

(New) Institutional Economics and Vertical Integration

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I. Coase



■ Ronald Coase

- British Economist
- Born 1910
- Nobel Prize in Economics in 1991
- *The Nature of the Firm*, 1937
- *The Problem of Social Cost*, 1960
- *The FCC*, 1959

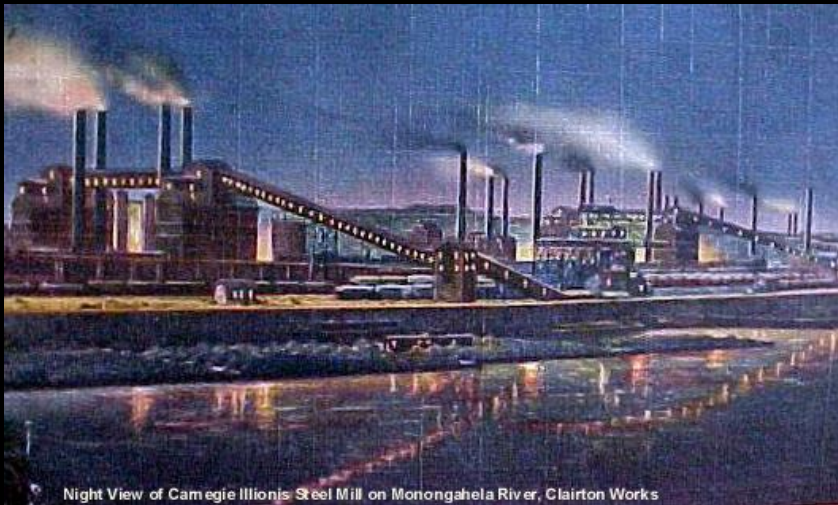
Overview

■ Three NIE Lessons

- Property Rights
- Default Rules
- Transaction Costs

→ Facts and Institutions Matter

Coase and Property Rights



Steel Mill emits pollution



Homeowners want clean air

Coasian Example

- \$100,000 worth of damage from pollution
- \$80,000 cost to put on scrubbers to eliminate emissions
- \$50,000 to change nearby land use

Choices

- Regulate so there is no pollution
- Tax on pollution
- Do nothing

Efficiency

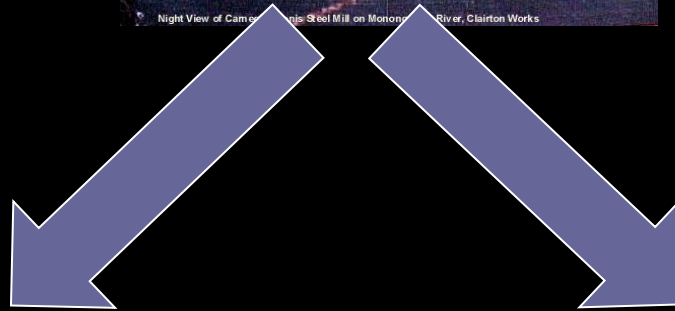
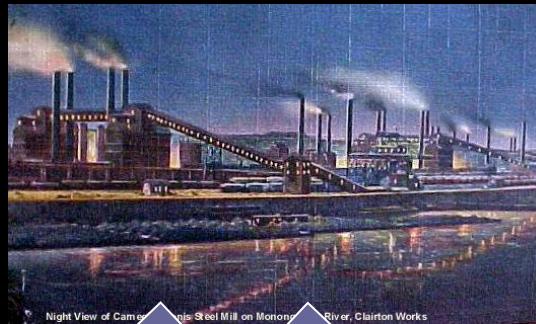
- Profits < \$50k, factory should shut down
- Profits > \$50k, then change land use
- (In our case, never install scrubbers: they cost \$80k vs. \$50k for changing land use)

Regulate to Prohibit Pollution

- Prevents \$100,000 worth of damage

Regulate to Prohibit Pollution

- Factory has two choices

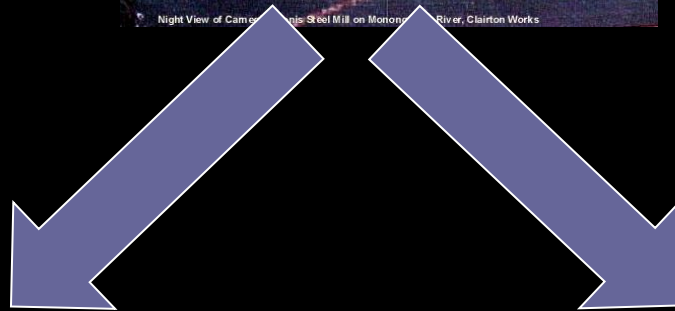
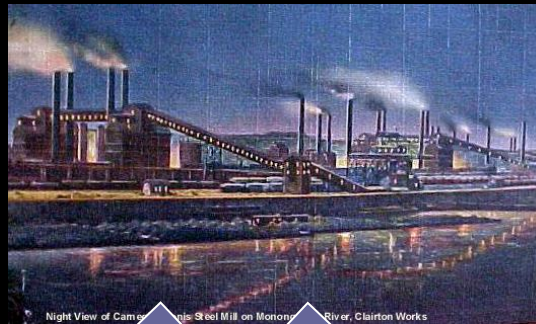


Install scrubbers

Shut down

Regulate to Prohibit Pollution

- Factory has two choices



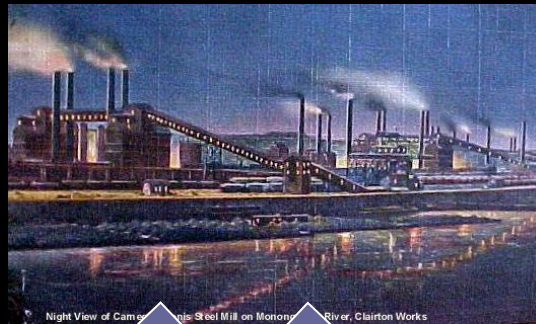
Install scrubbers

Shut down

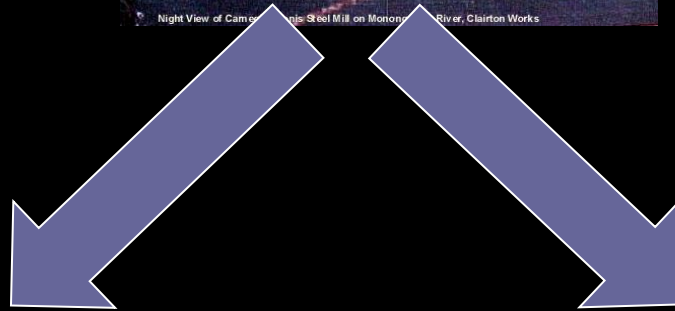
Install scrubbers if profit $>$ \$80k, otherwise shut down.

Regulate to Prohibit Pollution

- Factory has two choices



When is
this
inefficient?



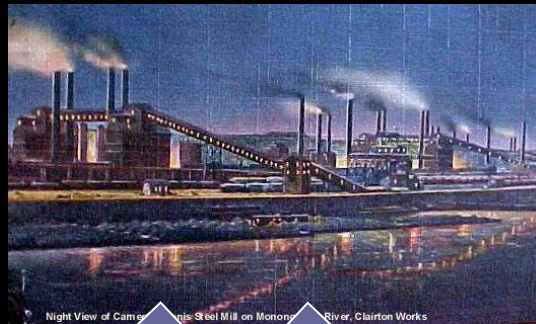
Install scrubbers

Shut down

Install scrubbers if profit $>$ \$80k, otherwise shut down.

Regulate to Prohibit Pollution

- Factory has two choices



Inefficient
when profit
is $> \$50,000$

Install scrubbers

Shut down

Install scrubbers if profit $> \$80k$, otherwise shut down.

Tax on Pollution

- Similar results
- If $\text{tax} > \text{profits}$, shut down
- If $\text{tax} < \text{profits}$, continue producing
 - If $\text{tax} > \$80$, install scrubbers
 - If $\text{tax} < \$80$, pay tax and pollute
- When is this inefficient?

Do nothing (Allow pollution)

- Nearby land use will change at cost of \$50,000 (or be abandoned)
- Imposes cost on nearby land owner

Do nothing (Allow pollution)

- Nearby land use will change at cost of \$50,000 (or be abandoned)
- Imposes cost on nearby land owner
- Efficient solution if Factory profits $> \$50,000$

Coasian Solution

- Low cost is to change nearby land use if output is worth enough
- Allowing tradability will get to efficient solution whereas others might not.

Coasian Solution

- Give right to pollute to factory
 - Profits $>$ \$50k, landowner will change use
 - Profits $<$ \$50k, landowner will pay factory not to produce

Coasian Solution

- Give right to pollute to factory
 - Profits $>$ \$50k, landowner will change use
 - Profits $<$ \$50k, landowner will pay factory not to produce
- Give right to fresh air to landowner
 - Profit $>$ \$50k, factory will pay landowner to change use
 - Profit $<$ \$50k, factory will not produce

Complexities with Coase Theorem

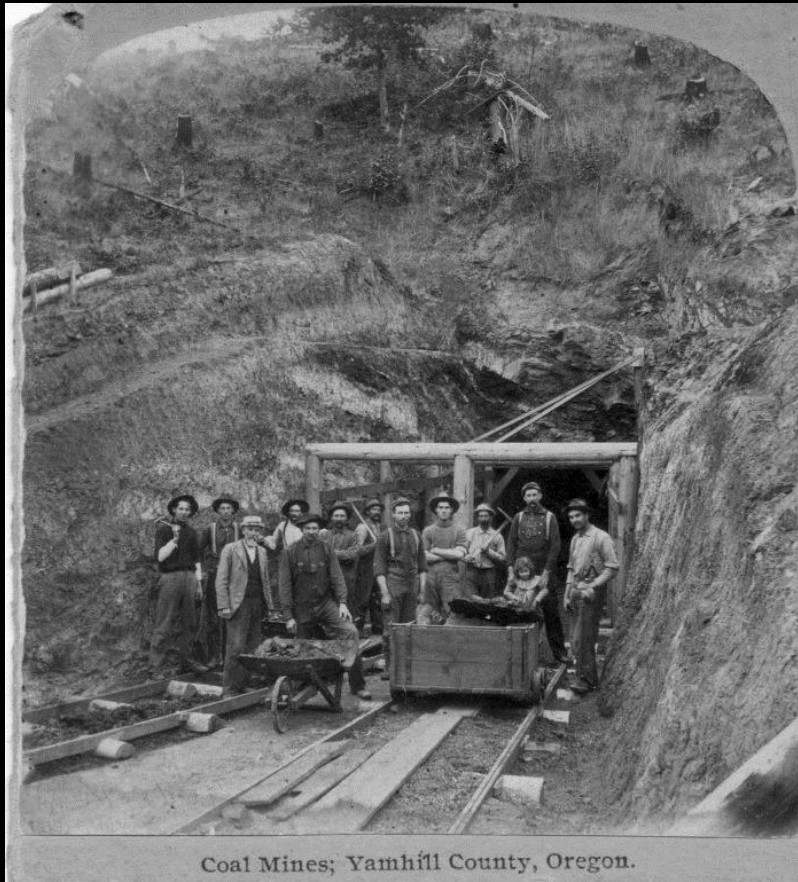
- Transaction costs
- Legal disputes
- Imperfect or asymmetric information (uncertainty?)
- Free rider problem
- Holdout
- Externalities
- Behavioral

II. Williamson



- Oliver Williamson
- American Economist
- Born 1932
- Stanford MBA
- Teaches at Cal
- Nobel Prize 2009

Bilateral opportunism



Terminals: hush a phone ('56)



Models for Hand-set Phone

A Telephone Silencer – the **HUSH-A-PHONE**

A solution of three phone problems of subscribers

Safeguarding Privacy: So others cannot hear confidential matters

Eliminating Phone Talk Annoyance: Quieting the office for personnel efficiency

Improving Hearing in Noisy Places: By keeping surrounding noises out of the transmitter

Write for Booklet T-E.

Hush-A-Phone Corporation, 43 W. 16th St., N. Y. City



Models for
Pedestal Phone

Tragedy of the Commons



III. Ostrom



- Elinor Ostrom
- American Political Scientist
- 1933 -2012
- UCLA PhD
- Indiana
- Nobel Prize 2009

Common Pool Resources

- Boundaries barring outsiders
- Rules with local conditions
- Inclusiveness in decision-making
- Monitoring
- Sanctions
- Conflict resolution

Canonical Vertical Structure

