



Defining the Agenda for the Next Decade of Research on Economic Governance

Symposium in Honor of

Oliver E. Williamson

2009 Nobel Laureate in Economics

Professor Emeritus of Business, Economics and Law
University of California, Berkeley

October 16, 2010

Gakushuin University
Tokyo



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Program

14:00 – 18:00

1. Introduction

2. Hideshi Itoh

Professor of Commerce and Management
Hitotsubashi University

Topic: “What Do Formal Contracts Do”

Break

3. Masahiko Aoki

Tomoye and Henri Takahashi Professor Emeritus of Japanese Studies
Department of Economics, Stanford University

Topic: “Corporations: Architecture, Governance and Varieties”

Break

4. Oliver E. Williamson

Edgar F. Kaiser Professor Emeritus of Business, Economics, and Law
University of California, Berkeley

Topic: "Public and Private Bureaucracies: The Transaction Cost
Economics Perspective"

5. Conclusion

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Organizing committee at the Faculty of Economics, Gakushuin University

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What Do Formal Contracts Do?

Hideshi Itoh

Abstract

In this paper I attempt to provide an overview of roles formal contracting plays. The main reason to use contracting is to lock in a commitment *ex ante* that one or both parties would otherwise not wish to honor *ex post*. To establish such a commitment, the formal contract must be enforced in the way the trading parties anticipate. Economists are, however, generally optimistic about courts as the contract-enforcing institution and assume that contractual terms contingent on verifiable states and/or actions are perfectly enforced. Judicial enforcement is more complicated and depends on contract law, courts' discretion, the parties' *ex post* costly action (e.g., submit evidence), and parties' *ex ante* costly contracting (e.g., costs of thinking of future contingencies and writing documents). I summarize recent economics literature attempting to relax the standard extreme assumptions on enforcement and to incorporate some of these features into formal analysis. I also explore how formally enforceable contracting interacts with informal enforcement mechanisms such as relational contracting and community enforcement.

Commitment via legal enforcement is not the only reason to use contracting, however. Formal contracts function as a coordination device when there are multiple equilibria. Contracts provide records that help parties who suffer from imperfect recall or have to delegate performance to their successors. And I in particular emphasize the communication function of formal contracting. Writing a formal contract, even if it were legally unenforceable, sends information about the contracting parties in their bilateral relationships from one of the parties to the other, or to the third parties who are potential future trading partners, and hence can be useful in maintaining a smoothly functioning relational contract. I study these less discussed functions of contracting using illustrative formal models.

Corporations: Architecture, Governance and Varieties

Masahiko Aoki

Abstract

I would like to present a simple, but solidly-theory-based framework for comparative studies of organizational architecture (OA) and corporate governance (CG). The legal notion of “corporations” as permanent entities historically emerged prior to the birth of modern nation states and business corporations: Roman Catholic church, universities (Bologna, Oxford, Paris, etc.) are created as corporations “for the encouragement and support of religion and learning.” (Blackstone, 18c.), I interpret these historical events as indicating an important, generic aspect of corporate organizations: the system of associational cognition for breaking the limit of individual cognitive capacity.

From this perspective I first identify five generic architectural modes of corporate organizational architecture (OA) characterized by the distribution of essentialities of cognitive assets between management (M) and the workers (W) with their relationships to physical assets (K) as tools of associational cognition. Then I inquire how the playing of each of these modes as a game can become incentive compatible with participating members. The recent development of potential game (Shapley & Monderer, Ui) can tell us that the distribution of corporate value generated by such a game according to Shapley value (Nash bargaining solution) can make the game as an identical interest game, i.e. the team. Then, by solving Nash equilibrium for each of these games the corresponding governance structure satisfying the requirements of efficiency and common sense of fairness can be derived. Finally, I illustrate these equilibrium OA-CG combinations with varieties of institutional forms and argue that the corporate landscape is becoming more diverse internalizing these varieties global-wise, but not necessarily characterized as national varieties as seen a few decades ago.

Reference

M. Aoki, *Corporations in Evolving Diversity: Cognition, Governance and Institutions*, Oxford University Press, 2010.

Public and Private Bureaucracies: The Transaction Cost Economics Perspective

Oliver E. Williamson

Abstract

Public Bureaucracy is large, growing, and consequential. Our understanding, however, is limited. Although successive efforts to address the issues have made headway, much remains to be done.

Partly this is explained by the interdisciplinary character of the public bureau – in that the political science, economic, and organization theory literatures are all implicated. There is also widespread confusion over the role of efficiency and how to define it. The relevant level of microanalytics with which to engage the issues is also disputed. Altogether, the sheer complexity is daunting.

This paper does not purport to solve the problem but takes the position that the lens of contract/governance as developed for the study of the private sector (including private bureaucracy) is pertinent. On the premise that solving a complex problem can often benefit from relating it to a simpler problem that has already been worked up, I begin with an examination of private bureaucracies (as examined through the lens of contract). I then apply this to public bureaus, where the problems are more complicated – especially because of the political nature of the issues.

I conclude with a speculative discussion of the challenges to entrepreneurship that are posed as among different nation states in the 21st Century.