

Is (not) the hierarchical nature of the firm repugnant?

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ABSTRACT. Since Coase's (1937) "The Nature of the Firm," economists have agreed that a transaction can exploit two mediums to allocate resources: a (market) price or a hierarchical structure such as the firm. However, despite there being a rich literature on repugnance of transactions that use the price as the medium, no one investigated the repugnance of transactions that exploit the hierarchy as the medium. This gap is quite surprising because a hierarchical transaction, for its asymmetric nature, should represent a likely candidate for repugnance concerns. This paper shows two main cases of repugnant transactions that exploit hierarchy as the medium and illustrates a criterion to test the repugnance in a firm's hierarchy.

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1. Introduction

In 1937, Coase showed that market and hierarchy are two alternative modes for organizing transactions. While a market transaction represents an allocation of legal entitlements over resources using the price as a medium, a transaction within the firm is an allocation which relies on hierarchy (cf. Vatiéro 2020a). The textbook case of Fisher Body and General Motors well illustrates these two mediums for transactions. Until 1926, Fisher Body supplied auto bodies to General Motors via price-based transactions. Instead, in 1926, when General Motors acquired Fisher Body, the former started ordering auto bodies from the latter, became one branch of General Motors, thereby exploiting for the same transactions within-firm hierarchy as a medium. Ample literature has addressed the *efficiency* of one medium versus the other in organizing transactions and allocating resources. This paper is instead on *repugnance*, and specifically on repugnance of hierarchy as a medium of transactions.

First, let me underline a common characteristic of transactions that uses price or hierarchy as the medium. In both cases, a transaction is not a relationship between a person and a thing—this relationship would not create *social* consequences—but represents a relationship of a person *versus* another person for owning, consuming, controlling, developing, etc., a thing.¹ In the sense of an adversary relationship between *trans*-actors (see also Pagano and Vatiéro 2019), what is the medium of a transaction can determine social concerns. For instance, the price as the medium matters for the degree of repugnance of a market transaction: “One often-noted regularity is that some transactions that are not repugnant as gifts and in-kind exchanges become repugnant when money is added” (Roth 2007:44). The repugnance to charging interest for loans, to paying birth mothers of children to put up for adoption, to trading votes and to exchanging pollution permits fall into this class. In these cases, the repugnance of a market transaction strictly depends on a price and cash payments. This class includes also human organs sale. While the donation of human organs is permitted, their sale is prohibited. That does not mean that no gains from price mechanism can be realized (e.g., Becker and

¹ This is in line with the idea of transaction by John Commons. Williamson’s praise of Commons’s idea of the transaction as the basic unit of the transaction cost economics is well known among scholars of institutionalist thought and methodology (e.g., Vatiéro 2020a).

Elias 2007), but that because of their repugnance, there are constraints, typically legal constraints, on these market transactions (cf., for instance, Healy and Krawiec 2017).

A similar perspective is in Calabresi and Melamed's (1972) *view on the Cathedral* that investigate how a state decides to protect an entitlement: property, liability, or inalienability rule. An entitlement is protected by a property rule to the extent that someone who wants to remove the entitlement from its holder must negotiate with him/her. Instead, an entitlement is protected by a liability rule if one interferes with a second one's entitlement paying a value determined by some organ of the state for it. Finally, an entitlement is inalienable to the extent that its transfer is not permitted throughout a price—even if the transfer without using price mechanism could be permitted. This circumstance is called 'modified inalienability' by Rose-Ackerman (1985) and market-inalienability by Radin (1987). The main motivation for this limitation—the entitlement is transferable but not saleable—is that a transaction could create costs and externalities of moralism (cf. Calabresi and Melamed 1972:1089).

However, to date, literature on the topic has concentrated primarily on the repugnance of the price as a medium of transactions (see Sandel 2013 for a survey), which has left a gap on whether and, if so, how a firm's hierarchy as a medium of transactions can determine repugnance. This gap is quite surprising because, given its hierarchical nature, the firm should represent a likely "candidate" for repugnance concerns. This paper makes an effort in the direction to investigate the repugnance of transactions organized via hierarchy (rather than the repugnance of transactions that use the price as a medium), such as the transactions within the firm.

This paper complements a recent book of Elizabeth Anderson (2017). She argues that the hierarchy in a firm is unaccountable: the boss is neither elected nor removable by subordinates. The hierarchy represents, in terminology of Anderson (2017), a *private* as opposed to a *public* government which generally depends on democratic structures. The unaccountability of the boss's power can represent a first reason to see the hierarchy of a firm as repugnant. A further case of repugnance may regard subordinates' autonomy. Lee (2018) has shown that the firm as a hierarchy is morally unacceptable because it fails to respect the autonomy of subordinates. Autonomy refers to the freedom to exercise our rationality to determine our ends and the respect for autonomy requires acting consistently with the recognition that we each have a dignity that proceeds from our freedom to exercise our rationality to set our own ends. In a relationship boss-worker, for instance, the work is not only a means that is allocated by considering pure technological relationships between factors, but also (and above all) an end for workers (Pagano 1985). Because of residual control rights à la Hart, in this framework, there is a morally unacceptable abdication of a part of the employee's autonomy to set own ends. Even if

it reduces transaction costs, the firm as a hierarchy “violates the moral requirement to respect the autonomy of those who contract into the firm” (Lee 2018:154). With respect to unaccountability of the boss (Anderson 2017) and that the hierarch may violate the autonomy of subordinates (Lee 2018), this paper introduces a different (but complementary) illustration of the repugnance in the hierarchal transactions within a firm.

The remaining part of the paper unfolds as follows. In the next section, I reexamine justifications of the hierarchy along with the hold-up theory. In Section 3, I propose two main cases of repugnance of transactions which use the hierarchy as a medium. In Section 4, I introduce and illustrate a criterion for evaluating and testing the repugnance of hierarchical transactions within a firm. I offer a discussion and some concluding remarks in Section 5.

2. The hierarchy in the hold-up theory

Consider a standard transaction between a supplier, say Anne, of a widget who can make a specific investment, and a client, say Bob, who buys Anne’s widget. Specific investments are those investments whose value in a particular transaction is greater than in the next best alternative. A familiar illustration of that investment is the relocation of a supplier’s factory closer to the client, as in the well-known Fisher Body–General Motors case. One consequence is that transaction-specific investments cannot be redeployed from existing uses and users, except with a significant loss of revenue. Namely, once such specific investments have been made, Anne (the investor) is “locked-in” transaction, and hence she is at Bob’s mercy and opportunistic behavior may rule. Such behavior may cause an *ex post* division of surplus which does not appropriately reflect *ex ante* investment decisions, and, as a consequence, these decisions may be distorted.

In an *ideal* world, Anne and Bob would write a state-contingent contract and rely on an external third party (e.g., a judge, a court, an arbiter) to settle their conflicts *ex post*. For instance, in the contract parties may define what is the price of the widget realized by Anne and sold to Bob, once that Anne has made the specific investment (e.g., the relocation of Anne’s factory close to Bob’s factory). However, each contract is incomplete (cf., among others, Williamson 1975, 1985; Hart 1995, 2017): the third party’s enforcement—that is, observing Anne’s and Bob’ conduct and punishing any

misconduct—is costly. This implies that Anne (the investor) is threatened by opportunistic behavior of the counterparty, i.e. hold-up risk. Bob (the non-investor) would indeed be able to extract more payment from Anne (the investor) because she, i.e., Anne, is locked-in the specific transaction. For instance, Bob may threaten to renegotiate the price of the widget produced by Anne’s factory because there is an unexpected change of final consumers’ demand. This change occurs under a particular state of the world that was not included within the description of all the possible states of the world when Anne and Bob signed the (incomplete) contract. Because the contract is missing on this scenario, the court’s enforcement is not free and Anne is locked-in the relationship, Bob may extract more quasi-rents from Anne than what was agreed ex ante. Anticipating the hold-up risk, Anne (the investor) will choose an under level of specific investments.

The hold-up problems encourage Anne and Bob to abandon the contractual form and manage their transaction in another way: the contracting parties might move from an institutional configuration with two independent agents towards a vertical integration where one party is the boss and the other is the subordinate. Namely, a market transaction between Anne and Bob is transformed in a hierarchical relationship. For example, Bob (the subordinate) will perform some *unspecified* task ex ante that Anne (the boss) will *order* him against some pre-established payments. Indeed, in the course of their relationship, unforeseen events may arise, and Anne may decide ex post what to command Bob to perform, because only a limited number of decisions are specified in the provisos of an incomplete contract established ex ante.

In practice, the hierarchy implies that the boss has the prerogative to decide unilaterally and tell the subordinates to do whatever is not ruled out by norms and contracts. This description is in line with the idea of residual control right(s) à la Hart: “the right to decide all usages of the asset in any way not inconsistent with a prior contract, custom, or law” (Hart 1995:30; cf. also Hart 2017). That is, residual control rights give to the boss the possibility to decide on all circumstances that are missing in an incomplete contract.² This institutional arrangement where one party, the boss, has residual control rights and thus determines the part that is missing in contracts and law, and another party, the

² Putting it differently, the hierarchy is a way to allocate resources and enforces transactions, when courts are costly. The boss has the role of an “endogenous” enforcer of transactions within the firm, because exogenous “courts will refuse to hear disputes between one internal division and another over identical technical issues. Access to the courts being denied, the parties must resolve their differences internally. Accordingly, hierarchy is its *own court of ultimate appeal*” (Williamson 1991:274, italics is added; cf. also Williamson 1975, 1979, 1985). Similarly, Bowles and Gintis (1990) argues that because contracts are incomplete and resorting to the courts is costly, thus parties will enforce their agreement privately—this is labeled *endogenous* claim enforcement by Bowles and Gintis (1990).

subordinate obeys to the boss's commands, "completes" incomplete contracts and mitigates inefficiencies of a transaction that relies on the price as the medium. A firm's hierarchy emerges as a substitute mechanism when costs for using market pricing are significant, in particular when transactions are threatened by hold-up. However, even if the firm as a hierarchy mitigates the hold-up problem, it could determine repugnance concerns.

3. The repugnance of the hierarchy

The transaction costs related to the hold-up problems represent one of the main economic reasons for the emergence of a firm's hierarchy (Williamson 1979). In this description of a firm as a hierarchy, the boss (or residual control rights holder) has the possibility to make unilateral decisions, as how to allocate productive resources, including labor, when there are gaps in the contracts. According to the so-called Grossman-Hart-Moore model (cf. Hart 1995, 2017), this arrangement will stimulate the residual control right holder to make specific investments, without the fear of being held up by others. For instance, Anne (the investor) does not need to worry about Bob holding up their specific transaction because a hierarchy entitles Anne to tell Bob what to do and obligates him to act under her direction. However, even if it could be an efficiency-enhancement, this arrangement could determine repugnant transactions. I provide two main cases of repugnance that are specific to a firm's hierarchy, namely an arrangement where an exogenous enforcement is too costly and the residual control rights are in action.

3.1. The boss's expropriation of subordinates' quasi-rents

According to Hart (1995, 2017), the allocation of residual control rights may mitigate the hold-up risk and consequent problem of under-investments in asset-specificity. However, residual control rights can protect one's specific investments in a firm, namely specific investments of the residual control rights owner, but these rights can not protect all investments within a firm. In particular, there

is a tendency to under-invest by subordinates whose relationships in the firm are protected only by incomplete contracts. The problem is that the hold-up risk that threatens contracts is still present in a structure of hierarchy as the firm. Now, the boss (Anne) may behave opportunistically because Bob is protected only by an incomplete contract. For instance, Anne may threaten to reduce Bob's salary because there is an unexpected change of final consumers' demand, while Bob is locked in the relationship because he made specific investments. This change of final consumers' demand occurs under a particular state of the world that was not included within the description of all the possible states of the world when Anne and Bob signed the (incomplete) contract.

The allocation of residual control rights improves incentives of the residual control rights' owner, namely the boss, but because residual control rights give boss some discretion due to the occurrence of unforeseen events, the boss may try to obtain extra quasi-rents—extra in the sense that the boss can try to appropriate quasi-rents that would be assigned to subordinates if contracts were complete. There is a risk of expropriation: because contracts are incomplete, they are not able to prevent that the hierarch (Anne) may use her authority (based on residual control rights that give the hierarch a degree of discretion on contingencies which are missing in a contract) to expropriate a part of quasi-rents that a contract would have allocated to subordinates, or, more generally, to decide in accordance with best interests of the boss, even if it may be quite unpleasant for subordinates. This is what Lorenzo Sacconi (Sacconi 1999, 2006; see also Fia and Sacconi 2019) calls the risk of abuse of authority, namely an opportunistic exercise of the authority by the boss.

One solution should be that effects of the opportunistic exercise of authority are anticipated and neutralized through a contract that defines a clear preventive compensation in the case of abuse by a hierarch. Codes of ethics and CSR may represent 'social' contracts that can mitigate the abuse of authority in a firm (see Sacconi 1999, 2006). However, this answer underestimates the difficulties arising from contract incompleteness. Moreover, these tools can determine repugnant transactions when they permit that the boss invades subordinates' private sphere (see Section 3.2).

Ex-ante the parties will fail to negotiate the value of the side transfer that ex-post they would recognize as the proper compensation for any opportunistic exercise of the hierarchy that will eventually occur. In fact, as it is impossible to establish ex-ante all the decisions that will prove to be available and relevant when unforeseen events have occurred, neither concrete limits to discretion nor their compensation can be explicitly defined. It being impossible to specify exactly the sphere and limits of exercise of authority, it is also impossible to exclude opportunistic behavior when the time for re-negotiation comes. That is what, in effect, Hart's (1995) model explicitly predicts, as it

proves that each governance structure implies some incentives distortions. The hierarchy gives the boss the possibility to take decisions not specified in a contract that may affect the returns of the investments made by subordinates and therefore distort their choices. Hierarchy may weaken the incentives of subordinates to invest in relationship-specific assets.

Then, subordinates are not protected by contracts (because the contract is incomplete) and they are “protected” by the boss but only until it is convenient for the boss. In this respect, the boss could try to obtain quasi-rents belonging to subordinates. However, the subordinates may sue the boss, but there are enforcement costs. And subordinates can sue the boss only for what is *inconsistent with* the contract and laws, not on what is *missing in* contracts and laws (which is instead left to discretion of the residual control rights holder). The incompleteness of contracts leaves the boss the possibility to ‘legally’ expropriate rents deriving from subordinates’ specific investments. Then, repugnant concerns may emerge.

3.2. The boss’s invasion of subordinates’ private sphere

There is a further issue that can be considered repugnant: the boss may affect the life and well-being of subordinates, not only inside but also outside of the firm—that is, in their private spheres, conflicting with liberal values.³ A firm’s hierarchy can determine repugnance in the sense that hierarchy could and does invade subordinates’ personal, private sphere outside the firm, including their homes, political activities and even choice of sexual partners. Let us consider the case of codes of business conduct in force today.⁴ IBM’s 2008 “Business Conduct Guidelines” specifies to its personnel that, although the majority of their personal interests pose no particular concerns to the firm, “Certain *off-the-job activities* can affect your IBM position, or can otherwise reflect negatively

³ According to liberal principles, there are private matters in which each individual should have the freedom to decide what should happen, no matter what others think, such that the individual’s choice must be understood as the best choice for society as a whole. Put differently, there is a personal, private sphere—an area of individual action—that is or ought to be protected against social encroachment (e.g., Sen 1970; Sugden 1985). In this paper, I do not wish to engage in a debate on the term *liberalism*. This paper follows Sen’s idea that liberalism maintains that individuals may act as “local dictators” over choices belonging to their personal, private spheres.

⁴ In Vatiello (2020b), I provide a reformulation, applied to the firm, of Sen’s Paretian liberal paradox.

on IBM. In cases where there is doubt, you must decide whether you can avoid harm through careful management of your conduct, or whether harm is unavoidable, *and therefore the activity must be avoided*" (p. 28, italics added). Political activities may pose concerns, as well. In its guidelines, IBM states, "You must consult with IBM Governmental Programs before accepting a political appointment to *any* government entity or running for government office *at the local, state, or federal level*" (p. 29, italics added). In both cases (i.e., personal interests and political activities posing concerns for IBM), a violation of the guidelines can result in disciplinary actions, including dismissal (p. 6). The reasoning behind the instruction is clear: Because certain personal interests and "off-the-job" (e.g., political) activities may create problems for IBM and undermine the surplus of the whole firm, the firm seeks to curb those activities. However, such limitations on individual conduct may affect choices of individuals on their off-the-job activities and therefore invade their private sphere. Simply put, there is a risk that these limitations in IBM's 2008 "Business Conduct Guidelines" that are applied by a hierarchical administration, even if they can be justified in terms of efficiency, may be seen as repugnant because they invade subordinates' private sphere.

Similarly, Google's Code of Conduct specifies in "Point III.5. Personal relationships at work" to its employees (italics added):

Be mindful of how your relationships within Google could impact or be perceived by others. *Romantic, physical or familial relationships are not permitted* between a Googler and another Googler or member of the extended workforce where one individual is in a position to exercise authority or supervision over the other. This prohibition includes any situation where one person is in the reporting line of the other, or, for example, a situation where one person is a project or a technical lead on a project on which the other person is working.

Such situations may require changes to work arrangements or even the termination of employment of either or both individuals involved. The reasoning behind that instruction is that "certain relationships" within Google may compromise or be perceived to compromise an individuals' ability to perform the responsibilities of their jobs, may create uncomfortable or conflict-ridden workplace environments, and may raise issues of fairness, favoritism and harassment. Indeed, those situations could spur an individual to pursue a personal benefit for him- or herself, or for his or her friends or family at the expense of Google or Google's users. Thus, Google advises, "All of us should avoid conflicts of interest and circumstances that reasonably present the appearance of a conflict" ("Point III., Avoid conflicts of interest"). In other words, conflicts of interest that derive from "romantic, physical or familial relationships" may undermine the team's production in a firm and the returns for team members. However, limitations concerning such conflicts invade the private sphere of

individuals by controlling and regulating, or even punishing, romantic relationships between co-workers. In an extreme, Google's Code of Conduct may induce a worker to avoid engaging in a romantic relationship with another worker, if he or she does not want to risk being fired. Again, that circumstance can be considered repugnant.

IBM's business conduct guidelines specify that certain off-the-job activities (e.g., accepting a political appointment to a government entity or running for government office) require advance consultation with IBM Governmental Programs. And, Google's Code of Conduct states that romantic relationships between co-workers, which can create an actual or potential conflict of interest, may justify the termination of either or both parties' employment. In both cases, a firm's hierarchy may affect fundamental rights and liberties (e.g., regarding political participation and sentimental relations). Potentially, as these two examples seem to show, the hierarchical nature of the firm could produce repugnant outcomes.

4. The principle of the impartial spectator

The hierarchical structure can be a cheaper way to organize transactions than the market mechanism that exploits the price as medium. Nonetheless, when is it that a transaction that uses hierarchy is (not) repugnant? In an appreciated and well-known book,⁵ Brennan and Jaworski (2016) provides a criterion for determining the repugnance in market transactions that we could revisit to assess the repugnance of hierarchical transactions. The central thesis of their book is that anything you may permissibly do for free, you may permissibly do for a price. In other words, if it is morally permissible to have a *thing* for free, then it is morally permissible to buy and sell it, namely to use the price as a medium for the allocation of this thing. The standard example is represented by human kidneys. They can be given for free (human organ donation), or in other terms, they are protected by an inalienable rule according to Calabresi and Melamed (1972), but their sale is prohibited. Brennan and Jaworski

⁵ For instance, Geoff Hodgson (2021: 154) writes, "Everyone interested in the 'moral limits to markets' debate should read *Markets without Limits*, by Brennan and Jaworski."

instead argue if the “transaction” of human organs for free is morally acceptable, then even their transaction for a price should be morally acceptable and permitted.

Although it may be disputable (e.g., Hodgson 2021 *on this journal*), we depart from this criterion to formulate a criterion for assessing the repugnance of hierarchical transactions: *Every transaction that is not repugnant without hierarchy, then it is not repugnant even with hierarchy as the medium*. In practice, consider two alternatives for the boss (Anne) on the organization of a transaction within a firm: according to the alternative A, the subordinate (Bob) is allocated to the task X; instead, for the alternative B, Bob is allocated to the task Y. Finally, suppose that Anne would choose the alternative A over the alternative B in a (imaginary) scenario without a hierarchical structure, namely in a scenario where the hierarchy is not the medium of the transaction. According to the criterion that is formulated above, if Anne, when she is the boss, chooses to arrange the transaction according to the alternative A, then this transaction is not repugnant. Instead, if Anne, when she is the boss, chooses to organize the transaction according to the alternative B, then such choice, because it is strictly dependent on the condition of using the hierarchy as a means of allocation of resources (whereas in the absence of the hierarchy, Anne would not have made that choice), leads to a transaction that must be considered repugnant.

What this principle requires is that the boss chooses (or behaves) *as* an impartial party. The role of impartiality in the evaluation of social judgements and social arrangements is well recognized in moral and political philosophy: If the party is impartial then his or her judgments and choices express justice (cf. Sen 2002). It may be useful to take up and translate in our perspective Adam Smith’s concept of the “impartial spectator” (or also called “supposed impartial spectator”), originally developed in his *The Theory of Moral Sentiments* (cf. Raphael 2007). When we must assess one’s conduct or choice, we need to “examine it as we imagine an impartial spectator would examine it” (Smith 1759 in 1976, III.1.2, p.110). And, “We can never survey our own sentiments and motives, we can never form any judgement concerning them; unless we remove ourselves, as it were, from our own natural station, and endeavour to view them *as at a certain distance from us*.” (Smith 1759 in 1976, III.1.2, p.110, italics is added). For our argument, it can imply that a transaction is just and thus, not repugnant if it is chosen by the boss “at a certain distance” from hierarchy, that is, if the boss would have chosen such transaction even in absence of the hierarchy. If so, the boss chooses or behaves like an impartial spectator.

Consider the risk of expropriation by Anne, the boss, over Bob (the subordinate)’s quasi-rents. This scenario where the boss (Anne) holds-up quasi-rents of the subordinates falls in the case of repugnant

transactions because Anne makes a choice (i.e., the expropriation) which is strictly biased by the hierarchical structure. That choice of the boss is not *at a certain distance* with respect to the hierarchical structure: She would not have made that choice if she were not the boss, much less if she were the subordinate suffering such expropriation. In other words, if she had behaved as an impartial spectator, she would never have chosen to hold-up subordinates' quasi-rents. Because the choice does not respect the principle of the impartial spectator, then it leads to an unjust, i.e., repugnant, transaction.

This idea of an impartial spectator recalls some of the results of Blair and Stout's analysis on public companies. In fact, the manager, or residual control rights holder in public companies, according to Blair and Stout must be an outsider. This is to protect the interests and especially the specific investments of each stakeholder. If the manager were the agent of one party (e.g. shareholders), this would benefit that party and protect the investments of that party only. But the other parties, such as workers, suppliers, etc., would be subject to the risk of opportunistic behavior of the boss, i.e. expropriation of their own quasi-rents, and this would push them *ex ante* to reduce their own specific investments. To avoid this sub-optimal outcome, the manager must not be the agent of one or more parties, but must be outside. The corporate governance structure should insulate managers from the control of any of the groups that comprise the corporate team, including its shareholders. While this legal structure may increase agency costs, it may also provide an efficient (albeit second-best) solution to the contracting problems that arise in team production. In Blair and Stout's perspective, the manager behaves as an impartial spectator: His/her choices will be *at a certain distance* from the interests of stakeholders. Then, his/her choices will determine hierarchical transactions which are not repugnant. Moreover, the impartiality of managers protects all stakeholders from choices in favor of one party and at detriment of another (the expropriation phenomenon), and therefore will incentivize the specific investments of all stakeholders.

A similar reasoning can be made when considering that the hierarchy can invade the private sphere. Again, if the boss were or behaved as an impartial spectator, s/he would minimize transactions that invade the private spheres of individuals. In practice, consider two alternatives for the boss (Anne) regarding the organization of a transaction within a firm: according to the alternative C, the subordinate's private sphere (e.g., Bob's sexual choices) is not invaded; instead, for the alternative D, the subordinate's private sphere is invaded. Suppose that Anne, the boss, would choose the alternative C over the alternative D in a (imaginary) scenario without a hierarchical structure, namely in a scenario where the hierarchy is not the medium of the transaction—one reason is that Anne, in a

scenario where she is not the boss, would prefer preventing the risk that another boss invades her private sphere. Then, if Anne is the boss and chooses to arrange the transaction according to the alternative C, then this transaction is not repugnant. Instead, if Anne chooses to organize the transaction according to the alternative D, then such choice, because it is strictly dependent on the condition of using the hierarchy as a means of resource allocation (whereas in the absence of the hierarchy, Anne would not have made that choice), leads to a transaction that must be considered repugnant. Anne's choice is not at *a certain distance from* the hierarchical structure, but her choices depends, among other things, on her position in the hierarchical structure of the firm.

5. Concluding remarks and research agenda

This paper illustrates that the boss has a degree of discretion on contingencies, which are missing in a contract and could lead to expropriate a part of quasi-rents of subordinates. In addition, the hierarchy assigns to the boss a right (residual control right à la Hart) that fails to respect (or may invade) subordinates' private sphere. Both cases represent two reasons to see hierarchical transactions as potentially repugnant. Moreover, this paper shows that the principle based on Adam Smith's impartial spectator can be a general criterion to assess when a hierarchical transaction is repugnant or not.

Future research should investigate two further issues, at least. First, what is the role that the context plays in perceiving or defining as repugnant certain hierarchical transactions? In the case of transactions that exploit the price as a medium, some transactions are repugnant in an absolute sense, as is the case with child pornography. But there are transactions that are not repugnant in an absolute sense. Roth (2007) reports, for instance, that eating horses is limited in California but not elsewhere; or, lending money for interest is repugnant in Islamic countries but not in the US or Europe. Khalil and Marciano (2017) provide an interesting distinction between distasteful and repugnant transactions and this distinction is based on the context. They argue that repugnant transactions do not involve context, while distasteful transactions involve the context. This paper has analyzed the general case of transactions that exploit the hierarchy as a medium. However, and it is worthy to underline, the idea of residual control rights à la Hart refers to a particular type of firm, i.e., a capitalistic firm, and then to a particular context, i.e., a capitalistic economy (cf. Screpanti 2001). In this respect, the context of capitalism plays a central role in the judgement on these transactions via hierarchy. One

consequence is that the principle of impartial spectator can be distorted by “closed impartiality” (Sen 2007): while closed impartiality refers to a specific group or context, open impartiality, which should characterize the impartial spectator, refers to *any* group or context. In Adam Smith, the requirement of impartiality invokes an open impartiality, namely disinterested judgements of *any* impartial spectator, not necessarily belonging to one group or context (Sen 2007). So, what is the role of the context in justifying or not repugnant transactions in *capitalistic* firms? This issue may deserve further investigation.

A second issue concerns the remedies. We focused on the role of the boss’s impartiality; but it is not the only way to “limit” repugnance in hierarchical transactions. Because subordinates make specific investments, exit from a specific transaction is costly; and when the exit is precluded for subordinates, the practice of voice becomes necessary as a means of grievance manifestation (Hirschman 1970, 1986).⁶ Voice could mean board representation by significant (classes of) subordinates and/or adoption of a polycentric form of governance à la Elinor Ostrom that contains many decision-making centers (cf. Deakin 2012, Turnbull 2020). Power in a firm should be distributed in a way that subordinates should be able to contribute to define at least some of rules that limit or regulate hierarchical transactions. Voice of subordinates would have the following (positive) effects: first, it could limit the boss’s expropriation given that the decision-making process on contingencies which are missing in a contract would involve also subordinates; second, if subordinates can exercise voice, they can limit invasions of their private sphere by a hierarch. How could the subordinates’ voice be structured to mitigate repugnance of hierarchical transactions? This issue may deserve further enquiries, as well.

⁶ Exit and voice are defined by Albert Hirschman as two contrasting responses of members of organizations to manifest dissent. In the case of firms, exit is the act of simply leaving, generally because a better job is provided by another firm. Voice is the act of organizing to complain or to protest. In comparison with exit, voice is typically a collective activity: to be effective voice often requires group action and is thus subject to all the well-known difficulties of organization, representation, and free riding. Exit and voice have very different impulses and are likely to arise in very different circumstances.

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