# Investidura com a Doctor “Honoris Causa” per la Universitat de València a Oliver Eaton Williamson

## Discurs d’acceptació

València, 28 octubre de 2004

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October 28, 2004

Very Honorable Rector Magnificus, Colleagues, and Guests

It is a great honor and a distinct pleasure to be awarded an honorary degree by the University of Valencia. This being a happy day in my academic life, I celebrate with joyful remarks.

I begin by relating a recent conversation that I had with a young colleague, who inquired about the need for "prizes" to motivate academic research. I responded that there are many excellent academics and only a limited number of prizes. If and as a person ties his or her satisfaction to the winning of prizes, many excellent academic researchers are bound to be disappointed. Since, from a number of accomplished researchers, only a few can be chosen, better that the prizes be regarded as windfalls. The satisfaction that comes from doing good research is where the real joy resides, to which prizes are lucky favors.

Think of it as going to a fine restaurant and enjoying an excellent meal. Courtesy of the house, the maitre d' presents you with his finest after-dinner liqueur as you prepare to leave. What a wonderful surprise. The skills of the chef in preparing the meal are nevertheless the fundamental construction. The chef's work is akin to our persistent research efforts that soak up our energies, day and night, year after year. Those ongoing efforts are their own reward.

To be sure, not every research project succeeds, so there are disappointments along the way. Still, we usually learn from negative results. And we usually have other sources of satisfaction to carry us through the hard times: family, friends, teaching among them. Indeed, I recall two of my most trying six-month research draughts as ones where I had no teaching responsibilities. My portfolio, as it were, was over-specialized in research, which is frustrating when it goes nowhere.

More often, however, I have had the good fortune of choosing projects where the research did make headway – usually of a modest, slow, molecular, cumulative kind. This has been especially true of the research that I have done on the "economics of governance," on which project I have been working for 34 years and counting.

The project had its origins in a state of disarray in the field of industrial organization during the 1960s. As Victor Fuchs observed at a Roundtable on Policy Issues and Research Opportunities in Industrial Organization in November 1970, "all is not well with this once flourishing field."

Antitrust and regulation are the two main public policy issues with which industrial organization is concerned. Having spent the academic year 1966-67 as the Special Economic Assistant to the head of the Antitrust Division of the U.S. Department of Justice (Donald Turner, for whom I had enormous respect), I was aware that antitrust enforcement was in crisis.

My experience with regulation also convinced me that both academics and regulators were biased in favor of regulatory over-reaching. A fundamental problem is that while there was an elaborate taxonomy of market failures, there was no corresponding recognition of regulatory failures. It was thus easy to prescribe regulatory intervention at the slightest hint of market failures.

Three crucial missing links were responsible for this state of affairs. First, orthodox economics assumed that the transaction costs of running the economics were zero. Albeit a great analytical convenience, economic systems, like physical systems, are beset with frictions – which, for economics, take the form of positive transaction costs. Second, the orthodox theory of firms and markets worked out of "simple market exchange," where the requisite governance was provided spontaneously by the "marvel of the market." Inasmuch, however, as simple market exchange is a polar case, provision for complex market exchanges supported by governance structures of a "conscious, deliberate, purposeful" kind should also be made. In that event, rather than think of the firm as a black box for transforming inputs into outputs according to the laws of technology, the firm should also be thought of as a mode of governance. Organization matters.

Third, the economic man of orthodox economic analysis is a very stunted version of what Frank Knight once referred to as "human nature as we know it." Specifically, the cognitive and self-interestedness of economic man were described as hyperrationality and myopic self-interest, respectively. Other social scientists observed that economic actors so described were "stick men," but many economists were unmoved.

Individually and collectively, the assumptions of zero transaction costs, organization is unimportant, and a stark description of economic man, provided a protective belt for orthodoxy. An obvious first move is to reverse the orthodox assumptions, whereupon transaction costs are positive and consequential, organization is important, and our research agenda and research methods turn crucially on our view of the nature of the human beings whose behavior we are studying. But what if someone else contends that even sunspots are important?

Plainly, those who allege that something new or different is important have the obligation to "show me!"

My PhD training at the Graduate School of Industrial Administration, Carnegie-Mellon University, which was a highly interdisciplinary program in which economics, organization theory, and operations research were combined, was respectful of orthodoxy, yet encourage maverick's to subscribe to the Carnegie Triple: be disciplined; be interdisciplinary; have an active mind. Being disciplined means to work out the logic and be wary of fanciful assumptions. Being interdisciplinary means to be prepared to cross disciplinary boundaries if and as the problems under examination spill over. And having an active mind means to pose the question, "What is going on here?" rather than to pronounce that "This is the law here!"

My instincts, training, and aforementioned experience with antitrust enforcement converged on the puzzle of vertical integration, the make-or-buy decision, which I reformulated by (1) making provision for positive transaction costs, (2) examining the key factors that distinguished markets from hierarchies in governance respects, and (3) describing human actors in more veridical terms. Whereas the orthodox interpretation of vertical integration that lacked a "physical or technical" aspect was that such integration had anticompetitive purpose and effect, I interpreted vertical integration as having its origins not in technology or monopoly but in the nature of the transaction. If and as complex contracts between firms were subject to breakdown in the face of disturbances, taking such transactions out of the market and organizing them hierarchically was commonly done in the service of efficient governance – by which I mean to infuse order, thereby to mitigate conflict and realize mutual gains. More generally, upon (1) recognizing that economic actors had both cognitive limits for describing complex contracts and cooperative limits for implementing such contracts, (2) taking adaptation to be the central problem of economic organization to which markets, hierarchies, bureaus, etc. have different management abilities, and (3) recognizing that transactions differ in their needs for ongoing management support, the basis for a different – more microanalytic, more organizational, more veridical – theory of firm and market organization was at hand.

Such a reformulation did not mean that the orthodox interpretation of vertical integration was always wrong. Rather, orthodoxy dealt with a special case. The governance approach had ramifications, moreover, beyond vertical integration to include other nonstandard and unfamiliar modes of contracting and economic organization – labor market organization, the uses of debt and equity, regulation and deregulation, corporate governance, etc. – as variations on a theme. Indeed, any issue that arises as or can be restated in contracting terms can be examined to advantage in terms of the economics of governance, which is to say that governance opens a new window upon the study of complex contract and economic organization.

Note, moreover, that the economics of governance is an interdisciplinary exercise – selectively combining law (especially contract law) and organization theory (to include human actors) with economics. Thus although economics remains the core discipline, it is no longer a stand-alone enterprise. Rather than ignore the contiguous social sciences, the economics of governance draws on these – if and as needed.

I would furthermore observe that the economics of governance is both a hard-headed and a user-friendly approach to the study of complex economic organization. It is hard-headed in that it requires the student of economic organization to work through the mechanisms of governance in a meticulous way, an example of which is the concept of "credible commitment." It is user-friendly in that crafting cost-effective contracting safeguards is the source of mutual gains.

The contrast between Machiavelli's advice to this Prince and the concept of credible commitment is illustrative. Thus Machiavelli advised his Prince that "a prudent ruler ought not to keep faith when by doing so would be against his interest, and when the reasons that made him bind himself no longer exist.... Legitimate grounds [have never] failed a prince who wished to show colourable excuse for the promise." Preemptive breach, however, is a very myopic way by which to view contract. If instead the parties to a contract look ahead, uncover contractual hazards, and introduce mechanisms to deter breakdown – such as penalties for breach, provide for information disclosure and verification when unanticipated events materialize, and design specialized dispute settlement forums (such as arbitration) that help the parties work through their differences – they can contract with greater confidence. More contracts will be negotiated on better terms with larger mutual gains in a credible contracting regime than will be observed in a regime where such commitments are lacking.

The informed design of credible commitments nevertheless comes at the cost of deep knowledge of the particulars. That is an added burden, in that the economics of governance requires practitioners to become familiar with new concepts and to develop microanalytic knowledge of both transactions and the governance thereof.

Such depth of knowledge is to be distinguished from the orthodox view that knowledge of the details "would only obscure our understanding of the basic issues." Such a cavalier attitude was once widespread and contributed to the public policy crises to which I referred earlier. The economics of governance advises the student of economic organization that the details matter and that these should be examined through the focused lens of contract/governance – which serves both to uncover and interpret key features.

The economics of governance furthermore invites empirical testing of the efficient alignment hypothesis, to wit: transactions, which differ in their attributes, are aligned with governance structures, which differ in their costs and competences, so as to effect a transaction cost economizing result. The number of such published empirical studies exceeds 1000 and is growing. Public policy toward business has also been reformed in the process.

The economics of governance is thus the product of many scholars and should be viewed as a work-in-progress, in that many refinements, extensions, and applications remain to be made – which I and many others view as a joyful prospect. The economics of governance is a project whose time has come.