Applying Heterodox Economic Theory to the Teaching of Business Law: The Road Not Taken

CHARLES R.P. POUNCY*

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I. PROLOGUE

When I was approached to contribute to a symposium on using insights from socioeconomics in the law school classroom, I was profoundly embarrassed. I recognized that by making presentations at conferences or through conversations with colleagues at such events, I often left them with the impression that my classes were well punctuated with concepts from the heterodox economic theories I use in my scholarship. That impression was fraudulent. My attempts to bring

* Associate Professor, Florida International University College of Law. B.A., Fordham University, 1976; J.D., Cornell Law School, 1979; LL.M., Temple University School of Law, 1995.

genuine intellectual diversity into the classroom precipitated a collision with institutional racism; in deference to what remained of my emotional and physical health after that encounter, I have made only the most subtle subsequent references to heterodox economic theory in the classroom. Thus, I was confronted with the option of perpetuating my fraud by writing a paper in which I would pretend to teach in ways that I do not, or to write about the things I may someday teach when I have regained the emotional and physical constitution to reengage in the battle to confront and disempower the ideologies of subordination. I have chosen to do the latter. All the events described in this Article occurred at the Beasley School of Law of Temple University in Philadelphia, Pennsylvania during the period August 1999 through June 2000.

II. INTRODUCTION

Throughout much of the legal community, the term "economics" evokes memories of undergraduate micro- and macroeconomic courses. At most American colleges and universities, these courses focus almost exclusively on neoclassical economic theory,[1] which forms the foundation of what is thought of as mainstream economics in the United States. For law school professors, the term may also bring to mind the Coase Theorem,[2] Cardozo's proximate causation conjecture,[3] and a number of

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1. *See* Charles R.P. Pouncy, *Contemporary Financial Innovation: Orthodoxy and Alternatives*, 51 SMU L. REV. 505, 540–41 (1998).

> Neoclassical economics describes the economy as a state of equilibrium, in which the forces of supply and demand interact to achieve optimal allocation of society's resources. The focus of neoclassical economics is on the decision-making activity of entrepreneurs, households and firms. It assumes that economic decision-making is voluntary, informed and rational (i.e., utility maximizing). The models used in neoclassical economics are based on transactions occurring in exchange (i.e., barter) markets, in which perfect competition prevails. In these markets, goods are exchanged for goods, with money serving only as a neutral intermediary in the exchange. Economic models based on exchange markets also assume gross substitution effects. The axiom of gross substitution states that the demand for good *A* will change only in response to a pricing differential between good *A* and a substitute product. Exchange transactions also are envisioned as being costlessly reversible, and as occurring in an ergodic environment, in which there are no financial institutions. The market becomes the instrument of allocation, and individual self-interested economic decisions collectively achieve an optimal societal equilibrium.

Id. (footnotes omitted).

2. *See generally* R.H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1 (1960). The Coase Theorem was a response to Arthur Cecil Pigou's conclusion that the ability of firms to externalize some of their costs of production, such as the ability of a manufacturer to force the costs of dealing with the pollution its manufacturing processes produce on the surrounding community. Pigou concluded that this problem was best

concepts that have crossed what has become an all too permeable barrier between orthodox economic theory and judicial opinions.[4] Included among such transplants we find opportunity costs, transaction costs, and other terms.[5] However, few law professors and, I suspect, even fewer

resolved by regulatory intervention. *Id*. at 28–29, 41. Coase, however, suggested that property rights between the producer of externalities and those impacted by it could be balanced through private contracts to achieve an efficient result. *Id.* at 39–44; *see also* JÜRG NIEHANS, A HISTORY OF ECONOMIC THEORY 320–23 (1990).

3. *See generally* Palsgraf v. Long Island R.R., 162 N.E. 99 (N.Y. 1928).

4. The neoclassical economic paradigm represents economic orthodoxy in the United States. Thus, the terms are often used interchangeably. For example, Frances Woolley writes, "Perhaps the most fruitful approach is simply to define neoclassical economics as 'mainstream, orthodox economics' or to 'think of traditional or neoclassical economics as that which is represented in intermediate text books.'" Frances R. Woolley, *The Feminist Challenge to Neoclassical Economics*, 17 CAMBRIDGE J. ECON. 485, 486 (1993) (quoting MARK BLAUG, THE METHODOLOGY OF ECONOMICS OR HOW ECONOMISTS EXPLAIN 160 (1980)). Similarly, Johan Deprez writes, "In opposition to the neoclassical or Chicago School perspectives, there exist a variety of other economics paradigms. In one way or another, these heterodox perspectives reject key foundational elements of the orthodox schools of thought." Johan Deprez, *Risk, Uncertainty, and Nonergodicity in the Determination of Investment-Backed Expectations: A Post Keynesian Alternative to Posnerian Doctrine in the Analysis of Regulatory Takings*, 34 LOY. L.A. L. REV. 1221, 1233 (2001) (footnote omitted); *see also* OLIVER E. WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALISM 7, 23–26 (1985) (describing economic orthodoxy in the post-World War II period); Timothy A. Canova, *The Disorders of Unrestricted Capital Mobility and the Limits of the Orthodox Imagination: A Critique of Robert Solomon,* Money on the Move: The Revolution in International Finance Since 1980 *(Princeton University Press, 1999)*, 9 MINN. J. GLOBAL TRADE 219 (2000) (using the term "orthodox" to describe dominant or mainstream economic thought); Thomas W. Joo, *Contract, Property, and the Role of Metaphor in Corporations Law*, 35 U.C. DAVIS L. REV. 779, 798 (2002) (describing the axioms of the neoclassical paradigm as "orthodox economics"); Nancy C. Staudt, *Constitutional Politics and Balanced Budgets*, 1998 U. ILL. L. REV. 1105, 1116 n.50 (1998) (contrasting the theory of "constitutional economics" with orthodox economic theory).

5. The term "opportunity cost," as employed by economists, refers to the opportunities an individual foregoes as a consequence of choosing one course of action from a number of potential alternatives. Gerald J. Postema, *Liberty in Equality's Empire*, 73 IOWA L. REV. 55, 74 (1987). The concept of opportunity costs has been used in the bankruptcy context to determine "those amounts that an undersecured creditor would have earned if it had been permitted to foreclose on its collateral upon default, sell the collateral, and re-invest the proceeds, which the stay prevents." *In re* Timbers of Inwood Forest Assocs., 793 F.2d 1380, 1403 (5th Cir. 1986). The concept is used in various areas, including in discussing the best way to set attorney fee awards in civil rights litigation. Bruce H. Kobayashi & John R. Lott, Jr., *In Defense of Criminal Defense Expenditures and Plea Bargaining*, 16 INT'L REV. L. & ECON. 397, 407–08 (1996); *see also* Christine Jolls et al., *Theories and Tropes: A Reply to Posner & Kelman*, 50 STAN. L. REV. 1593, 1600 (1998) (using the concept in law and economics discourse generally); Neil K. Komesar, *Exploring the Darkness: Law, Economics, and Institutional Choice*, 1997 WIS. L. REV. 465, 468 (using the concept in analyzing institutional choice).

lawyers fully appreciate the observation that economics is merely a discipline, not a science. The fact that it is a discipline based on highly questionable, if not improbable, assumptions is discussed in legal scholarship on occasion,[6] but I suspect this observation is less frequently discussed in law school classrooms. Moreover, the possibility that mainstream economics can be viewed primarily as an ideologically based signifying system whose normative function appears to be the legitimization of current distributions of assets, resources, and opportunities is rarely discussed anywhere in this society;[7] so, the absence of such discussions in the law school classroom, while unfortunate, is not surprising.

Transaction costs are the costs of trading goods and services that are incurred in addition to price. THE MIT DICTIONARY OF MODERN ECONOMICS 432 (David W. Pearce ed., 4th ed. 1992). The concept was popularized by Oliver Williamson, who took the position that "the economic institutions of capitalism have the main purpose and effect of economizing on transactions costs." OLIVER E. WILLIAMSON, ON THE ECONOMIC INSTITUTIONS OF CAPITALISM: FIRMS, MARKETS, AND RELATIONAL CONTRACTING 17 (1985).

6. *See, e.g.*, Canova, *supra* note 4, at 219.

> While economics is unable to predict events or to offer solutions with any degree of certainty, the discipline's pretentions as a value-neutral science have often permitted orthodox economists to rely on flawed assumptions, and to continue offering explanations and prescriptions without any sense of humility for the possibilities of their own errors.

Id.; Deprez, *supra* note 4, at 1222–23 (contrasting Keynes's emphasis on uncertainty in expectations formation with orthodox theory's view of expectational certainty); James R. Hackney, Jr., *"Law and Neoclassical Economics": A Response to Commentaries*, 16 LAW & HIST. REV. 163, 163–64 (1998) (discussing his efforts to unmask the political nature of neoclassical theory's treatment of allocation and distribution).

7. Charles R.P. Pouncy, *Stock Markets in Sub-Saharan Africa: Western Legal Institutions as a Component of the Neo-Colonial Project*, 23 U. PA. J. INT'L ECON. L. 85, 87–89 (2002).

> Orthodox economics, the neoclassical paradigm, requires the adoption of a number of highly unrealistic assumptions about the way both people and markets behave. Neoclassical theory assumes that humans are primarily and consistently motivated by the goal of maximizing their personal self-interest as they understand it. However, cognitive theory has convincingly demonstrated that humans employ a range of decisional heuristics that result in decision making that exhibits consistent biases away from the theoretical predictions of neoclassical theory. In contrast, heterodox theories tend to perceive human behavior as being embedded in social processes, which for example, structure the way humans perceive and react to information. Institutional theory also perceives the nature of its inquiry differently than does the neoclassical paradigm. The neoclassical paradigm seeks to construct models which emulate the laws of nature, particularly physics. Institutional economists base their analyses on their examination of the behavior of real economies in historic time; therefore, the institutional approach is more likely to produce results consistent with the reality of human processes. Finally, institutional economics uses the concept of increasing opportunity, a dynamic expanding view of what is possible, as its value premise. The neoclassical paradigm seeks the result that is efficient with no real concern about the consequences of efficiency on the telos of humanity.

Id. (footnotes omitted).

Therefore, it also should not be surprising that law professors and others who come from backgrounds that have been marginalized and oppressed by the policy instruments constructed using neoclassical economic theory, both generally and as it has infiltrated the law and legal thinking, would devote greater effort to interrogating mainstream economic theory than those who benefit from the ideologically determined distributions of assets, resources, and opportunities that this system achieves.[8] For me, the results of such study have led to an increasing appreciation of the usefulness and importance of the schools of heterodox economics in understanding the structure and consequences of law and law based societal interventions and a desire to share such insights with my students.

However, as a person of color functioning in an environment in which white racism is assumed to be either normative or precipitated by the behavior of people of color, introducing heterodox analyses of business law becomes a process necessarily fraught with danger. Unlike orthodox economics, heterodox economic theories examine the relationships between groups such as socioeconomic classes, races, and genders, as well as the role played by the distribution and maintenance of power and power relationships.[9] Therefore, using heterodox analyses in teaching standard law school courses can generate hostility toward the messenger whose message results in a critical examination of unearned privileges and the institutional structures that support and perpetuate them.[10] Heterodox economic analyses also favor conscious democratic decisionmaking rather than the caprice of the market.[11] However, in our society, free-market dogma has been conflated with freedom itself,

8. WILLIAM M. DUGGER, UNDERGROUND ECONOMICS: A DECADE OF INSTITUTIONALIST DISSENT xxi–xxii (1992).

9. *See, e.g.*, Howard J. Sherman, *A Holistic-Evolutionary View of Racism, Sexism, and Class Inequality*, *in* INEQUALITY: RADICAL INSTITUTIONALIST VIEWS ON RACE, GENDER, CLASS, AND NATION 39, 43–51 (William M. Dugger ed., 1996).

10. *See* Pamela J. Smith, *Teaching the Retrenchment Generation: When Sapphire Meets Socrates at the Intersection of Race, Gender, and Authority*, 6 WM. & MARY J. WOMEN & L. 53, 60 (1999). Noting that the 1980s brought increasing levels of racial segregation in housing and consequentially in education, Professor Smith argues that current law school students tend to be racially isolated, which can result in hostility towards professors of color in the classroom by students who perceive the presence of professors of color as a political challenge to the ideologies of white privilege and white superiority. *Id.* at 60–65.

11. Edyth S. Miller, *Seen Through a Glass Darkly: Competing Views of Equality and Inequality in Economic Thought*, *in* INEQUALITY: RADICAL INSTITUTIONALIST VIEWS ON RACE, GENDER, CLASS, AND NATION, *supra* note 9, at 87, 89.

rendering a critical assessment of market processes the equivalent of advocating totalitarianism.[12] The fact that heterodox economic theory provides useful platforms for the discussion of class, race, gender, and markets makes it an excellent vehicle for discussion of the ideological components of business law. However, the use of such theories in contemporary law classrooms, particularly by professors of color or members of other marginalized groups, can make such professors lightning rods both for those students who are particularly committed to the preservation of unearned privilege and power and for the institutional processes that have arisen in law schools to maintain the current distribution of power, privilege, and authority.

Thus, for me, the task of introducing aspects of heterodox economic theory into my classes in Business Associations, Banking Law, and Corporate Finance largely has been postponed to some future date. It will take more than a few post-tenure months for me to once again attempt to introduce undisguised heterodox economic concepts into the law school classroom. Unfortunately, my initial attempts to do so unleashed a plague of insult and abuse upon me by both students and administrators and also forced me to acknowledge that the vast majority of my colleagues were oblivious both to the mechanisms of institutional racism and to my expectations of equality. Therefore, this Article speaks to the future, when I have sufficiently recovered to once again attempt to bring intellectual diversity into my classrooms through the introduction of heterodox economic thought.

III. HETERODOXY

"Before economics became a 'science,' it was philosophy, concerned with questions of 'the good' for the individual and the nation."[13] Arising in the time of the Enlightenment, during which the patterns of regularity we now recognize as the modern sciences were being uncovered, philosophers looked for such patterns, inter alia, in the behavior of features of the economy. Thus, the search began to discover the natural laws of economics, which, like the laws of physics, operated automatically and which, like the laws of gravity, were undefeatable.[14] The classical

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12. *See, e.g.*, MILTON FRIEDMAN, CAPITALISM AND FREEDOM 8 (1982).

> Economic arrangements play a dual role in the promotion of a free society. In the one hand, freedom in economic arrangements is itself a component of freedom broadly understood, so economic freedom is an end in itself. In the second place, economic freedom is also an indispensable means toward the achievement of political freedom.

Id.

13. Pouncy, s*upra* note 1, at 539 (footnotes omitted).

14. *See* E. RAY CANTERBERY, THE MAKING OF ECONOMICS 35–36 (1976).

economists Adam Smith, David Ricardo, John Stuart Mill, and Karl Marx proposed various ways of looking at the macro economy; however, perhaps as a function in living in the early stages of the machine age, mechanical regularity became the holy grail of economic thinking.[15] To achieve this degree of regularity, Leon Walras removed the worrisome realities of capital-intensive production, capital assets, and financial institutions from his model of the economy in order to develop mathematical statements that would simulate in the economy the same homeostasis and equilibrium found in the natural world.[16]

To separate his way of thinking about the economy from what had preceded it, Thorstein Veblen[17] characterized the intellectual progeny of Marx, Mill, Smith, and Adams as neoclassical economists as he elaborated theories that would become known as institutional economics.[18] Despite the challenges presented to neoclassical economics by John Maynard Keynes when his understandings of the economy were able to explain and remedy the persistent unemployment of the 1920s and 1930s in the United States and Europe in the face of neoclassical impotence to

15. Mirowski argues that the mechanical pretensions of economic theory result from a conscious effort on the part of the nineteenth century progenitors of neoclassical economics to create a "scientific" economics.

> The dominant school of economic theory in the West, which we shall call "neoclassical economics," has in the past often been praised and damned by being held up to the standards of physics . . . . [T]he resemblances of the theories are uncanny, and one reason they are uncanny is because the progenitors of neoclassical theory boldly copied the reigning physical theories in the 1870s . . . . [T]hose neoclassicals did not imitate physics in a desultory or superficial manner; no, they copied their models mostly term for term and symbol for symbol, and said so.

PHILIP MIROWSKI, MORE LIGHT THAN HEAT 3 (1989).

16. Pouncy, *supra* note 1, at 539–41 & n.215.

17. Thorstein Veblen (1857–1928), one of the founders and promoters of institutional economic theory in the United States, rejected the efforts of economists to establish in economics the regularity found in the physical sciences. Instead, he viewed the economy from an evolutionary perspective. *See generally* Steven G. Medema et al., *Institutional Law and Economics*, *in* 1 ENCYCLOPEDIA OF LAW AND ECONOMICS 418, 421–22 (Boudewijn Bouckaert & Gerrit De Geest eds., 2000). For Veblen, what would become known as neoclassical economics sought to impose what Veblen found to be a false order and predictability of economic activity, in part due to its focus on the activity of the individual. Instead of the individual, Veblen focused his economic thinking on institutional processes and the ways that real economies, rather than models, evolve and change over time. *See* Herbert Hovenkamp, *The First Great Law & Economics Movement*, 42 STAN. L. REV. 993, 1019–20 (1990). Veblen's major works include *The Theory of the Leisure Class* (1899) and *The Theory of the Business Enterprise* (1904).

18. NIEHANS, *supra* note 2, at 161–63.

address this condition,[19] neoclassical theory survived by simply importing Keynesian viewpoints into what would be characterized as the neoclassical synthesis.[20] Reduced to mathematical expressions and popularized by Samuelson, the Keynesian policy instruments imported in the neoclassical syntheses were instrumental in ending widespread post-Depression unemployment and in strengthening both the position of the U.S. economy and the financial security of both the working class and the middle class in the United States mid-century.[21] Treating Keynes's insights into the economy as a special case limited to issues of unemployment, the neoclassical synthesis went on to find some of its strongest proponents in the U.S. legal academy.[22] Although the original U.S. law and economics jurisprudence was inspired by and relied on institutional economics,[23] this new legal theory and its corresponding jurisprudence would be based on the most primitive and most contestable features of the neoclassical synthesis, which rendered transparent its ideological agenda of protecting the current distribution of assets, resources, opportunities, power, and privilege.

As the noted institutionalist theorist William Dugger has said, "Alienated people reject the values, beliefs, and meanings of the world into which they are born. . . . People rebelling against their economy find contradiction in it."[24] When I was confronted with an economic theory whose proponents increase unemployment to lower business costs, which views race and gender-based discrimination as a rational response, and which valorizes the current distribution of assets, resources, and opportunities because they are achieved by market processes, I was compelled to look at alternative understandings of the economy and its operation.

The world of economic heterodoxy at its best is a world of mutually interacting understandings about the way real economies operate in real

19. Pouncy, *supra* note 1, at 543–44.

20. *Id.* at 544.

21. Eichner credits Samuelson with popularizing what would become the neoclassical synthesis by reducing Keynesian principles into mathematical expressions. Alfred S. Eichner, *Introduction* to A GUIDE TO POST-KEYNESIAN ECONOMICS 9–10 (Alfred S. Eichner ed., 1979). Keynes's insight that the persistent unemployment of the Depression era resulted not from dislocations of supply but rather from liquidity preferences that stifled demand for employment was instrumental in the development of New Deal policies that helped alleviate mass unemployment. *See* PAUL DAVIDSON, POST KEYNESIAN MACROECONOMIC THEORY 20–22 (1994); JOHN MAYNARD KEYNES, THE GENERAL THEORY OF EMPLOYMENT, INTEREST AND MONEY 148–49, 168–69 (1936); Ari Afilalo, *Not in My Backyard: Power and Protectionism in U.S. Trade Policy*, 34 N.Y.U. J. INT'L L. & POL. 749, 758 (2002).

22. Pouncy, *supra* note 1, at 544.

23. Charles R.P. Pouncy, *The Rational Rogue: Neoclassical Economic Ideology in the Regulation of the Financial Professional*, 26 VT. L. REV. 263, 314 (2002).

24. DUGGER, *supra* note 8, at xxi.

time. Although there are marked differences between institutionalists, post-Keynesians, Marxians, and others who reject the validity of the neoclassical synthesis, they are united in their concern that the ideologically derived consequences of these neoclassical policy instruments do not serve the long-term best interests of the people and the planet. Also, institutionalists, post-Keynesians, and Marxians all have much to contribute to our understanding of legal processes and the functioning of our legal institutions.

For example, each of these economic schools of thought presents perspectives which are germane to teaching law generally and to teaching business law specifically. From institutionalism we obtain, inter alia, the concept of transaction costs, which has been absorbed by the neoclassical synthesis;[25] more importantly, however, institutional economics also provides us with the concept of the institution as the organizing principle for society. "An institution is a socially constructed belief system about the way things are and the way things should be that organizes human thought and action. An institution is not an objective physical phenomenon, but a human mental construct."[26] To the extent that individuals adhere to the beliefs present in an institution, they operationalize it by transforming those beliefs into action.[27] So, for example, an understanding that legal constructs and doctrines are institutions permits an understanding that changes in our collective beliefs about the way things are should result in changes to our legal institutions. This view is an important component of the observation that economies are not equilibrating interactions between supply and demand, but are an evolving set of financial, social, cultural, and historical processes which, like other evolutionary processes, interact without any particular goal or teleological perspective unless one is imposed upon them.

From the post-Keynesians, we get the view that the goals of stable prices and full employment are not incompatible[28] and that inflation is best understood as resulting from conflicts over the distribution of

25. *Id.* at 95–96, 318.
26. Johan Stein, *How Institutions Learn: A Socio-Cognitive Perspective*, 31 J. ECON. ISSUES 729, 730 (1997).
27. WENDELL GORDON, INSTITUTIONAL ECONOMICS: THE CHANGING SYSTEM 16 (1980).
28. Eileen Appelbaum, *The Labor Market*, *in* A GUIDE TO POST-KEYNESIAN ECONOMICS 100, 104–05 (Alfred S. Eichner ed., 1979).

income and output rather than as the result of demand excesses.[29] Therefore, rather than controlling inflation by imposing austerity measures on workers, the policy instruments of post-Keynesian theory would confront inflation by adjusting the relationship between wages, profits, and prices, thereby spreading both the burdens and benefits of the capitalist modes of production.[30] This view lays bare the economic triage of corporate downsizing as merely a readjustment in the relationship between wages and profits, one which favors profits over wages.

The Marxian school provides us with the notion of overdetermination, namely, "the ceaseless dialectical interplay between the process of theory and all other processes in society."[31] An appreciation of overdetermination illustrates the contingency and contestability of all theoretical constructs. As each theory has its own indicia of truth, each theory's understanding of "reality" and of the truths associated with that reality is different.[32] Theory becomes what its practitioners understand it to be. Therefore, attempting to understand the economy and economic processes by reference to particular theoretical constructions can produce an analysis that is consistent with the theory being applied, but that has no necessary relationship to objective reality.

So, for example, where a neoclassical analysis would recognize a sequence of activities as illustrating a linear cause and effect relationship, a Marxian analysis is more likely to see a much more complex, nonlinear interaction between an event and all of the other processes that necessarily construct and contribute to that event. Thus, the way one understands economic causality within the context of a particular economic phenomena depends on the particular economic theory being employed by the observer. Therefore, for example, an overdetermined discussion of unemployment cannot be focused around the issue of the demand for labor, as it would if using the linear causal mechanism recognized by neoclassical theory, but instead must also be informed by the relative distribution of profits between workers and owners, the need to transfer

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29. Alfred S. Eichner, *Introduction*, *in* A GUIDE TO POST-KEYNESIAN ECONOMICS, *supra* note 28, at 3, 16–17.

30. Peter Kenyon, *Pricing*, *in* A GUIDE TO POST-KEYNESIAN ECONOMICS, *supra* note 28, at 34, 43–44.

31. STEPHEN A. RESNICK & RICHARD D. WOLFF, KNOWLEDGE AND CLASS: A MARXIAN CRITIQUE OF POLITICAL ECONOMY 7 (1987). Thus,

> different theories no more capture the essence of the social totality than do different cuisines or different modes of production or different systems of laws. Each of these is a constituent process of the social totality; each is overdetermined by all other processes and participates in the overdetermination of all.

Id. at 9.

32. *Id.* at 6.

labor from commercial to military uses, the amount of societal resources invested in education, the optimal prison population, and other factors. Because the demand for labor as a variable is ideologically opaque, focusing an analysis at that level obviates an examination of the various, more ideologically transparent processes that overdetermine unemployment. Similarly, an individual does not become unemployed because, for example, her skills become obsolete, but because of the relationships between the various societal processes within which she is embedded and her ability to be employed.

These insights and many others provided by heterodoxy suggest that neither "the law" nor neoclassically inspired law and economics is neutral. But, whether deployed separately or in concert, they act as interventions in consensus reality, our shared notions of the way things are, to produce ideologically determined consequences that favor the current distribution of assets, resources, and opportunities.

IV. THE MECHANISMS OF INSTITUTIONAL RACISM AND THE SUPPRESSION OF INTELLECTUAL DIVERSITY IN THE CLASSROOM: "LEGAL DECISION MAKING"

I looked forward to teaching Legal Decision Making, a first-year legal process course, because it would provide me with an opportunity to compare and contrast the consequences of using different economic perspectives in analyzing the law. I began the course segment devoted to the law and economics school of jurisprudence by asking the students to define or describe economics. After obtaining the usual responses concerning the allocation of scarce assets among various potential uses, I attempted to explore the concept of scarcity. The students were readily able to recognize the disconnect between theoretical and real world notions of scarcity. I believe they were prepared to see scarcity as an issue not of quantity but of distribution and from there to entertain the view that distribution was not a function of economics, but of ideology.

However, on the evening following that preliminary discussion, one of the students felt obliged to post a critique of my approach to the assumptions underlying neoclassical theory on a listserver maintained for this particular class by the school. The critique began, "With all due respect to Professor Pouncy, I believe he was mistaken several times during today's class discussion," and went on to provide the "Microeconomics 101" analyses for the points I had raised. In responding to the student, I encouraged him to explore the distinction between what he "knew" and what he assumed and pointed out, with no undue gentleness, that the positions he advocated were ideologically constructed and had consequences that were disastrous for large numbers of people. Of course, the students revolted, with the principal complaint being that I behaved as if I thought I knew more than they did.

When summoned to defend myself by Robert Reinstein, Dean of Temple's Beasley School of Law, I pointed out that the students' complaints were a thinly veiled challenge of my authority to profess based on my race. Unfortunately, at that point, I had not applied an institutional analysis to my situation, or I might have been better prepared for what was to follow. I was told that I would have no future with that organization if I blamed the students for their racism because their racism was evidence of a teaching problem; the students would not behave in a racist manner if I was not doing something to make them behave that way. Ultimately, I was told that "my problem" was that I had never gotten used to racism. I was instructed to get used to racism and everything would be fine. In fact, this was advanced as the only reasonable course of action because racism was not going to go away. As I listened, dumbfounded, I thought of my ancestors, packed into a slave ship on their way to what would become America. I recognized that the same diminished humanity that animated their captors continued to animate mine, and, as I often do, I wondered again what it might be like to be free.

From an institutional perspective, this organization was using its supposed "student-centeredness" as an instrument to maintain the relative distribution of professorial authority between black and white faculty members. Upon their arrival, the students were informed that they were the best judges of a professor's performance in the classroom, and shortly after my arrival, I was informed that it was not permissible for me to observe that the students' assessments of my performance might be based more on my race than on actual indicia of my teaching ability. Thus, by permitting the students to replicate the processes of institutional racism while insulating them from any critique based on their commitment to white privilege and white superiority, this law school hides its institutional racist processes under the cloak of its "student-centeredness."

I recognized that the personal risks associated with any genuine effort to add to the intellectual and cultural diversity of this organization were too great.[33] The vast majority of my students have been privileged by

33. Nevertheless, unconvinced of the depth of this organization's commitment to its institutional racist processes, in January 2000 I detailed my experiences as part of a presentation I made at a commemoration of the birth of Martin Luther King, Jr. After the presentation, only one relatively marginalized white colleague behaved as if the treatment I received was at all problematic.

the distribution of assets, resources, and opportunities achieved by the policy instruments of neoclassical economics. More importantly, even those who were not so privileged had nevertheless inculcated many of the assumptions of the neoclassical paradigm, such as methodological individualism, economic rationality, and the value of efficiency in evaluating economic results. Methodological individualism sufficiently eviscerates any notion of class consciousness. As Thorstein Veblen's work illustrated more than one hundred years ago, "Americans in the lower strata seldom think of the upper strata in the bitter terms of exploitation. Rather than feel resentment, those in the lower strata feel envy. They do not want to overthrow their exploiters. They want to move up into the higher strata themselves."[34]

Perceiving that there would be no institutional support for my efforts to bring the intellectual diversity provided by heterodox economic theory into the classroom, I followed the dean's advice. I tried to teach in ways that would present no challenge to the ideologies of white privilege and white superiority. I tried to teach in ways that would not require my students to acknowledge that I knew more than they did or that my intellect was in any way more developed than their own. I taught from within the confines of an intellectual and emotional straightjacket. The students and the administration were content, as was my therapist, who now had no concerns about financing her children's education.

However, I did begin to create teaching notes for when I was no longer colored. These notes contain observations and analyses that I would use in introducing heterodox economic analyses into the classroom should I ever determine that I could do so without further injury to what remained of my dignity.

V. TEACHING ABOUT THE CORPORATION

The neoclassically inspired theory of the firm takes as one of its starting points the ideologically generated view that private ordering is the preferred way of structuring financial transactions.[35] Although

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34. William M. Dugger, *Four Modes of Inequality*, *in* INEQUALITY: RADICAL INSTITUTIONALIST VIEWS ON RACE, GENDER, CLASS, AND NATION, *supra* note 9, at 21, 31.

35. *See* William W. Bratton, Jr., *The New Economic Theory of the Firm: Critical Perspectives from History*, 41 STAN. L. REV. 1471, 1516–17 (1989); Geoffrey P. Miller, *The Rise and Fall of the Classical Corporation*, 59 U. CHI. L. REV. 1677, 1687 (1992) (describing Milton Friedman, Gary Becker, and others as neoclassical economists who appreciate

unequal bargaining power is recognized, it is thought to be ameliorated either by the competitive processes supposedly present in markets or, as a last resort, by regulatory intervention.[36] This belief in the assumed benefits of private ordering rests in significant part on a belief in economic rationality as the preferred explanation of human motivation, which in turn generates the processes of methodological individualism as the appropriate focus for understanding financial and economic behavior. As a result, students are presented with the legally determined economic status quo as the only legitimate way of organizing and operating business enterprises and are encouraged to think that an economic system fueled by resource consumption is sustainable in perpetuity.

At the heart of this process are the rules of fiduciary responsibility and their interaction with the purposes of the corporation. Although contemporary events forcefully suggest the illusory nature of fiduciary responsibilities in the management of the U.S. corporation, there is little in the neoclassical bag of tricks to explain "bad decisionmaking" as opposed to self-interested decisionmaking. Although bad decisions may serve the personal interests of the decisionmaker, the processes by which they come about are exogenous to the firm, as opposed to self-interested decisionmaking, which tends to arise through endogenous processes. If we list each of these issues: private ordering, economic rationality, methodological individualism, and fiduciary duty, one can easily argue that the operation of each of these processes is justified by the role that it plays in neoclassical theory. However, if we remove the imprimatur of orthodox economics and look at these processes solely from the perspective of their distributive consequences, corporate law begins to look a lot less like an institution of U.S. democracy and more like a relative of contemporary Russian plutocracy. The institutions of private ordering, economic rationality, methodological individualism, and fiduciary duty concentrate power in the hands of corporate managers, whose exercise of this power is subject only to very limited review. These individuals then use such power to their personal or class advantage while giving the appearance of devotion to shareholder and corporate concerns.

A. The Process as a Unit of Analysis

To encourage students to look critically at the institutions of the corporation and corporate governance, I will rely to a great extent on

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markets as achieving beneficial private orderings and view regulation with skepticism).

36. *See, e.g.*, Alan J. Meese, *Liberty and Antitrust in the Formative Era*, 79 B.U. L. REV. 1, 85 n.448 (1999) (quoting Hovenkamp for the proposition that unequal bargaining power in market transactions does not justify the imposition of regulation).

some of the core principles of antiessentialist Marxian thought. The law of corporate governance constructs the process of corporate decisionmaking in a rather linear fashion. Corporate directors comply with their duty of care if their decisions are informed, rational, and made in good faith.[37] Individual directors interact with each other, with corporate staff, and with experts in assessing relevant information and generating a decision. Once made, this decision is insulated from serious further scrutiny by the operation of the business judgment rule, which presumes that the decisionmaking process complies with and fulfills the directors' duty of care.[38] However, within this construction of the corporate decisional process are embedded the basic assumptions of neoclassical economic theory. First, that the appropriate unit of analysis and observation is the individual actor, whether a person, a firm, a household, or a nation state.[39] Therefore, in the basic corporations course we spend most of our time examining the behavior of corporate managers from the perspective provided by the axiom "corporate directors act collectively but are judged individually."[40] Thus, the law understands the individual director in the same ways as the individual director is constructed by neoclassical economic theory, namely, as a fragmented set of preference functions with a limited range of motivating influences and, therefore, an equally limited range of decisional responses.[41] The business judgment rule acts to limit the inquiry that shareholders can make into the decisional processes of directors and managers by presuming that managerial decisions are made in ostensible good faith with a reasonable amount of information and that such decisions bear some relationship to shareholder utility maximization and conform with the directors' duty of care.

However, Marxian analysis suggests that director decisionmaking occurs within a set of processes that includes, but is not limited to, the processes and institutions generated by the business judgment rule, other legal doctrines, and the broad range of societal processes and their associated institutions. Thus, the corporate scandals de jour of the early 1990s, unlike contemporary corporate scandals, did not involve accounting

37. JAMES D. COX ET AL., CORPORATIONS 179–80 (1997).
38. Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984).
39. Pouncy, *supra* note 23, at 272–73.
40. *See, e.g.*, Eliopulos v. Knox, 848 P.2d 984, 988–89 (Idaho Ct. App. 1992). Bank directors act collectively as a board of directors, rather than individually for the bank, but they can be held liable for individual as well as collective wrongs. *Id.*
41. Pouncy, *supra* note 23, at 290.

fraud and associated fiduciary breaches, but the mismanagement of derivative instruments. One observation flowing from that period was that corporate managers were encouraged to use derivative instruments by a process that appeared endogenous to the ranks of corporate management. Corporate managers recognize that their decisions would play a significant role in the progress of their careers and further recognize that their decisions will be evaluated in relation to their consistency with the decisions of similarly placed managers. The result of this process is that managerial decisions consistent with conventional decisionmaking and popular sentiment will be rewarded asymmetrically in a manner consistent with conventional decisionmaking.[42] Thus,

> a manager might determine that using certain derivative instruments created, rather than ameliorated, certain risks. Therefore, she would refuse to invest in such instruments despite the fact that most of her managerial peers in comparable firms were doing so. In the short-term, such a manager is likely to be replaced with a member of the prevailing herd. Assume, however, that despite her better judgment, the manager follows the lead of her peers. She invests and ultimately suffers the significant losses that her peers also experience. Despite the losses suffered, she and her peers will not be punished severely. However, one who fails to jump on the bandwagon when the herd's instincts prove to be correct will be punished severely.[43]

The asymmetrical rewards mechanism cooperates with the business judgment rule so that managers recognize that their decisions will be insulated from scrutiny by the rule's presumption, assuming these decisions are based on their consideration of a reasonable amount of information; this result follows even if the information underlying a particular decision includes the managers' own assessment of the likely response of similarly situated managers to such a decision. The processes of the asymmetrical reward structure never surface in a court's analysis when it determines whether managers are entitled to the presumption of the business judgment rule; this result follows despite the fact that this process may have been a primary reason for the decision to use derivative products whose operation and risk the managers did not fully understand or appreciate.[44] Thus, while the decisions of an individual manager can be explained by reference to the economic rationality heuristic, such an explanation is incomplete and therefore inaccurate to the extent that it does not consider the operation of other processes that enable us to perceive the individual manager's decision as a function of a collective managerial class determination about the risks associated with acting in a manner contrary to the

42. Pouncy, *supra* note 1, at 564.
43. *Id.* (footnote omitted).
44. *Id.*

behavior of one's peers. When asked what role, if any, the asymmetrical reward structure should play in a court's application of the business judgment rule presumption, students should appreciate that the business judgment rule, with its focus on the individual, is largely oblivious to sectoral processes like the asymmetric reward structure. My suspicion is that although students will remain unconvinced that processes, like the asymmetrical reward structure, should play a role in assessing board decisionmaking, they will begin to look for other processes that impact board decisionmaking rather than focus exclusively on the decisional propensities of individual directors.

B. Organizational Culture and Cognitive Psychology

Institutional economic theory can be read as calling for a "multivoiced analysis" of what we ordinarily would characterize as economic processes. Law, ethics, and economics are viewed as interdependent variables "embedded in a web of causality that can only be discussed meaningfully" by employing a multidisciplinary analysis.[45] Thus, to interrogate the processes that have resulted in our current spate of corporate ethical lapses, it is necessary to employ what John R. Commons[46] called a "multilanguage analysis" using the languages of law, psychology, sociology, and economics in all of their diversity.[47] The ability to meaningfully use such an analysis is greatly advanced by contemporary developments in cognitive theory and organization studies that enhance our understandings of psychological and sociological

45. Pouncy, *supra* note 23, at 322.

46. While Veblen is thought of as having created the theoretical underpinnings of Institutional economics, John R. Commons (1874–1948) is viewed as creating the methodological foundations of institutional theory. *See generally* Medema et al., *supra* note 17, at 427–30. Commons identified "the transaction" as the proper analytical focus of economic behavior and was instrumental in developing the models upon which New Deal labor and social welfare legislation were based. Harry Arthurs, *Reinventing Labor Law for the Global Economy: The Benjamin Aaron Lecture*, 22 BERKELEY J. EMP. & LAB. L. 271, 278 (2001). Commons's major works include JOHN R. COMMONS, INSTITUTIONAL ECONOMICS (1934); JOHN R. COMMONS, LEGAL FOUNDATIONS OF CAPITALISM (1924).

47. J. Dennis Chasse, *The Transaction in a Many Language Hypothesis*, 31 J. ECON. ISSUES 375, 375–76 (1997). In his writings, Commons initially included physiology rather than sociology in his multilanguage analysis. This was in keeping with institutional economics' evolutionary perspective. However, he would later reject physiology as a less than useful subjectivity and substitute the study of social relations in his analysis. Joëlle Forest & Caroline Mehier, *John R. Commons and Herbert A. Simon on the Concept of Rationality*, 35 J. ECON. ISSUES 591, 592 n.1 (2001).

processes in the construction of human behavior and of behavioral responses to social processes.

By following the institutionalist perspective and employing the analytical tools of cognitive theory, *Joy v. North*,[48] a staple of corporate law casebooks, becomes susceptible to a different reading, a reading focused at the intersection of cognitive psychology and organizational culture. *Joy v. North* was a derivative action brought by the stockholders of Citytrust Bancorp, Inc. against the corporation's directors. The shareholder alleged that the directors breached their duty of care to the corporation by a series of loans to a real estate developer that employed the son of the bank's CEO.[49]

One question the case raises is why the directors continued to make loans to the developer when the developer was in default on earlier loans, and it was clear that there was little chance that these loans would ever be repaid. The standard analysis, consistent with neoclassical theory's use of the individual as the appropriate unit of analysis, encourages the student to look for the individual or individuals who are responsible for such faulty decisionmaking. The likely culprit is the bank's CEO, Nelson North, who, through a combination of power and force of personality, dominated the board and forced them to make clearly inappropriate decisions.

Cognitive theory, however, suggests a somewhat different analysis. Cognitive theory suggests that the way a problem is framed influences the way decisionmakers will choose from among available options. For example, Amos Tversky and Daniel Kahneman created an experiment in which the experimental subjects were asked to make decisions in the context of a health crisis situation. The options the subjects chose were strongly influenced by whether the crisis was framed in terms of the number of people expected to live, as opposed to the number of people expected to die. When the crisis was framed in the positive domain, namely, the number of people expected to survive, the experimental subjects chose risk-averse options. However, when the crisis was framed in the negative domain, namely, the number of people expected to die, the experimental subjects chose risk-seeking options.[50] Although the mechanisms that result in these decisional processes are still subject to question, it is nevertheless clear that in many instances individuals will seek even greater risk when the problem is framed in terms of a choice between a range of losses.[51]

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48. 692 F.2d 880 (2d Cir. 1982).
49. *Id.* at 894–96.
50. Sandra J. Hartman & Beverly H. Nelson, *Group Decision Making in the Negative Domain*, 21 GROUP & ORG. MGMT. 146, 148 (1996).
51. *Id.* at 148–49.

Moreover, when it is a group decision rather than an individual decision, the likelihood is that the collective group response will amplify the most extreme response, whether risk-avoiding or risk-seeking, advanced by an individual group member.[52] Additionally, one of the constellation of factors that predict risk behavior are the characteristics of the group making the decision. These include group composition, cultural risk values, leader risk orientation, and organizational control systems.[53] Thus, for example, a cohesive group located in a corporate culture with risk-seeking tendencies and led by an individual with risk-seeking tendencies will make riskier decisions than a group with a different set of organizational characteristics.

In *Joy v. North*, the directors' decisionmaking was clearly framed in the negative domain. The loan was in default, the bank's auditors recommended that the bank establish a loss reserve for the loans equal to fifty percent of their value, and the Comptroller of the Currency advised the bank to inform its directors to consult with their personal attorneys when the bank sought to exceed regulatory restrictions on loans to one borrower.[54] The corporate culture took its cues from the behavior of its CEO, who the court found to have completely dominated the bank's management.[55] When students are asked how they should advise a client corporation on the composition of its board, they readily recognize the value of board members capable of exercising decisional autonomy. In the future, I also will ask whether cognitive theory offers any further suggestions to lawyers when advising their corporate clients on board composition. My hope is that students may identify increased diversity as a means of preventing board domination while lowering the board's tendency towards critique-suppressing group cohesion and developing a single frame of reference with respect to making a particular decision. However, I suspect that students will be surprised by the conclusion that psychological research can be used to argue that greater diversity within

52. Tatsuya Kameda & James H. Davis, *The Function of the Reference Point in Individual and Group Risk Decision Making*, 46 ORGANIZATIONAL BEHAV. & HUM. DECISION PROCESSES 55, 71 (1990).

53. Sim B. Sitkin & Amy L. Pablo, *Reconceptualizing the Determinants of Risk Behavior*, 17 ACAD. MGMT. REV. 9, 12 (1992). In addition to organizational characteristics, risk behavior is also influenced by individual characteristics—risk preferences, risk perceptions, and risk propensity—as well as by two problem-related characteristics—problem familiarity and problem framing. *Id.*

54. *Joy*, 692 F.2d at 895.

55. *Id.* at 894.

leadership groups is a good thing. I doubt they will embrace the idea, but I don't believe they will be affirmatively hostile to it either. At that point, I may use such a discussion to ask whether the failure to have a genuinely diverse board should be viewed as a breach of the directors' duty of care.

VI. CONCLUSION

I do not believe that introducing any of the teaching points I have mentioned into the law school classroom present undue risks to white professors who might choose to raise them. White professors enter the classroom with the presumptions of competence and authority bestowed by whiteness. The mere presence of a professor of color who evidences a person of color consciousness is a threat to the ideologies of subordination, white privilege, and white superiority, thereby provoking a repressive institutional response. However, professors of color in schools that have interrogated their institutions and intervened to prevent professors of color from being subjected to institutional racism are in a significantly better situation than the rest of us. If students have been educated to recognize and to resist the process of institutional racism, then people of color, one of the natural constituencies for critical economic thought, will be freed to add genuine intellectual diversity to the study of the issues raised by the use of neoclassical economic theory in understanding business law issues.