

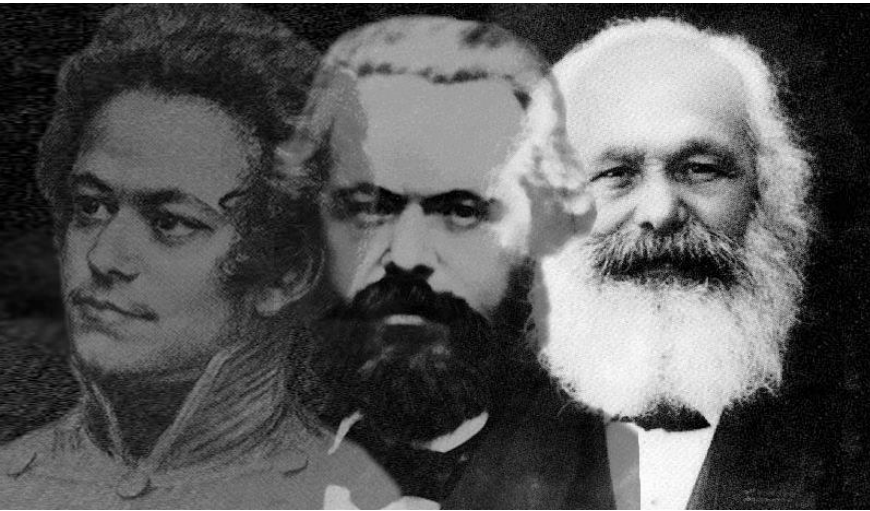
What the New Institutional Economics owes to Marx

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Oscar M. Lopez Professorial Chair Lecture

UP-CIDS Marx Bicentennial Lecture Series



Economic and philosophic manuscripts [Marx 1844]

Communist manifesto [Marx and Engels 1848]

Selected literature

A contribution to the critique of political economy (Preface) [Marx 1859]

Capital [Marx 1867]

Wage-labour and capital [Marx 1891]

Socialism: utopian and scientific [Engels 1892]

What do bosses do? [Marglin 1974]

Labour and monopoly capital
[Braverman 1975]

Selected literature

The nature of the firm [Coase 1937]

The problem of social cost [Coase 1960]

The rise of the Western world [North and Thomas 1973]

Markets and hierarchies [Williamson 1975]

Structure and change in economic history [North 1981]

Is it worth making sense of Marx? [North 1986]

Institutions, institutional change, and economic performance [North 1990]

Governing the commons [Ostrom 1990]

Comparative economic organisation [Williamson 1991]

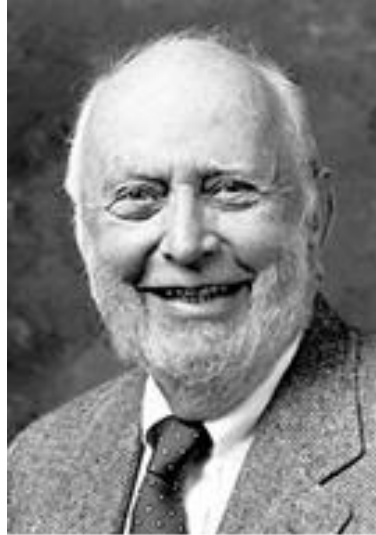
New institutional economics: taking stock, looking ahead [Williamson 2000]

Violence and social orders [North, Wallis, and Weingast 2009]

New institutional economics



R Coase
1991



D North
1993



Williamson
2009



E Ostrom
2009

NIE's contributions to mainstream economics

- opened the “black box” of the neoclassical firm
- studied distinctions between markets, firms, and alternative methods of governance affecting exchange, production, and credit
- introduced the role of the state, the law, norms, and informal rules in the study of efficient transactions
- provided a economics-based theoretical framework for studying history
- inspired theoretical and empirical work on the role of institutions in growth and development (e.g., corruption, rule of law, democracy)

Markets and firms



Marx on markets and firms

Division of labour: market v. firm

Division of labour in society is brought about by the purchase and sale of the products of different branches of industry, while the connexion between the detail operations in a workshop, is due to the sale of the labour-power of several workmen to one capitalist, who applies it as combined labour-power. The division of labour in the workshop implies concentration of the means of production in the hands of one capitalist; the division of labour in society implies their dispersion among many independent producers of commodities [*Marx 1867: 246*].

Marx on the division of labour

[I]n spite of the numerous analogies and links connecting them, **division of labour in the interior of a society, and that in the interior of a workshop, differ not only in degree, but also in kind.** The analogy appears most indisputable where there is an invisible bond uniting the various branches of trade. For instance the cattle-breeder produces hides, the tanner makes the hides into leather, and the shoemaker, the leather into boots. Here the thing produced by each of them is but a step towards the final form, which is the product of all their labours combined. [*Marx 1867:246*].

Marx on the division of labour

...[W]hat is it that forms the bond between the independent labours of the cattle-breeder, the tanner, and the shoemaker? It is the fact that **their respective products are commodities**. What, on the other hand, characterises division of labour in manufactures? **The fact that the detail labourer produces no commodities**. It is only the common product of all the detail labourers that becomes a commodity. [*Marx 1867:246*].

Marx on the division of labour

The division of labour in the workshop implies concentration of the means of production in the hands of one capitalist; the division of labour in society implies their dispersion among many independent producers of commodities. ...

Division of labour within the workshop implies the undisputed **authority** of the capitalist over men, that are but parts of a mechanism that belongs to him. The division of labour within the society brings into contact independent commodity-producers, who acknowledge no other authority but that of **competition**, of the coercion exerted by the pressure of their mutual interests [*Marx 1867:246*].

Marx on markets v. firms

- Division of labour *in society* differs from division of labour *within the firm*
 - Former based on relations of equals among independent producers coordinated by prices; latter based on authority
- Wage-labour entails the *employment relation*
 - an authority relationship inside the firm specific to capitalism (“capital as a social relation”)
 - presupposes worker’s “double freedom”
 - also worker’s “double alienation”: from purposive work and from appropriation of product

Marx on markets v. firms

This sphere that we are deserting, within whose boundaries the sale and purchase of labour-power goes on, is in fact a very Eden of the innate rights of man. There alone rule Freedom, Equality, Property and Bentham. ...The only force that brings them together and puts them in relation with each other, is the selfishness, the gain and the private interests of each. Each looks to himself only, and no one troubles himself about the rest, and just because they do so, do they all, in accordance with the pre-established harmony of things, or under the auspices of an all-shrewd providence, work together to their mutual advantage, for the common weal and in the interest of all [*Marx 1867: 123*]

Markets to firms (Marx)

- Superior productivity of division of labour within the firm over independent crafts production (scale economies; subadditivity)
- Existence of propertyless working class (proletariat) makes sale of labour-service possible and necessary.
- Inherent problem with *alien* purposiveness of wage-labour (“alienation”) hence need for “management”, authority, and monitoring.

Selling labour-power

... [L]abour-power can appear upon the market as a commodity, only if, and so far as, its possessor, the individual whose labour-power it is, offers it for sale, or sells it, as a commodity. In order that he may be able to do this, he must have it at his disposal, must be the untrammelled owner of his capacity for labour, i.e., of his person. He and the owner of money meet in the market, and deal with each other as on the basis of equal rights, with this difference alone, that one is buyer, the other seller; both, therefore, equal in the eyes of the law [*Marx 1867, Ch. 6*].

Selling labour-power

The second essential condition to the owner of money finding labour-power in the market as a commodity is this – that the labourer instead of being in the position to sell commodities in which his labour is incorporated, must be obliged to offer for sale as a commodity that very labour-power, which exists only in his living self. ... For the conversion of his money into capital, therefore, the owner of money must meet in the market with the free labourer, *free in the double sense, that as a free man he can dispose of his labour-power as his own commodity, and that on the other hand he has no other commodity for sale*, is short of everything necessary for the realisation of his labour-power [Marx 1867, Ch. 6].

Alienation

What constitutes the alienation of labour? Firstly, the fact that labour is external to the worker, i.e., does not belong to his external being: that he therefore does not confirm himself in his work, but denies himself, feels miserable and not happy, does not develop free mental and physical energy. Hence the worker feels himself only when he is not working; when he is working he does not feel himself. He is at home when he is not working, and not at home when he is working. His labour is therefore not voluntary but forced, it is *forced labour* [Marx 1844].

Alienation

It is therefore not the satisfaction of a need but a mere means to satisfy needs outside itself. Its alien character is clearly demonstrated by the fact that as soon as no physical or other compulsion exists it is shunned like the plague. ... Finally the external character of labour is demonstrated by the fact that it belongs not to him but to another. Just as in religion the spontaneous activity of the human imagination, the human brain and the human heart detaches itself from the individual and reappears in the alien activity of a god or of a devil, so the activity of the worker is not his own spontaneous activity. It belongs to another, it is a loss of his self [*Marx 1844*].

Authority

All combined labour on a large scale requires, more or less, a directing authority, **in order to secure the harmonious working of the individual activities, and to perform the general functions that have their origin in the action of the combined organism**, as distinguished from the action of its separate organs...

The directing motive, the end and aim of capitalist production, is to extract the greatest possible amount of surplus-value, and consequently to exploit labour-power to the greatest possible extent. As the number of the co-operating labourers increases, so too does their resistance to the domination of capital, and with it, the necessity for capital to overcome this resistance by counterpressure [*Marx 1867, Ch. 13, 231*]

Authority

This power is developed gratuitously, whenever the workmen are placed under given conditions, and it is capital that places them under such conditions.

Because this power costs capital nothing, and because, on the other hand, the labourer himself does not develop it before his labour belongs to capital, it appears as a power with which capital is endowed by Nature - a productive power that is immanent in capital [*Marx 1867, Ch. 13, 232*].

Coase and Williamson: markets and firms

The nature of the firm

In economic theory we find that the allocation of factors of production between different uses is determined by the price mechanism. The price of factor A becomes higher in X than in Y. As a result, A moves from Y to X until the difference between the prices in X and Y...disappears. Yet in the real world we find that there are many areas where this does not apply. **If a workman moves from department Y to department X, he does not go because of a change in relative prices, but because he is ordered to do so [Coase 1937].**

The nature of the firm

Outside the firm, **price movements** direct production, which is coordinated through a series of exchange transactions on the market. Within a firm these market transactions are eliminated, and in place of complicated market structure with exchange transactions is substituted **the entrepreneur-coordinator, who directs production** [*Coase 1937*]

The employment relation

It is important to note the character of the contract into which a factor enters that is employed within a firm. The contract is one whereby the factor, **for a certain remuneration** (which may be fixed or fluctuating), **agrees to obey the directions of an entrepreneur within certain limits**. The essence of the contract is that it should only state the limits to the powers of the entrepreneur. Within these limits, he can therefore **direct the other factors of production** ... [Coase 1937].

The employment relation

The main reason why it is profitable to establish a firm would seem to be that there is a cost of using the price mechanism. The most obvious cost of “organising” production through the price mechanism is that of discovering what the relevant prices are. ... The costs of negotiating and concluding a separate contract for each exchange transaction which takes place on a market must also be taken into account. ... A factor of production [within a firm] does not have to make a series of contracts with the factors of production with whom he is cooperating within the firm. For this series of contracts is substituted one [Coase 1937].

Firms v. markets (Coase)

Why not simply markets all the way? (Why make rather than buy?)

“transaction costs” arise in using the market

- costs of specification, measurement, monitoring, enforcement (especially amid uncertainty)
- as opposed to costs of the authority relation (employment)

Does not buy “division of labour” argument (Usher and Dobb).

Firms v. markets

Perhaps the most distinctive advantage of the firm, however, is the wider variety and greater sensitivity of control instruments that are available for enforcing intra-firm in comparison with inter-firm activities [*Williamson 1975: 113*].

Williamson [1991]

Assert that Coase is incomplete (e.g., firms can be also be replaced by long-term contracts on markets)

1. Ever-present behavioural assumptions: (a) *bounded rationality* in the midst of uncertainty and (b) *opportunism*
2. Emphasise key factors: *asset specificity* (i.e., asset required cannot be redeployed without substantial loss once committed; specialised to particular needs of buyers).

Williamson [1991]

Markets are favoured when assets are redeployable:

- buyer/seller can be replaced even if they defect
- competition among counterparties mitigates opportunism

Hierarchy (the firm) is favoured when assets are specific

- opportunism is mitigated by secure payment to counterparty, e.g., employment contract
- but must be weighed against costs of monitoring input

Dimensions

	Incentives	Command	Contracting
Market	strong	weak	strong
Hierarchy	weak	strong	weak

What if Marx met Coase and Williamson?

1. As applied to the Industrial Revolution: dispossession and mass production lower transaction costs of wage relationship:

- competition among workers mitigates opportunism
- continuity of machine-processes and mass production lowers monitoring costs

2. On the other hand, given expansion of predictable mass markets for standard goods (Marx's prediction):

- should ultimately undermine asset specificity
- working-class ideology also solves opportunism
- hence undermining argument for hierarchical governance

What if Marx met Coase and Williamson?

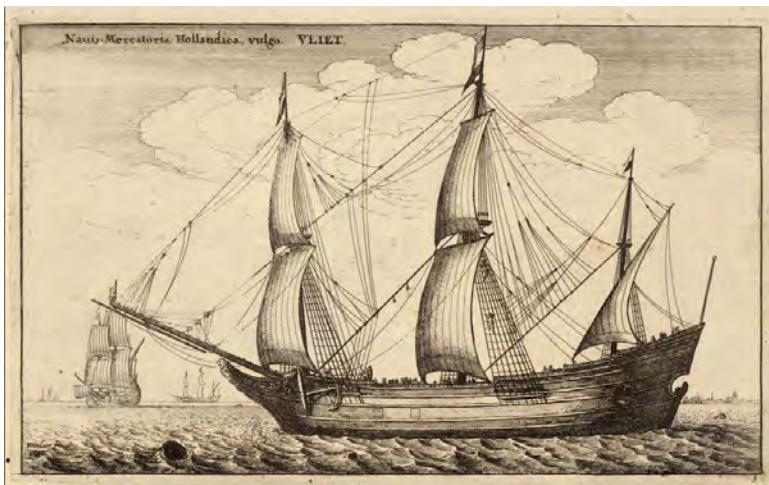
3. But what if in fact technological change and market uncertainty increase in some sectors more than others? (And suppose opportunism is not mitigated as a human trait.) Result is a differentiation among sectors.

- firms with idiosyncratic assets (e.g., associated with high tech and innovation) will be hierarchical or contractual
- other sectors commodified if tasks are undifferentiated and substitutable (e.g., outsourcing)

Bottom line: there may be no single outcome.



Institutional change in history



Institutional change in Marx

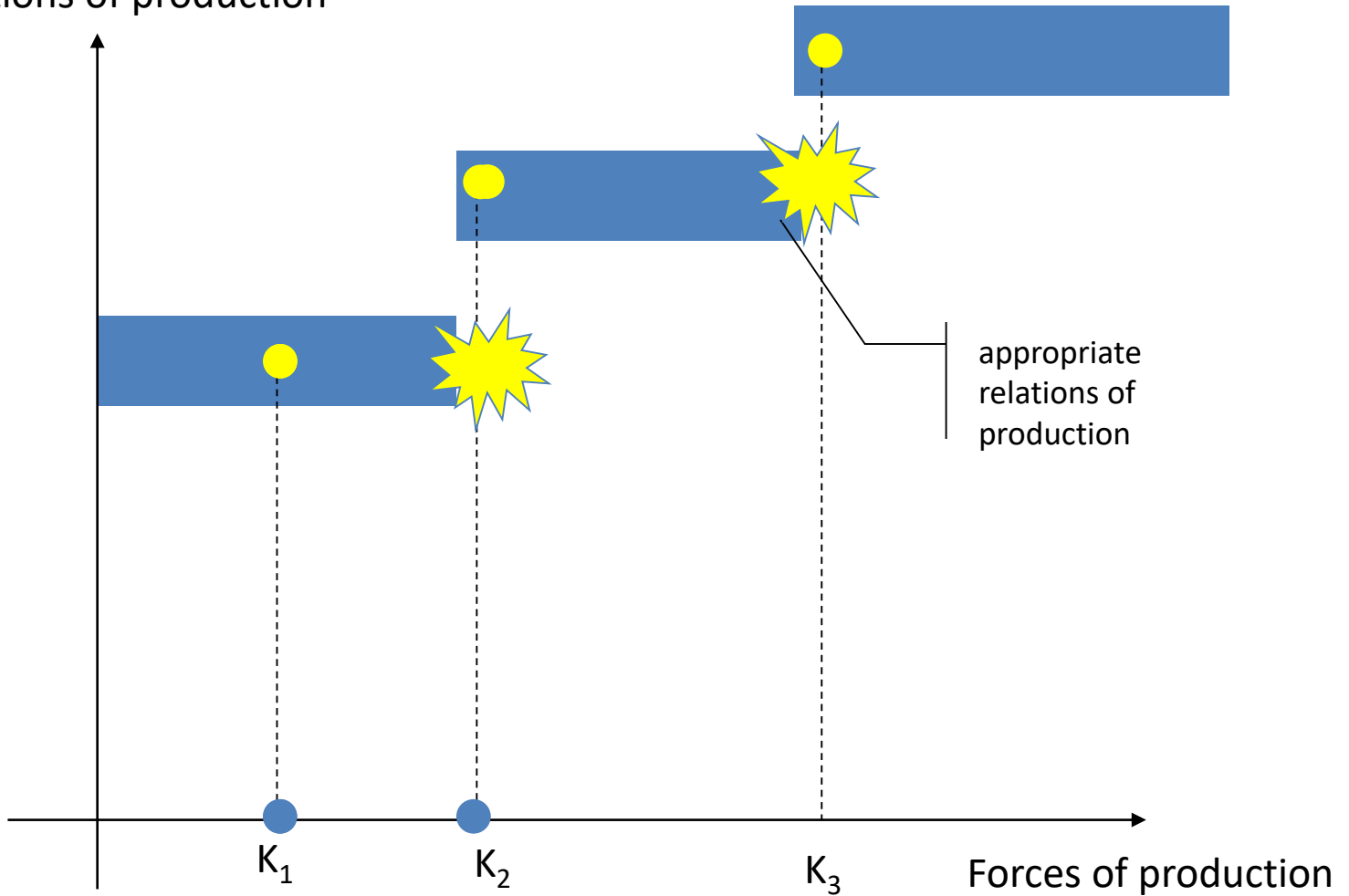
In the social production of their existence, men inevitably enter into definite relations, which are independent of their will, namely **relations of production appropriate to a given stage in the development of their material forces of production**. The totality of these relations of production constitutes the economic structure of society, the real foundation, on which arises a legal and political superstructure and to which correspond definite forms of social consciousness. The mode of production of material life conditions the general process of social, political and intellectual life.

Institutional change in Marx

It is not the consciousness of men that determines their existence, but their social existence that determines their consciousness. **At a certain stage of development, the material productive forces of society come into conflict with the existing relations of production or – this merely expresses the same thing in legal terms – with the property relations within the framework of which they have operated hitherto.** From forms of development of the productive forces these relations turn into their fetters. Then begins an era of social revolution. The changes in the economic foundation lead sooner or later to the transformation of the whole immense superstructure. [*Marx 1859*]

Historical materialism

Relations of production



Institutional change in Marx

Key points:

- postulate inexorable technological progress (*productive forces*) as the prime
- institutions (*relations of production* especially property rights) help or hinder development
- relations ultimately adjust to allow further development of productive forces
- agents are social classes motivated by what they perceive is possible or imminent (e.g., in the form of ideologies, political movements, etc.)

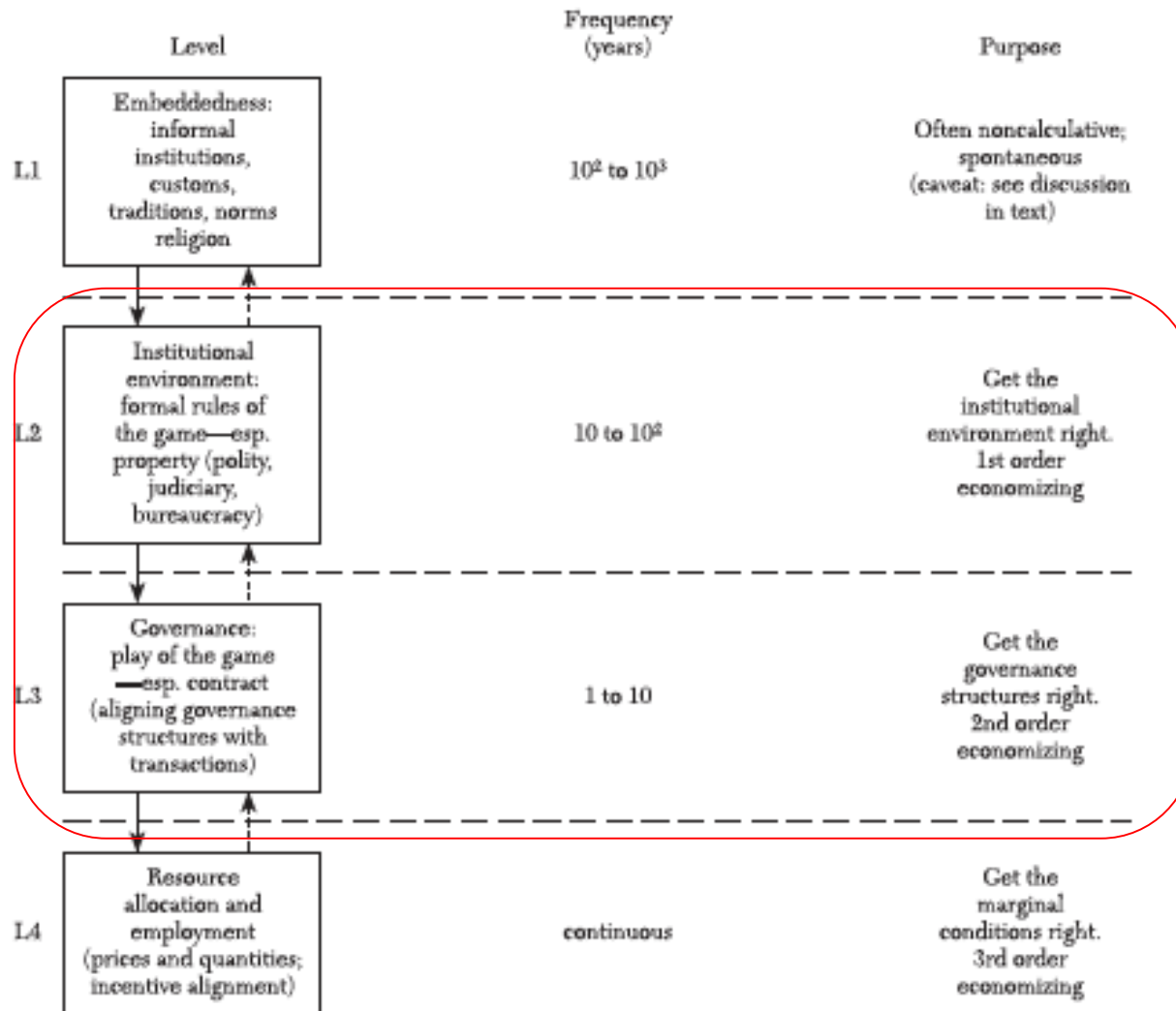
Institutional change in Marx

Key points:

- [Under feudalism, serfdom and bonded labour conflicted with the free labour needed by capitalism.]
- Technological change under capitalism is increasingly associated with socialised and mechanised production
- Socialised production conflicts with private appropriation and growing inequality.
- Disparity between the two is the source of expected change in property relations.

North: institutional change

The agent of change is the individual entrepreneur responding to the incentives embodied in the institutional framework. The sources of change are changing relative prices or preferences. The process of change is overwhelmingly an incremental one [*North 1990: 83*].



Williamson [2000]
four levels of analysis

- L1: social theory
- L2: economics of property rights/positive political theory
- L3: transaction cost economics
- L4: neoclassical economics/agency theory

Figure 1. Economics of Institutions

North: institutional change

A change in relative prices leads one or both parties to an exchange, whether it is political or economic, to perceive that either or both could do better with an altered agreement or contract. An attempt will be made to renegotiate the contract. However, because contracts are nested in a hierarchy of rules, the renegotiation may not be possible without restructuring a higher set of rules (or violating some norm of behaviour)....

North: institutional change

In that case, the party that stands to improve his or her bargaining position may very well attempt to devote resources to restructuring the rules at a higher level. In the case of **a norm of behaviour**, a change in relative prices or a change in tastes will lead to a gradual erosion and to its replacement by a different norm. ... Similarly, a custom or tradition may be gradually eroded and replaced with another... [*North 1990: 86*]

North: institutional change

...[C]hanges in **formal rules and/or enforcement** will usually require substantial resources or at the very least overcoming the free-rider problem. ...[E]ntrepreneurs and their organisations will respond to changing (perceived) price ratios either directly, by devoting resources to new profitable opportunities or – when change is unrealisable within existing rules – indirectly, by estimating the costs and benefits of devoting resources to altering the rules or enforcement of rules. [*North 1990: 86*]

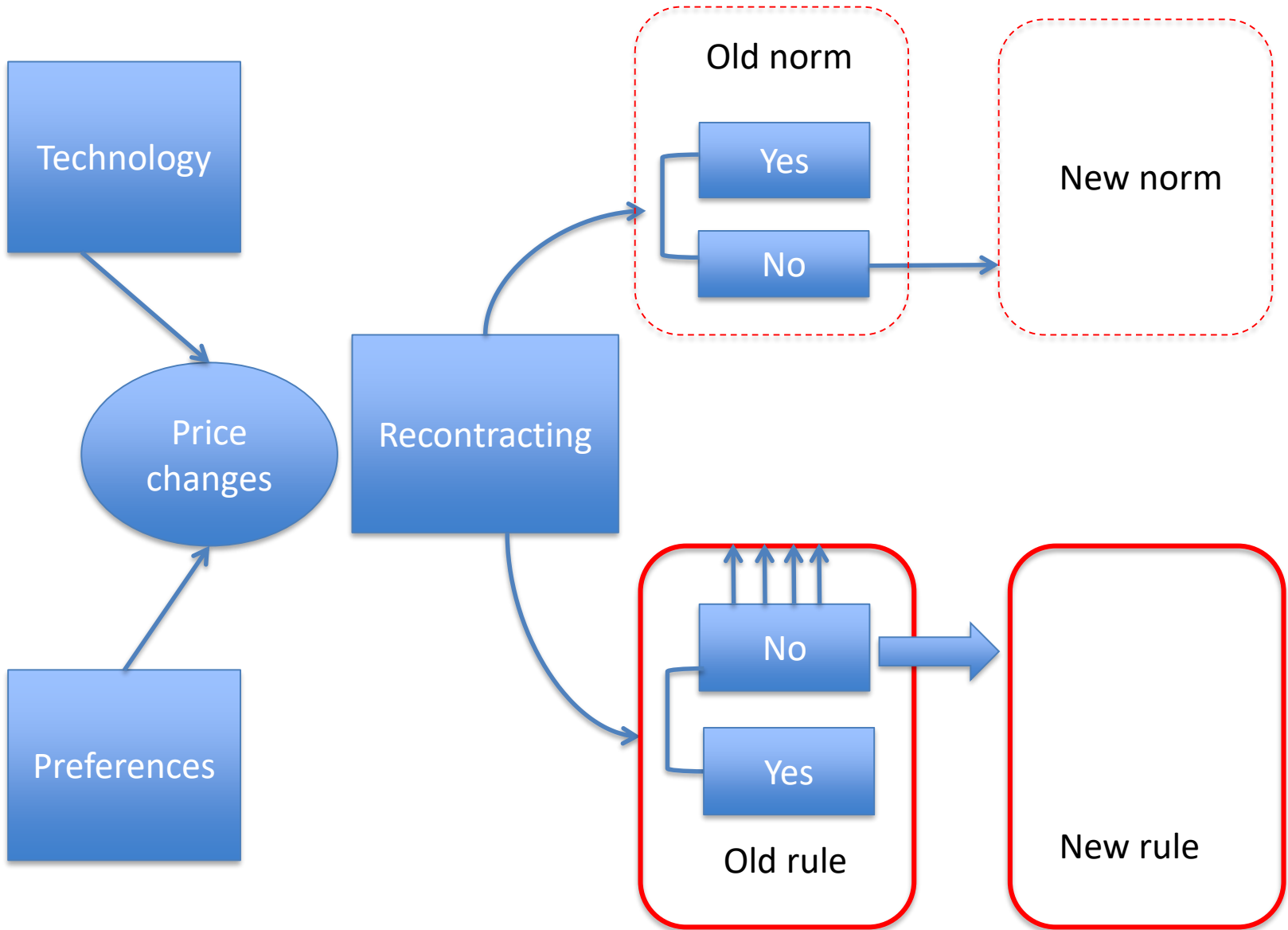
North: institutional change

To the degree that there are large payoffs to influencing the rules and their enforcement, it will pay to create intermediary organisations (trade associations, lobbying groups, political action committees) between economic organisations and political bodies to realise the potential gains of political change. The larger the percentage of society's resources influenced by government decisions...the more resources will be devoted to such offensive and defensive...organisations

[North 1990: 87].

North on Marx

[O]verall changes in productive forces reflect fundamental changes in relative prices that can come about from technological change, population change, and changes in the costs of military technology, i.e. gunpowder. These changes may or may not be realized in terms of reduced transactions costs. Whether or not they are will be reflected in whether property rights change so as to enable entrepreneurs to capture the potential productivity gains associated with these changes in productive forces. In turn, whether property rights change will be reflected in what happens to control of the political process, that is of the state [North 1986]



Institutional change in North

- Relative-price changes are caused by changing technology or preferences that lead to changing transaction costs.
- Individual agents (entrepreneurs) seek to accommodate by changing contractual arrangements if allowed to by higher-order rules.
- Benefit-cost calculus determines whether agents decide simply to operate under suboptimal rules, or alternatively:
- Devote resources to changing rules (generally incrementally or through revolution as a special case).
- Hence no automatic progression out of inefficient institutions.
- How societies recognise and accommodate wealth-enhancing institutional change bears upon their development.

Marx and North

1. Autonomous source of institutional change is not just technology but also preferences (e.g., slavery), or any exogenous event that changes relative prices. (Hence no inexorable eschatology, no “economic determinism”.)
2. Shared concern for “in/efficiency” of law, the state, and property rights, their compatibility with growth and development.
3. Posit social change as being primarily incremental, not revolutionary.

Marx and North

4. Agents of change are individuals not classes, with rational-choice theory as basis, i.e., profit-seeking.
5. Group action not assumed but explained (e.g., role of ideology in overcoming free-rider problem).
6. Open outcome: change depends on balance of power in (or versus) the state, the cognition and cohesion on the part of groups desiring change; and path dependence.

North on Marx

Yet it is worth making sense of Marx, despite the comments above; ...Surely it is not his Utopian vision; nor is it his formal theory – which has been so appealing to intellectuals of more limited capacity...Rather, it is Marx's larger vision of societal evolution [North 1986]

North on Marx

The complex relationships between the productive forces of an economy, the property-rights system of an economy, and the political structure are clearly at the heart of the dilemma of all economies through time in respect of the ability to realize the potential of an economic society.

North on Marx

It was Marx's genius to realize that this was the heart of the issue, and a hundred years before modern transactions-costs literature had begun to explore the issue in detail, he provided us with brilliant clues to it. He certainly did not resolve the problems, nor have his followers, but the fact that he recognized the issues and set them in the context of examining overall societal change gives Marx a pre-eminent role as a scholar of economic history. It is worth making sense of Marx [*North 1986*].

END