



Path Dependency, Stewardship and Human Flourishing: An Economic Exploration

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Abstract. Can theologians, philosophers and economists have a fruitful conversation about human flourishing? In practice, that does not appear to be so easy. Nevertheless, I believe it is worthwhile to bring knowledge from different disciplines into conversation. In doing so, I choose an approach that could be described as an embedded approach that uses already existing coherent economic concepts and places the question of normativity in individual transactions of economic agents. I take my starting point from the stewardship approach (Davis, Schoorman, & Donaldson 1997) as a complement to the traditional agent principal approach (Jensen & Meckling 1976) and I demonstrate the impact on organizations. Using path dependence of institutions as proposed by Williamson (2000) and further elaborated by Pierson (2004), I explore a justice approach to normativity that has roots in theology and philosophy and relate them to positive economic concepts. Finally, transaction cost economics can be used to express outcomes in economic terms.

Keywords: stewardship, human flourishing, normative economics, Transaction Costs Economics, New Institutional Economics

1. Introduction: from positive economy to normative economy

I approach normativity with a positive appreciation of insights economic science has provided. Scarce resources distributed as efficiently as possible to bring welfare. Market mechanism mediates supply and demand and determines the price. In the long run, all factors of production are variable, organizations or firms play no role. In the short run, organizations and households do play a role in traditional economic theory, as they are means to explain influence of exogenous variables on endogenous variables in case of change, and they take care of matching supply and demand. Today, many of the allocation transactions do not take place directly in the market. Most people are involved in organizations as employees and do not themselves engage in transactions in the market. If they do, they do so on behalf of the enterprise. In this regard it functions in the enterprise in a similar way: if marginal revenues exceed marginal costs a project can proceed, or a product or service can be delivered.

¹ I gratefully acknowledge the feedback and insights provided by the anonymous reviewer. I also appreciate the comments that Harry R. Commandeur and the colleagues of the research group The Reformation of Economic Thought have made while writing this article.

This traditional representation of economic thinking—positive economics—is increasingly being questioned. In addition to positive economics, there is normative economics: what is a good distribution of scarce resources in each situation. Some preferences seem to be better than others. When can one speak about human flourishing? Consequentialism is a teleological perspective on normativity which can be brought into models² as utility.³ A second perspective on normativity is deontology, the assumption of universal rights and duties. By putting constraints how the outcomes are achieved this can be included in the model.⁴ More recent virtue ethics is put forward as a third perspective to answer the question of just distribution. Nudging can be used to entice people and organizations to adopt desired behavior. Normative economics is often associated with the government, the public sector and of public institutions.⁵ In the private sector, however, (enlightened) self-interest determines the economic transaction. In recent decades there has been more criticism of the classical *homo economicus*. From anthropology other human images are presented.⁶ Usually, this does not sufficiently consider the principles of economic science, making it difficult to integrate these new insights.

Insights from psychology and sociology have led to a new economic approach of governance of organizations, stewardship theory (Davis, Schoorman, and Donaldson 1997). This approach sheds a useful light on the economic theory of functioning of organizations, which—as mentioned above—are an important part in matching supply and demand. Stewardship theory is complementary to traditional agent principal approach (Jensen and Meckling 1976). This approach is an embedded approach⁷ that uses existing coherent economic models to perform modifications within them, particularly at the level of individual transactions and agents.

In the next section (2), I show the place of organizations in economic organization theory (3) followed by the prolegomena of new institutional economy (NIE) to which this approach belongs. (4) I then place stewardship theory within the framework introduced by Williamson (2000). (5) I share some observations when using stewardship theory, strengths and limitations. (6) I reflect on normativity in economic relations of stewardship theory and introduce justice as an undergirding idea of economic relations. (7) I demonstrate the functioning of normativity with transaction costs economy (TCE) as a means. (8) I conclude.

² It evaluates consequences of one's behavior expressed in wellbeing and welfarism and leads to utility in economic terms.

³ This theory in its classical form has been developed by Jeremy Bentham and John Stuart Mill.

⁴ This model is an explication of the philosophy of Immanuel Kant.

⁵ In neoclassical economic theory selfishly acting economic men (*homo economicus*) will not change behavior, so normativity has to be enforced by government or public sector.

⁶ E.g. the *homo amans* (van Nes, Nullens, and Van den Heuvel 2022).

⁷ This classification is used by Goudzwaard and Jongeneel (2014) and is distinguished from thematic, welfare, and renewed normative approaches.

2. Organizations as part of the economic infrastructure

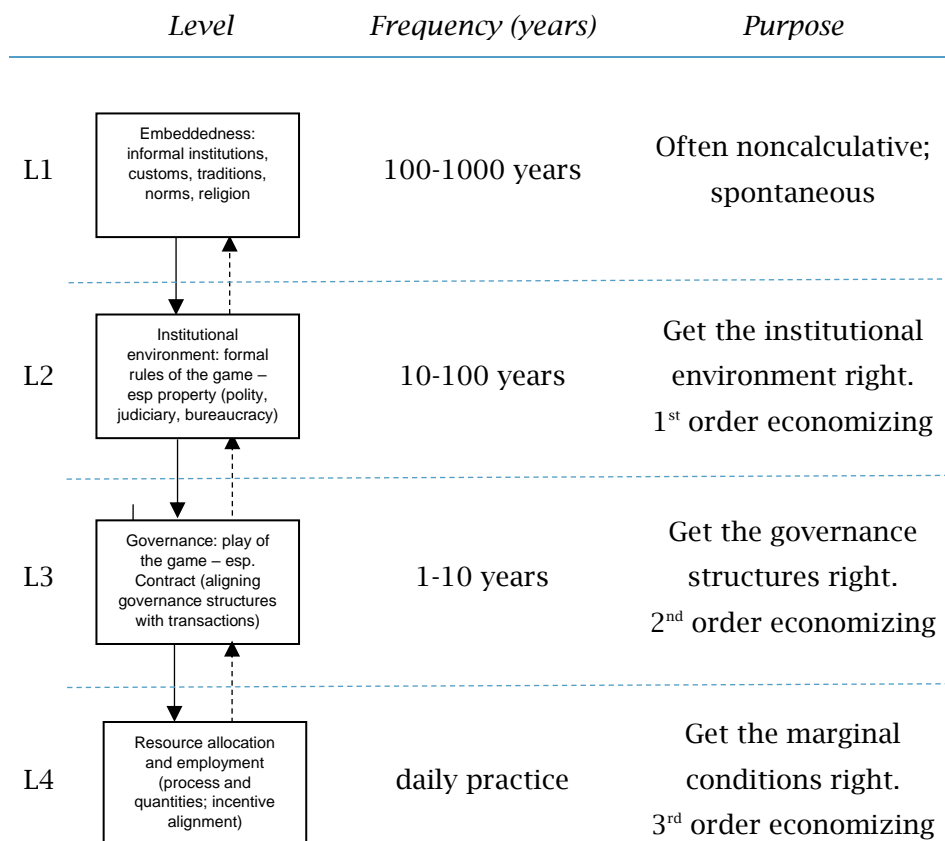
As mentioned, a substantial part of the allocation of supply and demand does not take place on the market, but within organizations.⁸ While the question raised at the time by Coase (1937) about the nature and limits of the firm did not find fertile ground in the neoclassical economic approach, it did provoke important contributions by Alchian and Demsetz (1972), Jensen and Meckling (1976), and by Williamson (1975; 1981; 1985)—contributions through which they manage to (partially) unlock the black box of the firm—and through which they lay a foundation under a new approach to economics, the new institutional economics. This approach has several partly overlapping concepts and theories, including evolutionary economics, transaction cost economics, property rights theory and positive agency theory—all aiming to explain the economic functioning of institutions (Klein 2000, 456). In the new institutional economy an important distinction is introduced between institutional environment and institutional arrangements (Davis and North 2008, 6ff). The institutional environment consists of laws and regulations as well as social conventions and norms. Institutional arrangements refer to the agreements in and between organizations and institutions. Explicating institutional environment into the analysis of economic development, using socio-historical data—partly influenced by the German new history school – enables the study of path dependency.⁹ The concept of path dependence underscores the significant influence of historical sequences and past actions on present outcomes. Once a nation or region commits to a particular trajectory, reversing this course becomes prohibitively costly due to entrenched institutional frameworks. This concept is aptly illustrated by the metaphor of a tree, where the initial branch chosen tends to dictate subsequent paths. Avner Greif's research on the Commercial Revolution (1996) elucidates how expectations shape coordinated actions and subsequently influence economic development. These expectations emerge from a complex interplay of economic, social, political, cultural, and technological factors. Once established, organizations develop vested interests that resist deviation from the established path, even when it is suboptimal. Concomitantly this is a form of meta-critique of economic science that starts from axiomatic presuppositions while our economic reality is created within a local context an embedded in a structure of norms and views on good life¹⁰. I want to juxtapose both perspectives—as I believe that outcomes of *the invisible hand* in economic processes only emerge in a world where these processes are permitted. In an overview, this looks as follows.

⁸ For brevity I refer to firm in the text hereafter, as the literature also often refers to the theory of the firm. More distinctions could also be made here in terms of types of organizations, but this is not important for the development of the argument in this paper.

⁹ The concept of path dependence as employed by Williamson lacks a clearly defined operationalization. Given the disparate ways in which this term is utilized across various academic disciplines, there is a potential for confusion. I adhere to the path dependence linkage as articulated by Pierson (2004) and Levi (1997).

¹⁰ This view is frequently expressed by Amartya Sen.

Williamson introduces four layers (L1-L4) of social analysis for conducting research (Williamson 2000, 596 ev):



L1: social theory

L2: economics of property rights/positive political theory

L3: transaction costs economics

L4: neoclassical economics/agency theory

As suggested by Williamson there is dependency between the layers. The layers above affect the layers below by putting constraints, which is expressed by the solid downward arrow. From level 1 – level 2 these are informal constraints (taboos, codes of conduct, etc.). The solid arrow between Level 2 – level 3 imposes formal constraints, legal design of society, legislation and design of the public sector. In this paper I mainly focus on L3 and L4 and the interaction between those layers. The solid arrow between level 3 – level 4 imposes formal constraints on contracts and resources. The dashed arrow upward indicates a social reaction by economic actors toward government, public sector and other institutional actors, proposing adjustments to individual arrangements or economic infrastructure because of economic outcomes as expressed in L4. Before looking more into detail, I first explain the foundational principles of NIE.

3. Prolegomena of NIE in relation to neoclassical economics

The premises of NIE are comprehensively described in the work of Furubotn and Richter (2005; Richter 2015). (1) methodological individualism: this premise emphasizes that individuals make different choices based on their own preferences. It follows from this that larger organizing contexts do not simply form a self-contained collective entity, but that when studying them, the individual preferences and behavior of those involved are the starting point. In this respect, social phenomena such as institutions and organizational culture may be important because they help shape human behavior, but together they form explananda and not explanans (Glas 2022, 126; Klein 2000, 457). Moreover, the interaction between the economy and preferences is no longer stable and preferences thus become endogenous (Garretsen and Peil 2001, 26). (2) The maximand: individuals choose from their own interests to maximize utility within the constraints of the given institutional structure. Connecting the institutional structure with the individual preferences of all individuals makes the institutional reality visible, with individuals making their choices within the prevailing frameworks—whether government, corporate or semi-governmental. This is a clear break with neoclassical and welfare approaches, which take the market—and market failure—as their starting point. (3) Bounded rationality (Simon 1957) with implication that not all economic exchange can be arranged via market transactions (Williamson 1975). This particularly affects contracting: we do not know everything, so we cannot capture everything. (4) Opportunistic behavior: following on from the previous premise, it is also true that not all economic actors always consider the interests of others and sometimes act with guile.¹¹ (5) Economic society: the economic arrangement of society in which it is possible for transactions to be established without coercion using individual property rights.¹² (6) Governance structure: the overarching structure by which the aforementioned property rights are organized and guaranteed.¹³ (7) Institutions: the formal and informal institutions together form the institutional framework, with the former category consisting of the formal laws of society and the latter consisting of the norms and customs in society. This framework can reduce uncertainty for economic agents, and it contributes to efficient decision-making. Moreover, it encourages long-term social behavior. Institutions help reduce the (coordination) costs involved in transactions. (8) The evolution of institutions: the emergence of institutions can occur on at least two grounds. In the first place based on formal rules by a competent authority and in the second place by the (spontaneous) collective ordering of individual own interests. Institutions established in the latter way—often referred to as norms—are relatively stable.¹⁴ The endogenization of

¹¹ Williamson (1975) uses the term “selfseeking with guile.” This has important implications in executing contracts.

¹² In neoclassical economics approaches to property rights compulsion is excluded and pressure groups are ruled out. Nowadays there is a growing number of societal pressure groups affecting economic behavior.

¹³ This overarching structure sanctions deviant behavior (external effects) by laws and rules, but it can also exist of subjective mechanisms such as value rationality or religiously based structures.

¹⁴ These institutions can be simulated from game theory as a Nash equilibrium model.

institutions in the general economic model is a key element in NIE. (9) Organizations: in (neo-)classical economic model, the profit-oriented enterprise is the only form of organization that plays a role—besides the market—in matching supply and demand. The new institutional economy considers all organizing relationships, both formal and informal forms of cooperation. (10) Social networks: these structures are an increasingly important organizing principle in society in which people and organizations form connections based on certain characteristics in order to achieve a social position (Burt 1992, 84). These network connections sometimes fall under a formal institution, sometimes under an informal one. In the latter case there may be, for example, embeddedness (Granovetter 1985) or culture. (11) Social capital: in addition to financial and human capital—both are reducible to an individual ownership claim—there is also social capital. The latter has joint ownership by the various actors in a relationship. When using financial and human capital, relationships with social capital yield additional returns (Burt 1992, 58).

Certain principles of NIE are the same as those of neoclassical economics: methodological individualism and (to a certain extent) individual rational choice given a set of constraints. Unavoidably transaction or information costs, and limited information result in institutions being important. Institutions are no longer perceived as neutral elements that do not affect economic behavior. More patterns of property rights can simultaneously exist, and there is no assurance of profit or wealth maximization. The object of the analytical focus shifts from collectivity to individual decision making (Furubotn and Richter 2005). The participation of the economists Armen Alchian, Ronald Coase, Douglass North and Oliver Williamson in this program underlines its importance.

Some scholars of this neo-institutional approach would argue that microeconomic theory is no different than a well elaborated version of the contract-rights and TCE.¹⁵ Neoclassical theory as a general equilibrium approach to supply and demand under the first-best Pareto¹⁶ criterion has incorporated this attention for institutions, which led to the addition of special constraints.¹⁷ If so utility maximalization hypothesis can be extended with individual choices of principal and agents including institutional constraints (contract rights and transaction costs; De Alessi 1983).

When introducing bounded rationality, incomplete information and transaction costs severe adjustments to neoclassical modelling must be made. Application of new constraints can lead to internally inconsistent models or interdependencies between constraints and objectives. But more important if we accept the existence of transaction costs as result of bounded rationality and incomplete information, it contradicts its own neoclassical

¹⁵ There has been fundamental critics on this view by Posner (1993) which was vigorously refuted by both Coase (1993) and Williamson (1993).

¹⁶ Regarding equilibrium-models I refer to Pareto. Kaldor-Hicks models have a problematic part in mediating harm and benefit, without explicit safeguards.

¹⁷ “First, an individualistic behavioral assumption; second, an assumption that specifying and enforcing the rules that underlie contracts is costly; and third, an assumption that ideology modifies maximizing behavior” (North 1984, 8).

assumptions. Another important objection is the acceptance of the existence of optimization costs¹⁸ causing circularity in the logical argument of efficient allocation.

Thus, NIE has its own principles does refer to classical economics but cannot be fully integrated because of incompatibilities of assumptions.

4. Principal agent theory, stewardship theory and TCE

A principal-agent relationship between two individual economic actors can be seen as the delegation of decision making autonomy in exchange of monetary reward (Arrow 1985). The agent takes decisions or performs work on behalf of the principal. The agent can have other goals or behave opportunistic. Relations in the principal agent approach can be extended with more agents, in literature often referred as complex authority structure. The nature of the relation is low-trust due to the fact that agents can opportunistically act in their own interest.

In principle, every contractual relationship contains elements of such a principal-agent model. According to this approach, it is possible to agree on complete contracts between principal and agent in which both principal and agent strive to maximize their utility function. This approach can be embedded in Arrow-Debreu's general equilibrium approach, where information asymmetry and uncertainty can be taken into account (Ross 1973, 138). With an uncertain outcome from the transaction, the principal will be willing to settle for a fixed fee so that the agent is rewarded with the remaining portion as compensation for his effort. Other motives for transaction between agent and principal that emerge from research are the fear of a takeover, competition, debt pressure and the situation in the labor market (Foss, Lando, and Thomsen 2000, 635).

The emergence of stewardship theory is an attempt to include (intrinsic) behavioral motivation of actors in economic transactions. Traditional approach suggests that managers motives are only monetary motivated. When economic actors both enter into a contract from a stewardship motive, this minimizes the potential costs of executing the contract and maximizes the potential performance. If there is a mixed motive between economic actors, the one who acts with a stewardship motive is betrayed and the other actor is opportunistic.

Transaction Cost Economy (TCE) has been developed to outline the costs of complex economic transactions.¹⁹ In these transactions—in classical principal agent theory, the principal takes the initiative to enter into a transaction with another agent. If both parties agree to participate for the purpose of executing the contract (i.e., no moral hazard a priori) then a principal-agent relationship is created. To determine the costs of a contract according to TCE, two human factors are involved: bounded rationality (Simon 1957) and opportunism

¹⁸ Existing of decision-method costs, data costs and selection costs leads in microeconomy to problematic use of the production function where the input prices are fixed. To determine profit-maximizing behavior the complete set needs to be considered.

¹⁹ According to Coase (Coase theorem) transactions costs will be zero if there is fully rationality (perfect competition, perfect information; Coase 1937; 1960).

(Williamson 1975). The basic features of a transaction in TCE are (1) asset specificity (2) uncertainty/complexity and (3) frequency (Williamson 1984).

TCE involves the costs of governance of the transaction and mitigation of risks and leads to mutual benefits. The ex-ante costs of such a transaction include: “(1) search and information costs; (2) drafting, bargaining and decision costs; and (3) costs of safeguarding an agreement. Ex post costs of contracting include: (1) monitoring and enforcement costs; (2) adaptation and haggling costs; (3) bonding costs; and (4) maladaptation costs” (Mahoney 1992, 566).

This assumes that in complex cases, contracts are always unavoidably incomplete. Transactions and their associated costs occur within a larger framework institutionally. As no one can predict ex post outcomes, it is important that there are safeguard.

5. Stewardship theory, strengths and limitations

Stewardship theory assumes collectivistic goal alignment among stewards rather than individualistic and opportunistic as in principal agent relations. This principal-agent relationship had a strong emphasis on financial self-interest of managers which led to large economic incentives but ignores other (intrinsic) motivations of managers. Stewardship theory with its mutual goal alignment offers an intuitively appealing alternative with a more broad perspective on human motivation (Bosse and Phillips 2016). This more nuanced view of man is in line with all kinds of motivational research on needs, personality and values from psychology. Note that the term stewardship is often used in Christian ethic of responsibility but is more strongly loaded there as it does not necessarily assume a win-win perspective. So this homonymous term in economics and theology can also be false friends as will be evident shortly.

Although—as we discussed in section 3—we see that NIE does not fit seamlessly together with equilibrium theories, we should expect that stewardship theory (minimizing potential costs of executing the contract and maximizing potential performance) under Pareto criterion would lead to a better situation and an (economic efficient) Pareto improvement. However, studies of this approach do not yet provide compelling evidence.²⁰

Engaging in economic transactions takes place in private firms, in cooperations, semipublic entities etc. Power inequality—e.g., monopolistic power or information asymmetry—could lead to coercive contracts even if they are voluntarily agreed upon. The principal in stewardship theory—as the leading contactor—has bounded rationality and cannot oversee

²⁰ “The idea underlying stewardship theory is that motivation is about self-actualization and an interest in the well-being of employees, not wealth maximization; thus, the theory implies, compensation plans might result in a more egalitarian distribution of resources” (Till and Yount 2019, 609). To this day, the introduction of stewardship theory in the nineties of the past century has not led to greater confidence in society or the narrowing of the gap between the best and least paid worker. On the contrary, the rich principals are getting richer and some of the agents in economic transactions are getting poorer. Nor has there been a major shift in how organizations and institutions are managed, on the contrary there is growing distrust today.

all the consequences for his agent. And not all the agents can oversee their goals and investments. Although there are high moral motivations by the steward this does not rule out undesirable contracts *a priori*.

Another major criticism is the anthropocentric worldview behind the principal-agent and stewardship theory. Nowadays people are concerned about climate change, environmental pollution, depletion of natural resources and animal welfare. These matters are not necessarily in focus in economic transactions, other than in case of legal provisions or personal motives. As a result, there is no bottom line in depleting nature, even though this is one of society's most pressing challenges.²¹

6. Normativity in economic relations and the role of justice

Positive economy analyzes allocation of scarce resources in a market context. Normative economics deals with questions about preferences and a good and just allocation of resources, in this article in the context of a stewardship perspective of the economic agent.

To provide a yardstick for normativity is complex. If we accept individual preferences towards allocation as mediators for equilibrium, we cannot use this endogenous preference in such a yardstick. From a utilitarian view on normativity general happiness as social utility under Pareto criterion would qualify, with the conditions of a rule of conduct and punishment for those who infringe the rules. Expediency leads to justice (Mill 1861). But problematically this approach neglects a possible weak position of economic agents and does not provide them safeguards.²² From its methodological framework it lacks any meaningful view on justice. Moreover to put it with Sen, maximizing behavior is not sufficient for rationality (Sen 2002). Another important critic on utility and preferences comes from Mark D. White who brings in Kantian perspective (2009). Among other things he points out that the consent part is missing in the traditional economic reasoning. Using the Pareto criterion in policy making enable consent to people who are not affected by a policy which violates the dignity of those who are affected.

Intuitively, justice seems a logical measure for making a just and good allocation which contributes to human flourishing. But that completely precedes Adam Smith: not justice but the pursuit of self-interest is the engine of the invisible hand (Smith 1776). Influenced by Rawls, there is now a greater appreciation of the pursuit of justice in economic relationships. From a deontological view on normativity we take a closer look to Rawls (1971; 1999) who advocates for justice preceding the good instead of goods prior to justice (as in utilitarian approaches). Rawls connects the desirability of justice with its feasibility and argues that justice cannot be deduced from premises and conditions, but its justification is revealed in the broad support of many considerations. Application of Rawls theory give to a certain extent

²¹ In a world where everybody unconditionally loves other people, environmental problems would not exist, as Ogaki and Tanaka (2017) argues (from a microeconomic perspective).

²² Existence of compensation disparities is an example.

safeguard to the least favored in the system. However, the normativity in this approach does not consider the relation between economic actors and the economic activity as such.²³

From a philosophical point of view, we can distinguish justice in economic relations on three levels. Commutative justice: what we owe to each other, which is expressed in fair play and level playing field. Participative justice, which is reflected in active citizenship, meaningful contribution to society and paying taxes. Distributive justice, what the community owes to its members. Although economists use other vocabulary for those phenomena, but monopoly power, market entry conditions, complete rationality all three refer to commutative justice and are dealt with in general equilibrium models. Paying taxes as participative justice is also present in economic modelling and distributive justice in the form of laws and institutions. In textbooks, economic agents have limited choice due to the competition (new agents and firms can enter and leave markets without barriers, so price are (almost) given. I started this article with the observation that allocation of scarce resources takes only to a limited extent place via market and mostly in organizations and firms. Economic theory in equilibrium models pay attention to a certain extent to justice as described above, but allocation via organizations and firms intrinsically lack constraints in the economic evaluation.

A final remark on economic relations. A human being cannot simply be reduced to his economic agency and the consequences of choices.

Economic transactions of a person are embedded in an environment of customs and norms and relations between agents and are not necessarily neutral. More strongly, economic relations are mutual.

7. The functioning of normativity with Transaction Costs Economy as a means?

The aforementioned view on normativity can be used in economic practice using Williamsons model (introduced in section 2). Daily economic practice takes place at level 4. Where the system results in undesirable outcomes (from a normative perspective) then those signals can be taken to a higher level via the dashed line and then lead to constraints imposed in reverse via the solid line.

Collectivistic goal alignment is key in the relation principal-agent with stewardship motives from both sides. In case of complex goals and not fully coinciding motives minimal safeguards are necessary²⁴ to prevent harm. Additionally, some economic transaction may not be desirable.

Suppose coffee company with high ethical standards wanting to sell coffee that did not use child labor. The initial transaction demands huge ex-ante investment for research, bargaining and safeguarding (e.g. are the agents bona fide, are they able to safeguard

²³ That is in contrast with common approaches to deontology where the rightness of action is subject.

²⁴ In traditional principal-agent relationship this leads to extended contracts. In case of mutual trust contractors expect respect for reciprocal interests. For unexpected situations one could expect social responsibility behavior.

exploitation, is not the product mixed with coffee from other sources, etc.). In this case it is a voluntary decision of a vanguard company. If they can contract an agent with stewardship motive, transaction costs involved will quickly drop as result of this relation with stewardship motive. In some cases, exploitation is so dire—the human dignity is at risk—leaving it to the market is not an option. In those cases, institutions at level 3 will develop laws and regulations to prevent from harm. A company who is forced to contract only agents who deliver child-labor free coffee will have much higher ex-ante costs as described above as long as those contractors are not a priori indistinguishable from others. The costs can be reduced by level the playing field using worldwide standards.

In some of the contracting relations there is a (power-)disbalance between the contracting parties which needs safeguards, especially when it comes to ex post costs of the contract. Such a safeguard is needed, for example, if company X use software from software company Y to process data. Company X should be able to trust the software manufacturer Y will release data when contract terminates or otherwise should X be able to switch to another system getting its own data. Differently manufacturer Y with power over company X data would be able to charge very high fees for years to come, with no alternative for the company X. In societies where there are checks and balances for power inequality between agents, transaction costs will decrease.

8. Conclusions

In economy, it is not easy to reconcile positive and normative economics. In equilibrium-models organizational activity is limited to a production-function. General remarks on normativity can be made. On the level of organizations, economic structures contribute to the general equilibrium. In those relations between economic agents, normativity plays a role. Agents with a stewardship motive have mutual trust and goal alignment allowing lower costs which leads to collectively higher benefits.

If we use the model of Williamson we can demonstrate how normativity functions in relation to its institutional context. From a joint perspective of agents with stewardship motive, safeguards are still necessary. In the institutional environment commutative, participative and distributive justice are important and shape the context.

For human flourishing in economic relations, protecting human dignity and preventing exploitative behavior are particularly important. Safeguards regarding justice are needed in economic relations. Those arrangements can be provoked by society and constrained by institutional measures. Those measures have impact on transaction costs (inter alia on general equilibrium) and can partly be remediated. Thus, we can say: justice undergirds economic relations.

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