

Governance Economics?

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Oliver Williamson passed away on May 21, 2020. This and other reminiscences are posted at <https://www.sioe.org/williamson-series>.

I came late to Williamson: of my first 25 publications, seven cited him; of the next 25, sixteen did. To me, this trend is significant—and I don't mean statistically.

In addition to the trend, there is also important variation: what I have learned from Olly has evolved over time. Five favorite sentences illustrate this evolution.

Like many, I dove into Olly's writings when I wanted to understand the "theory of the firm" (i.e., the make-or-buy question that determines the boundary of the firm). I didn't always find it easy going, but eventually seven words were burned into my memory: "fiat is frequently ... more efficient ... than ... haggling" (*AER* 1971: 114). I find it hard to imagine a more efficient summary of a theory of the firm—breathtaking!

Of course, others have also contributed to this domain, so I sought to distinguish one contribution from another. I became fond of a new sentence—this one more in Olly's unique patois: "The most consequential difference between the TCE and GHM setups is that the former holds that maladaptation in the contract execution interval is the principal source of inefficiency, whereas GHM vaporize ex post maladaptation by their assumptions of common knowledge and costless ex post bargaining" (*JEL* 2000: 605).

Looking back, I'm surprised and dismayed by how little time I got to spend in the same room as Olly, and I recall only one time we had a sustained two-person conversation. It was late afternoon on a beautiful summer day in 2002, in Lucca (Italy), and Olly had nobody walking back to the hotel with him after the conference in honor of Jim March's 75th birthday.

Lucca is surrounded by a huge wall—broad enough for trees, benches, and pedestrians on top, and tall enough for a nice breeze up there. If you look up "stroll" in the dictionary, you should see a picture of that afternoon on top of the wall. The atmosphere loosened our conversation.

About halfway back to the hotel, Olly told me he wanted to teach negotiations. I asserted that social psychology seemed to be the dominant input to that field. He said "They study deals that are done when you sign them; I'm interested in deals that start when you sign them."¹

¹ Perhaps my memory is tricking me, but it feels like "No, no, young Gibbons" and an avuncular pat on the top of the head accompanied this sentence.

I love this distinction. There are indeed deals that are done when you sign them. In fact, many of those require little or no negotiation to be signed—goods ordered online from Staples or services from TaskRabbit. These are transactions where contracts work well.

Then there are deals that start when you sign them. In Lucca, I interpreted such deals as contracts between firms, and by 2002 I had read enough Williamson to imagine that adaptation to future shocks could be a key reason why a deal might not be done when you signed it.

Today I think of such deals more broadly—including within organizations, such as the start of an employment relationship (or the imposition of a new organization chart). Of course, Olly wrote about this similarity of the governance problems between organizations and those within organizations: “substantially the same factors that are ultimately responsible for market failures also explain failures of internal organization” (*AER* 1973: 316).

As with make-or-buy, Olly’s language concerning this similarity evolved from the 1970s to the 2000s. Expressing the perspective in general terms, he wrote: “Private ordering efforts by the parties, to ... embed transactions in more protective governance structures, have the purpose and effect of mitigating the contractual problems that would otherwise arise” (*AER* 2002:438).

In sum, I found Williamson because of the binary distinction between integration versus non-integration, but I learned from him to focus instead on another binary distinction: transactions that are governed versus those that are priced. Alternatively, one can adopt a trinary distinction among (1) transactions that are priced versus (2a) those that are governed within a single organization and (2b) those that are governed in non-integrated settings. Comparing (1) versus (2a) is misleading—because it either omits (2b) or, worse, conflates it with (1). In short, non-integration is not always “the market;” transactions can be governed between as well as within organizations.²

I find myself trying to become a “governance” economist, and I owe a bunch of that to Oliver Williamson.

²

This trinary distinction appears in Gibbons (*AER P&P*, 2020: 172-6), which provides further details.