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The Theory of the Firm, Managerial Responsibility, and Catholic Social Teaching

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The costs of transacting the myriad individual contracts needed to operate a complex productive enterprise are prohibitive. The "firm" provided the solution, by substituting hierarchy and command for perpetual negotiations. The legal system played its part in the development of firms by establishing a sort of standard-form contract that defines the rights and duties of those operating under the umbrella of the firm. The primary duty of those who manage a firm is to maximize the interests of the firm's shareholders; that is, to maximize profits. Catholic social doctrine, while essentially supporting the critical elements of private enterprise such as private property and profits, does superimpose a higher duty. The firm must ensure that it never undermines the dignity of all who are affected by its economic activities. Workers, managers, and consumers may never be reduced merely to producing or consuming things. Every firm, moreover, has a duty to promote, and not to detract from, the common good.

The "theory of the firm" is a relatively modern economic construct and one with several variants. Firms produce goods and provide services and, as such, they play an important part in the supply/demand interaction that characterizes the economic order of non-socialist societies. A business firm's costs, prices, and economic power naturally matter to theoretical economists as well as to those shaping practical economic policy. Until quite recently, however, mainstream economists could generally not explain why firms existed or why they took any particular forms.[1] Economists since Adam Smith have been committed to the notion that markets allocate resources better than alternative means do. Firms, however, are critical economic institutions, but they are not characterized internally by market- or contract-based transactions.[2]

The market is replaced by managerial direction. If, as standard economic theory suggests, market-based exchange transactions represent the most efficient way to allocate resources, why are the many individual transactions necessary in a complex, ongoing, productive venture not conducted in this way? Traditional economic reasoning suggests that firms organized internally by discrete, market-driven contracts would have a competitive advantage over those organized hierarchically and ordered by fiat, but experience, intuition, and common sense could not verify that conclusion. Just the opposite is true, and the benefits of firms, primarily corporations in the American experience, are too obvious for them to be characterized as intrinsically inefficient. In short, while firms fit neatly into market-based analyses of productive economies, their existence and organizational structures cannot be readily understood in those same terms.

One early and popular perception of the modern firm linked the size and structure of business enterprises to the state of technology. This view of the firm was not surprising throughout the industrial age and continues to have explanatory power in today's "information age." Technological advances make new forms of production and organization possible. Firms develop to capture the possibilities. The productive genius of Henry Ford, for example, was possible because technology made it feasible to mass produce and market automobiles. Advances in transportation, communications, and production technologies in the late nineteenth century invited, if not compelled, the growth of interstate business firms in the United States.

The early industrial era accordingly produced large business enterprises, but it also spawned the social problems that were then associated with industrial firms, such as urban blight, sweatshops, and child labor. The large business firm presented social problems that had to be better understood and controlled as necessary. Most economists focused on the social benefits of these enterprises—economic growth—but they could not explain why they caused such social upheaval, at least not in rational economics terms. For many, these social dislocations were simply the price of progress.

The "mainstream" of economic thought has been under the sway of neoclassical economics since the late nineteenth century.[3] Over the past century or so, neoclassical economists have developed elegant theories to explain the workings of Adam Smith's "invisible hand." Their contributions have included the concepts of utility, opportunity costs, marginalism, price theory, and market equilibrium. Neoclassical economic models could capture well the characteristics of perfectly competitive and monopolistic markets. Since most industries fit neither model, however, economists also explored the world of imperfectly competitive markets, oligopolistic industries, and "monopolistic competition." The behavior and performance of firms in markets with these characteristics cannot be predicted with the certainty of producers in perfectly competitive markets or its monopolistic alternative, but they can be analyzed by using the tools of neoclassical economics. Functions with a firm, however, defy analysis using market-based models. The firm does not use the pricing mechanism to allocate resources internally.

The seminal 1932 study by Berle and Means[4] identified one critical characteristic of the corporate form as it had developed: The control of property had been separated from the ownership of property. A new class—managers—controlled and employed the property of others. That reality framed the issue for economists, as well as for social theorists. Theories that assumed the employment of society's scarce resources through individual, utility-maximizing, contractual exchanges did not fit a structure that divorced ownership from control. This insight identified the so-called agency problem.

Moreover, the dilemma for the neoclassical mind was not limited to the shareholder/manager relationship. Hierarchies, relational contracts, and legal obligations, rather than individual transactions between utility-maximizing individuals, define relationships throughout firms. A more complex model would have to reconcile the traditional neoclassical vision with the relationships found in firms.

Ronald Coase's classic article, "The Nature of the Firm," provided the breakthrough.[5] Coase's insight was that accounting for the costs of transactions could reconcile the existence of non-market-based organizations with neoclassical teachings about the efficiency of markets. Many years after publishing his seminal work in 1937, Coase remained convinced that economists generally did not appreciate his contribution and remained largely indifferent to the issue of the firm.[6] The climate has changed over the past several decades, however, and the implications of Coase's works have had significant impact on economic analysis, particularly as it relates to law and public policy. A rich, although not unified, economic theory of the firm has developed.

Many scholars, including Coase, Herbert Simon, Kenneth Arrow, and Oliver Williamson, were to develop more fully the critical role of transaction costs in economic relationships.[7] Significant elements of this newer thinking included notions of "bounded rationality" and "opportunistic behavior."[8] The relationships necessary for productive enterprises to organize and thrive must overcome human limitations; that is, the inability to foresee all contingencies and the tendency to behave opportunistically. Brian Loasby has stated that "[i]n conditions of perfect knowledge, the theory of the firm is very simple: There are no firms."[9] In the world of imperfect knowledge, however, firms make it possible to maintain ongoing productive relationships. Individuals enter into more or less, long-term contracts that commit their services to the common venture. The terms of the agreement compensate the manager or laborer for services and loyalty. Hierarchy and control replace market transactions, at least for some period of time.

From this economic perspective, a firm is seen as a "nexus of contracts."[10] For some in the enterprise, the terms of contracts defining their relationship with the firm will be individualized and specific. In general, individuals bringing specialized technical or critical managerial skills to the enterprise will negotiate more specific terms, while those with less-significant skill may be bound by the terms of agreements negotiated by representatives of the workers. The different forms of negotiation and contract can be explained in terms of transaction costs. In a sense, the firm is just the organizing force of these various agreements; hence, the term "nexus of contracts."

Given the breadth of potential events in a complex entity, however, all possibilities cannot be anticipated and addressed by contract. The law, therefore, establishes much of the needed order. Corporate, agency, and partnership laws, and their modern variants, for example, provide a sort of standard form contract that provide guidance to those who act on behalf of others.[11] In economic terms, they protect against opportunistic behavior by agents; that is, they reduce agency costs. The full breadth of the contractual relationships that may make up a firm is beyond the scope of this essay.

Recent events have put the relationship between managers and other firm constituencies, including the public, in particular focus. This article focuses on two, competing theories related to the responsibilities of managers. The first, which is generally favored by economists and reflected in American corporate law, commits managers solely to the maximization of profits for the benefit of the firm's owner/shareholders. Shareholders are the "residual" owners of the firm's assets. Maximizing their returns should provide the most efficient outcome for the firm and society.[12] Other constituencies of the firm, including employees, suppliers, and customers, can protect themselves through contracts or, when necessary, through protective legislation. The managers' duty, generally speaking, is to protect and enhance the shareholders' financial interests. As the last takers in the case of liquidation, shareholders only profit if every other interest in the firm has been satisfied.

The other model, which finds less support in law and practice in the United States, requires managers to consider the interests of all "stakeholders" in the firm. Under this theory, business decisions must account for the interests of employees, customers, and even the community in which the firm is located. This model, which is reflected in modern "constituency" statutes, treats the firm as a social creation that must operate for the benefit of society.[13] The benefits of legally sanctioned business organizations—limited liability and perpetual existence—come at some cost. The price of these benefits is a responsibility to the public that goes beyond simply maximizing the wealth of investors.

The emphasis on managerial responsibility highlights two aspects of firms. First, business firms are primarily organizing mechanisms. The most critical actors within a firm, as measured by status and compensation, are typically those responsible for organizing and directing the enterprise; that is, the managers. Second, the efficacy of firms can best be measured against the managerial goals of the enterprises. The value of firms to society, for better or for worse, must be measured by how well management performs its responsibilities, and that must be determined by the nature of those responsibilities.

From an economic perspective, it seems that firms participate in the process of efficiently allocating resources by overcoming costs that would otherwise make desirable transactions impractical. An assessment of the economic perception of firms should, therefore, consider both the organizing function and the social welfare goals of firms. This essay brings some of the significant principles of the Catholic social tradition to bear in this task.[14]

The Catholic Church began engaging the industrial age with Pope Leo XIII's encyclical letter, *Rerum Novarum*.[15] The corpus of this social teaching has grown through the writings of several twentieth-century popes, the Second Vatican Council, Bishop's Synods, and national, or regional conferences of bishops. While directly addressing concrete social, political, cultural, and economic problems, Catholic teaching avoids specific, concrete solutions to complex social issues. The Church recognizes the limits on its expertise in the secular realm.

The social teachings of the Catholic Church have evolved as the nature of society and its problems have changed.[16] The Church's guidance about social issues, however, has consistently upheld several fundamental principles. Applying this body of thought to the nature of the firm, or rather, to the economic perspective of the firm, there is little reason to question the essential organizing function of any form of business entities. The fundamental building blocks of the firm, by and large, are sanctioned by Catholic teachings. The Church favors private property,[17] including ownership of the means of production,[18] recognizes that individuals bring diverse talents to productive efforts,[19] and acknowledges that profits serve a valid purpose in an economic endeavor.[20]

Some of Catholicism's harshest challenges have been directed at socialist or utopian notions that everyone has a right to share equally in the rewards of economic endeavors. Pope Leo, in the seminal social encyclical, stated that the socialist solution to the problems of his times, the late nineteenth century, would dry up "the sources of wealth … themselves …; and that ideal equality of which so much is said would, in reality, be the leveling down of all to the same condition of misery and dishonor."[21] The Church, moreover, acknowledges that both labor and capital must combine to serve the common good and that the contributors of both must receive fair rewards for their contribution.[22] The instrumental, organizational role of the firm as such, therefore, seems to pose no problem from a Catholic perspective. The need for individuals to cooperate in order to best utilize the resources of the material universe is implicit throughout Catholic teaching. If, as economic theory suggests, the "firm" does this well, surely the Church could not object.

An analysis of the economist's understanding of the firm from a Catholic perspective can profit by focusing on both the goals pursued by firms and the way that people are employed to achieve those goals. Comparing and contrasting the perceived social goals of a business enterprise can be helpful. To neoclassical economists, the goal of most any endeavor is to further social welfare. At first blush, it is difficult to fault a system committed to maximizing the welfare of society, but the term can have many meanings. To economists, the welfare of society is enhanced when resources are allocated in ways that best meet the desires of members of that society. The ultimate goal, pareto efficiency, is to increase the utility of one or many without diminishing the utility of others. There are no losers, just winners. In more realistic models, welfare is enhanced when the net gains outweigh the costs. There are winners and losers, but the winners get more than the losers lose.[23] As a materialistic science, economics measures gains and loses to society in terms of utility which, in the context of firms, means profits. Individuals and firms, therefore, contribute to the commonwealth by producing newer and better goods or services at ever-lower costs. Those who do this well thrive and are profitable. Others fall by the wayside over time.

The Catholic counterpart to the phrase "social welfare" is the "common good." At some level of abstraction, the terms are synonymous. Promoting social welfare intuitively differs little from the notion of promoting the common good. As used in Catholic teaching, however, the common good cannot be reduced to utility or profit maximization. I will try to avoid comparisons of the practical, material nature of economics with the theological, eschatological foundations of Catholic social thought. It goes without saying that the Christian message is ultimately spiritual: It is a personal call to the Gospel and salvation through the sacrifice of Jesus Christ—and the foundations of Catholic social thought are sacred Scripture and the natural-law tradition. Using a purely spiritual benchmark in the context of this analysis, however, would simply end the discussion. Professional economists can no more deal with spiritual goods except in the loosest subjective sense of "utility" than professional theologians can cope with the mundane tasks of business organization.

Catholic social teaching, however, speaks to the material world, and its notion of the common good is not limited to the spiritual realm. To be sure, theological insights inform Catholic teachings, just as theoretical insights—occasionally even moral insights—inform traditional economic analysis, but the Church's social documents have effectively engaged secular economic and social matters. In a sense, the Catholic social tradition continues the Old Testament prophetic heritage by calling for an earthly society committed to charity and justice.

The Church's teachings have reflected a consistent anthropological perspective that distinguishes it from a system built on the notion of *homo economicus*. That anthropology is rooted in the Book of Genesis. The human person is a created being, made by God in the image of God, and the material universe was given to humankind for its use and benefit. This places the human person at the center of any understanding of human society. Pope John Paul II has explained well the relationship between God, humankind, society, and the physical universe as follows:

> [M]an has to subdue the earth and dominate it, because as the "image of God" he is a person, that is to say, a subjective being capable of acting in a planned and rational way, capable of deciding about himself and with a tendency to self-realization. As a person, man is therefore the subject of work. As a person he works, he performs various actions belonging to the work process; independently of their objective content, these actions must all serve to realize his humanity, to fulfill the calling to be a person that is his by reason of his very humanity.[24]

While always celebrating the dignity of the individual human person, the Catholic social tradition has also placed individuals in a broader context. Humans are social beings. They exist and flourish in community. Full expression of the personality cannot take place in isolation. Rather, it is developed through and expressed in interactions with others, the family, the workplace, or the larger community. Each person has a right and a duty to develop his or her own personality, which is reflected above all in a contribution to community through work. "Only man is capable of work, and only man works, at the same time by work occupying his existence on earth. Thus, work bears a particular mark of man and of humanity, the mark of a person operating within a community of persons."[25]

Catholic teaching also values highly the results of human enterprise, economic growth and development. Particularly since the papacy of John XXIII, economic development has been a primary component of the Catholic quest for justice in the world. It was so critical by the 1960s that Pope Paul VI, in a variation on the theme that there can be no peace without justice, declared that "development is the new name for peace."[26]

The principles discussed so far generally leave us agnostic about the business firm. Private property rights are inviolable; individual persons are inherently dignified, but they live in and must participate, primarily through work, in community; and economic growth and development are good. The firm, as an entity that organizes the means of production to employ workers and meet society's needs, cannot be faulted for violating any of these Catholic principles. If the ends of an enterprise promotes the common good, and if the means employed do not violate the dignity of any person, the firm would surely survive the scrutiny of Catholic social teaching. Why, then, has the Church been so critical of the capitalistic systems of industrialized societies? To be sure, Catholic social teaching has been most critical of socialism, but nineteenth-century liberalism (laissez-faire capitalism) has not escaped the Church's criticism.

The firm of modern society suffers from a Catholic perspective when it ignores the true nature of the human person and of the common good and sees profits as the only purpose for its existence. The pope states that "the purpose of a business firm is not simply to make a profit, but is to be found in its very existence as a community of persons who in various ways are endeavoring to satisfy their basic needs, and who form a particular group at the service of the whole of society. Profit is a regulator of the life of a business, but it is not the only one; other human and moral factors must also be considered which, in the long term, are at least equally important for the life of a business."[27]

In a Catholic business ethic, the human person cannot be considered a thing, and it does not matter whether that is as "factor of production," as a source of capital, or as a consumer. In the natural and divine order, things, including those things that are called "capital," are put at the service of humankind. When persons are put at the service of capital, the right ordering of society has been turned on its head. Within a firm, Catholic teaching insists that labor must have priority over capital.[28] And, the benefits of capital—for example, money, technology, and know-how—must combine with labor to promote the common good.

Catholic social teaching, in my judgment, provides support for all of the essential factors of modern business enterprise. Entrepreneurs play an important risk-taking role in business enterprise, and they are entitled to compensation for the risks they take. Once the period of high-risk development has passed, more risk-averse individuals and institutions will contribute to the endeavor, and they must receive a fair return for their investments. Throughout the life of the firm, managers will provide needed organization and direction, and they have a right to fair compensation. Naturally, those who "work in the field," the laborers, will always bring varying degrees of skills to the organization, for which they are entitled to a just, living wage. Business firms serve the important social function of providing the "workbench" at which persons in modern economic societies develop their personalities and contribute to the common wealth.[29]

Although Catholic teachings have emphasized the needs of the most vulnerable members of an enterprise—the problems of the working classes—its prescriptions stress the responsibilities of all involved in the firm. Each person, regardless of position or status within an enterprise, must consider the impact that his decisions will have on all within the organization and on society at large; that is, the common good. This responsibility is captured in two critical principles of the Catholic tradition: subsidiarity and solidarity.[30] Subsidiarity, as applied to a business firm, demands that decisions be made at the lowest, appropriate level within the enterprise. This devolution of authority enhances the sense of individual dignity throughout the enterprise and imposes responsibility for decisions on those who should best understand the consequences, economic and moral, of their choices. It posits decision-making authority in free and, hopefully, morally responsible individuals. The Fathers of the Second Vatican Council appreciated this concept and stated:

> In economic enterprises it is persons who work together; that is, free and independent human beings created in the image of God. Therefore, the active participation of everyone in the running of an enterprise should be promoted. This participation should be exercised in appropriately determined ways. It should take into account each person's function, whether it be one of ownership, hiring, management, or labor. It should provide for the necessary unity of operations.
>
> However, decisions concerning economic and social conditions, on which the future of the workers and their children depends, are rather often made not within the enterprise itself but by institutions on a higher level. Hence, the workers themselves should have a share also in controlling these institutions, either in person or through freely elected delegates.[31]

Solidarity requires every decision to promote the broader common good, and that increasingly means the good of the whole world. In John Paul II's words, "*Solidarity* helps us to see the 'other'—whether a *person*, *people*, or *nation*—not just as some kind of instrument, with a work capacity and physical strength to be exploited at low cost and then discarded when no longer useful, but as our 'neighbor,' a 'helper' (cf. Gen. 2:18–20), to be made a sharer, on a par with ourselves, in the banquet of life to which all are equally invited by God."[32]

Applying the two principles of subsidiarity and solidarity in the context of any particular firm will naturally call for prudential judgments that the Church leaves to be made by governmental bodies and individuals.[33] It is, however, difficult to reconcile these principles with a rule of law or practice that mandates business managers to simply maximize the returns to invested capital.

Catholic social teaching as it relates to the organization and operation of business enterprises is much richer than this essay can develop. Important social principles, including most notably the "preferential option for the poor," have not been addressed directly. However, the four concepts, which are the focus of this essay—*the dignity of the human person*, *the common good*, *subsidiarity*, and *solidarity*—provide an adequate starting-point for analysis. How do these notions comport with the economic theory of the firm? More specifically, how do they relate to the role and responsibilities of managers of a firm? May managers simply maximize the investors' returns or, alternatively, should they attempt to protect the interests of all firm "stakeholders"? Catholic social thinking is typically moderated and balanced, and this issue is no exception.

It is possible to find support, with qualifications, for both the profit-maximizing and stakeholder-interest-maximizing models of managerial responsibility. In a well-functioning firm, with a sound business ethic, management committed to maximizing shareholder profits should not present a serious moral dilemma. Such a theoretical firm would be compensating employees appropriately, using the earth's resources wisely and providing customers with quality products at fair prices. Attention to the "bottom line" does not detract from the common good.

In other situations, however, which likely better reflect reality in the modern American world of business, managers would maximize shareholders' returns only by imposing unacceptable costs on employees, consumers, and society generally. These costs—a sort of moral externality—may reflect the gains derived by depriving workers of their dignity, perhaps by paying less than a living wage or by maintaining an inhumane work environment, by polluting the environment or by producing dangerous, immoral, or excessively costly products. In this situation, managers cannot escape moral culpability by relying on a "duty" to maximize their shareholders' profits. They must, rather, employ the resources under their control in ways that promote the common good.

Business decisions, as with all choices that humans make, must be informed by a personal, moral, and humanistic sensitivity. The "stakeholder" model of business management may make more sense under these circumstances. The choice is left for those who make the policies applicable to business in any given society, and the decision should be informed by experts in many fields, including economics and management. The Church merely requires those who are involved in the formulation of policy to consider seriously and account for the implications of their choices as they relate to the dignity of all "stakeholders," particularly the workers, and the common good. That responsibility, moreover, attaches to those who must implement the applicable policies as well as to those who formulate the broader social norms.

To conclude, the difference between economic reasoning and Catholic social teaching is real but is not as great as it might first appear.[34] The "common good" of Catholic doctrine embodies a spiritual element that cannot be forced into a materialistic economic calculus. The reality, however, is that economists recognize and seek to account for the social costs of business enterprises. With perfect knowledge and no transactions costs, markets would allocate resources efficiently and perhaps, but not necessarily, equitably. These conditions, however, seldom exist in the real world and, although economists may have an aversion to governmental intervention in the economy, they generally accept the need for regulations that cure problems such as monopolies, externalities, asymmetrical knowledge, and opportunism.

The American commitment to managerial responsibility centered on shareholder surplus assumes that the problems of other constituencies will be met by other means. Labor unions and labor laws will take care of workers. Managers and independent contractors can bargain for their benefits. Consumers will be protected by contracts, tort laws, and regulations. Distributional injustice can be remedied through sound tax and fiscal policies. The shareholders must rely primarily on the success of management and, as the residual owners, the ensuring of their interest indirectly furthers the interests of all firm stakeholders.

The emphasis of Catholic teaching differs significantly from the individualistic ethos of the market and profit-seeking shareholders. It reflects a more communitarian ideal than the materialistic, contractarian vision of neoclassical economics or the personal autonomism of modern political liberalism. The Church seeks to maximize the common good, including the material goods that human society needs. Catholic teaching imposes no single option, however, and it calls for secular societies to pursue the common good in ways that conform to their own cultural values and norms, again within a morally acceptable framework. For the developed nations of the world, the "firm" as seen by free-market economists provides an acceptable and obviously successful model. It is surely not inherently bad, although experience has taught that it can be employed in ways that detract from the common good.

Is there, then, a Catholic theory of the firm? There is surely no well-defined prescription for a particular type of business organization. Catholic social thought, however, has much to say about the proper role of business in society. Neoclassical economics is stopped short when it attempts to measure social welfare in nonmaterial terms. The unquantifiable nature of "utility" is unsettling for economic theorists and empiricists alike, and so welfare maximization is invariably measured in terms of material wealth. Individual economic autonomy, private property rights, and free markets will capture personal, nonmaterial values in the choices that individuals make about the goods that they produce and consume. Consumers will, for example, give up more certain profits to invest in companies that pursue their social values. The firm, however, with its amorphous ownership/management structure, challenges the idea that the market will reflect the social values of individual participants. This is particularly true in large and increasingly global firms. The answer in dominant economic, financial, management, and legal doctrine seems to be that business owners want profits and that managers are obliged to accommodate this presumed desire.

The Catholic Church is not so confined in its teachings. The Church calls for business decisions that foster more than investor profits, and even more than utility maximization when the values maximized do not reflect proper Christian moral understanding. A Catholic "theory of the firm," while not rejecting efficiency and profitability, calls all within the enterprise to be committed to the common good and to recognize the dignity of every human person who is affected by the firm. It is richer than secular concepts of business enterprise, certainly in the American business sphere but not at war with sound business practices. Catholic entrepreneurs and managers are not asked to withdraw from the real world of business. Rather, they are called to bring a pervasive moral vision and judgment to their responsibilities. Nothing in Catholic teaching suggests that Christian values cannot be pursued in ways that increase the efficient allocation of resources, expand the availability of material goods, and ensure investors and managers a fair return for their risk, foresight, and work. A firm that conforms to Catholic principles may, in fact, be a competitive, efficient producer and market participant, as well as one that fosters the common good.

This essay has attempted to support the thesis that business organizations in modern capitalistic societies, like the United States, can conform to the principles of Catholic social teaching. It concludes, however, with a caution. Although the structures of business firms, and even the profit-maximizing norm, may be reconciled with Catholic teachings, the responsibilities of those within firms are great. Business enterprises are capable of producing goods in morally acceptable ways, but they can also behave and perform in ways that violate Catholic notions of morality and justice. Pope John XXIII taught, "If it is indeed difficult to apply teaching of any sort to concrete situations, it is even more so when one tries to put into practice the teachings of the Catholic Church regarding social affairs."[35]

Given the current business culture in the United States, managers wishing to operate within the Catholic social framework will likely find the task quite challenging. The Catholic social "project," however, is to call men and women of goodwill to bring the values of Christianity into every aspect of their lives. That, of course, is the ultimate challenge facing each Christian.

Notes

1. Nicolai J. Foss, Henrik Lando, and Steen Thomsen, "The Theory of the Firm," in Boudewijn Bouckaert and Gerrit De Geest, eds., *Encyclopedia of Law and Economics*, available at http://allserv.rug.ac.be/~gdegeest/5610book.pdf., 631–32.
2. Richard A. Posner and Kenneth E. Scott, *Economics of Corporation Law and Securities Regulation* (Boston: Little, Brown, 1980), 2–3.
3. Neoclassical economics began around 1870 with the works of Jevons, Menger, and Walras. See Paul A. Samuelson, *Economics*, 11th ed. (New York: McGraw-Hill, 1980) 786–87. For a description of neoclassical economics, see Roy E. Weintraub, "Neoclassical Economics," *The Concise Encyclopedia of Economics* (Indianapolis: Liberty Fund, Inc., ed. David R. Henderson, 2002). [Online] available from http://www.econlib.org/library/Enc/NeoclassicalEconomics.html; accessed 12 August 2003; Internet.
4. Berle, Adolph, and Gardiner Means, *The Modern Corporation and Private Property* (New York: Macmillan, 1932).
5. Ronald Coase, "The Nature of the Firm," *Economica* 4 (1937): 390.
6. R. H. Coase, *The Firm, the Market, and the Law* (Chicago: University of Chicago Press, 1988), 1–5.
7. Paul A. Samuelson and William D. Hordhaus, *Microeconomics*, 16th ed. (Boston: Irwin McGraw-Hill, 1998), 112. For an interesting, recent discussion and application of transaction costs economics, see Paul L. Joskow, *Transaction Cost Economics, Antitrust Rules, and Remedies*, 18 J. Law, Econ. & Org 95 (2002).
8. See, for example, Oliver E. Williamson, Book Review, *The Firm, the Market, and the Law*; by R. H. Coase, 77 Cal. L. Rev. 223 (1989) and *Corporate Governance*, 93 Yale L. J. 1197 (1984).
9. Brian J. Loasby, *Choice, Complexity, and Ignorance: An Inquiry into Economic Theory and the Practice of Decision Making* (Cambridge: Cambridge University Press, 1976), 70.
10. Martin Ricketts, *The Economics of Business Enterprise: An Introduction to Economic Organization and the Theory of the Firm*, 3d ed. (Northhampton, Mass.: Edward Elgar Publishing, 2002), 43–50.
11. Id. at 43–49.
12. Margaret M. Blair and Lynn A. Stout, *Trust, Trustworthiness, and the Behavioral Foundations of Corporate Law*, 49 U. Penn. L. Rev. 1735, 1780–1782 (2001).

13. See Committee on Corporate Laws, *Other Constituencies Statutes: Potential for Confusion*, 45 Bus. Law. 2253 (1990). The ABA Committee rejected amending the Model Business Corporation Act to include "other constituencies" provisions, but the article identifies states that had such provisions at the time of the publication.

14. An excellent and more thorough Catholic analysis of the nature of business can be found in S. A. Cortright and Michael J. Naughton, eds., *Rethinking the Purpose of Business: Interdisciplinary Essays from the Catholic Social Tradition* (Notre Dame, Ind.: University of Notre Dame Press, 2002).

15. The first, great, modern social encyclical held that the right to private property is inviolable. This theme has remained constant over the hundred years of evolution in the teachings. Pope Leo XIII, *Rerum Novarum* (On the Condition of Labor, 1891) 5; 12, reprinted in David J. O'Brien and Thomas A. Shannon, *Catholic Social Thought: The Documentary Heritage* (New York: Orbis Books 1992), 16; 19.

16. The Catholic social tradition is, of course, quite ancient in origin. This essay focuses on one part of that tradition that is frequently identified as Catholic social teaching, which consists primarily of a number of papal encyclicals addressing the "social issue." Roughly, they span the hundred years from *Rerum Novarum* (1891) through *Centesimus Annus* (1991).

17. *Rerum Novarum*, 14–39.

18. Pope John XXIII, *Mater et Magistra*, 109.

19. Pope Leo wrote that "[t]there naturally exist among mankind manifold differences of the most important kind; people differ in capacity, skill, health, strength; and unequal fortune is a necessary result of unequal condition. Such unequality is far from being disadvantageous either to individuals or to the community. Social and public life can only be maintained by means of various kinds of capacity for business and the playing of many parts; and each man, as a rule, chooses the part that suits his own peculiar domestic condition." *Rerum Novarum*, 17.

20. Pope John Paul II, *Centesimus Annus* (On the Hundredth Anniversary of *Rerum Novarum*, 1991) 35, reprinted in O'Brien and Shannon, *supra* n. 17, 35.

21. Pope Leo XIII, *Rerum Novarum* (On the Condition of Labor, 1891), reprinted in O'Brien and Shannon, *supra* n. 17, 12.

22. Pope Pius XI, *Quadragesimo Anno* (After Forty Years, 1931) 56, reprinted in O'Brien and Shannon, *supra* n. 17, 55.

23. This loosely but incompletely describes the notion of Kaldor-Hicks efficiency.

24. Pope John Paul II, *Laborem Exercens* (On Human Work, 1981), 6, reprinted in O'Brien and Shannon, *supra* n. 14 at 358.

25. *Laborem Exercens*, introduction.

26. Pope Paul VI, *Populorum Progressio* (On the Development of Peoples, 1967), 76, reprinted in O'Brien and Shannon, *supra* n. 17 at 258.

27. *Centesimus Annus*, 35.

28. *Laborem Exercens*, 12.

29. John Paul II states: "We can speak of socializing only when the subject character of society is ensured, that is to say, when on the basis of his work each person is fully entitled to consider himself a part-owner of the great workbench at which his is working with everyone else." *Laborem Exercens*, 14.

30. The principles of subsidiarity and solidarity are not reserved in Catholic social teaching to economic activities. They apply to all social endeavors, cultural and political, as well as economic.

31. Second Vatican Council, *Guadium et Spes* (Pastoral Constitution on the Church in the Modern World, 1965), 68.

32. Pope John Paul II, *Soclicitudo Rei Socialis* (On Social Concern, 1987), 39.

33. See, for example, *Laborem Exercens*, 14. This section of the encyclical discusses proposals for joint labor/shareholder ownership of business but acknowledges that they may not be feasible; that is, "applied concretely." This provides an example of the way the Church's social documents propose ideals while often leaving application of the principles to the prudential judgments of individuals and secular authorities.

34. For a more exacting Catholic critique of the firm, see Charles M. A. Clark, "Competing Visions: Equity and Efficiency in the Firm," in *Rethinking the Purpose of Business*, *supra*, n. 14. Professor Charles Clark argues persuasively that "if we want to have a more values-based and ethical economy, if we want to promote social justice, we must start by rethinking the place and role of the firm in our society and work toward instituting the values of Catholic social thought, which are the values necessary for a just society, into the operation of firms as well as the other economic units that comprise our economy.

35. Pope John XXIII, *Mater et Magistra*, 229.