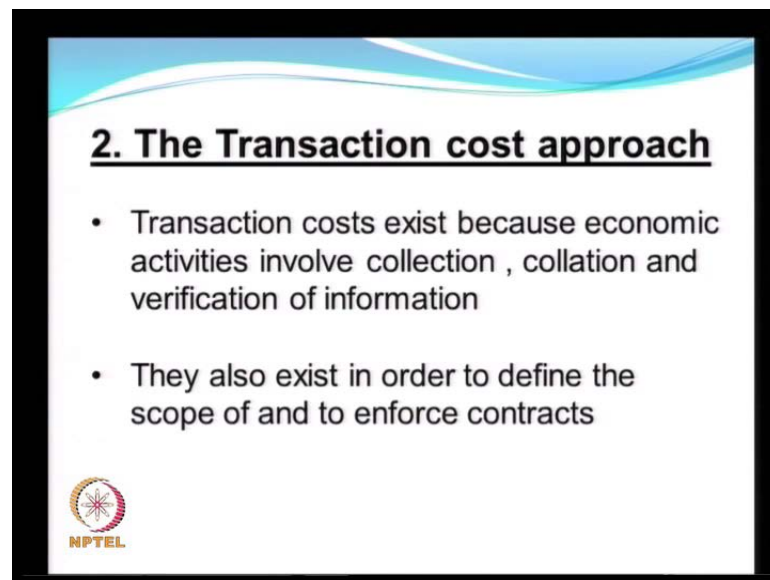


History of Economic Theory
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Lecture No. # 32
Transaction cost and Economic Anthropology approaches

We now get on to talking about, Transaction Cost approach to institutions.

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The idea of transaction costs goes back to the work of Robert Corse in 1937, towards a theory of the firm; where he talks about transaction costs involved in the way the firm operates on a day to day bases. Much later, Corse was to write a paper, which was (()) in 1960's on again transaction costs.

The underlying principle of talking about transaction costs is that contrary to the belief in new classical or standard or orthodox economics, that collecting collation and verification of information by firms is costless. And similar, activity by individuals in the market is costless, contrary to this belief that it is all costless; in reality, all these are costly activities involving expenses. And the bringing in of these costs considerably transforms the analysis of the economic activities themselves.

The simplest market that is conceivable of course is a Walrasian market, where there are zero transaction costs, underlying the assumption of perfect knowledge. But in all non Walrasian situations, which means in all real life situations, every economic actor has to spend time, energy, and resources on acquiring information, with there is a simply question of how to get from one place to another or whether is a question of how to invest some 100's of 1000's of rupees.

Every information, every piece of information is costly; in the sense that it involves a cost of collection; it involves a cost of compilation, and a cost of collation, and cost of elaboration and verification. More generally therefore, all transactions involved costs of various types, these transactions costs vary, but in order to look at in greater detail, we should know also the transaction cost not only relative information.

In other words, there are not only information costs, but the conduct of transactions themselves involved all kinds of costs. The best example of such costs is what, later came to be known as Corsican externalities, Robert Corse discusses a very interesting scenario of two producers, occupying two adjacent plants of land.

One of them owned by a confectioner, and another owned by a man who runs a hospital, the confectioner has a job of pounding flour everyday, to make bread and then baking it and making bread. The man, who runs a hospital of course, has a job of curing people haling them, treating them, and getting them well back home as fast as possible.

However, the confectioner has to pound the flour, to grind the flour, in order to get it ready to a bit, and this is a noisy and disturbing activity. And hospital owner finds that this is expensive, in terms of the trauma that it causes in a student I am sorry, in his patients and in the disturbance that it causes among the patients and so on, and so forth, so it is a costly thing.

So, question is either the confectioner has to relocate, for which the hospital owner has to compensate or the hospital has to relocate, and confectioner has to compensate. How expensive this process of getting, either one of them to relocate depends upon what kind of legal and political system exists; ideally if it were possible to solve this on a face to face bases, then we they can talk about it with each other, and one says to the other that it give so many 100 of 1000's of rupees. And then the other agrees, and they seal the agreement the next is the other man lives; it is a least transaction cost.

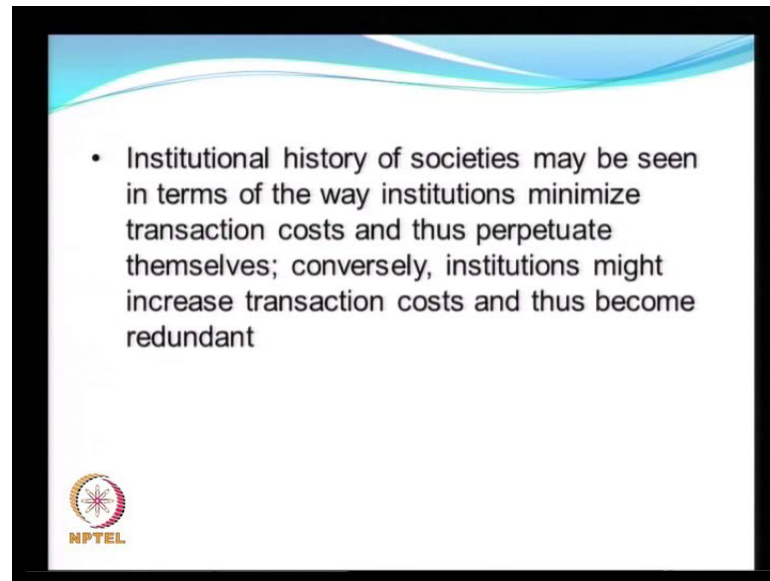
On the other hand, they could go into costly litigation, one could go into the court against the other, and sue him for damages, and request the court to order this other man to be evacuated from that place, force to leave and relocate, that is a costly legal process. Not just in terms of the fees to the lawyer involved, which is there of course, but the cost incurred by the court courts, which these people have to bear.

And then of course, invisibly behind all these the salaries of the judges and the various members of the court, and the enforcing authority the police force, and finally all the senators and law makers who get paid, in order to make these laws; in short transaction cost, can be either very minimal on a face to face negotiation bases or they could be quite extensive, in a complex political legal situation.

Now, here is a simple case which we discussed where, there was a dispute over the use of a piece of property by one person, but there could be a whole lot of other transaction costs involved, in the process of production, they could all have a Corsican nature. For example, the bank workers suddenly decides to go on a strike, and because of that a businessman loses out on that day's transaction, and loses several 100's of 1000's of rupees. Question is, can he go to the court, and enforce that the bank employees organization pays him back the costs, this is another transaction cost.

So, we have a whole lot of costs associated with the legal political institutions, connected with the production process in the economy, all of which are sources of transaction costs. Now, Douglass North made a very interesting study of how, the existence of transaction costs gave rise to the rise, and fall of institutions in a society historically.

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There are some institutions or rather every institution has a particular set of transaction costs, associated with it in the society. There are certain institutions, which minimize a transaction cost of the economic processes in the society, and there are others which do not do that. According to North, the institutional history of a society might be perceived, in terms of whether the institutions minimize or increase transaction costs, at any particular point in time.

North says that, institutions which minimize transaction cost are the ones which come to stay, and institutions which increased transaction costs, tend to feed out of existence sooner or later. Once again, there is a very interesting study available to us on agrarian systems in South India, where transaction costs constituted a salient element, in the very structure of institutions that society had over a period of time.

In the Tamil country, which is subject to this particular study, in the northern part of Tamil country; it is a paddy growing track, and highly a highly irrigated paddy growing track, but irrigated with 100's of small and large irrigation tanks, each with its own command area of paddy cultivation. And therefore, villages which cultivated this paddy, now, the logic of irrigating the fields with the water from tanks, involve some organizational problems, and some transaction costs.

For one thing, not every field had a direct access to the water from tanks there were a set of canals or channels, which went from the tanks down in the command area, and from

which water had to be taken to the individual fields. So, first a fall fields which were closely located to the tank had much greater access to water; fields which were further away from the tanks had lower access to water. So, here was a first transaction cost involved to the farmer, depending upon where his field was located.

Second water, had to be blocked as it flows down the channel, and as it as a level roast you cut a little channel through somebody else's field, so that the water would flow from there, on to your field. This means, that you have to (()) the permission of this man to take water through his field to your field, and that is it of transaction costs; you have to be on very good terms with him for else, you would not get water for your fields.

The third consideration was not all fields were of the same quality of soil, some fields retained water very nicely, some fields had more porous oil, and water quickly went through and it was not retained, not good for crops. So, once again, soil for differences made a big difference. And in this caste also played an important role, lands which were closed to the tank, when usually lands which belong to the upper castes, lands which were further down the channels away from the tanks, were usually lands, which did not belong to upper caste, but to lower castes.

So, once again where your fields were located, depended upon the caste (()) the village, so another set of transaction costs. So, here is a situation where a large number of issues, involved in simply taking water to irrigate the fields. And a large number of things, had to be resolved among the people, before a such a complex excuse me complex irrigation system could be managed.

So, institutions which managed, and distributed water in the village were the most important institutions, and around these institutions grew, other institutions in the village. So, for instance in the 18th century, the institutions which was like a local government in the villages was something called [FL] laterally means the village. Now, how important the [FL] was in its functions, how it could how how much it could enforces views, and its judgments on a number of issues, depended very much on, how important irrigation management was in that village.

If irrigation management was the central, and the village used lot of water from the tanks, then the members of [FL] were also members who are regulating the water distribution in the village, and therefore, anything that they said was important. On the

other hand, if the village was a dry land village, with not much irrigation available, not much water in the tanks, may be the water in the tanks might last month or so in a year, not much, and for this is time you have to, either depend on a well or on rain fed irrigation that sort of thing. Basically, not very certain agriculture, in all those villages it was found that the [FL] was not a very powerful institutions.

Because, irrigation management was not central, why this irrigation management was central in this village, because the economics paddy cultivation was such that, everybody had to plan a very homogenous cropping pattern, to optimize on the water used, when the water did come in the tanks. So, they had to plan cropping pattern in such a way that, they all optimized on water used at the same time, which meant which meant that the crop calendar was very uniform, moved along with water levels in the tanks.

When the crop calendar is uniform, then labour management becomes very uniform, because if crop calendar is uniform, when the peak season demands for labour, and off season demand for labour also became very uniform. There are particular periods in the village, when everybody wanted labour; there were particular periods in the village, when no body wanted labour, the surplus labour available.

So, management of labour is a crucial issue, what does we mean here, how does one manage to keep labourers well fed and happy, when most of the year they did not have work to do. And what was the way in which the employers manage to get workers to do some work, when everybody everybody wanted the workers. In other words, peak season was a time when, there was access demand for labour, and when access demand for labour existed, and if he lives the situation to go as it is, wages would head the sealing.

On the other hand, for the rest of the year, when there was not peak season, but lean season no demand, access supply of labour, at that time a fellow would work for you for a meal, so virtually zero or negative wages. So, if we have wages which are following the market, they would go up and down, let sea saw up and down; then market cannot regulate labour market I am sorry, the market cannot regulate labour relationships; labour relationships had to be part of the labour management strategy of the village as a whole.

In large number of South Indian villages therefore, during the lean season whole lot of rituals, during which all the landed families would made rise gruel, and the whole village

would be fed everyday in that; this is one way in which everybody was fed, and that was lean season, and there was no work going.

Likewise, they had a wage negotiation system, where by a person would join a family as a permanent farm hand on a one year contract, which was renewable every year. And his wages would be on a base wages would be fixed, so much of rise per month, and around that base wage would be negotiable bargains on bonuses, which he got during harvest, for extra work that he did and so forth.

In other words, management of labour was not just management of supply and demand of labour, but it was also management of relationship between labour and employer. Now, therefore, labour management also had to happen about the same time, as water management, as crop management, because everything surrounded everything surrounded the availability of water.

So, these villages you had all kinds of social and political institutions developing, minimizing transaction cost in irrigation, and therefore, developing implications were rest of the society; so the whole caste (()) these villages was found to be organized, around water management. Whole lot of institutions of moral (()) and (()), rights and wrongs, institutions of education, institutions of learning skills, they were all tied to water management. So, here is a case where whole societies continued to live for generations like this.

Now, suddenly in the 1960's, the government of India decides that it wants to announce, a package program in agriculture. So, the first thing the government does is, it says we will give you virtually interest free loans if you want to build, wells and pumps in your in your fields, because this will help us promote this new agricultural strategy, new technology and so on, and so forth. So, districts for instance like North Arcata in Tamil Nadu, which had the reputation of being a dry land district by 1970, three North Arcot they had 15 percents of all the pump sets in India.

So, what happens, the farmers are liberated over night from the compulsion to be a part of a water management organization, they have got their own pump sets, they have got their own wells. So, the whole system of irrigation management collapses, around it collapses the crop management, labour management, in other words every other

institution in the society. So, here is a situation where it could be argued, that transaction costs were minimized by a particular social organization, which existed for a long period, and suddenly the introduction of new laws displays the economic bases of the social organization, which is irrigation management; the the imperative of irrigation management. And it liberated each farmer from having to belong to irrigation management group, and having to listen to the irrigation managers about crop planning and so forth.

He could plant any crop that he will wanted, as long as he had a well and pump set, he could grow any crop that he wanted, any time of the year, it freedom completely from every other cycle, crop management, irrigation management, same he could employ workers as an how he like, because his crops varied. In other words, the whole organizational of rural society, which had been for century center around the transaction costs of water management, broke down.

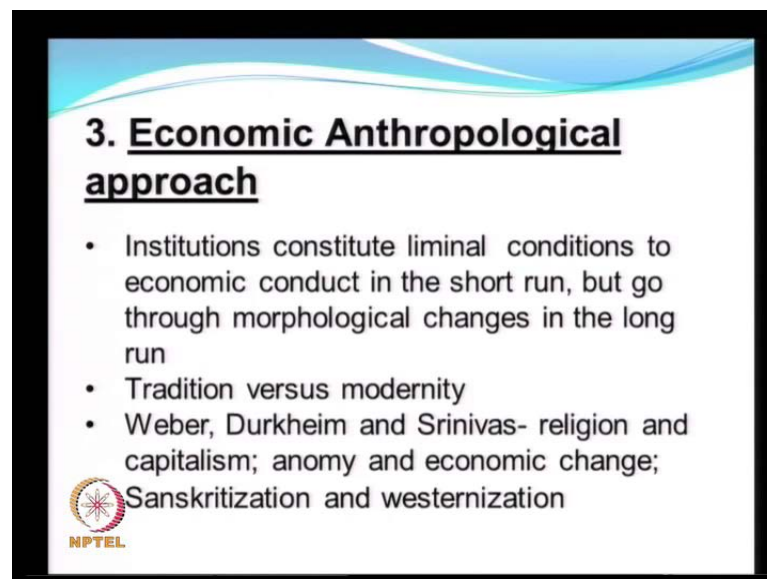
Here, is a classic case where transaction gone cost economist can perceived at actual work in deciding, the power and role of institutions in village. So, there is an big argument against green a revolution, in large number of quarters which says that, the bringing in a green revolution certainly save the food economy of the country, from crisis. It certainly enabled the farmers to produce enough food for the country, it certainly enabled famines and scarcities to be averted, but they led to the breakdown of the village. The social consequences of which, they said is something which cannot be replaced.

The question is not therefore, whether green revolution is good or bad, what we are saying is pre green revolution there was a transaction cost regime; post green revolution there was another transaction cost regime, but the structure of transaction cost change completely in the two periods. What was traditionally manage as a local law and order situation, now became law and order subject to the state government. And therefore, more generalized, and institutions of the village were now replaced by the governmental institutions police and courts and so on, and so forth, which we can regulatory institutions.

So, much for transaction cost as an option to (()) version, transaction cost economics argues, that there is not determinism about any such thing, as a production relations or

economic base. But the institutional argument north and others, enforce the case for a very dynamic fluid structure of institutions through history, as and how they minimize transaction costs, the institutions come into say. As and how transaction cost economies vanish, the institutions all or when, so rise and fall of institutions in human society historically is explained through transaction costs; in this mode of analysis, rather than through mode of production and superstructure. The third approach is what might be broadly called, the approach of economic anthropology.

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I am using the word economic anthropology in a broad sense, because the kind of economist I am I am sorry, I am going to kind of anthropologist I am going to discuss here, were certainly not people who advertised themselves of economic anthropologist. But their contribution to explaining economic anthropological phenomenon is significant.

The assumption in economic anthropology is that institutions constitute the liminal conditions to economic conduct in the short run, but in the long run the institutions themselves could undergo morphological changes, through economic transformation, it is a two way relationship. The greatest debate in economic anthropology since, the 1950's in India has been, the debate of tradition versus modernity.

This is an argument in economic anthropology that is society, which is traditional could have a number of advantages as stability of relationships, and stability of social

institutions. However, the society would also be a society would be that would be relatively stagnant, because there is no growth. On the other hand a growing economy would promote modernity in society, in culture, which would be much more dynamic, and moving, and changing. So, tradition versus modernity itself, became a major argument, a theme in argument, in talking about the pros and cons of economic development; and along with this is Owen, the arguments of great sociologists consider for instance the argument by Max Weber.

Max Weber argued that protestant religion grew, in those pockets of Europe, first where early forms of capitalist industrial or business organization existed, and that being so Weber attributed a one on one relationship between the rise in society of protestant ethic. And what he called the spirit of capitalism, Weber was trying to argue, that the emergence of capitalism in Europe I am sorry, emergence of Protestantism in Europe, had certainly something to do with the emergence of capitalism.

Let us look at this in a bit of detail, statistically Weber found that those centers, where Protestantism spread in Europe, were also the centers through in which capitalist form of industry trading etcetera, were prospering. Putting the two together Weber argued, that there must be something in Protestantism, which contributed to the development of capitalism. And Weber's argument ran as follows, Weber said that Weber said that there were aspects of protestant ethic, which propagated behaviour, which was very much in this spirit of capitalist development.

First of all Weber said, there Protestantism as suppose to catholicism argued that, the grace of god might or might not be yours in the life here after, but certainly the grace of god is yours, if you look upon your own trade, and your own vocation, as a service to god. In short the idea of calling the idea of calling in protestant religion, where in your profession, your trade, your vocation, was your calling or god given thing to do. And in being sincere in your calling, in being honest and committed to your work was an act of worship, in protestant ethic.

Now, according to Weber, the idea of calling therefore was something which paved the way towards productivity, paved the way towards thrifty behaviour, paved the way towards austerity, which was a crucial in the early faces capitalism. Secondly, protestants religion

argued, that both heaven and hell are here in the world with us; they are not to be found in a after life, as catholic religion advocated.

So, the bringing in of the time frame of human salvation to the present life, enabled Protestantism to create conditions where by there was commitment to work, there was commitment to productivity and so on, and so forth; this was another Weber's argument. Granted these, Weber said that the ethics of Protestantism, something was something which promoted this spirit of capitalism, and the spirit of capitalism thrifty behaviour, productive behaviour, hard work all those things.

So, the religion and the rise of capitalism, coincided in particular pockets in Europe was what Weber was arguing, but Weber went one step further, he started doing an analyses of oriental religions; and he came to the conclusion, they they did not do the something as capitalism did in Europe, he thought oriental religions were tying down people to traditions, and not creating the conditions conducive for the development of ethic, the spirit of capitalism.

So, Weber's conclusion was that, while Protestantism lay at the heart of the development of modern Europe, civiler development did not happen in the orient for the simple reason, that oriental religions did not permit this. In short here is an argument about institutions, either strangulating economic growth or not, in the 1960's an American anthropologist called Milton singer, studied South Indian industrialists.

And was considering, whether the Weberian Weberian approach could be justified at all, because South South Indian industries were all the once, he studied where Hindus, very traditional, very hide bound in their own way, and very prosperous in growing. So, singer says well here are very traditional people, and their having been traditional as nothing at all to do, with the fact that they grew.

So, there is considerable correction needed in the thinking of Weber or in Weberian analysis, it is so singer's conclusion. Subsequently it was found, whatever the relationship that Weber found between Protestantism, and capitalism, it did not mean a similar relationship should or should not hold, in respect to other religions and capitalism; this was Weberian institutionalism.

Let us take a brief look at a Durkheim; Durkheim could probably be described as one of the earliest founders of modern economic anthropology. Durkheim studied suicides, and the behaviour of suicides. Statistical behaviour of suicides over a period of time, he came to the conclusion that, whenever society was changing rapidly, economically, there were more suicides. When there was not such rapid economic change in the society, the number of suicides fell. So, Durkheim came to the conclusion, were brought while bringing in a concept of anomie, anomie meaning (()), Durkheim had in as an inference to this statistical information that he presented, that periods of rapid economic change are also period of anomie. Periods of not so rapid economic change are periods of order and stability.

In short, here is a (()) relationship stated between the level of peace and harmony in society, and the rate of economic change in society, whether Durkheim's analysis was verified on a large scale is not is a second question. But the most important question is that, Durkheim found a very solid relationship between peoples peace of mind, peoples orderliness of behaviour, all described by the world, (()) behaviour and the existence of rapid economic change.

When there was a rapid economic change, either for growth or for collapse it did not matter, when economy changed very rapidly norms breaks down, so there is a period of anomie. So, there is an inverse correlation between social peace and economic change as Durkheim found out, this is a very major institutional contribution.

Durkheim also argued that social solidarity is another factor which is affected with the economic change; in traditional societies societies held together, by form of solidarity which is organic, face to face societies have an organic form of solidarity. So, he said these all are form of organic solidarity, as suppose to these modern western societies had functional relationships, which characterized the society much more than kinship, and other relationships as in traditional societies.

So, where societies, were characterized by functional relationships across nuclear groups, Durkheim called it mechanical solidarity. So, mechanical versus organic solidarity is something, which characterized modern societies from, as distinct from traditional societies, this is Durkheim analysis.

Finally, let us consider a major contribution by a great Indian sociologist M. N. Srinivas, according to Srinivas, there were two major aspects to social change in India. As prosperity came to particular social groups, these groups underwent two kinds of changes, as prosperity came one thing that these groups was they engaged in westernization, they started using their money to adopt western styles of living, to send their children to English medium education, to get them to acquire western habits of eating, drinking and so forth, westernization. From simple things like stitching to western form of dressing, to adopting western life styles on a much larger scale, this is one thing.

The other thing which happened, another social change which happen and prosperity came to people was Sanskritization, this was more prevalent in rural India. When a particular community in a village became affluent or when particular caste group became affluent, the members of this caste groups started adopting the practices, ritual and other practices of a caste group above this. And slowly they start adopting, even the nomenclature by the caste group above this, and gradually their ritual status moves up in the society from lower to a higher level.

In other words, social status and social ranking adopt itself, according to a cultural change called Sanskritization, after some a some time after economic status changes. According to Srinivas, Sanskritization much more than westernization was the source of social mobility, in rural in rural India, as suppose to urban India. In urban India, westernization was the source of social mobility, in rural areas Sanskritization.

Now, what is important about Sanskritization is that, Sanskritization appear to leave the social structure interact, without fundamentally changing its structure, a permitted changes within the social structure, over a period of time; it seem to ensure both stability in the society, and change. So, according to Srinivas, Sanskritization was a major base of rural social stability, even when there was economic change. So, we have here, three sets of opinions among economic anthropologist, on three sets of issues relating to the relationship between institutions in the society, and economic activity.

First we had Weber, who talked about the relationship between religion and development of the capitalism, Weber argued to sum up that the development of capitalism was strongly influenced by the rise of protestant religion. Not only did Weber argued that the pockets were capitalism developed, were also pockets were Protestantism had come

started growing; he also pointed out that pockets in Europe, where Catholicism was predominant, were also pockets which were growing much slowly.

So, he also pointed out that Catholicism had a certain anti-growth impulse, anti-capitalist impulses, at least in the early stages in Europe. Weber also argued that, the existence of traditional religions, like Hinduism, Confucianism and so forth, in the east enabled the perpetuation of a static traditional perspective in minds of people, which ensured that this spirit of capitalism did not come about in these places.

So, he was trying to draw a relationship between eastern religions, I mean comparison between, eastern religion and western religion. In the west he found that Protestantism enabled capitalist thoughts to develop, he found that in the east the existence of traditional religions blocked the growth of capitalist ethos. This was subsequently questioned as I said by Singer, and other sociologists through their studies.

Following Weber was Durkheim in our argument, who showed that there was considerable correlation, between the existence of social harmony or harmony within the individual in the society; and the rate of economic change in the society. He found that, when there was rapid economic change, the level of anomie in the society grows, (()). He also found conversely, that when economic change was much lower, anomie was much narrower in his coverage.

This was because, according to Weber, societies with rapid economic change, which were all western societies, were characterized by mechanical solidarity, which was just a functional solidarity across the society; as opposed to organic solidarity in traditional society of the east, which ensured greater continuity of relationships, than in the west.

Finally, we also considered M. N. Srinivas, the Indian sociologist who argued that there were two forces of social mobility in India, Sanskritization and Westernization; he found that Sanskritization predominated rural areas and Westernization was more common in urban areas. In both cases a first economic movement, within the group was supported by a movement of Sanskritization type.

So, you could say that social mobility in rural areas, constituted the type Sanskritization, whenever there was growth, whenever there was development. But when such a

development existed in urban areas, it was more common for Weber to find I am sorry when more common for Srinivas to identify this urban areas, with Westernization rather than Sanskritization.

We have now seen three fundamental approaches, to the relationship between economic institutions I am sorry institutions in society and economic activities, to sum up we found that economic theory could afford to overlook institutions, because it made four very central postulates of perfect knowledge, uncertainty, rationality and hedonism. However, once these postulates are removed, the behaviour in economics becomes far more important than the, theoretical results regarding equilibrium and behaviour in economic realm, refine a strongly correlated with the institutions, that exist in society.

We found that there are three broad approaches, which relate social institutions, political institutions with economic activity; the first we said was a determinist Marxist approach, which said that the economic base was everything. And within the economic base, production relations were central, and this decidedly influenced the nature of social and political institutions which merely constitute that superstructure, over the economic base of the society.

So, by and large Marxian analysis, argued that there was a one way relationship between institutions and economic phenomenon. The one way was from economic change to institutions (()), in contrast the transaction cost approach of north and others clearly showed, that the relationship between institutions and economic phenomenon was a lot more varied. On the one hand there were institutions, which minimize transaction cost and society, which survived because they minimize transaction cost.

On the other hand, there were institutions could not minimize transaction cost, and therefore, fell on the way side as a society pass through. So, transaction cost was a major source of explaining the institutional history of society itself, this was the second approach. The third was a economic anthropological approach, where we found different sociologist have given, different explanations of the effect of social institutions on economic processes; we found Weber clearly identifying a positive role for the protestant ethic, in the emergence of capitalist spirit.

And conversely he found that such, a capital spirit did not emerge in countries, where traditional society prevailed, Durkheim argued there was a strong correlation between

anomie and economic change. And finally, Srinivas argued that there was a rural and urban divide, in whether Sanskritization was a source of social mobility with economic change or whether westernization was a source of social mobility, with economic change.

We know summed up, a study of relationships between economic activities on institutions, we find that in the short run institutions appeared to be dominating over economic activities. But in the long run, economic activities themselves had the propensity to transform and change institutions. And the study as we found, could be approached in any number of ways, and we showed three different ways in which this relationship could be studied. And in the next hour that we teach, we shall be studying evolutionary economics, good evening.