Roads Not Taken: The Coase Conundrum

Craig Freedman – UNSW

cfreedma@hotmail.com

I shall be telling this with a sigh
Somewhere ages and ages hence:
Two roads diverged in a wood, and I—
I took the one less traveled by,
And that has made all the difference
(Robert Frost *1916:1*).

Ronald Coase was 'at', rather than 'of' Chicago. This statement goes a long way towards explaining how the methodological aim and approach of Ronald Coase differed sharply from that of Chicago, meaning the Chicago School as defined by such luminaries as George Stigler or Milton Friedman. As he, himself, clearly claimed, he was a direct throwback to the Classical Liberalism that defined and formed the characteristic feature of the work of Frank Knight. The confusion is perhaps encouraged by the simple tendency to categorize economists, to lump them together under a myriad of preferred flags (neo-classical, Austrian, Marxian, Heterodox, Keynesian and onward indefinitely). This almost automatic tendency means that the very company that Coase kept makes such a characterization tempting no matter how misleading it ultimately is. Though he admired the work of such economists, shared lunch and conversation with them, this did nothing to make their approach to economics at all similar. Nor is this muddle at all clarified by the indisputable fact that Coase had very similar policy stances and was politically quite conservative. Accordingly, these simple and most notable characteristics tend to outshine clear differences. Meaning that the distinct methodological difference practiced by Coase and the founding members of the Chicago School varied radically to the extent that Coase himself expressed doubt that economists like Stigler and Friedman really understood what he was striving to accomplish. Nor, if you read their remarks or examine their work is there any evidence of any real understanding or sympathy for Coase's methods.

In contrast to the almost retro aura surrounding Coase, Stigler and Friedman were part of the post war attempt at scientific modernism. Stigler, for instance, sought to find generalizable and universal models (such as perfect competition) which could be applied directly to resolve all and any problem or policy issue. Although he seemingly jumped from issue to issue, Stigler, in the words of Isiah Berlin, was in fact a bred in the bone hedgehog (knowing one big thing), rather than an apparent fox (knowing many little things). Appearances, as always, can be misleading. In contrast, Coase insisted upon the value of exploring the nitty-gritty of time and place specific instances. Coase remained firmly at odds with these dominant Chicago figures in his approach to economics and his rejection of what he termed 'blackboard economics' (abstract theory). Harking back to the older, classical liberal methodology of such nineteenth century economists as John Stuart Mill, Coase took issue with the sort of pseudo positivism offered by his colleagues, Milton Friedman and George Stigler. He went so far as to question whether any research or progress could actually be achieved if one seriously adopted such methodology. Moreover, adhering to the classical liberal foundation of separating economic science from applications, Coase forswore any attempt to jump directly from theory to policy resolutions. Such analysis instead required judgment aided by time and place specific information. No a priori position could be justified.

Instead a more case by case approach was required. Therefore, unlike the Chicago School practitioners, government intervention was not automatically precluded. Too little, as well as too much government involvement remained a concrete possibility. Though also firmly adhering to the key role of data and quantification, Coase questioned whether George Stigler employed his empirical work more as a rhetorical device than an investigative tool.

Therefore, by exploring and analyzing this distinctive difference, such questions as Coase's response to the 'Coase Theorem' becomes clarified, as does the intent of much of his work. As is generally recognized, the Coase Theorem was formulated by George Stigler as his attempt to synthesize Coase's seminal paper on Social Cost. Though Coase in fact took no issue with what was for him a purely scientific formulation, for Coase, the structured Theorem failed to comprehend the point of what drives his very lengthy paper. Stigler, whether deliberately or not, seized instead on a bit of preliminary preparation that Coase conceived of as necessary (though hardly sufficient), and in doing so ignored the bulk and objective of Coase's thought. Coase employed the zero transaction construct to erase the then commonly held textbook paradigm of externalities (attributed to Coase's nemesis, Pigou). By demonstrating that in the absence of transaction costs, externalities provoke no discernable market difficulties, Coase could then focus on what he perceived to be the crucial issue, namely transaction costs. The great bulk of Coase's somewhat quirky paper deals with the world of positive, and serious, transaction costs, the very issue that Stigler largely ignores.

Given the deliberate differences in the approach (or methodology) attached to practicing economics, it is misleading and unproductive to lump Ronald Coase together with his erstwhile colleagues at Chicago. Coase himself for good reason concluded that his own work and objectives were misconstrued by those who claimed to be among his chief admirers. Even more importantly is the fact that by examining Coase and by contrasting him with his Chicago School compatriots, the importance of methodology is underlined. Here the emphasis is definitely not on prescriptive but rather on working methods employed by economists. Coase's approach continues to be important today since it largely determines the way in which economic policy options are constructed. If we take the lead offered by Coase and his classical liberal forbears then we must be willing to forswear the simple and easy path of jumping from theoretical verities to concrete policies.

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