Michigan Law Review

Volume 103 | Issue 1

2004

The Illusion of Law: The Legitimating Schemas of Modern Policy and Corporate Law

Ronald Chen
United States Court of Appeals for the Second Circuit

Jon Hanson
Harvard Law School

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Ronald Chen and Jon Hanson***

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* Law Clerk to the Honorable Robert D. Sack, United States Court of Appeals for the Second Circuit; Charles Hamilton Houston Fellow, Harvard Law School (2003-04). A.B. 1995, Harvard; M.Sc. 1997, M.B.A. 1998, Oxford; J.D. 2003, Harvard — Ed.

** Professor, Harvard Law School. B.A. 1986, Rice; J.D. 1990, Yale. — Ed. We are grateful to participants of the New York University Center for Law and Business Colloquium on Corporate Law, the Kirkland & Ellis Corporate Law and Economics Workshop, the Duke Law School Faculty Workshop; to Bill Allen, Jamie Boyle, Rob Daines, Sam Fraidin, and David Tabak for helpful comments; and to Jith Meganathan, Thomas Tso, and Allen Wong for helpful research assistance. Carol Igoe provided wonderful secretarial assistance. For financial support, we are grateful to the Harvard Law School Summer Research Fund and the Charles Hamilton Houston Fellowship. Finally, for their love and support our deepest appreciation and gratitude go to Yud-Ren, Jing-Jy, Irene, and Albert Chen, Fiona Griffiths, and Kathleen, Emily, Erin, and Ian Hanson.

"Every way of seeing is always a way of not seeing; every insight is a blindness."

— Alfred North Whitehead[1]

"The evolution of ideas has its own laws . . . ."

— Friedrich A. von Hayek[2]

"Businessmen who talk this way are unwitting puppets of the intellectual forces that have been undermining the basis of a free society these past decades."

— Milton Friedman[3]

I. INTRODUCTION

This Article is about some of the schemas and scripts that form and define our lives. It is about the knowledge structures that shape how we view the world and how we understand the limitless information with which we are always confronted.

This Article is also about the "evolution of ideas" underlying corporate law and all of modern policymaking. It is about the ways in which schemas and scripts have influenced how policy theorists, policymakers, lawyers, and many others (particularly in the West) understand and approach policymaking generally and corporate law specifically. It is about both the invisibility and blinding effect of those schemas. It is about the battle over those schemas and the prizes of victory. And, finally, it is about how the now-dominant schemas render us the "unwitting puppets of the intellectual forces that have been undermining the basis of a free society these past decades."

This Article takes as its starting point the notion that human behavior is influenced by features in our environment, and within us, of which we are largely unaware — our "situation."[4] Our situation is not fixed; it is both malleable and, more importantly, manipulable. Some of the most important features of our interior situation are

1. Alfred North Whitehead (as quoted by Stephen Klineberg, a favorite undergraduate professor for one of us, at http://www.rice.edu/sallyport/2003/winter/features/aprizedreputation/page4.html).

2. Interview by Thomas W. Hazlett with F.A. Hayek (May 1977), in *The Road from Serfdom: Foreseeing the Fall*, REASON, July 1992, at 28, 34, *available at* http://reason.com/hayekint.shtml.

3. Milton Friedman, *A Friedman Doctrine — The Social Responsibility of Business Is to Increase Its Profits*, N.Y. TIMES, Sept. 13, 1970, § 6 (Magazine), at 33 [hereinafter Friedman, *Friedman Doctrine*].

4. *See* Jon Hanson & David Yosifon, *The Situation: An Introduction to the Situational Character, Critical Realism, Power Economics, and Deep Capture*, 152 U. PA. L. REV. 129 (2003) [hereinafter Hanson & Yosifon, *The Situation*]; Jon Hanson & David Yosifon, *The Situational Character: A Critical Realist Perspective on the Human Animal*, 93 GEO. L.J. 1 (2004) [hereinafter Hanson & Yosifon, *The Situational Character*].

knowledge structures — the categories, schemas, and scripts through which we interpret and respond to the world around us.[5]

Insofar as the situation affects our behavior, there is immense value in influencing it. This opportunity results in a significant, largely unseen, competition over our conceptions of the world, of the groups and institutions within it, and of ourselves. We argue that our positive and normative understandings of all of law and policymaking are in fact subject to just that sort of competition. Our hypothesis is that large commercial interests are best suited to succeed in this competition over our situation, and that therefore our laws and policies are biased in their favor.

That is only half of it. Policies that purport to be in the public interest, but that actually serve primarily the interest of the most powerful, risk being delegitimated.[6] This Article examines how the schemas and scripts behind our laws manage, through illusion, to legitimate institutions, outcomes, policies, and laws that, in fact, reflect the situational power of large commercial interests. It is important to underscore at the outset that this Article does not contemplate a nefarious sleight-of-hand artist intentionally seeking to manipulate us and our worlds. Though some readers may be tempted to erect such a straw man,[7] to do so would be to misapprehend our arguments and misconstrue our evidence. The competition over our knowledge structures is a process akin to the familiar invisible hand of markets. The illusion is the handiwork, neither of an individual mastermind nor even a vast, elaborate conspiracy, but of a situational magician — an assertion that should take on meaning as the Article develops.

We begin our discussion in Part II with the dominant knowledge structures underlying modern policymaking, describing the emergence of what we term the "meta script" of policymaking — or the schemas that frame our approach to policy analysis today. Part III turns to the law regulating large commercial interests — specifically, corporate law — and examines the emergence and dominance of the new "macro script" of corporate law. It examines the schemas that identify and

5. *See* Ronald Chen & Jon Hanson, *Categorically Biased: The Influence of Knowledge Structures on Law and Legal Theory*, 77 S. CAL. L. REV. 1103 (2004) [hereinafter Chen & Hanson, *Categorically Biased*]. Loosely, *categorization* and *categories* refer to the classification of elements, experiences, instances, arguments, persons, places, things, and so on into groups. *Schemas* and *scripts* refer to the application of prior knowledge to those groups permitting predictions and inferences about the items categorized. For a far more detailed definition and analysis of knowledge structures, see *id.* at Part II.

6. *Cf.* TOM R. TYLER, WHY PEOPLE OBEY THE LAW 102-12 (1990) (describing need for perceptions of fairness in maintaining law's legitimacy).

7. Some of the motives behind that temptation are described in related work. *See, e.g.*, Hanson & Yosifon, *The Situation*, *supra* note 4, at 328-43; Adam Benforado & Jon Hanson, Naive Cynicism: Some Mechanisms of Dispositionism and Other Persistent Attributional Errors in Policy Debates (work in progress, on file with authors).

legitimate the purpose of the law. Parts IV and V highlight the signs of illusion in those schemas and then begin to unveil the situational magician behind those illusions. Corporate law works, as all illusions work, by relying on a set of schemas that guide our attention and inferences and play into our intuitions and motives.[8] Yet the outcome and response that this Article suggests is neither so benign nor light-hearted as that of a magic show. While its analysis is concentrated on corporate law, the Article's implications reach each of us, from law student to legal scholar, citizen to policymaker, and reveal something unsettling: all of us are susceptible to schematic sleight-of-hand, tricks that render us vulnerable to dangerous illusion. Where many have heretofore tended to see magic, this Article reveals the illusion of law and some of the unseen mechanisms that make it possible.[9]

This project's larger ambition, it should be noted, is not to encourage disillusionment with the purported goals of the law, but to provide insights that help tailor our means and to narrow the gap between our ends and our outcomes.

II. THE META SCRIPT OF POLICYMAKING

This Part begins with a stylized history of the emergence of what we call the *summary meta script* that currently dominates policy analysis.[10] The goal here is not to offer a detailed scholarly account of

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8. Given our thesis and the influence of our own nascent schemas, we acknowledge a similar danger that we may be tempted to see illusion where none exists. Just as audience members who want to see magic are putty in the magician's hands, a skeptic may see illusion even when magic exists. *See* Ronald Chen & Jon Hanson, Theorizing Illusion: The Laws Behind Our Laws (work in progress, on file with authors) [hereinafter Chen & Hanson, Theorizing Illusion]. We acknowledge that risk but proceed out of concern for the greater risk posed by the other side of two-headed coin. If there is illusion at work — as we believe history, social science, and market practices all indicate there may be — then it will not be discovered absent a dose of searching skepticism.

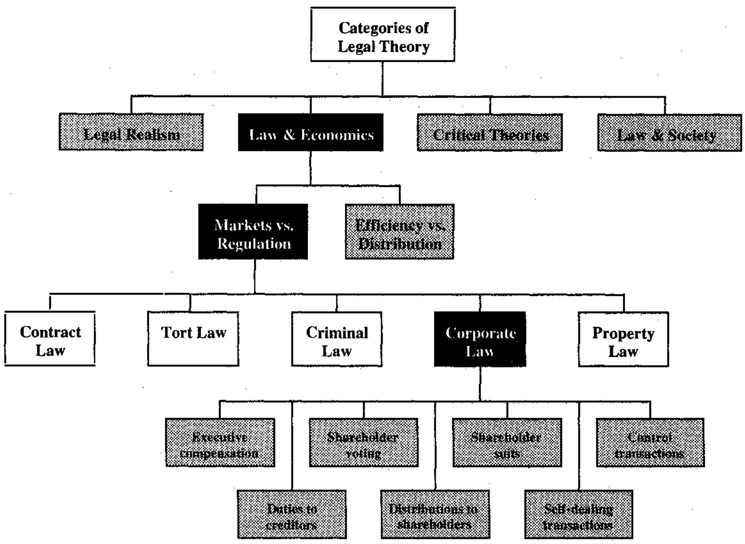
9. In this Article, we will be attempting to redescribe and connect familiar ideas in unfamiliar ways. Our schemas are moved often by the choice of words, language, frames, and metaphors and the ability of those factors to guide our attention and inferences. *See* Chen & Hanson, *Categorically Biased*, *supra* note 5, at 1174-218. Thus, in our effort to demonstrate that the familiar and comforting magic of law is really illusion, we will, more than we otherwise would, rely heavily on the precise words and arguments that legal scholars and judges themselves have used.

To some of our readers our analysis will be, like the magician's trick, disappointing when revealed. To many other readers our analysis will feel threatening. Our greatest difficulty, we expect, will be overcoming the subconscious urge that many readers will understandably have to minimize that threat, as well as the tremendous psychological burden of proof that now must be overcome by anyone hoping to demonstrate that our system is built largely on illusion. *See* authorities cited *supra* note 7. Given the tenacity with which magicians protect their secrets, *see* Chen & Hanson, Theorizing Illusion, *supra* note 8 (discussing the unmasking of and efforts to ostracize the "Masked Magician"), and the motive that even audience members have to see magic, persuasively revealing such an illusion and the tricks behind it is sure to be difficult and may simply be impossible.

10. In separate work, we provided an initial schematization of the law — an attempt, like any schema, to make our complex world manageable. *See* Chen & Hanson, *Categorically*

Biased, *supra* note 5, at 1249. We divided the law into *levels*, like categories, so that we might better understand them (see Figure below). The first and "highest" level of the law we labeled the *meta level*. The ideas, concepts, and conclusions generated at the meta level we call the *meta schemas* or *meta scripts*. Meta schemas are general, in that they inform our approach to, and understanding of, all areas of law and policy. The conventional view that legal rules should focus on efficiency concerns, leaving "distributional" issues for the "tax-and-transfer system," is an example of a meta script. *See infra* text accompanying notes 467-485 (briefly discussing the distribution versus efficiency debate). *See generally* Ronald Chen & Jon Hanson, Distribution versus Efficiency: Missing the Taste of the Pie (work in progress, on file with author) (examining that debate in detail) [hereinafter Chen & Hanson, Distribution versus Efficiency].

FIGURE. THE SCHEMATIC LEVELS OF THE LAW



The *macro level* involves specific areas of the law, such as corporate law, property law, or tort law — the divisions found on the covers of casebooks, treatises, and on the pages of law school course catalogues. Insights at the macro level are those that relate to the entire body of an area of law. These *macro scripts* make sense of an area of law, helping determine what disputes are resolved by it, what its goal or purpose is, and to what extent the given area of law overlaps or interacts with other areas of law. Macro scripts also can inform how individual cases should be resolved — which leads to the third schematic level of law.

The *micro level* is where the law is applied in specific doctrinal areas to specific cases and disputes. Thus, for example, within tort law, micro scripts include everything from battery to defamation to products liability. In corporate law, the micro level comprises questions involving the duty of loyalty, self-dealing, shareholder voting, shareholder suits, control transactions, and so on.

This schematization of the law into meta, macro, and micro levels provides a framework for our analysis in this Article and others to follow. In other work now in progress, we are testing our illusion-of-law hypothesis by comparing the micro scripts to the macro script of corporate law, Ronald Chen & Jon Hanson, The Illusion of Law: The Legitimating Schemas of Corporate Law Doctrine — Part I (work in progress, on file with authors) [hereinafter all the historical forces that have given shape to our current policy scripts. Rather, it is to highlight the ideas that are commonly said to have informed, or even caused, the changing tides in policymaking over the past quarter century. Section A picks up where the now-dominant meta schemas were first gaining credibility and a meaningful foothold in policymaking circles.

A. *The Emergence of the Summary Meta Script*[11]

Travel back in time to the early 1970s, a time when corporate CEOs were talking openly and often about their commitment to social responsibility,[12] when inflation rates were reaching record heights, and

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Chen & Hanson, Legitimating Schemas I); Ronald Chen & Jon Hanson, The Illusion of Law: The Legitimating Schemas of Corporate Law Doctrine — Part II (work in progress, on file with authors) [hereinafter Chen & Hanson, Legitimating Schemas II], by comparing the meta scripts within a given legal theory, Chen & Hanson, Distribution versus Efficiency, *supra*, by comparing the macro scripts across two areas of law, Ronald Chen, Client Primacy, Shareholder Primacy: The Invisible Hand of Corporate Law and the Ethics of Corporate Counselors (work in progress, on file with authors), and by comparing the meta schemas of various legal theories, Chen & Hanson, Theorizing Illusion, *supra* note 8. In other work, pretheoretic schemas (that is, schemas presumed by the theory as opposed to proven by it) regarding the forces behind human behavior and attributions of causation, responsibility, and blame have been closely scrutinized. *See, e.g.*, Hanson & Yosifon, *The Situation*, *supra* note 4; Hanson & Yosifon, *The Situational Character*, *supra* note 4; Adam Benforado, Jon Hanson & David Yosifon, *Broken Scales: Obesity & Justice in America*, 53 EMORY L.J. (forthcoming fall 2004) [hereinafter Benforado, Hanson & Yosifon, *Broken Scales*]. That work indicates that the dispositionist schemas of almost all laws and legal theories are, indeed, "deeply captured" by large commercial interests. Dispositionism — which includes the "illusion of choice" and the "illusion of individualism" — plays an integral part in the illusion of law.

This Article focuses primarily on the dominant meta schemas of policymaking and the dominant macro schemas of corporate law. Clearly the meta schema is one of the most valuable elements of our situation inasmuch as it seems likely to have the broadest influence over how we think about and approach all policies and policymaking. This Article also examines the macro schema of corporate law because, of all areas of law, it is difficult to think of one that would be more significant to corporations. If there is illusion to be discovered in our policy schemas, and if magic is any guide, one of the best places to look for it will be in the meta level of policymaking and the macro level of corporate law.

As we predicted in a previous article, and as this Article confirms, separating our analysis into these levels — and analyzing closely the knowledge structures that shape our understanding of these levels — helps us to see illusion where we once had seen magic and to see the trick where we might never have looked for it. *See* Chen & Hanson, *Categorically Biased*, *supra* note 5, at 1239-52.

11. By "summary meta script" we mean to refer to the terse conclusion of the more detailed argument or script that leads to it. The conclusory version has, as we will argue, become a powerful script in itself — a script that seems automatically to activate the presumptions associated with the longer rendition. At both the meta level and the macro level, we will examine the evolution of each summary script and its mutually reinforcing relationship with its more detailed partner.

12. *See infra* text accompanying notes 135-143. For reasons that we explore in subsequent work, the language of social responsibility has very recently gained some momentum in corporate America. *See* Ronald Chen & Jon Hanson, The Illusion of Law: Testing the Promises of Shareholder Primacy (work in progress, on file with authors) [hereinafter Chen & Hanson, Testing Shareholder Primacy] (summarizing the increasingly

when a lingering recession was pushing unemployment rates up and consumer confidence down.[13] It was a time when that combination of inflation plus recession, *stagflation*, bedeviled not only the United States but also several other western economies, including Britain's.[14]

In the United States, Jimmy Carter's popularity ratings tracked the economy's performance. His promise to stimulate jobs through greater government spending flopped. True, spending went up, but employment rates didn't.[15] With an energy crisis contributing to his woes, Carter implored Americans to change their ways: "[T]his is the greatest challenge our country will face during our lifetimes."[16] Indeed, Carter explained, it was the "moral equivalent of war."[17] He then warned Americans of what lay ahead on their then-current path in these apocalyptic terms:

> We will feel mounting pressure to plunder the environment. We will have a crash program to build more nuclear plants, strip-mine and burn more coal, and drill more offshore wells than we will need if we begin to conserve now. Inflation will soar, production will go down, people will lose their jobs. Intense competition will build up among nations and among the different regions within our own country.
>
> If we fail to act soon, we will face an economic, social and political crisis that will threaten our free institutions.
>
> But we still have another choice. We can begin to prepare right now. We can decide to act while there is time.[18]

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glaring evidence that shareholder primary is not delivering on its promise to increase social welfare); *see also infra* text accompanying notes 336-350 (briefly describing some of the trends and crises). McDonald's, for instance, has recently published an extensive social responsibility report. *See* MCDONALD'S CORP., MCDONALD'S WORLDWIDE CORPORATE RESPONSIBILITY REPORT (2004), http://www.mcdonalds.com/corp/values/socialrespons/sr_report.html (last visited Oct. 9, 2004). For an account of the recent crises that helped lead to that report, see Benforado, Hanson & Yosifon, *Broken Scales*, *supra* note 10, at Part III.

13. Between 1970 and 1975, for example, the inflation rate rose from 5.7% to 9.1% and the unemployment rate rose from 4.9% to 8.5%. *See* ECON. REPORT OF THE PRESIDENT 376, 400 (1999), http://www.gpoaccess.gov/usbudget/fy00/pdf/1999_erp.pdf; *see also* William Schneider, *An Insider's View of the Election*, ATLANTIC MONTHLY, July 1988, at 29, 31 ("[C]onsumer confidence dropped 33 percent after the 1973 surge in oil prices.").

14. *See, e.g.*, N. GREGORY MANKIW, PRINCIPLES OF ECONOMICS 750 (2004); JERRY Z. MULLER, THE MIND AND THE MARKET 380 (2002) (describing a rise in inflation in western Europe from about 1% in 1960 to 3.7% during the years 1961 to 1969, to 6.4% in the years from 1969 to 1973 before it "then shot up to over 10 percent per annum from 1973 to 1979"); JOSEPH STIGLITZ, ECONOMICS 445 (2002); ECON. REPORT OF THE PRESIDENT, *supra* note 13, at 450-51.

15. Although the unemployment rate did fall from 8.5% in 1975 to 5.8% in 1979, it quickly rose again to 7.1% in 1980. *See* ECON. REPORT OF THE PRESIDENT, *supra* note 13, at 376.

16. Jimmy Carter, The President's Proposed Energy Policy, National Television Address (Apr. 18, 1977), *in* 43 VITAL SPEECHES OF THE DAY 418, 418 (May 1, 1977).

17. *Id.*

18. *Id.* at 419.

And with that, Carter hoped Americans would join him in conserving energy and sacrificing many of the comforts to which they had grown accustomed.

In England, meanwhile, conditions were probably worse. By the middle of the twentieth century, as England was becoming just a country and not "The Empire," its economy, like its character, was being transformed. Its major industries were nationalized and a comprehensive welfare system was put in place.[19] For a time, this socialist democracy had seemed the best of all worlds: a luxurious safety net, a planned and thriving economy, and a voting populace. But it was not to last. By the early 1970s, the economy was, under Labour Party leadership, unraveling.[20] And when the energy crisis landed, it struck what would be the final blow to the Labour Party's grip on power.[21] Nationwide strikes, including most prominently the coal strike, led to what historians call the "Winter of Discontent."[22] Labour's Prime Minister, James Callaghan, sat at the helm, like Carter did in the United States, seemingly powerless and rudderless against the economic onslaught.[23]

Now jump ahead a few years. Portions of the world looked very different — as did their leaders. Jimmy and James had both been trounced by voters, and in their place were two very unlikely heads of state. In the United States, Ronald Reagan ushered in "Morning Again in America,"[24] while Margaret Thatcher became the first woman prime minister in England's history.[25] The two new leaders not only looked different, they *were* different from their predecessors —

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19. *See* DANIEL YERGIN & JOSEPH STANISLAW, THE COMMANDING HEIGHTS 25-26 (1998).

20. *See id.* at 96.

21. It was not until 1997 — nearly three decades later — that a Labour Party candidate was elected Prime Minister. But this was, even by their own account, a radically different Labour Party — "New Labour" — with the young, party-reformer Tony Blair in the lead. *See* LABOUR PARTY, TONY BLAIR, HISTORY OF THE LABOUR PARTY, *at* http://www.labour.org.uk/historyofthelabourparty (last visited Oct. 9, 2004).

22. *See* YERGIN & STANISLAW, *supra* note 19, at 104-05.

23. *See id.*

24. Lou Cannon describes Reagan's famous reelection advertisement, which stated:

> It's morning again in America. Today, more men and women will go to work than ever before in our country's history. With interest rates at about half the record high of 1980, nearly two thousand families today will buy new homes, more than at any time in the past four years. This afternoon, sixty-five hundred young men and women will be married, and with inflation at less than half of what it was four years ago, they can look forward with confidence. It's morning again in America. And under the leadership of President Reagan, our country is stronger, and prouder, and better. Why would we ever want to return to where we were less than four short years ago?

LOU CANNON, PRESIDENT REAGAN: THE ROLE OF A LIFETIME 512-13 (1991).

25. *See* MARGARET THATCHER, THE PATH TO POWER (1995).

each brazenly jettisoning conventional policies and actively promoting a new agenda.

The economies in both countries, after some very painful economic and political struggles, were turning around. Inflation rates were coming down and employment rates were going up, and the rudder and engine of success seemed firmly in place.[26] Indeed, the two countries displayed such a dramatic transformation that other countries still sinking into the quicksand of stagflation began looking to Reagan and Thatcher and their unconventional approach for a solution. Countries in Asia, Eastern Europe, and South America began mimicking the practices of the United States and Britain.[27] Even countries that had violently rejected capitalism altogether were changing course and transforming themselves through mostly nonviolent revolution to come into line with the emerging model.[28] A world that had been divided by seemingly immutable categories and boundaries was lumbering and then soaring toward convergence.[29]

So what changed in the interim? In the United States, what explains the bridge between Iranian hostages, gas lines, and an ineffective, do-good, peanut-farming president, on one hand, and the fall of the "evil empire," a growing economy, and a can-do, movie-star president on the other? In Britain, what explained the leap between a lagging economy built on nationalized industry and a complacent, deal-making, gray-headed socialist on one hand and a revitalized market-centered economy set free by a fiery blonde "Iron Lady" on the other? Across the globe, what changed to transform two moribund economies into two burgeoning economies that were the marvel of and model for much of the world? In brief, what changed was the meta script.

When Thatcher stepped into power, she strode confidently, doubtless about how to steer her country toward success. She carried new ideas and a firm determination to implement them. In the words of two authors who studied her rise:

> Margaret Thatcher knew exactly what she thought. Government was doing too much. "We should not expect the state," she declared not long after taking office, "to appear in the guise of an extravagant good fairy at

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26. *See, e.g.*, ECON. REPORT OF THE PRESIDENT, *supra* note 13, at 3.

27. *See generally* YERGIN & STANISLAW, *supra* note 19, ch. 5 (describing the "crisis in confidence" that led countries to follow the lead of the U.S. and Britain toward market-based economies).

28. *See id.* at 187.

29. We summarize an important example of that convergence — that is, in the macro script of corporate law — and examine some of its causes and effects in other work. *See* Ronald Chen & Jon Hanson, The Illusion of Law: False Starts in the Races for Corporate Law (work in progress, on file with authors) [hereinafter Chen & Hanson, False Starts]; Chen & Hanson, Testing Shareholder Primacy, *supra* note 12.

every christening, a loquacious companion at every stage of life's journey, and the unknown mourner at every funeral." She wanted to replace what she called the "Nanny State" and its cradle-to-grave "coddling" with the much more bracing risks and rewards of the "enterprise culture."[30]

Ronald Reagan was cut from the same ideological cloth.[31] Indeed, it was his ideological hankering, more than his Hollywood background, that made him stand out:

> Reagan was [initially] regarded as outside the mainstream of American politics, a genial figure from the far right. He was an ideologue using a vocabulary made obsolete by [Franklin Roosevelt's New Deal. He talked about rolling back government and] cutting programs; he promoted free enterprise and celebrated the magic of the market. That was understandable if one was a spokesman for General Electric.... But surely that was not the kind of rhetoric that was expected of a president of the United States.[32]

In short, Thatcher and Reagan were kindred spirits.[33] They both embraced and made famous a version of what would become the modern (post-Keynesian) summary meta script: "markets good; regulation bad."

But the success of these leaders did not turn on their creative genius. They were not peddling their own ideas. Rather, their success resulted from their effectiveness as de facto spokespeople for the scholars generating the ideas upon which the meta script was based. As new replaced old in the political arena, a revolution was taking place within economics, with scholars like England's John Maynard Keynes and his American student John Kenneth Galbraith supplanted

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30. YERGIN & STANISLAW, *supra* note 19, at 108.

31. As Lou Cannon writes:

> Reagan's principal mission in the presidency, or so he thought, was to rein in a government he considered an obstacle to economic opportunity and human liberty. His complaint that the federal government had 'overspent, overestimated and overregulated' changed iittle over the years, but the audience for this message grew steadily larger during the 1970s.

CANNON, *supra* note 24, at 819 (quoting Lou Cannon, *Reagan Announces, Urges Strength at Home, Abroad*, WASH. POST, Nov. 14, 1979).

32. YERGIN & STANISLAW, *supra* note 19, at 329. As Murray Weidenbaum, Reagan's first chairman of his Council of Economic Advisers, explained, "As we see it, the most appropriate role for government economic policy is to provide a stable framework in which private individuals and business firms can plan confidently and make their own decisions." *See* GEORGE C. EADS & MICHAEL FIX, RELIEF OR REFORM? REAGAN'S REGULATORY DILEMMA 2 (1984) (quoting Murray L. Weidenbaum, Economic Policy for 1982, Address Before the National Ocean Industries Association (Mar. 8, 1982)).

33. As Lou Cannon writes, at their first meeting "[Reagan and Thatcher] hit if off immediately, talking for more than an hour about the need for economic reform in Britain and the United States." CANNON, *supra* note 24, at 464. Reagan and Thatcher shared a belief that, in Reagan's words, "people will stay free when enterprise remains free." *Id.* (quoting President Ronald Reagan, Remarks Made During Margaret Thatcher's Visit to Washington D.C. (Feb. 26, 1981)).

by the competing ideas of Friedrich von Hayek of the "Austrian School" of economics and Milton Friedman and other members of his "Chicago School."

Hayek's ideas, many of which were contained in readable and, as it turns out, widely read books such as *The Road to Serfdom*, eventually won him the Nobel Prize in Economics.[34] For most of the twentieth century, however, Hayek found his ideas relegated to the distant periphery of economics and beyond the pale for policymakers.[35] But Hayek, who labored in the vast shadow of Keynes, was undeterred by obscurity and pursued his thesis with the confidence and energy of someone whose ideas were changing the world. Perhaps he was prescient. In any event, his perseverance paid off.

By making the invisible hand visible, Hayek's conclusions, which had once seemed obviously wrong, have become our obviously correct starting point. Thus, when Lawrence Summers, Harvard University's current President, teaches economics these days, he teaches students that "'the single most important thing to learn from an economics course today ... is the view that the invisible hand is more powerful than the [un]hidden hand. Things will happen in well-organized efforts without direction, controls, plans. That's the consensus among economists. That's the Hayek legacy.'"[36] And that legacy is why Vernon Smith, the 2003 Nobel Laureate in Economics, calls Hayek "the leading economic thinker of the 20th century,"[37] and why one writer recently referred to the twentieth century itself as the "Hayek Century."[38]

It was on Hayek's pro-market and anti-regulatory conclusions that Margaret Thatcher based her agenda. Hayek, she left no doubt, was her visionary. On a visit to the Conservative Party's research department, for instance, one of the members was extolling the virtues

34. *See, e.g.*, FRIEDRICH A. HAYEK, INDIVIDUALISM AND ECONOMIC ORDER (1948) [hereinafter HAYEK, INDIVIDUALISM AND ECONOMIC ORDER]; F.A. HAYEK, MONETARY NATIONALISM AND INTERNATIONAL STABILITY (Augustus M. Kelley 1964) (1937); FRIEDRICH A. HAYEK, THE PURE THEORY OF CAPITAL (1941); FRIEDRICH A. VON HAYEK, THE ROAD TO SERFDOM (1944).

35. Interview by Thomas W. Hazlett with F.A. Hayek, *supra* note 2, at 29 ("But within the economics profession it is no secret that Hayek was an academic outcast, a throwback, a marginal character whose ideas had been neatly disproven to all reasonable men in the scientific journals of his day.").

36. YERGIN & STANISLAW, *supra* note 19, at 150-51 (quoting Lawrence Summers).

37. Vernon L. Smith, *Reflections on* Human Action *after 50 Years*, 19 CATO J. 195, 208 (1999).

38. John Cassidy, *The Hayek Century*, HOOVER DIG., Summer 2000, http://www-hoover.stanford.edu/publications/digest/003/cassidy.html#top; *see also* MULLER, *supra* note 14, at 384 ("All in all, the 1980s and 1990s were a Hayekian moment, when his once untimely liberalism came to be seen as timely.").

of a middle course between right and left when she, according to one report, "brusquely interrupted him"[39] and

> reached into her briefcase and pulled out . . . Hayek's *The Constitution of Liberty*. She held it up for all to see. "This," she said sternly, "is what we believe." She slammed it down on the table and then proceeded to deliver a monologue on the ills of the British economy.[40]

In her various books and memoirs, Margaret Thatcher has, since her years as prime minister, continued to echo her allegiance to Hayek's ideas.[41]

Meanwhile, on the other side of the Atlantic, Ronald Reagan was singing from the same hymnbook. Reagan had read and absorbed some of Hayek's work.[42] And like Hayek, who saw the market as a marvel, Reagan touted the market's "magic." In a speech early in his presidency, Reagan urged his audience to place their faith in that magic:

> We who live in free market societies believe that growth, prosperity, and ultimately human fulfillment, are created from the bottom up, not the government down. Only when the human spirit is allowed to invent and create, only when individuals are given a personal stake in deciding economic policies and benefiting from their success — only then can societies remain economically alive, dynamic, prosperous, progressive and free.
>
> Trust the people. This is the one irrefutable lesson of the entire postwar period contradicting the notion that rigid government controls are essential to economic development.
>
> The societies which have achieved the most spectacular, broad-based economic progress in the shortest period of time are not the most tightly controlled, nor necessarily the biggest in size, or the wealthiest in natural

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39. YERGIN & STANISLAW, *supra* note 19, at 107.

40. *Id.*; *see also* JOHN RANELAGH, THATCHER'S PEOPLE: AN INSIDER'S ACCOUNT OF THE POLITICS, THE POWER, AND THE PERSONALITIES ix (1991) (recounting the same anecdote).

41. *See, e.g.*, MARGARET THATCHER, THE DOWNING STREET YEARS 12-13 (1993) (stating that "Hayek's powerful *Road to Serfdom*" had "left a permanent mark on my own political character, making me a long-term optimist for free enterprise and liberty"); *id.* at 618 (calling "Adam Smith . . . the greatest exponent of free enterprise economics till Hayek and Friedman"); MARGARET THATCHER, THE PATH TO POWER 50 (1995) ("[T]he most powerful critique of socialist planning and the socialist state which I read at this time, and to which I have returned so often since [was] F.A. Hayek's *The Road to Serfdom* . . . .").

42. When asked about which "thinkers or writers most influenced [his] conduct as a leader, as a person," Reagan put Hayek near the top of his list. *See* ROWLAND EVANS & ROBERT NOVAK, THE REAGAN REVOLUTION 229 (1981); *see also* MARTIN ANDERSON, REVOLUTION 164 (1988) (writing that Reagan had "read and studied the writings of some of the best economists in the world, including the giants of the free market economy — Ludwig von Mises, Friedrich Hayek, and Milton Friedman").

> resources. No, *what unites them all is their willingness to believe in the magic of the market place.*[43]

Perhaps even more important, Reagan surrounded himself with advisors who were themselves versed in Hayek's work and devoted to advancing the same free-market agenda. They were the group of economists from the University of Chicago, where Hayek had been in residence during the 1950s.[44] Among them was Milton Friedman, whose career, in many ways, resembled Hayek's.[45]

Though initially marginalized by the macroeconomic views of Keynes and Keynesianism, Friedman emerged as America's, and perhaps the world's, best-known free marketeer. Like Hayek, he would later win the Nobel Prize in Economics, and authored numerous popular books espousing his views, such as *Free to Choose*[46] (co-authored with his wife, Rose Friedman) and *Capitalism and Freedom*.[47] As those titles suggest, Friedman embraced two central premises as the foundation for policymaking: markets good; regulation bad. Those were, more generally, the premises of the Chicago School:

43. Ronald Reagan, The Magic of the Market Place: We Cannot Have Prosperity without Economic Freedom, Remarks at the 1981 Annual Meeting of the Board of Governors of the World Bank and International Monetary Fund (Sept. 29, 1981), *in* 48 VITAL SPEECHES OF THE DAY 34 (Nov. 1, 1981). The metaphor of market as God is quite common, as is the belief that one need only have faith in the market to begin enjoying its benefits. *See* Harvey Cox, *The Market as God: Living the New Dispensation*, ATLANTIC, Mar. 1999, at 18 (describing the "business theology"); *infra* note 71 (providing example from Schwarzenegger); *see also* Thomas Frank, *The Rise of Market Populism*, NATION, Oct. 30, 2000, at 13 (describing the growing faith in market populism during the 1990s).

44. Note that Hayek was not actually in the economics department, which prided itself on mathematical rigor and productivity. Jerry Muller describes the situation as follows:

> Whether because of the notoriety of *The Road to Serfdom* or because economists viewed his work on monetary theory as outdated, Hayek found it difficult to find a job at an economics department at a major American university. After failed overtures to a number of institutions, the chairman of the University of Chicago's Committee on Social Thought worked out an unusual arrangement by which Hayek became professor of social and moral science there, his salary paid by a private American foundation, the Volker Charities Fund.

MULLER, *supra* note 14, at 369 (footnote omitted).

45. Friedman and Hayek began sharing and debating ideas in the late 1940s through "the most influential society you have never heard of — the Mont Pelerin Society, . . . [an] association of laissez faire thinkers" brought together in Switzerland by Hayek. George F. Will, *Milton Friedman at 90: Man of the Century*, HOOVER DIG., Fall 2002, http://www.hooverdigest.org/024/will.html (last visited Oct. 9, 2004); *see also* YERGIN & STANISLAW, *supra* note 19, at 126-27. For a complete history of the Society and its influence, see R.M. HARTWELL, A HISTORY OF THE MONT PELERIN SOCIETY (1995). George Stigler's autobiography includes a photograph of himself, Aaron Director, and Milton Friedman. Beneath it, the caption reads: "[W]earing [their] conservative hats' at the first Mont Pelerin Society meeting in 1947." Stigler's caption includes this quip from Stigler: "The Society might better have been called the 'Friends of Friedrich Hayek.'" GEORGE J. STIGLER, MEMOIRS OF AN UNREGULATED ECONOMIST 116 (1988).

46. MILTON FRIEDMAN & ROSE D. FRIEDMAN, FREE TO CHOOSE (1980).

47. MILTON FRIEDMAN, CAPITALISM AND FREEDOM (1962).

> The Chicago economists believed, in practice, in a very small number of theorems about the way decision makers allocated resources and the ways these allocations led to prices. They trusted in markets and the effectiveness of competition. Left to their own devices, markets produced the best outcomes. Prices were the best allocators of resources. Any intervention to change what markets, left alone, would achieve was likely to be counterproductive. For the Chicago economists, the conclusions for government policy were clear: Wherever possible, private activity should take over from public activity. The less government did, the better.[48]

More efficiently, Friedman himself recently summarized the view of the Chicago School as "a strong belief in minimal government and an emphasis on free markets as a way to control the economy."[49] In a video version of "Free to Choose," Friedman summarizes the lessons of Chicago-School economics with the aid of a pencil. He asks how it happened that "literally thousands of people [from all over the world] cooperated to make this pencil. People who don't speak the same language, who practice difference religions, who might hate one another if they ever met.... What brought them together and induced them to cooperate to make this pencil?"[50] What Hayek described as a marvel, Friedman called "magic":

> It was the magic of the price system... that brought them together and got them to cooperate to make this pencil so that you could have it for a trifling sum. That is why the operation of the free market is so essential, not only to promote productive efficiency, but even more to foster harmony and peace among the peoples of the world.[51]

It should not be any surprise that Friedman's career was also highly connected with Hayek's, a point that he recently highlighted in his memoirs,[52] or that Friedman is hailed as one of the most influential intellectuals of his day.[53] But the important lesson, from our vantage point, is that the source of the Thatcher and Reagan revolutions was, at its core, a revolution in the meta script. Milton Friedman, speaking of Reagan and Thatcher's success, puts the lesson in the following terms:

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48. YERGIN & STANISLAW, *supra* note 19, at 146.

49. COMMANDING HEIGHTS: THE BATTLE FOR THE WORLD ECONOMY (PBS 2002).

50. *Free to Choose: Vol. I: The Power of the Market: The Pencil Story* (PBS television broadcast, Jan. 11, 1980), http://www.ideachannel.com/FreeToChoose.htm (last visited Oct. 9, 2004).

51. *Id.*

52. *See* MILTON & ROSE D. FRIEDMAN, TWO LUCKY PEOPLE: MEMOIRS 333 (1998); *see also supra* note 45 and accompanying text.

53. *See, e.g.*, Will, *supra* note 45 (celebrating Friedman "as America's most consequential public intellectual of the twentieth century").

> [B]oth of them faced similar situations. And both of them, fortunately, had exposure to *similar ideas*. And they reinforced one another. Each saw the success of the other. I think that the coincidence of Thatcher and Reagan having been in office at the same time was enormously important for the public acceptance, worldwide, of a *different approach* to economic and monetary policy.[54]

Thomas Sowell, economic historian at the Hoover Institute, similarly attributes the dramatic changes of the late twentieth century to a dramatic change in visions:

> The 20th Century looked for many decades as if it were going to be the century of collectivism .... Anyone who would have predicted the reversal of this trend ... would have been considered mad just a dozen years ago. Innumerable factors led to [the reversal], not the least of which was the bitter experience of seeing "rational planning" degenerate into economic chaos and Utopian dreams turned into police-state nightmares. Still, it takes a vision to beat a vision .... An alternative vision had to become viable before the reversal of the collectivist tide could begin with Margaret Thatcher in Britain and Ronald Reagan in the United States. That vision came from many sources, but if one point in time could mark the beginning of the intellectual turning of the tide which made later political changes possible, it was the publication of *The Road to Serfdom* by Friedrich A. Hayek.[55]

And so it was that the world was more or less transformed by a new meta script.[56]

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54. Interview by PBS with Milton Friedman (Oct. 1, 2000), *at* http://www.pbs.org/wgbh/commandingheights/shared/minitextlo/int_miltonfriedman.html (last visited Oct. 2, 2004) (emphasis added).

55. Thomas Sowell, *A Road to Hell Paved with Good Intentions*, FORBES, Jan. 17, 1994, at 60.

56. Nineteen Nobel Prizes have gone to economists who are more or less associated with the Chicago School. *See* YERGIN & STANISLAW, *supra* note 19, at 149. As further evidence of the meta script's influence, a number of think tanks that espouse an explicit commitment to the summary meta script are consistently ranked as among the most cited in the United States. *See* Fairness in Accuracy and Reporting, *Think Tank Monitor, at* http://www.fair.org/reports/index.html (last visited Aug. 25, 2004) (ranking think tanks by annual citations in the media). For example, the Heritage Foundation (ranked third in 2002), *see id.*, states on its website: "We believe ... in individual liberty, free enterprise, limited government, a strong national defense, and traditional American values." The Heritage Foundation, *About the Heritage Foundation, at* http://www.heritage.org/About/aboutHeritage.cfm (last visited Aug. 25, 2004). The fourth-ranking American Enterprise Institute, *see* Fairness and Accuracy in Reporting, *Citation of Think Tanks in Media, at* http://www.fair.org/extra/0307/thinktanks2002.html (last visited Aug. 25, 2004), states that it "is dedicated to preserving and strengthening the foundations of freedom — limited government, private enterprise, vital cultural and political institutions, and a strong foreign policy and national defense ...." The American Enterprise Institute, *About AEI, at* http://www.aei.org/about/filter./default.asp (last visited Aug. 25, 2004). And the sixth-ranking Cato Institute, *see* Fairness and Accuracy in Reporting, *Citation of Think Tanks in Media, at* http://www.fair.org/extra/0307/thinktanks2002.html (last visited Aug. 25, 2004), is similarly explicit in its mission "to broaden the parameters of public policy debate to allow consideration of the traditional American principles of limited government, individual

Today, simply listening to the pronouncements of policymakers, we come face to face with evidence that the summary meta script permeates the policy apparatus. Reagan was by no means the last president to embrace the basic tenets of the meta script. In Bill Clinton's 1995 State of the Union Address, he elaborated the "New Covenant"[57] of government policymaking. He complained about the extent to which moneyed interests seemed to exert more than their fair share of influence in Washington, a problem that he felt was getting worse:

> Three times as many lobbyists are in the streets and corridors of Washington as were here 20 years ago. The American people look at

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liberty, free markets and peace." The Cato Institute, *About CATO*, *at* http://www.cato.org/about/about.html (last visited Aug. 25, 2004).

It bears noting that even those think tanks, commentators, scholars, and policymakers that seem much less committed to the truth of the meta script are nonetheless tremendously influenced by it. At the risk of overgeneralizing, "centrists" tend to accept the meta script but see failure in markets and solutions in regulation more readily than do "conservative" proponents of the meta script. Their burden of proof in favor of regulation is lower than that of their libertarian counterparts. Compare BARBARA H. FRIED, THE PROGRESSIVE ASSAULT ON LAISSEZ FAIRE 30 (1998), noting that

> [t]he rhetorical trope that less state action should be the rule to which one recognized exceptions only as necessary was widely adopted by more progressive liberals as well, although (not surprisingly) they tended to find necessity with far more frequency than did their individualist counterparts. 'State interference is an evil, where it cannot be shown to be a good,' declared Oliver Wendell Holmes in 1881.

For example, the AEI-Brookings Joint Center for Regulatory Studies (a cooperative effort between the Brookings Institution and the American Enterprise Institute) has issued a number of reports analyzing regulation and providing recommendations for how to improve the regulatory process. *See* AEI-Brookings Joint Center, *Welcome to the AEI-Brookings Joint Center*, *at* www.aei.brookings.org (last visited Aug. 25, 2004). Such reports begin with the premise, as in the meta script, that regulation can be terribly costly and therefore must be justified rigorously. In recent testimony, the Center's Directors observe that

> [a]lthough regulations often have no direct fiscal impact, they pose real costs to consumers as well as businesses. Regulations aimed at protecting health, safety, and the environment alone cost over $200 billion annual or about 2% of GDP. Yet, the economic impact of federal regulation receives much less scrutiny than the budget.

How to Improve Regulatory Accounting: Costs, Benefits and Impacts of Federal Regulations: Hearing Before the Subcomm. on Energy Policy, Natural Res., and Regulatory Affairs of the House Comm. on Gov't Reform, 108th Cong. 51-40 (2003) (Joint statement of Robert W. Hahn and Robert E. Litan, Directors, AEI-Brookings Joint Center for Regulatory Studies), http://www.aei.brookings.org/publications/abstract.php?pid =317.

Meanwhile, even "progressives," in order to have influence or even an audience, are constrained by the power of the meta script to frame their arguments largely in terms of failed markets. *See infra* text accompanying notes 57-62.

57. In Clinton's 1995 State of the Union address, he explained that the

> New Covenant is a new set of understandings for how we can equip our people to meet the challenges of the new economy, how we can change the way our Government works to fit a different time and, above all, how we can repair the damaged bonds in our society and come together behind our common purpose. We must have dramatic change in our economy, our Government and ourselves.

President Bill Clinton, State of the Union Address (Jan. 24, 1995), http://usinfo.state.gov/usa/infousa/facts/speeches/clinton/95-1.txt [hereinafter 1995 State of the Union Address].

> their capital and they see a city where the well-connected and the well-protected can work the system, but the interests of ordinary citizens are often left out.[58]

Picking up other elements of the meta script, this New Democrat[59] then explained the need to disempower regulators and empower individuals through private, decentralized, market systems:

> The New Covenant approach to governing is as different from the old bureaucratic way as the computer is from the manual typewriter. The old way of governing around here protected organized interests; we should look out for the interests of ordinary people. . . .
>
> The old way dispensed services through large, top-down, inflexible bureaucracies. The New Covenant way should shift these resources and decisionmaking from bureaucrats to citizens, injecting choice and competition and individual responsibility into national policy.
>
> The old way of governing around here actually seemed to reward failure. The New Covenant way should have built-in incentives to reward success.[60]

It is not, of course, the case that Clinton felt that all regulation is bad or that all market outcomes are desirable.[61] But what seems clear is that the meta script played a significant role in anchoring his policy perspective and in the trajectory of his policy agenda.[62]

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58. *Id.*

59. For a thorough description of how the Democratic Party's agenda was transformed, beginning in the mid-1980s, to include such goals as the elimination of "big government" and welfare reform, see KENNETH S. BAER, REINVENTING DEMOCRATS: THE POLITICS OF LIBERALISM FROM REAGAN TO CLINTON *passim* (2000).

60. *Id.*

61. For example, in his 1996 State of the Union address, Clinton put it this way:

> We know big government does not have all the answers. We know there's not a program for every problem. We have worked to give the American people a smaller, less bureaucratic government in Washington. . . . The era of big government is over. But we cannot go back to the time when our citizens were left to fend for themselves. Instead, we must go forward as one America, one nation working together to meet the challenges we face together. Self-reliance and teamwork are not opposing virtues; we must have both.

President Bill Clinton, State of the Union Address (Jan. 23, 1996), http://www.washingtonpost.com/wp-srv/politics/special/states/docs/sou96.htm#budget.

62. Even in circumstances in which governmental regulation was deemed appropriate, the meta-schematic presumptions in favor of decentralization and individual choice still carried considerable weight:

> [W]e need to get Government closer to the people it's meant to serve. We need to help move programs down to the point where states and communities and private citizens in the private sector can do a better job. If they can do it, we ought to let them do it. We should get out of the way and let them do what they can do better.

1995 State of the Union Address, *supra* note 57; *cf.* Steven Croley, *White House Review of Agency Rulemaking: An Empirical Investigation*, 70 U. CHI. L. REV. 821, 827-29 (2003) (comparing Clinton's approach to Reagan's, including the fact that "the Clinton order embodied both the substantive and procedural aspects of the Reagan orders — imposing

Our current president is often more explicit in his adherence to the meta script. In a speech honoring Milton Friedman for his life's work, for instance, President George W. Bush observed that Friedman's "vision has changed America and it is changing the world"[63]:

> Milton Friedman has shown us that when government attempts to substitute its own judgments for the judgments of free people, the results are usually disastrous. In contrast to the free market's invisible hand, which improves the lives of people, the government's invisible foot tramples on people's hopes and destroys their dreams.
>
> He has never claimed that free markets are perfect. Yet he has demonstrated that even an imperfect market produces better results than arrogant experts and grasping bureaucrats. But Milton Friedman does not object to government controls solely because they are ineffective. His deeper objectives flow from a moral framework. He has taught us that a free market system's main justification is its moral strength. Human freedom serves the cause of human dignity. Freedom rewards creativity and work, and you cannot reduce freedom in our economy without reducing freedom in our lives.[64]

Bush notes that Friedman's "viewpoint was once controversial, as was Milton Friedman, himself"[65]:

> When he began his work, the conventional wisdom held that capitalism's days were numbered. Free market systems were thought to be unsuited to modern problems. Today we recognize that free markets are the great engines of economic development. They are the source of wealth, and the hope of a world weary of poverty and weary of oppression.[66]

As Bush observes, events that have unfolded as far away as Chile, Russia, Sweden, and China "demonstrate that the rest of the world is finally catching up with Milton Friedman."[67] And, illustrating the meta script's applicability to all policy areas, Bush notes that Friedman "has creatively applied the power of freedom to the problems of our own country, and in the process he has become an influential social reformer," shaping policies ranging from "national security" (Friedman was "the intellectual godfather of our all-volunteer army") to "educational reform."[68]

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cost benefit criteria for major rules and designating OMB as the central overseer and clearinghouse for agency rulemaking").

63. President George W. Bush, Remarks in Tribute to Milton Friedman (May 9, 2002), *in* PUBLIC PAPERS OF THE PRESIDENT (forthcoming), http://www.whitehouse.gov/news/releases/2002/05/20020509-1.html.

64. *Id.*

65. *Id.*

66. *Id.*

67. *Id.*

68. *Id.*

In light of President Bush's high regard for Friedman and the power of the basic markets-good, regulation-bad in our culture, it is little surprise that they were main themes in Bush campaign ads. In one television ad, "Healthcare: Practical Vs. Big Government," the voters are encouraged to see the choice between Bush and Kerry as the choice between free markets and regulation:

> On healthcare...
> President Bush and our leaders in Congress have a practical plan:
> Allow small businesses to join together to get lower insurance rates big companies get.
> Stop frivolous lawsuits against doctors.
> Health coverage you can take with you.
>
> * * *
>
> The Liberals in Congress and Kerry's Plan:
> Washington bureaucrats in control.
> A government-run healthcare plan.
> 1.5 trillion dollar price tag.[69]

Another theme of the campaign is ownership and building an "ownership society," or, in other words, a society that relies more on markets and less on government.[70] In one advertisement President Bush explains:

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69. *Healthcare: Practical vs. Big Government* (Bush-Cheney '04 television advertisement, Fall 2004), http://www.georgewbush.com/KerryMediaCenter/Read.aspx?ID=3512 (last visited Oct. 6, 2004) (script), http://www.georgewbush.com/News/MultiMedia/Player.aspx?ID=1018&T=5&PT= (last visited Oct. 9, 2004) (video).

70. President Bush wasn't the only one promoting the meta script. Senator Kerry also proved a strong adherent, at times appearing to compete with President Bush over who was the most fervent believer. As the Kerry-Edwards "Plan for America" made clear, the triumphs of the 20th century were as much about free markets as about democracy: "Throughout the 20th century, America's most trusted and reliable allies were the democracies of Europe; together, the two sides of the Atlantic ensured that democracy and free markets prevailed against all challenges." JOHN KERRY & JOHN EDWARDS, OUR PLAN FOR AMERICA: STRONGER AT HOME, RESPECTED IN THE WORLD 34-35 (2004), *available at* http://www.johnkerry.com/pdf/our_plan_for_america.pdf. And as Kerry also made clear, his goal was to "[i]mplement regulatory reforms that are pro-market and pro-consumer." The Kerry-Edwards Plan to Foster a Climate for America's Businesses to Create Good-Paying Jobs, *available at* http://www.johnkerry.com/pdf/pr_2004_0804.pdf [hereinafter Kerry-Edwards Plan].

The Kerry Plan promoted both the "markets good" and "regulation bad" sides of the meta script, arguing, "Too often, the Bush Administration has used regulatory reform to bail out corporations rather than promote true competition. As a result, regulations are standing in the way of efficiency improvements in many industries that would benefit consumers and businesses. As president, John Kerry will implement regulatory reforms that use market-based incentives while protecting the environment and consumers against abuses." Kerry-Edwards Plan, *supra*; *see also* Jacob M. Schlesinger & John Harwood, *Kerry Pitches Pro-Business Side Of His Platform*, WALL ST. J., May 3, 2004, at A1 ("Mr. Kerry called himself a Democrat who 'respects the laws of economics, and how money works, the psychology of the marketplace, the importance of confidence and fiscal responsibility.'").

Thus, even the virtues of regulation were cast in light of the power of markets. As Kerry

> One of the most important parts of a reform agenda is to encourage people to own something. Own their own home, own their own business, own their own health care plan, or own a piece of their retirement. Reforms that trust the people, reforms that say government must stand on the side of people. Because I understand if you own something, you have a vital stake in the future of America.[71]

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argued, "Our economic strategy recognizes that government does not create jobs or produce economic growth. Free markets, honest competition, America's entrepreneurial sprit and hard work do that. But the right public policies can foster an environment that makes strong growth and job creation easier, and the wrong policies can hurt. We understand that the right policies can promote an economic climate that will lay the foundation for private sector investment, foster vigorous competition, and strengthen the foundations of an innovative economy." KERRY & EDWARDS, *supra*, at 62.

That devotion to the meta script was no change in policy, but a natural extension of the faith in markets and suspicion of government that had characterized the Clinton years. *See infra* text accompanying note 57-62. As one reporter described the Kerry campaign: "Fiscal responsibility and deficit reduction, hallmarks of the Clinton years, are bedrock orthodoxy in the Kerry camp, too.... So is faith in the private sector's powers to generate prosperity. Job creation will come from corporate America, not government, once the right incentives and subsidies are in place, the war room says. In fact, the Clinton-era god of deficit reduction and private-sector supremacy is also worshiped in the Kerry camp." Louis Uchitelle, *A Kerry Team, A Clinton Touch*, N.Y. TIMES, March 28, 2004, § 3 at 1. Kerry's approach to student loans was an apt illustration of the way in which the meta script informed his approach even to minor campaign issues. As the Kerry touted: "I believe in free markets, and I believe Congress shouldn't be setting profits for banks. We need a market-based auction where banks get student loan business based on their ability to offer the best service at the lowest price." *See* Press Release, John Kerry Website, Kerry Statement on Student Loans, (Apr. 27, 2004), *at* http://www.johnkerry.com/pressroom/releases/pr_2004_0427a.html.

71. The ad is entitled "Ownership." *See Ownership* (Bush-Cheney '04 television advertisement, Fall 2004), http://www.georgewbush.com/News/Read.aspx?ID=3208 (last visited Oct. 6, 2004) (script).

The rising star of the Republican Party, Governor Arnold Schwarzenegger, makes his allegiance to the Friedman meta scripts at least as evident as President Bush does. When campaigning for Governor, Schwarzenegger wrote this in the Wall Street Journal:

> I have often said that the two people who have most profoundly impacted my thinking on economics are Milton Friedman and Adam Smith. At Christmas I sometimes annoy some of my more liberal Hollywood friends by sending them a gift of Mr. Friedman's classic economic primer, "Free to Choose." What I learned from Messrs. Friedman and Smith is a lesson that every political leader should never forget: that when the heavy fist of government becomes too overbearing and intrusive, it stifles the unlimited wealth creation process of a free people operating under a free enterprise system.

Arnold Schwarzenegger, *My Economic Policy*, WALL ST. J., Sept. 24, 2003, at A20, *available at* http://www.opinionjournal.com/editorial/feature.html?id=110004058 (Sept. 24, 2003). Schwarzenegger went on to describe California's woes as the predictable consequences of deviating from the Friedman prescription. And he concluded his analysis with this promise: "Our state will prosper again when we commit ourselves in California to 'Free to Choose' economics. This means removing, one by one, the innumerable impediments to growth-excessive taxes, regulations, and deficit-spending. If we do this we will bring California back as the untarnished Golden State." *Id.*

Then, in his keynote speech at the Republican National Convention, Governor Schwarzenegger brought thrills to the crowd by sounding the same themes: "If you believe a person should be treated as an individual, not as a member of an interest group, then you are a Republican. If you believe your family knows how to spend your money better than the government does, then you are a Republican." Governor Arnold Schwarzenegger, Keynote Speech at the Republication National Convention (Aug. 31, 2004), http://www.cnn.com/

Given the key role the presidents play in shaping and legitimating the work of administrative agencies,[72] it makes sense that even "regulators" — the "invisible feet". — are today eloquent spokespeople for the pro-market, anti-regulation schema.[73] For example, Michael Powell, Chairman of the Federal Communications Commission, echoes the meta script when he describes the objective of the FCC:

> [A well structured market policy] allows market forces to calibrate pricing to meet supply and demand. Consumers get the most cost-efficient prices and enjoy the benefits of business efficiencies.
>
> The result for consumers is better, more cutting edge products, at lower prices.
>
> Contrary to the classic bugaboo that markets are just things that favor big business and big money, market policies have a winning record of delivering benefits to consumers that dwarfs the consumer record of government central economic planning. Thus, if you are truly committed to serving the public interest, bet on a winner and bet on market policy.[74]

In short, markets are good, and have the ability to deliver benefits that dwarf anything that "government central economic planning" could deliver. Powell once summed up his faith in the market's magic this way: "My religion is the market."[75]

2004/ALLPOLITICS/08/31/gop.schwarzenegger.transcript/index.html. Indeed, the most memorable line of the speech was probably a Reaganesque call to faith in the magic of markets: "Now, there's another way you can tell you're a Republican. You have faith in free enterprise, faith in the resourcefulness of the American people and faith in the U.S. economy. And to those critics who are so pessimistic about our economy, I say: Don't be economic girlie-men." *Id.*

72. *See* Croley, *supra* note 62, at 821-22 (describing the heightened procedural and substantive intervention of Presidents in regulatory process, beginning with Ronald Reagan's pursuit of a deregulatory agenda); Nina A. Mendelson, *Agency Burrowing: Entrenching Policies and Personnel Before a New President Arrives*, 78 N.Y.U. L. REV. 557, 569-88 (2003) (summarizing the key role played by the President in legitimating agency activity that otherwise appears undemocratic).

73. Of course, the fact that recent presidents have more or less embraced one or another version of the meta schemas for policymaking may simply reflect popular conceptions, which the regulators' views likely also reflect. *Cf.* Jerry L. Mashaw, *Prodelegation: Why Administrators Should Make Political Decisions*, 1 J.L. ECON. & ORG. 81, 95 (1985) ("Citizens vote for a president based almost wholly on a perception of the difference that one or another candidate might make to general governmental policies."); Mark Seidenfeld, *Bending the Rules: Flexible Regulation and Constraints on Agency Discretion*, 51 ADMIN. L. REV. 429, 486 (1999) (explaining that voting turns on voter perceptions of candidates' general ideologies); Mark Seidenfeld, *A Civic Republican Justification for the Bureaucratic State*, 105 HARV. L. REV. 1511, 1568-69 (1992) (same).

74. Chairman Michael K. Powell, Consumer Policy in Competitive Markets, Remarks Before the Federal Communications Association (June 21, 2001), *at* http://www.fcc.gov/Speeches/Powell/2001/spmkp106.html.

75. Paul Davidson, *FCC Chief Powell Believes in Free Market*, USA TODAY, Feb. 6, 2002, at B1, *available at* http://www.usatoday.com/tech/news/2002/02/06/fcc-powell.htm.

Similarly, Thomas B. Leary, Commissioner of the Federal Trade Commission, described how the meta script had captured the imaginations of the Commissioners of the FTC:

> Although we may differ on the facts of individual cases, all of my colleagues agree that the objective is to maximize efficient outcomes. We all start in the same place and we are all trying to do the same thing. This broad consensus is a great demonstration of the power of ideas and, in my view, has made an immense contribution to consumer welfare.[76]

It is no exaggeration that policymakers today "all start in the same place" — from the viewpoint of the summary meta script and its presumption that markets are good and regulation is bad.[77]

B. *The Meta Script: Elaborating the Summary Script*

The previous Section provided a brief account of the power of a new meta script — but only the summary version of that script. We have yet to explore the full version of the meta script. This Section elucidates some of its key details.

1. *Austria's Basic Script*

Hayek, together with other members of the Austrian School, laid the foundation for the meta script. But the cornerstone, they claimed, had been placed by Adam Smith himself:

> As every individual, therefore, endeavours as much as he can both to employ his capital in the support of domestick industry, and so to direct that industry that its produce may be of the greatest value; every individual necessarily labours to render the annual revenue of the society as great as he can. He generally, indeed, neither intends to promote the publick interest, nor knows how much he is promoting it. By preferring the support of domestick to that of foreign industry, he intends only his own security; and by directing that industry in such a manner as its produce may be of the greatest value, he intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention. Nor is it always the worse for the society that it was no part of it. By pursuing his own interest he

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76. Thomas B. Leary, The Federal Trade Commission and the Defense of Free Markets, Speech to the David T. Chase Free Enterprise Institute (Oct. 7, 2002), *at* http://www.ftc.gov/speeches/leary/willimantic.pdf (last updated Aug. 15, 2003).

77. James Boyle has recently described how, "[o]ver the last 25 years, . . . the influential 'Chicago School' of lawyers and economists" has transformed antitrust law with the same sort of consumer-welfare based markets-are-good and regulation-is-bad arguments that we have been describing. *See* James Boyle, *Missing the Point on Microsoft*, SALON, Apr. 7, 2000, *at* http://archive.salon.com/tech/feature/2000/04/07/greenspan/index.html. And as Boyle goes on to illustrate, "[t]his point of view has no less a supporter than Federal Reserve Chairman Alan Greenspan." *Id.*

> frequently promotes that of the society more effectually than when he really intends to promote it.[78]

The Austrians built around that famous invisible hand metaphor, supplementing it with arguments that were easy to grasp and hard to refute.

To allocate resources in a society efficiently, Hayek explained, a great deal of information or knowledge must be brought to bear on the process.[79] To know who is best able to work for whom, and what products are most desired, and how the various factors of production should be mobilized, is to know more than any single individual or entity can possibly know.[80] Because of that imperfect knowledge, institutions of the state that attempt centrally to plan the movements of society's scarce resources are certain to perform poorly, no matter how well intentioned their efforts.

Markets are a different story.[81] Markets rely on prices, and prices carry the information that any one institution could otherwise not obtain. If a resource is particularly highly valued, its price will reflect that. If one person is better suited for a job than another, wages will ensure that the former gets the position.[82] If more leather is needed quickly to make shoes and furniture, then the promise of profits will automatically stimulate its production. At no time does a central planner need to understand why resources are moving as they are or attempt to anticipate how their movements ought to change next week.[83] The market, as Hayek put it, is a "marvel":

> The marvel is that in a case like that of a scarcity of one raw material, without an order being issued, without more than perhaps a handful of people knowing the cause, tens of thousands of people whose identity could not be ascertained by months of investigation, are made to use the material or its products more sparingly; that is, they move in the right direction.[84]

The allocation of resources through regulation is, Hayek would add, destined for failure:

> The government should certainly cease doing a great many things it does now. In that sense it depends upon the government ceasing to do things,

78. ADAM SMITH, THE WEALTH OF NATIONS 456 (R.H. Campbell & A.S. Skinner eds., Clarendon Press 1976) (1776).

79. *See* HAYEK, INDIVIDUALISM AND ECONOMIC ORDER, *supra* note 34, at 77-91.

80. *See id.*

81. *See id.*

82. *See id.* at 92-108; FRIEDRICH A. HAYEK, PRICES AND PRODUCTION (Augustus M. Kelley 1966) (1931) [hereinafter HAYEK, PRICES AND PRODUCTION].

83. *See* HAYEK, PRICES AND PRODUCTION, *supra* note 82.

84. FRIEDRICH A. HAYEK, THE USE OF KNOWLEDGE IN SOCIETY 15 (Institute for Humane Studies, Inc. 1945) [hereinafter HAYEK, THE USE OF KNOWLEDGE IN SOCIETY].

> and then that would open the possibility for other developments which you cannot guide and direct. Take the general complaint about British entrepreneurs being inefficient, lazy, and so on. All of this is a result of institutions. You would soon drive out the inefficient entrepreneur if there was more competition. And you would soon find that they would work hard if it was in their interest to do so. It is the set of institutions which now prevails which creates the new attitudes which are so inimitable to prosperity.[85]

Thus, even the detailed script is extremely simple. Central planners, no matter their noble intentions and no matter how good their plans may look on paper, have neither the knowledge nor the incentives they would need to bring together the unique and hidden preferences of millions of people,[86] and the unique and hidden costs of potential suppliers.[87]

As noted above, people had a difficult time appreciating the soundness of that script because of an ill-informed distrust of institutions that move because of greed and an ill-placed faith in institutions that purport to be motivated by a concern for our well-being.[88] The institution's motive is, according to this view, essentially an illusion.

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85. Interview by Thomas W. Hazlett with F.A. Hayek, *supra* note 2, at 33-34.

86. This argument against regulation and for markets turns in part upon the dispositionist view of consumers — a conception that is widely held but deeply flawed. *See* Hanson & Yosifon, *The Situational Character*, *supra* note 4, *passim*; *see also* Jon Hanson & Adam Wright, In the Driver's Seat: Why Promoting Dispositionism Is Good for Business (in progress) (on file with authors) (describing in some detail how the dominant dispositionist conception of the human actor is good for, and thus promoted by, large commercial interests).

87. The Royal Swedish Academy of Sciences, when awarding him the Nobel Prize, offered this summary of Hayek's work:

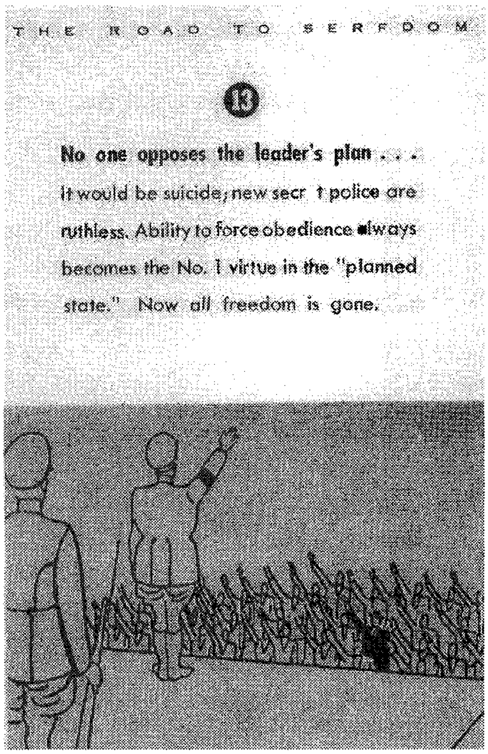
> The Academy is of the opinion that von Hayek's analysis of the functional efficiency of different economic systems is one of his most significant contributions to economic research in the broader sense. From the mid-thirties he embarked on penetrating studies of the problems of centralized planning.... He presented new ideas with regard to basic difficulties in "socialistic calculating", and investigated the possibilities of achieving effective results by decentralized "market socialism" in various forms. His guiding principle when comparing various systems is to study how efficiently all the knowledge and all the information dispersed among individuals and enterprises is utilized. His conclusion is that only by far-reaching decentralization in a market system with competition and free price-fixing is it possible to make full use of knowledge and information.

Press Release, Royal Swedish Academy of Sciences, The Sveriges Riksbank (Bank of Sweden) Prize in Economic Sciences in Memory of Alfred Nobel for 1974 (Oct. 9, 1974), http://nobelprize.org/economics/laureates/1974/press.html (last visited Oct. 3, 2004).

88. Hayek has suggested a related reason why we fail to appreciate the marvel of the market and the danger of regulation: pride of ownership. According to Hayek, had a benign human hand and intent directed market outcomes, we would celebrate those outcomes. But because we do not associate the outcomes with benevolently designed institutions, we do not trust the outcomes. In Hayek's words, "[I]f it were the result of deliberate human design, and if the people guided by the price changes understood that their decisions have significance far beyond their immediate aim, this mechanism would have been acclaimed as one of the greatest triumphs of the human mind." HAYEK, THE USE OF KNOWLEDGE IN

And that leads to a final element of the script: the illusion, according to the meta script, is not dangerous only because it will lead to inefficient allocations of society's resources. The magician is far more frightening than a cross-hatched triangle on a graph labeled "dead-weight loss." According to the meta script, what is at stake is our freedom. And, as depicted in Figure 1, the tendency to rely on apparently well-meaning "planners" is the very tendency that, in Hayek's terms, sends us blithely down "the road to serfdom."

FIGURE 1."NOW ALL FREEDOM IS GONE"



Source: HAYEK, ROAD TO SERFDOM (cartoon) 13 (1945).[89]

SOCIETY, *supra* note 84, at 15. Instead, because it happens invisibly, the whole apparatus is vastly undervalued.

89. The cartoon version of *Road to Serfdom* appeared first in *Look* magazine's February 6, 1945 issue. It was reprinted numerous times, including once by General Motors in their "Thought Starters" series. *See* http://www.mises.org/TRTS.htm. This provides some indication of the popularity of Hayek's ideas and the extent to which he and others promoted them. Hayek also published an abridged version of *The Road to Serfdom* in an

2. *Chicago's Elaborations*

For the most part, Milton Friedman and other members of the Chicago School found the Austrian School's meta script fully persuasive. They, too, presumed market outcomes trustworthy and regulations or governmental interventions suspect. If anything, the Chicago School economists simply added to the persuasiveness of the two elements by making more compelling arguments about how markets find and exploit all opportunities for gains to trade and how regulations and their unintended consequences often make matters worse. A classic example emphasized by Chicago Schoolers is the problem black markets. Attempts to prohibit certain trades often lead only to the costly creation of hidden markets, not to a meaningful change in behavior. Through black markets one can witness the difference between the welfare-reducing effects of regulatory coercion and the welfare-enhancing effects of markets.[90]

Consistent with the lessons of black markets is a broader message endorsed by the Chicago School: for almost any problem, markets have a solution. From consumer misinformation to externalities and from innovation to discrimination, no force would lead more quickly to an effective solution than the combined forces of markets.[91] Competition drives participants either to develop solutions or to be driven out of business by those who do. This dynamic, like that described in lay evolutionary scripts, leads toward superior institutions and outcomes. In the case of the market's natural selection process, consumer preferences determine winners and losers.[92] Ever more efficient allocations and forms emerge, not because of the intentions of the parties, but because of the power of the process, which ratchets

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extremely successful *Readers' Digest* article. *See* http://www.hayekcenter.org/friedrich hayek/hayekfftrts.html. Finally, the authorized editions of *The Road to Serfdom* have been published in several dozen languages. *Id.*

90. Friedman recently had this to say about why black markets are desirable:

> Well, the black market was a way of getting around government controls. It was a way of enabling the free market to work. It was a way of opening up, enabling people. You want to trade with me, and the law won't let you. But that trade will be mutually beneficial to both of us. The most important single central fact about a free market is that no exchange takes place unless both parties benefit. The big difference between government coercion and private markets is that government can use coercion to make an exchange in which A benefits and B loses. But in the market, if A and B come to a voluntary agreement, it's because both of them are better off. And that's what the black market does, is to get around these artificial government restrictions.

Interview by PBS with Milton Friedman, *supra* note 54.

91. A popularized summary of many of those arguments can be found in Milton and Rose Friedman's book, *Free to Choose*, which was prepared in conjunction with a PBS television series of the same title. *See* FRIEDMAN & FRIEDMAN, FREE TO CHOOSE, *supra* note 46. For information about the video series, see http://www.freetochoose.net (last visited Oct. 4, 2004).

92. *See infra* text accompanying notes 222-228 (describing evolutionary scripts).

in only one direction. As Friedman explains, "competition does not protect the consumer because businessmen are more softhearted than bureaucrats or because they are more altruistic or because they are more generous, but only because it is in the self-interest of the entrepreneur to protect the consumer."[93]

From that logic, it follows that whatever the market produces is, on the whole, what makes consumers better off.[94] As Friedman retorted when someone complained of the wastefulness of the almost countless options provided to consumers,

> If consumers really preferred one model [of Chevrolet] at a lower price than forty-seven models, GM would be foolish not to meet their desires. There are forty-seven models because that is what consumers want. That's what the critics really complain about — that under capitalism, consumers get what they want rather than what the critics think they should have.[95]

Like Hayek, Chicago Schoolers, particularly Friedman, believe that the distinctions between markets and regulation go beyond matters of mere efficiency. Human freedom turns on the existence of private property and capitalism — on more markets and less regulation. Friedman summarized the point in an interview this way: "What we've really been talking about all along is freedom. Although a number of my proposals would have the immediate effect of improving our economic well-being, that's really a secondary goal to preserving individual freedom."[96] In short, "capitalism is a necessary condition for political freedom."[97]

Of course, none of this really needs reviewing. The elements of the meta script and the perceived connection between markets and freedom represent the current consensus among policymakers — the

93. MILTON FRIEDMAN, BRIGHT PROMISES, DISMAL PERFORMANCE 165 (1983) [hereinafter FRIEDMAN, BRIGHT PROMISES].

94. *See* FRIEDMAN & FRIEDMAN, FREE TO CHOOSE, *supra* note 46, at 222 ("There will always be shoddy products, quacks, con artists. But, on the whole, market competition, when it is permitted to work, protects the consumer better than do the alternative government mechanisms that have been increasingly superimposed on the market.").

95. FRIEDMAN, BRIGHT PROMISES, *supra* note 93, at 50-51.

96. *Id.* at 57. In a recent interview about his role in Chile and Pinochet's regime, Friedman emphasized that although he was consulted by the authoritarian dictator, his message to Pinochet "was that freedom was a very fragile thing and that what destroyed it more than anything else was central control; that in order to maintain freedom, you had to have free markets, and that free markets would work best if you had political freedom." Interview by PBS with Milton Friedman, *supra* note 54.

97. FRIEDMAN, CAPITALISM AND FREEDOM, *supra* note 47, at 10; *see id.* at 8 ("economic freedom is also an indispensable means toward the achievement of political freedom"); *see also* FRIEDMAN & FRIEDMAN, FREE TO CHOOSE, *supra* note 46, *passim* (arguing that the well-intended attempts to regulate markets have failed and how prosperity and, more important, freedom, depends upon placing more faith in markets).

starting points from which most policy discourse departs, if it deviates at all.[98]

But the Chicago School did more than simply reiterate and reinforce the meta script. It also offered new, significant support for the conclusion that regulation was often harmful. The basic rendition, recall, located the problem for regulators at their lack of information.[99] From there, it was easy to conclude, as many had, that regulators would be inept. Chicago added a key argument, supported by suggestive evidence, that regulators would be not only inept, but also systematically biased.

In the 1960s and 1970s, Chicago School economists began to look at regulation with the sort of suspicion that the meta script counsels. George Stigler, noticing that lawmakers and regulators seemed not to take the advice of professional economists while claiming to be acting in the "public interest," decided it was time to truly test the public-interest claim. That is, he began to suspect that illusion was at work. To investigate whether this was the case, he knew that he had to ignore the rhetoric of regulators and look solely at "the actual effects of economic regulations."[100] Instead of listening to what the helmsman said about where he intended to steer the regulatory ship, Stigler set out to look at the compass, hoping from that to determine what was moving the ship.

What he found was striking: regulations, while purportedly promulgated for the benefit of consumers, appeared to be serving the interests of the regulated producers, be they individual firms, or industries, or occupational groups.[101] Most significantly, regulations that appeared to provide little or no benefit to the public nonetheless served as barriers to entry for producers, thus raising their prices and profits. From that evidence, Stigler began his search for the underlying causes of regulation and pioneered what would later be known as the "economics of regulation" and "public choice."[102]

98. *See supra* text accompanying notes 58-77.

99. *See supra* text accompanying notes 79-87.

100. STIGLER, *supra* note 45, at 115.

101. *Id.* at 116-18.

102. *See, e.g.*, George J. Stigler, *Free Riders and Collective Action: An Appendix to Theories of Economic Regulation*, 5 BELL J. ECON. & MGMT. SCI. 359 (1974) [hereinafter Stigler, *Free Riders*]; George J. Stigler, *Supplementary Note on Economic Theories of Regulation*, *in* THE CITIZEN AND THE STATE: ESSAYS ON REGULATION 137 (1975); George J. Stigler, *The Theory of Economic Regulation*, 2 BELL J. ECON. & MGMT. SCI. 3 (1971); DENNIS C. MUELLER, PUBLIC CHOICE II (1989); Sam Peltzman, *Toward a More General Theory of Regulation*, 19 J.L. & ECON. 211 (1976); Richard A. Posner, *The Social Costs of Monopoly and Regulation*, 83 J. POL. ECON. 807 (1975); *see also* DANIEL A. FARBER & PHILIP P. FRICKEY, LAW & PUBLIC CHOICE: A CRITICAL INTRODUCTION (1991) (providing a brief review of some of the early studies); Chen & Hanson, Theorizing Illusion, *supra* note 8 (same); Hanson & Yosifon, *The Situation*, *supra* note 4 (same); Steven P. Croley, *Theories of Regulation: Incorporating the Administrative Process*, 98 COLUM. L. REV. 1 (1998) (same).

Stigler summarizes the theory and his findings as follows: The "general theory of the behavior of governments"[103] is that "groups possessing political influence use the political process effectively to increase their incomes."[104] As he laments, "no matter how disinterested the goal of public policy, the policy is bent to help politically influential groups at the cost of the less influential."[105]

Assuming all that is true, there is still the question of what makes for "political influence." There is a vast literature devoted to exploring that very question.[106] Further, there is a consensus — though by no means total agreement — that several variables can play an important role, including how narrowly defined an individual's or group's interest is; how much the individual or group has at stake; what resources are available to the individual or group; the presence of economies of scale for the individual or group; and, if a group is involved, how well its members are able to cooperate to advance their shared end.[107] According to the consensus view, a group's ability to coordinate well will depend on some of those same variables and the number of members of the group.[108]

Generally, those sorts of considerations help make sense of much of the evidence that the Chicago scholars collected. That evidence suggested that producers, sellers, industries, or commercial interests, and not consumers or the public, are the prime beneficiaries of regulation. Thus, Milton Friedman begins the "regulatory capture" story as follows:

> All of these [regulatory] interferences with the market are justified as protection of the public interest, but, in fact, they endanger the public interest. In the absence of regulation and protection, we are told, we would be exploited and overcharged for shoddy service and unsafe products, degrading the quality of our lives and jeopardizing our safety.[109]

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103. STIGLER, *supra* note 45, at 115.

104. *Id.* at 120.

105. *Id.* at 119.

106. The classics include MANCUR OLSON, THE LOGIC OF COLLECTIVE ACTION: PUBLIC GOODS AND THE THEORY OF GROUPS (1965), and RUSSEL HARDIN, COLLECTIVE ACTION (1982).

107. *See* Chen & Hanson, Theorizing Illusion, *supra* note 8; Stigler, *Free Riders*, *supra* note 102, at 360-62; *see also* Richard B. Stewart, *The Reformation of American Administrative Law*, 88 HARV. L. REV. 1667, 1776-77 (1975) (describing tendency of regulators to favor well-organized interests).

108. Much more could be said about the public-choice literature, but an elaborate exegesis would do little to advance our thesis here, in part because our argument does not, as we will make clear below, depend heavily on the conclusions of that literature. In any event, we do provide a more fulsome review of public-choice literature in work now in progress. Chen & Hanson, Theorizing Illusion, *supra* note 8.

109. FRIEDMAN, BRIGHT PROMISES, *supra* note 93, at 26.

According to Friedman, however, the exact opposite is closer to the truth. It is not the public, but the regulated industry that most determines the contours and contents of the regulation. And those industries often use the regulation as a means of protecting themselves from the consumer-welfare-enhancing discipline of the market. As Friedman puts it:

> [I]t's in the clear and immediate interest of the regulated industry or industries to either neutralize the effect of that agency or use it to their advantage. Since the interest of an industry is direct and focused, it will spend a lot more time, money and energy to accomplish its goal than the public will to protect its interests. The public's interest is diffuse . . . . A consumer-protection agency might work for a brief period of time, but after the initial, faddish interest in the project dies down, the producers will move in with pressure for exemptions and other special rulings.[110]
>
> Even the strongest critics of the market and the warmest supporters of government will agree that these organizations have become the servants of those they were supposed to protect the public *from*. Yet there is now a demand for a federal consumer-protection agency. We never learn.[111]

This antiregulatory conclusion contributes immensely to the larger meta script. If the very institutions created to protect against powerful interests end up serving those interests, the effort to regulate has only increased the harmful power. And the case for relying more on markets and less on regulation seems greatly enhanced.

It is important to recognize that scholars still debate which interest will exert the most influence over the regulator and which regulators will be most and least vulnerable to the competition.[112] For now, though, we want only to highlight two features of regulation that the Chicago School helped us to see and about which there is very little debate. First, there is much to be gained from achieving influence over regulators, and, second, for that reason, there is a great deal of competition between potentially interested parties over the form of regulation.[113]

C. *From the Meta Script of Policymaking to the Macro Script of Corporate Law*

It is worth noting that a great deal of the work that made Hayek and Friedman famous, and that was implemented through Thatcher and Reagan, had to do with macroeconomic issues involving rates of

110. *Id.* at 23.

111. *Id.* at 22.

112. *See* Chen & Hanson, Theorizing Illusion, *supra* note 8.

113. *See* Hanson & Yosifon, *The Situation*, *supra* note 4, at 202-85 (introducing and summarizing same evidence consistent with the "deep capture" hypothesis).

growth, money supply, stagflation, and so on.[114] The message from Austria and Chicago was simple: stop attempting to manage the economy bureaucratically through money-supply manipulations and price controls; instead, be stingy with money supply and allow market pressures to drive the economy.

What made the new scripts particularly powerful is that the simple principle of markets good, regulation bad could be applied easily to virtually any policy issue. With this simple knowledge structure activated, those who held it began, often automatically, to see issues through its lenses.[115] And the pro-market, anti-regulatory vision quickly altered thinking in virtually all policy contexts. There emerged, for instance, a robust new mindset regarding microeconomic issues, and new fields of study, including "law and economics."

That leads us to the macro script of corporate law, developed by legal economists and, again, reflecting the same sorts of categorical thinking that many believe led to, among other things, the fall of the Soviet Union. That the macro script of corporate law closely resembles the meta script of policymaking (and, as we'll see, shares many of the same elements) is no coincidence. It reflects the success of a simple, attractive, and efficient way of thinking about the world and its institutions. It is also unsurprising that the same individual most responsible for promoting the policymaking meta script in the United States would be one of the first to promote the current macro script of corporate law. Nor does it come as a surprise that the macro script shares a similar summary version: let the business people pursue their profits without interference from others.

We turn now to the macro script of corporate law. In our analysis we remain aware of parallels between the macro script and the more general meta script of policymaking. We argue that the familiarity with the meta script, and the legitimacy with which we hold that script,

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114. Hayek, for instance, wrote a great deal early in his career on business cycles and on the perils of monetary expansion. *See, e.g.*, F.A. HAYEK, MONETARY NATIONALISM AND INTERNATIONAL STABILITY (Augustus M. Kelley 1964) (1937); FRIEDRICH A. HAYEK, MONETARY THEORY AND THE TRADE CYCLE (Augustus M. Kelley 1966) (1933); HAYEK, PRICES AND PRODUCTION, *supra* note 82; FRIEDRICH A. VON HAYEK, PROFITS, INTEREST, AND INVESTMENT (1939). Friedman was to pick up the same themes and run with them in his influential work on monetarism. *See, e.g.*, MILTON FRIEDMAN, THE OPTIMUM QUANTITY OF MONEY AND OTHER ESSAYS (1969); MILTON FRIEDMAN, A THEORY OF THE CONSUMPTION FUNCTION (1957); MILTON FRIEDMAN & ANNA JACOBSON SCHWARTZ, A MONETARY HISTORY OF THE UNITED STATES (1963); MILTON FRIEDMAN & ANNA JACOBSON SCHWARTIZ, MONETARY STATISTICS OF THE UNITED STATES (1970); MILTON FRIEDMAN & ANNA J. SCHWARTZ, MONETARY TRENDS IN THE UNITED STATES AND THE UNITED KINGDOM (1982).

115. *See* Chen & Hanson, *Categorically Biased*, *supra* note 5 (discussing schema activation and application).

plays an important role in facilitating acceptance of the dominant macro script of corporate law.[116]

III. THE MACRO SCRIPT OF CORPORATE LAW

A. *The Emergence of the Summary Macro Script*

As we describe below, the emergence of large commercial enterprises and the corporate form that facilitated that emergence were met with considerable trepidation and resistance.[117] It was not simply that the business corporation was "new," though that may have been sufficient cause for many to worry.[118] It was also that the aggregations of wealth and concentrations of interests made possible by the corporate form seemed a fairly obvious threat to our burgeoning democracy.[119]

1. *The Early Legal-Academic Debate*

We pick up the debate over corporations and the corporate form as it emerged in legal-academic circles in the first half of the twentieth century. The famous exchanges between Columbia's Adolph Berle and Harvard's Merrick Dodd on the nature of the corporation mark the real beginning of the modern corporate law debate.[120] Both shared a worry about corporations, but differed in the source of their concern.

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116. Because of that familiarity and the legitimacy that accompanies the meta script, we believe that the arguments comprising the macro script for corporate law elicit less scrutiny than they otherwise would. For example, just as most of us know, drawing upon the restaurant script, what to do with menus and when to pay the bill, the familiarity of the policymaking meta script primes us to accept the corporate law macro script. *See infra* text accompanying note 314. Insofar as the script is viewed as legitimate, eliciting positive affective response, the acceptability of the macro script will be even more automatic. *See* Chen & Hanson, *Categorically Biased*, *supra* note 5, at 1174-1211 (describing numerous determinants and conditions of schema use).

117. *See infra* text accompanying notes 504-552.

118. *Cf.* Ellen Peters & Paul Slovic, *The Role of Affect and Worldviews as Orienting Dispositions in the Perceptions and Acceptance of Nuclear Power*, 26 J. APPLIED SOC. PSYCHOL. 1427, 1428 (1996) (describing various qualitative factors that influence risk perceptions, including perceptions that the risk is new, unknown, and could create harm well into the future).

119. *See infra* text accompanying notes 504-539.

120. *See, e.g.*, A.A. Berle, Jr., *Corporate Powers as Powers in Trust*, 44 HARV. L. REV. 1049 (1931) (arguing that corporate managers should focus on shareholders) [hereinafter Berle, *Powers in Trust*]; E. Merrick Dodd, Jr., *For Whom Are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145 (1932) (arguing that corporate managers should be attentive not just to shareholders, but to all stakeholders); A.A. Berle, Jr., *For Whom Corporate Managers Are Trustees: A Note*, 45 HARV. L. REV. 1365 (1932) (responding to Dodd) [hereinafter Berle, *Note on Trustees*]. Other scholars have described the evolution in more detail. *See, e.g.*, C.A. Harwell Wells, *The Cycles of Corporate Social Responsibility: An Historical Retrospective for the Twenty-First Century*, 51 U. KAN. L. REV. 77 (2002).

In 1931, Berle focused on the problem of managerial discretion faced by contributors of capital.[121] He stressed the danger inherent in the fact that a shareholder holds only "an infinitesimal claim on massed industrial wealth"[122] and is therefore "helpless to do anything with it or about it, except to sell for what the security markets will let him have."[123] The shareholder's claim is thus "entirely in the hands of" managers.[124] In light of the collective-action problem faced by shareholders and the power exerted by managers, Berle described the protection of shareholders as the critical challenge facing corporate law — protecting shareholders from managers who might attempt to "transfer corporate wealth and power to themselves."[125] By framing the challenge in that way, Berle's work implicitly downplayed many of the problems that had loomed large in erstwhile criticisms of corporate practices and, in effect, laid the groundwork for what would become the profit-first (or profit-only) norm animating corporate theory.

Berle joined with Harvard economist Gardiner C. Means to write what would become their magnum opus, *The Modern Corporation and Private Property*.[126] Their argument, cited heavily to this day,[127] was that the "managerial revolution" had effectively removed power from the sea of faceless shareholders and placed it into the hands of a small number of managers. "The separation of ownership from control produces a condition where the interest of owner and of ultimate manager may, and often do, diverge, and where many of the checks which formerly operated to limit the use of power disappear."[128]

Berle's normative argument in favor of defending shareholders was bolstered as well by his *positive* claim that courts were then exhibiting "a new willingness to use their equitable powers to force directors, or indeed any group that dominated a corporation, to exercise the powers granted to them not only for their own benefit,

121. *See* Berle, *Powers in Trust*, *supra* note 120, at 1049 ("[T]he thesis of this essay [is] that all powers granted to a corporation or to the management of a corporation . . . are necessarily and at all times exercisable only for the ratable benefit of all the shareholders as their interest appears.").

122. Berle, *Note on Trustees*, *supra* note 120, at 1370.

123. *Id.*

124. *Id.*

125. Wells, *supra* note 120, at 88.

126. ADOLPH A. BERLE, JR. & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (1932).

127. A Westlaw search (allrev — 6/28/03) for "Berle /s Means" yielded 960 documents. When limited to after 6/28/1998, the search yielded 286 documents within the last five years — fifteen more than a search for "Ronald /s Chen or Jon /s Hanson" produced in that same five-year period .

128. BERLE & MEANS, *supra* note 126, at 6.

but for 'the ratable benefit of all the shareholders as their interest appears.'"[129]

Merrick Dodd framed the corporate law problem in terms more familiar to his audience, emphasizing the threat posed by corporations to nonshareholders. Where Berle worried about the power dynamics within the corporation, Dodd focused on the power dynamics between corporations and the rest of society. Arguing that corporate law should "protect the nation from corporations,"[130] Dodd redescribed the corporation as

> an institution directed by persons who are primarily fiduciaries for the institution rather than for its members. That lawyers have commonly assumed that the managers must conduct the institution with single-minded devotion to stockholder profit is true; but the assumption is based upon a particular view of the . . . nature of business as a purely private enterprise. If we recognize that the attitude of law and public opinion toward business is changing, we may then properly modify our ideas as to the nature of such a business institution as the corporation and hence as to the considerations which may properly influence the conduct of those who direct its activities.[131]

Where Berle sought to remedy the problems created by the separation of ownership and control, Dodd sought to take advantage of them.[132] Dodd did not disagree that shareholders needed special protection;[133] he argued simply that their vulnerability was not unique: "[I]t is undesirable, even with the laudable purpose of giving stockholders much-needed protection against self-seeking managers, to give increased emphasis at the present time to the view that business corporations exist for the sole purpose of making profits for their stockholders."[134]

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129. Wells, *supra* note 120, at 88 (quoting Berle, *Powers in Trust*, *supra* note 120, at 1049).

130. Wells, *supra* note 120,at 87 (discussing Dodd, *supra* note 120).

131. Dodd, *supra* note 120, at 1162-63.

132. Professor Wells describes Dodd's argument as follows:

> If directors could have new duties to shareholders imposed on them, could they not equally well assume duties to other groups that also had a stake in the corporation? So long as ownership and control were one, it made no sense to argue that the 'control' should treat owners as only one of many constituencies. With the separation of ownership from control it became possible to imagine those controlling corporations taking on responsibilities to groups besides owners.

Wells, *supra* note 120, at 91-92.

133. *See* Dodd, *supra* note 120, at 1147 ("The present writer is . . . in sympathy with Mr. Berle's efforts to establish a legal control which will more effectually prevent corporate managers from diverting profit into their own pockets from those of stockholders, and agrees with many of the specific rules which the latter deduces from his trusteeship principle.").

134. Dodd, *supra* note 120, at 1147-48.

Dodd's normative case also had an important positive component. He noted that there appeared to be a growing public consensus that corporations should be run for the good of society, and not simply the corporation's shareholders.[135] For instance, Dodd described the actions and noted the words of prominent corporate leaders such as General Electric President Gerard Swope, who proclaimed that "organized industry should take the lead, recognizing its responsibility to its employees, to the public, and to its stockholders."[136]

At least in the short run, Dodd's arguments for a broader constituency "won" the debate, in part because Berle himself began to register concern about the growing concentration of commercial enterprise.[137] In his book with Gardiner Means,[138] Berle conceded that the increasing concentration of business meant that directors would "have responsibilities not only toward their stockholders but also toward 'the workers, the consumers, and the State.'"[139]

With that intellectual consensus in place, it was not long before corporate spokespeople became vocal proponents for the broader view of the corporation — or of the duties of managers and directors. According to Harwell Wells's historical analysis,

> At least one other group, oddly enough, also agreed that corporations wielded great power across broad swathes of American life: corporate leaders. As in the 1920s, so in the postwar era, renewed corporate success led many business executives back to the ideal of business statesmanship. At least in public pronouncements, few corporate leaders failed to make a nod to their firms' "social responsibilities."[140]

And so it was that in 1933 David Rockefeller, like Gerard Swope before him, implicitly endorsed Dodd's social perspective of corporate management, rejecting Berle's shareholder perspective: "[T]he old concept that the owner of a business had a right to use his property as he pleased to maximize profits, has evolved into the belief that ownership carries certain binding social obligations."[141]

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135. *Id.* at 1148.

136. *Id.* at 1155 (quoting GERARD SWOPE, THE SWOPE PLAN 22 (1929)).

137. Actually, in the very short run, Berle denied the significance of Dodd's positive claims by describing Dodd's examples as "the exceptions rather than the rule." Berle, *Note on Trustees*, *supra* note 120, at 1372. Berle asserted that "[t]he industrial 'control' does *not* . . . now assume responsibilities to the community; his bankers do *not* now undertake to recognize social claims; his lawyers do *not* advise him in terms of social responsibility. Nor is there any mechanism now in sight enforcing accomplishment of his theoretical function." *Id.* at 1367. In fact, he indicated that the perception of socially responsible managers was a motivated "illusion," *id.* at 1371, born of "a pious wish," *id.* at 1368.

138. BERLE & MEANS, *supra* note 126.

139. Wells, *supra* note 120, at 94 (citing BERLE & MEANS, *supra* note 126).

140. Wells, *supra* note 120, at 100 (footnote omitted).

141. *Id.* at 100 (quoting HERMAN E. KROOS, EXECUTIVE OPINION: WHAT BUSINESS LEADERS SAID AND THOUGHT ON ECONOMIC ISSUES, 1920S-1960S, at 52 (1970)).

Two decades later, Berle graciously conceded defeat:

> Twenty years ago, the writer had a controversy with the late Professor E. Merrick Dodd, of Harvard Law School, the writer holding that corporate powers were powers in trust for shareholders while Professor Dodd argued that these powers were held in trust for the entire community. The argument has been settled . . . squarely in favor of Professor Dodd's contention.[142]

While conceding the battle, Berle had yet to surrender the war: he hopefully and, it turns out, presciently qualified his concession with the words, "at least for the time being."[143] That was the state of the corporate law debate in the early 1960s.

2. *The Resurgence of Shareholder Primacy*

As we summarized above, somewhere during the late 1960s and early 1970s, the intellectual tide in policymaking circles began to shift. In this country, the arguments of Chicago Schoolers were gaining momentum in all policy arenas.[144] And, given his confidence in the meta script and his general productivity, it is not surprising that Milton Friedman himself would weigh in with a macro version of the pro-market, anti-regulation meta script in the corporate context. Friedman's bottom line was the bottom line: market participants should worry about one thing — serving the interests of shareholders, which meant succeeding in the market, which meant maximizing profits.[145] According to Friedman, the maintenance of a free society requires that there be "one and only one social responsibility of business — to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game . . . ."[146]

The same tide that carried the Chicago School meta script to real-world prominence during the Reagan era (and since) also helped to carry Friedman's renewed intellectual case for shareholder primacy and profits — the macro script of corporate law.[147] It was not long

142. Adolph A. Berle, Jr., Rosenthal Lectures at Northwestern University, *quoted in* RICHARD EELLS, CORPORATION GIVING IN A FREE SOCIETY 29 (1956).

143. *Id.*

144. The ascendancy of those ideas reflected many elements of a larger process of "deep capture." *See* Hanson & Yosifon, *The Situation*, *supra* note 4, at Parts V-VI.

145. *See* FRIEDMAN, CAPITALISM AND FREEDOM, *supra* note 47, at 133-34; Friedman, *Friedman Doctrine*, *supra* note 3, at 32.

146. FRIEDMAN, CAPITALISM AND FREEDOM, *supra* note 47, at 133.

147. *See* Wells, *supra* note 120, at 124 ("Although Friedman's was a lonely voice in 1970, over the rest of the decade legal scholars would join the attack on corporate social responsibility, also using economic theory to throw doubt on the proposals offered by [proponents of corporate responsibility].").

before prominent legal scholars began to echo and reinforce Friedman's shareholder primacy rationale.[148] For the next three decades, that view gained increasing traction among intellectuals.[149] Even commentators who perceived that the broader notion of corporate law was still strong observed that the shareholder primacy norm appeared poised for dominance.[150]

For example, then-Chancellor (now-Professor) William Allen argued in 1992 that the shareholder primacy norm was experiencing a resurgence, which he predicted gathering forces would only strengthen:

> Each of the two dominant social trends that will exert potentially transformative power on corporate governance in the years immediately ahead — the evolution of a truly global economy and the continuing growth, and coming dominance, of institutional shareholders — is more consistent with the property conception of the corporation than with the entity conception.

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148. Indeed, around the same time that Friedman was writing on corporate law, Yale Law School Dean Eugene Rostow was applying the pro-market, anti-regulation metatheoretic schema to corporate law. Like Friedman, Rostow argued that the social-responsibility view "ignored the economic justification for business in the first place" and that the superiority of the profit-maximization norm had been scientifically proven:

> The economist has demonstrated with all the apparent precision of plane geometry and the calculus that the quest for maximum revenue in a competitive market leads to a system of prices, and an allocation of resources and rewards, superior to any alternative, in its contribution to the economic welfare of the community as a whole.

Eugene V. Rostow, *To Whom and for What Ends Is Corporate Management Responsible?*, *in* THE CORPORATION IN MODERN SOCIETY 46, 63 (Edward S. Mason ed., 1959). As Wells observes,

> Rostow's complaint highlights a factor worth noting in the late-1950s early-1960s debate over corporate social responsibility: it was rarely conducted in economic terms. In an era with only a rudimentary economic theory of the firm, critics of the corporation focused on its social or political role to the neglect of its economic function.

Wells, *supra* note 120, at 109-10.

149. According to Wells, "economic analysis [became] an important element in debates over corporate social responsibility" in the 1970s, but "not until the late 1980s would it win the field." Wells, *supra* note 120, at 110. In 1991, the emerging dominance of shareholder primacy is exemplified by the fact that legal-economist Jonathan Macey could open an article with the following assertion:

> Under traditional state and corporate law doctrine, officers and directors of both public and closely held firms owe fiduciary duties to shareholders and to shareholders alone. Directors and officers are legally required to manage a corporation for the exclusive benefit of its shareholders, and protection for other sorts of claimants exists only to the extent provided by contract.

Jonathan R. Macey, *An Economic Analysis of the Various Rationales for Making Shareholders the Exclusive Beneficiaries of Corporate Fiduciary Duties*, 21 STETSON L. REV. 23, 23 (1991).

150. *E.g.*, William T. Allen, *Our Schizophrenic Conception of the Business Corporation*, 14 CARDOZO L. REV. 261, 276 (1992).

> As the world becomes a fiercer place for American business, corporate management is forced increasingly to consider financial performance at every stage. Thus, evolving global markets encourage efficiency and value-creating management. These developments tend to push shareholders, as residual risk bearers, back towards the center of thinking about the enterprise. Creating shareholder value, for example, is increasingly a financial measure that is used internally in the making of corporate capital budgeting decisions. Indeed while the law seems to have ringingly endorsed a managerialist or entity orientation, full-bodied statements of the managerialist philosophy appear now to be rather out of fashion, even among members of senior corporate management. Today the talk is more likely to be about creating shareholder value than about social responsibility.[151]

In retrospect, Allen's predictions appear prophetic.

3. *"The End of History"*

At the turn of the millennium, Professors Hansmann and Kraakman proclaimed that "[t]here is no longer any serious competitor to the view that corporate law should principally strive to increase long-term shareholder value."[152] As if it were the inevitable and ultimate outcome of an evolutionary process,[153] they hailed the global convergence toward that basic model of corporate law as "The

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151. *Id.* at 279 (footnote omitted).

152. Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 439 (2001). By picking up the debate with Merrick Dodd and Adolph Berle and quickly proceeding through the Carter and Reagan eras to the "End of History," this Article may at first glance suggest that the competition over the meta and macro scripts guiding our understanding of the corporate form did not begin until the 1930s. In fact, the competition began long before that. We extend our discussion of the historical context below. *See infra* text accompanying notes 502-552. Until then, our discussion may be misleading in another way. By focusing on the dominant schemas shaping our approach to policymaking and corporate law, this Article may also suggest that no alternative scripts remain on the policy and legal landscape today and that everyone fully embraces the dominant meta script of policymaking and the macro script of corporate law. That is not our position. In fact, it is impossible to miss the growing anticorporate movement taking shape in the United States and around the world. Recent documentaries, including "The Corporation," "Fahrenheit 9/11," and "Supersize Me" are salient examples of that trend.

There are now and have long been competing scripts for corporate law and policymaking. Our contention is not that the dominant script has fully vanquished the "social responsibility" script and other alternative scripts. Our contention is that a competition exists at all times among competing scripts and that, often, it is possible to identify a more or less dominant script or collection of scripts. At this point, our focus is on describing the logic behind the currently dominant meta script of policymaking and macro script of corporate law.

153. The underlying theory and evidence for that perspective is provided in HENRY HANSMANN, THE OWNERSHIP OF ENTERPRISE (1996). *See, e.g.*, *id.* at 22 (explaining why "[i]t is reasonable to expect that, over the long run, cost-minimizing forms of organization will come to dominate most industries").

End of History for Corporate Law."[154] As Professors Hansmann & Kraakman observe:

> All thoughtful people believe that corporate enterprise should be organized and operated to serve the interests of society as a whole, and that the interests of shareholders deserve no greater weight in this social calculus than do the interests of any other members of society. The point is simply that now, as a consequence of both logic and experience, there is convergence on a consensus that the best means to this end (that is, the pursuit of aggregate social welfare) is to make corporate managers strongly accountable to shareholder interests and, at least in direct terms, *only to those interests*.[155]

Despite its early successes, Dodd's view of corporate law now appears to be the clear loser, at least among intellectuals.[156] Even

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154. Hansmann & Kraakman, *supra* note 152, at 439; *see also* MARINA V. N. WHITMAN, NEW WORLD, NEW RULES: THE CHANGING ROLE OF THE AMERICAN CORPORATION (1999) (describing the transition from "managerial capitalism," in which managers were given a great deal of discretion with company assets, to "investor capitalism," in which managers have been constrained to pursue profits).

Other scholars have been somewhat reluctant to accept fully Hansmann and Kraakman's international convergence claim. Mark Roe, for example, observes that in countries where product markets are not competitive, a norm of profit maximization may not, because of the ills of monopoly practices, promote social welfare. *See* Mark J. Roe, *The Shareholder Wealth Maximization Norm and Industrial Organization*, 149 U. PA. L. REV. 2063, 2080 (2001). According to Roe's analysis, this limitation on the profit norm corresponds with actual practice, as countries with a less (more) competitive marketplace tend to have corporate laws that less (more) rigorously promote shareholder primacy. *Id.* at 2069-70. Roe notes, however, that "[a]s Europe's product markets have become more competitive, its demand for, or at least tolerance of, shareholder primacy institutions has also increased." *Id.* at 2079.

Similarly, Professor Roe and Lucian Bebchuk argue that "path dependence" will act as a significant impediment to convergence. *See* Lucian Ayre Bebchuk & Mark J. Roe, *A Theory of Path Dependence in Corporate Ownership and Governance*, 52 STAN. L. REV. 127, 155 (1999). Drawing upon the regulation-is-bad element of the meta script, they describe how "initial ownership structures" can affect both "subsequent ownership structures" ("structure-driven path dependence") and "subsequent structures through their effect on the legal rules governing corporations" ("rule-driven path dependence"). *Id.* at 129.

We discuss Professor Roe and Bebchuk's insightful work in greater detail in a related article. *See* Chen & Hanson, False Starts, *supra* note 29.

155. Hansmann & Kraakman, *supra* note 152, at 441 (emphasis added).

156. There are, to be sure, some corporate law scholars who continue to challenge elements of shareholder primacy. For the most part, however, their work remains preliminary and marginal. Possible exceptions include the fascinating work on the team production theory of corporate law by Margaret Blair and Lynn Stout, *see, e.g.*, Margaret Blair & Lynn Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247 (1999), on director primacy by Stephen Bainbridge, *see, e.g.*, Stephen Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547 (2003), on the need for "corporate transparency" by Cynthia Williams, *see, e.g.*, Cynthia A. Williams, *The Securities and Exchange Commission and Corporate Social Transparency*, 112 HARV. L. REV. 1197 (1999), and on progressive corporate law by Kent Greenfield, *see, e.g.*, KENT GREENFIELD, THE BEGINNING OF HISTORY FOR CORPORATE LAW: PROGRESSIVE IDEAS FOR CONTROLLING CORPORATE POWER (forthcoming).

Blair and Stout do not dispute that "the idea of shareholder primacy has become increasingly popular among academics . . . ." Blair & Stout, *supra* at 326. They advance an alternative macro script, however, that they believe better explains the overall structure of though Berle conceded defeat after twenty years of debate, his vision has now emerged the clear winner.[157] As Harvard economist Michael Jensen recently concluded, shareholder primacy enjoys an impressive pedigree, finding support in "200 years of research in economics and finance."[158] The following Section examines some of the intellectual underpinnings of this dramatic turnaround.[159]

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corporate law as well as its application — a "team production" model in which the corporation is a nexus of contracts, both explicit and implicit, and the board acts as an independent "mediating hierarch" for all constituencies. In terms that seem to vindicate Dodd's earlier positive claims, *see supra* text accompanying notes 130-136, Blair and Stout write:

> If corporate law is not designed primarily to protect shareholders — if, instead, it is designed to protect the corporate coalition by allowing directors to allocate rents among various stakeholders, while guarding the coalition as a whole only from gross self-dealing by directors — then the rules of corporate law begin to make more sense.

Id. at 321 (emphasis omitted).

The recent focus on shareholders is, they argue, not a sign that directors are only concerned with shareholders, but a temporary consequence of "changing economic and political forces that have improved shareholders' relative bargaining power vis-à-vis other coalition members." Blair and Stout, *supra*, at 327. We hope to discuss in more detail Blair and Stout's important thesis and evidence in our future work.

157. If it had ever lagged in the first place. Of the 1950s, a time when it appeared that a broader notion of the corporation was dominant, Wells notes, "Corporate leaders spoke of the corporation's new responsibility, but none seemed ready to abandon the profit-maximizing and shareholder-primacy norms that had guided their actions for many years." *See* Wells, *supra* note 120, at 101.

158. Michael C. Jensen, *Value Maximization, Stakeholder Theory, and the Corporate Objective Function*, 14 BANK AM. J. APPLIED CORP. FIN., Fall 2001, at 8-9.

159. It is important to recognize that the convergence, and much of the scholarship celebrating it, occurred during the late 1990s — a time when, by some fairly salient measures, the American economy and American corporations were thriving. Proponents of the dominant schema have, it seems, been less vociferous or bold in their claims in recent years, owing largely, we believe, to the recent crises in corporate America, the faltering and sluggish economy, and the heightened perception of terrorist threats and of America's unpopularity in the world. *Cf.* Chen & Hanson, *Categorically Biased*, *supra* note 5 (describing the factors that lead people to engage in schema search and to think "bottom up").

Outside of legal academia, numerous books have been published about the corruption and destructive hubris of our profit-centered system. *See, e.g.*, ANDY KESSLER, WALL STREET MEAT (2003); BARBARA LEY TOFFLER & JENNIFER REINGOLD, FINAL ACCOUNTING: AMBITION, GREED, AND THE FALL OF ARTHUR ANDERSEN (2002); LEON LEVY & EUGENE LINDEN, THE MIND OF WALL STREET: A LEGENDARY FINANCIER ON THE PERILS OF GREED AND THE MYSTERIES OF THE MARKET (2002); FRANK PARTNOY, INFECTIOUS GREED: HOW DECEIT AND RISK CORRUPTED THE FINANCIAL MARKETS (2003); MIMI SWARTZ & SHERRON WATKINS, POWER FAILURE: THE INSIDE STORY OF THE COLLAPSE OF ENRON (2002). Within legal academia, the crises have, we believe, given greater voice to creative scholars, such as William Bratton and Kent Greenfield, who are generally outside the mainstream corporate law literature and who have long been quite skeptical of the sorts of knowledge structures or discourse within it. *See, e.g.*, William W. Bratton, *Enron, Sarbanes-Oxley and Accounting: Rules Versus Principles Versus Rents*, 48 VILL. L. REV. 1023 (2003); Kent Greenfield, *Ultra Vires Lives! A Stakeholder Analysis of Corporate Illegality (with Notes on How Corporate Law Could Reinforce International Law Norms)*, 87 VA. L. REV. 1279 (2001).

Although it is impossible to say what the long-term effects of these crises and of this sort of scholarship will have, it is clear that now is a fruitful time for progressive critics of corporate law. Indeed, several law journal symposia have recently been devoted to the issue.

B. *The Macro Script: Justifying the Summary Script*

In this Section, we elaborate upon corporate law's summary macro script of shareholder primacy — that is, profit maximization is good and social responsibility is bad — and examine the more detailed version of the corporate law macro script. The macro script constitutes a series of arguments that help to support, and have facilitated the dramatic ascendancy of, the summary script.[160]

1. *Friedman's Shareholder Primacy Script*

In our elaboration of the macro script, we give special attention to the arguments of Milton Friedman. We do so for several reasons — all of which reveal the unseen power of schemas. First, it was Friedman, as much as anyone, who fostered the intellectual emergence of the meta script of policymaking, which, we believe, itself helped to make the corporate macro script so dominant. Second, Friedman's early case for shareholder primacy was a seminal turning point in corporate legal theory. And third, Friedman's original rendition, although refined by subsequent legal-academic scholarship, provides the basic script (including implicit presumptions and intellectual anchors) with which proponents of the now-dominant view of corporate law begin.[161] As

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See, e.g., Symposium, *Corporate Irresponsibility: America's Newest Export?*, 70 GEO. WASH. L. REV. 867 (2002); Symposium, *Corporations Theory and Corporate Governance Law*, 35 U.C. DAVIS L. REV. 523 (2002); Symposium, *Enron and Its Aftermath*, 76 ST. JOHN'S L. REV. 671 (2002); *Lessons From Enron: A Symposium on Corporate Governance*, 54 MERCER L. REV. 663 (2003); *Socio-Economics and Corporate Law Symposium: The New Corporate Social Responsibility*, 76 TUL. L. REV. 1187 (2002).

160. It would be an understandable mistake to assume that the summary version of the corporate macro script is a derivative of the fuller version of the corporate macro script. The relationship between the elaborate and refined arguments and the summarizing conclusion is one of mutual reinforcement. And, if anything, the refinements discussed in this Section came *after* the summary version was more or less accepted by those scholars who generated the refinements. The refinements do, however, help to legitimate the summary schemas and persuade those who are initially dubious.

161. *See, e.g.*, ROBERT CHARLES CLARK, CORPORATE LAW 679 (1986) (citing Friedman's *New York Times* essay and calling it "[p]erhaps the most notable justification of the strict profit-maximizing goal"); Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547, 564 (2003) ("Milton Friedman's famous essay [on] corporate responsibility remains the classic statement of the shareholder primacy model."); Henry N. Butler & Fred S. McChesney, *Why They Give at the Office: Shareholder Welfare and Corporate Philanthropy in the Contractual Theory of the Corporation*, 84 CORNELL L. REV. 1195, 1196 (1999) (explaining that Friedman's piece "[c]halleng[ed] the prevailing views of the time in an important and then-controversial article"); Claire Moore Dickerson, *Human Rights: The Emerging Norm of Corporate Social Responsibility*, 76 TUL. L. REV. 1431, 1434 (2002) (attributing to Friedman the early version of shareholder primacy); Kent Greenfield, *The Place of Workers in Corporate Law*, 39 B.C. L. REV. 283, 289-90 (1998) (observing that Friedman "popularized the claim that the 'one and only . . . social responsibility of business' was to increase its profits"); Roe, *supra* note 154, at 2065 & n.2 (noting that "[s]hareholder wealth maximization is usually accepted as the appropriate goal in American business circles" and citing "the famous essay by Milton

Mark Roe describes, "Although aggressive when it appeared, Friedman's perspective is now mainstream in American business circles . . . ."[162]

Friedman, it is important to note, was writing when Dodd's view of the corporation was at its apex and corporate managers and judges believed that social responsibility was an important corporate constraint, if not the sole end of corporations.[163] To Friedman, the very notion of corporate social responsibility was not just wrong, but dangerously wrong:

> The businessmen believe that they are defending free enterprise when they declaim that business is not concerned "merely" with profit but also with promoting desirable "social" ends; that business has a "social conscience" and takes seriously its responsibilities for providing employment, eliminating discrimination, avoiding pollution and whatever else may be the catchwords of the contemporary crop of reformers. In fact they are — or would be if they or anyone else took them seriously — preaching pure and unadulterated socialism. Businessmen who talk this way are unwitting puppets of the intellectual forces that have been undermining the basis of a free society these past decades.[164]

Elsewhere, Friedman put the point more tersely: "Few trends could so thoroughly undermine the very foundations of our free society as the

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Friedman"); Dalia Tsuk, *Corporations Without Labor: The Politics of Progressive Corporate Law*, 151 U. PA. L. REV. 1861, 1862 (2003) ("One of the most enduring characteristics of modern American corporate law is its shareholder-centered vision of managerial duties, pointedly expressed by Milton Friedman, according to which corporate managers are agents of shareholders and must manage the corporation in ways that maximize the profits of their principals.").

162. Roe, *supra* note 154, at 2065 n.2. Another example from a recent Symposium, *Corporate Social Responsibility: Paradigm or Paradox?*, at Cornell Law School demonstrates the power of Friedman's script, both in the United States and abroad. Professor Yoshiro Miwa of the University of Tokyo opens his article by recalling:

> Professor Friedman's rebuttal to the social responsibility of corporate directors came to mind when I received an invitation to participate in this conference. When I first encountered Professor Friedman's position as an undergraduate in the late 1960s, my first reaction was surprise. At that time, most Japanese economists agreed that corporate directors have a fiduciary obligation that extends beyond their shareholders. For years I disagreed with Professor Friedman's argument . . . .
>
> Three decades have now passed since my initial exposure to Professor Friedman's argument against corporate social responsibility, and I have changed my position. Today, whenever I face an argument in support of "corporate social responsibility," I immediately respond with several questions . . . .

Yoshiro Miwa, *Corporate Social Responsibility: Dangerous and Harmful, Though Maybe Not Irrelevant*, 84 CORNELL L. REV. 1227, 1227-28 (1999). Professor Miwa goes on to recite verbatim Friedman's queries demonstrating the inability of businessmen to determine what is in the social interest. *See infra* text accompanying note 173 (Friedman quotation).

163. *See supra* text accompanying notes 135-142 (providing a few examples); Friedman, *Friedman Doctrine*, *supra* note 3, at 32 (describing the creation of G.M.'s "public-policy committee").

164. Friedman, *Friedman Doctrine*, *supra* note 3, at 33.

acceptance by corporate officials of a social responsibility other than to make as much money for their stockholders as possible."[165]

Friedman's apparent indignation stems from his starting assumptions that all corporate assets belong to shareholders. Any investment of those assets toward ends other than profit — like "spending someone else's money for a general social interest"[166] — is tantamount to "taxation without representation."[167] "The whole justification for permitting the corporate executive to be selected by the stockholders is that the executive is an agent serving the interests of his principal. This justification disappears when the corporate executive imposes taxes and spends the proceeds for 'social' purposes."[168]

Don't misunderstand. It's not that Friedman does not care about pollution, unemployment, or other social ills. One of Friedman's important themes was that the longstanding debates among those who worry about the harmful effects of profit-seeking institutions on society were for naught. The purported tension or conflict between the good and bad effects of profit-seeking were themselves illusion — mere figments of misguided, if well-meaning, imaginations. All stakeholders (employees, consumers, lenders, suppliers, neighboring communities, and so on) are better off, on net, if profit is the sole corporate goal, leaving the protection of stakeholders' interests to the private markets and governmental institutions specifically designed to protect those interests. With respect to private forms of protection, Friedman argued that profit-maximization helps eliminate various forms of discrimination, not because discrimination is immoral, but because discrimination is *unprofitable*:

> A businessman or an entrepreneur who expresses preferences in his business activities that are not related to productive efficiency is at a disadvantage compared to other individuals who do not. Such an individual is in effect imposing higher costs on himself than are other individuals who do not have such preferences. Hence, in a free market they will tend to drive him out.[169]

The unseen hand, Friedman argued, is also unseeing.[170]

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165. FRIEDMAN, CAPITALISM AND FREEDOM, *supra* note 47, at 133.

166. Friedman, *Friedman Doctrine*, *supra* note 3, at 33.

167. *Id.* at 122.

168. *Id.*

169. FRIEDMAN, CAPITALISM AND FREEDOM, *supra* note 47, at 109-10.

170. This claim, Friedman suggests, finds empirical support in some of history's noblest moments: "It is a striking historical fact that the development of capitalism has been accompanied by a major reduction in the extent to which particular religious, racial, or social groups have operated under special handicaps in respect of their economic activities; have, as the saying goes, been discriminated against." *Id.* at 108.

With respect to public forms of protection, he writes: "[T]he imposition of taxes and the expenditure of tax proceeds are governmental functions. We have established elaborate constitutional parliamentary and judicial provisions to control these functions, to assure that taxes are imposed so far as possible in accordance with the preferences and desires of the public."[171] Thus, according to Friedman, problems such as pollution and unemployment are problems for the government to address through tax-and-spend policies or antipollution regulations. The claim that corporations are in a better position to serve "social" ends

> must be rejected on grounds of principle. What it amounts to is an assertion that those who favor the taxes and expenditures in question have failed to persuade a majority of their fellow citizens to be of like mind and that they are seeking to attain by undemocratic procedures what they cannot attain by democratic procedures.[172]

Furthermore, Friedman argues, corporate directors have no expertise or special knowledge that would allow them to make decisions that are socially beneficial, except insofar as profit and social concerns coincide. He asks:

> If businessmen do have a social responsibility other than making maximum profits for stockholders, how are they to know what it is? Can self-selected private individuals decide what the social interest is? Can they decide how great a burden they are justified in placing on themselves or their stockholders to serve that social interest? Is it tolerable that these public functions of taxation, expenditure, and control be exercised by the people who happen at the moment to be in charge of particular enterprises, chosen for those posts by strictly private groups.[173]

Suppose, for example, that a director decides that he should spend corporate assets to help fight inflation:

> How is he to know what action of his will contribute to that end? He is presumably an expert in running his company — in producing a product or selling it or financing it. But nothing about his section makes him an expert on inflation. Will his holding down the price of his product reduce inflationary pressure? Or, by leaving more spending power in the hands of his customers, simply divert it elsewhere? Or by forcing him to produce less because of the lower price, will it simply contribute to shortages? Even if he could answer these question, how much cost is he justified in imposing on his stockholders, customers and employe[e]s for this social purpose? What is his appropriate share and what is the appropriate share of others?[174]

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171. Friedman, *Friedman Doctrine, supra* note 3, at 122.

172. *Id.* at 124.

173. FRIEDMAN, CAPITALISM AND FREEDOM, *supra* note 47, at 133-34.

174. Friedman, *Friedman Doctrine, supra* note 3, at 122.

On the other hand, requiring directors to focus solely on profits helps protect shareholders because the "criterion of performance is straightforward and the persons among whom a voluntary contractual arrangement exists is clearly defined."[175]

2. *Legal Academia's Elaborations*

The influence of Friedman's basic script of shareholder primacy and the larger meta script of policymaking is evident in the work of corporate law scholars defending the corporate macro script. These scholars place faith in the ability of profit-seeking behavior to unconsciously serve larger interests and harbor distrust for those who would attempt to serve vague, contestable ends such as the public interest or social responsibility. Even though some may view Friedman as an outlier advancing extreme versions of the various schemas,[176] the discussion that follows illustrates that virtually all of the modern elaborations on corporate legal theory are firmly anchored to Friedman's work.[177] Indeed, many elements of the detailed macro script are simply more sophisticated renditions of Friedman's original ideas.

a. Maximizing Shared Interests Across Categories. One common response to the question of whether directors should have a duty to serve the interests of nonshareholders has been to argue, as Friedman did,[178] that all stakeholders are automatically protected, as though by an invisible hand, if we allow corporations to do what they do best: maximize profits.[179] This response assumes that the interests of nonshareholders are aligned with those of shareholders. The most basic version of this first approach is the claim that the bigger the corporate pie, the better for everyone, because all stakeholders will enjoy opportunities for a larger slice. Easterbrook and Fischel explain:

175. *Id.* at 33.

176. Indeed, our knowledge of the phenomenon of *subtyping* leads us to expect this. Social psychological research has documented the tendency of individuals, when faced with nonstereotypical information, to subtype — or subcategorize — that information so that they may protect their active schemas and continue to see them as valid. *See* Chen & Hanson, *Categorically Biased, supra* note 5, at 1204-06; *see also* L. Johnston & M. Hewstone, *Cognitive Models of Stereotype Change: (3) Subtyping and the Perceived Typicality of Disconfirming Group Members*, 28 J. EXPERIMENTAL SOC. PSYCHOL. 360-386 (1992); Renee Weber & Jennifer Crocker, *Cognitive Processes in the Revision of Stereotypic Beliefs*, 45 J. PERSONALITY & SOC. PSYCHOL. 961 (1983).

177. As we noted earlier, a wide range of scholars have acknowledged Friedman's influence on corporate law. *See supra* text accompanying note 161.

178. *See supra* text accompanying notes 169-175.

179. As we will review, there are several types of arguments offered to justify shareholder primacy. Many scholars and commentators employ both types of responses simultaneously — sometimes without making any distinction and other times as arguments in the alternative.

> [M]aximizing profits for equity investors assists the other "constituencies" automatically. The participants in the venture play complementary rather than antagonistic roles. In a market economy each party to a transaction is better off. A successful firm provides jobs for workers and goods and services for consumers. The more appealing the goods to consumers, the more profit (and jobs). Prosperity for stockholders, workers, and communities goes [invisible] hand in glove with better products for consumers.[180]

Moreover, as stock ownership among workers and consumers has grown in recent decades — through pension and mutual funds — corporate profits are now being spread to a much larger percentage of the population, giving more people a direct stake in maximizing the size of the corporate pie.[181]

Allen and Kraakman make a similar point in their just-published and already-popular casebook.[182] They argue that most of the time a duty of loyalty to shareholders is equivalent to a duty of loyalty to any other corporate constituency:

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180. FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 38 (1991). Similarly, then-Chancellor (now-Professor) Allen described in the early 1990s the key rationale for the shareholder primacy view as follows:

> This rationale asserts that the purpose of business corporations is the creation of wealth, nothing else. It asserts that business corporations are not formed to assist in self-realization through social interaction; they are not formed to create jobs or to provide tax revenues; they are not formed to endow university departments or to pursue knowledge. All of these other things — job creation, tax payments, research, and social interaction — desirable as they may be, are said to be side effects of the pursuit of profit for the residual owners of the firm.
>
> This argument asserts that the creation of more wealth should always be the corporation's objective, regardless of who benefits. The sovereign's taxing and regulatory power can then address questions of social costs and re-distribution of wealth. Thus, profit maximizing behavior is seen as affording the best opportunity to satisfy human wants and is the most appropriate aim of corporation law policy. This second argument for the legitimacy of the corporation as shareholder property is not premised on the conclusion that shareholders do "own" the corporation in any ultimate sense, only on the premise that it can be better for all of us if we act as if they do.

Allen, *supra* note 150, at 269-70. At the time (1992), Allen was not arguing that this conception was dominant, only that it was then rapidly gaining ground. *See id.* at 279-80.

181. New ownership trends may also help ensure a more desirable distribution of that pie both by expanding the shareholder base and by helping to provide shareholders slightly more voice. Through pension plans and mutual funds, some have argued, the collective action problem facing shareholders may not be as significant as it once was. *See, e.g.*, Hansmann & Kraakman, *supra* note 152, at 452-53. Recent debacles in the mutual fund industry indicate, however, that the collective action problem is still quite acute. Moreover, stock ownership is still quite limited. *See* Nina A. Mendelson, *A Control-Based Approach to Shareholder Liability for Corporate Torts*, 102 COLUM. L. REV. 1203, 1229 (2002) (summarizing evidence that "[t]he vast majority of corporate stock held by individuals is held by wealthy individuals").

182. Actually, their casebook has, in one form or another, been quite popular for years. Reinier Kraakman has been generously sharing various renditions of it for well over a decade, and it has, for good reason, proved the favorite among many corporate law scholars, including most at Harvard Law School.

> When a solvent corporation pursues its regular business activities, the interests of its management, creditors, employees, and stockholders are largely congruent with the interests of its equity investors. Thus, it makes no difference whether managers think of themselves as furthering long-term shareholder interests or furthering a multiconstituency interest in long-term corporate welfare.[183]

Another version of the pie-maximization argument is that a wealthy society, much like a wealthy person, can afford nice things. Encouraging profit making thus promotes those ends that are widely shared among stakeholders but are otherwise unaffordable. Easterbrook and Fischel observe:

> Wealthy firms provide better working conditions and clean up their outfalls; high profits produce social wealth that strengthens the demand for cleanliness. Environmental concerns are luxury goods; wealthy societies purchase much cleaner and healthier environments than do poorer nations — in part because well-to-do citizens want cleaner air and water, and in part because they can afford to pay for it.[184]

Upon closer examination, according to this view, different types of stakeholders share a single interest: the public — in its various guises — benefits from those who pursue their private interests without regard to public concerns. Not only does allowing corporate managers to pursue profit single-mindedly just happen to yield many positive externalities for everyone in society, it also may be one of the best means of serving the interests of nonshareholder constituencies. Thus, Professors Allen and Kraakman write that "sophisticated proponents of the shareholder primacy goal" agree "that framing the board's mission as maximizing shareholder welfare also serves to maximize the welfare of other corporate constituencies and society as a whole."[185]

In sum, scholars have offered compelling arguments and evidence for the conclusion that shareholder primacy automatically serves all stakeholders in the name of serving just shareholders.

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183. WILLIAM T. ALLEN & REINIER KRAAKMAN, COMMENTARIES AND CASES ON THE LAW OF BUSINESS ORGANIZATION 286 (2003). Some scholars have gone further and claimed that the single-minded pursuit of profit is the best, and perhaps only, cure to certain social problems. *See supra* note 170 (summarizing Friedman's view on discrimination); *see also* Ronald J. Gilson & Reinier Kraakman, *Delaware's Intermediate Standard for Defensive Tactics: Is There Substance to Proportionality Review?*, 44 BUS. LAW. 247, 261 n.45 (1989) ("Note that for present purposes we assume that maximizing gains to target shareholders serves the broader objectives of shareholder and social welfare. This view is generally accepted by the courts but remains controversial among some commentators.").

184. EASTERBROOK & FISCHEL, *supra* note 180, at 38. Easterbrook and Fischel compare U.S. and Soviet pollution records as empirical verification for their theoretical claim. *Id.* ("Soviet plants pollute more than American ones and produce less, *because* they give less attention to profit rather than *despite* the difference. Within this nation, goals competing with profits are most likely to be sacrificed as profits fall.").

185. ALLEN & KRAAKMAN, *supra* note 183, at 287-88.

b. Balancing Conflicting Interests Across Categories. The "maximizing shared interest" script — that the interests of shareholders and nonshareholders are naturally and automatically aligned — may satisfy those who are already inclined toward shareholder primacy. But to the nonbeliever, who is suspicious about the role of corporations and corporate law, the "shared interest" script holds little weight.

What of the evidence, too commonly encountered, of corporate policies designed and justified as profit maximizing directly harming nonshareholder constituencies? What of the plant closings that destroy a community? What of the deadly products heavily promoted around the globe? What of the poor treatment of workers or the environment for the sake of profit? What of profit-maximizing discrimination? Proponents of shareholder primacy who have attempted to answer such questions have voiced several responses — each of which admits that some nonshareholders may be hurt but argues that alternative policies would entail even larger welfare losses.

The first answer insists that the price of freedom and long-term efficiency requires some short-term costs. The case for shareholder primacy — or capitalism, for that matter — is not premised on the notion that, if adopted, no one gets hurt. To the contrary, the presumption is that with freedom comes choice and with choice comes risk.[186] To accept the meta script of policymaking and macro script of corporate law is to accept the possibility — no, the certainty — that some groups and individuals will get hurt. Like "tough love" or compassionate conservatism, the path to greater long-term individual and social welfare involves both risk and reward, both pain and gain. Easterbrook and Fischel write:

> Frequently the harmony of interest between profit maximization and other objectives escapes attention. Firms that close plants in one area while relocating production elsewhere are accused of lacking a sense of responsibility to affected workers and communities. Yet such a statement ignores the greater benefits that workers and communities in the new locale enjoy. (They must be greater, or there would be no profit in the move.) Firms that cause dislocations by moving their plants are no less ethical than firms that cause dislocations by inventing new products that cause their rivals to go out of business, yielding unemployment at the failed firm. All competition produces dislocation — all progress produces dislocation (pity the makers of vacuum tubes and slide rules!) — and to try to stop the wrenching shifts of a capitalist economy is to try to stop economic growth.[187]

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186. *See supra* text accompanying notes 26-29.

187. EASTERBROOK & FISCHEL, *supra* note 180, at 38-39. Another common response to particularly egregious examples of harmed constituencies is to claim that the policy reflected "bad business" or "unprofitable" decisionmaking that would not be sustained in the market

Those upset about the outcomes suffered by a particular constituency, then, are often just calling the glass half empty when, in fact, it's nine-tenths full. A given group may have to pay a price for the many greater benefits that it previously enjoyed or will eventually enjoy.[188] Or one group may have to take a hit so that others can hit it big. But, one way or another, competitions produce not only winners, but also losers. And the existence of losers is the inevitable and telltale by-product of progress. Tempering those risks by curtailing the forces that generate them is tantamount to biting the invisible hand that feeds us.[189]

That argument, like the simpler one reviewed in the previous Section, is premised almost entirely on faith. It may be true that harms generated by profit-seeking institutions are trivial in comparison to those that would be suffered by us all were we to adopt an alternative regime. But it also may be false. Those skeptical of Friedman's good news about markets typically require more. Much of the legal academic scholarship over the past several decades has been devoted to amassing arguments and evidence to fill in what Friedman left out. That effort leads to the second answer.

The more sophisticated corporate law scholarship today begins by conceding, even emphasizing, that there *are* unintended, untoward consequences of the single-minded pursuit of profit. It then carefully argues why profit primacy is nonetheless in all stakeholders' interests.[190] There are a variety of versions of this approach, most of which seem complementary. For the balance of this Section, we attempt to summarize the main elements of those arguments.[191]

To frame the issue, many scholars begin by asserting that, precisely because of the conflict among corporate constituencies, the law must limit corporate fiduciary obligations to just one. Otherwise, the argument goes, neither corporate decisionmakers nor their monitors

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long term. Evidence of policies that seem to lower social welfare can thus be treated as evidence confirming, not undermining, the shareholder primacy norm.

188. As Mark Roe describes the conventional argument: "Current employees might be made worse off in some industries, but employees overall will have more opportunities, higher salaries, and better working conditions." Roe, *supra* note 154, at 2065.

189. Some scholars argue that, because corporate law, corporations, and all of their various constituencies are governed more or less by contract, current arrangements are prima facie good. We will explore that argument more thoroughly below. *See infra* text accompanying notes 379-392. For now, we want only to highlight the legitimating role that choice sometimes plays in the case for the shareholder primacy norm.

190. *See supra* text accompanying note 155.

191. Our goal here is not to detail the arguments of any one scholar, but to survey the arguments that seem to have been more or less accepted by the majority of corporate law scholars. For the most sophisticated and lengthy justification of shareholder primacy, see Henry Hansmann's book on the topic. HANSMANN, *supra* note 153. As thorough as Hansmann's analysis is, it is no less susceptible to many of the illusions that we describe *infra* Parts IV & V.

can distinguish good decisions from bad ones, and those in power will be free — consciously or not — to pursue their own private interests, to everyone else's detriment. The point was made at least as early as 1932, when Adolph Berle was first building the case for shareholder primacy:

> [Y]ou can not abandon emphasis on "the view that business corporations exist for the sole purpose of making profits for their stockholders" until such time as you are prepared to offer a clear and reasonably enforceable scheme of responsibilities to someone else.... Otherwise the economic power now mobilized and massed under the corporate form ... is simply handed over, weakly, to the present administrators with a pious wish that something nice will come out of it all.[192]

A half century later, Robert Clark summarized the point, in his seminal corporate law hornbook, as follows:

> A single objective goal like profit maximization is more easily monitored than a multiple, vaguely defined goal like the fair and reasonable accommodation of all affected interests. It is easier, for example, to tell if a corporate manager is doing what she is supposed to do than to tell if a university president is doing what she is supposed to do. Assuming[, as Clark does,[193] that] shareholders have some control mechanisms, better monitoring means that corporate managers will be kept more accountable. They are more likely to do what they are supposed to do and do it efficiently.[194]

Clark stressed the importance of monitoring again elsewhere, stating that an alternative regime would mean that "corporate decisionmakers would not be assigned the task of maximizing a single, objective, easily monitored goal ... [making it] very difficult to keep them truly accountable to a vague statement of purposes."[195]

In the following decade, Easterbrook and Fischel built their path-breaking efficiency-based corporate law work around the principle that shareholders come first. In their notably efficient words:

> [A] manager told to serve two masters (a little for the equity holders, a little for the community) has been freed of both and is answerable to neither. Faced with a demand from either group, the manager can appeal to the interests of the other. Agency costs rise and social wealth falls.[196]

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192. Berle, *Note on Trustees*, *supra* note 120, at 1367-68.

193. "They do. The major control mechanisms are their ability to vote in new directors, to respond favorably to tender offers for control, and to bring derivative lawsuits." *See* CLARK, *supra* note 161, at 20 n.51.

194. *Id.* at 20 (citation omitted). Clark remakes the argument later in the same book. *Id.* at 679.

195. *Id.* at 692.

196. EASTERBROOK & FISCHEL, *supra* note 180, at 38; *see also* RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 420 (4th ed. 1992) ("The manager who tries both to produce for the market at lowest cost and to improve society is likely to do neither well.").

Similarly, Mark Roe describes the argument in the following way: "[A] stakeholder measure of managerial accountability could leave managers so much discretion that managers could easily pursue their own agenda, one that might maximize neither shareholder, employee, consumer, nor national wealth, but only their own."[197] Economist Michael Jensen writes:

> [A] single-valued objective is a prerequisite for purposeful or rational behavior by any organization. In particular a firm that adopts stakeholder theory will be handicapped in the competition for survival because, as a basis for action, stakeholder theory politicizes the corporation and leaves its managers empowered to exercise their own preferences in spending the firm's resources. Equally important, shareholders internalize this [shareholder] criterion and may come to use it stringently in the evaluation of managerial performance.[198]

The key assumption in all of this deserves reiteration, because it will be a major focus when we begin to discuss the signs of illusion: shareholder primacy makes an important difference in managerial decision-making and in the ability of shareholders, courts, and others to monitor those decisions.[199]

Thus far, this second type of defense of shareholder primacy may help explain why boards should have only a single constituency, but it does not explain why that constituency should be shareholders. After all, the benefits of simplified decision-making and reduced agency costs owing to improved monitoring would seem to apply no matter the stakeholder group.

In the face of challenges on this issue, scholars have offered a seemingly watertight set of arguments for why that special privilege should go to shareholders. The arguments can be categorized into three steps: (1) other stakeholders don't need the protection of corporate managers and corporate law; (2) shareholders do; and, in any event, (3) it is the approach that corporations have chosen. We turn now to providing an extended version of that script.

i. Nonshareholders Don't Need Corporate Protection. The first step of the argument — that nonshareholder constituencies don't need

197. Roe, *supra* note 154, at 2065.

198. Jensen, *supra* note 158, at 10; *cf.* Business Roundtable, *Corporate Governance and American Competitiveness*, 46 BUS. LAW. 241, 245 (Nov. 1990) ("It is important that all stakeholder interests be considered but impossible to assure that all will be satisfied because competing claims may be mutually exclusive.").

199. *See also* Lynn A. Stout, *Bad and Not-so-Bad Arguments for Shareholder Primacy*, 75 S. CAL. L. REV. 1189, 1200 (2002) (noting that the "need to measure and monitor agent performance provides the foundation for the best of the standard arguments for shareholder primacy"). We should note that Blair and Stout's team production work, *see supra* note 156, is based on the idea that "the emphasis placed on principal-agent problems in the corporate literature during the last two decades has been both excessive and misleading." *See id.* at 328.

corporate law's protection — is fairly straightforward. Whether you're concerned about workers, consumers, or members of the community, all other stakeholders already enjoy the protection of other *private* and *public* legal-regulatory mechanisms — from various statutory and regulatory protections to common law protections including tort and contract, and from protective market forces to ethical imperatives impinging on corporate decisionmakers.[200]

Consider, for instance, the risks facing corporate employees. On the private side, contracting — including collective bargaining — and market dynamics are thought to provide considerable protection to the labor force. When workers agree to work for a corporation for a certain wage, they are made better off by that arrangement than they would be in their next-best job at a different wage (or without a job or wage at all). Otherwise, they wouldn't have reached the agreement. Absent some clear evidence of a market failure such as imperfect information, there is every reason to trust the choices of corporate employees. But there is also the public side of protection. Even with some market imperfections, workers (in this country at least) enjoy significant forms of regulatory protection, including pension laws, health and safety laws, minimum-wage laws, injury and disability compensation arrangements, antidiscrimination laws, sexual harassment laws, tort laws, and so on. So, the argument goes, there is no good reason to require corporate decisionmakers to take into account the interests of employees (any more than they otherwise would because of existing market and regulatory pressures).

With respect to consumers, the same two-part argument applies. First, consumers are protected by markets and contracting. If consumers don't like a product, they can simply not purchase it. Product warranties also protect consumers against certain risks, and those warranties are efficient, assuming product markets work reasonably well. Other less obvious markets or market actors also get involved. Doctors act as helpful intermediaries between patients and pharmaceutical manufacturers. Consumer-oriented groups, such as the

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200. As Robert Clark notes, this element of the macro script is especially counterintuitive to, and therefore not so easily digested by, many corporate law neophytes. Clark writes:

> Students studying corporate law for the first time are often puzzled or angered by the failure of the legal doctrines they encounter to do anything toward the effective solution of numerous social problems caused by corporations. As a result, they may object to the apparently unbridled power of corporate managers. Some, but by no means all, of the puzzlement may be dissolved when they realize that traditionally, the subjects of corporation law and securities regulation are simply defined to deal only with relationships between shareholders and managers (directors and officers), i.e., with the most capitalistic of relationships affecting capitalist enterprise. Business corporation statutes and the securities laws do not preclude laws regulating other corporate relationships. There are in fact a great many such laws.

CLARK, *supra* note 161, at 30.

Consumers Union, act as informers and watchdogs on behalf of consumers. And the media often acts to provide consumers information and warnings that will help protect them in the marketplace. Second, even if consumer-product markets are not perfectly well-functioning, considerable regulation already exists to assist consumers. If a product injures the consumer, for instance, the consumer can often obtain compensation through products liability law. Moreover, there are numerous regulatory agencies devoted to protecting consumers — such as the Food and Drug Administration, the Consumer Product Safety Commission, the Federal Trade Commission, and the Federal Communications Commission. Those agencies do everything from testing products, to requiring product disclosures, to setting standards for marketing, to mandating recalls, to fining corporations for violating regulatory prohibitions. There are also antitrust laws and the Department of Justice to protect consumers against any anticompetitive urges that sellers might have. Why should corporate law attempt to accomplish what these other areas of law and experts are specifically designed to achieve? Even if there were some problem with those agencies and other areas of law, it is difficult to see why corporate law, instead of these other areas of law, should be reformed to address that problem.

With respect to creditors and corporate suppliers, the same basic dynamics are said to be in place — though with a twist. These parties obviously can contract with the corporations to protect their interests; indeed, the relationship a corporation has with its creditors is prototypically contractual. According to conventional wisdom, however, because shareholders enjoy "limited liability," creditors are sometimes described as slightly more vulnerable to harmful corporate consequences, which is why business law is said to adjust somewhat to protect corporate creditors. And so it is that corporate law in most U.S. jurisdictions employs some form of dividend restriction and sometimes allows creditors to collect against a corporation outside of contract, pursuant to fraudulent conveyance law and veil-piercing doctrines. In addition, corporations are subject to other forms of regulatory restrictions and mandates — including those exacted through our complex systems of bankruptcy law. Again, with those protections in place, it makes little sense, according to the conventional wisdom, to deploy corporate law in a redundant effort to protect creditors.

Finally, with respect to corporate influence on local communities or society more generally, the same script applies. Municipalities and governments can and often do negotiate with corporations to perform certain functions and provide certain services for the community. Similarly, corporations often understand that it is in their interest — just good business — to be good local citizens and so voluntarily agree to behave accordingly. In addition, of course, there are numerous forms of regulation that communities can and do create to influence corporate behavior: environmental laws, nuisance laws, zoning restrictions, and tax laws. It is through those institutions and laws that the public voices and exercises its will. There is no need to ask corporate directors and managers to attempt to divine the "public interest" beyond what those laws already reveal. Furthermore, if the public wants more resources going toward some noncorporate goal, they can simply spend their own money in that direction. There is no need for a corporate middle person between what the public desires and what the public gets.

Corporate scholars have relied on many of those arguments to buttress the case for shareholder primacy.[201] Robert Clark, for example, writes:

> [N]o one need be made worse off by the corporation's having a single goal of profit maximization. The interests of nonshareholder groups like employees can be protected by contract, common law developments, and special legislation. Negative externalities like pollution can be corrected by tort law or by pollution laws telling companies not to pollute or taxing them when they do. The production of public goods like defense and the redistribution of wealth from rich to poor can be better accomplished by actual governments, which have a more legitimate claim to do these things. And corporate resources can still be diverted to these governmental activities, in small or great measure, as elected representatives see fit, because governments can tax both corporations and their shareholders.[202]

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201. For example, James Cox and Thomas Hazen argue as follows:

> The concentration of most businesses into a relatively few huge incorporated units is not due primarily to lax corporation laws or even to a corporation's privilege to hold shares in other corporations. Whether bigness in business should be curtailed or regulated, and how such controls should be accomplished, are unsettled questions of economic policy, not of corporation law. Various economic issues — for example, whether and the extent to which production, competition, monopoly, labor conditions, profits, and the concentration of wealth should be controlled by government — call for patient, thorough study. This task of regulating corporate bigness and curtailing supposed corporate 'evils' should not be confused with the task of establishing modern corporation laws to facilitate incorporation and to define and enforce the rights and duties of shareholders, directors, and officers.

JAMES D. COX & THOMAS LEE HAZEN, CORPORATIONS 39 (2003); *see also* JAMES D. COX, THOMAS LEE HAZEN, & F. HODGE O'NEAL, CORPORATIONS 37 (1997) (citing Thomas L. Hazen, *Corporate Chartering and the Securities Markets: Shareholder Suffrage, Corporate Responsibility and Managerial Accountability*, 1978 WIS. L. REV. 391).

202. CLARK, *supra* note 161, at 20-21; *see also id.* at 680 (making the same argument). It bears noting that Clark himself does not explicitly endorse this element of the macro script and seems, at one point, somewhat agnostic:

> Considering both prongs of the argument — that a single, objective goal increases management's accountability but need not preempt direct governmental regulation of corporations to make them socially responsible — one might conclude that profit maximization is a legitimate and desirable goal for business corporations.
>
> Whether this chain of reasoning actually withstands analysis is a hard question that demands a great deal of background knowledge.

According to Clark, not only is that a possibility, it is a reality. "Every major relationship between the corporation and persons or groups it affects is subject to vast and intricate bodies of legal doctrine and to legal enforcement mechanisms."[203] "These currently available controls include market forces, for example, corporation behavior is powerfully affected by consumer choices; legal mechanisms, for example, consumers can sue under existing tort law and consumer protection laws; and the right to lobby governments to tax and regulate corporation in certain ways."[204]

More recently, Professors Hansmann and Kraakman devoted the better part of an article to fleshing out the case for shareholder primacy. Like Clark, Hansmann and Kraakman are careful to point out that making shareholders primary in corporate law "does not imply that the interests of corporate stakeholders must or should go unprotected":

> It merely indicates that the most efficacious legal mechanisms for protecting the interests of nonshareholder constituencies — or at least all constituencies other than creditors — lie outside of corporate law. For workers, this includes the law of labor contracting, pension law, health and safety law, and antidiscrimination law. For consumers, it includes product safety regulation, warranty law, tort law governing product liability, antitrust law, and mandatory disclosure of product contents and characteristics. For the public at large, it includes environmental law and the law of nuisance and mass torts.[205]

Id. at 21.

203. *Id.* at 678.

204. *Id.* at 692.

205. Hansmann & Kraakman, *supra* note 152, at 442. Further, Jonathan Macey argues as follows:

> [T]he traditional common law rules of corporate governance, which provide that corporate directors have an exclusive obligation to maximize value for residual claimants and which rely on the contracting process to protect the legitimate and important interests of third parties, do not "exploit" nonshareholder constituencies. Rather, they best serve the interests of society as a whole.

Jonathan R. Macey, *Externalities, Firm-Specific Capital Investments, and the Legal Treatment of Fundamental Corporate Changes*, 1989 DUKE L.J. 173, 201 (1989)

Some take the argument a step further. Easterbrook and Fischel, for example, assert that shareholder primacy actually allows for more effective protections of nonshareholder constituencies when society confronts the question of how best "to deal with pollution, bribery, plant closings, and other decisions that have effects on people who may not participate in the corporate contract":

> Given wealth as a maximand, society may change corporate conduct by imposing monetary penalties. These reduce the venturers' wealth, so managers will attempt to avoid them. A pollution tax, for example, would induce the firm to emit less. It would behave as if it had the interests of others at heart. Society thus takes advantage of the wealth-maximizing incentives built into the firm in order to alter its behavior at least cost.... Society must choose whether to conscript the firm's strength (its tendency to maximize wealth) by changing the prices it confronts or by changing its structure so that it is less apt to maximize wealth. The latter choice will yield less of both good ends than the former.

Relatedly, Allen and Kraakman, in their just-published casebook, note that "[t]he laws of taxation, education, environmental and labor policy, product safety, and other issues of health, safety, and welfare" exist to "address the distribution of risks and rewards in society."[206]

This important set of legitimating arguments for shareholder primacy is commonly offered, not only by academics and judges, but also by business leaders. The Business Roundtable, for instance, echoes this fuller rendition of the macro script, stressing the notion that nonshareholder constituencies are well protected outside of corporate law:

> Corporations are chartered to serve both their shareholders and society as a whole. The interests of the shareholders are primarily measured in terms of economic return over time. The interests of others in society (other stakeholders) are defined by their relationship to the corporation.
>
> The other stakeholders in the corporation are its employees, customers, suppliers, creditors, the communities where the corporation does business, and society as a whole. The duties and responsibilities of the corporation to the stakeholders are expressed in various laws, regulations, contracts, and custom and practice.
>
> For instance, OSHA, civil rights laws, wage and hour laws, ERISA regulations and so forth determine many of the formal conditions of employment. Beyond these laws, the desire of responsible corporations to have loyal and motivated employees determines the kinds of relationships that corporations seek to achieve with and among their employees.
>
> Similarly, zoning laws, environmental regulations, the tax code and related laws and regulations define the corporation's legal obligations to its communities and society as a whole. As with employees, many corporations go far beyond mere legal requirements in supporting the communities in which they do business. The reasons range from wanting their employees to enjoy a good quality of life to a strong sense of responsibility, as an influential citizen, to help address urgent social problems.[207]

Sometimes corporate critics suggest that our ethical system, or our systems of values and morality, are debased by corporate culture and the consumerism that goes along with it. Responses to those claims have taken a familiar form. Corporations are merely responding to the preferences of consumers as manifested through consumer product

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EASTERBROOK & FISCHEL, *supra* note 180, at 37-38. According to Easterbrook and Fischel, then, shareholder primacy is justified not just because other constituencies enjoy other forms of protection but also because those alternative forms are more efficacious in a regime in which managers' allegiance is to shareholders and shareholders alone.

206. ALLEN & KRAAKMAN, *supra* note 183, at 2.

207. Business Roundtable, *supra* note 198, at 244.

markets. If there is a problem with social values, then that's a job for the civic, social, and religious institutions of our culture and would seem to have nothing to do with the largely reactive and reflective conduct of corporations. And, again, if there is some corporate behavior that is deemed unethical by the public, they have avenues for curtailing that behavior.

For example, this rationale can be found in the justifications offered by corporate executives, seeking to justify the concrete consequences of their pursuit of profit. Here, the rubber of the macro script meets the road of market practices. For example, Steven Goldstone, as Chief Executive Officer of RJR Nabisco, had this to say about the cigarette industry: "I have no moral view of this business .... I view[] it as a legal business. You shouldn't be drawing a moral judgment about a business our country says is perfectly legal ...."[208] "I know these guys love to put this in moral terms, but if they can't convince Congress to ban [tobacco], we don't have any choice but to sell it."[209]

Together, the arguments discussed above represent the key reasons offered for not giving corporate law protection to all those other stakeholders. Yet the question remains: why make directors and officers loyal to the interests of *shareholders*? According to conventional wisdom, the answer does not simply follow from the process of elimination. There are several positive reasons why *shareholder* primacy makes sense.

ii. Shareholders Do Need Protection. One key set of arguments for why shareholders — as opposed to some other corporate constituency — deserve the special, undivided protection of corporate law is the mirror image of the arguments offered above. That is, shareholders enjoy far less security from private mechanisms, such as contracting and market forces, or public mechanisms, such as administrative regulators, than do other constituencies. It is the shareholders, therefore, who are most vulnerable to adverse corporate consequences and most in need of corporate law's protections. Furthermore, directors and managers have the necessary expertise and are well placed to represent shareholder interests. That, according to conventional wisdom, is the primary purpose of corporate law: to ensure that directors and managers provide to shareholders the special protection that they need and can't otherwise obtain.[210]

208. Jeffrey Goldberg, *Big Tobacco's Endgame*, N.Y. TIMES, June 21, 1998, § 6 (Magazine), at 41.

209. *Id.* at 62.

210. As indicated above, creditors are a notable exception to the shareholder-centric focus of corporate law — the exception that proves the rule. *See supra* Part III.B.2.b.i. Because of the problems posed by limited liability vehicles, "[t]here remains general agreement that corporate law should directly regulate some aspects of the relationship

What is it that makes shareholders so vulnerable? On the private side, shareholders are thought to have a difficult time protecting themselves contractually. Tens of thousands of them contribute varying amounts of capital to corporate enterprise. The beauty of that arrangement, of course, is that corporations can thus raise money from many disaggregated individuals to engage in risky, capital-intensive ventures, without subjecting any single investor to too much risk.[211] The downside is that none of those individuals obtain a large enough stake in the corporation to justify monitoring it carefully or to do much about it if they did take the time to monitor and disliked what they saw. The benefits of monitoring or taking action accrue to all shareholders but the costs are borne by the individual shareholders who monitor. So, none monitor:

> In the typical publicly traded U.S. business corporation, no individual shareholder possesses a block of stock sufficiently large to provide a meaningful degree of control. This is true not only for individual shareholders, but even for groups of shareholders that might wish to act collectively in influencing corporate activity. For example, the five largest shareholders in General Motors — themselves institutions that represent the interests of highly dispersed individuals — together hold less than 6 percent of the corporation's stock. As a result, the managers of many large corporations have long been essentially self-appointing and self-policing, free of direct accountability to their company's owners.[212]

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between a business corporation and its creditors." Hansmann & Kraakman, *supra* note 152, at 442. We return to a discussion of creditors later in our companion article. *See* Chen & Hanson, Legitimating Schemas II, *supra* note 10. For now we observe only that this exception is used as additional evidence that, indeed, corporate law reflects a concern for protecting any and all constituencies that do not otherwise enjoy adequate protection.

211. Shareholder primacy is sometimes justified as a means of attracting shareholders' money. Shareholders deserve special protection because large enterprises are good for everyone and because, without special protection, shareholders will not contribute their wealth toward large enterprises. Robert Clark offers one rendition of this argument:

> Better accountability [to shareholders]... encourages people to participate in large organizations, in which claims on the organization and the power to manage it are necessarily separated; it helps such organizations exist and function well. Large organizations are in turn often desirable for everyone. They increase social welfare, because without them certain large scale business ventures would be impossible or would be carried out in a wasteful way.

CLARK, *supra* note 161, at 20; *see also id.* at 679-80. That argument presumes that large enterprises designed to serve solely shareholder interests happen also to increase social welfare. That presumption makes sense only if the first part of this more general case holds true — that is, that other constituencies are adequately protected. If it happens that large enterprises are harming certain constituencies and that social welfare is not necessarily increased in a shareholder primacy regime, then "better accountability" to the single constituency of equity holders may be undesirable, even if it does attract equity capital and subsidize large enterprises.

212. HANSMANN, *supra* note 153, at 57 (citations omitted).

Securities laws enacted initially to help shareholders cope with this problem proved ineffective — and some say made matters worse.[213] Thus while collective contributions of shareholders reduce one type of risk, the resultant collective action problem creates a new sort of risk, to which corporate law purports to respond.

Another explanation for why shareholders alone deserve the protection that corporate law affords begins — and virtually ends — with the premise that shareholders are unique among stakeholders in the sense that they all share one and only one interest — the maximization of profits. As Hansmann writes, "Investor-owned firms have the important advantage that their owners generally share a single well-defined objective: to maximize the net present value of the firm's earnings. The costs of collective decisionmaking are thus relatively low for investor-owned firms."[214]

All the other stakeholders have a variety of interests, and no shared sense of how to rank them.[215] Thus, among the larger group of "workers," some would prefer higher wages, others would prefer better working conditions, others would prefer better health-care coverage, and others would prefer better family leave policies. That conflict, inherent within all the other stakeholder groups, makes coordination, communication, and governance considerably more difficult — perhaps impossible — to do well. In comparison, shareholders, who simply want profit, are far easier to please.[216]

iii. The Pressures of the Situation. This third step is really a supplement to the first two — a sort of validation that the correct legal regime has developed. Proponents of the macro script argue that

213. The fact that shareholders do not enjoy robust regulatory protection outside of corporate law may be changing, as regulators purport to be cracking down on directors and managers on behalf of shareholders. The belief has long been, however, that there really is no effective form of regulatory protection for shareholders other than corporate law.

214. HANSMANN, *supra* note 153, at 62.

215. Hansmann notes that the conflicts that do exist among investors ("differences in tax status, risk preference, or liquidity") "can be eliminated by having them sort themselves among firms that have adopted different policies. Whatever differences that remain are likely to be modest in comparison with those that divide other classes of a firm's patrons, such as its employees or customers." *Id.*

216. As we noted earlier, the existence of a single maximand has important implications for decisionmaking and monitoring. *See supra* text accompanying notes 192-199. As Hansmann explains:

> [T]he existence of a reasonably obvious, simple, and even quantifiable common objective for a firm's investors as investors promotes efficiency by providing a relatively clear standard to employ in constructing legally imposed fiduciary obligations to limit self-dealing by powerful subgroups of shareholders. (The existence of a simple and quantifiable objective also reduces the agency costs incurred by a firm's shareholders as a whole in policing the firm's management, both by making it easier for them to judge managerial performance and by increasing the effectiveness of indirect — that is, nonvoting — devices for controlling managers such as professionalism, peer pressure, and shareholders' derivative suits.)

HANSMANN, *supra* note 153, at 62.

directors and managers *already* face strong market pressures to behave as if they are profit maximizers — and the market rewards them for their profit-maximizing choices. In fact, the pressures that product markets, capital markets, and labor markets create constrains directors and managers, eliminating any discretion to pursue the interests of nonshareholder constituencies.

Whatever the purported objective of corporate decision-making, any board will have to take profit maximization into account (or behave as if it does). To survive in the marketplace requires profits. To thrive requires lots of profits.[217] Thus, it is difficult to imagine that profits will not be a primary concern for corporate decisionmakers. And, given the assumption that directors can't serve two masters, it follows that profit should be their only master.

Clark emphasizes the fact that, all other arguments notwithstanding, directors really have little choice but to pursue profit because of the discretion-limiting influence of situational (that is, *market*) pressures. Managerial attempts to serve stakeholders in a way that sacrifices profits

> is only likely to be possible within a range of action that corresponds to managerial slack. In short, it is not likely to work very well; its economic effects are likely to be modest after all. For example, if any one corporation's board of directors decides to comply voluntarily with an expensive regulatory statute but their competitors do not, their company may take a beating in the market for its products. In addition, when the company's actual stock market value drops (because of its reduced earnings) relative to its potential value (as revealed by comparison to the stock market values of noncomplying competitor companies), the company may well become the subject of a takeover bid, after which the idealistic managers will be replaced. To be sure, these adverse reactions from the product and capital markets would not occur if managers of all firms in the industry acted as modest idealists. But how, short of coercive collective action of some sort, is the state of affairs going to come about? Any individual corporation will observe that the best of all possible worlds would be for the other corporations to act as modest idealists while it acted as a calculating opportunist, because then it would gain an enormous competitive advantage.[218]

217. Similarly, Easterbrook and Fischel observe that "self-interested entrepreneurs and managers, just like other investors, are driven to find the devices most likely to maximize net profits." EASTERBROOK & FISCHEL, *supra* note 180, at 6.

218. CLARK, *supra* note 161, at 687-88. The structure of Clark's argument is, as will become clear, common among proponents of shareholder primacy. That is, the observation is made that because of situational pressures, corporate decisionmakers, whatever their dispositions, will not be able to pursue non-profit-maximizing ends for long, lest they be driven out of business:

> If the idealist viewpoint were implemented by some form of managerial decision making, the managers might well lack the incentive or the slack to pursue the more broadly defined goals to a significant extent, unless they were somehow shielded more effectively than they now are from takeover bids, derivative lawsuits and competition in their product markets.

In light of such pressures, Richard Posner writes:

> The debate over whether modern corporations are really profit maximizers may have little practical significance.
>
> ....
>
> There are economic reasons for questioning both the feasibility and appropriateness of major corporate commitments to social goals other than profit maximization. In competitive markets, a sustained commitment to any goal other than profitability will result in the firm's shrinking, quite possibly to nothing. The firm that channels profits into pollution control will not be able to recoup its losses by charging higher prices to its customers. The customers do not benefit as customers from such expenditures; more precisely, they benefit just as much from those expenditures if they purchase the lower-priced product of a competing firm that does not incur them. Thus the firm will have to defray the expenses of pollution control entirely out of its profits....
>
> It is true that ... [a firm] may be able ... to continue in business by reducing its output. But it will not survive indefinitely, for at its lower output it will be unable to pay the owners of the scarce resources (land, technical skills, etc.) that it uses a rent equal to what those owners could obtain elsewhere; monopsony is rarely a long-run game.... The only exception would be if the owners of these resources (who might be the firm's shareholders) were altruists who received utility from the firm's practice of social responsibility. How likely is that?[219]

According to the basic script, not very likely. Executives, too, may be selfishly motivated in this model. But that's not the problem, because even the executive who embraces "personal power as a maximand"[220] will likely be constrained by market pressures to maximize profits:

> The most powerful corporate executive is the one who controls a highly profitable enterprise. He is least likely to encounter criticism from

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Id. Clark further elaborates the point as follows:

> [C]orporate behavior must often bend to the other controlling forces, such as consumer choices in the product markets. If a company keeps a relatively inefficient plant in operation, for example, it may have to charge more than competitors, lose business, and eventually be forced to change its practice or seek a government bailout. This need not happen if competitors are following similar policies of accommodating nonshareholder interest. But, once again, one must realize the limits of voluntary collective action.

Id. at 692. Of course, if there were some way — through legal rules, taxes, norms, process requirements, board-composition requirements, and the like — of placing situational pressures on all boards to pursue non-profit-maximizing ends, then the sorts of impediments that they mention would not exist. All firms would share the incentives, and survival would require optimally balancing those and other situational pressures. Thus, to observe that under current legal rules it is all but impossible for firms to give too much weight to non-profit-maximizing ends can, depending on the reform proposal, beg the question of whether the legal rule should endorse shareholder primacy. *See infra* text accompanying notes 370-391 (discussing "illusion of freedom").

219. POSNER, supra note 196, at 419-20.

220. *Id.* at 419.

shareholders, let alone a threat of a takeover. In addition, large profits generate capital (and enable additional capital to be obtained on favorable terms) that he can use for additional ventures.[221]

That leads to a related element of the macro script, which finds its roots in a simplistic version of Darwin's theory of evolution and natural selection. Owing to the situational pressures just described, scholars have argued that that there has been an evolutionary process at work within corporate law that has slowly but surely given us the ideal species of the corporation. The "survival of the fittest" works not only in the natural world, but also in the legal one.

Echoing those themes, William Allen has argued:

> Each of the two dominant social trends that will exert potentially transformative power on corporate governance in the years immediately ahead — the evolution of a truly global economy and the continuing growth, and coming dominance, of institutional shareholders — is more consistent with the property conception of the corporation than with the entity conception.
>
> As the world becomes a fiercer place for American business, corporate management is forced increasingly to consider financial performance at every stage. Thus, evolving global markets encourage efficiency and value-creating management. These developments tend to push shareholders, as residual risk bearers, back towards the center of thinking about the enterprise.[222]

All of the situational pressures are said to be pushing corporations and corporate law toward welfare-maximizing laws and conduct. As if through natural selection, the modern corporate form has emerged the fittest among the alternatives. As Hansmann and Kraakman observe, "the standard model earned its position as the dominant model of the large corporation the hard way, by out-competing during the post-World War II period the three alternative models of corporate governance."[223] Easterbrook and Fischel similarly observe, "Over tens of years and thousands of firms . . . tendencies emerge. The firms and managers that make the choices investors prefer will prosper relative to others."[224]

This use of the evolutionary schema helps shed light on other elements of the script. In particular, it provides comfort that the situational pressures legal economists identified above not only exist, but are *good* — indeed, the strongest and best form that nature can provide. The evolutionary element also provides support for the idea that regulation is unnecessary and even detrimental. Indeed, any

221. *Id.*

222. Allen, *supra* note 150, at 279.

223. Hansmann & Kraakman, *supra* note 152, at 468.

224. EASTERBROOK & FISCHEL, *supra* note 180, at 6.

institution that is not subjected to the rigors of natural selection is likely to be wanting. As Easterbrook and Fischel write:

> Corporate governance devices that have survived in many firms for extended periods are particularly unlikely candidates for challenge as mistakes. We have emphasized that the durability of a practice both enables people to gauge its effects and allows competition among firms to weed out the practices that do not assist investors. There is no similar process of weeding out among academic ideas or regulations. Quite the contrary, mandatory terms prescribed by law halt the process of natural selection and evaluation. Unless there is a strong reason to believe that regulation has a comparative advantage over competition in markets in evaluating the effects of corporate contracts ... there is no basis for displacing actual arrangements as "mistakes," "exploitation," and the like.[225]

Where regulations often go untested, corporations do not. And the corporate forms that are weak will, according to Easterbrook and Fischel, be "ground under by competition."[226] Similarly, states that do not adapt will be "ground under as well."[227]

This belief in the evolution of the corporate form provides us great comfort that the laws and systems — and, indeed, the dominant macro script — we see in place have survived the test of competition and emerged as the fittest means of advancing society's interests.[228]

c. The Illegitimacy of Social Responsibility. As we highlighted earlier, the modern macro script, like Friedman's original version, includes the argument that corporate boards and managers are not competent to make decisions based on social-responsibility concerns. Corporate law scholars sometimes push that argument further, pointing out that, because virtually all institutions are similarly unable to discern what choices serve the public interest, only specially designed democratic institutions should be given that task. According to Allen and Kraakman, corporate law is, by design, concerned with only "a slice of the human experience. Thus, legitimate political questions about, for example, the social distribution of wealth fall well outside the competence of corporate law."[229]

225. *Id.* at 31-32.

226. *Id.* at 13.

227. *Id.*

228. The scholars who advance this element of the script provide large amounts of evidence that document this process. We save a review of that evidence for another article in this series. *See* Chen & Hanson, False Starts, *supra* note 29.

229. ALLEN & KRAAKMAN, *supra* note 183, at 2. Relatedly, their initial observation conveys the notion that there is more to consider than "total wealth" or "even our share in it." *Id.* Yet after noting the concern with the "state of the world around us" and "the welfare of others," they return to the notion that the societal distribution of wealth is the critical counter-consideration to the maximization of wealth. *Id.* We have more to say on this

Governmental institutions — particularly legislatures — and only those institutions should concern themselves with big-picture issues while the rest of us should, literally and figuratively, mind our own business. This belief is implicit in Friedman's claim that those who object to the consequences of corporate profit-seeking have no valid complaint, for they have obviously "failed to persuade a majority of their fellow citizens to be of like mind and . . . are seeking to attain by undemocratic procedures what they cannot attain by democratic procedures."[230]

From this vantage point, proponents of the dominant macro script of corporate law often argue that, even if directors and managers wanted to provide protection to nonshareholder constituencies, the law should prohibit them from doing so. It is neither their purpose nor within their expertise, and allowing them to try to serve social ends violates democratic principles. Although Robert Clark doesn't go as far as Friedman, who called the concern for social responsibility "unadulterated socialism," he comes close:

> [I]t would constitute an illegitimate form of government — a case of oligarchy in disguise, and on a very grand scale indeed. When implemented by managerial or shareholder decision making, the high idealist's brand of social responsibility will reflect mostly upper class preferences. Consider, for example, that over half of the corporate stocks and bonds owned by individuals (or estates, trusts, and the like) in the United States are held by the wealthiest one percent of the population, and that managers of large publicly held corporations are paid incomes that send them into orbits far above the ordinary ground-level income. Policies defined by such persons will have a very different scheme of priorities and effects than policies made by democratically elected representatives of the entire population.[231]

The argument runs as follows: because corporate decisionmakers are likely to have a biased (that is upper-class) vision of the "public interest," they should not be permitted to pursue the "public interest." Instead, the public is better off if this elite group remains "apolitical" and focuses on only profits, while our institutions of democracy take care of the rest.

Thus, like Friedman, modern corporate law scholars have come to believe that concerns about social responsibility cannot legitimately lie within the purview of corporate law. Social responsibility is, ultimately, a political question and is therefore best left to democracy.

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subject in a related paper. *See* Chen & Hanson, Distribution Versus Efficiency, *supra* note 10.

230. *See supra* text accompanying note 172 (providing the more complete quotation).

231. CLARK, *supra* note 161, at 693 (citations omitted). And according to Clark, "[t]his is true even though democratically elected bodies are in fact heavily influenced by elite interest groups." *See id.*

3. *Summary*

As we have described it, the modern macro script of corporate law appears quite compelling — a formidable collection of arguments that all seem to point to the shareholder primacy summary script. Indeed, the logic of the macro script has won the day: Friedman's basic insight that all stakeholders are better off, on net, if profit is the sole corporate goal is now the conventional wisdom among prominent legal scholars.[232]

But appearances can be deceiving. If our hypothesis that corporate interests will be successful in the competition to influence our situation is correct, then we would expect that the schemas and scripts that underlie policymaking and corporate law will be likely sources of that success. In other words, if our hypothesis is correct, we expect that a close, critical inspection of those schemas and scripts we just reviewed will reveal pro-commercial illusions where we had otherwise seen magic.

IV. MAGIC OR ILLUSION?

We have examined the scripts used to justify shareholder primacy in corporate law and the pro-market, anti-regulatory presumptions of modern policymaking more generally. In almost every way, those scripts seem sound. With respect to the macro script, the idea that one constituency needs more protection through corporate law than the others seems plausible, and the desire to protect that more vulnerable constituency, laudable. It further stands to reason that shareholder primacy helps address shareholder vulnerability by providing judges and others a tractable means of measuring board behavior and one that is, in any case, consistent with the situational pressures of markets. In addition, the belief that laws will evolve in a social-welfare-maximizing direction to reflect the invisible market pressures seems to coincide with common intuitions about evolutionary processes and, more particularly, the widely held view that markets tend toward desirable outcomes. It is the familiar invisible hand of private interests unintentionally serving the public interest.

That leads to (or follows from) the policymaking meta script. There are, as we reviewed, compelling arguments that markets are good and regulation is bad. First, market actors will discover and exploit all opportunities for mutually satisfying trades and in that way will serve the public interest. And, second, regulatory agencies are likely to be both wasteful and beholden to certain powerful interests — usually the producers or sellers who are being regulated.

232. *See supra* text accompanying notes 178-185.

Those two elements of the meta script seem mutually reinforcing, like two sides of the same coin. When one argues that the path to prosperity and away from serfdom is to be found in the principles that markets are good and regulation is bad, it is tantamount to saying that the secret to business success is to be found in the principles that revenues are good and costs are bad. Markets and regulation are presumed to relate to each other the way heat and cold or lightness and darkness do — more of one means less of the other.[233] Thus, any argument or evidence that advances one of the elements of the meta script seems to advance the other as well.

Given the persuasive logic and influence of the meta script, it is not surprising that arguments of very similar form would readily be adopted in other contexts. As we suggested at the outset, it is the meta script's persuasiveness that provides the foundation for the corporate law macro script. The meta script thus seems to bolster the macro script, because shareholder primacy seems consonant with the "markets are good" schema. The idea that free-acting market participants seeking only profit promote the larger public interest is, because of the meta script, more readily accepted. The norm of maximizing corporate profits seems like an easy application of that invisible-hand logic. The pro-market element of the meta script also legitimates the idea that market pressures push corporations to maximize profits and legal regimes to focus on profit. Markets lead presumptively to desirable outcomes. According to those scripts, the trick is not to be fooled by the illusion that the self-serving motives behind those outcomes somehow contaminate the system.

Understood this way, it is difficult not to "marvel," as Hayek did,[234] at the magic of markets, as well as at the corporate law that promotes the businesses that maximize those markets. But is this the only

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233. Indeed, the claim "markets are good" is a relative claim, which more precisely translates to "markets are better than regulation." And the claim that "regulation is bad" similarly translates to "regulation is not as good as markets." Furthermore, many of the arguments seem to advance both simultaneously — such as the now conventional critiques of minimum wage laws and of rent control. For a microeconomic example, see Milton Friedman & George Stigler, *Roofs or Ceilings? The Current Housing Problem*, POPULAR ESSAYS ON CURRENT PROBLEMS, Sept. 1946, at 7, and for a macroeconomic example, see ROBERT LUCAS & THOMAS SARGENT, RATIONAL EXPECTATIONS AND ECONOMETRIC PRACTICE (1981).

There are, by the way, other reasons for this perception. For instance, both elements seem to depend on the same core vision of the human actor as dispositional. From that assumption it follows that markets respond to the preferences of consumers and regulation interferes with those preferences. *See* Hanson & Wright, *supra* note 86. Moreover, there is a long tradition among major political and philosophical thinkers of distinguishing between coercive state actions and noncoercive individual actions. We won't review that tradition here. Our point is simply to indicate that there is an easy schematic association, one that Friedman and many others have made explicit, that markets are "free" and regulation is coercive. *See infra* text accompanying notes 370-392 (discussing the illusion of freedom).

234. *See supra* text accompanying notes 85-87.

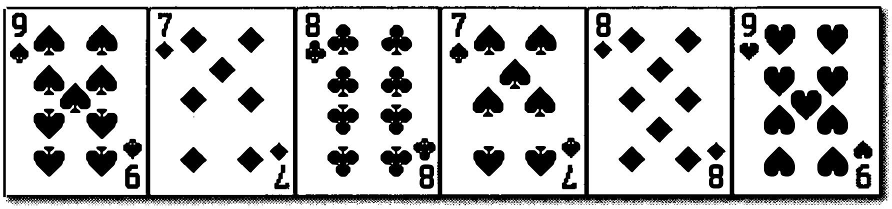
understanding that one can plausibly have of policymaking and corporate law? Is this magic? Or is it illusion?

A. *The Magician and Our Minds*

Good magicians are masters of illusion. The key to their skill is, in many ways, quite simple: magicians understand and exploit our knowledge structures, the schemas that tell us where to look and, just as important, what to look for when we look.[235] To illustrate this principle with a simple example, we would like to conduct a little magic of our own, which will require your cooperation.[236]

Begin by mentally selecting one card out of the following set.

FIGURE 2. PICK A CARD



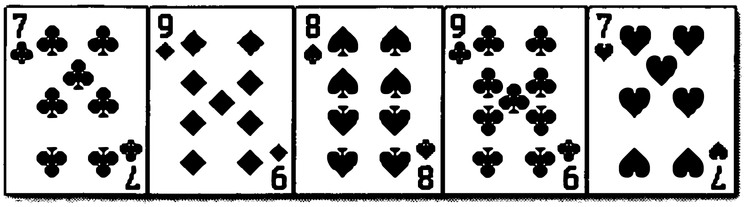
Touch it with your finger and concentrate on it. Now, here's the part that is a little weird: While you're focusing on your card, click your heels together three times. If you skip this part, the magic is almost certain to fail, so please just play along. Now, once you've completed that step, turn the page.

235. For a more extensive discussion of the many ways in which magicians rely on our knowledge structures to befuddle their audiences, see Chen & Hanson, Theorizing Illusion, *supra* note 8; *see also* PETER LAMONT & RICHARD WISEMAN, MAGIC IN THEORY: AN INTRODUCTION TO THE THEORETICAL AND PSYCHOLOGICAL ELEMENTS OF CONJURING (1999).

236. We learned this trick from The Amazing Hondo, *at* http://www.hondomagic.com/html/pick_a_card2.html (last visited Oct. 5, 2004).

Behold! We have magically removed your card from the pile:

FIGURE 3. THE CARD DISAPPEARS



Amazing, no?

Okay, by now you have probably discovered the "trick" behind the trick: the "card magic" schema influences what you focus on and what you infer about what you don't focus on. All activated schemas have that effect — regardless of how they were activated or who activated them.[237] And, if you were tricked by your schema initially, your motive to figure the trick out — a type of motive for accuracy — likely sent you back to the previous page to try a less schema-driven and a more bottom-up analysis of the cards. More specifically, you likely needed to pay more attention to situation than you were inclined (in part by the frame of the trick and in part by the limits of your perceptual abilities) to do. In any event, discovering the secret to the trick was, no doubt, somewhat disappointing.[238]

When we watch the most skilled magicians, we marvel at their abilities to conjure illusions. We pay far less attention to — indeed, don't notice — our own contributions to their efforts. This Article is as concerned with the audience — ourselves — as it is with the person on stage. When we wonder at the power and skill of the magician, we should reserve similar awe for our own contribution to the performance. It is the limits of our minds and perceptions coupled with our failure fully to appreciate those limits that transforms deception into magic and that renders us vulnerable to illusion again and again. Understood properly, the power of magic owes less to the power of magicians than to the unseen influences on our conscious perceptions. The magician's role is in locating and perfecting means of exploiting those influences.

237. We understand that this format is not ideal for doing magic. Still, the skeptical reader should know that this same trick is often quite successful when done in more conducive venues.

238. *See* Chen & Hanson, Theorizing Illusion, *supra* note 8 (describing the motivation to see magic, and the disappointment when the trick is revealed).

B. *Signs of Illusion*

We began this Article with the hypothesis that large commercial interests will be advantaged in the competition to influence the situation. Testing that hypothesis is difficult, because the hypothesis includes a prediction that, although its underlying structure will reflect the interests of corporations, the law will purport to serve the public interest generally, and its pro-commercial bias will be well-hidden by illusion. In the next Sections, we attempt to spot illusion and to uncover the trick behind it. Spotting illusion, of course, will be difficult. Were it otherwise, the magician would be quickly out of business.[239]

Given our understanding of illusion, it is clear where our efforts should begin. Illusions find their power in our schemas — in manipulating our schemas, misdirecting our attention, and shaping our inferences.[240] Our earlier research detailed the ways in which people rely on schemas and the potentially distorting consequences.[241] We briefly review that research here to recount some clues that suggest that illusion is at work.[242]

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239. There is the additional problem posed by the presumption of our approach: we are actively seeking evidence of illusion and are, in effect, assuming that illusion is at work. In that sense, we are not so different from other scholars or laypeople searching for evidence that confirms (or, less likely, contradicts) their thesis. *See* Chen & Hanson, *Categorically Biased*, *supra* note 5, at 1207-08 (reviewing evidence from social psychology regarding the biased ways in which people test their hypotheses); *see also infra* notes 257-268 and accompanying text (providing a brief summary of that evidence). But that doesn't reduce the risk that we may, as many do, find what we're looking for and fail to notice the nonsupportive and contradictory evidence that may exist. We attempt to address that problem in future work by examining a variety of types of evidence, including the evidence that many scholars indicate best demonstrates the "magic" of existing laws. *See, e.g.*, Chen & Hanson, False Starts, *supra* note 29; Chen & Hanson, Testing Shareholder Primacy, *supra* note 12. For now, we hope that readers will agree that we all have very good reasons — including many of the lessons of history and social science — to share the skepticism inherent in our illusion-seeking approach. *See generally* Hanson & Yosifon, *The Situation*, *supra* note 4; Chen & Hanson, *Categorically Biased*, *supra* note 5. In any event, if our own experience with the Hondo card trick is any indicator, discovering illusion requires actively looking for it.

240. *See* Chen & Hanson, Theorizing Illusion, *supra* note 8.

241. *See id.*; Chen & Hanson, *Categorically Biased*, *supra* note 5, *passim.*

242. Some readers have expressed a concern that we do not provide an alternative schema to the schemas we are criticizing. As Bill Allen cleverly put it, "[i]t takes a schema to beat a schema." We certainly understand the desire to have a way of resolving policy and corporate law disputes in a way that provides closure and seems legitimate. *See generally* Chen & Hanson, *Categorically Biased*, *supra* note 5, at 1182-1211 (discussing the motives that influence our schemas); Hanson & Yosifon, *The Situational Character*, *supra* note 4, at Part III.C.2 (summarizing the psychic benefits of such theories). In this Article, however, our goal is to provide a schema, not for how to make policy, but for how policy is made. In fact, that is one of the primary ambitions of the larger project of which this is just one piece — to better understand the process by which policy schemas are created. Understanding that process will, we believe, assist in the development of better policies and better processes for making policies. For now, however, the desire for quick, simplistic policymaking schemas

1. *Misdirection*

One of the most fundamental elements of illusion is misdirection.[243] The good magician is a master at making us look where she wants us to look. This technique is effective because the focus of our attention on one piece of information causes us to miss other, far more significant information. Thus, one sign of illusion would be evidence that our focus is heavily directed.

Research on schemas tells us that our desire to make our complex world manageable will often lead us to focus on information that is clear and easily categorized at the expense of information that is complex and outside our categories.[244] That tendency to turn away from difficult-to-manage information and to attend selectively to only the more easily digested information may provide fertile ground for illusion.

Social psychological evidence demonstrates that the ease with which we categorize information depends in large part on how that information compares with the prototypical examples of that category.[245] Thus, to detect the presence of illusion we should scrutinize the prototypes that we are given. Doing so is no easy task. Once those prototypes take root in our minds, it is difficult not to succumb to the cognitive efficiency they deliver.[246] But telltale signs that our categories are distorting our perceptions exist which aid the search for illusion. When an item is categorized, we see it as more similar to other items in that category, and more dissimilar to items outside that category, than it actually is.[247] Furthermore, our categories themselves are often not as "real" or "natural" as we assume, and evidence that our perceptions are illusory can often be found in the discovery that our seemingly real and seductively rigid categories are neither.[248] The more evidence there is of those sorts of effects in our

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should be resisted and the focus should be on better understanding our situational natures and our situations. *See id.*; Hanson & Yosifon, *The Situation*, *supra* note 4.

243. *See* E. SACHS, *quoted in* LAMONT & WISEMAN, *supra* note 235, at 28 (1999) ("Misdirection is the grand basis of the conjuror's actions.").

244. *See* Chen & Hanson, *Categorically Biased*, *supra* note 5, at 1240.

245. *See id.*; Eleanor Rosch, *Cognitive Reference Points*, 7 COGNITIVE PSYCHOL. 461, 532-47 (1975) [hereinafter Rosch, *Cognitive Reference Points*]; Eleanor H. Rosch, *On the Internal Structure of Perceptual and Semantic Categories*, *in* COGNITIVE DEVELOPMENT AND THE ACQUISITION OF LANGUAGE 111 (T.E. Moore ed., 1973) [hereinafter Rosch, *Internal Structure*].

246. *See* Chen & Hanson, *Categorically Biased*, *supra* note 5, at 1150-53.

247. *See id.;* W.F. Battig & F.S. Bellezza, *Organization and Levels of Processing*, *in* MEMORY ORGANIZATION AND STRUCTURE 321-46 (C.R. Puff ed., 1979); Henri Tajfel & A.L. Wilkes, *Classification and Quantitative Judgment*, 54 BRIT. J. PSYCHOL. 101, 104-08 (1963); Henri Tajfel, *Cognitive Aspects of Prejudice*, 25 J. SOC. ISSUES 79 (1969).

248. *See* Chen & Hanson, *Categorically Biased*, *supra* note 5, at 1149-50.

conventional scripts and schemas, the more likely it is that we are seeing illusion.

Our categorization process often helps determine what schemas we apply.[249] We should also be on the lookout, therefore, for biases in that process. The illusion and, perhaps, the magician's hand might be revealed where we find ourselves focusing on particular information or ideas, and not others, and interpreting them through particular schemas, and not others.

2. *Smoke*

Another of the staples in the magician's bag of tricks is the puff of smoke that, when it finally dissipates, reveals that what we once thought we saw has disappeared, and something different and quite unexpected has appeared in its place. Where there is smoke, there is likely to be illusion.

One form of cognitive smoke is to be found in ambiguity. As our other work has reviewed, ambiguity increases the range of viable schemas and strengthens the perceived plausibility of the one we have activated.[250] Where there is evidence that appears, upon close examination, to be in tension with our activated scripts, and that evidence is ignored or treated as ambiguous in those scripts, illusion may be at work.[251]

Our schemas and scripts themselves contribute to smoke-obscured illusion. As we noted at the outset, and as we thoroughly examined in our previous work, schemas and scripts serve an incredibly valuable role in allowing humans to gain a handle on, or an understanding of, a world that presents us with infinite quantities and types of information. Without knowledge structures, what we think of as "knowledge" would not be possible. But our schemas and scripts, because they are simplifying tools, come at a cost. This is true in large part because we are blind to their workings and effects. We trust our simplified vision of the world and do not believe that it is, in any significant way, distorted. Our perceptions seem accurate and holistic when, by necessity, they are inexact, partial, motivated, and biased.[252]

249. *See id.*, at 1139-41.

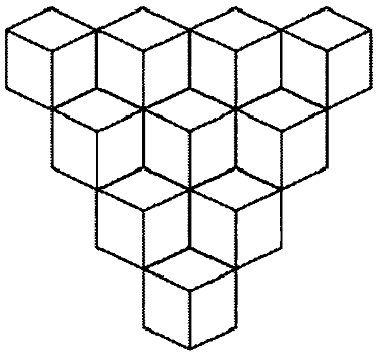
250. *See id.*, at 1201-04.

251. The creation of ambiguity is a standard technique in public relations and marketing campaigns. It was a technique notoriously employed, for instance, by the tobacco industry as a means of dealing with evidence of the harmful effects of smoking. *See* Jon Hanson & Douglas A. Kysar, *Taking Behavioralism Seriously: Some Evidence of Market Manipulation*, 112 HARV. L. REV. 1423, 1483-96 (1999) [hereinafter Hanson & Kysar, *Market Manipulation*].

252. *See* Chen & Hanson, *Categorically Biased*, *supra* note 5, at 1195-1211; Hanson & Yosifon, *The Situational Character*, *supra* note 4, at III.C.2.d.i; Lee Ross & A. Ward, *Naïve*

This suggests one of the key biasing influences of schemas. We tend to store knowledge like we store food — canned items here, refrigerated items there; butter on one shelf, fruits on another. Because we are motivated to believe that we base our knowledge and behavior on sound reasoning, we are easily convinced of the coherence of our own views. With schemas operating automatically outside our consciousness, we have no reason or obvious opportunity to pull them together to ensure that they cohere with one another. Moreover, when we are motivated to believe the conclusions that a schema helps us reach, we have little motivation to ensure that our schemas are internally consistent.

FIGURE 4. THE NECKER CUBE



The point is usefully made with the "Necker Cube" (see Figure 4). There are several things to notice about this well-known optical illusion. First, what is in fact a two-dimensional object appears three-dimensional to us. Second, there are actually two conflicting three-dimensional versions of the image that our minds can see and tend to alternate between. Third, and more important for our purposes, even if we consciously try, it is difficult to see a two-dimensional figure or both three-dimensional images at the same time. Each of those phenomena is a manifestation of our knowledge structures and of our cognitive motive to give order to the information to which we attend. We see what isn't there, and once our brain "makes up its mind" on one version, it does not simultaneously see an equally plausible alternative version. When our minds do reconstrue the image, the previous version disappears like magic. The two schemas for the image

Realism in Everyday Life: Implications for Social Conflict and Misunderstanding, *in* VALUES AND KNOWLEDGE 103 (Edward Reed et al. eds., 1996).

are kept on separate shelves, and only one is activated at any given moment. Finally, evidence of one version seems not to raise doubts about what we're seeing when we "see" the other. We perceive our perception as accurate, though neither our perception nor our perception of our perception is.

There is thus another source of smoke to be found in the undetected tensions within and between our schemas.[253] In looking for illusion, we should examine the circumscribed view of the world that our schemas provide and consider whether that perspective is in tension with a similar view, borne of another schema, that we might hold in other instances.[254] Because of the power of our schemas, our motive to question the inferences that our active schemas generate is often quite low. And yet our schemas operate independently of one another and rarely at the same time,[255] providing little occasion for challenging individual schemas, much less comparing and contrasting the logic across schemas. Evidence of illusion might be found by engaging in just that sort of difficult examination.[256]

3. *The Audience's Motives*

Our motivations also may provide clues to whether illusion is at work. The magician's skills are significantly enhanced by an audience that *wants* to be entertained, that *wants* to believe that what they are seeing is magic. To the extent that we want to see magic and that we are disappointed when the trick is revealed,[257] there may be greater reason to worry that we are seeing illusion.

The motivation to see magic can, as we detail elsewhere, come from many sources: from our desire for accuracy and accountability;[258] our desire to self-affirm, group-affirm,[259] and system-affirm;[260] our

253. *See* Chen & Hanson, *Categorically Biased, supra* note 5, at 1199-1201.

254. *See id.*

255. *See id*; ZIVA KUNDA, SOCIAL COGNITION: MAKING SENSE OF PEOPLE 463 (2001).

256. That process might expose something, too, about the identity of the illusionist. Patterns in those tensions — in how those tensions are resolved if they are indeed resolved at all — can be quite revealing. *See infra* text accompanying notes 269-271 (discussing the "tilt").

257. *See supra* notes 9, 238 and accompanying text.

258. *See, e.g.*, Chen & Hanson, *Categorically Biased, supra* note 5, at 1183-84; SUSAN T. FISKE & SHELLEY E. TAYLOR, SOCIAL COGNITION 231 (2d ed. 1991).

259. *See* Hanson & Yosifon, *The Situational Character*, *supra* note 4, at Part III.C.2.b; *see, e.g.*, David Dunning, *On the Motives Underlying Social Cognition*, *in* BLACKWELL HANDBOOK OF SOCIAL PSYCHOLOGY: INTRAINDIVIDUAL PROCESS 348, 352 (Abraham Tesser & Norbert Schwarz eds., 2001); Steven Fein & S.J. Spencer, *Prejudice as Self-Image Maintenance: Affirming the Self through Derogating Others*, 73 J. PERSONALITY & SOC. PSYCHOL. 31 (1997).

positional motivations;[261] our motive for closure;[262] and our motive to protect our schemas.[263] Affect, also, can have important influences on what schemas we apply and on what conclusions we draw from the schemas we do apply.[264]

In addition to exploiting, unconsciously, the confusion of smoke to further their motivations, individuals often display a variety of cognitive tendencies to satisfy their motives, such as selectively avoiding disconfirming evidence,[265] subtyping such evidence,[266] and reducing our cognitive effort when confronted with such evidence.[267]

Such insights, summarized more crudely, are that we often look where we want to look, see what we want to see, and ignore, depending on how strong our motivations are, the things we don't want to see. We won't look where we might not like the answer. And if for whatever reason we do look, we might still find good reason to ignore that answer if we are able to.[268] Evidence that we are engaging

260. For example, social psychologists have documented in research on system justification a desire for self-affirmation — or a desire, amongst both those who are advantaged and those who are disadvantaged, to see our world as just. *See* Chen & Hanson, *Categorically Biased*, *supra* note 5, at 1184-85; Hanson & Yosifon, *The Situational Character*, *supra* note 4, at Part III.C.2.b.iii; *see also* John Jost & Orsolya Hunyady, *The Psychology of System Justification and the Palliative Function of Ideology*, 13 EUR. REV. SOC. PSYCHOL. 111 (2003).

261. *See* Chen & Hanson, *Categorically Biased*, *supra* note 5, at 1187-89; *see, e.g.*, MARTHA AUGOUSTINOS & IAIN WALKER, SOCIAL COGNITION: AN INTEGRATED INTRODUCTION 270 (1995); JONATHAN POTTER & MARGARET WETHERELL, DISCOURSE AND SOCIAL PSYCHOLOGY: BEYOND ATTITUDES AND BEHAVIOR 50-52 (1987).

262. *See* Chen & Hanson, *Categorically Biased*, *supra* note 5, at 1189-95; Hanson & Yosifon, *The Situational Character*, *supra* note 4, at Part III.C.2.a & III.C.2.c; *see also* FISKE & TAYLOR, *supra* note 258, at 164.

263. *See* Chen & Hanson, *Categorically Biased*, *supra* note 5, at 1195-1211; Hanson & Yosifon, *The Situational Character*, *supra* note 4, at Part III.B.3.

264. *See* Chen & Hanson, *Categorically Biased*, *supra* note 5, at 1181-82.

265. *See id.*; *see also* Dieter Frey, *Recent Research on Selective Exposure to Information*, *in* 19 ADVANCES IN EXPERIMENTAL SOC. PSYCHOL. 41 (Leonard Berkowitz ed., 1986).

266. *See* Chen & Hanson, *Categorically Biased*, *supra* note 5, at 1204-06; *see also* Leonard Johnston & Miles Hewstone, *Cognitive Models of Stereotype Change: (3) Subtyping and the Perceived Typicality of Disconfirming Group Members*, 28 J. EXPERIMENTAL SOC. PSYCHOL. 360 (1992).

267. *See* Chen & Hanson, *Categorically Biased*, *supra* note 5, at 1197-99. We might also create circumstances in which schemas will be self-fulfilling — appearing consistent with our motivations or affect, but consistent only because our attempt to apply those schemas has made them so. *Id.* at 1207-11.

268. Just as there is a clear limit to how much magicians can store up their sleeves, there are limits to the extent that our motivations can help us see magic. And, indeed, once the sleeves are understood as a means to illusion, there is a limit to how long and baggy a credible magician's sleeves can be. To maintain the appearance of real magic, magicians are forced to develop new tricks. When we attend to information that is unambiguously inconsistent with the schemas we desire to apply, we might find ourselves forced to abandon those schemas in search of others. *See id.*

in such behavior suggests that the magic we think we see is merely illusion.

4. *The "Tilt"*

To the extent that we do observe the phenomena described in the previous Sections, our suspicions of illusion should increase. When we look for patterns in the way that tensions and ambiguities are resolved, it is helpful to have a hypothesis about the direction of the "tilt" to aid in our assessment of whether there is, in fact, illusion.

We have already hypothesized that the magician is shared commercial interests.[269] Assuming that hypothesis is correct, it is a small step to predict the direction of the "tilt" in the scripts that we have been examining. Specifically, we predict that corporations will, with respect to the meta and macro levels of policymaking and the law, tend to favor schemas that maximize the size of the pie that all corporations are competing over. Such schemas would — constrained by the need for legitimacy[270] — tend to justify maximizing markets, privatization, (negative) externalities, and profits while undercutting profit-reducing, cost-internalizing, and market-reducing regulations. To be sure, individual corporations or industries may also seek market-power-enhancing regulations that enable them to gain more of the share of the pie that corporations are competing over. Still, there is a common interest among all commercial enterprises to increase the number and size of opportunities for profit.[271] And that is the *shared* interest that we predict will most clearly define the general purpose of corporate law and policymaking.

The hypothesis that corporate law will be structured to maximize profit opportunities suggests the more specific prediction that law and legal theory will justify profit-seeking conduct minimally constrained by concerns for "other" constituencies. If there is an illusion, and if we are correct about the magician, then the macro script of corporate law and the meta script of policymaking will, *through illusion*, legitimate

269. *See* Hanson & Yosifon, *The Situation*, *supra* note 4, at 219-30; Chen & Hanson, Theorizing Illusion, *supra* note 8; Hanson & Wright, *supra* note 86; *supra* text accompanying notes 5-9.

270. A policy's legitimacy will depend on several variables. For instance, it needs plausibly to serve the "public interest" or "social welfare." Similarly, it must punish, prohibit, or otherwise deter, harm-causing behavior that falls below a certain standard of culpability (for instance, where the individual acted volitionally, with control, and pursuant to a bad or selfish motive). *See generally* Jon Hanson, Ana Reyes, & Daniel Schlanger, Attributional Positivism: The Naïve Psychology Behind Our Laws (work in progress) (on file with authors) (providing a positive theory of law — based on positive theory within social psychology known as attribution theory — regarding how and when citizens, courts, and lawmakers attribute causation, responsibility, and blame).

271. See authorities cited at *supra* note 269.

the ideas that markets are good, regulation is bad, and corporations should pursue only profits.

C. *Spotting the Illusion*

In this Section we expose five broad illusions within the macro and meta scripts. First, we argue that the perceived coherence of the scripts, both internally and with respect to each other, is more imagined than real. Second, we argue that the assumptions of exogeneity in the meta and macro scripts are illusory. Third, we show evidence of illusion in the biased categories employed in the macro and meta scripts. Fourth, we argue that the goal of "freedom" that the scripts purportedly advance is largely illusion. And fifth, we argue that the perceived threat posed by any deviation from the dominant schemas is, more than not, a false perception.

1. *The Illusion of Coherence*

We begin by looking carefully for possible tensions between and among the elements of the meta script of policymaking and the macro script of corporate law. This Section, in other words, tests the conclusion we reached above that the two scripts are both internally coherent[272] and externally synchronous.[273]

To identify tensions between the policymakers' meta script and corporate theorists' macro script, it helps to highlight three key elements of each. The macro script is built on three premises or presumptions: (1) shareholders are not adequately protected in their relationship with corporate boards and managers; (2) nonshareholders are adequately protected by other institutions; and (3) to correct for the first, corporate law is devoted to providing protection to shareholders by giving corporate decisionmakers a single maximand, thereby giving to others (including judges) the tractable task of monitoring corporate boards and managers.[274]

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272. Our primary focus in this Section will be on the conflict between the meta and macro scripts. It is worth noting, however, that even within the macro script there are tensions that we will not take time to review with care. For instance, in the arguments defending shareholder primacy, scholars often argue, first, that serving shareholder interests simultaneously serves the interests of other stakeholders. *See supra* text accompanying notes 178-185. Scholars, sometimes the same scholars, also argue that there is a tension between the interests of shareholders and that of other stakeholders. Indeed, according to that view, the tension is so great that, to avoid the untenable situation in which boards must seek to serve two masters or make decisions without the advantages of a simple and single maximand, shareholder primacy is necessary. *See supra* text accompanying notes 192-199. As the alert reader will discover, this is just a specific rendition of a more general tension that exists between the meta and macro scripts. *See infra* text accompanying notes 276-292

273. *See supra* text accompanying notes 233-234.

274. *See supra* Part III.B.

The meta script of policymaking also importantly depends on three presumptions: (1) that markets work effectively to overcome almost any problem and to ensure that resources are efficiently allocated; (2) that regulation works poorly largely because regulators lack the expertise or incentives needed to make judgments that are reliably in the public interest; and (3) that regulators, moreover, are likely to be captured by certain interests or groups — usually the group or interest being regulated.[275] The following Section unveils latent tensions between each of the two scripts' three premises.

a. The First Tension. The macro script's assumption that shareholders need special protection by corporate law[276] conflicts with the meta script's assumption that markets and contracting will provide more effective protection to virtually all groups than will regulatory alternatives.[277] If markets are superior to regulation, the question becomes, why don't markets protect shareholders adequately? Markets should do the trick, not just because private mechanisms might emerge to fill the shoes of state corporate law statutes,[278] but, more importantly, because shareholder primacy, under the guise of profit-maximization, is itself a market imperative.[279]

The tension between the meta and macro scripts implicates a tension within the macro script. Recall that a common refrain among corporate law scholars tells us that there are numerous situational forces — independent of corporate law — that lead corporate decisionmakers to maximize profits.[280] Competition for consumers, workers, managers, and capital invisibly conspires to coerce corporations to maximize profits. That belief is itself another manifestation of the influence of the pro-market element of the meta script. Indeed, the summary meta script's "markets are good" prong is just a more general version of the macro script's claim that situational pressures force corporations to act as if shareholder primacy were the goal.[281]

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275. *See supra* Part II.B.

276. *See supra* text accompanying notes 210-216.

277. *See supra* text accompanying notes 91-111.

278. *Cf.* EASTERBROOK & FISCHEL, *supra* note 180, at 34-35.

279. *See supra* text accompanying notes 217-228.

280. *See supra* text accompanying notes 217-228.

281. The preference for markets can be seen by measuring the height of the presumptions that corporate scholars have erected in favor of relying on markets. Clark, for example, states as follows:

> [E]ven massive regulatory failure doesn't necessarily imply a change in the corporation's residual goal of strict profit maximization. It does so only if (1) an alternative to external regulation were available that would result in better achievement of the legitimate public goals behind regulation, (2) the alternative would necessitate a change in the profit-maximizing goal, (3) the cost of the alternative (in terms of reduced monitoring and control of corporate managers' performance for example) would not outweigh the gains, and (4) no

With those scripts in mind, corporate law scholars defending the macro script assert that markets work and that directors and officers have little choice but to maximize profits. In part because managers are forced to pursue profit anyway, shareholder primacy is said to be an appropriate corporate law norm.[282] On the other hand, proponents of the macro script sometimes claim that markets do not provide adequate protection to shareholders and that directors lack necessary incentives to maximize profits, thus justifying the need for shareholder primacy.[283] Flipping the logic, either of the two conflicting arguments might have been used to help justify rejecting shareholder primacy.[284] For instance, it might be argued that, because markets are already pushing managers to pursue profit, corporate law need not worry about that end. Instead, it should require that directors take into account other concerns, knowing that they will otherwise pursue profits. Or one might argue that, because markets do not force managers to pursue profit above all else, managers have discretion to pursue other ends, a discretion that corporate law should exploit for the benefit of nonshareholders. In any event, scholars have not, for the most part, recognized the tension in the factual claims, much less resolved it.[285]

There are various responses that proponents of the macro script might offer to relieve that tension.[286] For instance, some might point out that although markets are generally preferred to regulation, in this case it has been demonstrated that shareholders are subject to a particular market failure — a collective action problem — that other constituencies do not suffer and that shareholders cannot otherwise

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other alternative reform strategy exists that would yield a better cost-benefit ratio but not involve a change in the corporation's goal.

CLARK, *supra* note 161, at 681.

282. *See supra* text accompanying notes 217-228.

283. *See supra* text accompanying notes 210-216.

284. Our claim is not that either argument, by itself, is compelling. Our point is that the same factual claims — even conflicting factual claims — can be used to justify any conclusion. In this case, all roads lead toward shareholder primacy.

285. Note another related tension. Scholars often argue that situational pressure may excuse managers for not more actively pursuing "social responsibility" ends. The situational forces are cited as a basis for legitimating the status quo. But when managers engage in acts that undermine that legitimacy, there is very little talk of the situational forces that may have led to that conduct. Instead, people blame disposition for the bad conduct, partly (we suspect) in order to minimize the problem and isolate its cause — like looking for bad apples and ignoring the barrel or the tree. Doing so helps to maintain the legitimacy of the system. *See* Chen & Hanson, Legitimating Schemas I, *supra* note 10 (discussing the "illusion of reform").

286. Of course, some individual scholars have come closer to avoiding or resolving this tension than others. For instance, Henry Hansmann, whose work we examine more closely below, has probably gone furthest in resolving this first tension. *See* HANSMANN, *supra* note 153.

solve on their own.[287] Were the factual predicates of this argument clearly established, that might help to relieve the tension. But it is not so obvious that shareholders' collective action problem is unique or any worse than the market failures vexing the contracts between corporations and other constituencies. Nor is it clear that shareholders lack alternative means of solving their problem.

For instance, employees would seem to suffer the same sort of collective action problem — there are many of them and only one employer. But the problem would seem worse for employees than for shareholders given that their human capital cannot be so easily diversified — that is, they have much more at stake than the typical shareholder has.[288] Furthermore, their ability to coordinate as a group through purely contractual means is likely constrained by the fact that they may not all share the same interests.[289] In fact, the common claim that because shareholders share a single interest, they should receive the greatest protection from corporate law may actually suggest a reason why shareholders are *less* vulnerable than other groups, and therefore less needy of corporate law's protections.[290]

The same argument might be made, perhaps more emphatically, with respect to society's interests. Understanding who constitutes "society" and how "society" would act together as a group is itself somewhat of a puzzle. Imagining that "society" would respond to the potentially harmful social effects of corporations or commercial interests seems to require a leap of faith beyond the leap needed to imagine that shareholders could act cohesively as a group to advance their collective interests.

Furthermore, the fact that other groups have adopted solutions to their collective action problems does not prove that shareholders need protection; it may only reveal how marvelously markets work, particularly when the law doesn't intervene. To look at the world as it is and claim that shareholders need the protection that corporate law provides because the market will fail to provide it may be to reverse the true causal relationship. The existence of contractual solutions for

287. *See supra* text accompanying notes 212-213; *see, e.g.*, OLIVER E. WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALISM 304-05 (1985) (concluding that "shareholders are among the least protected of corporate constituencies. Unlike workers, suppliers, or creditors, they are unprotected by explicit covenants or contracts and are unable periodically to renegotiate the terms of their relationship.").

288. *See, e.g.*, Kent Greenfield, *The Place of Workers in Corporate Law*, 39 B.C. L. REV. 283 (1998).

289. *See id.*

290. *See infra* text accompanying notes 454-465.

nonshareholders and the absence of contractual solutions for shareholders may reflect corporate law, rather than justify it.[291]

In a similar vein, the claim that shareholders lack other forms of protections seems overstated. It is true, as Bob Clark stresses, that "[t]he interests of nonshareholder groups like employees can be protected by contract, common law developments, and special legislation."[292] And, to be sure, legislation and administrative bodies have been established to do just that. Similarly, it is true that consumers enjoy the protection from, say, products liability law and the Consumer Product Safety Commission. It is also true, however, that shareholders enjoy similar protections: common law protections against fraud or misrepresentations; private regulatory institutions, such as the New York Stock Exchange; public regulatory institutions, such as the Securities and Exchange Commission; and other regulatory laws, including, most recently, the Sarbanes-Oxley Act. The robustness of those sources of protection might be greater were corporate law not, to some degree, preempting the field. Again, it can be misleading to take what is true today of corporate law and other institutions as natural, and fail to see that what is true today may, in large measure, reflect existing corporate law. Believing that, because other institutions do not adequately protect shareholders, corporate law should be devoted to that cause, may be to reverse the actual causal relationship.

Even if proponents of corporate law's macro script had succeeded in demonstrating that the problem facing shareholders truly is different in degree than that facing other constituencies, they would not have demonstrated that it is different in kind. Absent such a distinction, the presumption favoring markets over regulation still raises questions about the policy conclusion that corporate law should attempt to regulate on behalf of shareholders. Proponents have, after all, offered no rule for locating the threshold beyond which regulatory intervention — generally presumed to be "bad" — would be justified. In sum, this tension between the macro script's claim, that shareholders need special regulatory protection through corporate law, on one hand, and the meta script's claim that markets work, may reveal one of the ways in which what we see may be smoke-obscured illusion.

b. The Second Tension. There is a second tension between the two scripts that we've reviewed. Corporate law's macro script includes the argument that courts should, on behalf of disaggregated shareholders,

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291. *See* Chen & Hanson, *Categorically Biased*, *supra* note 5, at 1207-1211 (discussing the self-fulfilling effect of schemas); *supra* note 267 (same); *see also* Hanson & Yosifon, *The Situation*, *supra* note 4, at 175-76 (describing the self-fulfilling effects of dispositionism).

292. CLARK, *supra* note 161, at 20.

monitor corporate decisionmakers and intervene on behalf of shareholders when they deem appropriate.[293] On the other hand, the policymaking meta script presumes that centralized decisionmakers lack the information needed to make reliably welfare-increasing judgments.[294]

The likely response to this tension is that the presumption against regulation is overcome in this particular context. Because of the single maximand of profit, judges need far less knowledge or information than they do in other regulatory contexts. Because there is one goal, profit, courts can easily determine if the directors are acting in pursuit of that goal; therefore, regulation is likely to be relatively successful in this (exceptional) context. That was, after all, one of the key arguments in favor of shareholder primacy.[295]

Such a response, however, does not resolve the tension. First, as we'll indicate below and detail in future work, judges are not, in fact, able to reliably assess whether a board's decision will advance profit.[296] Even if they were, courts at the micro level (that is, in creating and applying corporate doctrine) have largely foresworn making such evaluations. They do not, in other words, assess business decisions to determine if they were well made. In fact, the "business judgment rule," under which judges presumptively decline to "second-guess" the business decisions of corporate managers, is a prominent theme of corporate law. And, strikingly, judges use the "imperfect knowledge" rationale of the regulation-bad meta script to justify that position.[297] Thus, the corporate law macro script is in tension, not only with the meta script, but also with its own micro script.

c. The Third Tension. The third tension may well be the most significant and the most straightforward. The corporate law macro script holds that nonshareholder constituencies are adequately protected through exogenous regulatory institutions.[298] Because regulation is presumed to serve the public interest, the argument goes, corporate law needn't concern itself with that end. This argument for shareholder primacy is treated as uncontroversial. At the same time, however, the policymaking meta script holds that regulatory institutions will tend to be captured — that is, they will generally fail to protect the public interest and instead will tend to serve special,

293. *See supra* text accompanying notes 211-213.

294. *See supra* text accompanying notes 79-87.

295. *See supra* text accompanying notes 191-199.

296. *See* Chen & Hanson, Legitimating Schemas I, *supra* note 10; Chen & Hanson, Legitimating Schemas II, *supra* note 10; *infra* text accompanying note 359.

297. *See infra* text accompanying note 359.

298. *See supra* text accompanying notes 200-209.

concentrated interests, often the producer group being "regulated."[299] That tension, as will become clear, is significant, not only because it has been overlooked, but also because it is particularly revealing with regard to who, or rather what, is behind the illusion.

2. *Schematic Illusions*

The schematic biases and illusions described above in connection with the Necker Cube may be an important source of the tensions discussed in the previous Section. We have separate scripts that we apply in separate contexts, and, so long as the scripts are not placed side-by-side and so long as the tensions are not highlighted, we don't experience the dissonance. With the meta script on one shelf and the macro script on another, we feel no need to invest the cognitive resources to examine the otherwise cognitively cheap schema-driven process. Put differently, each simplifying schema is more or less exogenous to the other.

In part because the interconnections and interdependencies between our mental models are frequently unrecognized or unexamined, we are blind to and easily manipulated by our situation.[300] The power of the widely discussed *framing effect* is just one of the better-known instances of a much more general human tendency to be constrained by our activated mental models.[301] Those tendencies are illustrated, also, in the illusions of "magic."[302]

The same tendencies characterize our use of policy schemas and help explain how the tensions between the macro script of corporate law and the meta script of policymaking remain largely unnoticed. Consider, again, the former. There is an implicit assumption — which generates what we call a *schematic illusion* — coursing like lifeblood through the elements of the corporate law macro script: all of the private and public forces and institutions described in the macro script are assumed to be fixed and unaffected by corporations and corporate law.

There are actually two facets of that schematic illusion. The first is that corporations are moved almost entirely by outside (exogenous) forces. Among them, consumers are most important. Corporations merely react to the market pressures that consumers create — hence,

299. *See supra* text accompanying notes 100-113.

300. *See supra* text accompanying notes 250-256. *See generally* Hanson & Yosifon, *Situational Character*, *supra* note 4, *passim*.

301. *See generally* Chen & Hanson, *Categorically Biased*, *supra* note 5, *passim*; Hanson & Yosifon, *Situational Character*, *supra* note 4, at Part III.B.

302. *See* Chen & Hanson, Theorizing Illusion, *supra* note 8 (summarizing some of the basic mechanisms of illusions).

the belief in consumer sovereignty.[303] This notion underlies all of the arguments in favor of relying on markets or contracts — a belief that because consumers are autonomous actors and only they know their preferences, institutions should therefore defer to their choices.[304] This concept of consumer sovereignty is implicit, if not explicit, in most U.S. laws and policies, including corporate law.[305]

The second facet of this schematic illusion is the assumption that corporations have no sway over those outside sources of corporate influence. Causal influences flow from all individuals and institutions to corporations and not the other way around. Thus, corporate practices and products reflect consumer preferences, regulatory parameters, and cultural shifts. They don't cause them. Corporate practices are driven and curtailed by market and regulatory dynamics. They don't drive them.[306] Markets, corporations, and corporate practices emerge out of a world taken as given. They don't alter it.[307]

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303. This type of argument is actually fairly common in the areas we reviewed above. Employees facing workplace risks are often said to prefer those risks, given the offsetting wage premiums that they enjoy. Employees, then, effectively call the shots. If they didn't, then why would they stay in their jobs?

304. As we highlighted above, this defense of shareholder primacy is not meant to deny that corporations will not sometimes engage in behavior that is harmful to nonshareholder constituencies. Rather, the assertion is that any such groups are harmed less than other groups are made better off. On net, communities and society at large are made better off. In addition, the argument goes, any attempt to intervene in those market relationships any more than we already do is likely to create unintended consequences — and harm the very people it is intended to help. The fear of unintended consequences emerges in part from the perception of the human actor as behaving according to stable, exogenous preferences — preferences that are simply invisible to anyone but the actor, except as revealed through behavior itself. Regulatory solutions are likely to lead to unintended consequences because regulators will not know those preferences and consumers will continue to act upon them. Market processes are preferred because they give the people what they really want. Any attempt to intervene with that process will simply force consumers to find some more expensive way to get what they want — or will end up hurting people more than it helps. For a more complete discussion of why regulations, but not markets, are often said to have "unintended consequences," see Hanson & Wright, *supra* note 86.

305. *See id.*; Leary, *supra* note 76.

306. Relatedly, as we discussed earlier, scholars may have reversed the causal connection between the fact that corporate law purports to serve shareholder interests and the fact that market institutions or other regulatory solutions are arguably not in place. *See supra* text accompanying note 289. Had scholars seen the way that current arrangements outside of corporate law may reflect corporate law, they would have been less inclined to claim that corporate law reflects those arrangements.

307. To the extent that the world isn't given, the argument sometimes continues, it is *other* institutions that have the greatest influence over how people think, what they want, and what they consider acceptable behavior. If anything, it is institutions such as the family, our churches, unions, universities, and our civic organizations that lie behind our thoughts and behavior. And, of course, if there is a corporate practice that is widely perceived as egregious — and somehow not reflective of aggregated, stable personal choices — the solution is not to alter corporate law or even to blame the corporation. The solution is to call on the legislatures or regulators to step in and alter the regulatory context to which the corporation is responding. In such instances, legislatures are, like markets, presumed to be

The psychological tendency to focus narrowly on only schema-relevant information and to assume the rest is fixed — sometimes called "focalism"[308] — is also observable in the meta script for policy making. Scholars examining the variables that help or hinder an entity's or group's ability to influence regulations assume that those institutions are unchanged by the competition itself.[309] In short, proponents of the macro script focus on the corporation and corporate law and assume that everything else is fixed while proponents of the antiregulation facet of the meta script focus on regulations and assume that everything else is fixed.

The fact that the meta and macro scripts are built on unexamined (and, as we'll see, dubious and conflicting) assumptions about what is moving and what isn't suggests that they may be fostering illusion.

3. *Categorical Illusions*

Schematic illusions do not appear out of thin air. Our previous article detailed the significant relationships between the categories we humans rely upon and the schemas we activate.[310] Categorization is often a necessary first step in our cognitive processes. And categorization depends significantly on the *prototypes* for our categories.[311] In determining what falls into what category, individuals will tend to compare information to their prototypes and categorize each item according to its similarity or dissimilarity with a prototype.[312] Thus, searching for categorical illusions in our macro and meta scripts requires looking for biases, not just in the categories we use, but also in the prototypes we rely on to define those categories.

We just suggested that our categories *trigger* particular schemas, and they do. But the relationship between categories and schemas can be more complex; our categorization process does not operate entirely prior to or independent of our schemas. Activated schemas can have a

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the legitimate conduit through which aggregated individual preferences are expressed. It's the consumer sovereignty norm in slightly different garb — citizen sovereignty.

308. *See, e.g.*, Timothy D. Wilson et al., *Focalism: A Source of Durability Bias in Affective Forecasting*, 78 J. PERSONALITY & SOC. PSYCHOL. 821 (1998).

309. We'll have more to say about this tendency in future work. *See* Chen & Hanson, Theorizing Illusion, *supra* note 8.

310. *See* Chen & Hanson, *Categorically Biased*, *supra* note 5, *passim*.

311. *See id.* at 1144-54.

312. *See id.* This prototype view has superseded the classical view, which argued that categories have clear boundaries and that the characteristics of an element would determine whether that element fell into the category. In contrast to the classical view of categorization, the prototype view accepted the fluidity of category boundaries, therefore acknowledging that our categories are flexible. *Id.*; *see also* Rosch, *Cognitive Reference Points*, *supra* note 245; Rosch, *Internal Structure*, *supra* note 245.

significant effect on what categories we rely on in the first place.[313] Furthermore, the schemas and categories are not themselves independent of all other influences. Affect, motivation, and priming, among other unseen interior phenomena, can also influence what categories and schemas we employ.

How might all this matter to corporate law and policymaking scripts? Among other ways, the fact that the meta script is so central to policy analysis suggests that it is, as social psychologists put it, "chronically primed."[314] Our minds are poised to see the world through the meta script's categories and schemas. It is in part for that reason, we suspect, that corporate law scholars have so readily employed the markets-good and regulation-bad script to questions of corporate law.

Priming can also determine which of the two elements of that script we adopt. Suppose we are asked to determine if an institution is a "market institution" or a "regulatory institution," in a case where categorization is unclear. If beforehand we encounter — are "primed" with — words like "freedom," "consent," "contract," and "revenues," our schema for markets will tend to be activated and we will tend to see a market.[315] Conversely, if we are primed with words like "coercion," "central planning," "socialism," "bureaucrat," and "public interest," we are likely to see the same institution as regulatory, and, consequently, see it as "bad." In both cases, our categories and schemas will create a corresponding, automatic affective response.[316] Thus, in light of the meta script (assuming we adopt it), we will have a positive affective response to the "market" institution and a negative affective response to the "regulatory" institution.[317]

Affect can be the cause, as well as the consequence, of our categorical processes. That is, if we feel positively toward an institution that itself, given the meta script, will lead us to perceive it as a "market" or market-like. A negative view of an institution likewise leads us to label it "regulation."

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313. *See* Chen & Hanson, *Categorically Biased*, *supra* note 5, at 1139-41.

314. *See id.* at 1180-81.

315. There are, of course, limits to such tendencies. *See id.* at 1242-43.

316. *Cf.* Robert L. Hale, *Coercion and Distribution in a Supposedly Non-Coercive State*, 38 POL. SCI. Q. 470, 471 (1923) ("It is because the word 'coercion' frequently seems to carry with it the stigma of impropriety, that the coercive character of many innocent acts is so frequently denied.").

317. For summaries of experiments of this sort, see *id.* The associations today are very much like those of the "first law and economics movement" a century ago. Barbara Fried notes "how deeply ingrained in late nineteenth- and early twentieth-century British and American thought was the view that the market was the province of freedom, and the government the province of coercion." FRIED, *supra* note 56, at 31.

As noted earlier, the categories employed have an immense influence on perceptions of the constituents of each category. For instance, we tend to see two members of the same category as more alike than we otherwise would. And we likewise tend to see two members of different categories as more different than we otherwise would.[318]

In our effort to spot illusion, therefore, we attempt now to determine if those automatic, nonconscious categorical biases are evident in the arguments underlying the macro script of corporate law and the meta script of policymaking.

a. Markets Versus Regulation. At the heart of the meta script of policymaking lie the categories of "market" and "regulation." There are numerous ways in which the categories of "free markets" and "state-interventionist regulation" — the invisible hand and the heavy hand — bias our understanding and thus serve to create illusion.

One category error has long been recognized — at least by some legal scholars. Robert Hale, three-quarters of a century ago, challenged the categories and claimed, in effect, that the idea that there is such a thing as a "free" market is itself illusion:

> [T]he systems advocated by professed upholders of *laissez-faire* are in reality permeated with coercive restrictions of individual freedom, and with restrictions, moreover, out of conformity with any formula of "equal opportunity" or of "preserving the equal rights of others." Some sort of coercive restriction of individuals . . . is absolutely unavoidable . . . .[319]

Recognizing the category error that Hale identified has since become a staple of critical legal scholarship.[320] As Jamie Boyle recently summarized:

> Without the rules of contract, tort, and property there would not *be* a market. Barring a belief in classical legal thought, how could we claim that the particular set of (common law?) rules found in this country at this time is any more natural, or nonregulatory than the rules imposed by the Securities and Exchange Commission (SEC)? . . . [R]eading much of the economic literature, one might imagine that the legal system came with preset, default positions. "Protect owners against physical invasion of land, allow formation of contracts when information is concealed,

318. *See* Chen & Hanson, *Categorically Biased*, *supra* note 5, at 1160-63.

319. Hale, *supra* note 316, at 470; *id.* at 471 ("What is the government doing when it 'protects a property right'? Passively, it is abstaining from interference with the owner when he deals with the thing owned; actively, it is forcing the nonowner to desist from handling it, unless the owner consents."); Robert L. Hale, *Bargaining, Duress, and Economic Liberty*, 43 COLUM. L. REV. 603, 603 (1943) ("What work we should do and how much we might consume were determined by a process known as freedom of contract. Yet in that process there was more coercion, and government and law played a more significant part, than is generally realized.").

320. *See* MARK KELMAN, A GUIDE TO CRITICAL LEGAL STUDIES 103-109 (1987); *see, e.g.*, DUNCAN KENNEDY, *The Stakes of Law, or Hale and Foucault!*, *in* SEXY DRESSING ETC.: ESSAYS ON THE POWER AND POLITICS OF CULTURAL IDENTITY 83 (1993).

> nullify contracts where lies are told . . . ." But this is silly. The choice is not between "regulated" and "unregulated" but between different kinds of regulation.[321]

The fact that this categorical error is well known in critical circles has not made it any less (and has perhaps helped to ensure that it has remained) unfamiliar among most legal scholars and policymakers.[322]

Even assuming that one recognizes the inevitability of "regulation," there are other ways in which those categories have led to illusion. Below, we discuss the prototypical forms of regulation and the resultant prejudices associated with naming an institution or policy "regulatory." First, it is illuminating to consider what proponents of the meta script seem to exclude from the category of "regulation."

Acts of "deregulation" are seen, as the name implies, as reductions in regulation. The assumption seems to be that, if regulation is bad, deregulation must be good. That presumption is strengthened by the exaggerated categorical distinction between "regulation" and "markets." Because the categories are understood to be two sides of the same coin, anything that reduces (bad) regulation is understood to expand (good) markets. Such an understanding means that the insights of Stigler and many others regarding the way "regulation" might be disproportionately influenced by powerful interests are presumed inapplicable. Thus, while it seems clear that acts of "deregulation" benefit (and are actively encouraged by) producers and may harm consumers, suppliers, employees, or some other disaggregated group, and while it is also clear that such acts are implemented by the very "regulatory" institutions that Stigler and others studied, deregulation is viewed through a very different lens than "regulation" is.[323]

Also excluded from "regulation" are the acts of virtually every private (market and nonmarket) institution in the economy.[324] Thus, the media is not "regulatory." Nor are employers, churches, civic organizations, universities, or knowledge structures. The bias in the categories becomes evident when one considers the fact that Stigler's logic applies well beyond the prototype of, say, the now-defunct Civil Aeronautics Board and should include any institution that can

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321. *See* JAMES BOYLE, SHAMANS, SOFTWARE, & SPLEENS: LAW AND THE CONSTRUCTION OF THE INFORMATION SOCIETY 89 (1996).

322. *See, e.g.*, Boyle, *supra* note 77 (describing the role of the category error in antitrust law).

323. *See* Hanson & Yosifon, *The Situation*, *supra* note 4, at 233-35 (reviewing Michael Powell's case for "deregulation" and the underlying presumption that deregulation is not captured).

324. *Cf.* LARRY LESSIG, CODE AND OTHER LAWS OF CYBERSPACE (1999).

influence the profits or success of groups who might compete to influence that institution.[325]

To understand a second biasing effect of the "regulation" and "market" prototypes, it is helpful to consider the widely understood effects of stereotypes. "Stereotypes" are simply the popular term for the wider phenomena we are discussing here. When we complain of racial stereotypes, for instance, we are complaining about the tendency to use extremely negative (or positive) exemplars of the category and to assume that what is true of the exemplar is true of all. The process is particularly harmful because, in addition to influencing our cognitions, the stereotype influences our attitudes (prejudices) and our behavior (biases).[326]

All of those prototype effects are evident with the categories of "regulation" and "markets." The prototypical forms of regulation, for example, are either the "plans" of some mid-level apparatchik or the rules promulgated by administrative agencies or commissions and published in the increasingly cumbersome and technical Federal Register. Given that prototype, labeling an institution as "regulatory," stimulates all of the negative affective and attitudinal associations that attach to communists and captured bureaucrats. The prototypical markets include bustling stock markets or gleaming supermarkets where options of every sort trade freely and the idiosyncratic tastes and preferences of all involved are satisfied and given expression.

As we've indicated, the reverse is also true. Assuming we subscribe to the meta script, when our encounter with an institution leads to, or happens to correspond with, a negative affect or attitude, we are more likely to see the institution as "regulatory." Similarly we tend, within the limits of illusion, to see those institutions that correspond with positive affect or attitudes as "market" institutions. Such categorical assignments activate the corresponding schemas, leading to the prejudices and biases associated with the meta script.

b. Profit Versus Social Responsibility. Above we asserted that the policymaking meta script has influenced virtually all of modern policy. We claimed further that the corporate macro script is a case in point: the shareholder primacy norm itself reflects the application of the meta script categories and schemas to the question of what corporate law's goal should be.[327] In this Section, we attempt to provide more direct support for those claims and, in doing so, illustrate the categorical and schematic biases just summarized.

325. *See* Hanson & Yosifon, *The Situation*, *supra* note 4, at 206-12 (describing "deep capture").

326. *See* Chen & Hanson, *Categorically Biased*, *supra* note 5.

327. *See supra* text accompanying notes 114-116.

Recall the long-standing debate between, among others, Berle and Dodd regarding the extent to which corporate directors and corporate law should be concerned with anything beyond profit. By the 1950s Dodd had by all accounts (including Berle's) won that debate.[328] When Milton Friedman turned his focus to the question, he brought to it his meta script for policymaking, summarized as markets are good and regulation is bad.[329] At the time, his was a lone (public) voice. But by the power of the meta script over policymaking generally, and its effective application by Friedman to corporate law specifically, his voice was soon joined by a chorus and transformed into what is now the conventional wisdom regarding corporations and corporate law.[330]

A close examination of Friedman's analysis and the subsequent refinements, however, reveals the very categorical biases we've identified. Friedman arrived at the corporate-law debate with the meta script activated and processed information through its categories. As is true in the application of the meta script to any new policy area, the basic question involved identifying those elements of corporate practices and corporate law that belong in the "regulation" category and those that belong in the "market" category. When examining the macro question regarding whether corporations should seek to serve only shareholders' interests (assumed to be profits[331]) or to serve the interests of other constituencies as well, the categorization was automatic.

Maximizing profits is clearly a "market" activity. "Social responsibility" is clearly "regulatory."[332] With that categorization, the categorical prejudices and schemas kicked in. Profits are simple and good. Social responsibility is difficult and bad. Thus, when Friedman approaches the issue, he asks whether

328. *See supra* text accompanying notes 137-142.

329. *See supra* text accompanying notes 144-150.

330. Of course, the fact that the most influential versions of the meta script and the macro script emanated, literally, from the same mind — Friedman's — provides some further evidence, we believe, that the former was helping to create the latter.

331. *See supra* text accompanying notes 166-167; *see, e.g.*, POSNER, *supra* note 196, at 420.

332. We suspect that much of what determines the categorization is not simply the clear associations between concepts like markets and profits, on one hand, and "social responsibility" and regulators' "public interest" rhetoric on the other, but also affective responses of Friedman and others to the concepts. We have noticed a general suspicion and seeming distaste for all notions of "doing good for others" in the writings of members of the Chicago and Austrian schools and a concomitant attraction to notions of "doing well for myself." *See, e.g.*, Friedman, *Friedman Doctrine*, *supra* note 3, at 124 ("I share Adam Smith's skepticism about the benefits that can be expected from 'those who affected to trade for the public good.'"). Any such affective response would, in turn, lead to the categorization of profits as market-related and social responsibility as regulation-related.

> self-selected private individuals [can] decide what the social interest is? Can they decide how great a burden they are justified in placing on themselves or their stockholders to serve that social interest? Is it tolerable that these public functions of taxation, expenditure, and control be exercised by the people who happen at the moment to be in charge of particular enterprises, chosen for those posts by strictly private groups?[333]

Notice how Friedman's description conjures the category of "regulation" and not "markets," and how the balance of his analysis is determined by the "regulation is bad" schema of the meta script. According to Friedman, directors, when claiming to promote social responsibility, are "self-selected." Instead of responding to the free choices of disaggregated individuals, they instead are imposing their own personal views on the hapless stockholders. Relatedly, the directors are not responding to the information contained in the price mechanism or to competitive pressures, but are simply imposing their ill-informed views. The goal of "social responsibility" is, to Friedman, indistinguishable from the governmental (that is, regulatory) "functions of taxation, expenditure, and control."

As we explored above, the macro script includes the assumptions that directors and managers lack the information and knowledge to make welfare-enhancing judgments about how to serve social responsibility[334] and that they are well-equipped to make the simpler profit-oriented judgments.[335] These assumptions reveal the power of the markets-good and regulation-bad meta scripts and, more importantly, the biasing influence of the categories. The macro script, because of that bias, wrongly assumes that corporate managers can avoid considering the "public interest" in their decisionmaking. Closer analysis reveals that such an assumption is, in several ways, a categorical illusion.

First, even prototypical "business decisions" involve one or more nonshareholder constituencies. Indeed, the very basic question of how consumers will respond to a new product involves attempting to understand the influence of a decision on a nonshareholder constituency. A "market analysis" is an analysis of consumer reaction to a new product or a new pitch. And "market strategies" reflect not the obvious and certain path of profit, but a corporation's best guess of overall effects. Almost as often, business decisions influence and must consider the reactions of the interests of employees, creditors, and suppliers. When those reactions are significant, they are ignored at the corporation's peril. "True, we can make a better mousetrap, but if

333. FRIEDMAN, CAPITALISM AND FREEDOM, *supra* note 47, at 133-34.

334. *See* Friedman, *Friedman Doctrine*, *supra* note 3, at 33 (emphasizing the "analytical looseness and lack of rigor" associated with the concept of business social responsibility).

335. *See supra* text accompanying notes 191-199.

conditions for our employees are worsened as a consequence, then we need to worry about how they will respond." "True, the law permits us to continue selling these deadly products, but if many consumers die as a consequence, our reputation may be badly tarnished." "Yes, we can pollute this stream, but what will it do to our community relations?"

Some industries, it seems, have devoted vast resources toward convincing the public, accurately or not, that they are committed to nonprofit ends. Even if one believes that the words and deeds of these corporations are neither truthful nor sincere, they reveal an ambiguity between the categories of "profits" and "social responsibility" for which the macro script fails to account. For instance, Philip Morris and other tobacco companies have long claimed that their primary concern is consumer health. In 1954, tobacco companies came together in response to evidence that cigarette use was correlated with lung cancer and published a lengthy, reassuring advertisement in newspapers across the country. Central to that advertisement was the following claim: "We accept an interest in people's health as a basic responsibility, paramount to every other consideration in our business."[336] In 1966, when many corporate executives were pledging their allegiance to social responsibility concerns, Phillip Morris emphasized their commitment in these terms:

> [W]e feel a deep sense of responsibility to our cigarette smokers. All of us who work in this industry feel a deep concern over questions raised about cigarettes and health. We will not rest until we learn the scientific facts that will provide solutions to the medical problems in question. We intend to leave no research question unanswered in our quest for the truth.[337]

A decade later, even as the case against corporate social responsibility was beginning to gain momentum, Philip Morris recommitted to the same end: "We in the industry took a position which is one that we think is probably the only correct or moral one, which is that some very serious charges have been made, and it's up to us morally to find the answers."[338] At the turn of the millennium, when corporate scholarship and corporate law had, according to many, reached "the

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336. TOBACCO INSTITUTE RESEARCH COUNCIL, A FRANK STATEMENT TO CIGARETTE SMOKERS (1954), *reprinted in* K.M. Cummings et al., *Failed Promises of the Cigarette Industry and Its Effect on Consumer Misperceptions of the Health Risks of Smoking*, http://tc.bmjjournals.com/cgi/reprint/11/suppl_1/i110 (last visited Oct. 7, 2004).

337. Joseph F. Cullman, President, Phillip Morris, Remarks Before the South Carolina Tobacco Warehouse Association (June 7, 1966), *available at* http://tobaccodocuments.org/state_strategies/220.html (last visited Oct. 7, 2004)

338. Interview by Thames Broadcasting with James C. Bowling, Vice President, Philip Morris, (Aug. 16, 1976), http://tobaccodocuments.org/pm/2024939913-9946.html (last visited Oct. 11, 2004).

end of history," Philip Morris apparently refused to make profits its sole concern. As their website at the time highlighted:

> The Philip Morris family of companies has been making grants to nonprofit organizations — local, national and international — since 1956, making it one of the nation's oldest corporate giving programs. Today, we are also one of the largest corporate contributors of monetary grants in the United States, with annual charitable contributions of more than $60 million in 1998. The reason we continue to give is simple: We want to make a meaningful difference in people's lives. You see, while Philip Morris is well known for being a family of companies, we are also a company of families. And the values and qualities that are important in our homes are also fundamental to our business. Foremost among these is a commitment to community service and lending a hand to others who need our help.[339]

More recently, Philip Morris Companies Inc. went so far as to change its name to Altria Group, Inc., in significant part to "focus attention on the qualities we want to reflect — such as operational excellence, financial strength, and a commitment to integrity and corporate responsibility."[340] And Philip Morris USA, the tobacco product subsidiary of Altria, has renewed its vow to Doddian decisionmaking: "We will support our mission by proactively engaging with our stakeholders to enhance our ability to act in a way that is consistent with society's expectations of a responsible company."[341]

The skeptic might claim that Philip Morris's repeated acts of social responsibility are actually intended to maximize profits and that Philip Morris's claims have been fairly transparent attempts to put a socially responsible face on greed-driven behavior. Perhaps so. But it is a hard case to prove, and there is clearly enough ambiguity between categories of "profit" and "social responsibility" to make it worth their while to claim to put the latter first.

Furthermore, if we remove "tobacco companies" from the story, the smoke of ambiguity becomes greater still. Shell purports to be integrating environmental and social considerations at all levels of its decisionmaking process. An internal document explains: "[W]e have moved on from what you might call corporate philanthropy, which often meant handing over money and sitting back, to the more structured approach of social investment."[342] That approach includes

339. www.philipmorris.com/pmcares (last visited June 10, 2000).

340. John Hoel, Director, State Governmental Affairs, Phillip Morris Management Corp., The Path to Responsibility at Phillip Morris Companies, Speech to South Tampa Chamber of Commerce (Nov. 20, 2002), http://www.altria.com/media/executive_speech/03_09_02_hoelspeechTampa.asp. (last visited Oct. 10, 2004).

341. http://www.pmusa/com/about_us/mission_values.asp# (last visited Nov. 21, 2004).

342. Sir Geoffrey Owen, Introductory Paper Delivered at Conference Entitled "Corporate Social Responsibility: Rethinking the Role of Corporations in a Globalizing

the development of "management systems, indicators, metrics and targets across a spectrum of economic, social and environmental dimensions of business performance."[343] McDonald's, in its 2004 Corporate Responsibility Report has, in response to corporate "scandals" and heightened "concerns about nutrition and health,"[344] recommitted to "being a responsible enterprise."[345] According to the extensive report, that

> means striving to do what is right, being a good neighbor in the community and integrating social and environmental priorities into our restaurants and our relationships with suppliers and business partners.
>
> We work toward responsible actions by understanding the perspectives and needs of our customers and other important stakeholders, by collaborating with experts to understand issues and opportunities and by inspiring the people in our system — company employees, owner/operators and suppliers — to share and act on these care values.[346]

Professor Dodd would be lovin' it.

Other companies, such as Ben & Jerry's Ice Cream, made their social commitments and their rejection of shareholder primacy a corporate mantra. Their "mission statement" includes an "economic mission" that focuses specifically on stakeholders rather than shareholders and a "social mission" that focuses on improving the quality of life "locally, nationally, and internationally."[347] As Ben Cohen, CEO of Ben & Jerry's, commented: "It makes no sense to compartmentalize our lives — to be cutthroat in business, and then volunteer some time or donate some money to charity. For it is business that is the most powerful force in our society.... [B]usiness sets the tone for our society."[348] Ben & Jerry's decision to focus on

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World"(Oct. 3, 2002), http://www.21stcenturytrust.org/owen.htm (last visited Oct. 10, 2004) (quoting Shell document).

343. *Id.* (quoting Shell statement).

344. MCDONALD'S CORP., *supra* note 12, at 2.

345. *Id.*

346. *Id.* at 3.

347. Ben and Jerry's professed "economic mission" is "[t]o operate the Company on a sustainable financial basis of profitable growth, increasing value for our stakeholders & expanding opportunities for development and career growth for our employees"; their "social mission" is "[t]o operate the company in a way that actively recognizes the central role that business plays in society by initiating innovative ways to improve the quality of life locally, nationally & internationally." *See* Ben & Jerry's, Our Mission Statement, *at* http://www.benandjerrys.com/our_company/our_mission/ (last visited Aug. 19, 2004).

348. Ben Cohen. Ben & Jerry's HOMEMADE, INC. 1990 ANNUAL REPORT 2 (1991) (cited in Lewis D. Solomon, *On the Frontier of Capitalism: Implementation of Humanomics by Modern Publicly Held Corporations: A Critical Assessment*, 50 WASH. & LEE L. REV. 1625, 1625 (1993)).

social responsibility proved, in the end, to be very profitable. The company was acquired at a sizable premium several years ago by Unilever,[349] and Ben himself cashed out at nearly $40 million dollars.[350] In sum, the categories of profit and social responsibility are difficult to distinguish, even when it comes to making prototypical business decisions.

It is not just businesspeople who have occasionally recognized the fuzziness between the categories of "profit" and the "public interest." As even corporate law scholars sometimes emphasize, corporate boards routinely make charitable contributions of one sort or another.[351] Those decisions may well enhance profits, but they need not. In any event, it's clear that they do have an effect on the interests of nonshareholder constituencies — those who enjoy the contributions and those who do not. There is little doubt that corporate executives must take those interests into account in deciding to whom, and how much, to give. Robert Clark, in this case, does not complain that such contributions have contributed to a grand "oligarchy," although the logic of his earlier argument suggests he should.[352] Friedman, too, finds charitable contributions acceptable, though he believes that they are, in fact, profit-motivated. He blesses that illusion, because such a "hypocritical window-dressing" "is one way for a corporation to generate goodwill as a by-product of expenditures that are entirely justified in its own self-interest."[353] And corporate law in practice has very little problem with those contributions and is quite liberal in permitting boards to determine the whens, hows, to whoms, and how muches of corporate charitable contributions, topics that we will examine more thoroughly in other work.[354] In sum, there appears to be

349. *See* Joanna Weiss & Stacey Chase, *A Swirl of Emotions: Ben & Jerry's Backers Applaud, Fear Buyout*, BOSTON GLOBE, Apr. 13, 2000, at B1.

350. David Gram, *Ben & Jerry's Founder Feeling Out in Cold; Questions Social Activism Since Buyout*, RECORD (Bergen County, N.J.), Dec. 1, 2000, at B3. Loosely, the size of the premium enjoyed by Ben and other shareholders may well have reflected the capitalization of previously untaken profit opportunities. Although Unilever assured Ben & Jerry's that they would maintain the company's traditional commitment to social activism, those assurances may not be legally binding. *See id.* As a result, Ben has expressed significant concerns about the direction of his former company. *See* Weiss & Chase, *supra* note 349 ("Now he worries that the food giant's promises of continued social activism may be melting away like a pint of Cherry Garcia left in the sun. 'Ben & Jerry's will become just another brand like any other soulless, heartless, spiritless brand out there — that's my concern,' Cohen said.").

351. *See* Chen & Hanson, Legitimating Schemas I, *supra* note 10.

352. *See supra* text accompanying note 231 (reviewing Clark's argument that allowing boards to pursue social responsibility may contribute to an oligarchy).

353. Friedman, *Friedman Doctrine*, *supra* note 3, at 124. Put differently, he sees social responsibility actions like regulatory actions — those that serve private interest but behind the "cloak" (his term) or illusion of the "public interest."

354. *See* Chen & Hanson, Legitimating Schemas I, *supra* note 10.

only support for the idea of corporate charity, and the idea that corporate directors and officers can judge wisely how best to serve, through their contributions, the public interest.

Furthermore, large corporations are not voiceless or noninfluential in the public sphere. Indeed, among voices, theirs is probably the loudest (which, by the way, is precisely what makes Friedman so upset with their "pontificating rhetoric"[355]). Large commercial interests routinely participate in policymaking of all sorts — policymaking that purports to serve the public interest. The phenomenon of heavy corporate involvement in policymaking is well understood and sometimes lamented among economists who criticize the outcomes of the regulatory process.[356] The claim that corporate managers should not get involved with issues of social significance because they lack the requisite expertise ignores the fact that a huge portion of corporate energy and resources are devoted precisely to those issues, a practice that the law has sanctioned and a practice that experience has helped to make perfect.[357] Here again, one element of the meta script is in tension with another. In short, executives and corporations are very much involved in the public sphere already. Either their involvement is incompetent and dangerous, in which case it should be prohibited, or it is not, in which case this "lack of expertise" claim falls flat.[358]

In addition, the dichotomy between the "public interest" and "profit" has been accompanied and reinforced by a false, or at least exaggerated, claim that decisions regarding the former are beyond the ken of corporate executives while the latter are standard fare. The preceding discussion helps make clear the flaw in that claim. But even if the focus of corporate executives were solely on profits, without regard to social ramifications, the difficulty of the decision can be

355. *See infra* text accompanying notes 556-561.

356. *See supra* text accompanying notes 100-113.

357. *See, e.g.*, Belotti v. First Nat'l Bank of Boston, 435 U.S. 765 (1977). Justice Rehnquist, in a solo dissent, eloquently raised the question of deep capture:

> A State grants to a business corporation the blessings of potentially perpetual life and limited liability to enhance its efficiency as an economic entity. It might reasonably be concluded that those properties, so beneficial in the economic sphere, pose special dangers in the political sphere. Furthermore, it might be argued that liberties of political expression are not at all necessary to effectuate the purposes for which States permit commercial corporations to exist. So long as the Judicial Branches of the State and Federal Governments remain open to protect the corporation's interest, in its property, it has no need, though it may have the desire, to petition the political branches for similar protection. Indeed, the States might reasonably fear that the corporation would use its economic power to obtain further benefits beyond those already bestowed.

Id. at 827.

358. What gives Friedman and the other scholars the expertise to know that laws in a world in which "social responsibility" is taken seriously (or the single-minded pursuit of profits is "curbed") are worse than laws in a world in which it isn't — given that they know that the laws will be very different in those two worlds?

immense. Deciding whether to maximize long-term or short-term profits is a complicated question, but it pales in comparison to the far more complex issue of how to do either successfully. If business decisions involve both prototypical profit-related concerns and, as we have argued they do, concerns about the public interest, then the degree of difficulty of these decisions may be greater still.

When we examine how the law is applied in practice, we see further evidence of this categorical illusion. Courts have largely abandoned careful monitoring precisely on the ground that they lack the competence to adequately judge even purely profit-oriented business decisions. Even though profit-related decisions are supposed to be relatively "easy," because they involve a single maximand, when faced with the supposedly easy task of monitoring that decision-making, courts have tended to draw upon the other side of the meta script — the idea that centralized decisionmakers do not have the knowledge or expertise to make good judgments. This difficulty in decision-making has led corporate law courts to avoid second-guessing any business judgment.[359]

Corporate law scholars, too, have argued in other contexts that virtually any goal that is actually motivated by some social interest can be framed in terms of profits.[360] If that is true, then it provides additional evidence that the boundaries between the categories of "profit" and "social responsibility" are not as clear as the macro script would have us believe. After all, if the claim is that "social responsibility" is too broad and amorphous a concept for directors to handle, and yet the category of "profit" can accommodate virtually any socially responsible decision, then that suggests that the category of "profit" is no narrower or simpler in practice than the amorphous category of social responsibility.

It is worth noting that when Friedman claims that decisions about social responsibility are far more complex than are decisions about profit, his argument is built more on his prototypes for the categories than on the categories themselves. Recall that for his prototype of a concern within the category of "social responsibility,"[361] he used inflation. Given his work on that topic and the importance of the problem at the time, it seems reasonable to do so. As a *prototype* for the "social responsibility" category, however, inflation seems an unusual choice — in part because it seems an unlikely corporate goal, even for those corporations whose directors claim to be devoted to the

359. *See* Chen & Hanson, Legitimating Schemas I, *supra* note 10 (examining the tension between the macro script and the meta script); Chen & Hanson, Legitimating Schemas II, *supra* note 10 (same).

360. *See* Chen & Hanson, Legitimating Schemas I, *supra* note 10.

361. *See supra* text accompanying note 174.

public interest.[362] Fighting inflation is a topic where the issues are, as Friedman elucidates, quite complex.[363]

Not all issues within the social responsibility category, however, are so difficult. A corporate board committed to taking social responsibility with respect to air or water quality faces a not-so-complicated question. It's a pretty safe bet that decreasing emissions or effluent would advance that goal and that increasing them would not.[364] Although deciding precisely how much to reduce and at what cost to the "bottom line" can be difficult, those complexities seem no less challenging than the ones facing executives deciding how much, what type, and what color of paint to use on a new model-widget. Put differently, Friedman did not show that corporate executives are incompetent as much as he showed that some issues within the "social responsibility" category are extremely complex and even insuperable. Even the "democratic" governmental bodies to which Friedman would defer have had an extraordinarily difficult time knowing how best to address problems of inflation — a point that should have been evident to Friedman, given that he devoted the better part of his career attempting to convince governments how their macroeconomic policies dealing with inflation were inherently flawed.

There are other schematic and categorical biases worth highlighting. As noted above, our categorization process is often influenced, if not determined, by our affective response to the item to

362. We have seen no evidence that any firms have, on their own, engaged in the practice of limiting their price increases in an attempt to slow inflation. And, to the extent that firms have held down prices in response to calls from government officials (such as when Presidents Nixon and Carter implored firms to cap prices to help stem the inflationary tide), firms were responding to governmental direction and, sometimes, incentives. Such examples, however, are beside the point; Friedman cannot fault executives for relying on the advice and incentives of the government, which he himself claims is the right institution to make such determinations. *See* Friedman, *Friedman Doctrine*, *supra* note 3, at 122.

363. *See supra* text accompanying note 174. Inflation — while having "microfoundations" — is a macroeconomic topic involving forces at a level that one corporation can hardly hope to affect. For example, one corporation is highly unlikely to affect a significant number of consumers' inflationary expectations, a key variable (it is thought) in the dynamics of the inflation rate.

364. To be sure, the clever analyst can tell an "unintended consequence" story that makes one do-good corporation's decision to reduce pollution the cause for more pollution in the long run. Indeed, even we can. But here, we'd prefer to offer two generic responses to such a causal story. First, as an argument that corporate boards should rely on governments to make relevant decisions about how best to reduce pollution, the "unintended consequence" of privately motivated, socially responsible acts usually fail. After all, the unintended consequence story is likely also to bedevil the governmental regulations (as these scholars and analysts would, were they looking just at the regulation, stress). Second, the fact that scholars and policy analysts are prone to imagine a complex set of causal stories when people operate outside of their model for appropriate behavior, but are blind to or accepting of the harmful, including unintended, consequences of schema-consistent behavior, is itself evidence of schematic and categorical biases.

which we are attending at a given moment.[365] Further, the way we categorize an institution or practice influences our attitudes and affective reactions to it as well as the associations that are primed by it. If, for example, we subscribe to the basic meta script of policymakers and we perceive something to fall into the category of "markets," perhaps because it is framed that way to us, we will tend to feel positively toward it and, thus, will tend to trust the institution and feel good about its potential and actual outcomes.[366] Conversely, if we perceive something to be "regulation," our affective response will likely be negative, as will our attitudes and associations.[367] An item categorized as "regulatory" will more likely be seen as coercive[368] and less likely be seen as consensual than it otherwise would be.[369]

In sum, the similarities, connections, and interactions between the categories of "profit," "market," "social responsibility," and "regulation" appear rife with illusion.

4. *The Illusion of Freedom*

Perhaps the most compelling reason offered for preferring markets to regulation is the idea that the former sets people free, while the latter coerces them.[370] So it is that Friedman titled his two best-known books *Capitalism and Freedom* and *Free To Choose.*

The meta script's reliance on freedom as its paramount norm has been integral to the case for maximizing markets and minimizing regulation in all contexts. Today, administrative regulators commonly use "freedom" as their primary stated purpose when calling for and enacting deregulation.[371] For instance, Thomas B. Leary, Commissioner of the Federal Trade Commission, recently explained

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365. *See supra* note 264 and text accompanying notes 313-318.

366. Below, we'll explain how it is that scholars, by characterizing corporate law as "market"-based, seem to have gone out of their way to see consent that is otherwise not obvious and to overlook "coercion," even when it is fairly obvious. *See infra* text accompanying notes 382-392. In fact, these scholars are not "going out of their way" to see some things and avoid others, they are simply floating easily with the automatic cognitive currents of their knowledge structures.

367. *Cf. infra* notes 393-412 and accompanying text (describing the illusion threat).

368. See *supra* text accompanying notes 164-168 for an example in which Friedman claims that executives purporting to serve the social interest are acting contrary to shareholder interests, but misses his own point that shareholders could, if they were unhappy with all the talk about social responsibility, vote them out of office.

369. For instance, economists often describe any governmental regulation as a coercive mandate and not as a price that businesses have the option of paying or not. *See generally* Hanson & Wright, *supra* note 86 (describing how the situational influence of governmental policy is more salient but no more influential than other situational forces).

370. *See supra* text accompanying note 8 (Hayek's version of this point); *supra* text accompanying notes 96-97 (Friedman's version).

371. *See supra* text accompanying notes 63-76.

that his concern, and that of his colleagues, was less with efficiency than with promoting freedom.[372] Echoing Hayek and Friedman's work, Leary describes the "fundamental and glorious idea . . . that people should be free to engage in whatever occupation they choose."[373] That freedom is what makes it possible for you

> to sell not only your labor, but also your goods and your ideas.
>
> The corollary of this seller freedom, and the thing that makes it fully effective, is the notion that buyers have the corresponding freedom to buy whatever they want. With rare exceptions, individual buyers can exercise this freedom, even if they choose things that are very bad for them. This is what we call consumer sovereignty, and it is also a precious legacy.
>
> I think economic efficiency is not a core value in itself but rather a way to mediate between conflicting freedoms.[374]

In making this appeal to freedom through markets, Leary is articulating the dominant perspective among policymakers. As Leary himself goes on to explain, "this new learning is mainstream competition law."[375] Indeed, "all of [his] colleagues agree that the objective [of policy] is to maximize efficient outcomes" to better mediate conflicting freedoms.[376] Michael Powell, current Chairman of the FCC, takes the same "markets are good because they encourage freedom," and "regulation is bad because it interferes with freedom" position. In a recent interview, for instance, he insisted that his preference for markets was based on the faith that markets "empower consumers: [the market] lets consumers choose the products and services they want — which is their right as free citizens."[377]

The view that the macro script in corporate law likewise promotes freedom is, as we should expect, also prevalent. And so, in concluding his case for shareholder primacy in corporate law, Friedman writes:

> The political principle that underlies the market mechanism is unanimity. In an ideal free market resting on private property, no individual can coerce any other, all cooperation is voluntary, all parties to such cooperation benefit or they do not participate. There are no "social" values, no "social" responsibilities in any sense other than the shared values and responsibilities of individuals. Society is a collection of individuals and of the various groups they voluntarily form.[378]

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372. Leary, *supra* note 76, at 2.

373. *Id.*

374. *Id.*

375. *Id.*

376. *Id.*

377. Powell, *supra* note 74.

378. Friedman, *Friedman Doctrine*, *supra* note 3, at 126.

More recently, Easterbrook and Fischel emphasize the contractual — that is voluntary — nature of corporate law in the following terms:

> To say that a complete relation among many voluntary participants is adaptive is to say that it is contractual. Thus, our reference to the corporation as a set of contracts. Voluntary arrangements are contracts. Some may be negotiated over a bargaining table. Some may be a set of terms that are dictated (by managers or investors) and accepted or not; only the price is negotiated. Some may be fixed and must be accepted at the "going price" (as when people buy investment instruments traded in the market). Some may be implied by courts or legislatures trying to supply the terms that would have been negotiated had people addressed the problem explicitly. Even terms that are invariant — such as the requirement that the board of directors act only by a majority of a quorum — are contractual to the extent that they produce offsetting voluntary arrangements. The result of all these voluntary arrangements will be contractual.[379]

And everywhere one looks, according to Easterbrook and Fischel's contractarian vision, there is freedom:

> The founders and managers of a firm *choose* whether to organize as a corporation, trust, partnership, mutual, or cooperative .... They *choose* what the firm will make or do and whether it will operate for profit, not for profit, or hold a middle ground, pursuing profit but not to the exclusion of some other objective (as publishers of newspapers do). They *choose* whether to allow the public to invest or whether, instead, the firm will be closely held. They *choose* what kinds of claims (debt, equity, warrants) to issue, in what ratios, for what price, with what entitlements: not only the right to receive payments (how often, in what amounts) but also whether these investments allow their holders to vote — and if to vote, how many votes, and on what subjects. They *choose* whether to incorporate (states have different legal rules). They *choose* how the firm will be organized (as a pyramidal hierarchy or a loose, multidivisional collective), whether central leadership will be strong or weak, and whether the firm will grow (internally or by merger) or shrink (by selling existing assets or spinning off divisions). Investors *select* members of the board of directors, who may be "inside" (part of the management team) or "outside" (often associated with investors, suppliers, or customers), and the board decides who exercises which powers on the firm's behalf. As a practical matter boards are self-perpetuating until investors become dissatisfied and a majority decides to redo everything to a new taste. With trivial exceptions all business decisions — including the managers' pay, bonuses, stock options, pensions, and perquisites — are taken by or under the supervision of this board, with no substantial inquiry by anyone else.[380]

379. EASTERBROOK & FISCHEL, *supra* note 180, at 14; *see also* text accompanying note 224 (quoting Easterbrook and Fischel's discussion of the "choices" involved in corporate law).

380. EASTERBROOK & FISCHEL, *supra* note 180, at 2-3 (emphasis added).

Easterbrook and Fischel are so impressed with the freedom inherent in corporate law that they conclude that, in fact, "[n]o contract used in our society is more likely to satisfy the conditions for enforcing voluntary agreements" than are "the terms under which corporations operate."[381]

We do not dispute that markets, contracts, and corporate law, particularly framed this way, can easily be understood as reflecting the free, voluntary acts of the individuals involved. Nor do we dispute that this appearance helps make markets, contracts, and corporate law quite appealing. But things may look different when one is wary of illusion. If it turns out that markets, contracts, and corporate law are not in fact as free as they seem, then their normative appeal may disappear.

One of the most thoroughly demonstrated phenomena in social psychology is, as we highlighted at the outset, that people can be influenced by situational forces of which they are unaware.[382] A related finding is that individuals tend to attribute people's actions in those circumstances, not to the situation itself, but to dispositions. Put differently, they may have some difficulty at first, but typically they will find a way to make sense of "their choice" to act as they did. Behaviors, according to conventional attributional schemas, reflect "choices" which, in turn, reflect stable preferences.[383] The situation often moves us though we perceive we are freely choosing and willing our actions. Of course, if "the situation" is particularly salient and powerful — say, a gun to the head — then we no longer see our actions as volitional when faced with the choice "your money or your life." But most of the time we miss most of the significant effect of the situation. In sum, social psychology gives us reason to believe that our "freedom" — conceived as preference-driven choices — is often an illusion.

In this specific context, too, there is reason to worry that the freedom glorified in the meta script of policymaking and the macro script of corporate law is itself illusion. The idea that consumer product markets promote freedom — that consumers are sovereign in the marketplace — has been challenged at length in other work.[384]

381. *Id.* at 24; *see also* ALLEN & KRAAKMAN, *supra* note 183, at 2 ("Corporate law addresses the creation of economic wealth through the facilitation of voluntary, ongoing collective action.").

382. *See supra* text accompanying notes 4-5.

383. For an expansive treatment of these tendencies, see Hanson & Yosifon, *The Situation*, *supra* note 4, at Part II, and Hanson & Yosifon, *The Situational Character*, *supra* note 4, *passim.*

384. *See* Hanson & Kysar, *Market Manipulation*, *supra* note 251, at 1444-50; Hanson & Yosifon, *The Situation*, *supra* note 4, *passim*; Hanson & Yosifon, *The Situational Character*, *supra* note 4, *passim*; Benforado, Hanson & Yosifon, *Broken Scales*, *supra* note 10, *passim.*

Here, we want to focus solely on the notion that corporate law is contractual, thus enabling participants to choose whatever business form and pursue whatever end they like. As Easterbrook and Fischel suggest, the magic of the market is, in their view, that anything goes:

> An approach that emphasizes the contractual nature of a corporation removes from the field of interesting questions one that has plagued many writers: what is the goal of the corporation? Is it profit, and for whom? Social welfare more broadly defined? Is there anything wrong with corporate charity? Should corporations try to maximize profit over the long run or the short run? Our response to such questions is: who cares? . . . If a corporation is started with a promise to pay half of the profits to the employees rather than the equity investors, that . . . is simply a term of the contract. It will be an experiment. Professors might not expect the experiment to succeed, but such expectations by strangers to the bargain are no objection. Similarly, if a bank is formed with a declared purpose of giving priority to loans to minority-owned businesses or third-world nations, that is a matter for the venturers to settle among themselves. So too if a corporation on building a plant, undertakes never to leave the community. Corporate venture[r]s may select their preferred "constituencies."[385]

Thus, the contractarian view of corporate law purportedly removes any concern about coercion. Any interesting questions go away, because everyone is free to do as they please, and no one is forced to do anything. When we see corporations, then, as focusing solely on profits and ignoring all other constituencies, we can be sure that they are doing so because that is what they want to do. Existing practices reflect existing preferences and thus maximize welfare (and profit).

But there is a major problem for Easterbrook and Fischel, and virtually all other defenders of the macro script who presume that people's behavior reflects nothing other than their disposition-driven choices: because of powerful situational constraints, there is, it turns out, virtually no freedom for individuals to choose what commercial forms they prefer, what laws they want to apply, or what ends they want their entities to serve. We are not alone in making this claim. It is an argument made often and persuasively by proponents of the macro script in other contexts.

As we've illustrated already, a common refrain in the macro script is that market pressures leave business managers little choice but to

385. EASTERBROOK & FISCHEL, *supra* note 180, at 35-36. Here, Easterbrook and Fischel assert that there might be departures from the dominant macro script of profit maximization. But they later predict that those departures will be few and far between and suggest that the default rule for corporate law should therefore be shareholder wealth maximization. They write that "the background term should be the one that is either picked by contract expressly or is the operational assumption of successful firms." *Id.* at 36. And that means profit maximization: "For most firms the expectation is that the residual risk bearers have contracted for a promise to maximize long-run profits of the firm, which in turn maximizes the value of their stock." *Id.*

adopt only those goals, forms, and laws that are profit maximizing.[386] But the point is perhaps more tellingly made if we make it through Easterbrook and Fischel's own words. In the same work in which they celebrate corporate law as fully contractual, they repeatedly emphasize that market pressures limit the freedom of business managers. At one point, for instance, they explain that although managers might be tempted to pursue some other end, "they find that the dynamics of the market drive them to act as if they had investors' interests at heart. It is almost as if there were an invisible hand."[387] The invisible hand, then, is a metaphor for what we call the (invisible) situation. Its effect here is to determine venturers' behavior while convincing those involved that they are the ones calling the shots.

In some ways, it is as if the invisible hand is pointing an invisible gun at the market participant's head, and the invisible mouth is whispering "your money or your life."[388] In Easterbrook and Fischel's terms, "the firms that pick the wrong terms will fail in competition with other firms competing for capital."[389] "The history of corporations has been that firms failing to adapt their governance structures are ground under by competition."[390] So it is true, as Easterbrook and Fischel underscore, that "[c]orporate venture[r]s may select their preferred 'constituencies,'" but should they not "freely choose" shareholders as their "sole" constituency, those venturers can look forward to being "ground under by competition."[391] It is analogous to saying that the person who holds onto his wallet and loses his life acted freely, and that we should therefore celebrate the outcome.

Of course, that is not the view that economists and the law take of such unfair bargains. Easterbrook and Fischel, for instance, write that "[c]ontracts signed under threat of force displace voluntary

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386. *See supra* text accompanying notes 217-222. One strain of this argument insists that managerial discretion is itself an illusion:

> Businessmen do have discretion in the sense that they face a range of choices, as do quarterbacks in football games and contestants on quiz shows. But just as a quarterback who calls the wrong play may see his team suffer a loss or hopeful contestants may see their hopes dashed by a wrong answer, a firm which makes a bad judgment will suffer financial consequences. Firms that make the most accurate decisions will prosper and the pressures of competition will cause all others to copy them and seek even more accuracy. This pragmatic groping for the profit-maximizing product and price-output ratio may well appear as discretion, but it is discretion fettered by market rewards and penalties.

RALPH K. WINTER, GOVERNMENT AND THE CORPORATION 61 (1978).

387. EASTERBROOK & FISCHEL, *supra* note 180, at 4.

388. The narrow exceptions for when we see situation (for example, a gun to the head) in laws and legal theories are discussed at length in Hanson & Yosifon, *The Situation*, *supra* note 4, and Hanson & Yosifon, *The Situational Character*, *supra* note 4.

389. EASTERBROOK & FISCHEL, *supra* note 180, at 17.

390. *Id.* at 13.

391. *Id.*

arrangements and are unjust. . . ."[392] So why aren't the contracts signed under threat of "market force" seen as involuntary or unjust? At least in part, it is because of the illusion of freedom.

5. *The Illusion of Threat*

Our freedom may, as we've suggested, be largely an illusion, but it is an illusion that we cherish. And, for good reason: there's a lot to like about freedom.[393] And likewise, we cherish the capitalistic-democratic foundations of our system precisely because it is the basis of our perceived freedom. To suggest, as we have, that our freedom is largely illusory represents a threat, not just to our views of ourselves, but to our understanding of our entire system.[394]

Yet we are hardly the first to suggest that our system may be under threat. In fact, the success of the entire meta script and macro script has, we believe, turned significantly on the presence of a perceived threat. Just as the "markets are good" element of the meta script is based significantly on promoting the norm of "freedom," so is the "regulation is bad" element. But the "regulation is bad" element is fueled largely by its conscious and subconscious associations with freedom-reducing institutions — from fascism to communism and from socialism to serfdom. Indeed, a major goal of Hayek's *Road to Serfdom* was to highlight the connections among those various examples of what he placed within a single category of totalitarianism. Under that unifying classification, all those alternatives began to look alike, and democratic-capitalism was seen as exceptional — in a category by itself.

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392. *Id.* at 22.

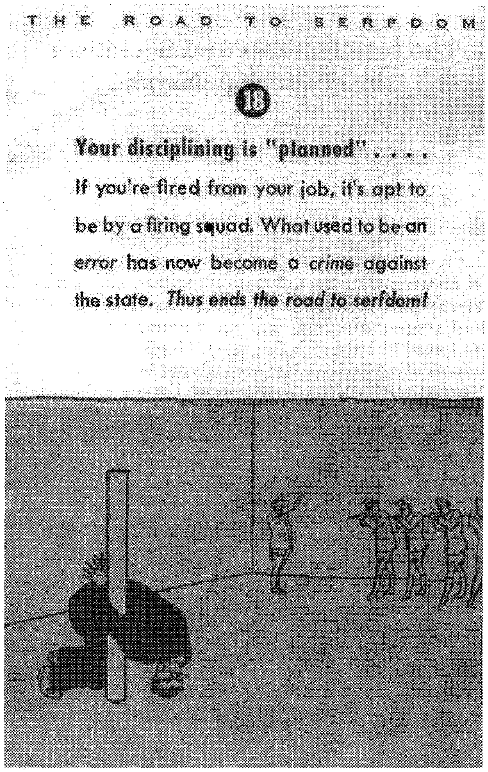
393. There is even a lot to be said for the illusion of freedom. But that must await future work.

394. James Boyles observes:

> [I]n the contemporary Unites States, it is possible to challenge the assumption that the "free market" will always produce the right answer. It is harder to challenge the language of freedom and choice in which such discussions are often couched and hardest of all to question the epistemology of autonomous subjects on which it depends. Some criticisms are seen as legitimate attempts to explore the internal problems of a system of beliefs, some are seen as challenges to the system itself, and some cannot even be understood as meaningful speech acts.

BOYLE, *supra* note 321, at 189.

FIGURE 5. "THUS ENDS THE ROAD TO SERFDOM!"



Source: HAYEK, ROAD TO SERFDOM 18 (1945).

Within our system, too, the threat to freedom has been endlessly trumpeted. When Friedman and Hayek spoke of "free markets," they were speaking of "free people." And limits on free markets constitute threats to our freedoms.[395] The regulator is the gunman, regulation is the gun, and our system and freedom stand in the cross hairs. That is the salient situational force that the frames of the meta script encourage us to see.

In addition to the examples that we have provided throughout this Article, consider economist David Henderson's recent book, *The Joys of Freedom*.[396] Throughout he emphasizes the continuing threat

395. *Cf.* Reagan, *supra* note 43 ("[L]et me speak plainly: we cannot have prosperity and successful development without economic freedom. Nor can we preserve our personal and political freedoms without economic freedom.").

396. DAVID HENDERSON, THE JOYS OF FREEDOM: AN ECONOMIST'S ODYSSEY (2002).

regulation poses to our freedom. He writes: "[D]espite the proven economic success of freedom, much of the world, including the United States, is hanging on to freedom's opposite, government control."[397] Referring to Al Gore's argument that the government should act, not as a "big brother," but as nurturing "grandparents," Henderson admonishes: "[I]f you want to stick with [Gore's] model, think of the government as grandparents with guns who have never met you and don't care much about you."[398] There's that gun again. Henderson concludes by connecting more explicitly the government regulations in this country with those same, threatening totalitarian regimes that motivated Hayek's analysis: "The fall of the Berlin Wall and the utter collapse of the vicious antihuman communist regimes around the world *was* a great victory. But the victory is incomplete. People should be much freer than any government in the world is letting them be."[399]

The same "regulation is coercive" script figures prominently, too, in the macro script's case against "social responsibility." Friedman opens his famous article on the topic by emphasizing how the "contemporary crop of reformers" promoting the idea that business has "a 'social conscience'" is in fact "preaching pure and unadulterated socialism."[400] Later in the article, Friedman ratchets up the threat: "the use of the cloak of social responsibility, and the nonsense spoken in its name by influential and prestigious businessmen, does clearly harm the foundations of a free society."[401] And then, in case we had missed it, Friedman closes his article with this warning:

> [T]he doctrine of "social responsibility" taken seriously would extend the scope of the political mechanism to every human activity. It does not differ in philosophy from the most explicitly collectivist doctrine. It differs only by professing to believe that collectivist ends can be attained without collectivist means. That is why . . . I have called it a "fundamentally subversive doctrine" in a free society . . . .[402]

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397. *Id.* at 41.

398. *Id.* at 42-43.

399. *Id.* Similar conceptions of threats to our freedom and our system played a significant role in the 2004 presidential election. For a summary of that evidence and a more thorough analysis of the psychological effects of threat, see Benforado & Hanson, *supra* note 7.

400. Friedman, *Friedman Doctrine, supra* note 3, at 33.

401. Friedman, *Friedman Doctrine, supra* note 3, at 126.

402. Friedman, *Friedman Doctrine, supra* note 3, at 126; *see also* FRIEDMAN, CAPITALISM AND FREEDOM, *supra* note 47, at 133 ("Few trends could so thoroughly undermine the very foundations of our free society as the acceptance by corporate officials of a social responsibility other than to make as much money for their stockholders as possible.").

The message is clear. Notions of "social responsibility" pose a significant threat to our system and therefore to our freedom.

Easterbrook and Fischel are a bit subtler in describing the threat. It is not just "that firms failing to adapt their governance structures are ground under by competition."[403] The situational lesson also applies across regimes: "The history of corporate law has been that states attempting to force all firms into a single mold are ground under as well."[404]

Most recently, Professors Allen and Kraakman similarly emphasize the significance of the profit-maximizing corporate form to our system:

> The bankruptcy of the old Soviet-style planned economy is exhibit one in an argument for the importance of incentives and the law of ownership, control structures, and legal protection of capital. Marxism doctrinally denied the productive contribution of capital to the collective effort to produce wealth. Anglo-American corporation law, on the other hand, recognized from the beginning the legitimate rights of the shareholders who contributed equity capital to the business enterprise. The collapse of the Soviet economy and its political control system and the success of the Anglo-American model of legal regulation of large-scale enterprise suggest that an organization's internal governance affects its performance.[405]

Although Allen and Kraakman do not make the threat explicit, it is there all the same. Lest we go the way of the discredited Soviet system, it's best we stick with the basic Anglo-American corporate form, in which shareholders come first.[406]

So why all this attention to threat? There are probably several reasons. First, the writers no doubt feel that our system is superior to the alternatives and that it is threatened by challenges to the macro script. Unsurprisingly, their writing reflects those concerns.

Second, those feelings themselves reflect the same sort of categorical errors that we discussed above. Scholars and policy analysts have combined into a single category all "totalitarian" and "collectivist" regimes, including Nazism and communism. They have then lumped into that same category any form of "regulation" — even within a capitalist democracy — if that regulation seems to interfere with "free markets." And into that same category, they have also added any corporate goal other than pure profit. Those unfamiliar with the various scripts would no doubt experience many of the

403. EASTERBROOK & FISCHEL, *supra* note 180, at 22.

404. *Id.*

405. ALLEN & KRAAKMAN, *supra* note 183, at 3.

406. *Id.* ("Additional evidence of the significance of the law of enterprise organization is the dominance of the corporate form throughout the world. The basic legal form of large-scale firms is remarkably similar in almost all economies.").

threats we've mentioned as farcical. To the uninitiated, it seems a long leap from "social responsibility" to "fascism." But the scripts and categories we've been discussing bring the ideas together effortlessly, like the script for "firing squad" brings together the otherwise distinct images of blindfold, rope, and gun. With the meta script and macro script in place, what might have been a gigantic jump becomes a greasy and steep decline.

Third, the perception of a threat simply advances the case of the meta and macro scripts' proponents. In a pathbreaking series of studies, social psychologist John Jost and his colleagues have found that across individuals, and across social groups, there is a powerful motive to justify systems and rationalize the status quo.[407] Individuals not only perceive the existing social fabric as an equitable arrangement, but may go as far as to see it as "natural," or even "inevitable."[408] Certainly the evolution script — so common in corporate justifications of the macro script — is consistent with those findings.[409] The system-affirming, or system-justifying, motive is immensely powerful when triggered by perceptions of system threat. This may well explain why Friedman opened and closed his article with a threat and why Hayek chose such a threat-evoking title for his most famous book.

The literature on the system-legitimacy motive provides further lessons. The evidence to date suggests that many people internalize negative stereotypes of even their own identity groups when doing so helps legitimate the system as a whole. High-status individuals are not the only ones motivated to see low-status individuals as dispositionally deserving of their status. Low-status individuals share that motive, particularly when the system is under threat. The powerful presence of the system justification motive in low-status groups permits a maintenance of the social, political, and economic status quo, and acceptance on the part of low-status groups of their own unequal position in society. In short, system threats promote the motive to

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407. *See* John T. Jost et al., *Non-conscious Forms of System Justification: Implicit and Behavioral Preferences for Higher Status Groups*, 38 J. EXPERIMENTAL SOC. PSYCHOL. 586 (2002); John Jost, *Outgroup Favoritism and the Theory of System Justification: An Experimental Paradigm for Investigating the Effects of Socio-economic Success on Stereotype Content*, *in* FUTURE DIRECTIONS IN SOCIAL COGNITION (G. Moskowitz ed., 2001); Jost & Hunyady, *The Psychology of System Justification*, *supra* note 260. For extended discussions of system-legitimacy work and some of its implications for law and legal theory, see Hanson & Yosifon, *The Situation*, *supra* note 4; Hanson & Yosifon, *The Situational Character*, *supra* note 4; Benforado, Hanson, & Yosifon, *Broken Scales*, *supra* note 10.

408. *See* authorities cited *supra* note 407.

409. *See supra* text accompanying notes 222-227; *see also* Chen and Hanson, False Starts, *supra* note 29 (summarizing convergence hypothesis and "race for corporate law" literatures); *supra* text accompanying note 224 (quoting Easterbrook and Fischel on "natural selection" process in corporate law). The natural selection script is also commonly used in defenses of the meta script. *See supra* text accompanying notes 91-95.

affirm the system even (indeed, particularly) among those who are most disadvantaged by the system.[410]

What might that tendency imply about any attempt to legitimate existing power relationships? This question is taken up in detail in other work.[411] For now, we will simply observe that were powerful interests seeking to maintain a self-serving illusion, one of the best means of doing so — that is, of legitimating the system, the power dynamics, and the knowledge structures behind it — would be to suggest that the system is under significant threat by those who challenge it. The strategy would be even more effective if the audience is, together with the threat, simultaneously offered a reassuring and simple set of stereotypes and scripts that naturalize and legitimate the status quo and help further advance the trajectory being challenged. In sum, one of the best ways to promote existing arrangements is to create the illusion of a threat to those arrangements.[412]

To be sure, the threat need not be illusory for the technique to work. For reasons that we have already provided, the threat does appear to be largely an illusion. Insofar as the categorical distinctions between "regulation" and "markets" are illusory, and insofar as the categorical distinctions between "profit" and "social responsibility" are illusory, and insofar as the freedom supposedly at risk is itself illusory, the threat is an illusion.

The illusion of threat provides further evidence for our general thesis that there is a still larger illusion in play. But there is more. It may be that as a consequence of this illusory threat to our illusory freedom, any hope of more meaningful freedom truly is being threatened. Those are the subjects of the next Part.

V. UNVEILING THE TRICK AND THE MAGICIAN

The previous Part went looking for, and claimed to find, numerous signs of illusion that have gone largely unnoticed in the scripts for policy making in general and for corporate law more particularly. This

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410. *See* authorities cited *supra* note 407.

411. *Id.*

412. We do not presume that anyone has been conscious of this strategy and intentionally implemented it. Although it is true that individuals seeking to promote dispositionism are likely to highlight any possible threats, it is also true that individuals perceiving threats are likely to promote dispositionism. Furthermore, those individuals can be one and the same.

There is interesting empirical evidence, by the way, that individuals who embrace conservative world views tend to perceive threats to the system more readily than do individuals with more liberal world views. *See, e.g.*, John T. Jost et al., *Political Conservatism as Motivated Social Cognition*, 129 PSYCHOL. BULL. 339 (2003); *see also* Benforado & Hanson, *supra* note 7 (considering the implications of that evidence for legal theory — particularly the history of law and economics and examining implications of that evidence for dynamics of policy debates).

Part attempts to take some of the conventional arguments behind the dominant meta and macro scripts to their logical conclusion and to identify tilts and tendencies in what we have found. We hope, through the process, to put the pieces back together in a way that better explains the dominant approach to policymaking and that more clearly reveals not only the existence of illusion, but also the magician behind that illusion and its bag of tricks.

A. *Revealing the Basic Tricks*

As we have stressed several times, categories and schemas play a major role in helping us understand our world. As we have also illustrated, however, those same cognitive tools play a major role in distorting what we "know" about our world. One of the central lessons of those examples and of the literature on knowledge structures is that our categories, schemas, and scripts lead us astray by connecting items — concepts, ideas, images, and so on — that should be kept separate and by separating items that are in fact connected.

This Section attempts to reveal some tricks by putting together, or looking for connections between, two scripts that, although they emerge from common origins and bear an unmistakable likeness to one another, have been kept apart in practice. This Section, in other words, explores the implications of assuming, first, that the meta script for policy making and the macro script for corporate law are both true and, second, that those two scripts are connected as two pieces of a larger dynamic.

What would it mean for the macro script of corporate law if the meta script for policymaking were simultaneously taken seriously? The macro script, recall, assumes that nonshareholder constituencies are protected in significant part by regulatory institutions designed with each group's interests in mind.[413] As that script has conventionally unfolded, corporate law scholars have made little effort to determine the efficacy of those regulatory institutions. From the vantage point of the macro script, regulation and the regulatory process are viewed as exogenous and reliable. In short, regulation is good.

Now add the meta script, which takes regulation and the regulatory process as one of its primary focuses. According to the meta script, regulation is actually endogenous: interests compete to determine who among the various regulatory constituents will be served by the regulation and at whose expense. That, recall, was a major insight driving the economics of regulation literature.[414] The

413. *See supra* Part III.B.

414. *See supra* text accompanying notes 100-113; *see also* Press Release, Royal Swedish Academy of Sciences, The Sveriges Riksbank (Bank of Sweden) Prize in Economic Sciences in Memory of Alfred Nobel for 1982 (Oct. 20, 1982), *available at* http://nobelprize.org/

regulatory literature also provides reason to worry that the playing field of competition for regulatory favors is not level and that regulations therefore tend disproportionately and inefficiently to serve the most powerful interests. In short, regulation is bad.

The large literature debating what constitutes "power" in the context of regulatory competition is complex, too vast and intricate to do justice to here.[415] Still, Stigler's important early work on the topic provides some loose but useful starting assumptions. Regulatory institutions tend to be captured by the interests being regulated. That is especially true when those interests are, among other things, narrow, well-financed, and otherwise well-suited for coordinating and cooperating as a group.[416] Based on that presumption, we will now *assume* that the regulated commercial interests will tend to wield greater power than any of the numerous disaggregated constituencies with whom they battle in the competition for regulation.[417]

We are now ready to unveil one of the tricks of the illusion.[418] Place the two scripts side by side and examine them closely. What should be clear is that the meta script's "regulation is bad" element undermines corporate law's macro script, which assumes that "regulation is good."[419] Given that regulation is endogenous to the economic system, and assuming that corporate interests tend to enjoy power advantages over other interests, corporate law scholars cannot justifiably presume that workers will be adequately protected by employer regulations, even though those regulations are ostensibly serving the workers' interests.[420] Neither can they conclude that consumers are well-protected by manufacturer regulations, despite any claims that those regulations are intended to guard the interests of consumers.[421] Similarly, scholars cannot ignore the environment on the grounds that it is well-protected by so-called "environmental" regulations.[422] And

economics/laureates/1982/press.html (explaining that one implication of Stigler's work is that "legislation is no longer an 'exogenous' force which affects the economy from outside, but an 'endogenous' part of the economic system itself") (last visited Oct. 8, 2004).

415. *See* Chen & Hanson, Theorizing Illusion, *supra* note 8 (providing a detailed discussion); *see also* Hanson & Yosifon, *The Situation*, *supra* note 4 (introducing "power economics" and discussing some of the factors that contribute to regulatory power).

416. *See supra* notes 103-111 and accompanying text.

417. We come back to this assumption below.

418. Please lower your expectations; as we noted earlier, discovering the trick behind most illusions is often disappointing. *See* Chen & Hanson, Theorizing Illusion, *supra* note 8, (describing the reactions of audiences when the secrets of magic are revealed).

419. The "regulation-is-bad" script undermines the "regulation-is-good" script, and not the other way around, because the former is based on theoretical and empirical investigation, whereas the former is based merely on assertion.

420. *See supra* Part III.B.2.b.i.

421. *Id.*

422. *Id.*

scholars cannot simply presume that communities and society as a whole will be well-protected against the harms caused by corporations.[423] If we take seriously the basic "regulation is bad" meta script, there is strong reason to presume that those "regulatory" institutions will tend to serve the very institutions that they are supposed to guard against — corporations — and will actually harm, or at least will not as adequately serve, the interests of their purported beneficiaries.

That's the first trick. There are more in this magician's bag.[424] Look again at the two scripts side-by-side, this time focusing initially on the meta script of policymaking. The "regulation is bad" element of that script largely assumes, as was implicit in our review, that the characteristics of competitors are exogenous.[425] An interest — be it an individual, an institution, or a group — is assumed to have either a clear and narrow goal and to be relatively concentrated and well-coordinated, or not (or somewhere in between). Insofar as an interest has such characteristics, it is likely to do well in the competition for regulatory influence. To the extent that it does not, it is likely to suffer in that competition.[426]

But why are those interests assumed to be fixed? If the "regulation is bad" meta script were to take the lessons of the corporate macro script seriously, then it would be clear that those characteristics are themselves endogenous. Market institutions that, owing largely to intense situational pressures, evolve toward an organizational form that is superior to any other for creating and exploiting opportunities for profit[427] would seem certain to gain a distinct advantage in the competition for regulation. By accepting an evolutionary argument, the macro script implicitly accepts that competition influences not only the shape of the product, but also the shape of the producer. And given that there are immense potential advantages to, and profits in, "capturing" various forms of regulation, a market participant's failure to evolve ensures that that institution will "be ground under by competition."

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423. *Id.*

424. Indeed, there are more than we can detail in this Article. For example, the dominant schemas behind corporate law justify ignoring numerous effects that corporations might have on other constituencies or concerns (for example, workers, consumers, creditors, suppliers, communities, the environment, non-human animals, and many institutions and conceptions within our culture) by legitimating those effects. They do so directly by legitimating market outcomes and deligitimating certain types of regulatory interference. And they do so indirectly, inasmuch as they reflect and reinforce the system-legitimating species of dispositionism underpinning almost all policy schemas. *See* Hanson & Yosifon, *Situational Character*, *supra* note 4, *passim*.

425. *See supra* Part II.

426. *See supra* text accompanying notes 100-113.

427. *See supra* text accompanying notes 222-227.

With that trick unveiled, our somewhat tentative assumption above — that corporate interests will tend to win the competition for regulatory influence — gains a much firmer foothold. Corporate interests win in any competition for profits because,[428] more than any other interest on the globe, that is what they have evolved to do.

Those two tricks taken together again reveal, among other things, how our schematic and categorical biases distort our thinking. Despite their many similarities, the two scripts are not only separated in our minds but the conclusions of each are ignored when considering the other. "Regulation is bad" assumes that regulations (and we would add all law and other private and public institutions that might be profitably influenced)[429] are endogenous. But it also assumes that the shape of the participants is exogenous. The corporate macro script, in contrast, treats the form of the organization as endogenous and regulations, as well as everything else around corporations, as exogenous. The failure to treat all institutions as endogenous makes the trick possible.[430] And the source of the tricks is, notice, less the consequence of anyone's conscious intentions and more the result of hidden features of our minds.

That tendency to focalize and to treat institutions and issues as exogenous[431] contributes to still other tricks. For instance, the widely held assumption that contracts work reasonably well assumes that somehow contracting and regulations operate independently of one another.[432] But they do not.[433] The bargaining position of a corporate

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428. We recognize that not all corporations have the same interests of all other corporations. We discuss this point in other work, *see* Chen & Hanson, Theorizing Illusion, *supra* note 8, but for now we'll make three quick assertions. First, corporations have many interests that they more or less share. For those interests, they will be on the same side of the competition. Second, the issues involved in the macro script (e.g., profit versus the environment or profit versus workers) are an example of such interests. And, third, many of those shared interests are also specific to each corporation, and each corporation will have an incentive to promote them, both individually and collectively.

429. *See supra* text accompanying note 325.

430. The human tendency to focus on only a thin slice of an issue or on one or two variables is amplified in economists who tend to place high value on mathematical renditions of policy arguments. The desire for closure, clarity, and mathematical tractability leads to a particularly strong tendency to exogenize. As we've argued, however, tractability has its costs. In Amartya Sen's words:

> The demands of tractability can conflict with those of veracity, and we can have a hard choice between simplicity and relevance. We want a canonical form that is uncomplicated enough to be easily usable in theoretical and empirical analysis. But we also want an assumption structure that is not fundamentally at odds with the real world, nor one that makes simplicity take the form of naivety.

Amartya Sen, *Goals, Commitment, and Identity*, 1 J.L. ECON. & ORG. 341, 341 (1985).

431. *See supra* text accompanying notes 303-309.

432. *See supra* notes 200-207 and accompanying text.

433. *See supra* text accompanying notes 319-326.

constituency will depend immensely on numerous situational forces and conditions, including the laws and regulations governing the relationship between that constituency and corporate interests. Regulations, contracts, and much more will often be intertwined and mutually reinforcing. In light of the fact that corporate interests are generally advantaged in shaping existing regulations (and other situational variables), the contractual landscape will also tend to be tilted to favor corporations. Regulatory capture contributes to what might be called contractual capture.[434]

Thus, one might, as many do,[435] attribute the outcome of labor contracts to little more than the free interactions of workers and employers under a given regulatory environment. But such a dispositionist viewpoint misses the role of laws governing either those contracts locally or similar contracts in other jurisdictions across the nation or globe.[436] Similarly, it misses the influence of workers in the given jurisdiction or in other jurisdictions whose own situations (including regulatory protections) may place them in a relatively feeble bargaining position. Insofar as employers can shape existing laws or the existing labor pool or shop for alternative laws and labor pools, the contracts will favor employers. A potential employer's ability to hire other workers at a lower wage (or at a similar nominal wage with fewer protections or benefits) reduces the ability of existing workers to bargain for more. In that way and others, contracts often reflect situational conditions over which employers and large corporate interests wield disproportionate influence.

A parallel argument can be made for virtually any corporate stakeholder. Inasmuch as large commercial interests are, as we have argued, advantaged in capturing all relevant elements of the situation, they will be more or less successful at promoting situations that maximize corporate profits while minimizing the take of corporate stakeholders. The next section considers that distributional effect.

1. *A Concrete Example of the Basic Tricks*

In revealing the tricks, the previous Section relied on the somewhat generic rendition of the macro script provided in Part III, *supra*. It is illuminating to examine one critical example: Henry Hansmann's superb book on why firms are organized as they are and,

434. Both are just examples of situational or deep capture.

435. *See supra* notes 200-207 and accompanying text.

436. *Cf. supra* text accompanying notes 319-326 (discussing biasing categories of "free markets" and "regulation").

more particularly, why shareholder primacy has emerged as the most prevalent organizational form.[437]

In that book, Hansmann compellingly argues that "over the long run, cost-minimizing forms of organization will come to dominate most industries."[438] That is true both because of the "conscious design and imitation on the part of the entrepreneurs who organize firms" (that is, disposition) and because "higher-cost forms of organization tend to be driven out of business by their lower-cost competitors" (that is, situation).[439] It follows, writes Hansmann, that "[i]f we observe that a particular form of ownership is dominant in a given industry, this is a strong indication that the form is less costly than other forms of ownership would be in that industry."[440] As Hansmann details throughout his book:

> An important reason for the prevalence of investor-owned firms in market economies is that contracting costs for financial capital are often relatively high compared with contracting costs for other inputs — including labor — and for most products. A second reason is that, however poorly situated investors may be to exercise effective control, there are often no other patrons who are in a better position, either because they lack the requisite homogeneity of interest or because they are too transitory and dispersed.[441]

In short, the sum of contracting costs and governance costs tends to be minimized with investor ownership — and that is what makes investor-ownership dominant in most (though not all[442]) contexts.

We do not dispute most of Hansmann's careful analysis or his remarkably wide-ranging evidence.[443] And, with respect to Hansmann's positive or descriptive story, we basically agree with one reviewer, who wrote that "Hansmann succeeds brilliantly."[444] Problems emerge, however, when one places Hansmann's sophisticated version of the macro script for corporate law against the meta script for policymaking. Taking seriously the meta script's presumptions about regulation undercuts Hansmann's assertion that

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437. *See generally* HANSMANN, *supra* note 153.

438. *Id.* at 22.

439. *Id.*

440. *Id.*

441. *Id.* at 296.

442. Much of the power of Hansmann's analysis comes from the fact that the exceptions to investor ownership — for instance, worker ownership or producers' cooperatives — prove the cost-minimization rule. *See id.* at 66-148.

443. Hansmann amasses revealing evidence of varying forms of business enterprise from across industries, nations, and time periods. *See id.*

444. Eric W. Orts, *The Future of Enterprise Organization*, 96 MICH. L. REV. 1947, 1961 (1998) (reviewing HANSMANN, *supra* note 153, and G.P. STAPLEDON, INSTITUTIONAL SHAREHOLDERS AND CORPORATE GOVERNANCE (1996)).

the process he describes leads to, not only the "cost-minimizing" form of ownership, but also to the "form of ownership . . . that is most desirable from a social point of view."[445] It undercuts, that is, Hansmann's foundational normative premise.[446]

To better understand why that is true, note that Hansmann's focus is basically limited to just one dependent variable — the form of "ownership." Like most of us, Hansmann assumes that his vision is not impaired by his narrow focus and that he sees all that he needs to see in order to make an accurate assessment of institutional arrangements.[447] That unconscious tendency to miss features of the situation leaves us largely blind to influences and dynamics that can be more significant than the ones of which we are aware.[448] So it is that Hansmann happens to miss many of the implications of his work.

The same competition that Hansmann so richly elucidates seems likely to influence, not just the form of enterprise ownership, but also the form of all that is mutable and worth competing over — from prototypical regulations to knowledge structures. Insofar as the form of enterprise ownership *does* evolve in response to the "logic of the market,"[449] it will do so in ways that influence the situational variables that Hansmann takes as given.

The assumption that all other variables are fixed by no means reflects, we believe, a deliberate attempt to trick his readers. Far from it. That Hansmann devotes major portions of his book to analyzing how well different types of groups can work together to advance their own interests and how market forces encourage success in that regard, while assuming that "regulation" is independent of that process and essentially good,[450] reveals the biasing power of knowledge structures. The trick is more or less on us all — the unseen consequence of the larger schematic illusions in policymaking scripts. When those illusions are taken seriously and the tricks are observed, it is difficult to

445. HANSMANN, *supra* note 153, at 23.

446. When Hansmann claims that the implicit but powerful competition among forms of organization is "cost-minimizing" or "efficient" he means that it leads "to a situation in which there is no alternative arrangement that could make any class of patrons better off, by their own subjective valuation, without making some other class worse off to a greater degree." *Id.*

447. *See supra* text accompanying notes 305-306.

448. *See supra* text accompanying notes 243-255.

449. HANSMANN, *supra* note 153, at 295.

450. *See, e.g., id.* at 151 ("We see here an important phenomenon that we shall meet again . . . when we examine other industries such as banking and life insurance. Governmental regulation to protect consumers can substantially improve the viability of investor-owned firms in industries where they would otherwise have difficulty competing with consumer cooperatives.").

conclude that existing arrangements are, in fact, the "most desirable from a social point of view."[451]

2. *Refined Evidence of the Tricks*

If the claims made in the two previous Sections are correct, then some interesting predictions follow.

First, consider again the "regulation is bad" element of the meta script. If corporations are indeed changing form to better take advantage of regulatory profits, then corporations should have, over the last several decades, increasingly taken on the characteristics that scholars have identified as effective in that competition. We will not offer a thorough test of that prediction here, but there is one prominent characteristic worth highlighting.

The conventional wisdom among economists, political scientists, public-choice theorists, and other scholars examining regulatory competition is that groups with a single, narrow interest have an important advantage over groups with many, conflicting interests.[452] The single-interest advantage not only assists a competitor in deciding what policy positions to endorse and resist; it also facilitates coordination and cooperation within any group of similarly placed competitors. Thus a group with a single, shared interest will be able to work together more efficiently and to influence regulations more effectively than groups with multiple interests, other things equal.[453]

451. *Id.* at 23. The tendency to exogenize can be seen in many contexts, all of which seem to be mutually reinforcing. It is not just academics who miss the fact that commercial entities will change their form to better exert regulatory influence or otherwise cope with regulatory institutions. Regulators also tend to assume that the commercial entities' form and shape is independent of the regulations. For instance, many regulatory institutions adjust fines or damages according to the wealth of the entity being penalized. The practice spans institutions as diverse as jury-determined punitive damages in tort law to the Environmental Protection Agency's settlement guidelines. *See* DAN B. DOBBS, THE LAW OF TORTS § 382, at 1068 (2001); PROSSER AND KEETON ON THE LAW OF TORTS § 3, at 15 (W. Page Keeton et al. eds., 5th ed. 1984) (describing role of wealth in punitive damage assessments); Mendelson, *supra* note 181, at 1241 & nn.149-52. The common justification for such rules or guidelines is that the survival of an entity should not be unduly burdened by regulatory penalties. *See, e.g.*, Memorandum from Barry Been, Director of Site Remediation Enforcement, EPA, General Policy on Superfund Ability to Pay Determinations 1-2 (Sept. 30, 1997) (explaining that settlements should not place entities under "undue financial hardship"), http://www.epa.gov/compliance/resources/policies/cleanup/superfund/genpol-atp-rpt.pdf (last visited Oct. 8, 2004). A problem with this seemingly sensible rule, as Nina Mendelson has argued, is that firms can, and often do, alter their shape precisely to reduce their perceived "ability to pay." Mendelson, *supra* note 181, at 1241; *see id.* at 1245-46; Lynn M. LoPucki, *The Death of Liability*, 106 YALE L.J. 1 (1996). Again, the tendency to exogenize serves the ends of large corporate interests who can, by moving risky activities to corporate forms with comparatively few assets, externalize costs to potential victims.

452. *See* authorities cited *supra* note 102; *see, e.g.*, OLSON, *supra* note 106, at 48-49; Chen & Hanson, Theorizing Illusion, *supra* note 8.

453. *See* FARBER & FRICKEY, *supra* note 102.

Look carefully. The key regulatory-theory explanation for why some interests are better able to influence regulation than others is identical to "an especially important consideration"[454] that Hansmann offers to explain why investor ownership has become so prevalent and why other forms of enterprise organization have emerged in other contexts. Both boil down to the notion that groups can be more successful when, other things equal, their members enjoy *homogeneous* interests.[455] Hansmann summarizes much of the evidence contained in his book and the seemingly "obvious conclusion" to be drawn from it this way:

> [A]lthough there are hundreds of thousands of firms in the economy, and although these firms exhibit a diverse variety of ownership structures, including a surprisingly large number of firms in which ownership is not in the hands of investors, in virtually all cases the group of individuals to whom ownership is given is extremely homogeneous in its interests. It is extraordinarily rare to find a firm in which control is shared among individuals who have stakes in the enterprise that are at all dissimilar.[456]

With the value of homogeneity of interests in mind, it is illuminating to recall the major shift in corporate practices and corporate law over the past thirty years.[457] Corporations that once had loosely defined ends, including "social responsibility," evolved into entities with a single, shared maximand — profit.[458] Furthermore, as a quick review of Part III will confirm, most of the arguments for shareholder primacy (that is, the macro script) seem to have direct application, not only to the competition for consumers, workers, and capital, but also to the competition for regulatory advantage.[459] In sum, the evolution of the form of enterprises and of corporate practices near the end of the twentieth century represented a transformation of commercial interests from a group of entities with relatively heterogeneous and multiple goals to a group with a shared, single goal. That homogenization occurred both on an intra- and inter-firm basis. Assuming that the conventional schemas are correct,[460] that implies

454. HANSMANN, *supra* note 153, at 288.

455. *Id.*

456. *Id.*

457. *See supra* text accompanying notes 120-158.

458. *See supra* text accompanying notes 152-159. Indeed, according to the macro script, a single-minded focus on profits is — or should be — one of the defining characteristics of corporations. *See supra* text accompanying notes 217-227.

459. *See supra* text accompanying notes 161-231.

460. Some critics of public-choice theory have argued that the basic capture script is inconsistent with the evidence that regulators often make decisions in accordance with their ideology and apparent beliefs about what is in the public interest. *See, e.g.*, Steven P. Croley, *Public Interested Regulation*, 28 FLA. ST. U. L. REV. 7, 29 (2000); Cynthia R. Farina, *Faith, Hope, and Rationality or Public Choice and the Perils of Occam's Razor*, 28 FLA. ST. U. L. REV. 109, 115 (2000). It is true that public-choice models, like all economic models,

that the last several decades has heightened the power of commercial entities — individually and collectively — to advance their interest by influencing other regulatory institutions (defined broadly).

Thus, when Hansmann observes that homogeneity of interests "is evidently a significant factor in the widespread success of the modern investor-owned business corporation,"[461] we can only agree. Unfortunately, though, that is part of the problem. What Hansmann (with Kraakman) has described as the normatively desirable "end of corporate law history,"[462] in which "corporate enterprise [is] organized . . . to serve the interests of society as a whole"[463] appears upon closer inspection to reflect a normatively suspect expansion of corporate power behind an illusion of "aggregate social welfare."[464]

All that leads to a related prediction. If corporate interests are advantaged in the competition for regulation, and if that advantage has been heightened over the last quarter century or so as shareholder primacy has solidified, and if "regulation" is defined broadly, as we have argued it should be, then there should have been growing corporate influence over those regulations in that time period. Again, this is the topic of future work, but we do not believe that many would dispute the proposition that corporate influence has indeed grown immensely in that time period.[465]

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embraced a predominantly dispositionist view of the regulatory process, one in which the actions of "captured" regulators were often described as conscious and intentional attempts to serve their own interests at a cost to the public. The deep capture hypothesis assumes, in contrast, that capture occurs through more or less situational means and that regulators perceive themselves to be acting in the public interest, regardless of whether they are in fact. *See* Hanson & Yosifon, *The Situation*, *supra* note 4, at 206-12. Indeed, that is a belief that most of us are motivated to have about most of our actions. *See* Hanson & Yosifon, *The Situational Character*, *supra* note 4, at Parts III.C.2.b.i & III.C.2.d.i. To satisfy that motive, we seek "reasons" to make sense of our behavior. *Id.* A key role of the schemas we examine in this Article is that they serve that purpose.

461. HANSMANN, *supra* note 153, at 288; *see also id.* ("[A]nd it also appears to be an important reason for the relative paucity of worker-owned firms, which otherwise have some significant efficiency advantages.").

462. *See supra* text accompanying notes 152-155 (summarizing Hansmann and Kraakman's "end of history" argument).

463. *See supra* note 155 and accompanying quotation.

464. *Id.*

465. For a sample of popular books sounding this theme in a variety of contexts, see ERIC ALTERMAN, WHAT LIBERAL MEDIA (2003); CYNTHIA CROSSEN, TAINTED TRUTH (1994); CHARLES DERBER, CORPORATION NATION: HOW CORPORATIONS ARE TAKING OVER OUR LIVES AND WHAT WE CAN DO ABOUT IT (1998); BARBARA EHRENREICH, NICKEL AND DIMED: ON (NOT) GETTNG BY IN AMERICA (2001); ROBERT KUTTNER, EVERYTHING FOR SALE: THE VIRTUES AND LIMITS OF MARKETS (1997); ROBERT D. MANNING, CREDIT CARD NATION: THE CONSEQUENCES OF AMERICA'S ADDITION TO CREDIT (2000); ROBERT W. MCCHESNEY, RICH MEDIA, POOR DEMOCRACY (1999); MARION NESTLE, FOOD POLITICS: HOW THE FOOD INDUSTRY INFLUENCES NUTRITION AND HEALTH (2002); ROBERT G. PICARD, THE ECONOMICS AND FINANCING OF MEDIA COMPANIES (2001); PAULA M. RAYMAN, BEYOND THE BOTTOM LINE: THE SEARCH FOR

Still, we will highlight one example here: corporate law itself. The conventional account of corporate law steers wide of suggesting that corporate law is a regulatory institution. In fact, as we summarized, it is widely understood as "contractual" and "voluntary" — the stuff of markets.[466] Given that categorization, it has been relatively automatic for scholars to assume that corporate law — like markets — are good. Under our definitions (and arguably under theirs), however, "corporate law" is better understood as "regulatory." Whether, for instance, corporations have an obligation to take into account the interests of various constituencies will greatly influence their profits. And corporate law is, also according to conventional wisdom, subject to influence from exogenous sources. If corporate law is understood as a form of regulation, then the "regulation is bad" element of the meta script leads to the prediction that corporate law is itself "captured."

The prediction is easily confirmed by what we have already reviewed. Corporate law *qua* regulation advances the interests of corporations against competing interests by, among other things, endorsing shareholder primacy. And shareholder primacy promotes corporate interests by, among other ways, making corporations more effective competitors for all forms of regulation.

B. *The Disappearing Distribution Trick*

In this Section, we want to reveal a separate but related trick to those identified above. A review of most corporate law treatises and virtually all corporate law scholarship demonstrates that "distributional" considerations are understood to be beyond the scope of corporate law. To those familiar with the legal-academic literature, this is no revelation. Distribution is one of those topics that legal scholars rarely dwell on, except in the occasional articles discussing whether ignoring distribution is appropriate. According to conventional wisdom, legal rulemaking should be concerned solely with efficiency considerations and "distributional" concerns should be addressed through the tax-and-transfer system.[467] In other work, we argue that this general tendency to categorize "distributional" effects as separate from nondistributional effects (usually "efficiency") reflects the influence of the same scripts and biases that we have identified here.[468] Although this is not the place to review that work, it

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DIGNITY AT WORK (2001); ERIC SCHLOSSER, FAST FOOD NATION: THE DARK SIDE OF THE ALL-AMERICAN MEAL (2001).

466. *See supra* text accompanying notes 376-378.

467. *See generally* Chen & Hanson, Distribution Versus Efficiency, *supra* note 10.

468. *See generally id.*; *see also* KENNEDY, *supra* note 320. Occasionally, efficiency-oriented scholars do look at distributional consequences. In a recent work, for instance, Steven Schwarcz implements what he describes as a "balancing test" that would worry about

is worth briefly examining here how corporate law scholars in particular have justified their omission of the distribution question.

Conventional corporate law scholarship is, again, almost devoid of distribution talk. In their book on corporate law, for instance, Easterbrook and Fischel never explicitly broach the topic.[469] As early proponents of the now-dominant macro script, they set the tone for the current discourse by making it clear that corporate law is about maximizing wealth, not distributing it. Those corporate law scholars who have given the topic attention have done little more than to make that position explicit.[470]

Professors Allen and Kraakman, for instance, observe that "the search for efficiency is, and should be, at the core of organizational law"[471] and that "efficiency in the production of wealth [ought to be] the principal standard for evaluating current law."[472] By "efficiency," they mean Kaldor-Hicks efficiency[473] or "wealth maximization," which they rightly emphasize "has important limitations": "[I]t has little to say about the legitimacy of initial distributions of wealth. Additionally, it can be criticized for ignoring the actual distributional consequences of policies . . . ."[474]

So how do corporate law scholars justify ignoring those limitations? The trick — and, here again, we mean the subconscious cognitive trick, not a conscious sleight of hand — is a familiar one. "Distributional" considerations are separate from "efficiency" considerations, and the former is beyond the expertise of corporate law scholars and corporate law. That does not mean that distributional considerations are unimportant or should be ignored. It just means that society should rely on other institutions that are designed to address such concerns.[475] Allen and Kraakman explain:

not just whether a policy was Kaldor-Hicks efficient, but also the extent to which the externalities associated with the policy should be internalized. *See* Steven L. Schwarcz, Collapsing Corporate Structures: Resolving the Tension Between Form and Substance 28-33 (Nov. 11, 2003) (unpublished manuscript) (on file with authors).

469. *See* EASTERBROOK & FISCHEL, *supra* note 180. Nor does Hansmann in his book on the ownership of enterprise. *See* HANSMANN, *supra* note 153.

470. *See, e.g., supra* text accompanying note 202.

471. ALLEN & KRAAKMAN, *supra* note 183, at 7.

472. *Id.*

473. As they describe it, "[A]n act (or a rule) is efficient . . . if at least one party would gain from it after all those who suffered a loss as a result of the transaction or policy were fully compensated" — though actual compensation is not required. *Id.* at 5.

474. *Id.* (emphasis omitted).

475. Actually, Milton Friedman and Friedrich von Hayek do believe that "distributional" considerations should be pretty much ignored altogether — in significant part because they believe the institutions that would attempt to make such determinations lack the information that they would need and would, in the effort, interfere with people's

> Corporation law has been . . . as a field limited to only a slice of the human experience. Thus, legitimate political questions about, for example, the social distribution of wealth fall well outside the competence of corporate law. The laws of taxation, education, environmental and labor policy, product safety, and other issues of health, safety, and welfare address the distribution of risks and rewards in society. Corporate law addresses the creation of economic wealth through the facilitation of voluntary, ongoing collective action.[476]

As that passage illustrates, the conventional script for dismissing distributional concerns is little more than a specific application of the more general macro script used to dismiss all considerations beyond shareholder primacy. Similarly, it is little more than a specific application of the more general arguments used against *ever* considering distributional considerations in legal rulemaking.

There are several things to notice about the disappearing distribution trick. The first is just a restatement of a point we made in the previous Section: if one takes seriously the possibilities that institutions or ideas are subject to competition whenever they might be profitably influenced, and that corporations are highly advantaged in that competition, then one should be extremely skeptical about any claim that the tax-and-transfer system will ensure an appropriate distribution of wealth. The tax-and-transfer system will be heavily skewed to favor those interests with the greatest ability to influence it.

Second, the categorization of policy concerns into separate policy arenas — efficiency pursued through legal rules and distribution pursued through the tax-and-transfer system — is a source of some now-predictable categorical illusions. The categories, for instance, obscure the fact that legal rules have immense distributional consequences. Consider one of the most important defining features of the corporation — limited liability of shareholders.[477] The history of how that feature gradually emerged — it did not spring fully formed upon the arrival of the corporate form — reveals that it was "developed as a broad-based investment subsidy"[478] at the behest of

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freedom. *See, e.g.*, FRIEDMAN, CAPITALISM AND FREEDOM, *supra* note 47, at 161-76; Interview by Thomas W. Hazlett with F.A. Hayek, *supra* note 2.

476. ALLEN & KRAAKMAN, *supra* note 183, at 2; *see also* Friedman, *Friedman Doctrine*, *supra* note 3, at 124 (arguing that the claim of some that corporations should serve social purposes "amounts to . . . an assertion that those who favor the taxes and expenditures in question have failed to persuade a majority of their fellow citizens to be of like mind and that they are seeking to attain by undemocratic procedures what they cannot attain by democratic procedures").

477. *See* Mendelson, *supra* note 181, at 1203, 1208-09 & n.14 (2002) (collecting authorities that emphasize the importance of limited liability to the success of the corporate form over alternative arrangements).

478. Mendelson, *supra* note 181, at 1212.

large industrialists.[479] To be sure, efficiency stories have been offered to justify limited liability.[480] On the other hand, those stories are highly contestable,[481] and, more to the point, there is no denying that the emergence of limited liability had immense distributional consequences. It is not that scholars would, if pressed, deny that legal rules have such effects. The point is that by placing those effects in the "other" category, scholars are not mindful of them in practice. Out of sight, out of mind. Only if the issue is raised need one even access the "tax-and-transfer" defense.

Because distributional concerns are otherwise removed from the cognitive picture, policy analysts do not attend to them or their significance — even when alternative legal rules would have the same "efficiency consequences." If a transaction between A and B will yield gains to trade of $100, no matter who gets the entitlement or how the entitlement is protected, A and B would be primarily interested in the distributional consequences. By not being attentive to distribution, we forget that the As and Bs of the world will be competing for legal rules that favor them distributionally — even when doing so compromises efficiency.[482] Now for the capture script: certain interests will tend to be advantaged in those competitions . . . .[483]

It is wrong and potentially dangerous to assume that "corporate law" and "distribution" belong in separate, independent categories.

That line of argument leads to the prediction that, particularly over the last quarter century, corporations would have been more or less successful at reducing the legal protections and bargaining power of all of the constituencies with whom they compete for distributional shares. Relatedly, it suggests that wealth disparities would have been heightened between, on one hand, corporations and the individuals who exercise the most power over them and, on the other hand, individuals without such influence. We will not test those predictions here; however, a casual inspection of trends in employment law, unionization, tort law, safety and health regulations, wealth

479. *Id.* at 1210-11.

480. *See, e.g.*, CLARK, *supra* note 161, at 8-10; EASTERBROOK & FISCHEL, *supra* note 180, at 40-45. *See generally* Mendelson, *supra* note 181, at 1212-32 (reviewing various justifications).

481. *See, e.g.*, Henry Hansmann & Reinier Kraakman, *Toward Unlimited Shareholder Liability for Corporate Torts*, 100 YALE L.J. 1879 *passim* (1991); Mendelson, *supra* note 181, *passim*.

482. *Cf.* Duncan Kennedy, *Law-and-Economics from the Perspective of Critical Legal Studies*, *in* 2 THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 465, 470-71 (Peter Newman ed., 1998) (summarizing several distribution-based criticisms of law and economics and their importance).

483. *See supra* text accompanying notes 103-112. We suspect that reducing a group's bargaining position in the marketplace will often concomitantly reduce their efficacy as competitors for regulation.

distributions, and so on seem quite consistent with this basic story.[484] We attempt a more systematic examination of distributional trends in subsequent work.[485]

Assuming our description of the tricks and their effects is roughly accurate, the disappearance of distribution from policy analysis further reveals the power of our categorical and schematic biases. As a general matter, most of us tend to believe we are witnessing the workings and outcomes of fair competitions in a legal regime that basically plays no more of a role than an umpire behind home plate. Given that worldview, the winners and losers in our system appear as the winners and losers in that same game — in which, on average, the more talented, harder working, more deserving — in short, the better — team wins. In part because of our categories, distribution is off the table, not because it isn't in play but because it has vanished from our sight. As a general matter, those who are poor deserve to be. And as for those who are rich, "more power to 'em."

C. *Revealing the Magician*

As the smoke obscuring the tricks clears, the once-invisible threads between the macro script and the meta script become clearer still, and the magician, too, comes into focus. That a meta script that maximizes markets and minimizes regulation is good for the collective interests of

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484. For example, data on union membership rates among wage and salary workers document a steep and steady decline in the United States since the 1950s. *See* Richard B. Freeman, *Spurts in Union Growth: Defining Moments and Social Processes*, *in* THE DEFINING MOMENT: THE GREAT DEPRESSION AND THE AMERICAN ECONOMY IN THE TWENTIETH CENTURY 265 (Michael D. Bordo et al. eds., 1998); *see also* DAVID CARD ET AL., UNIONIZATION AND WAGE INEQUALITY: A COMPARATIVE STUDY OF THE U.S., THE U.K., AND CANADA, at tbl.1 (Nat'l Bureau of Econ. Research, Working Paper No. 9473, 2003), *at* http://www.nber.org/papers/w9473 (last visited Oct. 28, 2004) (showing data that unionization rates have declined steadily — from 30.4 percent in 1960, to 26.4 percent in 1970, to 22.2 percent in 1980, to 15.3 percent in 1990, and 13.5 percent in 1999).

Similarly, changes in the "Gini coefficient," which measures income inequality (with a value of 0.0 for perfect equality and 1.0 when one family or household "has all the income and the rest have none"), are also remarkably consistent with the changes in the meta script. *See* ARTHUR F. JONES & DANIEL H. WEINBERG, U.S. CENSUS BUREAU, THE CHANGING SHAPE OF THE NATION'S INCOME DISTRIBUTION 1 (2000) ("With two exceptions, the Gini coefficient decreased between 1947 and 1968.... Since 1968, however, this trend has reversed. Income inequality for families, measured by the Gini coefficient, increased between 1968 and 1998."); *see also* Richard B. Freeman & Lawrence F. Katz, *Rising Wage Inequality: The United States vs. Other Advanced Countries*, *in* WORKING UNDER DIFFERENT RULES 29, 32 (Richard B. Freeman ed., 1994). As Freeman and Katz note:

> In the 1980s overall wage dispersion increased in the United States to levels greater than at any time since 1940. The hourly earnings of a full-time worker in the ninetieth percentile of the U.S. earnings distribution ... relative to a worker in the tenth percentile ... grew by 20 percent for men and 25 percent for women from 1979 to 1989.

Id. For a more detailed examination of those trends, see Chen & Hanson, Distribution versus Efficiency, *supra* note 10.

485. See Chen & Hanson, Testing Shareholder Primacy, *supra* note 12.

corporations is self evident. We've already indicated how the macro script benefits from the meta script, but we believe that the two are mutually reinforcing. The meta script — its success in the marketplace of ideas, such as it is — benefits from the macro script because the macro script empowers corporations in the competition over regulatory institutions and ideas. Put differently, the success of the meta script itself reflects the heightened ability of corporations, owing to corporate law and the macro script, to influence our institutions and ideas (including the meta script itself).

When the dynamics are seen as connected, what once seemed clearly right begins to seem clearly wrong. Milton Friedman writes: "[T]here is one and only one social responsibility of business — to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game."[486] Friedman is missing the tricks: "the rules of the game" are not fixed and independent of what business does; indeed, the Friedman doctrine has given business little choice but to "use its resources and engage in activities designed to increase its profits" by changing the "rules of the game."

So, who is the magician? By now, the question should answer itself. Every element of the meta script and macro script — from "markets good" to "regulation bad" and from "profit good" to "social responsibility bad" — seems designed to maximize and legitimate the power of large commercial interests. Every tension that exists reveals a *tilt* in favor of those interests. Freedom is understood increasingly in terms of our role as "consumers" and our "freedom to choose" whatever products we are willing to pay for. The illusion of freedom and the illusory threat to that freedom favors no group so much as the large corporate enterprises that benefit immensely from our blindness to, and their ability to manipulate us through, the situation. Restrictions to freedom wielded through "lawful" situational forces are ignored. "Regulation" and the process of "capture" is defined to implicate only those institutions that tend to limit the powers of corporate interests. "Distribution" is defined to protect existing, corporate-favoring wealth disparities and the policies that help create them. And the power of markets to shape corporate forms is presumed to stop at the moment the effects would be clearly malignant.

As we emphasized at the outset, the power of magic is less the power of magicians and more the unseen influences over perceptions and behavior. The magician's role is, through trial and error, to discover and perfect means of exploiting those influences. The corporation, and the competitive process that we have perceived as freedom-producing, may be better understood as a freedom-curtailing

486. FRIEDMAN, CAPITALISM AND FREEDOM, *supra* note 47, at 133.

magician. Consciously and, more often, unconsciously, commercial entities alter the situation to their advantage through many of the same invisible processes that we associate with the marketplace.

1. *The Situational Magician*

We must emphasize that the "magician" schema may be as misleading as it is revealing. While it is true that some individuals sometimes deliberately attempt to manipulate other peoples' conceptions and, in turn, their behavior, rarely do those individuals do so in a conscious attempt to advance corporate interests. And rarer still do they do so malevolently. The magician operates off the radar of human consciousness. In that sense, the "magician" we speak of is less the sleight-of-hand artist, whose goal it is to trick people. The winner of the competition for the situation is better understood as a situational magician — a product of the combined effects of the participants in the competition. As we have argued, every relevant portion of the situation will be the subject of competition and capture. Our focus in this project is on the shared schemas within our commercial, consuming, and policymaking systems.

Such shared schemas — that they exist and how they operate — have recently been the focus of a new field of social psychology known as cultural psychology. Culture, according to that scholarship, is defined as

> the set of ideas that coordinate the actions and construct the meanings of a group of people. More often than not these ideas are implicit and automatic, guiding our practices, structuring our institutions, and generally infusing the everyday business of our lives. As people engage with a culture's practices, artifacts, and institutions, their thoughts, feelings, and behaviors come to reflect the culture's values and beliefs.[487]

Embedded as seeming natural elements of our culture, our schemas are easy to miss. Yet they are as powerful as they are invisible, exerting great influence over what we see and how we behave, even at times in which we are most careful in our assessment of the world. The meta script of policymaking and the macro script of corporate law can be understood as "cultural schemas" that serve those cultural actors who can best shape them.

Psychologists have documented the many ways in which culture and our schemas are intertwined.[488] Schemas that seem very natural in

487. Alana Conner Snibbe, *Cultural Psychology: Study in More than the Exotic Other*, 16 AM. PSYCHOL. SOC'Y OBSERVER (Dec. 2003), *at* http://www.psychologicalscience.org/observer/getArticle.cfm?id=1444 (last visited Oct. 11, 2004).

488. *See, e.g.*, Joseph P. Forgas & Michael H. Bond, *Cultural Influences on the Perception of Interaction Episodes*, 11 PERSONALITY. & SOC. PSYCHOL. BULL. 75 (1985); Joseph P. Forgas, *Person Prototypes and Cultural Salience: The Role of Cognitive and Cultural Factors in Impression Formation*, 24 BRIT. J. SOC. PSYCHOL. 3 (1985); Joan G.

one culture are completely foreign in others. Individuals in some cultures, for example, are more aware of the situation, more easily appreciate its influences, and therefore are less likely to miss the situational magician.[489] Individuals primed with the schemas of other cultures, such as our own, are more susceptible to the situational magician's invisible hand — and the trend on that score is not promising. The now-pervasive meta schemas of policymaking and macro schemas of corporate law are likely to make us even more vulnerable over time, fulfilling the very schemas upon which they are based.[490] Those schemas not only influence our behavior; they also legitimate our behavior[491] — for ourselves and others — as well as any bad effects that result.[492]

Thus, the situational manipulation is more complex than we are accustomed to imagining or capable of identifying, at least without looking hard for it.[493] The situational magician can perhaps be best

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Miller, *Culture and the Development of Everyday Social Explanation*, 46 J. PERSONALITY & SOC. PSYCHOL. 961 (1984).

489. *See, e.g.*, KUNDA, supra note 255, at 532.

490. For example, researchers have documented the self-fulfilling behavioral consequences of educational priming in the economic approach to policymaking. Studies have shown that increased exposure to economic training — a process that primes students with "role schemas" infused with expectations of self-interested behavior — results in increased propensity to act out of self-interest and behave noncooperatively. The more individuals had been primed with these schemas, the more their actions conformed to them. *See, e.g.*, John R. Carter & Michael D. Irons, *Are Economists Different, and If So, Why?*, 5 J. ECON. PERSP. 171, 177 (1991); Robert H. Frank et al., *Does Studying Economics Inhibit Cooperation?*, 7 J. ECON. PERSP. 159, 170-71 (1993); Robert H. Frank et al., *Do Economists Make Bad Citizens?*, 10 J. ECON. PERSP. 187 (1996); Gerald Marwell & Ruth E. Ames, *Economists Free Ride, Does Anyone Else?: Experiments on the Provision of Public Goods, IV*, 15 J. PUB. ECON. 295, 309-10 (1981).

491. The primacy of profit and removal of morality is one example of this phenomenon. Acceptance of such a schema makes acceptable the actions of corporate agents who pursue, without regard for others, corporate profits in every field — from consumer markets to lobbying. *See also supra* text accompanying note 208 (describing the RJR Nabisco Chief Executive Officer's view that we "shouldn't be drawing a moral judgment about a business our country says is perfectly legal"). The schema thereby makes capture more palatable and thus more possible.

492. There are a variety of ways in which the schemas of corporate law help us to ignore or legitimate externalities. If, for instance, it is profit-maximizing to pollute and our schemas assure us that other constituencies are adequately protected, then there is little reason to refrain from polluting. If de-beaking chickens is likely to increase profits, and your job is to make a profit, then you do it. If schemas tell you to pursue profit within the law, then it follows that you would even work to change the law and the perceptions of those who apply it. *See, e.g.*, John M. Darley, *How Organizations Socialize Individuals into Evildoing*, *in* CODES OF CONDUCT: BEHAVIORAL RESEARCH INTO BUSINESS ETHICS 13 (David M. Messick & Ann E. Tenbrunel eds., 1996); George Loewenstein, *Behavioral Decision Theory and Business Ethics: Skewed Trade-offs Between Self and Other*, *in* CODES OF CONDUCT: BEHAVIORAL RESEARCH INTO BUSINESS ETHICS 214 (David M. Messick & Ann E. Tenbrunel eds., 1996). This separation of the bottom line from all other considerations allows for greater capture and greater profits.

493. *See* Chen & Hanson, Theorizing Illusion, *supra* note 8 (discussing dispositional and situational magic).

understood as a dynamic amalgam of, among other things, commercial entities intentionally and unintentionally pursuing their shared interests within a system that, with the aid of schemas and categories (1) provides those interests a competitive advantage in influencing that system; (2) denies, ignores, or downplays that advantage in influencing that system; and (3) otherwise legitimates the outcomes of that system. Yet the situational magician has not emerged through some sort of blatant and well-crafted conspiratorial design, but through a process that is better likened to an invisible hand.

2. *The Magician's Invisible Hand*

Ironically, the supposed originator of the invisible hand metaphor, Adam Smith, provides some of the most compelling evidence for the existence of a situational magician. Today, scholars and policymakers who celebrate the wisdom of Adam Smith and his "invisible hand" metaphor appear to have construed his metaphor to confirm their schemas — further evidence of the effects of knowledge structures. But a few scholars and commentators have begun to see another side of the invisible hand metaphor and of Adam Smith's famous work. Jonathan Schlefer calls the "invisible hand" metaphor "one of the most often distorted passages in economic literature."[494] According to Schlefer, the passage "makes Smith sound as if he thought that the invisible hand always leads individuals who are pursuing their own interests to promote the good of society. He did not."[495]

More recently, economic historian Emma Rothschild devoted a chapter of her book to the beginnings of the "invisible hand imagery." According to Rothschild, there are good reasons to believe "that Smith did not especially esteem the invisible hand."[496] By researching the contemporaneous "invisible hand" metaphors that Smith was probably familiar with, Rothschild discovers that they tended to have negative, sometimes gruesome, connotations.[497] Reexamining his work

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494. Jonathan Schlefer, *Today's Most Mischievous Misquotation*, ATLANTIC MONTHLY, Mar. 1998, at 16.

495. *Id.*

496. EMMA ROTHSCHILD, ECONOMIC SENTIMENTS: ADAM SMITH, CONDORCET, AND THE ENLIGHTENMENT 116 (2001).

497. In addition to other evidence, Rothschild points to three examples of the invisible hand that likely influenced Smith's use of the imagery. Describing the first, Rothschild writes:

> The earlier intellectual history of invisible hands turns out to be generally grim. The most famous invisible hand in Anglo-Scottish literature is that of Macbeth's providence. "And with thy bloody and invisible hand," Macbeth apostrophizes the night in Act III, in the scene immediately before the banquet and Banquo's murder; he asks the darkness to cover up the crimes he is about to commit:
>
> Come, seeling night,

with that meaning in mind, she concludes that "[t]he image of the invisible hand is best interpreted as a mildly ironic joke."[498] It is little wonder that the situational magician has been missed. Seeing an "invisible" hand is challenging enough. But because that hand is, through conventional schemas, presumed to be good, we have been primed to see magic where we might otherwise have seen illusion.

No matter what Adam Smith may have intended with his metaphor, those who claim to be his intellectual descendents have ignored one of his strongest admonitions. Smith cautioned that, with the emergence of large, wealthy, and single-minded corporate entities, the invisible hand could be dangerous.[499] Smith lamented the tremendous power of such enterprises and the situational forces to which they were subject, writing that "[n]o other sovereigns ever were, or, from the nature of things, ever could be, so perfectly indifferent about the happiness or misery of their subjects [as] the proprietors of

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> Scarf up the tender eye of pitiful day,
> And with thy bloody and invisible hand
> Cancel and tear to pieces that great bond
> Which keeps me pale.

ROTHSCHILD, *supra* note 496, at 118-19. Rothschild argues that Smith "is likely to have known Macbeth well," having "lectured on Shakespeare's use of metaphor." *Id.* at 119. Similarly, she writes:

> Smith was a great admirer of Voltaire's tragedies, and Voltaire, too, invokes several invisible and disagreeable hands.... In Act IV, Oedipus recounts the memorable day in Corinth when, as he arrived at a temple with offerings to the gods, the altar began to shake, a terrifying voice was carried to him by the winds, and "an invisible hand pushed away my presents."

Id. Third, Rothschild explains:

> There is an earlier invisible hand which is even more unpleasant, and which Smith probably also knew; it appears in one of Ovid's *Metaphorphoses*, in which the hero (the warrior Caeneus, who is at the time surrounded by centaurs, one of whom is taunting him because he had been born a woman, Caenis), "twisted and plied his invisible hand, inflicting wound within wound." The hand is invisible here because it is behind the victim's back; in the edition of Ovid which Smith owned there is an illustration, as a frontispiece to this particular book of the *Metaphorphoses*, of a gloved hand stabbing a soldier between the shoulder blades with a long spear.

Id.

498. *Id.* at 116.

499. *See* L. ROBERT HEILBRONER, THE WORLDLY PHILOSOPHERS 38-39 (1953) (emphasizing Smith's nuanced view of human behavior and the world at large, as evidenced in *The Theory of Moral Sentiments*, published in 1759). When Adam Smith wrote, the prototypical seller was a small merchant who privately owned his own means of production and who looked much like the typical consumer, except for his specialized tools and skills. SMITH, *supra* note 78, at 37. The large corporate form that today is the norm among sellers (at least as measured by percentage of revenues) was barely on the scene. It is for that reason that Smith understood something that seems to have been forgotten since. He saw that the question of whether resources are allocated via markets or regulations was different from the question of whether market actors should be corporations pursuing only profit. But the emergence of entities such as the "East India" and "Hudson's Bay" companies made a strong impression on Smith — and a very bad one. *Id.* at 641, 741-53.

such a mercantile company are, and necessarily must be."[500] Smith accordingly admonished readers to beware the distorting influence of those corporate entities across the socio-economic landscape:

> The proposal of any new law or regulation of commerce which comes from this [mercantile] order, ought always to be listened to with great precaution, and ought never to be adopted till after having been long and carefully examined, not only with the most scrupulous, but with the most suspicious attention. It comes from an order of men, whose interest is never exactly the same with that of the public, who have generally an interest to deceive and even to oppress the publick, and who accordingly have, upon many occasions, both deceived and oppressed it.[501]

Smith's point, as we might make it, is that commercial interests, particularly large corporations, are likely to promote illusion in the form of self-serving laws and regulations disguised as in the public interest. Indeed, according to Smith, such behavior is "necessary," as if profit-maximizing firms are led by an invisible hand to "deceive and even oppress the public."

3. *The Emergence of the Magician*

We have argued that the legitimacy of our system is built upon the credibility and coherence of the meta script of policymaking and the macro script of corporate law.[502] Our hypothesis is that the schemas

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500. SMITH, *supra* note 78, at 752.

501. *Id.* at 267; *see also id.* at 644 ("It is the industry which is carried on for the benefit of the rich and the powerful, that is principally encouraged by our mercantile system. That which is carried on for the benefit of the poor and indigent, is too often, either neglected, or oppressed.").

502. Until now, we have done little to put our arguments in context. In this section, we take a step back to consider the larger situation of the dominant schemas by examining the historical context in which those schemas arose.

But even with that, we are barely scratching the surface of the situation of our schemas. This Article, despite its heft, reflects the cognitive miserliness that hampers most human analyses; it pursues closure within a limited amount of space and time and relies on simplifying — and often oversimplifying — schemas to do so. This section attempts to add a little more context, more situation, and to suggest some of the many ways in which our analysis is still too narrow. The role of schemas is much broader than we've suggested thus far, and there are clearly more schemas and scripts at work than we have thus far identified. Thus, although this Article attempts to add context and situation to the debate over corporate law, it has likely left in the shadows more situations than it has illuminated. Future work — by us and others — will provide further light on aspects of the situation that we have been unable to focus on here.

There are, for instance, numerous schemas and scripts that exert important influences on corporate law that we have not explored in this Article. Consider some of the *complementary legal schemas* that reinforce the schemas we have examined. At the meta level, another key script that helps to inform our approach to all areas of law is the conclusion that legal rules should pursue efficiency, and not distributional, considerations. *See, e.g.*, Louis Kaplow & Steven Shavell, *Should Legal Rules Favor the Poor? Clarifying the Role of Legal Rules and the Income Tax in Redistributing Income*, 29 J. LEGAL STUD. 821 (2000); Louis Kaplow & Steven Shavell, *Why the Legal System is Less Efficient than the Income Tax in Redistributing Income*, 23 J. LEGAL STUD. 667, 669 (1994). That script is quite similar to, and seems to provide independent support for, the other meta script (that markets, associated with efficiency, are good and regulation, associated with distribution, is bad) and the corporate macro view (that corporate law should focus on maximizing wealth, associated with efficiency, and disregard "other" considerations, associated with distribution). We alluded to the existence of such a meta script earlier. *See supra* Section B. Like the "markets are good, regulation is bad" script, the hardening belief that the proper focus of legal rules is efficiency and that distributional considerations are best left to the tax-and-transfer system, has played a pivotal role in influencing our understanding of all areas of law, including corporate law. *See* Chen & Hanson, Distribution Versus Efficiency, *supra* note 10. Seeing shareholder primacy as an "efficiency" consideration, and social responsibility as "distributive," a meta script that counsels a singular focus on "efficiency" is bound to lend credence to a macro script that seems also to adopt such a focus. And that distribution-efficiency lens is only one instantiation of a macro phenomenon we describe below in which our focus in all areas of law has shifted away from seemingly difficult-to-target, complicated considerations for which little consensus exists, and toward more easily targeted and focused maximands. The distribution-efficiency meta script is sure to make the separation of those two types of considerations seem more natural, neutral, and correct, and to legitimize the displacement of more difficult-to-grasp (that is, situational) concerns. *See id.*

Dynamics at the macro level mirror those at the meta level. While the meta script of policymaking has influenced the macro script of corporate law, each likely reinforcing our willingness to accept the other, macro scripts in *other* areas of law also have influenced and reinforced our now-dominant approach to corporate law. For example, at the same time that corporate law's focus has narrowed to shareholder primacy, the schemas of tort law have followed a similar path, reflecting the power of the distribution-efficiency meta script as well as the "markets are good," "regulation is bad" script, and mirroring the narrowing focus on shareholder primacy in corporate law. The dominant approach to tort law now directs a focus on minimizing the costs of accidents and maximizing wealth and the notion that products liability should serve solely the interests of consumers. The "consumer sovereignty norm," as it is commonly referred to, removes from the table many traditional conceptions of justice in favor of a singular focus on seemingly easy-to-target efficiency considerations. *See* Steven P. Croley & Jon D. Hanson, *Rescuing the Revolution: The Revived Case for Enterprise Liability*, 91 MICH. L. REV. 683, 713-67 (summarizing and exemplifying the focus on cost-minimization or wealth-maximization in the products liability debates); Benforado & Hanson, *supra* note 7, *passim* (describing the trend in legal theory away from more situationist, toward more dispositionist, analyses of tort law).

Like the schemas of corporate law and tort law, the schemas of legal ethics over the past three decades have also experienced a revolution. Again there has been narrowing of focus on a single constituency — client interests above all — in place of the difficult-to-see, impossible-to-target moral considerations that once dominated the ethical codes. The elements of the script that have fueled that transformation bear an uncanny resemblance to their counterparts in corporate law. *See, e.g.*, Ronald Chen, Client Primacy, *supra* note 10; Ronald Chen, The Illusion of Ethics: The Legitimating Schemas of Legal Ethics (work in progress) (on file with authors). While our approach to corporate law has surely reinforced our willingness to accept similar approaches in other areas of law, so too have those other approaches reinforced the legitimacy of the "shareholder primacy" macro script. There is much more to say on these topics, but for now our goal is only to emphasize that the dynamic is far more complex, and the situation far more encompassing, than this Article has thus far suggested.

On top of the complementary meta and macro scripts we've just described, there is a more fundamental schema: *dispositionism.* Dispositionism is a self schema (a schema with which we attempt to make sense of ourselves and others) and an attributional schema (a schema with which we make attributions of causation, responsibility, and blame). It presumes that human behavior results from preference-driven, free choices and that outcomes reflect those choices. Dispositionism is at the heart of our legal system and forms the foundation for most laws and legal theories in the United States. For a discussion of dispositionism and some of its influence on laws and legal theories, see Hanson & Yosifon, *The Situation*, *supra* note 4, *passim*; Hanson & Yosifon, *The Situational Character*, *supra* note 4; Benforado, Hanson & Yosifon *Broken Scales*, *supra* note 10, *passim.* The dispositionist view of the human actor is integral to the "markets are good and regulation is bad" meta script and the "profits are good and social responsibility is bad" macro script of corporate law. *See* Hanson & Wright, *supra* note 86.

Another broad category of the situation that this Article has neglected is a group of schemas that we call *metaphorical schemas* — metaphors that have facilitated (or not) our acceptance of both the meta script of policymaking, the macro script of corporate law, as well as many complementary legal schemas. We have already alluded to some of the most prominent metaphorical schemas earlier in this Article. Specifically, we noted how *evolutionary* schemas have bolstered the "markets are good" side of the meta script by drawing upon a positive view of competitions and tournaments and also the way in which the corporate form, as the inevitable outcome of an evolutionary process, was heralded as naturally triumphant in that process.

In other work, we describe in more detail the way in which the evolutionary schema has biased our view of the outcome of competitions over corporate law at the state and global levels. *See* Chen & Hanson, False Starts, *supra* note 29. As that work reveals, those primed with the evolutionary or tournament schemas are more likely to interpret what was once seen as a "race to the bottom" for corporate law as, in fact, a "race to the top." *See id.* But the evolution and competition scripts have many effects on these sorts of debates. For instance, it is easier to accept shareholder primacy as the macro goal of corporate law when we are told that shareholder primacy has emerged victorious following a global competition among numerous competitors. Relatedly, when we conceive of corporations as engaged in a competition or tournament, it is easier to accept the idea that there should be just a single measure of success (like points on the scoreboard or numbers in the win column). In that way, the competition metaphor helps to legitimate single measures of success at every level of law. The competition notion likewise influences our perceptions of the debate itself, priming us to look for a clear winner or loser (for example Berle & Means versus Dodd) between scholars or business forms. The idea that we have reached some "end of history" is itself a manifestation of the notion we have witnessed a competition of ideas, business forms, and laws in which the best form wins.

Other metaphorical schemas abound. In the distribution-efficiency debate noted above, the metaphor of a pie-making — that legal rules should focus on maximizing the size of the pie, while job of slicing it up should be left to the tax-and-transfer system — has a significant influence on how scholars see the issue. *See* Chen & Hanson, Distribution Versus Efficiency, *supra* note 10. Similarly, we have described the role of the *invisible hand* metaphor, just as we have ourselves been promoting our own metaphor of *illusion.* The metaphor of *capture*, likewise, has a long history and is employed on both sides of many debates. And the metaphor of the corporation as a *person* has shaped the corporation and corporate law significantly. These metaphors and many more like them play a more significant role in our thinking and in our laws than most of us realize. *See* Chen & Hanson, *Categorically Biased*, *supra* note 5, at 1211-15.

The role and power of metaphorical schemas, as well as some of the most influential metaphorical schemas, are detailed in the fascinating work of cognitive linguist George Lakoff. Examining the metaphorical schemas through which conservatives and liberals see the world, Lakoff concludes that conservatives tend to see the world through a "Strict Father" model while liberals tend to rely more on a "Nuturant Parent" metaphor. *See* GEORGE LAKOFF, MORAL POLITICS 64, 65, 108 (2d ed. 2002); Jith Meganathan, Judges as Political Actors: Cognitive Linguistic Evidence 21-26 (work in progress); *see also id.* (providing an intriguing application of Lakoff's insights to legal decisionmaking). The Strict Father model — or metaphorical schema — is based on a view that "[p]eople, left to their own devices, tend simply to satisfy their desires. But, people will make themselves do things they don't want to do in order to get rewards; they will refrain from doing things they do want to do in order to avoid punishment." LAKOFF, *supra*, at 67. "Children," the view holds, "must never be coddled, lest they become spoiled; a spoiled child will be dependent for life and will not learn proper morals." *Id.* at 66. Thus, the metaphor of the "Strict Father" who is most effective when he teaches his children through discipline and punishment nicely complements the view of individual choice embodied in the dominant meta script and echoed in the dominant macro script of corporate law.

Not all schemas are *complementary*. Although we have been focusing primarily on the "winning" or dominant participant in the competition for situation, there are schemas of themselves not only reflect the power of the corporate form, but also help to amplify that power. It is, we believe, illuminating to return to the origins of the corporate form and to examine how thoughtful observers reacted to its emergence prior to the creation and wide acceptance of the schemas legitimating its power. Our hypothesis, which already finds some confirmation in a closer reading of Adam Smith,[503] suggests that these observers, uninfluenced by modern schemas, would have been more aware and suspicious of the

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various types that are employed by those who today are critical of the meta script of policymaking and the macro script of corporate law. Indeed, as the historical overview in this section demonstrates, many people throughout history — long before the Doddian view we discussed earlier — held a very different script than the one that dominates today.

Similarly, the schemas supporting the dominant view are not today without challengers. For example, there exist alternative metaphorical schemas that support alternative conceptions of the corporation. The metaphorical view of the government as a Strict Father competes with the Nurturant Parent view. LAKOFF, *supra*, at 64, 65, 108. The latter provides cognitive fuel for critics of the dominant schema by highlighting the role of the parent "to nurture children and to protect children from external dangers." Meganathan, *supra*, at 22. "[U]nlike the Strict Father model — where parents must observe strict noninterference towards mature children — adult children [in the Nurturant Parent model] and their parents retain ties of interdependence." *Id.* at 23. The "ties" are the very responsibilities to "children" that the Doddian view promotes. Thus, just as there are always in existence alternatives to the dominant scripts, so, too, are there likely to exist alternatives to the schemas — metaphorical and otherwise — that support those scripts. The connection of the Strict Father metaphor to dispositionism and the Nurturant Parent metaphor to situationism is explored in Benforado & Hanson, *supra* note 7.

Another metaphorical schema demonstrates the way in which two conflicting schemas may co-exist. Various groups, books, articles, and even movies have promoted and continue to promote to this day the alternative schema, which, at the extreme, likens corporations to an experiment gone horribly awry, a man-made Frankenstein loose on the landscape destroying everything in its path. Drawing upon that metaphor, the script primes us to be concerned about the possibility that big business, which was created by humans, is now beyond our control, and even controls us. That metaphor is central in the documentary THE CORPORATION (Zeitgeist Films 2004), available at www.thecorporation.com. In the legal ethical realm, the alternative script has the Frankenstein, not only running roughshod over society, but devouring lawyers in the process. *See, e.g.*, George W. Bristol, *The Passing of the Legal Profession*, 22 YALE L.J. 590, 613 (1913) ("The lawyer . . . is being devoured by his own Frankenstein."); Ronald Chen, The Illusion of Ethics: The Legitimating Schemas of the Legal Profession (work in progress). Similarly, tort law's critics commonly borrow from the Frankenstein script by highlighting the well-meaning utopian goals of those responsible for expanding tort law and the "out of control" tort system that is now purportedly doing significant damage in our culture. *See* Benforado & Hanson, *supra* note 412.

But the Frankenstein metaphorical schema is also an example of the way in which our schemas are flexible and may be manipulated. For, as the alternative script promoted the idea of the corporation as Frankenstein, the counter script drew upon the same metaphor, transforming the Frankenstein into a misunderstood monster for which our fears were unfounded. The Frankenstein was not, as the critics suggested, a monster devoid of humanity, but was, rather, a "person" with a "soul" — sensitive and compassionate. *See, e.g.*, ROLAND MARCHAND, CREATING THE CORPORATE SOUL: THE RISE OF PUBLIC RELATIONS AND THE CORPORATE IMAGERY IN AMERICAN BIG BUSINESS (1998). Similarly, we have already seen the ways in which the metaphors of *capture* and the *invisible hand* are employed to advance different sides of the same debate. Thus, not only are there competing meta and macro scripts, but there are also contradictory means of applying the same schemas and scripts.

503. *See supra* text accompanying notes 491-495.

situational magician than most legal scholars are today. This Section not only provides some support for that hypothesis, it also suggests some of the situational forces that helped to promote corporate power, even as many influential policymakers expressed concerns and attempted to limit that power.

a. Early American Corporations. The history of the American corporation can be traced back at least as far as old English law.[504] It was the (mostly bad) experience with the English joint stock companies as much as the influence of English laws, however, that shaped how corporations were initially regulated in America.[505]

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504. *See* RON HARRIS, INDUSTRIALIZING ENGLISH LAW 16-17 (2000); Andrew L. Creighton, The Emergence of Incorporation as a Legal Form for Organizations 34 (1990) (unpublished Ph.D. dissertation, Stanford University) (on file with author).

505. Prior to the sixteenth century, the English common law and the King delegated to public institutions the powers of incorporation. Corporations were "quasi-governmental bodies, existing largely independent of the state, with broad political, taxation, and coercive powers." Creighton, *supra* note 504, at 34. By definition, corporations posed a threat to the state's power.

Toward the late sixteenth century, the state centralized its powers, HARRIS, *supra* note 504, at 17, and the King attempted to gain the upper hand on corporations and to exploit their ability to tax by giving himself the sole power to incorporate and control corporations. Creighton, *supra* note 504. The King's goal was to create profit-making entities from which he could derive income so as to "close the gap between [his] declining land revenues and . . . growing military and civil expenses." HARRIS, *supra* note 504, at 41. During this period, the monarchy had lost much of its taxation powers because of reforms based on the principle of "no taxation without representation" (i.e., no taxation without parliamentary oversight). *Id.* The King used his new powers to control and tax previously unregulated companies engaged in foreign trade as well as those he sent to manage persons in foreign lands and colonies. By creating corporations, the King helped to align the economic and political interests of shareholders (usually rich merchants) with the King instead of Parliament. The King exercised control through the use of charters; he used judicial writs to dissolve and forfeit charters if there was any abuse. HARRIS, *supra* note 504, at 18; *see also* Harold J. Laski, *The Early History of the Corporation in England*, 30 HARV. L. REV. 561, 587 (1917) (noting that if the corporations engaged in profit-seeking to the detriment of the public, the King could drag the officers of the corporation to court).

By the end of the sixteenth century, large corporations were in decline as a result of several different factors, including the ability of government to raise income from other sources (e.g., excise and custom taxes), the political wrangling between King and Parliament, the failure to protect the corporate monopolies from competition, and the inefficiencies of monopolies. HARRIS, *supra* note 504, at 50-51.

Just as the number of corporations generally began to decrease, however, a few that held influence over public finance were gaining in power. Those survivors, called "moneyed" corporations, took on national debt in exchange for some of their stock. Frenzied speculation in the stocks of those companies, especially the South Sea Company, inflated a major price bubble. The bubble eventually popped once huge amounts of national debt were held in stock and once investors eventually came to realize that the corporations behind that stock were never going to deliver the sorts of profits originally touted. A brief history of the South Sea Bubble and many stock market crashes since can be found at http://www.stock-market-crash.net/index.htm (last visited Oct. 12, 2004). Connected to those events, Parliament passed the Bubble Act of 1720, which, among other things, prohibited certain "corporate" actions without royal charter. *See* S. Samuel Arsht, *A History of Delaware Corporation Law*, 1 DEL. J. CORP. L. 1, 2 (1976). The Bubble Act led to a decline in the use of corporations for pure profit motives and shifted profit-seeking entrepreneurs to unincorporated partnerships for roughly the next century of British history.

Business corporations did not figure on the Colonial American landscape. The early corporations tended to be devoted to education, trade, land, religious, and military purposes.[506] The rise in business corporations was, in part, a result of the American Revolution, which removed the royal monopolization of incorporation *and* the British corporations' taxation of Americans.[507] A strong distaste for British corporate control united two disparate interests: domestic American businessmen and political activists. The latter perceived "corporate" entities, in general, as a corrupting influence on the British government. The former were less worried about the corrupting influence of the corporations on British policy than they were about the corrupting influence of British policy on traditional business practices. British corporate powerhouses, such as the East India Company, were given special privileges in conducting business in America.[508] The monopolization of the tea trade by the East India Company and excise taxes imposed on the Americans due to the influence of that joint-stock company were some of the most significant mobilizing factors behind the war — as the Boston Tea Party famously illustrates. Political activists and businesspeople[509] alike

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Conventional histories hold that the Bubble Act represented the state's effort to *prevent* regulatory capture by corporations through the stock-for-debt exchange. Historian Ron Harris has recently upended the received wisdom, however, by demonstrating that the Act itself was the brainchild of the South Sea Company, the corporation that, more than any other, stoked the overheated speculation and, thus, inflated the bubble. *See* HARRIS, *supra* note 504, at 68, 77-78 (describing "[t]he third explanation"). Among other methods, the South Sea Company sought to achieve influence by giving stock to many of the King's mistresses. *Id.* at 70. Harris documents the numerous links between the Parliament and the South Sea Company and describes the South Sea Company's "well-planned full-scale operation for manipulating Parliament." *Id.* at 69-70. More specifically, Harris explains how the South Sea Company managed to insert into the legislation clauses designed to protect itself and some of the other major corporations — including several insurance companies and the East India Company. *Id.* at 67. According to Harris, the South Sea Company hoped to corner the "bubble market" and thus prompted the state to regulate the other "smaller" bubbles. *Id.* at 68 ("The South Sea directors believed, justifiably or not, that the 'traffic [in bubbles] obstructed the rise of the South Sea stock.'").

506. HARLAND PRECHEL, BIG BUSINESS AND THE STATE: HISTORICAL TRANSITIONS AND CORPORATE TRANSFORMATION, 1880S-1990S 26 (2000). Two prominent examples are Dartmouth College and the state of Georgia. *See* 1 JOSEPH STANCLIFFE DAVIS, ESSAYS IN THE EARLIER HISTORY OF AMERICAN CORPORATIONS 35 (1917) (discussing the charter for the state of Georgia).

507. Importantly, the American slogan of "taxation without representation" was the main motivation for the British court to authorize corporations that dominated their colonies — the court through corporations could *tax* foreign nationals, like Americans, precisely because they had *no representation* in Parliament.

508. As noted above, the 1720 Bubble Act prohibited certain "corporate" actions from occurring without royal charter. *See supra* note 505. Consequently, American business enterprises were, in effect, prohibited from competing with the English monopolies.

509. During the war, American merchants focused more on aiding the Revolution than they did on profits (though they were to profit handsomely from the demise of British economic control). *See* 1 DAVIS, *supra* note 506, at 394-95; *see also id.* at 371-72 (describing

had something to protest; and, to both, the British corporation comprised a major part of the problem.[510]

The pre-revolutionary experiences and the realization of independence combined to stir a momentous debate over whether to allow incorporation in the newly founded nation. Participants in the Constitutional Convention declined to grant "the explicit power to incorporate" in order to improve the document's prospects of being ratified.[511] And "the torrent of opposition that greeted Congress's incorporation of the first Bank of the United States in 1791 served to establish the *states* as the primary creators of American corporations and as sites where arguments against corporations developed most fully."[512]

Concerns about the potential power of the corporation and the pre-revolutionary experiences remained central in the minds of many of the most influential leaders and policymakers. For instance, in 1817 President James Madison, upon his retirement from office, reflected on the nation's situation during and after the Revolution in an undated essay entitled *Monopolies, Perpetuities, Corporations, Ecclesiastical Endowments*.[513] The essay's main concern was the power of religious corporations to coalesce a majority of persons in efforts to control other smaller religious "corporations" and accumulate massive

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William Duer's corrupt dealings with, and resultant influence over, the Revolutionary government).

510. *See* Andrew J. O'Shaughnessy, *The Formation of a Commercial Lobby: The West India Interest, British Colonial Policy and the American Revolution*, 40 HIST. J. 71, 71 (1997) (noting that the West Indies lobby influenced British policy and war strategy with respect to the American colonies). The coupling of the revolutionary war and its anticorporate message has been repeated throughout American history. *See* Seema Sohi, *The People's Bicentennial Commission and the Construction of the Public Memory*, 10 UVM HIST. REV., Dec. 1999, *at* http://chipmunk.uvm.edu:6336/dynaweb/histrev/hrvol10-/@Generic__BookTextView/712;cs=default;ts=default (reviewing the use of the Revolutionary War as analogy to the 1970s and the rise of large corporations). Franklin D. Roosevelt made the same comparison, stating that:

> It was natural and perhaps human that the privileged princes of these new economic dynasties, thirsting for power, reached out for control over Government itself. They created a new despotism and wrapped it in the robes of legal sanction. In its service new mercenaries sought to regiment the people, their labor, and their property. And as a result the average man once more confronts the problem that faced the Minute Man.

Franklin D. Roosevelt, Acceptance Speech for the Renomination for the Presidency (June 27, 1936), *at* http://www.presidency.ucsb.edu/pppus.php?admin=032&year=1936&id=82.

511. *See* Pauline Maier, *The Revolutionary Origins of the American Corporation*, 50 WM. & MARY Q. 51, 52 (1993).

512. *Id.* (emphasis added).

513. For a history, reprint, and annotations for this essay, see Elizabeth Fleet, *Madison's "Detatched Memoranda,"* 3 WM. & MARY Q. 534, 551 (1946).

economic power in comparison to other institutions such as the state.[514] Madison warned that

> there is an evil which ought to be guarded against in the indefinite accumulation of property from the capacity of holding it in perpetuity by ecclesiastical corporations. The power of all corporations, ought to be limited in this respect. The growing wealth acquired by them never fails to be a source of abuses.[515]

A year earlier, Thomas Jefferson wrote: "I hope we shall . . . crush in [its] birth the aristocracy of our monied corporations which dare already to challenge our government to a trial of strength and bid defiance to the laws our country."[516]

The concerns expressed by those leaders were reflected in the laws of their day. The process of incorporating typically required that "a private bill be introduced in the state legislature, be considered by the legislative committees, pass by both houses, and be signed by the governor.[517] And to achieve that end required making a plausible case that the entity seeking incorporation be one that would serve the public interest. It was in part for that reason, that business enterprises were among the last associations to get incorporated.[518]

b. The Rise of the Modern American Corporation. During the first half of the 19th century, the convergence of two separate groups — merchants and politicians — slowly diverged into pro-charter and anti-charter groups.[519] In the early 19th century, commercial interests

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514. *Id.* at 554-55. His essay analogized corporations to copyrights: a person or group of persons is given the privilege of monopoly by the state in exchange for bringing their invention or services to the public. *See id.* at 551.

515. *Id.* at 556.

516. Letter from Thomas Jefferson to George Logan (Nov. 12, 1816), *in* THOMAS JEFFERSON, 12 THE WORKS OF THOMAS JEFFERSON 44 (Paul Leicester Ford ed., 1905).

517. JAMES D. COX ET AL., CORPORATIONS 29 — 30 (1997).

518. Creighton, *supra* note 504, at 37. As Creighton notes:

> The emphasis on public benefit may account for the order in which charters of incorporation came to be issued: churches and schools are thought to have received incorporation first, then gradually canals and other business organizations of obvious and direct benefit to the public, and finally charters are issued to organizations where the public benefit is more removed and general.

Id. at 38. Businessmen eager to establish some permanency for their private associations and private interests had to frame their enterprise as serving the public even when doing so stretched the meaning of the category considerably. Creighton, *supra* note 504, at 38-39. The framing was simplified inasmuch as lawmakers believed "that they [business corporations] were vital for economic growth." *See* George D. Smith & Davis Dyer, *The Rise and Transformation of the American Corporation*, *in* THE AMERICAN CORPORATION TODAY 28, 37 (Carl Kaysen ed., 1996).

519. *Cf.* Cathy Matson & Peter Onuf, *Toward a Republican Empire: Interest and Ideology in Revolutionary America*, 37 AM. Q. 496 (1985) (describing the "interest" of merchants during the Revolutionary War).

pushed to deregulate the corporate form, citing the need to aggregate capital in order to advance the "progress" associated with industrialization.[520] Consequently,

> the period from 1800 to 1850 saw substantial changes in the law of corporations. From its early form as an ad hoc organization that was as much a vehicle for conferring monopoly privileges on a small group of investors as it was a legal form for conducting business, the corporation evolved into a distinctive entity legally available to all, which could be shaped to suit the needs of particular businesses with few restrictions on entry, duration, or management.[521]

After 1835, numerous states began to permit entrepreneurs to incorporate their businesses through standardized processes. "With the arrival of general incorporation laws, in contrast to incorporation by special act, businessmen could with certainty and efficiency gain the benefits of corporate status for their businesses."[522]

The increasing liberalization of corporate law "did not occur without opposition."[523] President Martin Van Buren, in his first State of the Union address to Congress (1937), expressed grave concerns about the increasing dependence of states on local banks for financing and the growing influence of corporations, mostly banks, over public finance: "I am more than ever convinced of the dangers to which the free and unbiased exercise of political opinion — the only sure foundation and safeguard of republican government — would be exposed by any further increase of the already overgrown influence of corporate authorities."[524] More generally, political commentators worried that the corporate form

> would in time come to dominate the social landscape. This possibility was deeply upsetting to the egalitarian sensibility of the Jacksonian Democrats of the early to mid 19th century. One critic in 1833, for example, published the view that "Against corporations of every kind, the objection may be brought, that whatever power is given to them, is so much taken from either the government or the people... [T]he very existence of monied corporations is incompatible with equality of rights."[525]

520. *See* LEWIS D. SOLOMON ET AL., CORPORATIONS LAW AND POLICY: MATERIALS AND PROBLEMS 5 (3d ed., 1994).

521. *Id.* at 6.

522. COX ET AL., *supra* note 517, at 31.

523. SOLOMON ET AL., *supra* note 520, at 5.

524. Martin Van Buren, First Annual Message (Dec. 5, 1837), *at* http://www.presidency.ucsb.edu/showdoc.php?id=681&type=1&president=8&mth=12 (last visited Oct. 28, 2004).

525. ALLEN & KRAAKMAN, *supra* note 183 (quoting WILLIAM M. GOUGE, SHORT HISTORY OF PAPER MONEY AND BANKING IN THE UNITED STATES 17 (2d ed. 1835)).

Such concerns slowed, but did not stop, the growing power of corporations and the growing liberalization of corporate regulations.[526] With corporations' growing wealth and power[527] came greater corruption. By the 1850s, many large corporations, created in part through federal subsidies, were securing political favors and were frequently caught up in public scandals.[528] Near the conclusion of the Civil War, President Abraham Lincoln, writing to a friend about the trends he had been witnessing, offered this lament:

> [W]e may all congratulate ourselves that this cruel war is nearing its close. It has cost a vast amount of treasure and blood. The best blood of the flower of American youth has been freely offered upon our country's altar that the nation might live. It has indeed been a trying hour for the Republic; but I see in the near future a crisis approaching that unnerves me and cause me to tremble for the safety of my country.
>
> As a result of this war, corporations have been enthroned and an era of corruption in high places will follow, and the money power of the country will endeavor to prolong its reign by working upon the prejudices of the people until all wealth is aggregated in a few hands, and the Republic is destroyed. I feel at this moment more anxiety for the safety of my country than ever before, even in the midst of war. God grant that my suspicions may prove groundless.[529]

The efforts to tame the American corporation continued. For instance, the Sherman Act and rail regulations were passed in the last quarter of the nineteenth century.[530] And in response to concerns that

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526. The debate was partially over schemas. Competing conceptions of corporations as "public" or as "private" had its early beginnings in the early 1800s where laws governing municipalities diverged with laws governing business enterprises. The categories were routinely manipulated by both businessmen and their critics alike. MORTON HORWITZ, THE TRANSFORMATION OF AMERICAN LAW, 1870-1960, at 111-114 (1992). Businessmen, for instance, argued that corporations were public when they needed state protection from "competitive injury," *id.* at 111, and as private when they needed independence from "state interference," 1 DAVIS, *supra* note 506, at 47. Similarly, there were and still are debates about whether the corporation is or is not a "person."

527. *See* MARTIN J. SKLAR, THE CORPORATE RECONSTITUTION OF AMERICAN CAPITALISM, 1890-1916, at 24 (1988). "In 1890, Justice Stephen Field estimated that three-quarters of the wealth of the United States was controlled by corporations." HORWITZ, *supra* note 526, at 71.

528. *See generally* LAWRENCE M. FRIEDMAN, A HISTORY OF AMERICAN LAW 512-13 (2d ed. 1985) [hereinafter FRIEDMAN, HISTORY OF AMERICAN LAW]. For a classic example of this combination of subsidy to, and capture by, corporate interests, see *Illinois Central Railroad Co. v. Illinois*, 146 U.S. 387 (1892), the case in which the United States Supreme Court created the "public trust" doctrine. *But see* Joseph D. Kearney & Thomas W. Merrill, *The Origins of the American Public Trust Doctrine: What Really Happened in* Illinois Central, 71 U. CHI. L. REV. 799 (2004) (offering a fascinating and compelling challenge to the conventional wisdom regarding *Illinois Central*).

529. EMANUEL HERTZ, 2 ABRAHAM LINCOLN: A NEW PORTRAIT 954 (1931).

530. Criticisms leveled against corporations at this time were that monopolistic practices were inefficient and changed patterns in the "distribution of wealth and power." OLIVIER ZUNZ, MAKING AMERICA CORPORATE 1870-1920, at 33-36 (1990). Critics wanted the state

corporations were too often misleading shareholders, the "trust doctrine," which announced management's fiduciary duties to shareholders (and creditors), emerged in various states.[531]

Those attempts to rein in corporations had limited effect, in part because of other factors that heightened corporate power. In 1886, the Supreme Court indicated that a corporation is a "natural person" in the eyes of the U.S. Constitution.[532] That opinion, though ambiguous on its face, was to be interpreted in a way that gave corporations many of the same rights and protections as other natural persons under the Bill of Rights.[533] In the name of "free speech," for instance, corporate persons were given the right to attempt to influence government policies, laws, regulations, and public opinion.[534] In the ensuing years, corporations used that right to lobby state legislatures[535] to loosen the reins further by, for example, eliminating the requirements that corporations serve the "public good," live for a finite period, and not own stock in other corporate "persons," and also by instituting the risk-reducing privilege of limited liability for corporate investors.[536]

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to regain the power to limit and regulate corporate activity through special charters. Naomi R. Lamoreaux, *Partnerships, Corporations, and the Limits on Contractual Freedom in U.S. History: An Essay in Economics, Law, and Culture*, *in* CONSTRUCTING CORPORATE AMERICA 29, 39 (Kenneth Lipartito & David B. Sicilia eds., 2004); *see also* Creighton, *supra* note 504, at 101 (describing study of the content of charters and noting that charters for "for profit" entities more often contained special provisions that limited duration, and details of governance structures.)

531. *See generally* FRIEDMAN, HISTORY OF AMERICAN LAW, *supra* note 528, at 514-17. For an example of this "trust language," see *Upton v. Tribilcock*, 91 U.S. 45 (1875).

532. Santa Clara County v. S. Pac. R.R. Co., 118 U.S. 394 (1886). The significance of this case is detailed in HORWITZ, *supra* note 526, at 66-107. This debate continues today. *See, e.g.*, David F. Linowes, *The Corporation as Citizen*, *in* THE UNITED STATES CONSTITUTION: ROOTS, RIGHTS, AND RESPONSIBILITIES 345 (A.E. Dick Howard ed., 1992) (arguing that corporate personhood means corporate responsibilities as citizens).

533. *See S. Pac. R.R.*, 118 U.S. 394 (1886); *see also* John Dewey, *The Historic Background of Corporate Legal Personality*, 35 YALE L.J. 655 (1926); Morton Horwitz, *Santa Clara Revisited: The Development of Corporate Theory*, 88 W. VA. L. REV. 173 (1985); Harold J. Laski, *The Personality of Associations*, 29 HARV. L. REV. 404 (1916); Arthur W. Machen, Jr., *Corporate Personality*, 24 HARV. L. REV. 253 (1911); Gregory A. Mark, *The Personification of the Business Corporation in American Law*, 54 U. CHI. L. REV. 1441 (1987).

534. *See, e.g.*, J. WILLARD HURST, THE LEGITIMACY OF THE BUSINESS CORPORATION IN THE LAW OF THE UNITED STATES 1780-1970 (1970); David Millon, *Theories of the Corporation*, 1990 DUKE L.J. 201.

535. Or perhaps it is more accurate to say that state legislatures competed with one another to win corporate registrations (and the benefits that accompany them). *See* Chen & Hanson, Legitimating Schemas II, *supra* note 10.

536. For a brief, but illuminating historical overview of how limited liability gradually developed as a defining feature of corporations, see Mendelson, *supra* note 181, at 1208-17. As Mendelson explains, "limited liability for corporate shareholders.... arose separately from and apparently later than the other characteristic corporate features," and "was far from fully established until the early part of the twentieth century." *Id.* at 1209, 1211 (citing HORWITZ, *supra* note 526, at 94). Consistent with our story, Mendelson points out that, although the trend toward limited liability was justified as a means of encouraging the

Again, the growing power of corporations occurred despite serious fears on the part of many policymakers and commentators about the potentially harmful effect of corporations. As legal historian Lawrence Friedman explains, "[t]he triumph of the corporation as a form of business was neither painless nor noiseless."[537] Grover Cleveland, in his State of the Union in 1888, reacted with fear to the Supreme Court's actions in *Santa Clara County v. Southern Pacific Railroad Co.*[538] and the growing power of corporations:

> As we view the achievements of aggregated capital, we discover the existence of trusts, combinations, and monopolies, while the citizen is struggling far in the rear or is trampled to death beneath an iron heel. Corporations, which should be the carefully restrained creatures of the law and the servants of the people, are fast becoming the people's masters.[539]

So what explains the increasing laxity of corporate regulation and the ultimate "triumph of the corporation"? Probably the most significant forces contributing to the transition of the American corporation have been the dynamics of federalism and the need felt by certain individual states for financial relief, particularly following the Civil War.

The Civil War, after all, wreaked havoc on many Northern state budgets, which had been drawn down to advance the Union cause. As states began looking and competing for ways to raise funds, several came to see that they could, in effect, sell laws to corporations.[540] New Jersey's legislature fast became a leader in that competition by

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"'small-scale entrepreneur' and companies with public functions," *id.* at 1210, it was "large-scale industrialists [who] pressured the political process for limited liability." *Id.* at 1210-11 (citing Phillip I. Blumberg, *Limited Liability and Corporate Groups*, 11 J. CORP. L. 573, 592-93 (1986)).

537. FRIEDMAN, HISTORY OF AMERICAN LAW, *supra* note 528, at 171.

538. 118 U.S. 394 (1886).

539. Grover Cleveland, Fourth Annual Message (First Term) (Dec. 3, 1888), *at* http://www.presidency.ucsb.edu/showdoc.php?id=731&type=1&president=22&mth=12 (last visited Oct. 28, 2004). He said right before this quote:

> We discover that the fortunes realized by our manufacturers are no longer solely the reward of sturdy industry and enlightened foresight, but that they result from the discriminating favor of the Government and are largely built upon undue exactions from the masses of our people. The gulf between employers and the employed is constantly widening, and classes are rapidly forming, one comprising the very rich and powerful, while in another are found the toiling poor.

Id. He was worried about the capture of corporations on institutions and the increasing plight of the unemployed and rising poverty levels.

540. CHRISTOPHER GRANDY, NEW JERSEY AND THE FISCAL ORIGINS OF MODERN AMERICAN CORPORATION LAW 23, 25 (1993); *see also* FRIEDMAN, HISTORY OF AMERICAN LAW, *supra* note 528, at 524-25 (noting that New Jersey incorporated 1366 corporations just in the first six months of 1866, including the most notorious corporations such as the "Whiskey Trust").

charging corporations — including those whose economic base was outside of the state — a chartering fee to incorporate in New Jersey. Of course, New Jersey was not getting something for nothing. To attract buyers, the New Jersey legislature promulgated particularly liberal corporation laws and lowered the hurdles to groups who wished to obtain a corporate charter.[541] The effort paid off, as New Jersey quickly became a favorite place for businesses to incorporate.

It is worth noting that, although the New Jersey legislature passed the requisite enabling laws, the actual innovator was James Brook Dill, an ex-counsel for Standard Oil, who had strong financial dealings with the New Jersey administration.[542] Equally influenced by corporate interests and similarly in need of funds,[543] Delaware soon rose to challenge New Jersey.[544] New Jersey blinked when its Governor, Woodrow Wilson, pushed through more restrictive corporation laws on his way to the White House.[545] In his Inaugural Address, Wilson noted:

> If I may speak very plainly, we are much too free with grants of charters to corporations in New Jersey.... I would urge, therefore, the imperative obligation of public policy and of public honesty we are under to effect such changes in the law of the State as will henceforth effectually prevent the abuse of privilege of incorporation which has in recent years brought so much discredit upon our State.[546]

New Jersey's temporary withdrawal from the corporate-law competition launched Delaware into the lead, where it remains today without meaningful rivals.[547]

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541. GRANDY, *supra* note 540, at 43. These "general incorporation laws" allowed any group to obtain a corporate charter, so long as they fulfilled certain minimal requirements. *See* Lamoreaux, *supra* note 530, at 33.

542. GRANDY, *supra* note 540, at 40. Horwitz tells a similar story. Several corporation lawyers connected with Cromwell's firm "were among those active in the drafting of this amendment," and, as Alfred D. Chandler has written, "[t]he New Jersey legislature quickly obliged." HORWITZ, *supra* note 526, at 83.

543. Members of the DuPont family were delegates to the constitutional convention and executives held positions on important committees. PRECHEL, *supra* note 506, at 38.

544. GRANDY, *supra* note 540, at 79 (explaining how small states close to capital markets such as New Jersey and Delaware were attractive states because they depended so heavily on corporations for revenue that they were "held hostage" to the corporations).

545. *Id.* at 81-84. As Grandy notes, under the "tutelage of Louis Brandeis," Wilson's position on corporations changed when campaigning for the presidency. During his governorship, he was against the managerial excesses of corporations (the *agency problem* argument); while during his presidential campaign, he was against the "monopolistic practices of firms" (the *efficiency, anticompetition* argument).

546. *Id.* at 81.

547. Some believe Delaware's dominance is the desirable outcome of a neutral "market" and "federalist" experimentation. We take up that argument and the larger "race to Delaware" debate in work now in progress. *See* Chen & Hanson, False Starts, *supra* note 29.

In 1933, Supreme Court Justice Louis D. Brandeis summarized the history of the American Corporation this way:

> The prevalence of the corporation in America has led men of this generation to ... accept the evils attendant upon the free and unrestricted use of the corporate mechanism as if these evils were the inescapable price of civilized life and, hence to be borne with resignation. Throughout the greater part of our history a different view prevailed. Although the value of this instrumentality in commerce and industry was fully recognized, incorporation for business was commonly denied long after it had been freely granted for religious, educational, and charitable purposes. It was denied because of fear. Fear of encroachment upon the liberties and opportunities of the individual. Fear of the subjugation of labor to capital. Fear of monopoly. Fear that the absorption of capital by corporations, and their perpetual life, might bring evils .... There was a sense of some insidious menace inherent in large aggregations of capital, particularly when held by corporations. So, at first, the corporate privilege was granted sparingly; and only when the grant seemed necessary in order to procure for the community some specific benefit otherwise unattainable. The later enactment of general corporation laws does not signify that the apprehension of corporate domination had been overcome.... The general laws, which long embodied severe restrictions upon size and upon the scope of corporate activity, were, in part, an expression of the desire for equality of opportunity.[548]

According to Brandeis, the law was often liberalized to advance corporate interests, not for lack of concern, but rather for lack of *meaningful choice*.[549] The relaxation of corporate restrictions was based on the "conviction that it was futile to insist on them; because local restriction would be circumvented by foreign incorporation."[550]

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548. Louis K. Liggett Co. v. Lee, 288 U.S. 517, 548-49 (1933) (Brandeis, J., dissenting). Brandeis elaborated the corporate limitations as follows:

> Limitations upon the amount of the authorized capital of business corporations was long universal. The maximum limit frequently varied with the kinds of business to be carried on ....
>
> ....
>
> Limitations upon the scope of a business corporation's powers and activity were also long universal. At first, corporations could be formed under the general laws only for a limited number of purposes — usually those which required a relatively large fixed capital, like transportation, banking and insurance, and mechanical, mining, and manufacturing enterprises. Permission to incorporate for "any lawful purpose" was not common until 1875; and until that time the duration of corporate franchises was generally limited to a period of 20, 30, 40, or 50 years. All, or a majority, of the incorporators or directors, or both, were required to be residents of the incorporating state. The powers which the corporation might exercise in carrying out its purposes were sparingly conferred and strictly construed. Severe limitations were imposed on the amount of indebtedness, bonded or otherwise. The power to hold stock in other corporations was not conferred or implied. The holding company was impossible.

Liggett, 288 U.S. at 550-56 (footnotes omitted).

549. *Cf. supra* Part IV.C.4.

550. *Liggett*, 288 U.S. at 557.

From the perspective of any given state, it was better to give corporations what they wanted and try to keep them in-state, than to have them achieve the same ends elsewhere. Situation, not free choice, dictated the outcome.[551]

That legal trajectory, in the face of widespread anxieties, became the wellspring for some of the most famous legal-academic debates of the twentieth century — debates that were fundamentally about the proper purpose, not just of corporations, but of corporate law in general. That is where Adolph Berle picked up the discussion and where, particularly when Milton Friedman joined the debate, the corporate commentators began to lose sight of the situational magician.[552]

D. *Protecting the Illusion and the Magician*

With those claims about the illusion, the tricks, and the magicians in place, it is revealing to return to Friedman's seminal argument for shareholder primacy. As it turns out, he provided important clues at the outset that, indeed, the macro script was offered as an illusion to be employed by the magician.

Friedman, recall, begins his analysis by claiming that the then-prevalent Doddian notion that businesses owe a responsibility to society was perilously wrong. The undemocratic misuse or theft of shareholder assets in the name of "social responsibility" poses an immense threat to our social freedoms. Of course, any such threat to shareholders is only as significant as it is feasible. So it might seem that Friedman's concern was based on an underlying belief that directors had actually been misusing shareholder property. But look closer.

Scrutinizing Friedman's entire argument, one discovers that the purported threat is, according to Friedman, mooted by the various

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551. *See* Chen & Hanson, False Starts, *supra* note 29 (discussing the situational influence of the race for corporate chartering); *see also* Mendelson, *supra* note 109, at 1232 n.115 (providing situational reasons why limited liability might be the dominant approach, even if not the most efficient — e.g., conformity with other states; collective action problem stemming from fact that benefits of corporations tend to be internalized to state while costs are externalized; corporate/shareholder interests better represented than potential tort victims in competition over regulation).

552. In fact, it had begun well before then. Brandeis's critical assessment was exceptional even then. By the 1890s, corporations were widely understood as having a personal *right* to incorporation and a *right* to personal wealth. And, thus, the seeds of shareholder primacy and the meta scripts of the late twentieth century were taking root. *See* HERBERT HOVENKAMP, ENTERPRISE AND AMERICAN LAW: 1836-1937, at 33 (1991) (quoting Christopher Tiedeman who wrote in 1900 that "an act of incorporation simply guarantees to the incorporators the right to act and do business as a corporate body, subject, of course, to the laws of the land, and the legitimate control of government"). And so it was that President Coolidge noted in the 1920s that "[t]he business of America is business." Carl Kaysen, *Introduction and Overview*, *in* THE AMERICAN CORPORATION TODAY 3 (Carl Kaysen ed., 1996).

situational forces that constrain the decisions of corporate directors. As Friedman puts it:

> [W]hether he wants to or not, can he get away with spending his stockholders', customers' or employees' money? Will not the stockholders fire him? (Either the present ones or those who take over when his actions in the name of social responsibility have reduced the corporation's profits and the price of its stock.) His customers and his employe[e]s can desert him for other producers and employers less scrupulous in exercising their social responsibilities.[553]

In other words, Friedman, given his view of markets, ultimately concedes that managers have no choice but to maximize profits. A manager is not "free to choose" social responsibility, or at least not more than once. The situation of markets eliminates that freedom.[554] Thus it is here that Friedman's argument begins to reveal some of its deepest tensions and flaws — and, in that way, provide its clearest confirmation of our law-as-illusion hypothesis. If managers cannot, in practice, pursue "socially responsible" policies that are not simultaneously profit maximizing, then why is Friedman so upset?

The claim that boards are making "undemocratic" (non-profit-maximizing) policies fails for several reasons. First, board decisions cannot be, according to Friedman's logic, undemocratic. After all, directors were voted into office by the shareholders, and any decision that shareholders don't like will be the basis of the directors' "firing." So there *is* a democratic process in place, according to Friedman, that reveals shareholder consent to existing policies.[555] Indeed, that fact should lead Friedman to conclude that the talk of "social responsibility" and the investments made by corporate directors purportedly to advance that interest *must* be efficient, as proven by the fact that the directors, who made those goals explicit, are still in office! Second, Friedman's own logic shows why any policy that is not

553. Friedman, *Friedman Doctrine*, *supra* note 3, at 122.

554. *See supra* text accompanying notes 370-391 (discussing illusion of freedom).

555. One might argue that Friedman meant by "democratic" to exclude arrangements that are nongovernmental. He does, at one point, go out of his way to emphasize that governmental arrangements are carefully designed to serve social welfare: "The imposition of taxes and the expenditure of tax proceeds are governmental functions. We have established elaborate constitutional, parliamentary and judicial provisions to control these functions, to assure that taxes are imposed so far as possible in accordance with the preferences and desires of the public." Friedman, *Friedman Doctrine*, *supra* note 3, at 122. But such an argument would contradict Friedman's primary views, which see governmental institutions as second-best options to markets. Here, the fact that the market has generated a voting mechanism for shareholders and that, in addition, shareholders have the option to exit by selling their shares would seem to make clear that shareholder democracy is more reliable than its governmental counterpart. Friedman certainly provides no reason to think otherwise. Furthermore, the basic claim that governmental institutions and policies are based on reasonably reliable attempts to satisfy the "preferences and desires of the public" flies in the face of a basic presumption of Milton Friedman and many who accept the neoliberal script that government policies fail miserably at that task.

profit maximizing will be disallowed by other situational (that is, market) forces, assuming shareholder disapproval is not enough.

Now we know that Friedman is upset about, not the practice, but the preaching of social responsibility. Since the "preaching" does no real direct harm to shareholders, and indeed can be to their benefit, we cannot help but wonder what is bothering Friedman. His worry cannot be with managerial discretion — there is none. What really seems to be troubling Friedman is that "influential and prestigious businessmen" speak publicly about "the nonsense" of social responsibility.[556] The problem is not that corporate decisionmakers will use their position to pursue the public interest at a cost to shareholders. The problem is that the accepted script, which businesspeople use in the belief "that they are defending free enterprise,"[557] suggests that the unbridled pursuit of profit may be bad for society. Such speechifying, Friedman stresses, has the exact opposite effect, threatening "the possible survival of business in general"[558] and encouraging the extension of "the political mechanism to every human activity."[559] His concern, then, is that the script might not be in the interests of the magician.

Friedman's primary audience, it seems, is not corporate law scholars or policymakers, but the businesspeople who are spouting this dangerous antibusiness script. Friedman's principal purpose is to admonish them to be less "short sighted[]"[560] and to work more effectively toward their collective, long-term (that is, macro) interest:

> This [talk of social responsibility] may gain [businessmen] kudos in the short run. But it helps to strengthen the already too prevalent view that the pursuit of profits is wicked and immoral and must be curbed and controlled by external forces. Once this view is adopted, the external forces that curb the market will not be the social consciences, however highly developed, of the pontificating executives; it will be the iron fist of Government bureaucrats. Here . . . businessmen seem to me to reveal a suicidal impulse.[561]

So, let's review. In response to the argument of many businesspeople that business might have an obligation to "social ends," Friedman argues that their only obligation is to maximize profits within the laws and that doing otherwise is "unadulterated socialism," because they are spending shareholder money without shareholder consent. But, because markets would punish, and

556. Friedman, *Friedman Doctrine*, *supra* note 3, at 124.

557. *Id.* at 33.

558. *Id.* at 124.

559. *Id.* at 126.

560. *Id.* at 126.

561. *Id.* at 126.

shareholders would oust, managers who were not maximizing profit, Friedman's real concern is not that directors would actually attempt to serve the public interest. Rather, he believes that by accepting the then-conventional corporate-responsibility script (of the sort that Dodd advanced), businesspeople were legitimating governmental intervention in private affairs. Friedman is thus concerned foremost with the power of scripts and importance to business of adopting a script that is in their shared interest[562] — that is, one that would maximize markets (or "the invisible hand") and minimize regulation (or the "iron fist").

In other words, Friedman was advising business leaders that their livelihood, like that of professional magicians, depends on creating and maintaining illusion.[563] As this Article helps demonstrate, they have heeded that advice. And that is the problem. As Friedman himself elegantly warns: "We have been forgetting the basic truth that the greatest threat to human freedom is the concentration of power, whether in the hands of government or anyone else."[564]

VI. Conclusion

As this Article suggests, the revolution of ideas that has shaped policymaking and corporate law in recent decades reflects the predictable outcome of a predictable competition over schemas. Recognizing this, the words of Adolph Berle seem eerily prophetic, providing a fitting summary, as well as a sense of the enormity of what our schemas and scripts have accomplished. In 1965, not long before the revolution of ideas would capture the minds of policymakers, Berle wrote the following about corporations:

> [W]henever there is a question of power there is a question of legitimacy. As things stand now, these instrumentalities of tremendous power have the slenderest claim of legitimacy. This is probably a transitory period. They must find some claim of legitimacy, which also means finding a

562. Note that here Friedman seems to be conceding that the laws are not exogenous, but are, in fact, influenced by something as abstract as "rhetoric." His real point is, like ours, that scripts matter a great deal in policy analysis and policymaking. And, in the end, he has not made an argument that social interests should not be taken into consideration at all. Indeed, he emphasizes that that is a job for government to pursue through it policies. Ultimately, he is complaining, not about the practice of corporate social responsibility, but the rhetoric of corporate executives that might make governments more willing to pass laws that harmfully interfere with corporate interests (even though passing such laws is, according to Friedman, the proper domain of government). *See supra* text accompanying note 171.

563. In such a way, Friedman was serving the same function as the World Alliance of Magicians. *See* Chen & Hanson, Theorizing Illusion, *supra* note 8 (discussing efforts by the World Alliance of Magicians (WAM) "to preserve the wonder and amazement of the Magical Arts for the general public, to protect the secrets of the magic profession from exposure and to reinforce the positive contributions of the Magical Arts to society.").

564. FRIEDMAN & FRIEDMAN, FREE TO CHOOSE, *supra* note 46, at 309.

> field of responsibility and a field of accountability. Legitimacy, responsibility, and accountability are essential to any power system if it is to endure. They correspond to a deep human instinct.[565]

With new schemas and scripts, the transitory period is now complete. The battle has been won; the war of ideas is over. Or at least that's the way some experts see it. As Hansmann and Kraakman recently pointed out, the dominance of the macro summary script of corporate law is evident in its

> acceptance by a worldwide network of corporate intermediaries, including international law firms, the big five accounting firms, and the principal investment banks and consulting firms — a network whose rapidly expanding scale and scope give it exceptional influence in diffusing the standard model of shareholder-centered corporate governance.[566]

That once revolutionary schemas and scripts now seem so natural, even obvious, is a testament to the power of illusion. And the fact that this illusion has so long been mistaken as magic is a testament to the power of the situational magician. This Article should serve as a warning to all of us that, rather than marvel at the converging approaches to policymaking and corporate law, we should be suspicious of them. As Berle understood, "whenever there is a question of power there is a question of legitimacy." This Article has pursued that question and found, not magic, but the illusion of law.

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565. A.A. Berle, *Economic Power and the Free Society*, *in* THE CORPORATION TAKE-OVER 86, 98-99 (Andrew Hacker ed., 1965).

566. Hansmann & Kraakman, *supra* note 152, at 449.