ELSEVIER

Journal of Retailing 86 (3, 2010) 227–231

Journal of Retailing

Transaction Cost Economics: The Origins

Oliver E. Williamson

University of California, Edgar F. Kaiser Professor Emeritus of Business, Berkeley, United States

Abstract

This paper is an autobiographical recollection of how my interest in and work on transaction cost economics progressively developed. It begins with an overview of the transaction cost economics project. A sketch of my undergraduate and graduate education follows. Key events in the 1960s that set the stage for my 1971 paper on "The Vertical Integration of Production" are then described. This paper would turn out to be the entering wedge from which transaction cost economics would take shape and continues today, as set out in the closing pages of the article.

Keywords: Transaction cost economics; Pre-transaction cost research; Enumeration of the key events

This paper owes its origins to a request that I received from Arne Nygaard, asking me to write an introductory note for this special issue of JR. Rather than leave it at that, however, Arne went on to suggest that I "reveal the story behind the success story of TCE . . .. I would like to know if there is a Newton story of falling apples (actual time and place). . .. I would like to know more about . . . Carnegie Mellon and the group of people there and the other universities where you worked."[1]

The answer to the first of these is that there was no falling apple, but I did benefit from a series of insights that, individually and collectively, served to unlock the gates to transaction cost economics. I begin by sketching the key moves that led into the transaction cost economics project. I then provide the details and people who participated in various stages of development.

An overview

As I look back on this project I sometimes think that I was predestined to do transaction cost economics. So many events "lined up" that it cannot be explained any other way. But of course, that is nonsense. It is not that one thing led inexorably to another but rather that my intuitions and interests and makeup were such that it was easy for me to incorporate new knowledge and insights as events unfolded.

It could have been otherwise, but there was not a lot of slippage in the various turns in the road that I describe below. I should nevertheless make clear that I owe a great deal to people who took an interest in my career and urged me to widen my horizon and/or reposition. I am especially grateful to my wife Dolores who was continuously supportive and adapted quickly, constructively, and cheerfully to new circumstances.

Significant events that led me into transaction cost economics include: (1) my undergraduate training at MIT, which provided me with analytical apparatus and grounding that would serve me well in the years ahead; (2) working for three years as a project engineer with large corporations and the U.S. government, which gave me a sense of how large bureaucracies operate, before deciding to do graduate work; (3) enrolling in the PhD program at the Graduate School of Business at Stanford only to discover, with the aid of junior faculty, that my real interests were in economics and that the Graduate School of Industrial Administration at Carnegie was, as it were, tailor made for me; (4) reveling in the excitement of interdisciplinary teaching and research at Carnegie; (5) discovering that "teaching is learning" in my first job as Assistant Professor of Economics at Berkeley, where I was presented with many opportunities, as an applied microeconomist with interests in firm and market organization, to reformulate old issues constructively; (6) finding even more such opportunities when I left Berkeley to take a job as Associate Professor of Economics at the University of Pennsylvania, to include a "teaching as learning" experience in the newly created School of Public and Urban Policy; (7) serving as Special Economic Assistant to the Head of the Antitrust Division, where I came to appreciate that much of the economic literature that informed antitrust enforcement was wrong-headed; (8) my intuition that vertical integration could be usefully examined from a

[1] I have addressed these issues before, but in a less personal and less focused way than I attempt herein.

0022-4359/$ – see front matter © 2010 Published by Elsevier Inc on behalf of New York University.
doi:10.1016/j.jretai.2010.07.006

lens of contract perspective in a combined economics and organization theory way; and (9) an appreciation that a wide range of other economic and organizational phenomena could be interpreted as variations on a few key transaction cost economizing themes.

From engineering to business to economics

As indicated, my engineering training at MIT provided me with a good toolkit and grounding – where by the latter I mean that although hypothetical ideals are often a good place to start it is necessary thereafter to make provision for friction, resistance, turbulence, and "human nature as we know it."[2] (It was vital for me and, I conjecture, for many other applied microeconomists, to be grounded in this way.)

I was accepted into the PhD program at the Graduate School of Business at Stanford in 1958 and took a series of MBA courses in the first year, one of which was economics as taught by James Howell. Jim had recently received his PhD from Yale, then worked with Aaron Gordon, at Berkeley, on the Gordon-Howell report of the status of U.S. business schools,[3] and had accepted an assistant professor appointment in the business school at Stanford. Howell was a very lucid, no-nonsense teacher and I found the subject of economics fascinating. After one of my visits to his office to discuss nuances he pronounced that I had very good intuitions and should be taking courses in the economics department. I followed his advice and took a microtheory class with Kenneth Arrow. Needless to say, that was an exhilarating experience. That is the only class that I took with Ken, but it had immediate and lasting effects. He remembers me as "asking good questions" and, to my very great pleasure, describes me as one of his students. This class with Ken settled the idea that I should take more economics, which I was able to do because the second year MBA program was very flexible and allowed me to take courses in economics, mathematics, and statistics outside of the Business School in my second year.[4]

Because of an office crowding condition, three PhD students, myself being one, shared an office with another new faculty appointment, Charles Bonini, who had just finished his PhD at Carnegie. Chuck would ask me about my interests periodically, I would describe them, and he would tell me "You ought to be at Carnegie." I knew nothing of the PhD program in the Graduate School of Business at Carnegie, but I eventually inquired and quickly recognized that this was a leading-edge program from which I was sure that I would benefit. Having applied for and received a three-year portable fellowship from the Ford Foundation, and with the agreement of my wife to leave California for Pennsylvania, Dolores and I and our two children arrived in Pittsburgh in September 1960. We discovered, to our surprise and delight, that Pittsburgh was a very nice city.

[2] The quoted phrase is from Frank Knight (1965, p. 270).

[3] This study was sponsored by the Ford Foundation.

[4] I spent most of the second year in the classrooms of Herman Chernoff, Bernard Haley, Emanuel Parzen, Melvin Reder, and Hirofumi Uzawa.

Enumeration of the key events

The overarching insight that I learned at Carnegie was the "Carnegie Triple": be disciplined; be interdisciplinary; have an active mind. Jacques Dreze speaks for me and many others in his statement that "Never since have I experienced such intellectual excitement" (1995, p. 123). Highlights, at Carnegie and later, include the following:

1. The playful remark by James March in his organization theory class that large corporations are managed so as to "maximize slack," rather than profits. This immediately registered on me as a research opportunity.
2. The "Selling Expense as a Barrier to Entry" paper that I prepared for Herbert Simon's class on "Mathematical Social Science" was mainly an exercise in applied price theory, for which I was a bit apologetic. Simon saw it differently: "Anything that advances our understanding of complex phenomena is to be valued." I was relieved by his pluralistic view of social science. And I was pleased when (a revised version of) this term paper was published in the February 1963 issue of the *Quarterly Journal of Economics*.
3. Although he did not put it this way, Jack Muth had a way of "pushing the logic to completion" that I had not previously witnessed. Pushing the logic would sometimes reveal that behavior that many public policy analysts, myself included, thought of as objectionable was altogether predictable. If deviations from normative public policy are not contrived but are the natural result of the circumstances, then understanding rather than misconstruing the origins of the regularities would be vital to the making of public policy.
4. Allan Meltzer encouraged me to "be my own man" at a critical juncture in my career where there was a divide in the road. Things could have gone otherwise.
5. Milton Friedman's critique of the simple Keynesian model, as based on empirical work that he had done jointly with Meisselman, was contested at the National Bureau of Economic Research conference on money-macro at Carnegie in 1962. No one's position was changed by the arguments that ensued, but Friedman had the data and empirical analysis to support his position. The graduate students in attendance concluded that when "he says, she says" impasses arise, he/she who has the data has the advantage.[5]
6. I read Alfred Chandler's book, *Strategy and Structure* sometime in the mid-1960s and was taken aback. In addition to competition in the product market and competition in the capital market arguments on which I had previously relied[6] as checks upon managerial discretion, such discretion could also be held in check by internal organization.

[5] Friedman later advised me (by email, on February 6, 2006) that "I believe in every area where I have had some influence that it has occurred less because of the pure analysis than it has because of the empirical evidence that I have been able to organize."

[6] Managerial discretion is projected to be greater if competition in product and capital markets is weak.