What is Morally Right With Insider Trading*

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Introduction

Insider trading *per se* is obtaining information from non-public sources—private acquaintances, friends, colleagues—and using it for purposes of enhancing one's financial advantage. As Vincent Barry explains, "Insider dealings refers to the ability of key employees to profit from knowledge or information that has not yet become public."[1] Sometimes such a practice can be conducted fraudulently, as when one who has obtained the information has a fiduciary duty to share it with clients but fails to exercise it, or in some other criminal fashion, as when the information is itself stolen. These are not, however, features of insider trading as such, as understood in the context of the discussion of business ethics. Never mind that in the enforcement of government regulations it is in fact fraud that is cited that makes the conduct illegal that is referred to as insider trading.[2]

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1 Vincent Barry, *Moral Issues in Business* (Belmont, CA: Wadsworth Publishing Company, 1983), p. 242.

2 Rule 106-5 of Securities Exchange Act of 1934. See, also, SEC v. Texas Gulf Sulpher (1968); U.S. v. Chiarella (1980), and U.S. v. Newman (1981). Both definitions and sanctions vary somewhat from state to state and case to case. *Black's Law Dictionary* states that "Insider trading ... refers to transactions in shares of publicly held corporations by persons with insider or advance information on which the trading is based. Usually the trader himself is an insider with an employment or other relation of trust and confidence with the corporation" (St. Paul, MN: West Publishing Company, 1991), p. 547. Pub. L. 100-704, Sec. 7, Nov. 19, 1988, 102 Stat. 4682, provides that

(Which suggest that the bulk of the relevant law does not concern itself so much with what many in the business ethics community worry about, namely, "justice as fairness," but with "justice as honoring of contracts.")

What makes the insider trading business ethics discussions focus upon distinctive is that the information on which trade is based is not known to others within the interested trading community asdie from the insider. Insider trading is to deal with the aid of what is not so called "public knowledge" and, thus, it gives the trader an advantage over the rest of the market participants who are on the outside.

It is against the common view of insider trading presented in business ethics discussion that I want to argue that it may be one's achievement or good fortune to learn of opportunities ahead of others and there is nothing morally wrong with this. In fact, acting on such information can be prudent, exhibiting good business acumen, whenever it does not involve the violation of other's rights. The conventional view rests on the belief that others have a right to one's revealing to them information one has honestly obtained ahead of them. But there is no sound general moral principle that requires this.

We clearly make morally unobjectionable use of special information for our own benefit, despite the fact that others might also benefit were it available to them: as when we are first to learn of the presence of a potential dating partner, a good buy on a used car, or a house coming up for sale in a highly preferred neighborhood. To take advantage of such special opportunities is a sign of good judgment, not of unfairness or deception.

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there be a study and investigation of, among other things, "impediments to the fairness and orderliness of the securities markets...."

While the language of securities law does mention the fairness that is most often the concern of those discussing insider trading in the field of business ethics, it seems that the main focus of the law and the regulatory bodies fine tuning and enforcing it has to do with fraudulent trading in insider information or its misuse by those who have fiduciary duties not to disclose and use it until it is made available to the general trading public.

Those who claim otherwise as regard insider trading confuse the market place with a game in which rules are devised or set down with the special purpose of giving everyone an even chance—e.g., when in golf or steeple chasing handicaps are assigned, or when in pro football the lowest ranked team gains first choice in the player drafts. The market is more akin to life itself, in which different persons enter with different assets—talents, looks, genetic make up, economic and climactic circumstances—and they must do their best with what they have. In life, apart from occasionally benefiting from the generosity or charity of others, all one has is a fighting chance. Children of musically proficient parents will probably benefit "unfairly" as far as obtaining musical opportunities is concerned. Those born in Bombay, to poor parents, will face harder times than those born in Beverly Hills to movie star parents. No general moral requirement exists for strangers to even this out, only to abstain from imposing obstacles on others, from violating their rights to liberty. The marketplace, too, is a setting wherein different persons face different circumstances. People do not have a natural obligation to perform involuntary service to strangers. In competing with others for opportunities that the market provides by way of demands one can fulfill in return for voluntary compensation, one is treating all other agents with the respect they deserve as the potential traders they mostly are in such a context. Exceptions exist, of course, as when one trades with friends or family, which raises some moral complications. But the norm is where people treat each other as seeking to find opportunities for trade, nothing more. Other human relationships can obtain side by side, of course, but we can keep the commercial ones distinct enough to understand the ethics that ought to govern us as we embark upon trade. Let me now develop some of these points.

What is Insider Trading?

In fact, however, the concept “insider trading” employed in business ethics discussions has a broader meaning: it includes anyone’s ability to make deals based on not yet publicized knowledge of business opportunities. Insider trading as such, apart from what it may be related to in some cases (such as fraud or the violation of fudiciary duty), involves making financial investments on the basis of knowledge others do not have and may not be able to obtain in ordinary ways. *A* knows the president of a firm who tells me that they are thinking of expanding one of their divisions or have struck oil in a new field, so *A* buys a block of stock in anticipation of the increase of value once the deal is done or the knowledge becomes public. *A* is not deceiving anyone, nor is *A* defrauding anyone. *A* is not taking anything from others that *A* wasn't freely given. *A* is acting on special, "insider," information, that is all.

It is conventional wisdom to treat this version of insider trading as morally wrong because it supposed to adversely affect others by being unfair. As one critic has put it, "What causes injury or loss to outsiders is not what the insider knew or did, rather it is what they themselves [the outsiders] did not know. It is their own lack of knowledge which exposes them to risk of loss or denies them an opportunity to make a profit."[3] By the fact that these others do not know what the insider does know, they are harmed since they are not able to make use of opportunities that are in fact available, knowable to us.

But what kind of causation is it that fails to make a difference when it does not exist? If someone's knowing a good deal has no impact on what another does, it cannot be said that any harm upon another had been caused by that someone. Certainly, had the other known what the insider knew, he or she could have acted differently. By not acting differently, he or she could easily have failed to reap

[3] John A. C. Hetherington, "Corporate Social Responsibility, Stockholders, and the Law," *Journal of Contemporary Business*, Winter 19973, p. 51; quoted in op. cit., Barry, *Moral Issues*, pp. 242-43. One feature of the business ethics discussions of insider trading and other normative topics is that there is hardly any attention paid to the distinction between ethics and public policy. Thus, even if there were something ethically objectionable about some business practice, this does not ipso facto warrant rendering it illegal or subject to government regulation. An analogy might help here: when we discuss journalistic ethics, it is clear enough that journalists may engage in unethical behavior that should not be made illegal. This same distinction is not generally observed when it comes to the profession of business. For an exception, see Tibor R. Machan, ed., *Commerce and Morality* (Lanham, MD: Rowman & Littlefield, 1988), especially "Ethics and its Uses." For a business ethics perspective hospitable to viewing business as a morally honrable profession, see Tibor R. Machan, "Professional Responsibilities of Corporate Managers," *Business and Professional Ethics Journal*, Vol. 13 (Fall, 1994).

advantages the insider did reap. But nothing here shows that the insider *caused* any harm, only that he or she had a better set of opportunities. Unless we assume that valuable information known by one person ought, morally—and perhaps legally—be distributed to all interested parties—something that would beg the most important question—there is no moral fault involved in insider trading nor any causation of harm.[4]

Because of the widespread but mistaken view that insider trading is morally wrong, it is conventional wisdom to support its legal prohibition. Of course, even if morally wrong, it may not follow that it should be morally prohibited. Yet there is reason to think that the moral objections are wrongheaded. Because of this we may suspect that the opposititon to insider trading is more likely the result of widespread, strong a prejudice against gaining economic prosperity without sharing it. Clearly there is a lot of thinking afoot in our era to the effect that a level playing field is morally mandatory when people embark upon commercial or business endeavors.[5]

Why Insider Trading Is Right

Certainly I am at an advantage when I posses information others lack. Nearly everyone in the marketplace is in that position to a

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[4] If someone does not do what he or she ought to do, the causation involved may be the kind that consist in taking away of a supporting feature of an action. Someone who steals a part of my car engine causes it to fail to operate properly by removing what such operation needs. That is how stealing can cause the ensuing harm. Fraud produces harm similarly: something one owns, namely, what another has legally committed to one, is in fact withheld. But without such commitment, nor even a moral duty to provide, no causation of the lack of desired advantage can be identified. For more on this, see Eric Mack, "Bad Samaritarianism and the Causation of Harm," *Philosophy and Public Affairs* , Vol. 9 (Summer 1980).

[5] The most prominent is, of course, John Rawls, *A Theory of Justice* (Cambridge, MA: Harvard University Press, 1971). One main problem in Rawl's defense of "justice as fairness" is that Rawls believes that no one can deserve his or her advantages or assets in life—it's all a matter of luck. As he puts it, "No one deserves his greater natural capacity nor merits a more favorable starting point in society." The reason? Because even a person's character (i.e., the virtues he or she practices that may provide him with ways of getting ahead of others) "depends in large part upon fortunate family and social circumstances for which he can claim no credit" (104). If one rejects this deterministic account of virtues, then a trader's prudence cannot be discounted as one assesses whether he or she deserves to gain from how trade is conducted.

certain extent. One might even wish to call this “unfair” in the sense in which any kind of good fortune may be to some people’s but not to others’ advantage. More precisely, though, the concept of fairness does not apply in this context, even though many believe otherwise. For someone to act fairly requires some prior obligation to distribute burdens or benefits among a given number of people in some suitable proportion or in line with certain specified procedures. But to act fairly does not amount to a primary moral duty—for example, thieves can fairly enough distribute their loot and yet are morally delinquent. Only when one ought to treat others alike, which may occur in special circumstances such as paying attention to all the students in one’s class or feeding all of one’s children equally well, does fairness count for something morally important.

As this applies to insider trading, if I have a prior obligation to share my information with others, that is, a fiduciary duty to clients or associates, then it is not that the information is “from the inside” but that it is *owed to others* that makes my dealings morally and possibly legally objectionable. It is only in such cases that fairness is obligatory, as a matter of one’s professional relationship to others, one established by the promise made or contract one has entered into prior to the ensuing duty to be fair. It is only then that one cause injury by refusing to do what one has agreed to do, namely, divulge information prior to using it for oneself. Accordingly, Hetherington’s objection to insider trading is without moral force. What he should have objected to is the breaching of fiduciary duty, which may occur on occasion by means of failing to divulge information (possibly gained “from the inside”) that has been—perhaps even contractually—promised to a client.

Furthermore, if I have stolen the information—spied or bribed for or extorted it—again the moral deficiency comes not from its being inside information but from its having been ill gotten.

What if the information was come by accidentally? I overhear some people talking in the lavatory or at a bar after they’ve had too much to drink and have loose tongues. Am I wrong to make use of it?

Here again the issue is just what I owe others. Do I have a natural obligation to share my good fortune with other people?

In emergency situations, when others are in dire need or have met with some natural disaster, virtues such as generosity and charity are usually binding on those who are able to assist. Yet these are not obligations in the sense of something the law must enforce. Indeed, enforcing generosity or charity is impossible—the moral significance of a virtue is destroyed if it is practiced at the point of a gun! Furthermore, in the context of the normal hustle and bustle of life, no such virtues are called for toward strangers, only toward those one is related to by prior commitments, intimacy, and love. Instead, in the ordinary course of life one ought to strive to live successfully, to prosper, to make headway with one's legitimate projects, not embark upon the tasks of emergency crews during an earthquake. Unless one is professionally suited for those professions that address those in special need, one has no business to meddle in the lives of others and ought to carry forth without compunction in those tasks that advance the lives of those one has freely embarked upon to promote.

From he viewpoint of common sense ethics, the idea that there is something morally amiss with insider trading has little to support it. One clearly has no moral , let alone legal, obligation to share information with strangers that may benefit one in other familiar circumstances.

Imagine, for example, that an appealing eligible single woman moves into a neighborhood in which several eligible men would like to meet her. I, one of these men, obtain (insider) information about her impending arrival before others and approach her before other men in my position learn of the fact that she will be part of the community. Have I done wrong? Isn't the prospect of successful romance even more important to people than the prospect of successful investment? Suppose, again, that I learn of a very good violin teacher who is moving to our town and I am first in line to take lessons from him. Am I doing something morally wrong? Nothing supports such a view.

Of course, were I someone who is in no great hurry with finding a mate and had a friend who is, I might generously tell him about the impending arrival of the lady. This would be generous but not obligatory. The same would hold if I had a friend of whose musical ambitions with the violin I am well aware and I learned of the opportunity for taking lessons from a new master in our neighborhood. Were I to forget about my friends in these cases, this might well be justly held against me. But the same does not apply when it comes to strangers.

In fact, there are areas of commerce where all this is not only accepted but praised. Consider news reporting. When a news reporter scoops the competition, no one considers this legally actionable, nor, indeed, morally insidious. On the contrary, it is a mark of professional excellence. Why does this not apply in the case of insider trading? I'll turn to this next.

The Bad Reputation of Commerce

The reason these situations, as distinct from insider trading, do not invite widespread moral rebuke is that we tend to consider objectives such as finding the right mate or learning a musical instrument something benign, morally untainted. When it comes to making economic or financial gains, in many quarters there is an initial moral discomfort about it. The shadow of greed looms very large and tends even to overwhelm prudence, which is, after all, the first of the cardinal virtues.

Why Insider Trading Seems Wrong

Indeed, the intellectual source of moral disdain for insider trading is the more general disdain for economic or commercial self-enhancement, at least among moral philosophers and others in the humanities. There seems to be no end to how fiercely commercial success is demeaned among many of those who preach and reflect upon morality. Yet this seems to me to be utterly misguided.

Becoming prosperous can be a means toward the attainment of numerous worthy goals and should, thus, itself be deemed to be a worthy goal. Not that riches cannot be pursued obsessively, but it need not be done so at all. Any other goal can also be pursue*d to a fault*. An artist can be over ambitious vis-a-vis being an artist and, thereby, neglect family, friends, polity. Even truth can be pursued too fanatically. The chances for corruption through the pursuit of economic advantage are no greater than through other pursuits. The disdainful attitude toward commercial professionals is entirely unjustified, a prejudice that deserves as much study as prejudices toward racial, religious or ethnic groups.

What about the fact that we encourage fairness in athletic competition, such as imposing handicaps in golf and horse racing? What about the way baseball and football leagues utilize the player draft to even out the advantages of teams? Does this not indicate that we stress fairness more than I have allowed? Don’t we find fairness

ness heavily stressed in the allocation of chores in families and fraternities, not to mention teams?

Bad Analogies

These examples are misleading. It isn't fairness *per se* that's stressed in golf and horse racing; what appears as such is actually an effort to foster games and races that capture and keep the interest of spectators. The same holds for the policy on player drafts. If a team wins repeatedly, interest will begin to wane and the sport will lose its fans.

As to families, there exists a prior obligation to share burdens and benefits among the members, if not equally than at least proportionately. Parents have invited their children into the family, as it were, and when benefits (or burdens) are reaped, all those invited should share them.

Among people who are not in such relationships no fairness principle operates. No doubt, sometimes we make a mistake and transfer the attitudes we have acquired for how to handle matters in the family to other areas of our lives, but that is an illogical extrapolation. And this is evident enough by considering that if I am born to a family with musical talents or good genes, it is not my duty to make sure that those born to families without them somehow share my advantages. Nor am I doing the right thing in imposing my burdens on members of families who do not suffer as mine does. That sort of policy would be more appropriate associated with envy and resentment, not with moral decency.

The Moral Merit of Insider Trading

Accordingly, seeking to benefit through ingenuity and shrewdness is good business, and good business is as important a professional trait as good medicine, good law, good education, etc. Professional ethics, in turn, cannot condemn that which is in accord with ethics in general, such as fortitude and prudence. Competence and skill, even excellence, at managing the material progress one might be able to make in life ought not to be treated as less important than competence and skill at managing artistic, scientific, educational or other types of progress.

There are those who defend insider trading because it contributes to the overall efficiency of market transactions. They argue that those trading from the inside send signals to others whose reactions then help propel the market to its new level of efficiency.

There may be something to this line of defense, although it comes perilously close to arguing that the end justifies the means. Unless the actions of the individuals who engage in insider trading can themselves be shown to be justified, such arguments do not do much good. One can show benefits to society at large based on theft, even murder, yet these are by no means justified based on such reasoning.

Insider trading, moreover, is held to be morally suspect not because its overall value to the society is denied but because many regard fairness, equality, a level playing field, the most important criteria for a morally decent marketplace. The fact is that those are actually not what counts most for the morality of trade. That place is occupied by the respect for individual rights. Within the framework of such respect, insider trading is entirely unobjectionable. In addition, it can be perfectly ethically, commendable, to act based on such information: it is a matter of prudence and commercial savvy, both of which should be encouraged from those who work for a living.[6]

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