

# **LECTURE 6.3**

## **TRANSACTION COST ECONOMICS**

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Transaction costs are faced by agents whenever they interact: costs of thinking, planning, contracting

- Transaction costs may be lower when internalised within a firm, because the firm has decision-making authority
- Authority is what defines the firm
- The cost of authority is the risk of errors and decision-making rigidity, leading to an inefficient allocation of resources.

Rather than having to specify every detail into a myriad of contracts, people can become employees with more scope to vary in their actions and duties as required.

# TRANSACTION COST ECONOMICS

## Strengths:

- Provides insight into where the boundaries of the firm – where the costs and benefits of internalising versus externalising transactions are equalised.

## Weaknesses:

- Transaction costs remain somewhat ambiguous.
- The source of authority is not clear. How is a refusal to do what is asked (by an employee for example) resolved?