RONALD COASE INSTITUTE

Working Paper Series

New Institutional Economics: From Early Intuitions to a New Paradigm?

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Working Paper Number 8

September 2012

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This version: September 23, 2011

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Abstract

NIE is a success story by many measures: four Nobel laureates in under 20 years, increasing penetration of mainstream journals, and significant impacts on major policy debates. This success is remarkable for a field that took shape as recently as the 1970's around some relatively vague intuitions. It is even more so when we consider that it was divided from birth into distinct schools of thought. This paper reviews the history of NIE including the creation of an international society (ISNIE), documents the sometimes bumpy road to its current successes, and elucidates the challenges ahead. Will NIE be quietly absorbed by mainstream theory, or will it radically transform neoclassical economics into a new paradigm that includes institutions?

I. Introduction

New Institutional Economics (NIE) is a success story by many measures. To mention a few: four Nobel laureates in under 20 years; significant impacts on major policy debates ranging from anti-trust law to development aid; increasing penetration of mainstream journals; and a large and growing body of adherents, applied research, and relevant datasets. This success is remarkable for a field that took shape as recently as the 1970's around some relatively vague intuitions. These early intuitions were progressively transformed into powerful conceptual and analytical tools that spawned a vigorous base of empirical research. The current robust institutionalization of NIE is all the more remarkable when we consider that the field was divided from its birth into several decentralized and distinct schools of thought. One prominent school, identified with Coase and Williamson, focuses on property rights and contracts at the firm level. Another, identified with Douglass North, analyzes broader institutional environments and the role of the state. These schools began productive discussions and attracted new adherents with the creation of an international society in 1997 -- the International Society for New Institutional Economics or ISNIE.[2]

NIE's successful institutionalization should not obscure its roots as a revolutionary paradigm and the continued resistance to some aspects of its research program. Nor should it mask NIE's persistent divisions, despite the fruitful dialogues within ISNIE. ISNIE has greatly increased interactions, but there is no general theory of institutional economics and NIE is in many ways a still decentralized field of inquiry. Indeed in some ways new institutional economics is still more of a movement than a field, a movement that is characterized by its stress on rules and norms, by its examination of the microanalytics of firm and market organizations and the ramifications for public policy, by its search for dynamic rather than static explanations of economic evolution, and by its openness towards interdisciplinary approaches and towards case studies and other less mathematical methodologies. Yet despite this openness to less formal approaches and inductive reasoning on some occasions, prediction and empirical testing are much more the norm in NIE than in early institutional economics. And, unlike the economics of famous early institutional economists such as Veblen, Ayres, Commons, and Mitchell, NIE is more accepting of much of the neoclassical paradigm -- with certain important exceptions that we describe below. These exceptions are basic and have turned out to have powerful implications for understanding the institutional

[2] There are a number of other schools of thought that developed simultaneously and are closely associated with or even part of NIE that we do not have space to cover adequately here. These include, for example, the theories of Mancur Olson, public choice theory and the work of Buchanan and Tullock, and the work of positive political scientists such as Ken Shepsle and Barry Weingast. Closely associated with NIE is the work of Harold Demsetz, in the continuation of the property rights approach. However, when it comes to the history of how ISNIE was born and developed, we think that the two branches on which we focus here led the way and represent the dominant group of participants. Our *Handbook of New Institutional Economics* (2005) includes a relatively wide spectrum of the contributors to NIE, including the four Nobel laureates, although some other major names (e.g., Barzel, or Demsetz) are missing

environment and the institutions of governance which can progressively transform economics towards a paradigm that is radically different from the previous approach.

This paper reviews the history of NIE including the creation of ISNIE, documents the sometimes bumpy road to its current successes, and elucidates the challenges ahead. It provides a succinct overview of how a new school of thought evolved from disparate concepts to a core of influential theories. The paper also contributes unique insights into how a new movement becomes institutionalized from authors who were part of the core team that created the International Society for New Institutional Economics, edited the first handbook of new institutional economics, and are close associates of the central intellectual founders. The next section considers the origins of NIE, summarizing the key concepts that underlie all institutional analysis and describing the central contribution of Ronald Coase. Section III traces the transformation of NIE from early ideas to analytical tools, considering in particular the evolution of transaction cost economics as embodied by the work of Oliver Williamson, and institutional analysis, as represented by the work of Douglass North. Section IV documents the diffusion of NIE, including the history of ISNIE from its earliest founding meetings to its emergence as a well-established organization. The paper concludes with a discussion of NIE's successes and challenges. One success is also a challenge – the growing mainstream popularity of NIE. Will this popularity transform NIE or will NIE transform economics? We conclude with a research program aimed at clarifying ideas that are still fuzzy, exploring areas where institutional research has barely penetrated, and refining methodologies that meet NIE's demanding task of combining rigor with complexity.

II. The intellectual origins of NIE

Virginia Woolf once asserted that "on or about December 1910 human character changed." (Woolf, 1928, p.4) We cannot be so bold in dating when economics changed,[3] but we can date the origins of the changes introduced by NIE. They emerged from the confluence of several major contributions: two pioneering papers from Ronald Coase, "The Nature of the Firm" (1937) and "The Problem of Social Costs" (1960/1988a), two defining books -- North and Davis on *Institutional Change and American Economic Growth* (1970) and North and Thomas on *The Rise of the Western World* (1973), and the land mark book *Markets and Hierarchies* (1975) by Williamson. Although there were predecessors, as with all schools of economics, these four contributions became the building blocks that transformed NIE's initial intuitions into a useful analytical apparatus.

II.A. *Key concepts.*

NIE is rooted in several early traditions of economic thought. As a young economist Ronald Coase initially posited himself in the British tradition from Smith to Marshall to Arnold Plant. He was further influenced by his drive to respond the increasingly radical challenge to this British tradition by the then ascendant Pigovian school of thought.[4] Oliver Williamson learned interdisciplinary social science in the PhD program at the Graduate School of Industrial Administration at Carnegie Mellon University, which he used to continue the teaching of Kenneth Arrow, Alfred Chandler, Ronald Coase, and Herbert Simon. Douglass North had been a Marxist until he was increasingly exposed to neoclassical economics and to new perspectives opened by his

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[3] Although we might note that Ronald Coase was born in December 1910.

[4] See his *Essays on Economics and Economists* (1994).

research in economic history. Yet North maintained a strong interest in political science, and has close ties with political scientists such as Elinor Ostrom, Barry Weingast, and others.

The robust innovations in positive political economy that coincided with the early development of NIE also had an influence. This included Mancur Olsen's theories of collective action and governance and the contributions of Duncan Black and Kenneth Arrow. Parallel with the rise of NIE, positive political scientists such as Kenneth Shepsle, Barry Weingast, and many others began to analyze voting behavior under majority rule, to assess the effects of electoral systems, legislative and bureaucratic rules, and constitutions, and eventually to analyze other institutions governing the state, the judiciary and societies in general. Also influential were the concepts of what came to be called 'public choice,' identified with the work of James Buchanan and Gordon Tullock.

Other ideas that shaped NIE came from managerial sciences (e.g., Chester Barnard), the legal tradition (e.g., Llewelyn and Macneil), history (e.g., the cliometrics group), sociology (e.g., Merton and Macaulay), and other fields. This rich heritage served sometimes as a source of inspiration and sometimes as a constraint to be overturned. But NIE ultimately went beyond its forbearers and contemporaries to develop building blocks of its own. The resulting key concepts – transaction costs, property rights and contracts – became the "golden triangle" of NIE, which we illustrate graphically in Figure 1. These three concepts, combined with NIE's increasingly radical behavioral assumptions (see North 2005), progressively structured the two leading branches of NIE. Let us consider briefly the origin of those three key concepts.

Figure 1 about here

NIE is founded on the work of Ronald Coase and especially on his ideas about transaction costs. The concept of transaction costs arose in Coase's 1937 paper "The Nature of the Firm" when he asked, why are there firms?[5] Why doesn't all exchange take place in the market by means of short-term contracts among individuals? His answer was that there are costs to transacting in the market: a would be trader must find someone with whom to trade, get information on price and quality, strike a bargain, draw up a contract, and monitor and enforce the contract. A firm can reduce these transaction costs under certain circumstances by eliminating the need for bargains among the many owners of the factors of production and replacing them with coordination by a hierarchy. Steven Cheung (1983) later enriched this idea by showing some of the circumstances when a firm might have lower transaction costs than a market, because "the determination of prices is costly because of the number of transactions, because consumers lack detailed information on the use of each component or contribution to a commodity, because of the difficulty of measuring varied and changing activities, and because of the need to separate contributions." (Ibid., p. 9) Ronald Coase explained why the concept of 'transaction costs' is so central to NIE in his paper to the *American Economic Review* in 1998.[6] As he pointed out, the organization of transactions, with the inevitable costs it incurs, determines what goods and services are produced and the capacity of any economy to take advantage of the division of labor and specialization. Thus, transaction costs profoundly influence not just individual firms but the size and activities of the entire economy.

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[5] At about the same time that Coase wrote his paper, Commons (1934, p. 4) introduced the idea that "…the ultimate unit of activity…must contain in itself the three principles of conflict, mutuality, and order. This unit is a transaction." Coase was apparently unaware of this development, but later on Williamson (1975, p.6, 1996, p. 7) integrated it into his approach to transaction costs.

[6] "New Institutional Economics."

The concept of transaction costs spawned advances in both organizational economics and institutional analysis. Transaction costs are at the core of Williamson's work on the choice between market and firm and North's work on political transaction costs and on why countries are rich or poor. We explore both in section III.

The second key concept, property rights, was part of Coase's argument in "The Problem of Social Cost" (1960). There Coase explored the harmful effects (or externalities) that occur when the exercise of one owner's rights causes some harm or cost to owners of other rights. Coase illustrated the reciprocal nature of externalities with the example of a cattle-raiser whose herd destroys the crop of a neighboring farmer. As he noted, there would be no crop damage without the cattle, but there would also be no crop damage without the crops. "An increase in the supply of meat can only be obtained at the expense of a decrease in the supply of crops." (Ibid, 1960, p 2) If market transactions were costless, the farmer and the rancher would strike a bargain to rearrange their rights in ways that increase the value of production. Depending on the initial assignment of rights, the liability laws, and the relative values of land, crops, and cattle, the rancher might decide to pay damages, pay for fencing, pay the farmer for not cultivating, or buy or rent the farmland -- or the farmer might decide to pay the rancher for removing the cattle or buy or rent the ranchland,

Neoclassical economics assumed that what people trade are physical or virtual commodities. As Coase later argued in his paper "The Federal Communications Commission" what they really trade are rights, the rights to perform certain actions (Coase 1959). The NIE concept of property rights was further developed in a contribution by Armen Alchian, initially published in *Il Politico* in 1965. Alchian defined property rights as a set of rights to take permissible actions to use, transfer, or otherwise exploit or enjoy the property. While Coase argued that property rights with their duties and privileges are established by the legal system, Alchian pointed out that rights may be enforced by law but are more often enforced by etiquette, social custom, and social ostracism.[7]

Here again Coase's original idea was expanded and operationalized in NIE's subsequent development. Williamson's work on contracts, which we explore below, demonstrated that property rights are vulnerable to opportunistic predation and that private ordering is usually less costly than the legal system in enforcing rights. North analyzed how differences in the distribution and quality of enforcement of property rights affect the different ways societies develop. Elinor Ostrom further enhanced the concept of property rights by analyzing how the damaging effects of poorly defined and enforced private property rights can be avoided through community governance. Ostrom applied Coase's insight that using markets can be costly to common property resources such as irrigation systems or fishing grounds. When most analysts assumed that only private property or government regulation could overcome the over exploitation and degradation of common property, Ostrom's theory and extensive field work showed that where the boundaries of the users and resources are clearly defined, monitoring and enforcement by tightly-knit community groups with strong social norms and procedures for making and enforcing rules produces superior outcomes to state regulation or private ownership. She also developed a theoretical framework that provided a foundation for scientific analysis

[7] Demsetz (1967) substantiated Alchian's view in his controversial analysis of the emergence of private property rights among the 'Montagnais', a tribe of Northeastern Canada, a paper in which he argued that property rights arise when they become economically beneficial.

of complex, heterogeneous institutions through comparative microanalytics and thoroughly tested her hypotheses through laboratory and field experiments.

Contract is the third core concept in NIE. The idea of contract was also introduced by Coase, but in the very specific context of his 1937 analysis of how firms differ from markets. Critical to the institutionalist concept of contract are two assumptions: contracts are agreements between parties, written or unwritten, that are (1) never perfectly enforced and (2) never perfectly complete. These two assumptions were progressively developed along different paths that correspond to the two main branches of NIE. The 'Northean' branch emphasized early on the key role of contract enforcement and the institutions it requires, particularly the polity (North, 1981, chap. 4).[8] This was later developed into a theory of its own based on detailed analyses of the role of coercion in protecting property rights and individual rights, and of the tradeoff between the high cost of private protection of property using private police or private armies and the risk of state protection of property, which might reduce private costs but invite state encroachment on rights (see North et al., 2009; and also North and Weingast, 1989; Weingast, 1993; Greif, 2005).

Williamson flagged the second assumption of incomplete contracts as early as 1971 in a paper on vertical integration. In his formulation, opportunism -- the idea that parties to an exchange might defect from the spirit of cooperation when the stakes are great -- overturned neoclassical behavioral assumptions. He defined a contract as "an agreement between a buyer and a supplier in which the terms of exchange are defined by a triple: *price*, *asset specificity*, and *safeguards*" (ital. from OEW, 1996, p. 377).

[8] See also the influence of Buchanan & Tullock (1962) on North; and Buchanan (1975) on Williamson. Barzel's contribution (e.g., 1989) to the analysis of property rights and the violence of the State also deserves mention here.

Williamson's concept of contract became central to the NIE analysis of governance, as emphasized by the Nobel Committee in 2009. It became the source of many successful empirical investigations, making the Coasian approach operational in micro-economics and industrial organization.

These three concepts – transaction costs, property rights, and contracts -- are not the only concepts developed by new institutionalists over the years, but we would argue that they encapsulate the central core of NIE and are what make its paradigm so distinctive.[9] Consider how NIE differs from early institutional economics in its acceptance of the essential core of neoclassical economics – scarcity and competition – yet also differs radically from the orthodox approach since its core concepts reject assumptions of perfect information, perfect rationality, and zero transaction costs, and underlie the search for a dynamic model of economic change radically different from the static models of standard neoclassical economics.

II.B. The Central Role of Ronald Coase

As we have seen, transaction costs are at the heart of new institutional economics. The idea of transaction costs was born when Ronald Coase, a 21 year old getting a degree in commerce, traveled to the United States in 1931-32. Coase was strongly influenced by his firsthand encounters with businessmen struggling during the great depression. He contrasted what he saw during his travels with Adam Smith's argument that the activities of competitive firms are coordinated by the invisible hand of the price system, which led him to the idea as he later described it that "Firms will emerge to organize what would otherwise be market transactions whenever their costs were less than the costs of carrying

[9] Among some of the other ideas variously associated with NIE as documented by Richter are those in the field of evolutionary economics, public choice and political economy, institutional history, modern Austrian economics, constitutional choice, and collective action (Richter 2005).

out the transactions through the market. The limit to the size of the firm is set where its costs of organizing a transaction become equal to the cost of carrying it out through the market. This determines what the firm buys, produces, and sells." (Coase 1990, p. 7)

Coase's argument was a radical departure from neoclassical economics,[10] which had assumed that choices between firm and market and decisions about firm size and production were driven by technology, not transaction costs. Once economists accept that transaction costs are central to the economy, then the focus of their research must change. "It makes little sense for economists to discuss the process of exchange without specifying the institutional setting within which the trading takes place since this affects the incentives to produce and the costs of transacting" (Coase 1992). In another famous paper, "The Problem of Social Cost" (1960), Coase laid the basis for NIE's emphasis on applied research when he further admonished economists not to analyze an ideal world, but "…to start our analysis with a situation approximating that which actually exists," (Coase 1960, p.43).

In later work Coase argued that transaction costs profoundly influence not just the size and activities of individual firms but the size and activities of the entire economy. "If the costs of making an exchange are greater than the gains which that exchange would bring, that exchange would not take place and the greater production that would flow from specialization would not be realized. In this way transaction costs affect not only contractual arrangements but also what goods and services are produced." (Coase 1992, p. 716) This perspective later flowered in Northean institutional analysis.

[10] Beside continuous references to Smith and Marshall, Coase acknowledged the strong influence of Arnold Plant, his supervisor at the London School of Economics, of Robbins, Hayek and Hicks, the leading figures at the time he studied at the LSE, and also the readings they recommended. See Coase 1994, chap. 15 for a relatively detailed account of these influences.

For more than 30 years Coase's insights about transaction costs were largely neglected, in part because they contradict central assumptions of neoclassical economic theory. In neoclassical economics the firm is an organization that transforms inputs into outputs. Its boundaries are defined by economies of scale and scope, and its purchases and sales are costlessly coordinated by the price mechanism.

When mainstream economists did show an interest in Coase's ideas, they were preoccupied not by the effects of transaction costs but by the effects of zero transaction costs. The idea of zero transaction costs comes from "The Problem of Social Costs" (1960). There Coase argued that if transaction costs were zero, then it would not matter who was found to be legally liable for a social cost, say, for air pollution, since the affected parties could costlessly negotiate agreements to maximize their wealth. Through these costless negotiations, the right to take actions that impose costs on others would be acquired, subdivided, and combined in ways that bring about an outcome that has the greatest value on the market, as we saw earlier in the case of the farmer and the cattle raiser. This idea, christened the Coase Theorem by George Stigler, was not central to Coase's argument but economists zoomed in on it and argued voluminously about its merits, often misinterpreting Coase's point about transaction costs. Coase was not arguing that transaction costs are unimportant or that we should study a world of zero transaction costs, quite the contrary. He regarded "the Coase Theorem as a stepping stone on the way to an analysis of an economy of positive transaction costs." (Coase 1992, p. 717). Why were so many economists captivated by the Coase Theorem? Coase's answer: "The world of zero transaction costs, to which the Coase Theorem applies, is the world of modern economic analysis, and economists therefore feel quite comfortable handling the intellectual problems it poses, remote from the real world though they may be." (Coase 1990, p. 15). As a result of this attitude, transaction costs could not easily be incorporated into a general theory without transforming economics.

Confusion over the Coase Theorem is not the only reason why Coase's insights about transaction costs were neglected for so long. Another reason, as Oliver Williamson has argued (Williamson 1989), is that the concept of transaction costs was vague. Transaction costs may determine the choice between firms and markets, but what specific factors determine that choice? Williamson launched a school of thought that operationalized transaction costs by "(1) identifying the behavioral assumptions that are responsible for transaction costs and developing their contractual ramifications; (2) proposing a basic unit of analysis; and, (3) developing the logic of microeconomic organization – whereby some transactions are predictably organized one way and others are organized another – and discovering and explicating distinctive patterns or regularities in the process" (Ibid., p. 229-230). As we will show in the next section, transaction cost economics developed the general theory that standard neoclassical economics resisted, analyzed empirically how transaction costs influence firms, and spurred a wealth of empirical research with important policy implications. In the subsequent section of the paper we will also discuss how the school of thought pioneered by Douglass North has analyzed what transaction costs imply for whole economies and societies and for long run economic performance with widespread reverberations in political science, development economics, sociology, anthropology, and elsewhere.

III. From early ideas to analytical tools

In the late 1960's and early 1970's, the early ideas about transaction costs, property rights and contracts were already developing into what became the core concepts of what Williamson christened New Institutional Economics (Williamson, 1975, chap.1). A research program progressively blossomed that challenged some of the main assumptions of standard neoclassical economics. As we have mentioned, this program developed almost simultaneously along the two branches that are the focus of this paper. Below we first consider the work of Oliver Williamson and transaction cost economics. Following that we summarize the second school, which we shall call institutional analysis, and the work of Douglass North. These two schools of thought were not the only trends affecting the new institutional economics; other important thinkers included Steven Cheung, Harold Demsetz, and Elinor Ostrom (see Figure 2). The new movement influenced a large body of followers, some of whom we flag in Figure 2.

Figure 2 about here

III.A: Transaction cost economics and Williamson.

The intellectual origins of Williamson's ideas are well documented.[11] At Stanford he studied management and also discovered economics, thanks notably to Kenneth Arrow. Later at Carnegie he was exposed to the rich multidisciplinary approach developed by Herbert Simon, Richard Cyert, James March, and others. His approach was also shaped by field experience in the early phases of his career, which exposed him early on to problems of governance. In particular he experienced first hand the internal organization of large firms and bureaucracies, first as a young graduate from MIT working as a project engineer and travelling extensively to Asia in the late 1950s, and

[11] See Williamson's bio sketch in 1986b; his paper on the Carnegie connection (1996, chap. 1); and notes and remarks spread over several chapters of his books from 1975, 1985, and 1996.

later as a young economist working on issues of mergers and acquisitions at the Department of Justice. The period at Justice from 1966-67 helps explain his continuing interest in managerial sciences and also fed his thinking about vertical integration and contractual relationships.[12] We illustrate these influences graphically in Figure 3.

Figure 3 about here

We can see how this background matters if we consider how Williamson's ideas have evolved. *The Economics of Discretionary Behavior* (1964), based on his dissertation at Carnegie, complemented and extended the question raised by Coase in 1937: if firms exist, what is their role and what are the limits of management?[13] By the 1970s Williamson's research on issues of internal organization converged with his growing interest in vertical integration or what was later called the "make or buy" trade off. In his landmark paper "The Vertical Integration of Production: Market Failure Considerations" (1971) he developed the idea that much vertical integration results from what he called "transactional failures", which open the way to comparative advantages for the firm over arm's length competition. In twelve compact pages this paper summarizes the main ideas that he later developed at length in *Markets and Hierarchies* (1975) and deepened in subsequent publications. Williamson emphasized upfront that "…the substitution of internal organization for market exchange is attractive less on account of technological economies associated with production but because of what may be referred to broadly as 'transactional failures' in the operation of markets for

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[12] Before and after that episode, Williamson delivered several papers on pricing in non-standard arrangements.

[13] In a personal communication (April 9, 2010) Williamson confirmed having read Coase (1937) –reprinted in the influential *Readings on Price Theory* (1953) commissioned by the AEA -- while working on his dissertation at Carnegie, and Coase (1960) on social costs and (1964) on regulation right after they were published.

intermediate goods" (1971, p. 112). Williamson turned to internal organization as a better explanation than the production function for why integration might be preferred to markets. Integration becomes particularly likely when a small number of potentially opportunistic actors must deal with technically complex products in a changing environment; with integration they can take advantage of "the wide variety and greater sensitivity of control instruments" (p. 113) and the flexibility offered by "fiat" as a less costly "conflict resolution machinery" (p. 114). Here are central themes later developed in M*arkets and Hierarchies*: incentives, control, and administration on the one hand; small numbers, complexity and uncertainty on the other.[14]

Williamson's 1971 paper also provides a second and complementary explanation for vertical integration: "contractual incompleteness." (p. 117) Williamson pushed the idea of contractual incompleteness further in "Transaction Cost Economics: The Governance of Contractual Relations" (1979)[15]. This title says it all. While *Markets and Hierarchies* integrated intellectual sources as diverse as Arrow, Barnard, Chandler, Commons, Coase, Hayek, and Simon to explain how integration might overcome market failures, this 1979 paper operationalized the effects of transaction costs on contracts. This paper detailed Williamson's now well-known triplet of transactional attributes -- uncertainty, frequency, and, most importantly, transaction-specific investments -- and analyzed how different types of contracts and the alternative governance structures in which they are embedded are aligned or misaligned with these three attributes. This

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[14] The full title of the book, rarely quoted in its entirety, is: *Markets and Hierarchies: Analysis and Antitrust Implications. A Study in the Economics of Internal Organization*. Almost simultaneously, Williamson who was then editor of *The Bell Journal of Economics* published a special issue on the same theme of "internal organization."
[15] Published in the *Journal of Law and Economics*, later integrated in *The Economic Institutions of Capitalism*.

landmark analysis launched a stream of empirical research that sealed the success of transaction costs economics.[16] But the 1979 paper did not stop there. Although the trade-off between markets and hierarchies remained at the forefront, the paper also considered cases where the cost of integration is so high that firms may decide not to integrate but may also chose not to switch back to standard market contracts. Instead they may choose another form of governance, then identified as "bilateral structures, where the autonomy of the parties is maintained. " (p. 250). This reasoning was later extended to more complex structures, christened hybrids (Williamson, 1991), which opened the way to another abundant stream of empirical research (Ménard 2012).

The 'antitrust implications' flagged in the full title of *Markets and Hierarchies* also stimulated a body of research on regulation and more generally on the institutional embeddedness of governance structures. An important contribution to this literature was Williamson's "Franchise bidding for Natural Monopolies –in General and with Respect to CATV" (1976). This paper highlighted the importance of contract implementation and its complex interaction with the institutional environment. Williamson's analysis employs a subtle examination of alternative contractual solutions for the supply of public utility services, substantiated by a case study of a cable television company that examined "transactions in much greater microanalytic detail than has been characteristic of prior studies of regulation and proposed alternatives thereto." (1976, p. 73).[17] In "Franchise Bidding" Williamson uses the same methodology and concepts to elucidate how "The match of governance structures with transactions that results from these economizing efforts" (1979, p. 253) can be used to unravel regulatory issues, as illustrated by his

[16] Monteverde and Teece (1982), Masten (1984) and Joskow (1985) deserve special mention in the initiation of the empirical dimension of this research program.
[17] The franchising of cable TV by the city of Oakland.

discussion of the Schwinn case, in which this producer of quality bicycles was sued by competition authorities because of the restrictions it had imposed on franchisees (1985, pp. 183 sq.). [18]

Two more recent works, *The Mechanisms of Governance* (1996), and "The New Institutional Economics: Taking Stock, Looking Ahead" (2000, a paper based on the presidential address delivered at the Third Annual Conference of ISNIE) summarize the further development of the analytical framework Williamson first presented in the 1970s. New advances included more attention to hybrid modes of organization[19], the exploration of the impact of financial choices on governance, and analyses of credible commitment and its role in regulation and development. This last topic bridged the gap between transaction cost economics and institutional analysis.

As we can see from this brief summary, by the 1990's the Williamsonian wing of the NIE was well established and had developed increasingly explicit links with the Northean wing.

III.B. Institutional Analysis and North[20]

Douglass North's approach to institutional analysis was influenced by his experience in the Merchant Marine during the Second World War, which affected his early interest in the productivity of ocean shipping and his later views on violence. He was also heavily influenced by the ideas of Joseph Schumpeter and the economists he got to know when he spent a year at the NBER in the mid-1950's, including Solomon

[18] These aspects were systematized in the influential paper by Levy and Spiller (1994); extensive additional research is summarized by the several contributors to Ménard and Ghertman (2009).
[19] See Ménard (2009) for a detailed analysis of Williamson's evolution on this issue.
[20] This section draws on Menard and Shirley 2011.

Fabricant and Simon Kuznets. We illustrate these early influences graphically in Figure 4.

Figure 4 about here

North began applying neoclassical economic tools to history (and in the process became a founder of the new field of cliometrics), yet he also began to deviate noticeably from a strictly neoclassical approach by incorporating institutions. In 1968 he began his departure from the standard model in his famous paper on productivity in ocean shipping (one of the most quoted research works in economic history according to the Nobel committee). In that paper he argued that technological change did not always play the preeminent role in fostering productivity that most economic historians had claimed (North 1968). Instead a reduction in piracy, the agglomeration of goods in a few large ports, and the increase in populations in larger more organized markets were more important than technology in explaining productivity gains in shipping since 1600.

North began to develop a theory of institutions that he applied to key events in American history in a joint book with Lance Davis, *Institutional Change and American Economic Growth* (North 1971). He also began to analyze European history from an institutional perspective, and increasingly concluded that the tools of neoclassical economics "were not up to the task of explaining the kind of fundamental societal change that had characterized European economies from medieval times onward" (North 1993, p. 3). Rather, he argued that new institutional arrangements such as written contracts enforced by courts were largely responsible for successful European economic development, as he powerfully documented in his 1973 book with Robert Thomas *The Rise of the Western World: A New Economic History* (North and Thomas 1973)

This theoretical framework, which North further developed in his breakthrough book *Structure and Change in Economic History* (North 1981), was useful in explaining European and American history. But North was still not satisfied with its answers to some fundamental questions, such as: why do institutions change? And, why are some countries rich and some countries poor? North's initial framework assumed that institutions were efficient, and that institutions changed when the net benefit from change outweighed the cost. How could these assumptions be true when for centuries most countries have suffered under persistently inefficient institutions causing persistently poor economic performance? North wanted a realistic explanation for why societies choose the institutions they have and why they choose to change them. He abandoned the neoclassical assumptions about human rationality and boldly began to develop economic models that incorporated politics, ideology, and beliefs (North 1990).

In North's seminal 1990 book, *Institutions, Institutional Change, and Economic Performance*, institutional change occurs when those economic or political entrepreneurs who have the bargaining strength to change institutions perceive "that they could do better by altering the existing institutional framework on some margin. But their perceptions crucially depend on both the information the entrepreneurs receive and how they process that information" (Ibid., p. 8). Their information is often incomplete, their models imperfect, and their reforms "path dependent" -- constrained by the existing set of institutions. Radical reforms are also constrained by societies' inherited belief systems. "Societies that get 'stuck' embody belief systems and institutions that fail to confront and solve new problems of societal complexity" (North 1994, p. 6). The sticky nature of beliefs and institutions helps explain why underdevelopment has been so persistent in most of the world and why efforts to reform by importing rules, laws, and constitutions from elsewhere have been so unsuccessful. Shared beliefs do sometimes change, however, and so to understand beliefs better, North turned to cognitive science and its study of how humans use mental models to explain and interpret the world (North 2005, p. 77).

North recently joined with John Wallis and Barry Weingast to modify his earlier framework to explain all of recorded human history (North, et al. 2009). They begin their analysis ten thousand years ago when small groups of powerful elites discovered that by sharing power rather than fighting each other they could increase productivity and thereby, their rents. The elites formed coalitions that included specialists in violence who could protect non-military elites, such as traders or the clergy. Through their monopoly on violence the elites could limit outsiders' access to valuable resources – land, labor, capital – and valuable activities – trade, worship, education, thereby securing their privileged access to rents (Ibid., p. 30). These rents in turn gave the elites an incentive to continue to abide by their agreements to limit violence, creating a stable equilibrium. The result, which North and his coauthors called "limited access orders," have endured and are today the dominant social order -- the "natural state." Limited access orders are the norm; while the open access societies that emerged in Europe after the industrial revolution and that characterize modern developed countries are the exception.

North's theory of open and limited access orders is the latest in his evolving insights about how institutions explain long run economic performance. Such insights have stimulated a large body of applied research. In political science, for example, the new political economy (NIE applied to politics) analyzes how legislative, executive, constitutional, and political party rules explain economic policies and, by inference, economic performance. Initially these studies largely focused on the United States, but recently a wealth of studies have analyzed European and developing and transitional countries. Similarly, case studies of telecommunications, water, electricity, and management of natural resources have analyzed how broader political and constitutional institutions affect sector rules, and how sector rules determine sector performance. Another example is in law and economics, where studies of how the legal system frames market transactions and investor incentives have multiplied since the 1980's.

Applied institutional analysis has focused largely on formal, written institutions, neglecting North's emphasis on societal norms.[21] One exception is Ostrom, who showed the importance of strong social norms and informal procedures for making rules and enforcing sanctions to community and user groups that successfully managed common property. Avner Greif is another institutionalist who treats social norms seriously. For Greif, beliefs, norms, and organizations are as much a part of institutions as Northean rules. Indeed, for Greif institutions are such powerful motivators precisely because they incorporate individuals' beliefs and internalized norms about the world, including their expectations of how others will behave and will expect them to behave. Like Ostrom, Greif is also one of the small but growing groups of institutionalists whose empirical work encompasses both transaction cost economics and institutional analysis. (See for example, Greif 2006.)[22]

[21] The same is true of econometric studies regressing growth on institutional variables. Of 59 such studies that were categorized by Shirley, only 6 dealt with informal institutions, specifically trust and social capital (Shirley 2005).

[22] Another example of this sort of synthesis can be found in the case studies of urban water reform in Shirley, 2002.

IV. The Diffusion of NIE and the Development of ISNIE

During the late 1980's and early 1990's, both the number of researchers attracted to institutional research and the influence of NIE in economics and other fields increased dramatically. We can see this in the growing references to Coase, North, Williamson, and other institutionalists; in the multiplication of presentations and special sessions on institutional research at international conferences; and in the increasing number of publications on institutional subjects in refereed journals.

With the spread of research on NIE an informal network of institutionalists began to emerge. Numerous scholars were attending each other's presentations at meetings in economics, managerial sciences, history, and other social sciences. The birth of this network was further boosted by Rudolf Richter who organized, initially with Eirik Furubotn, an annual research seminar on institutions starting in the Summer of 1983 in Germany.[23] All leading institutionalists attended at one point or another, and their contributions were published in the *Journal of Institutional and Theoretical Economics*. The network was further stimulated by the creation of the *Journal of Law, Economics, and Organization* by Williamson, Mashaw, and Romero, with the first issue published in the Spring of 1985.

Participants in this informal network were very loosely connected, and there were few opportunities for the different schools of thought to interact except through haphazard encounters in formal conferences. The sporadic nature of these encounters prompted some network members to think about organizing more systematic discussions.

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[23] Held in Mettlach for the first two years than in Wallerfangen, under which name the seminar became known.

These early actors wanted to change the dominant economic paradigm by creating a more structured forum for scholarly exchange. They saw this new organization as a way to promote and support new ideas, foster a dialogue between the distinct schools of new institutional economics, diffuse NIE more widely and systematically, and unite NIE's adherents in an effort to transform economics and the social sciences more broadly. They expected the productive dialogues within this new organization would foster collaborative research cutting across the branches of NIE, across international boundaries, and across the disciplines of social science. This dialogue would also encourage more research on topics heretofore only marginally penetrated by NIE, such as research on underdeveloped economies. The resulting organization – the International Society of New Institutional Economics or ISNIE – met many of their early expectations, although much more remains to be done.

In what follows, we briefly review the diffusion of NIE, first through a preliminary statistical analysis showing its growing influence, second through the birth and initial development of ISNIE, which became a major support to that diffusion.

IV.A: *Data regarding the diffusion of NIE*

The rapid diffusion of new institutional economics can be seen in Figure 6 that shows the number of publications with the term ”new institutional economics” in the title, abstract, or keywords according to *Econlit*. As we would expect from our previous discussion, the term does not appear before 1975 and begins to take off in the 1990's and 2000's. Because Figure 6 relies on a database of the economics literature, it does not reflect the perhaps much faster acceptance of new institutionalism in other fields.[24] Most of the publications about NIE are not in journals. Most of the journal articles that do appear are not in mainstream economics journals, reflecting the revolutionary nature of the new institutional movement. According to *Econlit*, over these three decades there was only one article with NIE in its title, abstract, or key words published in the *American Economic Review* (by Ronald Coase in 1998) and one in the *Journal of Economic Literature* (by Oliver Williamson in 2000). The rest of the economics journals generally considered to be in the top twenty had none.

Figure 6 about here

However, if we search in *Econlit* for our three central concepts of NIE – contracts, property rights, and transaction costs -- we better capture the expanding influence of NIE (Figure 7). Of course these terms, particularly contracts and property rights, are not solely found in NIE literature, yet their upward trend partly mirrors the diffusion of new institutional economics over the period.

Figure 7 about here

Finally, we can track the diffusion of NIE through citations of three of its leading scholars, Coase, North and Williamson. Figure 8 shows the same acceleration in citations in the last two decades that we saw in the previous charts. The citations in Figure 8 were compiled by the Web of Science and only refer to journal articles. They probably grossly underestimate the actual number of citations since they do not include references to North's and Williamson's widely popular seminal books.

Figure 8 about here

[24] A search of Goggle Scholar for publications using the term new institutional economics in the title produces over 600 entries (using 'publish or perish' software to eliminate duplicates) compared to 862 in Econlit, despite the restrictive nature of the search (title only).

IV.B: ISNIE, from conception to maturity.

Another important indication of the development of NIE is the progressive organization of its contributors in a society that has attracted a continuously increasing number of researchers, particularly young ones. The creation of ISNIE was influential in the successful development of NIE as a movement. There is no doubt that the ideas of Coase, North, and Williamson would have been hugely influential had ISNIE never existed, but NIE as a movement would have fared quite differently without ISNIE. At the time ISNIE was created, NIE was on the periphery of economics, despite Coase's and North's Nobel prizes. It adherents often were isolated in their departments; most did not succeed in publishing their institutional papers in mainstream journals; and many advised their PhD students that dissertations using the NIE analytical frameworks that they themselves preferred would probably not be accepted by the rest of the university. By bringing a critical mass of like-minded scholars together with new institutionalism's most famous luminaries, ISNIE helped enhance the legitimacy of NIE as a field of scholarship and persuade a wider audience of the validity of its core concepts.

The exact moment when a new movement is born is always difficult to trace. Long before a formal organization emerges there are many preliminary discussions, some of which can be documented through letters, faxes, e-mails (already significant at the time ISNIE was born), and less tangible records such as notes on informal meetings and phone calls. We relied on all such sources to construct the following history of the formation of ISNIE. Figure 9 highlights some of the highpoints of ISNIE's history; we provide more details in the appendix. Below we briefly summarize the main events.

Figure 9 about here

IV.B.1. Preliminaries: 1991-1995.

New institutional economics received an important stimulus when 'the Central Bank of Sweden Prize in Economic Science in Memory of Alfred Nobel' was awarded to Ronald Coase in 1991 and to Douglass C. North only two years later. Two Nobel prizes in such a short time span attracted worldwide attention to an area of research that had been largely ignored or undervalued by many economists and social scientists. Of course, not all this attention was favorable; some commentators were quite critical of these unorthodox choices. But the prizes heartened many early institutionalists and prompted others to investigate this new field.

Meanwhile members of the informal network of institutionalists that we described earlier began to discuss the possibility of formalizing ties. Noteworthy in these developments was a one-day conference organized by Claude Ménard in Paris on May 26, 1994, and followed the next day by an informal meeting in which participants considered the idea of a formal network. Douglass North was particularly supportive of the idea.[25] Another important event was the Wallerfangen symposium on NIE organized by Erich Schanze in June 1995, on "Transformations in the Institutional Structure of Production." A mix of scholars attended and the conference's size favored intensive exchanges. The participants once again discussed the possibility of a more active network, which was particularly favored by the younger participants.

In the following months, things accelerated, as we summarize below.

[25] Paul Joskow and Oliver Williamson were two other leading NIE figures who participated actively in this event. The conference received organizational support from Eric Brousseau and Jean-Michel Glachant, who became two entrepreneurial figures at ISNIE.

IV.B.2 The emergence of a project: 1995-1996.

Ménard continued the discussions about a better organized network with North, Williamson and others at Washington University in St. Louis in 1994. Lee and Alexandra Benham later suggested holding a series of mini-seminars and the first one was scheduled for April 1996 at Washington University. This mini-seminar turned out to be an important stimulus to the creation of ISNIE. Following the discussion of scientific papers, the group explored the possibility of a more formal network and most of those present agreed that gains could be expected from a better organized network.

The following months saw extensive exchanges between the Benhams, Ménard, and Shirley. The group drafted a letter to invite interested scholars to join a new society for NIE and the Benhams asked Coase and North, as Nobel laureates, to sign it. The Coase-North letter was issued on October 4, 1996, and emphasized the international dimension of the network as well as the diversity of disciplines involved.

The core group[26] pushed forward the formation of the new society, recruiting Ronald Coase to be the first President, and North, Williamson, and other well-known scholars to join the Board.

IV.C. The St-Louis Conference and the formal birth of the Society

The core group also decided to hold the first meeting of the new society on September 19-21, 1997 at Washington University and issued invitations to a conference to discuss a theme suggested by Ronald Coase: "The Present and Future of the New Institutional Economics."The group was taken aback by the enthusiastic response from leading scholars, many of whom promptly accepted the invitation to the conference. The core team devoted itself to the program for the conference, with Lee and Alexandra

[26] Alexandra Benham, Lee Benham, Claude Ménard, and Mary Shirley.

Benham shouldering the logistical and some of the financial burden of an event that attracted much more interest than expected. Simultaneously the team also intently discussed the organization of the society and its governance, including (1) structure of the society (constitution and by-laws, president, board, staffing and allocation of responsibilities if there were to be two headquarters, one in St-Louis, the other in Paris); (2) communications with members (yearly meetings, newsletters, websites); (3) budget and fund raising; and (4) next meeting (Paris, September 1998; themes to consider as top priorities). John Drobak offered to do the legal work to establish the new society.

Ronald Coase remained remarkably supportive through the whole process, sending letters to foundations to raise money, proposing new themes, suggesting the organization of sessions at different meetings of international associations, etc. His enthusiasm generated very positive externalities for the core group as did the support of leading figures such as Douglass North and Oliver Williamson.

ISNIE's first meeting in St. Louis was a huge success. Enthusiasm and participation far exceeded anything that had been anticipated. The Benhams were swamped, but did a wonderful job organizing the event without supporting staff or adequate funds. At Ménard's suggestion, Coase, the Benhams, Ménard, and Shirley met informally on Sunday after the conference to discuss final arrangements. The group proposed a provisory structure with Benito Arrunada, Lee Benham, Ronald Coase, Harold Demsetz, John Drobak, Scott Masten, Claude Ménard, Douglass North, Rudolf Richter, Mary Shirley, Barry Weingast, and Oliver Williamson, as members of the Board, with Benham, Drobak, Ménard and Shirley acting as the Executive Committee. Although still legally nonexistent, the new Society was born.

IV.D Taking off: 1998-2001

The months following the St. Louis meeting were devoted to the formal creation of the Society and the organization of the second conference to be held in Paris, September 18-19, 1998. Meanwhile John Drobak was working hard in St-Louis to get ISNIE incorporated as a Missouri Nonprofit Organization (filed on February 24th), and to produce minutes, bylaws, and other legal documents in March and early April.[27] The Benhams, Drobak, Ménard, North and Shirley met in Washington DC, on April 8 to discuss details of the organization of the society (election of the Board, headquarters, membership payments, funding etc.) and to plan the program for the upcoming Paris Conference. Thanks to North and Coase, funds were raised from several foundations, which helped establish its headquarters at Washington University in St-Louis[28] and provided some financing for the Paris Conference. The second conference was another huge success: 250 scholars from 30 countries attended, including most of the leading figures in NIE. A book of selected papers delivered at the conference gives a good sense of the main issues preoccupying NIE researchers at that time.[29]

Around this time tensions also began to develop, no surprise for a young and rapidly expanding organization. One issue was whether ISNIE should be a single international society with directly affiliated members or should there be regional or even national branches to take advantage of local initiatives and meet local needs? There was already a European branch (ISNIE-EUROPE) which had been started at the time the

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[27] Bylaws, Minutes of the first Meeting of the Board of Directors (with all the names already mentioned on the Board and Benham, Drobak, Ménard, North and Shirley on the Executive Committee) and application with the Internal Revenue Service for a non-profit status (confirmed on May 14, 1998).
[28] For the first two years, Mary Drobak provided most of the services on a voluntary basis.
[29] *Institutions, Contracts, and Organizations: Perspectives from New Institutional Economics*. (Ménard, ed., 2000)

society was being established in the U.S. and had been developing its own activities. Despite this early initiative, the members eventually decided that ISNIE should be a single international organization. The second and more serious issue was whether the society should be a scientific association similar to other academic societies focused primarily on its annual conference as its tool to diffuse the themes and improve the quality of NIE research. Or should ISNIE be a proactive organization, going beyond the annual meetings to support specific research programs and training for younger scholars? Debate became heated in the Fall of 1999 after another successful ISNIE conference was organized by Mary Shirley in Washington, D.C., a meeting that again attracted a large crowd.

Ronald Coase increasingly favored a more proactive organization that would support and encourage younger scholars and support specific research projects, particularly those analyzing issues in developing and transitional economies. Even before this issue arose, he had raised funds from private foundations to subsidize the travel of such scholars to the 1998 and 1999 ISNIE meetings. And in the Fall 1999 *Newsletter* of the Society, a publication prepared with great editorial care by Alexandra Benham from its beginning in 1998 until its end in 2003, Coase said that the aim of ISNIE should be to transform economics, indicating his preferences were for a more proactive approach. This issue was resolved in February, 2000, when, with the support of Ronald Coase, Alexandra and Lee Benham, Claude Ménard, and Mary Shirley created the *Ronald Coase Institute*, "to support research and to assist scholars in New Institutional Economics, with an emphasis on Developing and Transitional Economies" (Draft from February 23, 2000). From then on, the two entities would evolve separately, each specializing in their own mission.[30]

ISNIE continued to prosper and mature. At the initiative of Oliver Williamson, ISNIE's third President, the Board agreed to change the statutes of ISNIE to better organize the Board and elect the president for one year instead of two (North presided for two years and Williamson was expected to do so as well), and to create a president-elect in charge of organizing the Annual Conference before becoming president. A Board meeting held in Berkeley in early February 2000 confirmed the new arrangement,[31] stabilizing the organization of ISNIE. It can be said that ISNIE then entered its mature phase as an academic society, with its annual conference a lively occasion of exposition and exchange of ideas among a very motivated and evolving crowd of participants.

V. Successes and Challenges

The birth and rapid development of the society (ISNIE), and the steep increase in references and citations related to NIE show how quickly new institutional economics spread, but tell us little about the impact NIE has had on economics in particular and on the social sciences more broadly. Ultimately, the acceptance of a new approach depends on the quality of its arguments and evidence and on the motivation of contributors to explore new frontiers. In impact too NIE has been successful beyond most people's expectations, to the point where its growing acceptance has proved a mixed blessing in some ways.

V.A. The Growing Acceptance of NIE: A Mixed Blessing?

[30] Today the Ronald Coase Institute provides training, mentoring, and other support to young scholars and maintains a network of almost 400 institutional researchers.
[31] The formal amendment was registered on February 11, 2000 and the Bylaws modified accordingly.

Although there were preliminary signs of a growing influence in the 1980's, NIE really began to spread among mainstream economists and scholars from other fields in the 1990's. It was then that it began to attract great interest among scholars in political science, management, law, sociology, and anthropology, among others. Yet there is still continued resistance and even total ignorance of institutional concepts among too many scholars, particularly in economics.[32] Papers still appear in prestigious journals on the cost of trade without any reference to Coase or transaction costs, or on the factors determining growth, without any reference to institutions or to North.

Nevertheless, the speed of NIE's dissemination has been striking. Initially the school of institutional analysis identified with Douglass North captured a wider audience, although Coasian-Williamsonian ideas were highly influential in specific fields such as industrial organization, managerial science, and law and economics. This different rate of acceptance could be because the collapse of the planned economies opened a Pandora Box of choices among institutions for building a market economy and Northean analysis could help inform these choices. Northean analysis was also useful for explaining underdevelopment, prompting considerable enthusiasm among the aid community (who conveniently ignored North's argument that institutional change is slow and requires societies' to alter shared beliefs and norms that are not usually susceptible to outside intervention). Despite increasing acknowledgement that transaction costs were relevant in explaining vertical integration, the Coasean-Williamsonian approach enjoyed a slower pace of acceptance. This could be because, in its broader meaning, this approach posed a direct challenge to the dominant paradigm, overturning entire segments of standard

[32] There were astonishing reactions to the award of the Nobel Prize to Ostrom and Williamson in that respect.

micro-economics and possibly its foundations. The Northean analysis, in contrast, explored largely new territory and seemed to avoid some of these frictions, although as we argue below, this was probably illusionary.

This changed in the 1990's and 2000's when an upsurge of papers drew on Williamson's ideas for testing transaction costs hypotheses about vertical integration and, to a lesser degree, hypotheses about non-standard modes of organization or hybrids.[33] The Williamsonian approach also became very influential in analyses of marketing, strategic behavior, and other managerial issues, while Coasian themes permeated the 'Law and Economics' research that Coase had promoted as the long time editor of the *Journal of Law and Economics*. Ostrom and her analysis of collective action and its institutional embeddedness in the economics and politics of natural resources and environmental issues also became increasingly influential during this period. (Many other contributors to NIE could be added of course.)[34]

In the 1990's there was also an upsurge in papers by mainstream economists that incorporated institutions into neoclassical models, prompting John Nye to comment sardonically, "We are all institutionalists now." Typically these papers adapt a standard macroeconomic growth model by adding institutional variables to cross country regressions.[35] In 2008 Shirley counted 59 studies finding significant correlations between long run growth in GDP and such institutional variables as property rights, political

[33] Partial surveys are provided in Shelanski and Klein (1995), Klein (2005), Ménard (2004a; 2011).

[34] Leading figures contributed to *The Handbook of New Institutional Economics*, and references provided in their different chapters substantiate the richness of analysis already available at the time the book was published. This can be completed by the collection of papers in Furubotn and Richter (1991), in the seven volumes by Ménard (2004b), in Brousseau and Glachant (2008), and in the synthesis already proposed by Furubotn and Richter (1997)

[35] These papers were part of the rise of new growth economics, which began in the mid-1980's when macroeconomic models began to take an interest in the hitherto neglected issue of long-run growth (Sala-I-Martin 2002) . In addition there is a political science literature regressing growth on democracy that includes studies dating back to the 1960's which is not considered here.

freedom, economic freedom, civil liberties, institutions supporting cooperation such as trust and religion, and (negatively) political instability (Shirley 2008, p. 81).

"Institutions" in most of these correlations are not specific rules or norms, but broad abstractions, aggregates of experts' subjective rankings of corruption in government, bureaucratic quality, rule of law, freedom of expression, or similar generalizations that the authors claim are clusters of institutions or proxies for institutional quality.[36] But regardless of what these variables measure, even when different measures from different sources are used, they have statistically robust and arithmetically large correlations with long-run growth (See Shirley 2008, p. 80). These strong correlations explain why [some] "Growth economists who, as mentioned earlier, used to rely almost uniquely on pareto-optimal-complete-market-perfectly competitive neoclassical models, now systematically abandon their traditional paradigms **without being ashamed** and they discuss the role of institutions **without thinking they are doing second-rate research**" (Ibid., p. 17, emphasis added).

This popularity is a mixed blessing because it has sometimes been accompanied by misinterpretations and distortions of NIE's main ideas. The studies using broad institutional proxies in cross country growth regressions seem at odds with NIE's emphasis on the need to measure and understand specific institutions. They often ignore the unobserved beliefs and rules that determine how observed rules and laws function in practice (Greif 2006 pp., 20-21), and defy North's admonishment that identical laws or

[36] As proxies these variables have serious drawbacks. One is that they reflect contemporary institutions yet are being used to explain growth over decades and even centuries. Another drawback is that they measure outcomes (e.g. secure property rights) of many different institutions rather than a set of specific rules or laws, making the exercise seem rather tautological (Shirley 2008, p. 80). And they measure observable institutional characteristics, ignoring the unobserved beliefs and norms that are crucial to how observed rules and laws function in practice (Greif 2006, pp. 20-21). In practice identical laws or rules, be they laws guaranteeing property rights or rules defining electoral procedures, produce very different outcomes across countries.

rules produce very different outcomes across countries. These early and crude attempts to analyze institutional effects using broad proxies in cross country growth regressions have evolved into more sophisticated models, as exemplified by the work of Daron Acemoglu, Simon Johnson, and James Robinson (2001, 2002, and 2005). Acemoglu, Johnson and Robinson employ the same broad institutional indices as other studies but they also exploit detailed historical measures of settler mortality, urbanization, and population density and a case study of Korea to argue that difference in economic institutions are fundamentally responsible for differences in long run economic growth.

The enthusiasm for institutions among some macroeconomists touches on the broader question of whether NIE is a mere modification of the standard neoclassical model or a new paradigm, which we consider next.

V.B. Is NIE a departure from or an annex to the standard neoclassical model?

The widening recognition of the relevance of NIE, certified by four Nobel awards within 15 years, raises the question: Is NIE a modification of the standard neoclassical model, or is NIE a new paradigm? North, Williamson, and other early new institutionalists did not argue that they were creating a paradigm that overturned the standard neoclassical model. To the contrary, one of the things that distinguished new institutional economics from earlier institutional economics was NIE's acceptance of the positive contribution of neoclassical economics to our understanding of the impact of scarcity and competition as well as the acceptance of the usefulness of the tools developed for analyzing what Williamson, in his presidential address to ISNIE (Williamson, 2000) qualified as second-order issues (see also Furubotn and Richter 1997). True, a central assumption of standard neoclassical models was overturned at the dawn of NIE with Coase's insistence that positive transaction costs could not be assumed away without ignoring the very reason why firms exist. Moreover, because of transaction costs, property rights can no longer be perfectly defined, nor can contracts, giving rise to risk and ex post opportunism; the latter was never seriously contemplated in the standard neoclassical model. Yet some of the early NIE literature assumed that Coase's profound ideas could be accommodated in the neoclassical model through a few, marginal modifications. One tentative modification was bounded rationality: people's choices are constrained by costly information and the limits of their cognitive competence, but they still "act consistently with their preferences when presented with alternative opportunity sets" (Eggertsson 1998, p. 18). These opportunity sets are themselves defined by institutions, especially the legal system, since institutions determine property rights. But gradually it has become apparent that positive transaction costs do not just modify the neoclassical paradigm at the margin, they transform it; they "produce an economic universe that is *strikingly different* from the one envisioned in neoclassical economic theory" (Furubotn and Richter 1997, p. 445 italics in original). The implications of this transformation have not always been fully recognized by institutionalists, and as a consequence some NIE studies employ contradictory assumptions of zero transaction costs and positive transaction costs in the same model.[37]

[37] In some models of management, for example, the decision makers evidence limited information and bounded rationality about some matters yet are perfectly informed and make rational choice decisions about others. For example, corporate shareholders are assumed to have limited information about management because of high monitoring and enforcement costs, giving a manager the freedom to pursue her independent interest at shareholder expense. But the manager in these models is implicitly assumed to be completely rational with precise knowledge about how to maximize her own welfare (Ibid.). Similar contradictions arise in principal/agent theories where the principal cannot acquire the costly information to monitor the agent fully, but is perfectly informed about the agent's characteristics and type (Furubotn and Richter 1997).

As emphasized by Coase in his Nobel lecture (Coase, 1992), even the earliest assumptions of NIE fit uncomfortably within the standard model; more recent ideas work even less well as adaptations of the neoclassical paradigm. The new transaction cost paradigm posed serious challenges to the mainstream approach to regulation (Joskow, 2002; Ménard and Ghertman, 2009). And it would be a tough stretch for the neoclassical paradigm to absorb the concept of bounded rationality or integrate opportunism in its models. It would be even more of a stretch to include the idea that learning is filtered through mental models shaped by individual experience and society's shared beliefs and norms. Does it enhance our understanding of behavior when we characterize such individuals as maximizing preferences within a constrained opportunity set? And should we, as North argues, build dynamic models of economic evolution that transform the standard neoclassical model? Or, to take another example, earlier NIE posited a binary decision between markets and firms, now it incorporates a host of hybrid modes of organizing with very different governance characteristics. Are these choices well specified by simply incorporating transaction costs into a standard model? Do we, as Williamson contends, need to substitute discrete structural analysis for standard marginal analysis? Despite these drawbacks to the standard model, many important concepts of the classical paradigm, such as scarcity and competition, are central in both neoclassical and new institutional economics. And, although NIE's emphasis is unambiguously on substance, new institutionalists fully acknowledge the relevance of modeling and the importance of appropriate methods, such as econometrics and experimental economics, to test its core propositions.

The likelihood is not that NIE will offer a successful alternative to the standard neoclassical paradigm but rather an expanded paradigm that incorporates much of the standard model but goes well beyond it. Few institutionalists would be ready to claim that NIE offers a fully articulated, expanded paradigm today. But the creation of ISNIE has made the prospect of such an expanded paradigm far more attainable.

Conclusion: A Research Program for the Future

An expanded paradigm would require a more unified theory of institutions than now exists. Because of NIE's openness to many disciplines, there are conflicting theories and even conflicting definitions of institutions. Even among economists, NIE still shows evidence of its decentralized beginnings. In particular there is no theory describing satisfactorily the interaction between the North's institutional framework (the scaffolding for human transactions) and Williamson's structure of governance (the matrix in which the integrity of a transaction is organized). Any synthesis between these two schools of thought must address a lot of issues (see Ménard 2001) that will likely shape much future research. One central question is: how do the (Northean) rules that determine the security and functioning of property rights or the laws that affect contractual credibility and enforcement shape the choice of (Williamsonian) modes of governance and of the ways to organize transactions? A related question is: what are the comparative costs of different institutional schemes, such as different judicial systems for implementing contractual laws?

Besides the need to bridge the gap between the general institutional framework and specific transactions and modes of governance, there are other research areas where

NIE is still underdeveloped. One such area is innovation, specifically: how do different modes of organizing transactions at both the microanalytical level and at the level of the institutional framework affect the development of capabilities and the dynamics of innovation? Related to this question is the enigma of institutional change. Institutional change is far from fully explained in NIE, and some aspects of the theory make it seem almost impossible. Yet profound changes in institutional frameworks do happen, and long standing beliefs and conventions do change, sometimes abruptly.[38] The whole area of informal institutions -- belief, norms, conventions, and the like – needs further work. There has been some progress in treating these less tangible institutions more rigorously, helped by the growing popularity of behavioral economics and neuroeconomics, but they are still not well incorporated into most institutional theories or analyzed seriously in most NIE empirical research.

Methodology is another underdeveloped area. Most of the models used in the NIE literature are uncomfortable adaptations of standard neoclassical models with the inconsistencies mentioned earlier. Some institutionalists, such as Greif and Ostrom, have made considerable progress using game theory; experimental economics is also yielding promising results. One challenge to the model builder is NIE's stress on realism and detail, which greatly complicates the modeling problem. The challenge of realism has also required many institutionalists to develop their own datasets, see for example the database of political institutions created by institutional economists at the World Bank[39] and to engage in extensive field research, vividly illustrated by the tremendous body of field work done by Elinor Ostrom and her followers.

[38] For example, the convention in China of foot binding, which had been practiced for millennia, was ended in a decade (Mackie 1996).
[39] See: http://go.worldbank.org/2EAGGLRZ400

NIE has also made considerable progress using focused case studies; think of Coase's study of the FCC, Williamson's study of Oakland's CATV, North and Weingast's study of the Glorious Revolution, Ostrom's comparative case studies of common property systems, Levy and Spiller on the telecommunication industry, and all the studies collected in *Analytic Narratives* (Bates, et al. 1998). Despite the poor opinion that most mainstream economists have of case studies, they have proven to be a valuable tool for understanding the rich details inherent in institutional analysis, especially when they are informed by theory and conducted with rigor.

The rising popularity of new institutional economics that we have documented in this paper is only part of the story. There is still continued resistance to NIE in some quarters and, even worse, total ignorance of the issues at stake among cohorts of young scholars, particularly in economics.[40] To illustrate, it is still possible in this beginning of the 21st century to publish papers in prestigious journals on the cost of trade without considering transaction costs and without reference to Coase or Williamson, or on development without reference to institutional factors determining growth or to North. In thinking about the future relationship between NIE and standard mainstream economics we can be guided by the words of the person who, more than any other, started this field, Ronald Coase:

> The influence of New Institutional Economics will be exerted in the various sub-disciplines of economics. Guerrilla actions will take place which will result in the New Institutional Economics dominating first one and then another of these sub-disciplines, as indeed is beginning to happen. When this process has gone on for

[40] There were astonishing reactions to the award of the Nobel Prize to Ostrom and Williamson in that respect.

some time the leaders of our profession will find themselves Kings without a Kingdom. There will be no overturning, but in Judson's words, an opening-up.[41] We will not replace price theory (supply and demand and all that) but will put it in a setting that will make it vastly more useful (Coase 1999).

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[41] Judson refers to Horace Freeland Judson, *The Eighth Day of Creation: Makers of the Revolution in Biology*, New York: Simon and Schuster, 1979.

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Figure One: Key Concepts of NIE

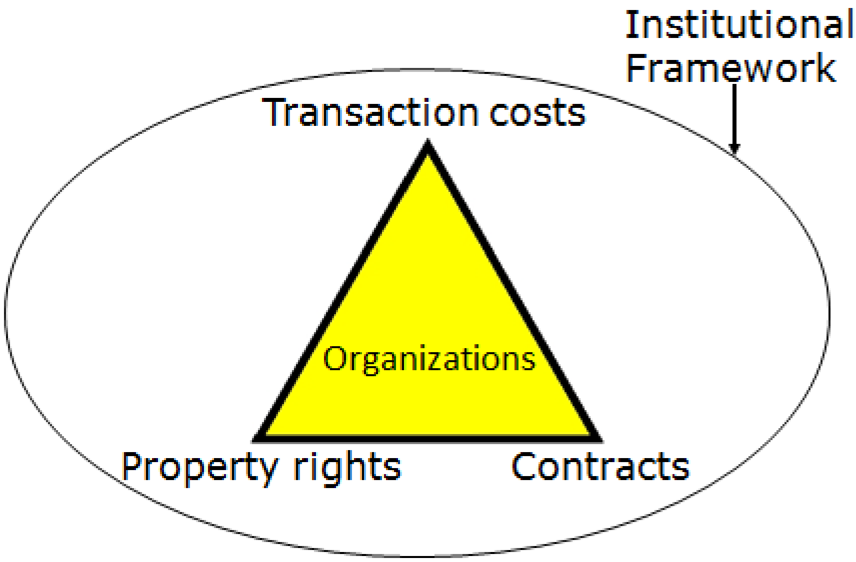


Figure 2: Origins of Early Ideas

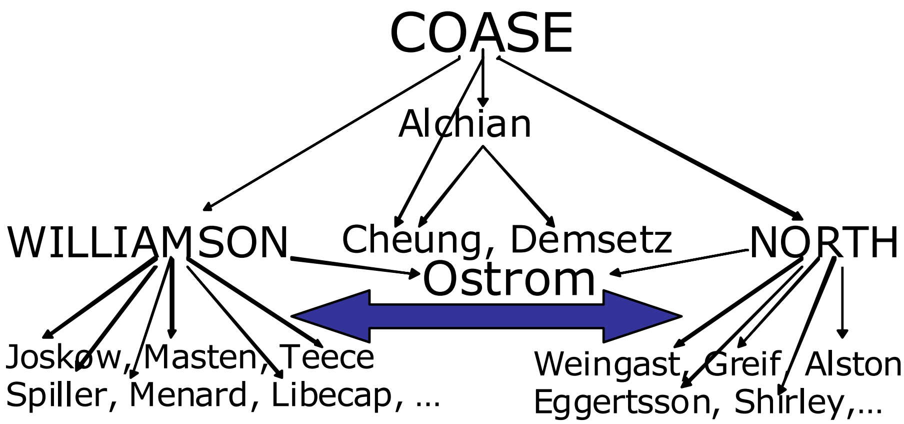


Figure 3: Origins of the Williamsonian School

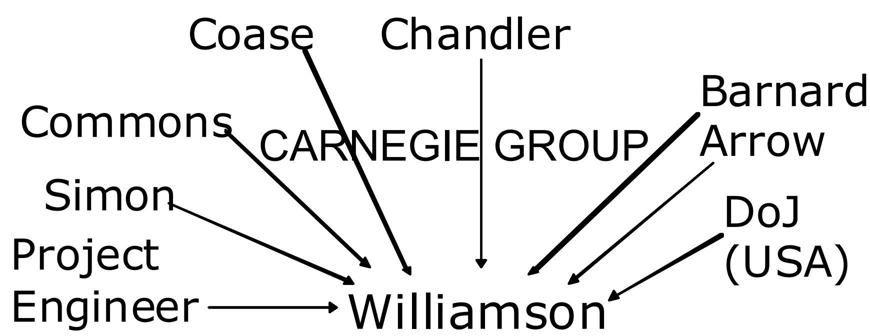
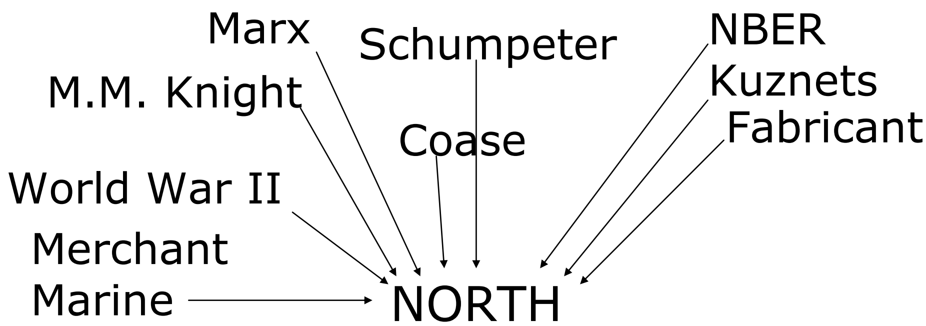


Figure 4: Origins of the Northean school



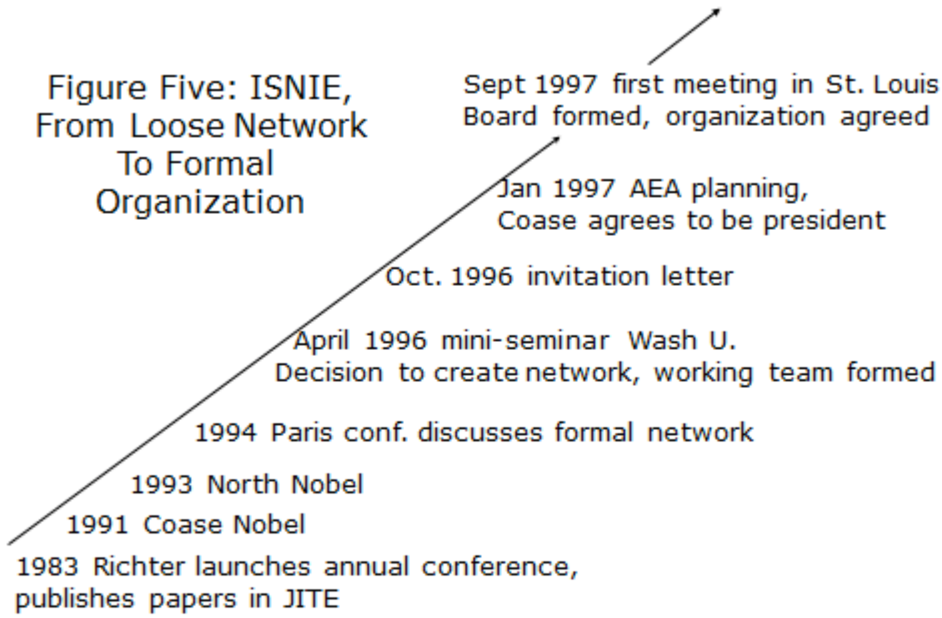
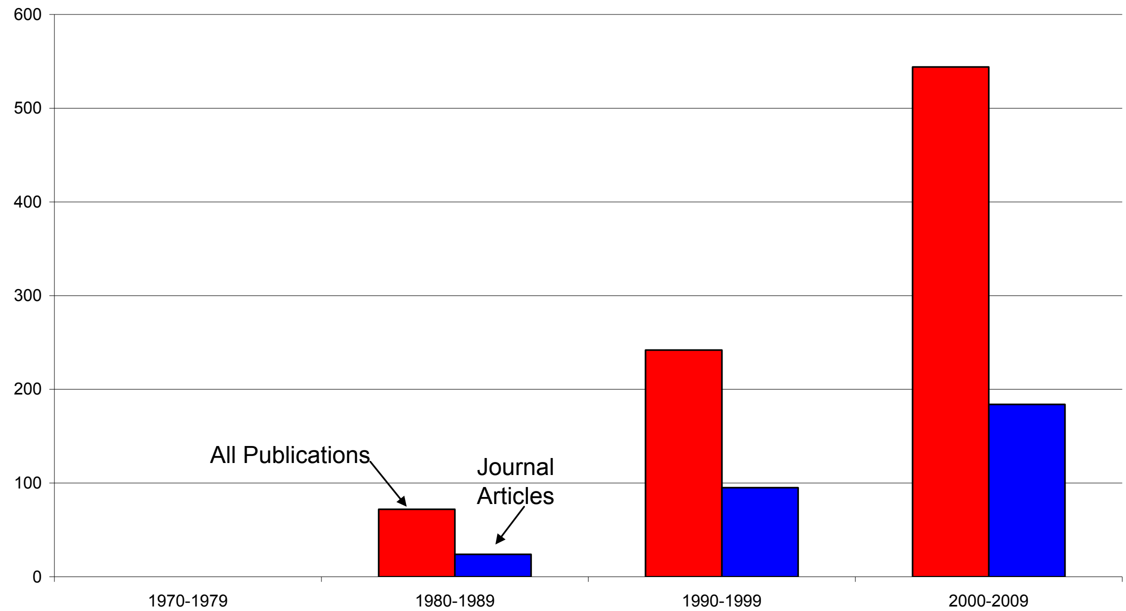


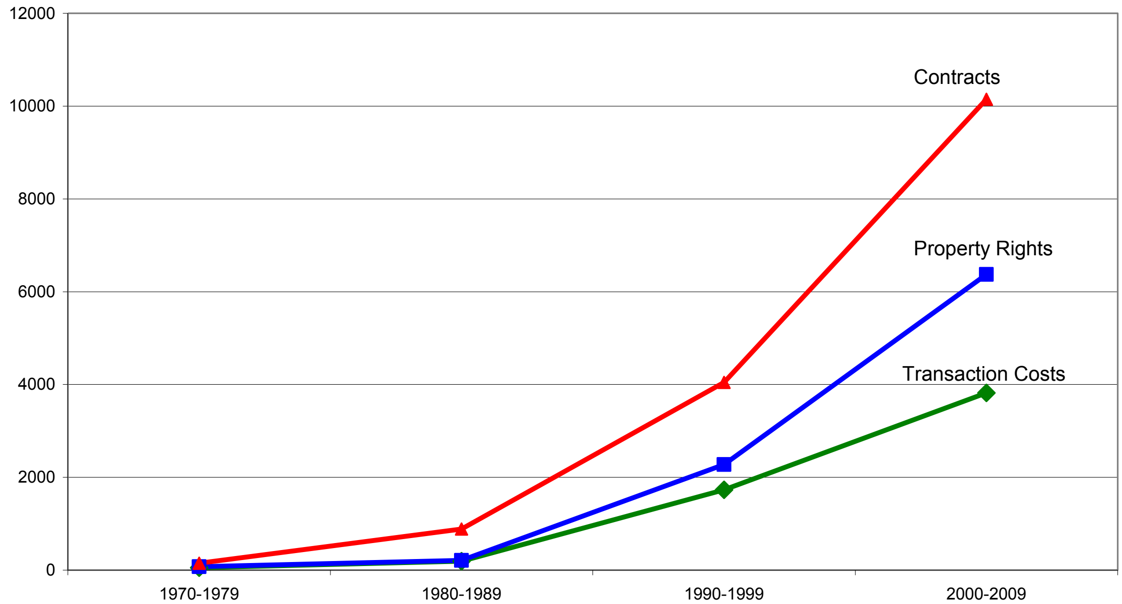
Figure Five: ISNIE, From Loose Network To Formal Organization
Sept 1997 first meeting in St. Louis
Board formed, organization agreed
Jan 1997 AEA planning,
Coase agrees to be president
Oct. 1996 invitation letter
April 1996 mini-seminar Wash U.
Decision to create network, working team formed
1994 Paris conf. discusses formal network
1993 North Nobel
1991 Coase Nobel
1983 Richter launches annual conference,
publishes papers in JITE

Figure 6: Number of Publications with "New Institutional Economics" in Title, Abstract, or Keywords
(According to Econlit)



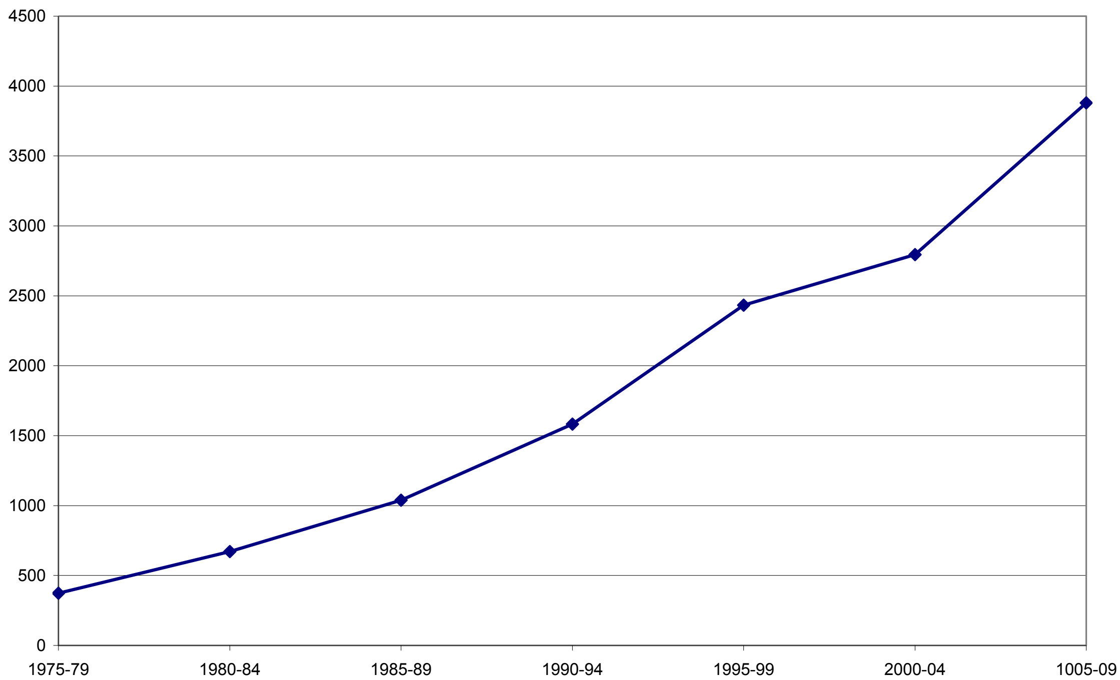
Source: Authors' calculations based on Econlit: : www.aeaweb.org/econlit.

Figure 7: Number of Publications with Central NIE Concepts in Title, Keywords, or Abstract
(according to Econlit)



Source: Authors' calculations based on Econlit: www.aeaweb.org/econlit.

Figure 8: Citations of Coase, North, & Williamson, 1975-2009
(Articles only)



Source: Authors' calculations based on Web of Science.

Appendix:
ISNIE: From Conception to Maturity

DATE	EVENT
1991	Ronald Coase wins Nobel Prize
1993	Claude Ménard initiates preparations for a conference on transaction cost economics at Sorbonne in Paris
1993	Douglass North wins Nobel Prize
May 26, 1994	Conference at Sorbonne organized by Claude Ménard with assistance of Eric Brousseau & Jean-Michel Glachant attended by North, Williamson, Joskow, and others active in NIE.
May 27, 1994	ISNIE MILESTONE: Conference attendees discuss the idea of a formal network, idea strongly supported by Douglass North
June, 1994	Wallerfangen symposium on NIE organized by Erich Schanze; over 50 attendees; discusses possibility of formal network.
April, 1995	Ménard visits Washington University in St. Louis, further discussion of a network with North and Alexandra and Lee Benham. Benhams suggest mini-seminars to promote further discussion; Ménard proposes that his group in Paris, ATOM, might produce an e-letter linking NIE scholars
April, 1995-April, 1996	Dispersed discussion continued between Ménard and Benhams
April 13-14, 1996	ISNIE MILESTONE: "Conference on Contracting," First mini-seminar organized by the Benhams at Washington University in St. Louis with Claude Ménard. Other attendees included: Ronald Coase, Keith Crocker, Jean Ensminger, Scott Masten Mary Beth Mohrman, John Nye, Mary Shirley, Mike Sykuta, and other researchers and young scholars from St. Louis. Discussion of possibility of formal network.
April - October, 1996	Extensive exchanges between Benhams, Ménard, Shirley. Propose formal letter of invitation to join network and Benhams to ask Coase and North as Nobel laureates to sign it. Ménard is asked to develop a European network.
September 12, 1996	Ménard issues a letter inviting interested parties to send information for the first e-letter of the European Network, which started being diffused on the net that Fall.
Sept. 19, 1996	Shirley writes a draft letter of invitation for Coase & North signatures that mentions "Society for NIE".
October 4, 1996	ISNIE MILESTONE: Letter of invitation to join a new society signed by Coase & North is circulated to large group of NIE scholars.
January, 1997	Core group of Benhams, Ménard, Shirley take advantage of AEA meetings in New Orleans to push agenda forward with North, Williamson and others. Core group decides to hold the first meeting of the network in St. Louis in 1997 with Alexandra and Lee Benham taking responsibility to organize it.

Date	Event
January 3, 1997	North hosts dinner to discuss board composition, structure, etc. of the new organization (attended by Benhams, Crocker, Ménard, North, Shirley, Sykuta).
January 4, 1997	Benhams, Ménard, Nye, Shirley meet informally to discuss governance details.
January 5, 1997	Benhams, Ménard, Shirley inform Williamson of the earlier discussions and ask for his support and participation in the governance. He later agrees.
8-Jan-97	ISNIE MILESTONE: Ronald Coase agrees to be first ISNIE President
Feb - Sept, 1997	Core team in constant contact about organization of meeting. Mike Sykuta implements on-line registration at U. Pittsburg. Surprisingly large amount of registrations. John Drobak offers to do legal work to establish new organization. Strong support and active involvement of Coase.
September 18, 1997	ISNIE MILESONES: Small planning meeting with Coase, core team of Benhams, Ménard, and Shirley, and Alston, Arrunada, Brousseau, Crocker, Dnes, Ensminger, Glachant, Keefer, Levi, Nye, Sened, Sykuta, Yen, Zylbersztajn held in afternoon. Formal planning meeting that evening with Coase, Arrunada, Benhams, Demsetz, Drobak, Masten, Ménard, North, Richter, Shirley, Weingast, Williamson. Meeting accepts core team proposal of a provisory structure with board of directors (Arrunada, Lee Benham, Coase, Demsetz, Drobak, Masten, Ménard, North, Richter, Shirley, Weingast, and Williamson) and executive committee (Lee Benham, Drobak, Ménard, Shirley). North agrees to be president following Coase and to serve two years.
September 19-21, 1997	ISNIE MILESTONE: First meeting held in St. Louis, organized by Alexandra and Lee Benham without supporting staff or adequate budget. Participation and enthusiasm far exceed expectations.
February 1, 1998	Formal non-profit association registered in Paris as Association Internationale d"Economie Neo-institutionnelle or AINEI. Organizers are Ménard, Brousseau, Glachant, and Saussier.
February 24, 1998	ISNIE MILESTONE: ISNIE formally incorporated as Missouri Nonprofit Organization; documents filed by John Drobak
February - Sept., 1998	Drobak produces bylaws, minutes, and other legal documents. Core team begins preparation for upcoming Paris conference. Funds raised from foundations by Coase and North. Headquarters established at Washington University in St. Louis. Mary Drobak serves as secretary on voluntary basis. Alexandra Benham begins producing newsletter.
April 8, 1998	Benhams, Drobak, Ménard, North and Shirley meet in Washington DC to discuss details of organization and plan program for Paris conference.
September 18-19, 1998	Second conference, organized by Claude Menard, is held in Paris, chaired by Douglass North. Ronald Coase made Doctor Honoris Causa from Sorbonne. 250 scholars from 30 countries attend. See Ménard, ed. 2000 for some of the papers presented and a sense of the main issues preoccupying NIE researchers.

Date	Event
September 16-18, 1999	Third meeting, organized by Mary Shirley, is held in Washington, DC.
Sept., 1999 - Sept. 2000	Issues arise over whether to have regional or national branches or one single society (decision is single society), and whether to focus primarily on annual conference or take a more proactive approach to support younger scholars (decision is annual conference).
February 2000	Creation of 'The Ronald Coase Institute'. First directors are: Lee Benham, Claude Ménard, Douglass C. North, Mary M. Shirley, with Ronald Coase acting as scientific advisor and Alexandra Benham as Secretary to the Board. (Later, Kenneth Arrow, Gary Libecap and Elinor Ostrom join the Board).
February, 2000	Board decision to change statutes to better organize board, elect president for one year, and create position of president-elect in charge of organizing conference.