theory exists, and this volume collects some of his classic articles probing those very foundations. "The Nature of the Firm" (1937) introduced the then-revolutionary concept of transaction costs into economic theory. "The Problem of Social Cost" (1960) further developed this concept, emphasizing the effect of the law on the working of the economic system. The remaining papers and new introductory essay clarify and extend Coase's arguments and address his critics. "These essays bear rereading. Coase's careful attention to actual institutions not only offers deep insight into economics but also provides the best argument for Coase's methodological position. The clarity of the exposition and the elegance of the style also make them a pleasure to read and a model worthy of emulation."—Lewis A. Kornhauser, *Journal of Economic Literature* Ronald H. Coase was awarded the Nobel Prize in Economic Science in 1991.