

NEW INSTITUTIONAL NEOCLASSICAL ECONOMICS OR INSTITUTIONAL ECONOMICS?

Dr. Javier Aranzadi

STRUCTURE OF THE PAPER

1. The object of social science.
2. Coase and the nature of the firm.
3. The firm as a institution

1. The object of social science

- We all agree with Williamson (2010, p. 678 when he says that the object of social sciences is human action.
- R. Coase from his masterful 1937 article stresses that we are dealing with the real people.
- But starting from the same human action we can arrive to quiet different approach to institutions
- The new neoclassical institutional economics and the institutional approach presented here mean a very different concept of the firm as an institution.
- As Herbert Simon says: “Nothing is more fundamental in setting our research agenda and informing our research methods than our view of the nature of human beings whose behaviors we are studying... *It makes a difference to research, but it also makes a difference for the proper design of.... Institutions*” (1985, p. 303)

2. Coase and the nature of the firm.

- For the neoclassical model the existence of the firm is something quite problematic. When Coase ([1937] 1988) asked, why firms come to existence? Williamson gives us this astonishing answer, the firm is the organizing form of last resort to be employed when all else fails (Williamson, 1991, p. 279).
- Coase (1937) says: “ It can be assumed that the distinguishing mark of the firm is the supersession of the price mechanism” (p. 389)
- The article was written during the debate about socialism and the dispute between Keynes and Hayek.
- In what real market is he thinking? In perfect competition based in *homo economicus*.

2. Coase and the nature of the firm.

- But starting from the study of human action we follow the Aristotelian first person approach.
- For Aristotle the person is a *zoon politikon*. As Solomon said: “the Aristotelian approach begins with the idea that we are, first of all, members of organized groups... we are not, as our favorite folklore would have it, first of all individuals – that is, autonomous, self-sustaining, self-defining creatures-” (Solomon 1992, p. 146).
- With this expression we indicate the person’s essential openness to her fellow people by means of society and culture. Thus every individual action is social and has a cultural significance

2. Coase and the nature of the firm.

- Coase 1937 (p. 398) rejects the importance of the division of labor for the existence of the firm.
- But Hayek articles (1937) 'Economics and Knowledge' and (1945) 'The Use of Knowledge in Society' established what is the real economic problem: coordinating people within their social institutions.
- There is a social division of labor because there is a social division of knowledge. (Mises, 1920).
- Hayek explains the logic of choice. But as Ghoshal points out: "This pretense [the use of *homo economicus*] has demanded theorizing based on partialization of analysis and the exclusion of any role for human intentionality or choice" (2005, p. 76).
- S Ghoshal article "Bad for practice: a critique of the transaction cost theory" (1996) clearly addresses the Coase problem.

2. Coase and the nature of the firm

- The peculiar character of the problem of a rational economic order is determined precisely by the fact that the knowledge of the circumstances of which we must make use never exists in concentrated or integrated form but solely as the dispersed bits of incomplete and frequently contradictory knowledge which all the separate individuals possess.
- The economic problem of society is thus not merely a problem of how to allocate “given” resources –if “given” is taken to mean given to a single mind which deliberately solves the problem set by these “data”.
- It is rather a problem of how to secure the best use of resources known to any of the members of society, for ends whose relative importance only these individuals know ([1945] 1976, p.77).

2. Coase and the nature of the firm

- H. Simon raises the problem for the neoclassical model: “The description of the parties who participate in these transactions is minimal. However as soon as firms are elaborated to become more than simple nodes in a network of transactions, to be producers, difficult and important questions arise for the theory” (1991, p. 25).
- So, *pace* Coase much of our modern world’s business is carried in an economics of organizations , in which could be a more realistic assumption saying “markets as beginning where organizations fail” (Rumelt, Schendel, & Teece, 1991, p. 19).

3. The firm as a institution

- In two previous articles “The Possibilities of the Acting Person within an Institutional Framework, Goods, Norms, and Virtues” *Journal of Business Ethics* 99(1), 2011 and “The Natural Link Between Virtue Ethics and Political Virtue: The Morality of the Market” *Journal of Business Ethics*, 2012 I presented how to based economic models in a theory of human action.
- The division of labor is an expectation of the role. It is a particular case of great importance in the process of institutionalization.
- It enables people to specialize in a task, and to expect the exchange of the goods produced by each person.
- As Solomon (1992, p. 163) says ‘buyer’ and ‘seller’ are established roles within an organized system: firms.
- We are always members of organizations.

3. The firm as a institution

- Value creation, the driving force of the modern organization, cannot be reduced to a factor of production or to objective knowledge.
- Ghoshal, Bartlett and Moran (1999) say: “corporations, not abstract economic forces or governments, create and distribute most of an economy’s wealth, innovate, trade and raise living standards” (1999, p. 9).
- Firms based in people acting together, sharing the culture of the organization, towards virtue-based ethics, create and distribute most of the economy’s wealth, innovate, trade and raise living standards.
- The firm’s essential function is to enhance the real possibilities of its employees. The greater these possibilities, the greater the possibilities of monetary profit.
- The market economy based in firms has a very positive moral content: the possibility of excellence of human action.

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