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COMMENT

ETHICS, ECONOMICS, AND INSIDER TRADING: AYN RAND MEETS THE THEORY OF THE FIRM

JONATHAN R. MACEY*

INTRODUCTION

The practice of insider trading has been met with excoriation by members of the legal community, who view it as a paradigmatic case of the unethical abuse of power by corporate officers and directors. Those of us who pray for a less impassioned and more focused treatment of the subject have ridiculed the shallowness and the moral fervor of the majority, who Mr. Lawson in his article The Ethics of Insider Trading describes succinctly as "foot-stampers." ¹

It has long been thought that one way to focus the insider trading debate in a more constructive way would be for a serious scholar to treat the ethical dimensions of the subject in a meaningful way. Such a treatment would bring the issues into sharper focus and quell the empty emotionalism that appears to drive the current debate. Unfortunately, insider trading is a surprisingly difficult subject area within the realm of corporate law, and ethical philosophy is not the simplest field of study either. Combining the two, which was Mr. Lawson's task, is an extremely ambitious undertaking. As Mr. Lawson points out, he is the first even to make the attempt. For this he is to be congratulated. But what Lawson has shown here, I think, is the close relationship between ethics and economics to any analysis of insider trading. His failure to come to terms with the ethical implications of the impressive economic literature on insider trading is a deep flaw in his effort.

Economists, and those interested in law and economics, have made great strides in applying economic principles to the legal

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issues that surround insiders' trading activity. Much of their work addresses the question of whether insider trading hurts or harms firms, shareholders, markets, or economies. Thus in a very real sense, the utilitarian aspect of the ethics of insider trading already have been exhaustively canvassed. As I will explain later, in my view the attempt to critique insider trading using ethical philosophy—divorced from economic analysis—is something of a non-starter, because ethical theory does not have much to add to the work that has already been done by economists.

Thus, in some sense, I suppose Mr. Lawson has given us about all we can expect from a writer on this subject—an interesting and provocative essay. Unfortunately, what is interesting and provocative about his essay has less to do with the specifics of insider trading than with such larger questions as whether the concepts of private property can be legitimated. While ethical theory has a lot to say about the legitimacy of private property, it is not entirely clear that the debate among philosophers differs from the debate among economists, except in the vocabulary used by the respective disciplines. Indeed, Mr. Lawson's article is strongest when it confirms the conclusions of economists. In those areas where Mr. Lawson's arguments find themselves in real or imagined conflict with economic efficiency notions, his ethical theory becomes obscure.

Mr. Lawson is amazingly kind in his treatment of the many earlier writers who ignore economic theory and decry insider trading on the simple basis that "it's just not right." He claims that it is not fair to criticize such people for these sorts of assertions because constructing fully developed, internally coherent moral theories is not easy to do, and proving such theories may well be impossible. On this basis Mr. Lawson rather patronizingly declares that until greater minds offer the current genera-

tion of theoreticians something more helpful, it is unfair to criticize the embarrassingly bad quality of the existing scholarship on the ethics of insider trading.

Mr. Lawson's gentle treatment of the foot-stampers is unwarranted. The current scholarship that decries insider trading as "unfair" completely lacks reasoned argument. Often those who brand insider trading as unfair do not even attempt to explain what insider trading is, much less why it is unfair. Mr. Lawson strives to bring the debate out of its current antediluvian state by organizing a useful taxonomy that describes the core premises of those who are railing against insider trading. Using this taxonomy, Mr. Lawson finds three distinct sets of moral objections to insider trading. Unfortunately, he too fails to provide a precise definition of the term "insider trading," and this shortcoming severely limits the usefulness of his taxonomy.

The kindness shown by Mr. Lawson to the moral apologists for insider trading rules reflects a deeper flaw in the article. Most of the scholarship that attempts to label insider trading as unethical is based simply upon ideology, not ethical philosophy. Mr. Lawson does not adequately recognize the distinction between ethical theory and ideology, and as a result often confuses the two. His proposed organizational framework itself relies upon the ideology of Ayn Rand to classify all theories as either "altruistic" or "egoist." The influence of Ms. Rand's teachings upon Mr. Lawson's analysis makes it difficult to understand what, if anything, his article has to offer for those who do not share his faith in her belief system.

Another shortcoming in Mr. Lawson's article is that it assumes, without any explanation whatsoever, that there is, or at least may be, a conflict between the outcomes generated by an analysis of insider trading based on natural rights and an analysis based on efficiency notions. This faulty assumption results in needless quibbling between Mr. Lawson and writers in the law and economics movement whose work precedes his own.

Finally, Mr. Lawson's effort to clarify the ethical dimension of the insider trading issue suffers from not recognizing the basic economic principles that underlie many of the concerns about insider trading. As a result, he fails to address some of the stronger justifications for the arguments he condemns.

The remainder of this Comment explores each of the shortcomings I have identified and discusses why moral theory is un-
likely to offer much hope for resolving the issue of whether, not to mention how, to regulate insider trading. As I have argued elsewhere, the phenomenon of insider trading is simply another instance, and not even a particularly special case, of the larger set of issues that fall under the general heading topic of property rights in information. While ethical theory has much to say about property rights, it is really the wrong tool to use on the problem of insider trading, since there is nothing special about the ethics of insider trading. Ethical questions regarding how to allocate the rights to use valuable corporate information simply do not differ from ethical questions regarding how to allocate the rights to other assets.

I. ETHICS VS. IDEOLOGY IN THE DEBATE AGAINST INSIDER TRADING

It is not difficult to confuse ethical judgments with ideological beliefs. Indeed, in close cases the distinction is quite subtle. At the extremes, however, the analysis is easy. Ethics has to do with the establishment of individual, moral standards of conduct. The goal of ethical theory is to arrive at clearly delineated moral standards from carefully constructed premises, which themselves are subject to justificatory critique. Ideology, on the other hand, is merely a descriptive term for the prejudices of a particular class or group that are reflected in their doctrines and opinions. While ethical theory starts from the bottom and seeks to construct a set of principles from first premises, ideology starts at the top with its conclusions and proceeds downward to justify these results on sociological, cultural, psychological, or epistemological grounds. While

5. Karl Marx and Friedrich Engels were the initial proponents of this approach.
6. Examples of the cultural, sometimes called "psychocultural," approaches to ideology are contained in the work of Clifford Geertz and Leon Dion:
   Our hypothesis is that political ideology is a cultural and mental complex which mediates between the norms associated with given social attitudes and conduct and the norms which the political institutions and mechanisms tend to crystallize and propagate. In other terms, political ideology is a more or less integrated system of values and norms, rooted in society, which individuals and groups project on the political plane in order to promote the aspirations and ideals they have come to value in social life.
Dion, Political Ideology as a Tool of Functional Analysis in Socio-Political Dynamics: An Hypothesis, 25 Canadian J. Econ. Pol. Sci. 47, 49 (1959); see also Geertz, Ideology as a Cultural
ethical theory seeks to ground moral judgments on carefully constructed logical hypotheses, "[i]deology is an emotion-laden, myth-saturated, action-related system of beliefs and values about man and society, legitimacy and authority, acquired as a matter of routine and habitual reinforcement."9

Mr. Lawson fails to recognize that when commentators such as William Painter, Louis Loss, and Ralph Nader decry any and all forms of insider trading, they are not advancing any theory at all, much less an ethical theory. Rather, they are condemning insider trading on the basis that it is antithetical to a set of cultural norms that were acquired through routine and habitual reinforcement, and therefore are nothing more than ideologically-based belief systems. Professor Painter is particularly honest about the origins of his beliefs regarding insider trading. He scoffs at moral philosophy,10 choosing instead to ground his arguments purely in emotional terms.11 Indeed, in a triumph of anti-intellectual sophistry over reasoning and analysis, he defends arguments against insider trading on the grounds that they contain elements of “simplicity and immediacy which make up for their lack of theoretical respectability”12

Far from objecting to such anti-intellectualism, Mr. Lawson actually refers to such ramblings as “fair” questions with which all “legal scholarship must, at some point, come to grips.”13 Because the vast majority of Mr. Lawson’s essay is a critique of the existing moral notions about insider trading, he ultimately ends up doing more to legitimize these empty ideas than to expand our understanding of insider trading.

7. Needless to say, the leading proponent of the psychological approach to ideology was Freud, who expounded the view that ideological is “essential to man’s psychological well-being as well as to the continuity of culture,” Rejai, Ideology, in 2 DICTIONARY OF THE HISTORY OF IDEAS 552, 557 (1979).
8. Etienne Bonnet de Condillac is “widely acknowledged as the founder of [this] school of ideology.” See id. at 553.
9. Id. at 558. See also R. GUESS, THE IDEA OF A CRITICL THEORY 4-12 (1981).
10. But, after all, what is morality? Attempts to provide a “rational” foundation for moral judgments have a way of being unconvincing. The whole philosophy of ethical judgments has a pedantic quality which escapes the ordinary individual who merely stamps his, or her foot and declares, inarticulately that “I don't care, it's just not right.”
11. “Even if the content of moral statements be primarily emotive, which is doubtful, a satisfactory morality must be emotionally satisfying . . . .” Id.
12. Id. at 159.
13. Lawson, supra note 1, at 775, 776.
Mr. Lawson thus appears to have exceedingly low standards for what constitutes ethical theory. It is therefore not surprising that he weaves his ideas rather confusingly throughout a discussion of the writings of others instead of expressing his own ideas about the ethics of insider trading in any systematic fashion.

Taken as a whole, what emerges from Mr. Lawson's effort is an analysis, albeit a highly inconclusive one, based on classical egoism, which he summarizes in a sub-section titled "An Egoistic Interlude." Egoism is the belief, which Mr. Lawson traces back to the classical Greek tradition of eudaimonism, that the individual's highest moral calling is to himself. In essence, it seems, the egoist's moral calling in life is to "identify that human excellence that is distinctively his own—that is, his daimon—and the principles of conduct that will allow him to develop that excellence and flourish as a person." Unfortunately, of course, because "each person has unique potentialities that, in the particular circumstances in which he finds himself, ought to be actualized if he is to flourish as a person," it is not possible to construct any universally applicable principles of moral conduct. Thus, to mention but a few, Aristotle and Hegel are out, and Kant and Hume obviously are out also. Locke should be out too, but for some reason he is not.

Mr. Lawson's idea is that most of the criticisms of insider trading are, in the final analysis, grounded on notions of altruism and are therefore unacceptable. Mr. Lawson finds it important to rehabilitate egoism because of the lack of good argument in favor of altruism. This line of reasoning has two

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14. Id. at 747. At one point Mr. Lawson includes a Lockean theory of insider trading, which I discuss in the following section. See id. at 763-69. Because Mr. Lawson believes that "something like a Lockean... approach flows from eudaimonism [classical egoism]," id. at 768, little is lost by not treating his Lockean arguments here.

15. Id. at 748.

Because of the highly individualistic nature of egoism, this belief system does not provide an acceptable basis for actually solving moral problems. The reason is that such problems characteristically involve conflicts of interest; the moral problem is to provide a fair solution. Imagine a judge deciding a case in a particular way on the ground that the outcome promotes her (the judge's) best interest! Egoism can be saved from irrelevancy only if it can be shown to require acts and decisions that involve a due concern for others. I am grateful to David Lyons for this point.

16. Id. at 748.

17. Id. at 749.

18. See infra notes 30-46 (discussing application of Locke's work to insider trading).

19. Lawson, supra note 1 at 747.
flaws that relate specifically to the insider trading debate.

First, as Mr. Lawson himself at times seems to recognize, there may not be a conflict between egoism and altruism. Egoism at least pretends to concern itself with individual flourishing, not simply short-term wish fulfillment at the expense of others. To say that someone is an egoist does not necessarily mean that he is not altruistic, particularly if altruism is the means through which he best can flourish. Indeed if one's "unique potentialities" are altruistic in nature, then the tenets of egoism and altruism would dictate the same conduct.

Second, and perhaps more importantly, it is not clear precisely what egoistic theory implies for insider trading besides a seemingly absurd result. If we take Mr. Lawson's suggestion seriously and look at the insider trading controversy by invoking an egoistic ethic, the analysis becomes virtually comic. Mr. Lawson appears to say that the egoist who finds himself in possession of material, non-public information about a particular firm must decide whether trading on the basis of that information is "self-fulfilling," that is, whether it "will allow him to develop . . . and flourish as a person." Mr. Lawson defends this position against the straw-man argument that self-fulfillment is a better guide to human action than peer pressure. The more difficult question is whether self-fulfillment is a better guide to human action than one's own sense of individual duty and moral responsibility.

Frankly, the unrefined argument that acquiring money is good is not really worthy of discussion, because all sides—yes, even the egoists—agree that there is a significant difference between making money in some wealth-creating activity like investment or entrepreneurship and making money by stealing it. The only moral (or economic) question worth asking is where insider trading lies along the continuum that runs from wealth creation to theft. Mr. Lawson does nothing to help us sort this out. Similarly, Mr. Lawson explains that refraining from insider trading might be a good idea if one has agreed not to engage in insider trading prior to disclosure, or if failure to disclose prior to trading would "seriously damage someone of

20. Id. at 751-52.
21. See id. at 748.
22. See id. at 762 (The statement that "Theft is wrong" is "as close to an uncontroversial moral proposition as one is going to get").
But these are precisely the situations that those of us who have been engaged in the study of insider trading have been studying. What constitutes an “agreement” not to engage in insider trading? Is such an argument an implicit part of every manager’s employment agreement? And if it isn’t, why not?

The freedom given to corporate officers and directors as a manifestation of the separation of ownership and management in the large, publicly held corporation, makes contractarian analysis of insider trading issues very difficult. Reasonable people, who agree on a wide range of corporate law matters, divide on the seemingly intractable issue of how to allocate the privilege to trade on material, non-public information.

As Mr. Lawson himself appears to suggest at various points in his article, “[t]he moral inquiry with respect to insider stock trading thus centers on where the network of contracts between the firm and its shareholders, suppliers, lawyers, accountants, investment bankers, printers, and so on, places the right to trade on the information.” This is a point that has been made both implicitly and explicitly by many, including myself. But it is not at all obvious what this inquiry has to do with egoism—or with altruism for that matter.

To take a very simple example of the difficulty of determining whether a particular corporate act is consistent with ethical norms, suppose we observe a Harvard law student leaving Langdell Hall late one snowy evening. Shrouded beneath his parka is an electric typewriter that belongs to the law school. Is the student doing anything wrong in removing this typewriter? The answer depends on whether someone with legitimate authority (that is, the owner of the typewriter or his agent) has given the student permission to take the machine. The analysis

23. Id. at 752.
24. Frank Easterbrook has been particularly alert to this problem. See Easterbrook, Insider Trading as an Agency Problem, in PRINCIPALS AND AGENTS: THE STRUCTURE OF BUSINESS 81-98 (Pratt & Zeckhauser eds. 1985).
25. Compare Easterbrook, supra notes 2 and 24, with Carlton & Fischel, supra note 2.
26. See, e.g., Lawson, supra note 1, at 767-73.
27. Id. at 766.
28. See Carlton & Fischel, supra note 2; Haddock & Macey, A Coasian Model of Insider Trading, 80 NW. U.L. REV. 1449 (1986); Macey, supra note 2.
29. Mr. Lawson tells us that the contractarian approach to insider trading finds its intellectual roots in Locke. See Lawson, supra note 1, at 769. Having said this, he then asserts that “something like a Lockean approach flows from eudaimonism [classical egoism].” But he declines to tell us how or why this connection is made.
is the same for traders who use inside information. In the first step of the analysis we invoke Locke to determine who has legitimate ownership rights over the relevant information. If it is the person trading in the information, there is no ethical problem whatsoever: We are simply observing a person making proper use of his assets. So, for example, there is no ethical issue when a tender offeror purchases stock in a target company before disclosing his plans to the target’s shareholders. The tender offeror, as the creator of the news that there will be a tender offer, is the rightful owner, according to a Lockean analysis, of this information. 30 The problem arises when the person trading on the information is not its rightful owner. In such a case, we must first determine whether the trader has the actual or implied authority of the owner to use the information before we can know whether or not his actions are ethically justified. Thus, as is explored more fully below, the dichotomy between efficiency principles and the ethical norms implied by natural rights analysis is a false one.

II. NATURAL RIGHTS VS. EFFICIENCY

In an earlier article I argued that inside information was an economic asset not unlike other intangible assets such as patents and trade secrets. 31 I argued that Locke’s work could provide the analytical framework under which the property rights in material, nonpublic corporate information could be allocated. The basis for invoking Locke was my belief that applying his theory for allocating property rights would lead to an efficient system of legal rules that maximized social welfare. A Lockean allocation of property rights in inside information maximizes societal welfare, in my view, because it lowers the costs of doing business for certain firms, thus benefitting shareholders, 32 and also because it creates incentives for individuals and firms to use resources efficiently. 33

Mr. Lawson does not like my efficiency-based approach to Locke. He claims that even though the analysis reaches conclu-

30. Macey, supra note 2, at 28 n.98 (“because a corporation that makes a tender offer expends great resources to do so, information that a target company is an appropriate target may be said to exist in a ’state of nature,’ to use Locke’s analysis”).
31. See Macey, supra note 2. As used here, inside information refers to any information not already reflected in the price of the firm’s stock.
32. See Haddock & Macey, supra note 28.
33. Macey, supra note 2, at 32.
sions that are quite close to his own, such an approach would, in effect, deny to the individual the central ethical role in his own life. Mr. Lawson is creating a controversy out of whole cloth, because he does not analyze whether there is a conflict between natural rights analysis and the economic goal of attaining efficiency. Instead, he blithely assumes away the most interesting philosophical question of the entire debate, which revolves around whether such a conflict exists.

By asserting that if there is a conflict between natural rights and society’s welfare, so much the worse for society’s welfare, Mr. Lawson saves himself the trouble of having to consider whether the natural rights basis of the Lockean proviso in fact differs from the efficiency based approach to property rights issues. Contrary to Mr. Lawson’s unsupported assertion that the “conceptual difference” between a Lockean approach and an efficiency-based property rights approach is “enormous,” the better argument seems to be that the difference between the two approaches is non-existent.

As is well known, it was Locke’s view that rightful acquisition of unowned property (such as material non-public information about a particular firm) takes place when a person mixes his labor with the property. There is no controversy at all that this aspect of Locke’s theory of property is consistent with efficiency notions. Wealth is created when human resources are devoted to improving the natural endowment in such a way that others are willing to pay to acquire these improvements. The willingness to pay leads to mutually consensual transactions that improve the welfare of the contracting parties, and, ultimately, of society as a whole. Awarding property interests to those who make such improvements—that is, to those who mix their labor with unowned property—provides them with the incentive to create wealth.

The trouble arises when we consider the so-called “Lockean Proviso” which appears to limit the acquisition of unowned

34. Lawson, supra note 1, at 751-52.
35. Id. at 770.
36. Id. (claiming that economically based allocations of property rights “are not Lockean even in the loosest sense of that term”).
37. As Geoffrey Miller has pointed out, “the Lockean Proviso . . . has a function not unlike the role of certain efficiency criteria in modern economic thought.” Miller, Comment: Economic Efficiency and the Lockean Proviso, 10 HARV. J.L. & PUB. POL’Y 401, 411 (1987).
property to those cases in which, after the acquisition, “there is enough, and as good left in common for others.”38 As Geoffrey Miller has shown in a carefully reasoned essay, however, “[T]he Lockean proviso is not violated if someone takes [an asset] out of the commons in excess of his or her pro rata share, so long as the benefits to others resulting from the excess . . . being placed in productive use exceed the value of the excess land which is taken.”39

It is easy to see why there is harmony between the Lockean Proviso and economic efficiency since market economies require those who acquire new assets to leave “enough and as good” for others by paying for the property. Taking assets out of the state of nature is thus consistent with the Lockean Proviso if doing so makes at least one person better off and no one worse off than they were before the exchange was made.40 The danger that Mr. Lawson sees in placing too narrow a focus on economic efficiency thus seems misplaced.41

Having considered and rejected Mr. Lawson’s warning that there may be hidden inconsistencies between economic efficiency and Locke’s understanding of natural rights, we return to Mr. Lawson’s equally important, but equally unsupported, declaration that “something like a Lockean . . . approach flows from [classical egoism.]”42 Notwithstanding this assertion, there are deep inconsistencies between Locke’s ideas about the basis of natural rights and the ideas that Mr. Lawson presents as classical egoism.

At the outset, it is not clear why an egoist is comfortable with Locke’s notion that one must mix his labor with unowned property before claiming it for his own. For the egoist, the only prerequisite should be whether acquiring the property would be necessary or useful for one seeking “to develop . . . excellence and flourish as a person.”43 Indeed, because any consideration of the welfare of others in society is anathema to the egoist, it is difficult to imagine any justification for placing any restraints

38. J. Locke, Two Treatises of Government 329 (P. Frasleit ed. 1698).
40. Id. at 410.
42. Lawson, supra note 1, at 768.
43. See id. at 748.
on an individual’s removal of unowned property from a commons.

Of course, the Lockean Proviso, which constrains those who would remove property from a commons by forbidding such removals unless there is “enough and as good left for others,” presents even more severe problems for the egoist. Why should the egoist, who cares only about his own self fulfillment, be concerned with whether there is anything left for others after his taking?

The gulf between Mr. Lawson’s egoism and the conception of property rights that is shared by Locke and by efficiency based economists is deeper than even these two examples indicate. At their core, efficiency based justifications of property rights are based on concerns about social welfare. Indeed the whole concept of Pareto optimality, which is a fundamental component of efficiency, is predicated on the idea that, to be efficient, an economy must allocate resources in such a way that no change in allocations will make anyone better off without making another worse off. Unlike the economist or the Lockean, the egoist is decidedly uninterested in a system of social ordering that contains such decidedly universalist requirements. Similarly, the economic abhorrence of waste, which is shared by moral theorists like Locke, has no special place within the moral framework of the egoist. If being wasteful is important for a person to “actualize his unique potentialities,” then waste is O.K.

Finally, contrary to Mr. Lawson’s assertions, egoism can not be reconciled with natural rights analysis for the same reason that egoism can’t be reconciled with any rights theory based on uniform treatment of moral actors. Namely, the egoistic belief that it is impossible to specify a precise content for a classical egoist ethic, because each person has unique potentialities that ought to be actualized if he is to flourish as a person. As such, it seems to me that any natural rights theory is bound to be inconsistent with Mr. Lawson’s egoism, since such theories are likely to intrude on someone’s notion of self-fulfillment.

At bottom, the Lockean approach and the economic approach justify themselves on the benefits they hold for society

44. J. Locke, supra note 38, at 332, 335-38 (arguing that waste is contrary to the laws of nature).
45. Lawson, supra note 1, at 749.
as a whole. Adam Smith’s invisible hand justifies market processes on the grounds that such processes guide societal resources to their most highly valued uses, and thereby increase overall welfare. But, once again, in sharp contrast to egoism, the justification for private ordering comes from a societal rather than an individualistic perspective. Similarly, as John Sanders has pointed out, Locke’s theory for allocating property rights to private individuals is based on the goal of furthering overall human welfare.46

Thus, it seems to me that Mr. Lawson has it backwards when he says that there is an analytic gulf between economic theory and Lockean ideas about property rights, but no such chasm between the egoistic ethic and the principles of Locke. In fact, it seems clear that, while Locke’s ideas are fully consistent with Adam Smith (not to mention Chicago-school welfare economics), there is a strong tension between the ideas of Locke and the principles of egoism.

III. THE ARGUMENTS THAT LAWSON CONDEMNS

Mr. Lawson finds three sets of moral objections in the litany of arguments against insider trading. He addresses these objections from an egoistic perspective. I will argue that, in those places that his analysis furthers our understanding of the ethics of insider trading, it is because it intersects at these particular junctures with standard economic analysis. Incoherence comes when his analysis strays from the efficiency criterion familiar to the economist.

A. Absolute Equality

Into Mr. Lawson’s first category fall those who argue that it is always immoral for a trader to take advantage of an informational advantage over his trading partner, regardless of how he obtained the advantage. Mr. Lawson argues that the problem with the absolute equality argument is that it is based on altruism: Those in possession of information someone else does not have must give it to the other person before “taking advantage” of that person in a market transaction. I disagree. One

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could be an ardent believer in altruism and still reject the idea of absolute equality among trading partners.

As Mr. Lawson seems to recognize, informational advantages provide the motivation for important aspects of almost every transaction in a market economy. Virtually every plumber, builder, lawyer or doctor who charges for his services is profiting from an informational advantage he enjoys over his trading partner. To forbid such trading would deprive people of the incentive to learn the skills necessary to become proficient at these trades and professions. Similarly, to require stock traders to disclose any informational advantage to their trading partners would deprive such traders of any incentive to expend the resources necessary to discover undervalued or overvalued firms. The discovery of such incorrectly valued assets benefits traders because they can profit by trading in the underlying stock. The discovery also benefits society as a whole because it drives capital to its highest valued uses, thereby increasing societal wealth.

Altruistic policy-makers, who by definition are desirous of policies that increase the wealth of others, will want to encourage the production of valuable information about corporations in order to improve the operation of the capital markets. They will do this by permitting people to profit on the information they discover. Thus I agree with Mr. Lawson that the ethical argument in favor of complete informational equality is non-existent. But the flaw in the fairness-as-equality argument is not that it relies on altruism, but that it makes investors worse off than they would be under an alternative arrangement as a group and therefore cannot be justified on altruistic grounds.47

B. Equal Access

In an early and influential article, Victor Brudney argued that the crucial ethical issue in the insider trading debate concerns the question of unequal access to inside information rather than unequal possession of inside information.48 His is an in-


teresting and important argument that deserves to be taken seriously. Much to his credit, Mr. Lawson handles this issue extremely well, but his response to Professor Brudney is purely economic. There is not a hint of egoism in it. Mr. Lawson correctly points out that Judge Easterbrook has gone a long way towards answering Professor Brudney’s equal access argument by pointing out that access to a particular piece of information is a function of the cost of obtaining such information.49 In other words, smarter people or people who have invested resources to develop their human capital in such a way as to better assimilate information, or corporate officers and directors are always going to have superior access to information. As Judge Easterbrook points out, the resulting inequality of information is a consequence of the division of labor and cannot really be said to be unfair.50

With Judge Easterbrook, Mr. Lawson concludes that unless one can argue that it requires no skill or diligence to become a corporate insider or to acquire enough funds to purchase information, the distinction Professor Brudney offers is not particularly promising.51 This is a good application of Judge Easterbrook’s point, and once again, Mr. Lawson deserves credit for his invocation of this insight. But the argument does not appear to have anything to do with the concept of egoism. Rather, like much of Judge Easterbrook’s work, the argument is couched in a decidedly economic framework. It is based on the economic notion that society benefits if we provide people with the incentive to develop the attributes and skills necessary to become corporate insiders. It has nothing to do with egoism.

C. **Insider Trading and Property Rights in Information**

The final ethical argument Mr. Lawson identifies as bearing on the issue of insider trading concerns the subject of property rights in information. As I have previously observed, the burgeoning literature on property rights contains the best reservoir of information about the advantages and disadvantages to society of permitting insider trading in its various forms and permutations.52

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49. Lawson, *supra* note 1, at 756-57.
52. See Macey, *supra* note 2.
Frankly, it is difficult to tell precisely what Mr. Lawson thinks about the utility of a property rights oriented approach to the insider trading problem. First Mr. Lawson states that the proposition that "it is morally wrong to trade on information that does not belong to you . . . is as close to an uncontroversial moral proposition as one is going to get."\(^{53}\) So far so good. But next, Mr. Lawson breaks from his earlier analysis by refusing to concede that it is necessarily morally right for someone to trade on the basis of information that does belong to him.\(^{54}\) Why not? From a legal or an economic perspective, the whole point of assigning somebody a property right in an asset is to permit that person to put it to use. Usually the best way to use information about the future price performance of a particular stock is to trade the stock. And the only justifiable reason to forbid one from using his property in the way he wants is if the use creates a negative externality by causing a noncompensable harm to others.\(^{55}\) Mr. Lawson is unwilling, however, even to concede that property owners have the right to select among the various noninvasive uses of property rights.\(^{56}\) Because Mr. Lawson does not elaborate upon this rather surprising remark, one can only wonder what he has in mind. In what sort of situation would it be morally wrong for the owner of a bit of information to trade on such information in a noninvasive manner? I can think of none.

Mr. Lawson appears to recognize that the moral inquiry with respect to insider trading centers on where the web of contracts between the firm and the network of people, including shareholders, with whom the firm has relationships assigns the right to trade.\(^{57}\) He ignores, however, that this analysis presumes that those people who control the property rights to insider information may alienate it. If they can alienate it (presumably to somebody who plans to use it), why can they not use it themselves without violating any moral principle?

Mr. Lawson's endorsement of the property rights orientation

\(^{53}\) Lawson, supra note 1, at 762.

\(^{54}\) Id. at 753.

\(^{55}\) Often the harm is compensable. When it is, the owner of the asset must gauge whether this particular use of the asset brings him benefits that outweigh the cost of the use, including the cost of compensating third parties for the harm he has caused them.

\(^{56}\) "A [classical egoist], at least, while perhaps not wishing to deny a person the legal right to trade on his information, would hardly say that any noninvasive use he chooses to make of it is morally right." Lawson, supra note 1, at 783.

\(^{57}\) Id. at 764.
to insider trading is rather half-hearted. He states that the "problems with the Lockean property rights approach, whether based on Lockean principles of acquisition or on first possession, are legion."\(^{58}\) In particular, he is unsure why we do not "assume that all assets, including all persons and their talents, skills, and efforts, constitute a common fund."\(^{59}\) Economic theory contains answers to all of Mr. Lawson's questions. For example, the well-known tale of the Tragedy of the Commons explains the problems inherent in communal ownership of property.\(^ {60}\) If every member of a community has unlimited access to the resources of the community, then the community's resources soon will be used up unless they happen to be available in infinite supply. The system of private ownership of assets, by contrast, effectively can use the price system to ration the assets in such a way as to preserve them properly and to benefit all members of the community.\(^ {61}\)

IV. CONCLUDING COMMENT: THE ECONOMICS OF THE ETHICS

Upon close inspection, the moral questions that Mr. Lawson poses melt into economic questions. As Lloyd Cohen has pointed out, the economic concepts of efficiency and social wealth maximization are not only consistent with our moral intuitions, but also with Kant's decidedly altruistic notion that one should not act in such a way that would be objectionable if it became a universal practice.\(^ {62}\) The point is almost tautological. If, somehow, a natural rights analysis assigned the property interest in a particular asset to a person who was not the highest valuing user of that asset, in a world in which exchange is possible, that person would sell the asset to the person who valued it more highly. The tough ethical issues lie when one is called upon to decide how initial entitlements should be distributed. Once this is done, it is difficult to find an ethical quarrel with a system of transferring assets based on mutually consensual exchange.\(^ {63}\)

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58. Id. at 768.
59. Id.
63. See Haddock & Macey, supra note 28.
Thus, it appears to me that Mr. Lawson's article is the intellectual equivalent of a sound and light show at Disneyland. It is a fun excursion, presenting us with the appearance of actual motion and adventure, but at the end we are right back at the point where we started. We are left wondering whether egoism really has anything much to say about the ethics—as opposed to the ideology—of insider trading.

Having said this, it is interesting to ponder why a practice such as insider trading, which appears to involve purely economic issues, has become the subject of such a high level of moral condemnation. There are two possible explanations: one is socio-biological, and the other is economic.

To the biologist, the "gut-feelings" that comprise the sort of moral indignation described by Professor Painter\(^64\) are, like other human characteristics, "selected for their capacity to promote survival and reproduction" thereby leading to the survival of the species.\(^65\) It would not be surprising, therefore, to discover that humans had evolved in such a way so that feelings of moral indignation were tied to wealth maximization. If insider trading is like lying or stealing, it would not surprise the biologist if humans had developed an aversion to it and a way of involuntarily signalling that aversion to potential trading partners.\(^66\) Such signals are valuable because people will pay a premium to engage in transactions with those they know to be trustworthy. In other words, it pays to have a strong sense of morality, even if such a sense makes us keep commitments in situations in which immediate material incentives favor breaking them.\(^67\) To the biologist, that we feel a strong sense of moral outrage at a particular act often indicates that the act is not in our long run interests, either individually or as a species.

But the analysis is not so easy. It is clear that lying and stealing are wrong, but it's not clear that insider trading is synonymous with these practices. In some cases it may be, but in others clearly it is not. To the extent that self-interested individuals and groups can convince the public that all forms of

\(^64\) See Painter, supra note 10.
\(^65\) This point recently was made in the context of the closely related subject of the human conscience by Robert Frank. See Frank, If "Homo Economicus" Could Choose His Own Utility Function, Would He Want One With a Conscience?, 77 AM. ECON. REV. 593 (1987).
\(^66\) Id. at 595.
\(^67\) Id. at 594.
insider trading should be the subject of moral excoriation, however, these individuals and groups will find it easier to achieve their own ends. Thus the alternative explanation to the self-preservation hypothesis for why insider trading is so widely condemned is one based on the economic theory of regulation.

If insiders are banned by law from trading there will be trading profits available to those who are next in line to acquire the information and assimilate it into a profitable trading strategy. Putting the matter more succinctly, if true insiders—defined as corporate officers and directors—are barred from trading, “those market professionals who devote their careers to acquiring information about a firm, an industry, or a group of firms or industries and to developing skills for evaluating the information they obtain” consistently will be the ones to profit on inside information if true insiders are barred from trading. If insiders are barred from trading, these market professionals thus have an incentive to lobby for legal rules that bar insiders from trading. This sort of lobbying is expensive, but to the extent that barring insider trading can be made to appear to be in the public interest, then those pressing for passage of rules against insider trading will find their costs have been reduced. Thus, the second hypothesis about why the practice of insider trading has become the object of moral indignation is that it is in the interest of certain interest groups to move public opinion in this direction. Because arguments that insider trading is the same as lying or stealing have a surface plausibility, and because other interest groups do not have the ability to counter these arguments about the ethics of insider trading, it is at least conceivable that public opinion about insider trading has been shaped by special interest groups for political ends.

If this is the case, then obviously the presence of moral indignation at the practice of insider trading should not guide our judgments regarding the desirability of the practice. Nor

69. See Macey, Promoting Public-Regarding Legislation Through Statutory Interpretation: An Interest Group Model, 86 Colum. L. Rev. 223 (1986); G. Tullock, Rents, Ignorance and Ideology 15-16 (1987 manuscript, on file at the JLPP).
should discussions about the relative merits of altruism and egoism, since both systems of belief can support arguments for as well as against insider trading. Rather, notwithstanding Mr. Lawson's contrary assertions, contractarian-based efficiency arguments hold the most promise for guiding us as to which instances of stock trading are ethical and which are not.