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Regulating information flows: Is it just? Insider trading and mandatory-disclosure rules from a free-market perspective

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Abstract Much of Henry Manne's work on insider trading emphasised that this practice enhances quick dissemination of information and ultimately efficiency. In this paper, we draw attention to the fact that regulating insider trading encroaches upon the foundations of a free-market economy, and boils down to a question of envy, rather than justice. In particular, there is nothing undesirable, fraudulent or shameful in a process through which selected agents (the insiders) transform dispersed information into specialised knowledge, and make use of it. One may be envious that insiders make a profit or avoid a loss thanks to their privileged position. Yet, insiders do not steal any information and do not violate any property right. Their only constraint is an explicit contractual agreement with their employer. In that case, the government might be required to enforce the contract. Regulation would be illegitimate.

Keywords Insider trading · Information · Justice · Property rights

JEL Classification G18 · G28 · K22

1 An introduction to insider trading, justice and fairness

A considerable portion of Henry Manne's writings is devoted to the economics of information and to the analysis of government intervention in firms' lives. In particular, Manne's work on insider trading and corporate governance shows that

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regulation reduces and distorts the flow of information and that, therefore, its outcomes are inefficient or at least less efficient than those generated within a free-market context. In brief, fears that unfettered stock-market dealings and the freedom to devise corporate-governance arrangements in accord with the shareholders' preferences involve manipulation and fraud are misplaced (Manne 2009 [1966]a). Certainly, trading in stocks within a free-market context offers potential benefits to selected stakeholders, including directors and senior managers. Yet, Manne illustrates that rather than being the outcome of misappropriation (let alone fraud), the benefits reaped as a result of insider trading are a form of remuneration that varies in accord with the agents' willingness and ability to exploit the information they acquire on the workplace (Manne 2009 [1966]b, chapters 9 and 10 and, from a different angle, Hirshleifer 1971). In a similar vein, regulation that requires corporations to disclose all kinds of information about their operations is an unnecessary burden that has little to do with the efficiency of capital markets.

The debate that followed Manne's original contributions has led to persuasive and robust conclusions that support his original insights[1]: Insider trading is indeed relatively efficient. Although we do not intend to minimise the importance of this literature, however, we suggest a different approach to the very topics dear to Henry Manne. In particular, we reject the consequentialist viewpoint, according to which the final word on regulation depends on efficiency. Instead, we investigate to which extent insider trading and limited disclosure of corporate information violate the foundations of a free-market economy, which include a Kantian principle of justice. According to this principle, regulatory intervention is legitimate only if it complies with the presumption of justice, according to which just is what is not unjust; and unjust is whatever violates one's physical integrity, one's freedom to choose, and one's (private) property rights (Berlin 1969; Nozick 1974; De Jasay 1998/2002: chapter 10).

We also compare the requirement of Kantian justice with the notion of fairness (a synonym for "desirability"), a term that the authorities frequently invoke when regulating insider trading and prescribing mandatory disclosure of corporate information. Within the world of corporate governance, unfair conduct identifies situations in which those operating within the company create relevant information, exploit such information before it circulates within the company itself or before it goes public, manipulate it, and possibly act with a view to taking markets by surprise, with relatively little concern for the interest of their principals (the shareholders).[2]

References to fairness are ubiquitous. For example, regulators tend to emphasise that asymmetric information is an example of unfair behaviour,[3] and mistakenly consider unfair behaviour a synonym for fraud or theft. Hence, this is the gist of the

[1] See Manne 2009 [1970], Macey (1991), Banerjee and Eckard (2001) and Loke (2006). See also Beny (2005) for a different view, and Epstein and Fischel (1991: chapter 11), who argue that the evidence about the benefits of regulating insider trading and enforcing mandatory disclosure is ambiguous.

[2] See the passionate defence of mandatory disclosure of information by Sommer (1973). His argument was criticised in Manne (2009 [1974]: 41 ff.).

[3] Park (2010) emphasises that the US regulators have moved from a concern for efficiency to one for fairness, against "unjustified enrichment".

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argument, absent some form of regulation, knowledgeable actors are bound to deceive the public, which presumably has a right to enjoy information free of charge. Put differently, public opinion and academia tend to consider unfair behaviour (a subjective concept) a presumption of injustice, thus creating a presumption of illegitimate behaviour. Within the framework of insider trading, this is equivalent to saying that since insiders know more than their counterparts do, they necessarily engage in fraudulent behaviour and are a threat to the very functioning of a free-market economy. For example, Section 16(b) of the SEC Act 1934 [15 U.S.C. § 78p(b)], the origin of all insider trading provisions, begins by stating: "For the purpose of preventing the *unfair use* of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer…". In a similar vein, recital No. 5 of the European Directive 89/592/CE required that all the EC States repress insider trading (until then lawful), since investors will not confide in the markets if they are not "*placed on an equal footing* and… protected against the *improper use* of inside information" [italics added].

However, fairness is meaningless unless one resorts to utilitarianism (De Jasay 2015: 10–11). Hence, this notion can be neither a substitute for justice, nor a source of legitimate regulation. Put differently, and in contrast with the traditional view, this article posits that fairness—i.e. what some individuals think it would be desirable—does not justify government encroachment upon individual freedom. Only unjust behavior does.

In order to pursue our investigation, therefore, in the next two sections we illustrate our point by discussing the presence of asymmetric information—allegedly a major source of inefficiency and a major theme in the insider-trading literature—and its relevance in terms of fairness, justice and envy.[4] We then focus on the nature of property rights on information when employees and directors are involved (Sects. 4, 5), and extend our analysis to regulation and information within corporations (Sect. 6). Section 7 summarises the main results of the paper and concludes by emphasising that the notions of private property, fairness and unjust enrichment offer no basis for the ongoing efforts to regulate insider trading and enforce mandatory disclosure of corporate information. Finally, we suggest that these regulatory actions are motivated by envy, populism and possibly the regulators' rent-seeking ambitions.

2 Asymmetric information and fairness

As mentioned above, asymmetric information is traditionally regarded as a major source of inefficiency. This also applies to the realm of insider trading and corporate governance, and offers a good example of how the issues of fairness, efficiency and justice tend to be confused. The traditional case against asymmetric information takes for granted the presence of three components: (a) individuals are not all

[4] As pointed out in Schoeck (1966: chapter 2), envy is a feeling of hostility towards those who are better off, especially when these belong to the same community and one believes that their prosperity has been obtained with little effort or by accident. Envy frequently involves pleasure at seeing other people's wealth destroyed.

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equally knowledgeable (asymmetric information *stricto sensu*), and this creates undesirable inequalities; (b) some individuals behave opportunistically (unfairly) by failing to honour somebody else's trust,[5] and (c) as a result of the lack of trust, a community misses out on welfare-enhancing exchanges. In fact, the first element is hardly a problem. Individuals present different talents and preferences; they invest different amounts of resources in their own human capital (education and, more generally, the acquisition of knowledge); they decide to buy (or not to buy) information, and they pursue different interests and professional careers. Put differently, the presence of specialised (dispersed) knowledge is inherent in human nature and interaction; and is actually welcome, since it contributes to the division of labour and makes economic growth possible (Smith 1981 [1776]; I.i–I.ii; Hayek 1945; Easterbrook and Fischel 1991: 253). In regard to point (b), opportunism is undoubtedly unfair, and is typical of situations in which empathy is weak and shame and ostracism are poor deterrents.[6] Yet, the presence of outcomes that a portion of the population deems undesirable does not legitimise law-making. Rather, the role of law-making consists in detailing and sanctioning violations of just conduct—say, preventing a party from intentionally lying about the nature of the good/service exchanged or taking advantage of high enforcement costs and performing differently than agreed. Certainly, if individual A consents on terms falsely represented to him, expressly or implicitly, by individual B, or if B does not perform according to the agreed-upon contract, individual B is an opportunist and a thief (Rothbard 1998 [1982]: 143 f.; Slutskiy 2016). Yet, the fact that one suspects that B is an opportunist and could perhaps fool A is not enough to limit B's liberty of action, or create barriers to trade between A and B. Limits can be created and enforced only if B actually cheats/steals.

Put differently, many individuals are untrustworthy, and asymmetric information certainly creates opportunities for unfair behaviour, possibly fraud. Likewise, there is no doubt that most of us would be richer and happier if opportunism were held in check more effectively. Yet, from a free-market vantage point, the presence of asymmetric information per se does not encroach upon the foundations of voluntary exchange and, therefore, does not justify policy action and coercion. The dispersion of knowledge is no proof of unfair behaviour, and even if it did, unfair behaviour is not a crime: it involves no cheating, no violation of property rights and no physical aggression.

[5] Sometimes, abuse of trust is in fact breach of contract, which is a crime, rather than just an undesirable occurrence. Hence, one should not confuse asymmetric information and opportunism with fraud. Fraud occurs only in transactions in which a party deliberately conceals or provides false information about the good, and the other party subscribes to the deal by relying on that information. Under such circumstances, the consent to the transfer is flawed and, therefore, the acquisition of the good amounts to theft.

[6] "Opportunism" describes the behaviour of those who pursue their interest by taking advantage of somebody else's trust (see Rose 2011: 21). Opportunism may be undesirable (unfair), but it becomes a crime—i.e. it violates a principle of justice—only if it involves breach of contract.

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3 Insider trading, asymmetric information and envy

Let us now move to insider trading, an expression that defines "all trades where information is asymmetric … where one of the parties has superior information" (Fischel and Carlton 1982: 860). Since it involves asymmetric information, insider trading certainly features specialised knowledge. This knowledge gives insiders the possibility of pursuing their own interest, a chance that other individuals do not have. Thus, insiders can make a profit (or avoid losses) when good or bad news are about to be announced, and insiders buy or sell stocks before the public does. Yet, opportunism is out of the question, since insider trading is not based on trust. Hence, fairness is out of the question. Share-trading is silent and impersonal, and the very essence of this kind of negotiations consists in the fact that the parties involved in the transaction have different opinions about the value of a given company, and believe that the market price already factors in much of the information available, regardless of how it has been acquired and by whom. Of course, traders on the stock exchange are aware that some people might know better. They consider whether this additional knowledge has already been priced in, and decide to trade or to abstain as a result of their speculative thinking and of their judgement and willingness to suffer the consequences of future news. To repeat, insider trading has nothing to do with opportunism.

Likewise, insider trading has nothing to do with fraud and, therefore, with justice. Unless a contract binding a company's employee to the shareholders explicitly forbids it, insider traders do not cheat or steal; nor do they violate or threaten the physical integrity of their counterparts. Put differently, an insider who operates on the stock market violates nobody's freedom to choose and encroaches upon none of the shareholders' property rights, let alone those of the party involved in the deal. Although employees are usually required not to disclose sensitive information about the company in which they operate, this does not imply that an employee cannot make use of that information. In fact, insiders who have privileged access to good/bad news and buy/sell shares from/to one or more anonymous sellers/buyers have a duty not to tell their counterpart(s) the detailed reasons behind their decision to trade. Outsiders know it and have a choice. Either they ask their brokers to investigate the counterpart each time they trade on the stock exchange, and then decline to trade with insiders and with their friends or acquaintances; or they accept that the buyer/seller might be an insider and bear with it.[7] Experience shows that outsiders always go for the second alternative. And for at least two good reasons. First, for most people the price they should pay to acquire that piece of information before it is factored in the value of the share is too high compared to the value of the transaction.[8] Second, since the actual price of a share is given (most operators are

[7] As pointed out in Manne (2009[1966]b: 25), Conant (1960) had already observed that "if the shareholder does not bother to ask questions, he assumes the uncertainty that the insider may deal with superior knowledge". Note that Manne (2009 [1970]: 349) advocates mandatory disclosure of the company's policy regarding insider trading. We take a different view, and argue that companies should be allowed to decide whether to disclose their rules regarding insider trading.

[8] Large investors usually try to dig out the information they need by looking for rumours and chatty insiders—i.e. by trying to become virtual insiders themselves.

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price takers), decisions to buy and sell stocks depend on one's expectations about the future price of that stock. Hence, the wise trader is probably much more interested in knowing what the insiders are doing at any given moment, than in ensuring that they are not trading with insiders. In other words, one would like to identify the insiders and replicate their behaviour, rather than outlaw them. However, insiders have good reasons not to reveal their plans of operations before they act, and the fact that they tend to keep a low profile gives outsiders no right to force insiders to behave differently.[9]

To summarise, insider trading is the product of specialised knowledge, but specialised knowledge is not necessarily unfair (opportunistic), let alone fraudulent, unless the shareholders explicitly forbid insider trading when appointing directors and hiring employees. This should be more than enough to give insider trading the green light. So, why has insider trading enjoyed such a bad reputation during the past five decades? And why have Manne's views on insider trading provoked generalised scepticism and frequent opposition?

We posit that the debate about insider trading is actually driven by envy, rather than by concerns for justice. Public opinion resents that some individuals have easier access to information and, therefore, enjoy more opportunities to make profits or avoid losses, regardless of the fact that these actors violate no fundamental right, that they cause no harm and, as argued by Manne, that they actually provide a valuable service by ensuring that relevant information is spread out relatively quickly. Put differently, the general public tends to ignore the normative implications of property-right theorizing. It simply assumes that the information acquired by the insiders is an undeserved privilege that produces undeserved profits; and that undeserved profits must be eliminated, or that they necessarily belong to the community, rather than to allegedly privileged individuals. Hostility to insider trading is then strengthened by the belief that exchange is a zero-sum game, so that the benefits accruing to the insiders are necessarily a loss to the rest of the world, and that the benefits taken away from the insiders are in fact a benefit returned to the community. Finally, hostility is solidified by the prevailing notion of fairness, following which justice is obtained when outcomes are evenly distributed across the community, regardless of the inputs involved.[10] Policy-making and regulation follow these populist beliefs.

This vision is widespread among the developed economies. For example, the OECD community maintains that "insider trading… should be prohibited" because it "entails manipulation of the capital markets" and "can be seen as constituting a breach of good corporate governance as [it] violate[s] the principle of equitable treatment of shareholders" (2015, n. IIIE).

The USA follow this road up to a certain point. As a matter of fact, American courts argue that the fiduciary duties of a company's employees and other collaborators also include abstention from taking advantage of inside information.

[9] Certainly, the owner of a given stock exchange might decide to ban insider traders, or Muslims, or all people less than 5-foot tall. However, these restrictions will probably encourage entrepreneurs to open a stock market to which all these groups have access. Competition will decide whether both stock exchanges can survive, or whether one will outcompete the other.

[10] See Schoeck (1966: chapter 4).

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Hence, trading based on such information is regarded as a forbidden "deceptive device" [Section 16(b) of the SEC Act 1934]. On the other hand, all other persons who receive information from insiders or others can operate with no restrictions, unless they use inside information obtained from an insider in return for some tangible benefit or as a gift.[11] In particular, receiving confidential information in a security does not involve per se a duty not to trade on such security.[12]

By contrast, the European approach is much more aggressive, and driven by the attempt to prohibit the use of information legitimately acquired. In particular, the EU aims at putting on the same footing all actual or potential investors.[13] To this effect, the preamble of EU regulation n. 596/2014 reproduces recital No. 5 of the European Directive 89/592/EC, namely that "purpose of this Regulation,… is to protect the integrity of the financial market and to enhance investor confidence, which is based, in turn, on the assurance that investors will be *placed on an equal footing* (italics added)" (recital No. 24).

For example, EU Regulation No 596/2014 requires that all EU member countries (a) extend the range of the inside information so as to include "research and estimation based on publicly available data", on the sole condition that the information is "routinely expected by the market" or is about "views from a recognized market commentator or institution" (recital No. 28); (b) define insider trading as a situation in which, regardless of whether he is an insider, the agent "knows *or ought to know* [emphasis added] that it is inside information" (Art. 8, §§ 3 and 4); (c) forbid disclosure of inside information regardless of whether such information is actually used in subsequent stock trading [Art. 14 (c)]; (d) enforce administrative sanctions for millions of euro that hit both the offender and the offender's employer (Art. 30).[14] This piece of legislation has been followed through by Directive 2014/57/EU, which requires that all member states enforce criminal sanctions of up to 4 years of imprisonment against individual offenders, and judicial winding-up as far as the company is concerned. In this case, the (inquisitorial) aim is

[11] See *U.S. v. Newman*, 773 F.3d 438 (2nd Cir. 2014); *U.S. v. Salman*, 792 F.3d 1087 (9th Cir. 2015), affirmed by 137 S. Ct. 420 (2016); *U.S. v. Martoma*, No. 14-3599 (2d Cir. 2017). In *Dirks v. S.E.C.*, 463 U.S. 646 (1983), the Supreme Court held that the anti-fraud provisions of federal securities laws [Section 10(b) of Sec. Exch. Act 1934 and CFR240.10b5.1-2] do not require symmetric information when dealing in securities markets, and that they do not bar from trading persons who have access to confidential information [for a critique see Epstein (2016)].

However, the American legislator considers that, regardless of any inside information, when trading in a given security takes place at least twice within a period of 6 months, and the trader holds more than 10% of equity or is a director or a senior executive of the company involved, then trading "shall inure to and be recoverable by the issuer" (Section 16(b) of Sec. Exch. Act 1934).

[12] See Schroeder (2014, 186 ff.), who also refers to the famous Cuban case.

[13] Of course, this is wishful thinking. On the one hand, it is impossible to offer equal and complete information to everybody. On the other hand, it is impossible to hit those who abstain from buying or selling thanks to the information they have acquired.

[14] However, the EU legislator has pointed out that "the mere fact that a person uses its own knowledge that it has decided to acquire or dispose of financial instruments in the acquisition or disposal of those financial instruments shall not of itself constitute use of inside information": art. 9, § 5. This is known as "self-insider dealing". Despite the EU rules, however, in Italy self-insider dealing has been considered a crime (Trib. Milano Sez. III, 02/02/2016, Cremonini, in Società, 2016 (4): 513) and also an administrative offense (Cass. civ. Sez. II, 16/10/2017, n. 24310).

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to "make it possible to use more effective methods of investigation and enable more effective cooperation within and between Member States" (recital n. 7).[15]

The striking contrast between the vagueness of the normative formulation [e.g. art. 7 § 1(a) Reg. No 596/2014: "inside information shall comprise… information of a precise nature… which, if it were made public, would be likely to have a significant effect on the prices of… financial instruments"] and the severity of the sanctions represents not only a serious breach of the rule of law. As pointed out in Easterbrook and Fischel (1991: 310–311), it is also a heavy economic burden for the listed companies in terms of direct and indirect costs: excessive use of legal advice, untimely disclosure, abandonment of projects that are profitable only if sensible information is kept confidential, etc.

We believe that both the academic profession and the insiders themselves have done a rather poor job in opposing this regulatory drive. Long ago, Haddock and Macey (1987) pointed out that market professionals do benefit from regulating insider trading. This may explain why they probably welcomed the new legislation. However, such benefits do not apply to economists and legal scholars, most of whom have accepted rather arbitrary, envy-driven value judgments,[16] and failed to tackle what we deem as the key question—property rights. In particular, they have neglected to consider that an individual deserves legal protection only when he is about to fall victim to those who threaten his/her personal integrity or violate his/her property rights. Hence, insiders should not be sanctioned unless they infringe upon somebody else's rights (including those created by a contract).

On the other hand, it appears that the shared idea that insider trading leads to unfair profits has ultimately provoked a sense of shame among the very insiders (Schoeck 1966). In other words, the derogatory meaning assigned to asymmetric information, the inevitability of envy and the power of public opinion have created a situation in which individuals end up developing a sense of shame that in fact has no reason to exist. The result is that regulation has remained unopposed, and has offered legitimacy to a demagogic sense of fairness.[17]

4 Insider trading I: employees and shareholders

Let us now further pursue our line of investigation. In particular, we ignore fairness and opportunism and focus on justice. As pointed out earlier, this means assessing whether insiders—employees and directors—violate somebody else's property rights. From a free-market perspective, and unless they aggress and provoke

[15] The Regulation and the Directive were enacted in April 2014, but came into force in July 2016. The UK and Denmark rejected the Directive, but could not opt out of the Regulation.

[16] In fact, there is very little evidence that insiders make inordinate amounts of profits (Jeng et al. 2003). Thus, the feeling of envy seems directed towards a class of people (the world of finance and the high-income earners), rather than towards profits per se.

[17] Bhattacharya and Daouk (2002) note that the enforcement of insider-trade regulation has been "spotty". If they are right, a more prosaic explanation emerges: ineffectual enforcement would give insiders an incentive to negotiate a remuneration package that takes into account the ban on insider trading, and then trade all the same.

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physical harm to other individuals, there is no doubt that owners can do whatever they like with their tangible property, subject to the contract they have underwritten with the other shareholders. Of course, in most cases, such contract establishes that each shareholder can do what he wants with the company assets only after he has obtained approval by a majority of the other shareholders. In fact, the owners' discretionary power is limited to selling and buying shares, rather than to making use of the firms' tangibles assets; and they have the right to act in order to prevent non-authorised individuals from encroaching upon their property (including the firm's tangible assets).

Within regard to insider trading, however, the emphasis is on intangibles. As we pointed out in a recent article (2018), the free-market vision offers four different views on property rights and intangibles: the Lockean perspective, the consequentialist approach, the performative contradiction thesis, and what we define as the "no-harm" standpoint. We shall examine them in turn and draw conclusions.

According to the Lockean perspective broadly understood, one's intellectual skills and efforts are assimilated to physical labour: "Given that ownership over our body can readily be understood to include our mind, it might be assumed that Locke's theory can extend to the appropriation of the intangible fruits of intellectual labour" (Craig 2002: 39). Put differently, ideas are the product of the intellectual abilities of an individual or of a group of individuals, i.e. they are an intangible extension of the individual. Thus, the mixing of one's intellectual power with other resources (including the ideas and know-how that already exist)[18] gives the individual a right to appropriate a share of the resources that belong to the common pool and also to appropriate the result of the creative efforts that follow.[19] If accepted, the Lockean vision could justify the birth and enforcement of copyrights, patents and the product of innovative activities in general.[20] With regard to companies, therefore, the Lockean visions explains why an employer is entitled to write down in a contract that the salary includes the purchase (by the employer) of

[18] Of course, one wonders whether when the actor mixes his own ideas with those already in existence, he can legitimately appropriate and use intangible resources that belong to the common pool, and yet claim property rights on the final output. Although we shall not pursue the matter further in this paper, this is not a marginal point, since virtually all ideas are developed by exploiting some pre-existing body of knowledge.

[19] See Locke (1691 [1824], Two Treatises of Government, Book II, chapter V, §§ 27–32). In particular, the natural right to property becomes enforceable by the authority (government). The literature has put forward an interpretation of the Lockean view on property rights and intangibles based on excludability (without which the notion of property is vain) and inexhaustibility (the so-called Lockean Proviso, which preserves the principle of equal opportunities). Child (1990) exemplifies this literature. Yet, we prefer to ignore this view, since in this case excludability is created through an act of violence (patents are created and enforced by the government). Thus, from a free-market standpoint, excludability would lack legitimacy. Moreover, we believe that within the Lockean context, the notion of equal opportunities is questionable. First, although granting equal opportunities might be desirable, it hardly qualifies as a natural right (De Jasay 2015, part I). Second, the notion according to which first appropriation of an idea does not prevent others from thinking about something else misses the point.

[20] However, see Craig (2002) for a different opinion and a review of the literature.

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the results of the employee's intellectual efforts (innovation), which the firm will thus acquire at no additional cost.[21]

However, it is not obvious that the Lockean vision can be extended to the realm of information, which is indeed intangible and surely the result of one's entrepreneurial efforts, but which does not result from mixing one's intellectual skills with other outputs, the act of mixing playing a key role in the Lockean process of appropriation. Put differently, one can make a Lockean claim in favour of exclusive property rights on the production of knowledge and the *use* of information (e.g. data treatment and analysis). Yet, information—and open information in particular—is like data and facts, which are the involuntary and unintentional outcome of the voluntary action of individuals. As a consequence, and not unlike the case of positive externalities, one can hardly claim that information is owned by anybody. Rather, everybody can use data and facts (information), because nobody can claim exclusive rights to something he/she has not created or acquired by rightful first ownership. Clearly, this also applies to employees who acquire information related to the firm in which they operate.

According to the Lockean vision, therefore, employees might be rightfully required not to disclose information about the existing or newly-created in-house know-how (innovation), which usually belongs to the firm. However, data and facts regarding a company's life can hardly be appropriated through a Lockean procedure. Although they are produced within the company, they do not belong to the company. There is no reason why one should prevent other individuals from doing whatever they want with the information upon which they stumble.

The above line of reasoning also applies to insider trading, which is in fact based on the use of information and facts (positive externalities), rather than on the exploitation of know-how and innovation (Lockean property). In contrast with what claimed by Epstein (2016), therefore, the Lockean theory on private property does not justify opposition to insider trading.

A different free-market justification for private property rights to information is firmly based in the consequentialist camp, and presents a line of reasoning that is also partially shared by the Austrian and neoclassical visions (Rothbard 1973: 30–45; Kinsella 2001; Demsetz 1967). Although this literature usually mentions the notion of scarcity, its focus is actually on the concept of rivalry, and argues that societies establish property rights in order to solve this very problem (rivalry).[22] Absent property rights—and private property rights in particular—individuals

[21] Of course, such contract implies that the innovator-employee is the first owner of the idea and has enforceable property rights on it. However, this agreement is not free from ambiguities. What happens if the employees do develop an innovative idea, but fail to make it available to their employer and fail to ensure that the company exploits it to its own advantage? Does this mean that the employees should tell their employers about whatever goes through their minds, just in case something turns out to be useful? The answer is generally negative, unless the employment contract explicitly relates to a job that consists in producing innovative ideas. Under these circumstances, employees must definitely let the employer know about all that comes to their mind in relation to the latter's business.

[22] The notions of scarcity and rivalry are of course related. Certainly, there can be no rivalry (presence of competing users) unless a resource is scarce. Similarly, the problem of scarcity (finite resources) arises only when there is an issue about rivalry. According to the consequentialist literature, property rights are introduced to discipline users, rather than to remedy scarcity.

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would fight to access scarce resources and hasten to (over)exploit them, lest somebody else does so. When enforced, property rights ensure that conflicts are defused and efficiency enhanced.

Within the realm of intangibles, however, rivalry is not a problem, and the institution of (private) property is pointless. This has consequences for the acquisition and use of information, which is scarce (there is never enough of it), but is non-rival. Put differently, and consistent with the free-market approach, one cannot use violence in order to acquire information. However, non-rivalry ensures that nobody can claim first-owner exclusive rights on the information acquired. Those who buy information are actually buying easy access to the existing information, not the information per se. Individuals can of course use the information they have the way they prefer. But ownership is a different matter, since according to the consequentialist perspective, information can be obtained, but not owned. To summarize, nobody can object to insiders who make use of information that is accessible to anybody but belongs to nobody.

A third view—the performative-contradiction thesis—has been put forward by Rothbard (1982: 32 and fn. 6) and further elaborated by Hoppe (1987: 72 ff.; 1988: 21). In brief, they argue that life is necessarily based on the property of one's own self, otherwise no action (including breathing) would be possible. Consistency with the property of one's self requires compliance with the freedom-from-coercion principle, which involves no aggression. In other words, if we enjoy a (natural) right of property to ourselves, physical aggression is the only limit to human action, since such aggression would violate a natural right. Hence, the acquisition and use of knowledge and information are legitimate as long as one does not resort to violence against any tangible asset (similarly to the consequentialist view) or another person.[23] The very question of property is therefore moot, with consequences in regard to insider trading: insider traders commit no crime (no violence), while regulating insider trading is an offense against the principle of self-ownership.

Finally, a fourth line of thinking defines private property in terms of the freedom-from-coercion principle. As long as those who appropriate a resource comply with the freedom-of-coercion principle (and thus respect other people's physical integrity), appropriation is legitimate. In this case, the burden of proof is reversed, in that the opponents of private property must show that an act of appropriation is wrong and that, therefore, it justifies expropriation; and not vice versa. In this light, the acquisition and use of knowledge and information are legitimate unless one resorts to violence. Hence, the very question of property becomes pointless, and insiders should be allowed to do whatever they like.

To conclude, if one accepts that the basis of regulation is legitimacy, and that the basis of legitimacy is justice, then all intervention aiming at restraining the acquisition and use of information rests on one's views about the (legitimacy of the) foundations of private property. Consistency with a Kantian notion of justice and with the prevailing free-market views on property rights suggest that insider trading can be restricted only by the rightful owners of information, but that the very nature

[23] Aggression is tolerable only as a form of self-defence (violence to oppose violence or a credible threat of violence).

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of information ensures that there are no such owners. The fact that one's privileged position gives him/her easier access to useful information is irrelevant. From this viewpoint, therefore, regulatory intervention is in fact an act of aggression. Certainly, when negotiating a contract, the employer can take into account the fact the employee will be enjoying a privileged position, but cannot prevent him/her from using information that he (the employer) does not own.

The socialist view is different. Within this context, the rightful owner of all tangible and intangible goods is society as a whole, the legal representatives of which—politicians and bureaucrats—decide who can do what with the resources available. Hence, the discussion on what best serves the social interest boils down to a debate about the preferences of the political and bureaucratic elites. The approach to insider trading is no exception and explains why, from a socialist perspective, the normative outcome is ultimately a matter of discretion.

5 Insider trading II: directors and shareholders

The same line of thinking applies to situations in which the insider is not an employee, but a director, i.e. an individual who takes the strategic decisions on behalf of the shareholders, and also ensures that the employees' opportunistic behaviour remains within tolerable limits. In other words, while an employee acquires the information by looking for it or by sheer happenstance, a director produces information by defining the strategies and taking the key decisions that affect performance. From the Lockean perspective, therefore, one may argue that directors are the first owners of the information they produce. This interpretation raises two questions.

First, suppose that the statute of the company includes a clause that requires that directors are not allowed to give sensible information away to outsiders, but must make it available to the shareholders, who will then use it as they please. Would such an arrangement make sense? Would it be enforceable?

The short answers to both questions are clearly in the negative. The creation of new information by the directors is the outcome of an interactive process with other insiders (employees and other directors) as well as with outsiders (suppliers, buyers, competitors and other producers at large). As a result, identifying the piece of information that is the exclusive production of one or more individuals (the members of the company's board of directors) is virtually impossible. Furthermore, let us assume that such identification was indeed feasible, and that the director is contractually bound to transfer the information he has created to the shareholders and only to the shareholders. Does this mean that each shareholder has a right to be informed about what happens at hourly or daily intervals, but only in proportion to the number of shares each shareholder owns? Moreover, does this mean that each shareholder can make use of the information he/she has, subject to approval by the other shareholders? Regardless of the feasibility of this arrangement, it is obvious that this clause would bring no value to the shareholders, it would involve enormous expenses, and would multiply the possibility that sensitive information is leaked out, and harm the company. This explains why owners give up on their eventual right to

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being informed, and let the directors use the information in the best interest of the company.

A second issue regards the directors' salaries. Shareholders are frequently reluctant to pay directors according to the performance of the company. This is due to the fact that directors should supervise the senior managers. Remuneration according to performance would encourage collusion between the directors and the top management, and possibly induce the directors to turn a blind eye when the senior managers tend to smarten up the accounts or engage in entrepreneurial strategies that favour short-run results at the expense of long-run profitability. Yet, a fixed remuneration is a poor incentive to keep a close eye on what the top executives are doing. Letting the directors preserve ownership of what they produce or obtain (privileged information), and possibly forcing them to disclose their trading after the trading has taken place, serves the shareholders' interests in two ways. First, by being free to make money through insider trading, directors have an incentive to acquire information about the company's life—both in regard to the strategic decisions and to the main operational activities.[24] Moreover, by disclosing information about their insider trading, they are more likely to reveal how they expect the company to perform in the future.

6 Corporate governance and information

Insiders are not the only targets of the regulators' attempts to manipulate the flow of information in the world of business. Regulators also warmly welcome mandatory disclosure of corporate information, which includes early disclosure of price-sensitive information. For example, sub-heading n. V of OECD (2015) is titled "Disclosure and transparency" and recommends "that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company". Furthermore, such information is deemed essential in order "to ensure [the] equitable treatment" of all shareholders and their "ability to exercise their shareholder rights on an informed basis"; "to attract capital and maintain confidence in the capital markets"; to avoid "unethical behaviour… to a loss of market integrity at great cost, not just to the company and its shareholders but also to the economy as a whole"; even to "improve public understanding of the structure and activities of enterprises, corporate policies and performance with respect to environmental and ethical standards, and companies' relationships with the communities in which they operate".

National lawmakers have widely accepted and adopted the OECD (2015) Principles (inclusive of n. V). For example, EU and US rules generally require that corporate entities release a wide body of information, including periodical financial statements. The rules are particularly stringent for listed companies, which are also required to publish, at the very moment it comes to life, all information that *might*

[24] See Manne (2002) on the difference between the rewards reaped through stock options and insider trading.

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affect their share prices. In other words, by forcing the company to disclose information, the legislator nullifies the efforts of those who might engage in insider trading and hope to go scot-free.[25]

Interesting enough, the recent legislation goes beyond what might affect share prices. For example, when recommending the "timely and accurate disclosure… on all material matters regarding the corporation", n. V of OECD (2015) specifies that "material matters" include "business ethics, the environment and, where material to the company, social issues, human rights and other public policy commitments", because "such information may be important for certain investors and other users of information to better evaluate the relationship between companies and the communities in which they operate and the steps that companies have taken to implement their objectives" (V.A.2).

Put differently, the authors of the Principles claim that disclosure of corporate governance offers present and future shareholders all the information they need, and promotes confidence in the market process. Moreover, it serves the interest of "other users of information", and represents a "powerful tool for influencing the behaviour of companies" (incipit of n. V), which would thus be exposed to social and political evaluation and, eventually, would be vulnerable to the regulators' disapproval.

The implementation of the Principles mentioned earlier has varied across countries. For example, since the time Congress issued the Securities and Exchange Act (1934), the USA federal legislators have been delegating broad powers to the SEC.[26] In particular, this agency can issue "such rules and regulations as the Commission may prescribe as necessary or appropriate for the proper protection of investors and to insure fair dealing in the security" [Section 13(a)]; and it can also require companies to spread "additional information concerning… *operations of the issuer*… necessary or useful for the protection of investors *and in the public interest*" [Section 13(l) and also 14(a) regarding proxies; italics added]. Yet, the SEC and the courts have not made full use of their prerogatives: they have been reluctant to enforce total disclosure in the realm of environmental and social governance ("ESG"), and have resisted pressures from various quarters (including accountants, lawyers and militant groups).[27]

By contrast, the EU bureaucrats have assumed a much tougher stance. From 2011, they have been demanding that the EU Council and Parliament approve Directive 2014/95/EU, which requires mandatory disclosure of "non-financial and

[25] Similarly, some US regulation tries to prevent that recipients of selective disclosure—e.g. analysts and institutional investors—take advantage of the information they obtain, and profit "at the expense" of small investors.

[26] In recent times, the Dodd-Frank Act (2010) and the Iran Act (2012) have added specific statutory provisions that enforce mandatory disclosures applying to (a) "conflict minerals" originating in the Democratic Republic of the Congo, (b) payments to governments by resource extraction, (c) certain activities relating to sanctions against Iran [Section 13(p), (q), (r)].

[27] See for instance J. Roger, "Why investors should look beyond a company's financials", at http://fortune.com/2015/08/11/; "Proxy Preview 2016", published at http://www.proxypreview.org/; Securities and Exchange Commission, "Concept release", 33-10064, at https://www.sec.gov/rules/concept/2016/33-10064.pdf, April 13, 2016, 204 ff.; *Nat'l Res. Def. Council, Inc. v. Sec. and Exch. Comm'n*, 606 F.2d 1031 (1979).

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diversity" information by selected large undertakings and groups, amending Directive 2013/34/EU on periodic financial statements. They ended up obtaining what they wanted: "disclosure of non-financial information is vital for *managing change* towards a sustainable global economy *by combining* long-term *profitability with social justice and environmental protection*" (recital n. 3; italics added). This means that from the beginning of the financial year 2017, "large undertakings" with more than 500 employees "shall include in the management report a non-financial statement containing information to the extent necessary for an understanding of the undertaking's development, performance, position and impact of its activity, relating to, as a minimum, environmental, social and employee[28] matters, respect for human rights, anti-corruption and bribery matters" (art. 1 § 1). Moreover, the EU bureaucracy has advocated mandatory disclosure of the companies' worldwide income-tax declarations, to enhance "public scrutiny of corporate income taxes borne by multinational undertakings operating in the Union" as "an essential element to further foster corporate responsibility, to contribute to the welfare through taxes, to promote fairer tax competition within the Union through a better informed public debate and to restore public trust in the fairness of the national tax systems".[29]

Now, even if one neglects to comment on whether these rules are effective in pursuing the goals mentioned above,[30] mandatory disclosure of information has nothing to do with the "smooth functioning of the markets". Mandatory disclosure could perhaps make capital markets more appealing to the large public. Yet, one should note that sellers are themselves interested in building a reputation for honesty and transparency if they want to see their shares traded in significant volumes. More generally, defining the by-laws regarding what and when to disclose should remain the shareholders' job, provided that there is no intention to fool third parties.

The upshot is that when we read that "disclosure of non-financial information is vital *for managing change*" and for enhancing "social justice and environmental protection", one suspects that these rules do not aim at improving the functioning of the stock markets. Rather, we tend to believe that the true goal consists in limiting the shareholders' freedom to choose, and forcing them to comply with the preferences of the bureaucrats.

7 Concluding remarks

Since the mid-1930s, limiting or banning the use of insider information and—later—mandating disclosure of corporate information have been suggested as effective devices to avoid fraud, strengthen confidence in the securities markets and possibly pre-empt another Great Crisis. Some literature has argued that regulating

[28] Including "age, gender, or educational and professional backgrounds… diversity policy" (art. 1 § 2).

[29] See recital n. 5 of the Commission proposal 2016/0107 (COD) 2.4.2016 for an amendment of Directive 2013/34/EU.

[30] For example, Manne (2009 [1974]) doubts that mandatory disclosure enhances investors' confidence. See also Burton (2016), who raises serious doubts about the efficacy of the Dodd-Frank Act.

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the flow of information in the world of business is a welcome response to situations characterised by asymmetric information and, therefore, it enhances efficiency. Yet, most current legislation is driven by the ideal of fairness and allegedly unjust enrichment.

We argue that the efforts to control virtually all the information produced within large companies in fact violate the notion of justice typical of a free-market economy. In particular, neither insider trading nor corporate confidentiality are examples of fraudulent behaviour and, therefore, they do not justify government intervention. Rather, the regulators' activity witnesses to the policymakers' efforts to extend their power on the economy; and that in order to obtain this goal the authorities exploit envy and engage in populism. This trend seems more marked in the European Union than in the USA.

We have also observed that opposition to insider trading and mandatory disclosure of information has been surprisingly weak. As a matter of fact, eradicating regulation against insider trading requires a strong sense of personal responsibility and the rejection of utilitarian social-contract theorising: shared personal wishes and a vaguely defined idea of social fairness (relativism) are no sources of rights. This also explains why a repeal of the current legislation regarding the information produced within the company remains unlikely. It would require a different cultural environment, a different moral code and a class of policymakers able and willing to resist the temptation to exploit envy to extend their legislating powers.

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