

# Against Posner against Coase against theory

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In two articles published in 1993, Richard Posner characterised and vigorously attacked Ronald Coase's methodological orientation. Coase resisted Posner's diagnosis, but did not provide a response. This paper offers a response which Coase might have given. One of Posner's major claims was that Coase is 'anti-theoretical' or 'hostile to theory'. Here it is suggested that Posner's allegations suffer from serious unreflected ambiguities. Once we distinguish between a few different meanings of 'theory' (and 'theoreticity'), and between attitudes and accomplishments in regard to theory (or between being *anti*-theoretical, *non*-theoretical, *pro*-theoretical, and theoretical), it becomes possible to argue that Coase does not hold an anti-theoretical attitude even if his accomplishments fall short of theory in many (but not all) senses of the word. The larger relevance of this conflict is that its confusions tend to be characteristic of parts of the economics profession more widely.

## I

Intellectual debates are often indispensable for scientific progress, but sometimes they appear as hopelessly wayward, based on confusion and misunderstanding. The suspicion easily arises that the latter might be the case in the recent clash between Richard Posner and Ronald Coase, two prominent economists working on issues where law and economics meet. To Posner's merciless attack on his methodological views (Posner 1993A, 1993B, 1993C), Coase responded bluntly that Posner has provided 'a highly inaccurate account of my views' (Coase 1993B, p. 96). Presumably, Coase found the degree of inaccuracy in Posner's portrayal of himself so annoying that he decided not really to engage himself in a debate at all. The case was closed before anything close to a solution was forthcoming. In consequence, we still lack a clear understanding of whether Posner's account really missed the mark, and, if so, why and how.

There are many important aspects to this confrontation, but in what follows I shall focus on just one major thread in Posner's critique, namely his allegation that Coase is misguided in being against theory in economics. Put simply, my argument is that Posner's account is itself misguided owing to unrecognised ambiguities in the vocabulary he employs. Sorting out these ambiguities may help others to orient themselves with respect

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to the conflict between the two economists and their ways of doing economics—as well as the more general issue that Posner vs. Coase exemplifies.

The larger significance of this conflict is also obvious: the notion of theory appears to be a chronic issue between economists of different persuasions, such as between ‘old’ and ‘new’ monetarists and between ‘old’ and ‘new’ institutionalists. Whether the notion of theory is an ‘essentially contestable concept’ is debatable, but the following scrutiny is motivated by two characteristics that it appears to share with such concepts. First, economists feel strongly about this concept; it is loaded with great methodological value and therefore its use has quite some rhetorical power. Second, it is easy and tempting to misuse the term ‘theory’ because of its ambiguity and highly loaded character. My view is that such misuse is quite extensive among economists, and a focused case study introducing a few simple distinctions may therefore have relevance for other cases as well.

Posner phrases his claim variously. He refers to Coase’s ‘antitheoretical’ arguments (1993C, p. 200), his ‘disdain for theory’, his ‘dislike of theory’ (*ibid.*, pp. 205, 209), and his ‘hostility to theory’ (*ibid.*, pp. 205, 207). In response, Coase explicitly denies that he is against theory in economics (Coase, 1993B). Let us see if we can make sense of this issue, beginning with two fundamental ambiguities in Posner’s arguments.<sup>1</sup>

## II

It is puzzling, to say the least, to find Posner attributing to Coase ‘disdain for’, ‘dislike of’ and ‘hostility to’ theory, while at the same time he classifies some of Coase’s work as ‘theoretical’ (Posner, 1993C, p. 197), characterises Coase’s classical articles on the firm and on social cost as ‘theoretical papers’ (Posner, 1993A, p. 78), refers to ‘Coase’s theory of transaction costs’ being in ‘the tradition of simple theory’ (Posner, 1993C, p. 205) and to Coase’s case studies being guided by ‘basic economic theory’ (*ibid.*, p. 206). There must be either an inconsistency or an ambiguity in Posner’s usage of the terms ‘theory’ and ‘theoretical’. An inconsistency would arise if there were a single fixed meaning of ‘theory’ across Posner’s comments. I think, however, that it is more plausible to interpret the puzzle as being created by an ambiguity, to be discussed in a moment. My strategy is to sort out a number of different meanings in which ‘theory’ and ‘theoretical’ are being used and can be used.

There is another major ambiguity in Posner’s attack, and this one is due to a failure to acknowledge the difference between being *anti*-theoretical and *non*-theoretical: that is, between being against theory as a matter of principle and not being theoretical in one’s actual research work. When we combine this distinction with a number of senses in which the terms ‘theory’ and ‘theoretical’ can be used, we reach a clearer idea of where Coase stands. It appears that in most cases Coase is, at most, non-theoretical rather than anti-theoretical. It is notable that it is possible for Coase to be both non-theoretical and *pro*-theoretical without inconsistency. While theoreticity and non-theoreticity represent *accomplishments*, pro-theoreticity and anti-theoreticity represent *attitudes*. As we shall see, Coase’s work in many cases exemplifies a pro-theoretical attitude together with a non-theoretical accomplishment. In some cases, not only is his attitude pro-theoretical, but also his accomplishment can be characterised as theoretical.

<sup>1</sup> For other reactions to Posner’s critique, see Williamson (1993 and 1994).

## III

Posner's ambiguity is manifest in the two explanations he provides for Coase's presumed anti-theoreticism. The first explanation concerns Coase's hesitations about conventional mainstream economic theory:

Hostility to public intervention in markets beyond what is defensible in strict wealth-maximization terms is thus a leitmotif in Coase's work. The relation between this hostility and his doubts about modern economic theory is this: so many economic theorists in this century have been interventionist that economic theory itself has become dominated by concepts, such as 'perfect competition' (the conditions for which are never satisfied in the real world), 'externality', 'public good', 'social welfare function', and 'market failure', that seem like invitations to interventionist prescriptions. (Posner, 1993C, p. 201)

This is Posner's suggested explanation for the fact that Coase does not accept 'theory', where 'theory' means a particular economic theory, namely conventional neoclassical theory. This is the first meaning in which Posner uses the term 'theory' where it is tied to a particular theoretical substance or conceptual content. Now it does not seem to be at all clear whether Coase is 'anti-theoretical' in this peculiar sense: Coase's own formulations turn out to be somewhat ambiguous on this issue. On the one hand, he implies an affirmative position by saying things such as this: 'What differentiates the essays in this book is not that they reject existing economic theory...but that they employ this economic theory to examine the role which the firm, the market, and the law play in the working of the economic system' (Coase, 1988A, p. 5). On the other hand, Coase puts forth a more radical statement that '[n]onetheless, once included in the analysis, they [certain institutional features of the economic system] will, as I believe, bring about a complete change in the structure of economic theory' (Coase, 1992, p. 713).

It is obvious that Coase certainly is against *some characteristics* in conventional neoclassical theory (such as the central role given to standard price theory formulated in terms of utility maximisation), but whether he can be regarded as being against this theory depends on how central we take those characteristics to be for the theory. If we take those characteristics to constitute the core or 'essence' of conventional neoclassical theory, that is, if we take them to define what it is for a theory to be conventional neoclassical theory, then we have to conclude that Coase is 'anti-theoretical' in this peculiar sense. If the 'essence' of conventional theory lies elsewhere, such as in those features of it that Coase himself finds helpful in his own work (e.g., standard demand and supply analysis), then he certainly is not against this theory, but only against some of its peripheral characteristics.<sup>1</sup> Whatever we should think about this matter, we are here witnessing a clear case of misuse of the term 'theory': Posner seems to attempt to monopolise the term as a label for his favoured type of theory, that is, 'modern economic theory', as he puts it in a rhetorically skilful way.

It is easy to see that Posner's explanation cited above has little to do with the claim that Coase is against theory more generally, in senses that are neutral with respect to specific theoretical substance. There is a second explanation, however, that presupposes such a

<sup>1</sup> There are two debatable issues related to this. One is whether neoclassical economic theory has a unique, identifiable 'essence' or 'core' with sharp boundaries. The other issue is concerned with what elements belong to this 'core' provided it exists. Unfortunately, both issues are far too large to be dealt with here. But, fortunately, it is sufficient for the argument to notice that the disagreement between Posner and Coase is partly about the contents of a particular theory or set of theories and that Posner is misusing the term 'theory' in this context.

general disdain for theory. In putting forth this second explanation, Posner refers to what he calls Coase's 'methodological Englishness' as a reason for the latter's alleged hostility to theory in general.

Hostility to theory is a bright thread in the carpet of English thought... I am thinking here of the common sense, empiricist, anti-theoretical tradition in English philosophy that runs from Samuel Johnson and Locke and Hume to Moore, Ayer, and J. L. Austin. (1993C, p. 205)

As a closer look at the issue will reveal, this suggested explanation is problematic in a number of ways. Its presupposition, namely the presumption that Coase is anti-theoretical, is still in multiple ways ambiguous and questionable. Together with the first explanation, it also fortifies the misleading impression that what ultimately turns out to be a matter of *theoretical disagreement*, that is, a matter of being for or against particular theories, is in fact an issue of being *for or against theory in general*.

#### IV

So let us try to sort out some of the remaining ambiguities regarding Posner's implicit notion of theory. As an indication of Coase's 'methodological Englishness', Posner refers to his 'English mistrust of abstraction' (1993C, p. 206). One interpretation of this is that Posner considers Coase to 'mistrust' general concepts (such as those of the firm and the market) and general claims (such as those about the nature of the firm and the law of demand) as opposed to concepts and claims concerned with particular things and phenomena (such as the organisational history of Union Carbide). This idea is supported by the following passage:

But the new institutionalists, like their predecessors the old institutionalists, think of institutions in a grittier sense [than theorists of perfect competition]. They study not 'the market', but the *concrete* institutions that enable markets to work—for example, the rules of the Chicago Board of Trade; or long-term contracts in the uranium industry; or how public utilities set rates; or the terms on which diamonds are offered to dealers; or the common law system of property rights in animals... Intensive scrutiny of *particular* institutions implies in turn an emphasis on the case study... (Posner, 1993A, p. 76; emphases added)

It is true that Coase thinks that case studies should play an important role in economic research. And it is clear that Coase's 'emphasis on the case study', the study of 'particular', 'concrete' institutions at a low level of abstraction on the one hand, and the 'mistrust of abstraction' that Posner attributes to him on the other, would indeed go together nicely. Unfortunately, Posner misrepresents Coase's position—and the position of the 'new institutionalists' in general. There should be no doubt that Coase is interested in institutions both in the concrete and in the abstract; he has studied not only particular markets and particular firms but also 'the market' and 'the firm' in the abstract. In other words, he has considered what may be called both marketness (i.e., what it is to be a market) and firmness (i.e., what it is to be a firm) as well as their particular exemplifications. In Coase's research strategy, the role of the case study is to serve as an indispensable element in the process of abstraction whereby adequate abstract notions are pursued (for details, see Mäki, 1998A). There is no 'mistrust of abstraction' in Coase; on the contrary, his work manifests a considerable *trust* in abstraction! If abstraction is taken to define theoreticity, Coase is not anti-theoretical in this sense, not even non-theoretical, but very much theoretical as regards both his attitudes and accomplishments. He may

have views about the proper procedures of getting at abstract theory that Posner does not accept, but this does not support Posner's accusations.

## V

Another perspective on the notion of theory is related to the idea that theories proper resort to 'theoretical' or 'nonobservational' entities (such as quarks and photons in physics) to explain observed regularities among phenomena. Suspicion of such unobservables has indeed been characteristic of the 'English' tradition of commonsense empiricism that Posner attributes to Coase. Posner does not cite any evidence in support of this interpretation of Coase's views but, as it appears, it seems possible to point out an element in Coase's economic thought that might be used to serve this purpose: namely, Coase's critique of the assumption of utility maximisation. The interpretation required to back up Posner's claim is suggested by Coase's statement that

whatever makes men choose as they do, we must be content with the knowledge that for groups of human beings, in almost all circumstances, a higher (relative) price for anything will lead to a reduction in the amount demanded... The generalization of such knowledge constitutes price theory. It does not seem to me to require us to assume that men are rational utility maximizers. On the other hand, it does not tell us why people choose as they do. (Coase, 1988A, p. 5)

This appears to mean that price theory for Coase consists of empirical generalisations. As pointed out, one standard idea of theory implies that it is the task of theory to explain empirical generalisations; theory is something distinct from empirical generalisations and invokes 'theoretical' or nonobservational entities that are not depicted by those generalisations but are postulated to explain them. In the case of the generalisation called the law of demand, economists have traditionally introduced a distinct 'theoretical' entity called 'utility' and assumed that people maximise it, and this is construed as part of a 'theoretical' explanation of the law of demand. Coase rejects this idea by saying that utility is 'a nonexistent entity which plays a part similar, I suspect, to that of ether in the old physics' (*ibid.*, p. 2). This would seem to give us reason to conclude that Coase's approach is anti-theoretical in the sense of exemplifying some kind of empiricist reductionism: theories reduce to empirical generalizations.

Once again, even though there is evidence for the foregoing conclusion in Coase's writings, an alternative interpretation suggests itself that portrays Coase as non-theoretical rather than anti-theoretical in this sense. This interpretation is supported by Coase's conjecture that 'ultimately the work of sociobiologists (and their critics) will enable us to construct a picture of human nature in such detail that we can derive the set of preferences with which economists start' (*ibid.*, p. 4). Such a theory would 'relate preferences to certain basic needs' (Coase, 1978, p. 244). Thus, Coase seems to be dissatisfied with the current conventional theoretical explanation of the law of demand, rather than excluding the idea of pursuing a theoretical explanation in general. He even seems to have realist grounds for his position: since he does not believe utility is a really existing entity, he prefers to do without it until something more reliably real (as well as explanatory) has been postulated in its stead. This is further supported by Coase's suggestion that utility is similar to ether in physics, something that the progress of science will reject as a non-existent entity. There is nothing anti-theoretical in this; on the contrary, it represents a strongly pro-theoretical attitude. It is a pro-theoretical attitude

together with a non-theoretical accomplishment: Coase has not provided a biologically informed theory of needs.

This same conclusion, supported by the example of the law of demand, can be reached at a more general level. Namely, Posner's allegation of Coase's radical empiricism, the latter's 'methodological Englishness', does not fit with Coase's idea of theories purporting to 'get to the essence of what was going on in the economic system' (Coase, 1988C, p. 68). A radical empiricist would not accept essences into the ontology of economics, since they are not available to sense experience. It is most intriguing to observe that it is Posner's view that is closer to 'methodological Englishness' in this respect. Posner is content with theories that predict well without describing correctly the mechanisms that generate the phenomena predicted: 'A model can be a useful tool of discovery even if it is unrealistic, just as Ptolemy's astronomical theory was a useful tool of navigation...even though its basic premise was false... We should be pragmatic about theory. It is a tool, rather than a glimpse of ultimate truth, and the criterion of a tool is its utility' (Posner, 1993A, p. 77).<sup>1</sup>

Against this, Coase says, '[f]aced with a choice between a theory which predicts well but gives us little insight into how the system works and one which gives us this insight but predicts badly, I would choose the latter' (Coase, 1988C, p. 64). Coase's rejection of the instrumentalist view of theories is clear-cut: 'But a theory is not like an airline or bus timetable. We are not interested simply in the accuracy of its predictions. A theory also serves as a base of thinking. It helps us to understand what is going on' (Coase, 1988C, p. 64). Coase is here suggesting that while bus timetables may be useful in predicting the behaviour of buses, they fail to give us a plausible idea about the mechanisms and processes that keep buses running as they do. On the other hand, Posner's view of theories seems to be such a 'timetable view'. His instrumentalist reluctance to go behind the veil of experience to see 'how the world works' is an expression of anti-realist empiricism about how theories work.<sup>2</sup>

Looked upon from this perspective, two conclusions can be drawn. First, the concept of theory allows for both an instrumentalist and a non-instrumentalist (i.e., realist) version. Posner cannot justifiably claim that if one does not hold an instrumentalist conception of theory, one is against theory. Second, it is rather the other way around: there is a sense in which we may say that if one holds a certain kind of instrumentalist view of theory, one is against theory. The Coasean view of theory as a penetrating account of 'how the world works' gives theory a powerful role and an irreducible status, while Posner's instrumentalist conception downplays theory and gives it just a timetable status. Timetables can in principle be formulated in terms of empirical generalisations; thus, perhaps surprisingly, it is Posner who is closer to the kind of anti-theoretical empiricism that he wrongly attributes to Coase.

## VI

It is not clear that the concept of theory is linked to that of approximation, but a remark on this may be worth making in passing. Posner makes this peculiar statement: 'The formal models of economics hold only as approximations. Coase is not interested in

<sup>1</sup> Posner is mistaken if he thinks that the two options he mentions, namely theory as 'a false but useful tool' and theory as 'a glimpse of ultimate truth', exhaust the options. One can avoid instrumentalism without possessing or pursuing ultimate truths.

<sup>2</sup> However, unlike Coase, Posner does not seem to be an empiricist about how theories are generated.

approximations. He is interested in observable reality' (Posner, 1993C, p. 206). The claim about Coase being only interested in observable reality is undermined by the observations given above. The claim about Coase not being interested in 'approximations'—whatever this expression is supposed to mean in this context—is undermined by two quotations from well-known sources. In 'The Nature of the Firm', Coase says that the definition of the firm he has developed in that article 'closely approximates the firm as it is considered in the real world' (Coase, 1937, p. 404). In 'The Problem of Social Cost', Coase argues that '[a] better approach would seem to be to start our analysis with a situation approximating that which actually exists' (Coase, 1960, p. 43).

## VII

Yet another variation in Posner's usage of 'theory' is to link it to the idea of mathematical formalisation. He argues that Coase '[will not] allow a place for formal theory' (Posner, 1993C, p. 206) and that Coase is 'wrong [in being] against formal theory' (Posner, 1993A, p. 78). To get things straight, the first remark to be made on this is that we are talking here about one style of theorising or one type of theory, that is, mathematically formalised theory, not theory in general. The property of being formalized cannot be taken to constitute a necessary condition of the property of being theoretical, even though some economists appear to think so, thus misusing the term 'theory'. However, this is not the primary issue at hand.<sup>1</sup> The more restricted question to be answered is this: is Coase against mathematically formalised theory as Posner claims?

It is true that Coase has admitted that, early in his career, mathematics 'was not to my taste' (Coase, 1993A, p. 36); it is also true that he ridicules the role that mathematics may play in conventional economics as follows: 'In my youth it was said that that what was too silly to be said may be sung. In modern economics it may be put into mathematics' (Coase, 1988B, p. 185). However, none of this in itself implies that he is against mathematical formalisation. Quite the contrary is the case. Coase puts his view about the role of mathematics in economics rather clearly:

My remarks have sometimes been interpreted as implying that I am hostile to the mathematization of economic theory. This is untrue. Indeed, once we begin to uncover the real factors affecting the performance of the economic system, the complicated interrelations between them will clearly necessitate a mathematical treatment, as in the natural sciences, and economists like myself, who write in prose, will take their bow. May this period soon come. (Coase, 1992, p. 719)

In other words, Coase believes mathematical formalisation is needed, but not before economists have got the fundamental abstractions right. Since Coase does not think conventional theory has got all the basic abstractions quite right, he is not particularly impressed by what he regards as little more than formally elegant 'blackboard economics' (for a detailed analysis of this notion of Coase's, see Mäki, 1998A). The disagreement between Coase and Posner is therefore not over mathematical formalisation itself, but once again over theoretical substance. Again, the conclusion is that Coase is not anti-theoretical in the peculiar sense of being against mathematically formalised theory as a general principle, but rather holds a pro-theoretical attitude, subject to a constraint, even

<sup>1</sup> Two other issues are related to this. One is whether mathematical formalisation is at all appropriate in economics. The other is concerned with the specific kind of mathematics that would be appropriate, provided there are no obstacles to using mathematics in general. Fortunately, these issues are not relevant for the present argument.

though the accomplishments of his own research are non-theoretical in the present sense. The constraint is the principle that a formalised theory should be based on adequate abstractions; it should represent the real rather than an imaginary world. Coase writes that his 'analytical scheme can be put into mathematical form. This should give us hope but only if this analytical power is used to enlighten us about the real rather than an imaginary world' (Coase, 1993A, p. 73). We might want to say that Coase's own theoretical accomplishments are concerned with ensuring that this constraint be satisfied by trying to get the fundamental abstractions right.

### VIII

Another variation to be considered is the idea that 'being theoretical' somehow connotes 'completed theory'. Posner says that Coase 'has not attempted to develop a *theory* of transaction costs' (Posner, 1993C, p. 207). Coase is very well aware of this circumstance. In his Nobel Lecture he cites Williamson's suggestion that 'the non-use or limited use of my thesis in 'The Nature of the Firm' [is due] to the fact that...the concept of transaction costs has not been incorporated into a general theory', and admits that 'I think this is correct' (Coase, 1992, p. 718). Once again, Coase is certainly not anti-theoretical in the sense of being against completed theory. Even though his accomplishment has been non-theoretical in this peculiar sense, he holds a strongly pro-theoretical attitude, as evidenced by the following: 'My dream is to construct a theory which will enable us to analyze the determinants of the institutional structure of production... My dream is to help complete what I started some fifty-five years ago and to take part in the development of such a comprehensive theory' (Coase, 1993A, p. 73).

### IX

It remains to be noticed that there has to be a loose notion of theory and theoreticity that is shared by Posner and Coase and that both attribute to Coase. Otherwise none of Coase's work could be characterised by Posner as 'theoretical', guided by 'basic theory' and leading to 'theory'. Otherwise it would be unintelligible for Coase to characterise the situation prior to 1937 by saying that 'what was lacking in the literature [on industrial organisation], or so I thought, was a theory', and that his 1937 article was written to fill the gap (Coase, 1988 [1972], pp. 61–2); or to criticise the older stream of institutionalist economics for anti-theoreticism by stating that 'the American institutionalists were not theoretical but anti-theoretical... Without a theory, they had nothing to pass on except a mass of descriptive material waiting for a theory, or a fire' (Coase, 1984, p. 230).<sup>1</sup> The minimal notions of theory and theoreticity implied in such passages have to connote, in positive terms, something like 'conceptual' and 'explanatory', and, in negative terms, something like 'unlike data' and 'different from empirical case study'. It is also likely that there is more than such a minimal notion at play here. There is a sense in which Coase is not only pro-theoretical in his attitudes but also theoretical in his achievements.<sup>2</sup>

<sup>1</sup> It is a separate issue whether Coase is correct in this characterisation of (at least all of) the 'old' institutionalist economics. For discussions of the issue of theoreticity in the context of the new and old institutionalism, see Mäki (1993, pp. 19–25) and Rutherford (1994).

<sup>2</sup> Many of Coase's metatheoretical papers have been collected in Coase (1994). For further discussions on Coase's views about the nature of economics, see Medema (1994), Mäki (1994A, 1998A, 1998B), and Foss (1994).

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This was Coase's reaction to Posner's allegations: 'How Posner came to interpret my position as being anti-theoretical I cannot imagine. It is certainly untrue' (Coase, 1993B, p. 97.) The foregoing examination might make it easier to imagine—even if not to accept. Posner's unreflected and misguided exploitation of the ambiguity of the strategically loaded terms 'theory' and 'theoretical' may be an extreme exemplification of a mal-practice obtaining among economists, but insofar as it is an exemplification of such a practice at all, its critical examination might have broader consequences.

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