

IN PRAISE OF INSIDER TRADING

MATTHEW O'KEEFFE



A few months ago I had the misfortune to see the latest Oliver Stone offering, *Wall Street*. In the final scene, Martin Sheen is driving through downtown Manhattan with his son on their way to court, where the latter awaits sentencing for insider trading. The film closes with Sheen's lines:

"It's time you started to do something with your life. It's time you started to produce something, rather than living off the buying and selling of others."

One wonders if this is intended as a criticism of insider dealers in particular or just stockbrokers in general. Obviously Mr. Stone put as much thought into the implications of *Wall Street* as he did into the implications of that other "much acclaimed" film, *Platoon*.

THE PRODUCTIVITY OF STOCKBROKERS

Stockbrokers (or market-makers, as they are now called) do in fact produce something. The Stock Exchange exists because certain companies are far too big to be owned by individuals. So without the Stock Exchange there would be a far greater concentration of wealth, far more of the kind of Machiavellian billionaires depicted in *Wall Street*. It is, in fact, the expertise and advice offered by stockbrokers which allows ordinary laymen and non-billionaires to use the Stock Exchange. And it is these stockbrokers who provide the vital service whereby small investors and institutional investors alike can participate in the trading of shares (the fact that among

these institutional investors are alternatives to the welfare state such as the pension funds should make the Stock Exchange even more attractive for a libertarian). Some stockbrokers have always managed to provide a better service and win a bigger market share through knowledge of inside information. Recently, these stockbrokers have become known as "insider traders".

THE VIRTUE OF INSIDER TRADING

I say recently because a little over ten years ago, before the creation of regulatory bodies and the passing of legislation like the Financial Services Act, the "crime" of insider trading was unheard of on the London Stock Exchange. If insider trading has become criminal in the 1980s, then it should be regarded in the same light as the "crime" of bootlegging in the U.S.A. of the 1920s, i.e. as a crime invented by the government. Neither "crime" involves any direct trespass against person or property.

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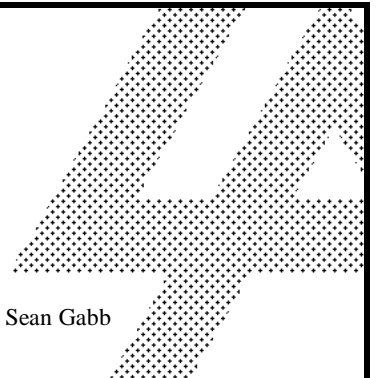
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FOR LIFE, LIBERTY AND PROPERTY



The sole reason for the laws against both is that the moral majority regarded them as “wrong”.

What, then, is “wrong” with insider trading? What is wrong with “the use of confidential information to make a profit on the stock market” (my dictionary definition of insider trading)? Is it the idea of confidentiality that is frowned upon, or perhaps the idea of profits? Both, I would hazard. The very mention of the words “insider trading” or “insider dealers” conjures up images of super-rich speculators and tycoons huddled in cliques, trading dark secrets and reaping immense fortunes. Of course there must be some truth in this. Unfortunately, however, hostility towards insider dealing merges in practice with hatred of capitalism itself in the belief that “the rich get richer and the poor get poorer”. Of course, this is not how free enterprise works. Nor, I think, is it how insider trading works. If a stockbroker learns of an imminent takeover bid and uses this confidential information to make a profit on the stock market, clearly he has become the richer for it. But even if the insider dealer acts purely for personal gain, it is hard to see who, if anyone, has become the poorer. On the contrary, if he is a good stockbroker, it is quite easy to see others who have benefitted, such as the stockbroker’s clients. Consider if I were to become a brilliantly successful insider trading stockbroker tomorrow — wouldn’t *you* want to put your money with me? How long would it be before I started to attract the custom of my “law abiding” but less successful contemporaries and win a bigger and bigger share of the market? And wouldn’t all my clients, rich and poor, knowledgeable or otherwise, receive the benefit of my access to inside information?

INFORMATION AS PROPERTY

What surprises me most when I ask these questions, are the answers I get from those who recognise the tyranny of the taxman and normally describe themselves as being in favour of property rights. J. Neil Schulman has written (in *Towards a Natural Rights Theory of Logoright*, Philosophical Notes No. 5, Libertarian Alliance), with similar surprise, of the failure of most proprietarians to defend property rights in logos:

“... they are entitled to the same respect and protection as property rights in land, butter, guns, cars, radio frequencies and gold that I have heard property rights advocates defending endlessly ...”

The same entitlements apply for information. If a man is entitled to exercise dominion over his property and person, then why not over his thoughts and knowledge? Taxation without representation is indeed tyranny, but if I held a position in the financial world, I would consider it just as tyrannical for some Financial Services Gestapo to deny me the right to keep and act on secrets. The attack on insider dealing is an attack on privacy itself, camouflaged by a lot of moralising sentiment.

Perhaps the greatest case against insider trading regulations is their sheer unworkability. The year before last I interviewed Peter Quinnen, Chairman of James Capel and Co., the largest firm of stockbrokers in the City of London. Quinnen agreed that insider trading is no greater now than it has been in the past:

“My opinion is that anywhere where there is money changing hands and profits to be made, there is always a lot of speculation about takeover bids which you can’t really avoid and that is part and parcel of the way any market works ... What’s the solution? I don’t think you can eliminate it (insider trading) altogether and I certainly don’t think that necessarily we’ve got the right answers so far from the changes in the legislation ...”

There will always be people happening upon insider information, and the only real thing to prevent them from acting upon it, according to Quinnen is “the gentleman’s code of honour”. And when such people do choose to act on inside information, it is simply a physical impossibility to detect them all, as their decisions, thanks to information technology, are now made on a split-second worldwide basis. Insider trading is, indeed, impossible to eliminate. This is not to say that financial regulations are having no effect. My friends Chris and Judy Tame have recently substantially reduced their involvement in their financial services business because of them. The strict rules concerning how information must be conveyed to clients had made it much more difficult for them to work effectively. These same regulations which were intended to facilitate the spread of information have, in fact, stifled it.

THE GREATER FRAUD OF INFLATION

The revelation of Peter Clarke at the *Liberty ’89* conference that he was “entirely in favour of insider trading” quite startled me. It also made me think. What was so fraudulent about insider trading? Why not decriminalise it? Clarke also pointed out that there is a far greater fraud being conducted *legally* in the City. Libertarians are right to be concerned with force and fraud, but even the many who will still regard inside deals as fraudulent should try to maintain some sense of priority; to use Clarke’s words, insider trading is nothing compared to “the real chicanery of central banking”. Schulman, again, has well identified the chicanery in his definition of inflation:

“Inflation is the process whereby central bankers in collusion with politicians — to mutual benefit — have counterfeited warehouse receipts for a commodity the public have chosen as a medium of exchange and traded those counterfeits to those they have defrauded and forced into accepting them.”

Insider trading should be legalised. This would not exempt frauds like Boesky who *stole* information through the use of bribes. Neither gentlemanly “codes of honour” nor over-zealous regulations seem to me the answer to the problem of fraud in Wall Street or the City of London. What is needed is a strict system respecting and protecting property rights in information, one which will surely be more conducive to the dissemination of information than the regulation-strangled system we have now. When voluntary exchange becomes the basis of disseminating information, perhaps people will realise that the truth about capitalism and the institutions of private property is that “the rich get richer and the poor get richer”.