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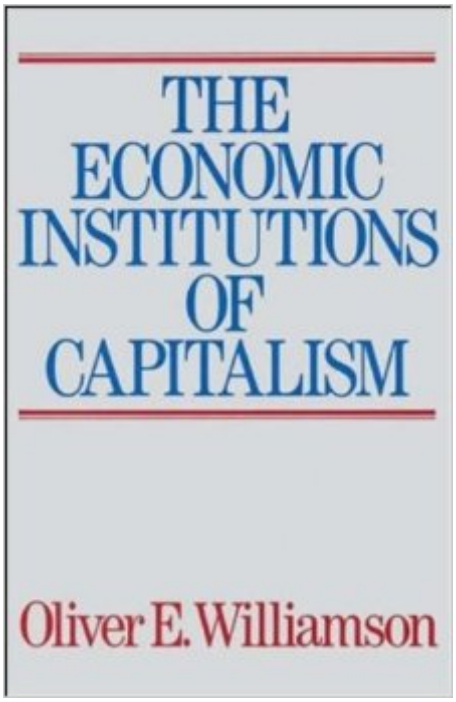
The Economic Institutions Of Capitalism



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Synopsis

"An extraordinarily impressive achievement and must reading for all serious students of law, economics, and organization".--Paul L. Joskow, Professor of Economics, Massachusetts of Technology.

Book Information

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Customer Reviews

EIoC is a classic work of new institutional economics. In it, Williamson works out his theories of transaction cost economics across an array of interesting economic questions. Most of the covered topics will be of interest not only to economists, but also to lawyers and policymakers. Among other examples, Williamson tackles such subjects as vertical integration, corporate governance, and industrial organizations.Williamson's core idea is the theory of transaction cost economics. We can analogize transaction costs to friction: they are dead weight losses that reduce efficiency. They make transactions more costly and less likely to occur. Among the most important sources of transaction costs is the limited cognitive power of human decisionmakers. Unlike the Chicago School of law and economics, which posits the traditional concept of rational choice, Williamson asserts that rationality is bounded. Put another way, he assumes that economic actors seek to maximize their expected utility, but also that the limitations of human cognition often result in decisions that fail to maximize utility. Decisionmakers inherently have limited memories, computational skills, and other mental tools, which in turn limit their ability to gather and process information. As he demonstrates, this phenomenon, known as bounded rationality, has pervasive implications for understanding how institutions work.At the policy level, transaction cost analysis is

highly relevant to setting legal rules. Suppose a steam locomotive drives by a field of wheat. Sparks from the engine set crops on fire. Should the railroad company be liable? In a world of zero transaction costs, the initial assignment of rights is irrelevant. If the legal rule we choose is inefficient, the parties can bargain around it.

I was searching for something about comparative organizational forms - such as how is Toyota organized differently than GM and how does this benefit them? - when I found this. After searching around, I discovered that Oliver Williamson is both one of the most prolific writers and one of the most cited. Coase's 1937 essay, "The Nature of the Firm", challenged economists to open up the black box that neoclassical economics refers to as "the firm". Williamson responded by creating a whole new tool box for analyzing a wide variety of relationships called the New Institutional Economics (NIE). This book summarizes the state of NIE as of 1985.The basic outline of NIE is easy to grasp, but shifts the focus of economics from choice to contract. Contractual man, furthermore, is not the perfect maximizer assumed in neoclassical economics. It might help if the reader knows a little about antitrust theory as it applied in the middle of the 20th century to vertical integration since much of this book is dedicated to showing why that theory overlooked the efficiency benefits. Williamson then applies it to the organization of labor (hierarchy vs. team production), unionization, corporate governance, and finally public utility franchise bidding.While I respect Professor Bainbridge's experience teaching material this difficult, I personally didn't find the writing so bad as to deduct a star. Yes, it is jargon-filled, but this is a specialist's field. Once you learn the vocabulary, it seems to move along at a good pace without suffering from some of the archaic terminology found in law texts. It contains some rather simple math (which the reader can skim without losing anything of the argument). I especially liked how Williamson diagrams the decision-making process.

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