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ETHICAL ISSUES**

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In the first weeks of January 1993, the dealers in Mercabarna, the food wholesale central market in Barcelona, saw an increasing movement of foreign trucks loaded with vegetables, many of them coming from the Netherlands. Spain is a country naturally gifted for Mediterranean crops, whereas the Dutch must resort to greenhouses to obtain cheap vegetables. Nevertheless, Dutch foodstuffs began to invade the Spanish markets as soon as the regulations and barriers to the free circulation of goods and services were dismantled by the Single European Market on January 1, 1993. The Spanish farmers and dealers immediately understood that the competitive conditions in their markets had changed. Many of them had already prepared for the new competition; others adapted to it after the invasion, and others preferred to ask the government for more protection. But the erection of new trade barriers was no longer feasible: after 1993, opportunities, profits, life itself will be different for many Europeans.

This paper deals with certain ethical problems that arise between the State and businesses as a result of laws and regulations. It consists of two parts with an introduction. The first part attempts to justify the existence of the State, the moral duties it imposes on businesses, why firms must obey the law, and the ethical challenges that this duty poses for companies. The second deals in more detail with the ethical problems of a special form of relation between the State and businesses: regulation.

Business and the State

If we are to believe the economists, economic freedom is the normal setting for business, because the absence of restrictions guarantees an optimal allocation of resources, under certain conditions. Nevertheless, economic life is far from unrestricted freedom. And this is good for companies: when the law of the jungle dominates, business disappears. Moreover, governments like to have power and influence. And many lobbies or interest groups succeed in getting regulations that benefit them, even if they damage consumers and competitors. Finally, in many cases ideology curtails economic freedom in the name of supposedly higher principles.

Law and regulations are, then, an important part of the background of business. They restrict the set of possible actions and decisions available to businesses and lay charges and costs (*e. g.*, taxes) upon them, using the coercive power of the State. They also protect

companies, reduce uncertainty and offer opportunities. This poses a lot of problems for businesses, as they try to know and observe the law, but also to take advantage of it, avoid the charges it imposes, adapt themselves to the legal and regulatory environment, change it (if possible), and use it as a shield or weapon against other economic agents. And all this contributes to shaping their goals, strategies, structures and policies. A change in the legal background has important consequences for companies in every function and activity (also from the point of view of business ethics).

We are not interested here in the positive reasons why laws and regulations exist, but in the ethical problems that they pose for businesses. We will focus first on law, discussing the ethical arguments for the existence of laws and then the ethical problems they pose for companies.

Part One

ETHICS AND THE LEGAL FRAMEWORK OF BUSINESS

Why law?

What is the *raison d'être* of law? Is it an arbitrary imposition of power that free people may morally oppose? Or is it something that society needs and all reasonable people must obey? What are the ethical foundations of law? And what should be the ethical attitude of business towards the law? Here we must make a detour and briefly discuss the philosophical and ethical explanation of the existence of law before discussing its implications for business ethics.

Sociability is one of the basic features of human beings. It implies their need to live in society, first in order to survive, but above all as a prerequisite for personal development. Human beings become members of collective bodies, ranging from the family and the local community to the nation and world society, including companies, religious and civic organizations, voluntary associations, and so on. All of these spheres of association, natural or voluntary, have in common the creation of rights and duties that govern both individuals and groups and that require some sort of organization, protection and defense: in short, an institutional and legal framework.

We use the term State to refer to the institution that is defined by means of a legal order and that exercises the authority and power to facilitate the development of the citizens and the goal of society, the so-called common good. The government is the representative of the State and the visible manifestation of its authority and power. This applies to government at all levels (central, regional and local) and in all its aspects (executive, legislative and judicial, as well as administrative).

The first task of the State is to establish and develop the legal and institutional framework within which (economic) life takes place. Moreover, it provides services for society: it collects taxes and other levies in order to cover its expenditure, ensure economic stability and redistribute income; it makes transfers and buys goods and services, etc.; it is a customer of companies, often their supplier as well, and not infrequently their owner, advisor and controller. And, as the government is not a physical person, its relationships with citizens are articulated through complex organizational and administrative structures (parliament,

government, magistracy, civil service, etc.) and are mediated by legislators, senior executives, civil servants, advisory bodies, political parties, etc.

In particular, the market economy and the world of business would be inconceivable without the institutional and legal framework that guarantees the rights and duties of economic agents and sets forth the «rules of the game». For example, it defines property rights, their content, how they are given, the limitations they are subject to, how they are transferred, their relationship with the rights and duties of other individuals or groups, how disputes are settled, etc.

The State creates and legitimates the law. Coercive power cannot be exercised continually; the authority of the State must be accepted and this requires a legal order based, in turn, on ethical foundations: the acceptance of certain principles and the embodiment of certain values. Thus, the State is founded on law, and ethics and is bound by both, since the State's power is not (or should not be) absolute or arbitrary but subject to a legal and moral order.

The previous paragraphs suggest that there is a role for the State, a role not only compatible with freedom, justice, the dignity of the individual and other ethical values, but also necessary for the social achievement of the members of society. However, life frequently ignores these principles, as there are many instances of arbitrary, unjust, discriminatory and immoral decisions or actions by governments. Despite this, we cannot discard the role of the State as ruler of society, and we must obey its (just) laws.

What is law?

In a wide sense, the law is a rational declaration of will made by the appropriate authority to order behavior in society towards the goal of society, the common good. This means that a piece of legislation must be obeyed from the ethical point of view if it has the following characteristics:

(1) It is a rational act, *i. e.*, it excludes the legislator's arbitrary will as the origin of law. From the point of view of ethics, an arbitrary act is not a law, and companies or individuals are not obliged to obey it (but let us not forget that the State holds the coercive power to impose compliance even with despotic or irrational precepts).

(2) It is ordered towards the achievement of society's goal, the common good. Different laws will address different aspects of this purpose. Therefore, the law must be just: provisions made for the sole and unjust benefit of the legislator or of a faction are therefore excluded (although there may be just laws advocated by a particular interest). A law that does not (directly or indirectly) serve the common good cannot be laid upon companies or individuals.

(3) It has a normative content, a «must be», not merely a desire, a purpose or an intention. Guidelines or suggestions do not have the ethical force of law (this is the case, for example, of voluntary import restraints or guidelines on wage or price increases).

(4) It is coercive, because it is based on the State's power to impose certain forms of behavior and prohibit others by means of the appropriate sanctions. But the law should be observed not out of fear, but because of ethical persuasion. This raises the ethical problem of

resistance to unjust laws (for example, laws that discriminate against minorities on the grounds of race, religion or beliefs) when they carry the force of coercion.

(5) Because it is just, law must be general, addressing a group rather than an individual, and non-discriminatory. On occasions, this may give rise to a conflict between the general rule and what is just for a particular case (so that, in certain circumstances, a law cannot be enforced on a particular citizen or firm).

(6) Nevertheless, the law must be permanent, even though it is brought into being with the intention of having a temporary validity. Therefore, it remains in force until it is repealed. Hence, the non-retroactiveness of laws: citizens cannot be required to adapt their behavior to a law that has not yet been passed.

(7) It must be enacted in the proper manner by means of a set of procedural requirements, and it must be known by all those it addresses (this is why ignorance of the law is no excuse for not obeying it).

(8) It is an act of the competent authority, as specified in each country's legal order.

Moreover, the law must meet other conditions: (1) It cannot be a totalitarian imposition, in the name of ideology, class, race or political power, but must respect the dignity and freedom and the fundamental rights of the individual. If it restricts individual freedom or rights, it is so that they may be developed in an ordered fashion, in harmony with the freedom and rights of other citizens. (2) Law is *necessary* to regulate life in society, but is not sufficient. The legislator cannot (and should not) intervene in all facets of life. (3) The content of civil law must be dynamic, matching the evolution of knowledge and circumstances. (4) It is not necessary that laws be accepted by the citizens, nor that they be the will of the majority.

The plurality of legal settings in Europe

In a multicultural arena composed of different nationalities (although with pretensions to unity), such as Europe, one finds a variety, not just of specific laws, but of legal frameworks. The Continental system considers justice as a system of abstract statements that have their source in laws and that form a coherent whole that is peculiar to each country. The Anglo-Saxon system, on the other hand, asserts that justice is not the body of laws but that laws are basically a source of knowledge about justice. For the Continentals, laws are a higher criterion of justice and have an intrinsic validity, while the Anglo-Saxons consider that laws may lose validity and disappear, without any need for a positive act of repeal. Laws, for the former, delimit individual rights, while for the latter the rights are primary and any law that does not recognize them does not deserve to be called a law.

However, from the ethical viewpoint, the function of the law is the same in both systems: both have standards of behavior, expressed either in a formal code or in Common Law, and specified in detail or left to the free interpretation of the judges. And these are the rules that citizens must obey.

Does *legal* means *moral*?

Ethics is a practical science that directs man's actions towards the achievement of his goal. All human actions contribute in one way or another, positively or negatively, to this purpose; therefore, all are subject to ethics, even if they are not subject to law. Hence, moral criteria are much more far-reaching than the contents of laws: not all human behavior can be subject to law (law cannot order or prohibit, for example, a person's internal acts, such as thinking, desiring, loving or hating, nor many of his external acts). Therefore, it may be legal to pour toxic waste into a river if it is not prohibited by a law, but it may be immoral.

Moreover, laws change (sometimes arbitrarily), whereas it does not seem reasonable that moral criteria should change in the same way. And it is easy to find examples of contradictory laws, which, if legality meant morality, would require incompatible moral behavior.

What is more, laws themselves must be governed by moral criteria, which gives rise to the classic distinction between just and unjust laws. Thus, a law that violates a person's dignity (sanctioning slavery, for example) is not just and therefore cannot be accepted and observed.

It is reasonable to conclude, therefore, that law cannot be the ultimate criterion of morality. However, obedience to the law may be an ethical duty, and this takes us to the core of our discussion.

Why obey the law?

We are therefore led to the conclusion that a just law, one that meets the conditions stated above, must be observed, not merely for practical reasons (to avoid punishment, for example), but also for moral reasons: there is an ethical obligation to observe it. Philosophical reasons can be given for this (law orders behavior towards the common good of society and it is the duty of all citizens to further this common good), and also practical ones (because of the harm that would be done to society if the law were not observed). Thus, driving on the right or on the left is a practical decision, not an ethical one; however, once the decision has been specified in a law, the common good requires that everyone respect this rule, so that it is no longer a debatable, practical criterion but an ethical one.

The obligatory nature of the law should be interpreted in a fairly strict sense: it is always assumed that laws must be observed, so the possible reasons why a law cannot be ethically enforced in a particular case should be carefully assessed. A detailed moral analysis of the law and its circumstances is necessary in order to decide if a particular precept is morally binding or not.

The observance of law is objectively an ethical action, although it may not necessarily be so subjectively: a citizen who pays his taxes with great reluctance, for fear of punishment, produces the result desired by the legislator, but he does not improve as a person, since it is the intention that governs the personal results of ethical actions. And it is also desirable that citizens not only formally observe laws but that they voluntarily follow them insofar as laws contribute to the common good of society. As Aristotle said, one of the purposes of law is to «educate citizens in virtue, by knowing the means that lead to virtue and the essential end of the most worthy life» (*Politics*, IV, 13). Legality is satisfied with the

result, while morality operates on the agent's intention; by behaving in accordance with the law, he learns to act not only legally but also ethically. Thus, observance of law does not detract from the individual's freedom and dignity.

Multinationals and the ethical problems posed by the variety of national laws

The fact that different countries have different laws does not alter the moral duty to obey the law, not because of the rule of thumb «When in Rome, do as the Romans do», but because of an ethical principle that obliges people and organizations to contribute positively to the good of the society they operate in, and this good is represented, in part (not wholly), by that society's laws.

Moral problems are often raised in multinational or transnational companies: which law should they obey when the legislation of the headquarters' country is not the same as that of the subsidiary's? This question can be solved by respecting the distinction between legality and morality. If the legislation of the country a firm is operating in is different, but is just, it must be followed because by doing so one contributes to that country's common good. If there is no law, or if it is not in accordance with moral criteria, one must always follow the moral criteria.

Let us take an example: what must companies do if environmental legislation is stricter in Germany than in Portugal? The answer is this: German and Portuguese companies operating in Germany must observe German legislation if it is not unjust, even though it is stricter than Portuguese legislation. And German and Portuguese companies operating in Portugal must observe Portuguese legislation, except when, given the greater permissiveness of Portuguese law, they consider in all conscience that they should not observe it, in which case they should follow their moral criterion (which may or may not match German legislation).

An interesting moral dilemma arises when a company operating in a country with high environmental standards has to compete with another company producing in a country with less strict (but not necessarily unethical) environmental requirements, so that the former has a competitive disadvantage. This case calls for the sort of harmonization of legislation that is intended in the European Single Market.

Conclusions on law and business ethics

Companies do not operate in a vacuum but within an extensive legal and institutional framework that facilitates (or hinders) their activity. Institutions such as the family, democracy, private ownership, contracts, taxes or wages constitute the medium within which business activity is carried out and which itself is governed by rules, regulations, codes, habits and customs created by society in the course of history. Within this legal and institutional framework, the State plays an important role as the representative of society and embodiment of authority. The first task of the State is to define a legal framework that will give consistency and legality to society's institutions, norms and regulations.

The State thus has the power to pass laws, which, if they meet certain conditions, are morally binding. Law is necessary to attain the common good of society and of its members. Companies must contribute to this good, and this is why they must obey the law. Therefore, respect for the law is one aspect of the moral behavior of a company, but it is not everything. Ethics is above law and is also the source of the power of the law to oblige morally.

Laws are not something sacred, as Latin culture sometimes pretends: they are no more (and no less) than an instrument at the service of the common good of society. They are not an obstacle that must be knocked down, jumped over or bypassed. They should be respected as a condition for the proper functioning of society, and even as a condition for personal freedom. (Nevertheless, it must be recognized that in practice many laws may be defective or even immoral, and therefore not binding).

Part Two

THE REGULATION OF BUSINESS

Regulation is a body of general rules or specific actions imposed by the government which interfere with the mechanism for resource allocation in the market, either directly or indirectly, *e.g.* by influencing the decisions of consumers, suppliers, workers and companies. From the point of view of a firm, a regulation is a specific interference (coercive, but sometimes simply in the form of recommendations) by the government or by a regulatory agency in its affairs outside the realm of market transactions.

Governments have been regulating economic activity for a very long time. Since the 1970s, however, there have been a number of changes in the way this regulation is carried out, and we are now seeing the consequences of these changes:

(1) Governments and experts are more sceptical about regulation, so that deregulation is now the catchword. This means making more room for the market (and for ethics as a condition for the performance of markets).

(2) Instead of regulating structure (for example, the number of firms competing in a market, or their relative size, as in the antitrust policy), governments tend to regulate behavior (for example, preventing entry barriers from being raised against new potential competitors). In this way, companies are trusted more (and they are given greater legal, social and ethical responsibility).

(3) Regulations extend to a large number of new fields (environment, health and safety at work, consumer protection, product safety, etc.); it is more functional than industrial; less aimed at competition and more at quality of life. This is also positive from the point of view of business ethics.

(4) There has been a strong movement towards privatization of public companies as a form of deregulation. At the same time, this movement is accompanied by re-regulation in order to balance the incentives of the new private owner against the requirements of economics and ethics (if, for example, the basic telephone service is privatized, the rights of users and suppliers of other services, the so-called value added services, to use the basic network in fair and competitive conditions must be clearly established).

(5) Although regulation is justified when there is a market failure (a situation in which the free play of market forces does not produce the social optimum), the existence of State failures is also admitted. Regulation is not a panacea.

(6) Therefore, governments must carefully study each problem before deciding what the most suitable regulation would be (if regulation is indeed necessary). Also, they must search for alternatives to regulation, such as the so-called competitive regulation mechanisms like competitive franchises or licenses (competitive bidding among the possible suppliers of a good or service under monopoly conditions); or competition between regulatory offices; or reliance on the market whenever possible (a «pollution market», for example, that defines rights to ownership and economic incentives that encourage more appropriate behaviors in each case), and so on. Again this means more freedom and moral responsibility for business.

(7) Nowadays, the existence of two extreme strategies with regard to regulation is recognized. On the one hand, there is the «adversarial approach», or «regulation + litigation» (the State establishes regulations and takes legal action against those that do not observe them). On the other hand, there is the «cooperative approach», or «negotiation + incentives» (which seeks to obtain the cooperation of all the parties involved –users or consumers, producers, government, etc.– in gathering information, designing the regulation, implementing it, imposing sanctions, etc.). These changes have an ethical appeal in that they are more effective and less costly, and also in the greater freedom they give to the agents involved, the greater degree of cooperation, the appeal to companies' sense of responsibility, etc.

Diversity or harmonization of regulations within the European Community

The process of economic unification that began with the Common Market and continued with the Single Market and the projected Economic and Monetary Union, possibly with Political Union as its ultimate goal, implies major changes in the regulatory environment of the member countries of the European Community (EC) and any other countries that may join the EC in the future. What are the ethical implications of this process?

At national level, there arises the need to adapt a large number of regulations, with significant economic and moral effects. Assuming that all the changes are justified from the economic viewpoint (which is not the case), governments must also consider the costs and benefits they will impose on their citizens. Many of these changes will benefit some citizens and harm others, which is not a hindrance if these changes are expected to bring about an improvement of the common good: increased competition (which will lead to lower costs and prices and a greater efficiency), access to new markets, safer and better quality products and services, greater freedom in the circulation of goods, services, capital and people, etc. Thus, from the ethical viewpoint, the above-mentioned changes should be considered as being positive.

Governments should also give thought to the inevitable losers from these changes. It is not a matter of preventing there being any losers, but of providing suitable adjustment measures (a period of advance warning, for example, but not economic aid, which is not permitted by the European Commission). In short, the idea is that companies should have the same possibilities of competing within

the EC, regardless of their nationality; therefore, governments should facilitate the adjustment to this situation.

A typical case would be the regulations regarding product quality, safety and hygiene. National governments must accept the foreign products and services that meet the conditions established in their home country (principle of the country of origin). Consequently, all the governments will foreseeably set minimum conditions (which is the aim pursued by EC legislation) so that the products are sufficiently safe for use by consumers but without imposing excessively restrictive conditions for domestic companies or discriminating arbitrarily against products from other member countries.

At the same time, governments should also avoid regulating against products from non-member countries: competition should be free within the EC and also for products coming from outside. A typical example would be the regulation of airlines or road transport. The evidence from the deregulation of these industries carried out in the United States and the United Kingdom shows that it results in lower costs and prices, greater economic efficiency, more competition, greater choice for users, wage moderation (in industries that are protected from competition, wages «swallow up» a large part of the benefits of protection), etc. The effect on the quality of the service is not clear, although the evidence from the North American airlines suggests that small towns have not been neglected, there have not been more accidents and customers' needs are better catered for, although at the cost of greater congestion in the airports and delayed flights. It therefore seems that the results are encouraging, but in spite of this the EC is still reluctant to liberalize, probably because of the loss of control of national airlines that this would involve and lobbying by the companies concerned.

Adapting national legislation to EC rules is not a simple process. Often, it is not simply a question of ordering or prohibiting something: for example, in the process of adapting environmental legislation, countries must change their production structure and the products with which they will be able to compete in the future, redesign equipment, alter processes, etc. Thus, any change of regulations must be approached with caution, although it should not be omitted: at present, many regulations serve only to protect existing, dirty industries and hinder the advent of new, cleaner ones.

Why regulation?

Economists usually argue that, under certain conditions, the free market ensures the efficient allocation of resources and the greatest possible growth of output, given the endowment of factors (land, labor, capital, etc.) and their ownership, the technology available, the state of knowledge, etc. If this is so, there is no economic justification for public regulation, except when one or more conditions are not fulfilled. Hence, in practice, the economic justification for regulation is usually based on one of the following arguments, which we will utilize to introduce the forms of regulation and a broad set of related ethical issues (the specific issues of the regulated companies will be discussed further on).

1. Market power

The typical case discussed under the heading of market power is natural monopoly, when, given the size of the market, the existence of a single supplier guarantees the lowest costs. If, for example, each distributor of gas, telephone, water or electricity had to build and maintain its own network, the cost of the service would be much greater than with a single supplier. However, if there is only one supplier, it may charge a monopoly price, higher than that which would prevail in competitive conditions. Thus, natural monopolies give rise, firstly, to economic inefficiency as a result of prices that are too high and production that is too low and, secondly, to an ethical problem, since the monopolist obtains extra profits at the expense of the consumers.

The regulation of natural monopolies seeks to establish a price that is closer to that which would be obtained in competitive conditions. Several solutions have traditionally been applied, all of which have their drawbacks:

(1) Public ownership of the monopoly company. This gives rise to efficiency and morality problems, owing to the lack of incentives to produce a quality good or service at the lowest possible price and incorporate technical advances.

(2) Pricing by the regulatory agency. But it is difficult to define efficient and fair pricing criteria. If, for example, the public transport tariffs are too low, they will penalize the factors used in production or endanger the quality of the service, the introduction of innovations and even the survival of the firm. If they are too high, the economic and ethical problems of the monopoly re-emerge.

(3) The prices set by the agency often include some type of subsidy, for example, for the extension of the telephone network to rural areas. But the technical and moral problems increase dramatically when there are cross-subsidies: when, for example, a monopoly is granted for a low-operating-cost, city center bus line on the condition that other peripheral, high-cost lines also be served at a low price. Apart from the inefficiency in the use of resources, it is equivalent to taxing the users of the former line to benefit the users of the latter, a practice which is morally questionable.

(4) In services that operate a network (telephone, water, electricity or railroad) it is common for competition to be encouraged by having the network operated by different suppliers (several railroad companies, for example), while maintaining the ownership of the network (the railway lines and stations) as a regulated public service. This case raises ethical problems concerning the different treatment given to different users and the question of guaranteeing free access to all, even potential future competitors, against the interests of those already in existence.

(5) Another solution is the competitive licence: the monopolist must periodically compete with other potential suppliers to win the licence that will enable it to operate the service for a further period of time. This also raises moral issues because the price charged is a monopoly price (even though the extraordinary profit is collected by the government through the bidding). There is also the possibility that the potential competitors reach an agreement to fix a low bidding price or to unfairly exclude other competitors, etc.

When the monopoly is not natural but arises from a lack of competition due to collusion, a cartel, artificial entry barriers, customs tariffs, protectionism, etc., the solution is not to regulate the market but to put an end to the problem by taking antitrust measures,

reducing tariffs, facilitating the entry of competitors, etc. However, if the advantage of the company is the result of its innovative superiority or greater efficiency, then the wisest thing to do is not to intervene.

2. *External effects*

External effects occur when the actions of an economic agent affect other agents without there being a direct market transaction between them. For example, when a plant pollutes the atmosphere or a river, or when its trucks congest the roads, it is passing on to others a cost that should be borne by it alone. Or, at the other extreme (positive externalities), when a company carries out research or staff training programs, it is indirectly improving the scientific and technical level of the other firms, which do not pay for it.

The actions to be carried out to correct external effects will depend on the type of effect produced.

(1) If there is a problem of congestion (of telephone lines, roads, radio or TV waves, etc.), the number of suppliers can be restricted (for example, by distributing a limited number of radio frequencies), although this too can cause a number of technical and moral problems, such as that of maintaining competition and establishing equitable criteria for rationing the scarce resource. Another possibility is to use the competitive licence mentioned above. Alternatively, the right to use the service (the right of users to connect to a congested or congestable network) can be regulated. In other situations, taxes can be used, such as those levied on the purchase and use of automobiles or on fuel consumption to penalize traffic congestion.

(2) There is an interesting kind of external effect based on trust. For example, if the customers of a bank doubt its capacity to return the funds deposited in it, they may start a rush to withdraw those funds, which will undoubtedly place the bank in a situation of illiquidity (and the problem may spread to other banks). The solution to this type of situation is based on the implementation of regulations designed to restore confidence: cash and solvency ratios, the Central Bank acting as a lender of last resort, deposit insurance, minimum capital, etc. A moral and economic problem related to this type of solution is the risk of their being too strict, because the authorities prefer security to efficiency. It may also lead to undesirable behaviors (for example, if there is a generous deposit insurance, a bank's administrators may undertake operations that are excessively risky).

(3) Another type of external effect is that which gives rise to the obtainment of a licence or permit (normally accompanied by the payment of a fee) for certain activities, such as digging ditches in streets for laying electric cables or telephone lines, or occupying land to lay a railway line or erect telegraph posts. A licence opens the door to a privilege, so that new ethical questions may arise.

(4) As we have already said, there are positive external effects that should be encouraged. Thus, the State may grant a temporary monopoly to work a patent in order to create an economic incentive for research; or it may grant the monopoly to run a motorway for a certain period of time, enabling the construction costs to be recovered, etc. In these cases, the firm has an extra economic incentive to fulfil some of its social responsibilities.

External effects always have important ethical implications on account of the consequences that the actions of a company may have on other people. It is part of the moral responsibility of firms to take these effects into account, although there may be no easy way to implement this responsibility.

3. Internal effects

Internal effects are costs or benefits within an economic transaction that do not form part of the agreement. There are many examples of these effects: a good or service that does not have the quality agreed or expected, or that is not safe or hygienic, etc. A common internal effect is related to the lack of information: before entrusting our case to a doctor or lawyer, we want to know whether he is competent, and before buying a medicine, we want to make sure that it has no harmful side effects, etc.

The lack of information, or the unequal distribution of information among economic agents, is a problem with economic and moral implications. It can be corrected by measures that affect the product or service, such as the standardization of contracts (common in transportation, financial services, insurance, etc.) or the establishment of standards governing the good or service, its production process and distribution (for example, the standards regarding the quality, safety or hygiene of goods, or the standards of behavior of certain professionals such as doctors, lawyers, financial intermediaries, etc.).

There are regulations that deal with the inputs (qualifications of employees, use of dyes or preservatives in foods), the final service (the coverage of an insurance policy or the establishment of transport conditions), certain results (maximum authorized emission of pollutants), certain permitted or prohibited operations (for example, by a bank), conditions of health and safety at work, working hours, the granting of licenses to carry out certain activities or membership of a professional association as a prerequisite to do so, the requirement of certifications (financial ratings, classification of hotels or campsites), the performance of tests (to examine a professional's qualifications, the contents of a product, the strength of a material, the properties and effects of a medicine, etc.), the involvement of specialists in an operation (realty agents), etc.

The moral problems raised by these regulations vary considerably. For example, compliance with a standard does not necessarily guarantee quality, and the possession of a qualification does not guarantee possession of the necessary knowledge (once more, legality does not mean morality). Standards can also be used as entry barriers to reduce competition, and the standardization of contracts can encourage abuses of the lack of knowledge of less experienced customers, etc.

Sometimes the regulations require the disclosure of certain information for the benefit of the customer (for example, that the professional attending him has a degree in medicine, or that the drug he buys has passed certain tests). On occasions, the contents of the regulation concern the provision of this information (the contents and expiry date of packaged foodstuffs, the name of the manufacturer, the price, etc.). Other examples are the financial and economic information that must be provided by companies listed on the stock exchange.

A specific ethical and economic problem related to the non-internalization of certain costs is that of occupational diseases and accidents. It may be difficult for the worker to obtain information about the risk he is incurring; hence, his inability to take appropriate

protective measures (which, in any case, he cannot take unaided, if the company does not take them). As it is expensive for firms to establish internal prevention and protection standards, they often prefer to pay compensation for damages. However, this implies that health and safety will never be an internal affair but an external cost, and so measures will not be taken to solve the problem. Meanwhile, the dignity of the individual, the basis of all ethics, is disregarded.

The information on occupational diseases and hazards will be inadequate if firms are given no incentive to compile it and make it available to their workers. The problem lies in the fact that the workers are often unaware of the nature of the products they are handling and of the hazards they involve, and it is not in the company's interest to provide this information, as it would mean higher safety standards, demands for higher pay to cover the risks, and larger claims by workers who sustain illness or injury. However, if there is to be any justice in labor relations, this information is vital, in the same way that the worker's dignity demands that he be informed of his occupational hazards.

4. Other arguments

If a certain distribution of income or wealth does not seem to be fair, measures may be taken to correct it, either directly (through taxation, subsidies for basic needs, education, health, housing, etc.) or indirectly (by correcting the supposed causes of the unfairness by means of obligatory education, a minimum wage, unemployment insurance, etc.).

Redistributive policies have a clear ethical component (positive, but perhaps also negative, when what is sought is the unjust benefit of a particular group or when the results of the regulation are ethically undesirable). They contain an interesting combination of economic and moral effects, which must be separated into their individual components in each case. For example, a minimum wage policy usually increases the income of some unskilled workers but is likely to have the result that fewer of them are employed, or fewer jobs are available for new entrants to the labor market. Similarly, a generous unemployment insurance allows unemployed workers to look for a new job without anxiety, but it also enables the loafer to enjoy a long period of income without working. Finally, a rent freeze usually improves the tenants' standard of living, but at the cost of the income of the owners of the dwellings (and it can also lead to the disappearance of rented housing from the market, to the detriment of future potential tenants). These are ethical issues for the policy makers, but also for businesses, at least insofar as they affect their social responsibility.

There are other arguments for regulation: protecting employment or incipient industries, defending sovereignty or national security, redressing the balance of payments, etc. Not all of them are equally convincing. It should be added that regulation is not necessarily the best procedure for solving these problems (and from the ethical viewpoint, the first thing that must be demanded of a regulation is that it be efficient, in other words, that it achieve its purpose at a reasonable social cost, justly shared out).

Are there ethical grounds for regulation?

The first question posed by regulation refers to its very morality: can the State dictate rules that impose a limitation on the freedom of action of businesses? The answer, as

we saw, is in the affirmative: since the State is responsible for the common good of society, it can (and must) regulate, even though companies wish to regulate for themselves, because companies are not always able to define the problem with sufficient objectivity or devise the best solution. For example, there are «free rider» problems: if a group of companies voluntarily accept a regulation, there is an economic incentive for any one of them to follow a different course of action and benefit from doing so, at least in the short term. Therefore, the State must uphold regulations with its coercive power. Also, the State must represent those who cannot make themselves heard (for example, future generations).

However, this duty must be exercised with particular care because economics and empirical evidence very often show that regulation may be unnecessary, even counterproductive. This does not mean that the State should not regulate, but that it should act with particular prudence, strength and equanimity.

Is there a direct moral justification for regulations? Specifically, can regulations correct ethical failures? The idea is appealing but arguable. Let us consider an example. It seems fair that two users of the same telephone network should pay the same rates, whether they are near the station or far away from it. However, the private and social costs of serving the client who is further away are greater. Should the user who is nearer pay a higher price that subsidizes the user who is further away? What criterion of justice should be used in this case: the same price for everyone, or a price that is proportionate to the cost? Furthermore, economics suggests that cross-subsidies are not efficient, and that, if it is considered desirable to price below cost in some cases, it is preferable to establish a subsidy financed by a general tax and not, as in the case we are considering, by a «tax» levied on the low-cost user through a high price. Economic regulations must have solid economic foundations, not only loose ethical motivations.

Nevertheless, there are also examples of regulations that seem to be substitutes for ethical rules. For example, would legislation on pollution be necessary if companies always respected the environment? But the ethical rules are general («do not harm the environment», or «do not harm the environment if possible»), whereas companies need more concrete rules to work with. What does «harm the environment» mean? Is every damage undesirable, however slight it may be? Moreover, ethical companies may not know what is good or bad for the environment, or how to avoid the damage. Therefore, there is a role for regulation even if people always try to behave ethically.

Ethics and regulation, therefore, are not equivalent. They may be complementary (companies that try to be ethical need regulations to guarantee success), unrelated, or even substitutes (if people always behaved ethically, certain regulations would be superfluous).

However, to regulate is to interfere with the mechanisms of the market, which are justified on the grounds of economic efficiency. This implies a generic presupposition against regulations, because they limit the freedom of the economic agents, impose a cost or loss, and may limit economic efficiency. When, then, are specific regulations acceptable?

When is a regulation ethically obligatory?

Here, we apply the general principles of the morality of law (as regulation is basically the specific development or application of the right to legislate).

(1) There has to be a problem that, from the technical (economic) viewpoint, demands a regulation. Regulation cannot be the result of arbitrariness, caprice, ideology or particular interests.

Often, a bad regulation is merely the result of an inadequate definition of the problem. For example, the question is sometimes raised of whether the sale of low quality products should be prohibited (in developed countries because of the standard of living acquired, and in developing countries because, it is argued, it is immoral to sell there what it would not be moral to sell in advanced countries). Apart from the fact that this is usually an argument used to reduce the competition from cheap products, it contains an ambiguity *ab initio*. If by low quality product one means, for example, a simple, cheap car with little more than what is necessary to travel but sufficiently safe and solid, then there is no economic or ethical argument against it; not all cars have to be a BMW or a Rolls. However, if by low quality we mean defective manufacture or an unsafe product, then it is obvious that there are ethical objections to their sale in any country.

(2) Regulation must be the most suitable solution (or, at least, sufficiently suitable). Here, policy makers must be realistic, rejecting the «best possible solution», which may be too expensive, but also a «sufficient» regulation that does not go far enough. What makes a «reasonably» safe car or an «acceptable» level of emission of pollutants will depend in each case on society's values and on the foreseeable effects of regulation.

Governments must also avoid excessive regulation. For example, the conditions imposed on USA nuclear power plants after the *Three Miles Island* accident (1979) were excessive, motivated more by the desire of the regulatory agency to protect itself against criticism in the event of possible future failures than by a reasonable study of what was necessary in each case.

(3) The regulation must be general, applicable to all those who are in the same situation, and non-discriminating.

(4) It must be concrete, so that it can be implemented without ambiguities, as far as possible. For example, an advertisement can be forbidden because it deceives the consumer, because it is based on an untrue argument, or because the product is harmful, but not on the grounds that it «rests on non-rational persuasion» or «gives rise to unviable consumption models» (which can, however, be used to argue an ethical case, not a legal case, against such advertising).

(5) As regulation has negative effects on freedom, competition, costs, prices, etc., it must meet certain conditions for it to be called ethical. For example, it would have to observe the impartiality principle (the regulation will not attribute unjustified benefits or harm to any person or group) and the proportionality principle (the harm done by the regulation is in proportion to the benefits obtained from it). It should also be remembered that a specific regulation may obstruct competition (becoming an entry barrier for future competitors), require other regulations (setting the price of a basic necessity is the first step towards reducing its supply, which will require further regulatory measures to correct it), change the motivations of the economic agents (such as the incentive to work among unemployed people covered by a generous unemployment insurance), introduce significant costs (bureaucracy, licenses, delays, etc.) or have any number of other effects whose economic and ethical consequences must be duly examined.

Another important point is the political process inherent in regulation: the proliferation of regulatory agencies, the creation of lobbies, the risks of unethical behaviors to obtain a regulation or protection from a regulation (for example, bribes), the attempts to retain a regulation even when it is no longer necessary (because there are always parties interested in its continued existence), etc.

In short, the regulator will no doubt have to proceed with due caution in order to match the desired goal with effects that are not always desired. He must listen to the regulated parties, who are the ones who know best their problems, but using his own judgment, so as not to accept their biased arguments without question. He must listen to the experts, but he must adapt their recommendations to the specific situation. He must apply imagination and fortitude, and beware of popular solutions in his search for effective and reasonable cost solutions (a limit to the maximum allowable pollution by a factory is a simple and attractive solution, but it is usually very inefficient). And all the while, he must negotiate with political interests, lobbies, those who stand to lose and those who stand to gain, etc.

(6) Finally, the regulation must be applied equally to all the affected parties. Otherwise, the common good, which the regulation is precisely designed to serve, is harmed, and an injustice is committed.

Gambling in Europe

«As Conservative members of parliament gathered at Westminster last November [1990] to elect a successor to Margaret Thatcher as leader of their party and the government, a camera crew from Italian television was covering the event from the headquarters of Ladbrokes, the UK's largest betting shop operator. The Italians' interest was engaged by Ladbrokes offering odds on such a serious battle as if it were just another contest at Rome's Campanelle race course» («The odds against harmony», *International Management*, October 1991, p. 89). Like many other sectors, gambling has also spread through Europe, so that the European Commission has been studying the possibility of harmonizing the way it is regulated.

Gambling and gaming differ only in that the experience and ability of the player are not relevant in the latter. Both go back a long way in history, and have raised ethical problems for centuries. Sometimes they have been accused of immorality on account of the prevailing motivation: profit. Probably they deserve a wider judgment: they are not essentially immoral activities (save in certain cases), although they may have undesirable effects (time-wasting, addiction, quarrels, acts of vengeance, poverty, the temptation to bend the rules or use unethical means, etc.). In these cases it is necessary to apply the ethical rules of an action with both good and bad effects.

The ethical problem must also be analyzed taking into account the culture, temperament, lifestyle and regulation of the country. In France, for example, casinos have been legal since 1907 in spa towns, but remain banned within a radius of 60 kilometers of Paris. In Denmark they were legalized very recently in order to discourage Danes from travelling to Germany to bet. The French and the British are

fond of betting on horse races, but Spaniards are not. In England there is not (at the time of writing) a national lottery, as there is in other countries (probably because of the opposition of football-pools operators).

Governments regulate gambling and betting very strictly, for public order and control reasons, but also because they obtain huge financial revenue from these industries. And this is the cause of several contradictions: for example, in Portugal, Spain, France, Italy and Greece casinos are legalized as a tourist attraction, although 80 per cent of their customers are nationals. In the Netherlands the government tolerates illegal private casinos. They are also illegal in Belgium, but the Treasury officials control them, for revenue reasons. In Spain the addiction of young people to legal slot machines is a source of concern for specialized psychiatrists.

But there are also reasons for a European regulation of gaming and gambling. The freedom of movement of people and services puts into question the existence of legal monopolies such as that of Pari-Mutuel Urbain in horse-race betting in France, compared with the freedom of business in other countries (in addition to the fiscal and financial advantages the French government has given to Pari-Mutuel, contrary to the EC criterion of free competition). Moreover, national lotteries (the great majority being publicly owned or run) fight back the entry of foreign lotteries in their own country. Finally, technological progress and the deregulation of financial markets make it easy to operate in a foreign country, seeking the highest profits.

In any case, the European Commission does not seem to be interested in entering into the regulation of such a complex and conflict-ridden sector at the moment.

Ethical problems of regulation: the point of view of business

Companies may be affected by a regulation before taking decisions (for example, before starting the production process of a drug that is subject to restrictions as regards content, tests, advertising, etc.), or when the decision is being implemented (when, for example, after a certain period of time selling a domestic appliance, it is made subject to new safety requirements). From the ethical viewpoint, both situations should be given the same treatment, although implementation may be much more difficult in the second case.

It is therefore common that when a new regulation is issued, companies first react by avoiding or ignoring it (pretending that the regulation does not exist), or by opposing it (trying to change the regulation, requesting an exemption, or a lengthy adjustment period, or subsidies to implement it, etc.). Later on, they decide to fall into line with the new regulation, although perhaps with little enthusiasm. Only truly ethical companies will quickly overcome these stages and accept their responsibilities, which include accepting the need for the regulation, making any internal adjustments that may be necessary and cooperating actively with the authorities, turning what initially seemed to be a threat into a strength (and obviously this does not prevent them from objecting to regulations, when necessary).

It is very difficult to summarise the ethical problems that a regulated company can be faced with, as the situations can vary considerably. Here, we will only mention some of these problems, briefly explaining the criteria that are applicable in each case.

(1) A just regulation is morally obligatory for all the parties affected by it. The force of this obligation will depend on the type of regulation, its scope and effects, the nature of the problem, etc. There is a difference between omitting the composition of a packaged food and discharging toxic waste into a river. However, a company that wishes to behave ethically at all times must obey every regulation as if it were a moral duty. Even though some experts hold that business ethics is concerned only with results, not with intentions, motivations or attitudes, this criterion seems to be more appropriate for law or regulation than for ethics.

(2) A regulation may not always be morally binding. For example, if the managers of a company are convinced that the safety standards for a product are counterproductive, they may not observe these standards. Obviously, the argument that extra costs will be incurred, or that profits (even large profits) will be lost, is not sufficient to justify sidestepping the regulation. Nevertheless, when the damage produced by not observing a regulation is very small and the damage caused by observing it is very great, the moral criterion that «no one can be obliged to do the impossible» (nor even the very difficult, if the reason is good enough) can be applied.

The moral decision whether to disobey a regulation requires more than general arguments (such as «governments always do things worse than the market») or circumstantial evidence (such as «on such and such an occasion, the government was wrong»); it demands a genuine conviction, founded on a careful analysis of the actual regulation, the circumstances, the situation of the company, etc. (including, in many cases, the advice of an expert or moral adviser). Indeed, if the managers of a company believe that a regulation is unjust (discriminatory, clearly inefficient, enforced without any regard for the rule of law, etc.), then they must not obey the regulation, as this would amount to doing something wrong (although legal).

(3) The absence of regulations does not justify unethical behavior. No one can expect all possible forms of behavior to be covered by a regulation. Consequently, above and beyond regulations (and their loopholes) one must observe the rules of ethics.

An interesting example is the shipment of toxic waste to Third World countries, where there is no law prohibiting dumping (and the argument that this provides these countries with the opportunity to make a profit is false, as the social costs of dumping the waste will probably be far greater than any benefits it might bring).

(4) Should regulations be applied at the lowest level possible and strictly according to the letter of the law, or should they be observed in a wide sense and in accordance with the spirit of the law? If the aim is to avoid legal conflicts, then minimal compliance may be sufficient, but if the aim is to act ethically, then the criterion must be to promote the common good. This implies observing the spirit rather than the letter, and complying with regulations in a broad sense (although this does not mean that extra moral duties be laid upon the company: if, for example, the law requires that certain additives or coloring contained in a food product be stated on the packaging, then, even from a moral viewpoint, it will be sufficient to do only that).

(5) A regulation cannot be used as an alibi for non-ethical behavior. Therefore, it is not ethically correct to scrupulously comply with a regulation when doing so entails breaking a rule of ethics. To follow the instructions regarding the dosage of a drug when there is reason to suspect that this dosage is harmful is not morally acceptable.

(6) The obligation to observe a just regulation creates a dilemma for a company when its competitors do not observe the regulation. The law-abiding company finds itself at a disadvantage: if it observes all the regulations on protection of the environment, safety at work, tax payments, etc., its costs may be far higher than those of other companies, particularly in certain unethical circles, and it may lose competitiveness. What should it do?

It is not possible to give an answer to this question without knowing the circumstances of the case: whether it can report its unethical competitors to the authorities or to the press, whether it can negotiate with them the joint implementation of the regulations, what would be the effects of not observing each regulation, how difficult the competitive situation is, etc. In any case, it seems reasonable to conclude: (a) that the obligation to observe all regulations remains valid, as a general rule; (b) the rules concerning the morality of an action with both good and bad effects must be applied to this particular situation; and (c) in many cases, the dilemma may be solved by a higher authority (a producers' association, the government, the European Commission, etc.).

It is a fact of experience that many ethical dilemmas are the consequence of bad decisions taken in the past. Managers who know that new legislation on environmental protection is imminent and yet fail to prepare the company for the new rules are to be blamed if at some time in the future they are caught in the false dilemma of polluting the environment or closing down the firm.

It is also a fact of experience that a little ingenuity and initiative can help to solve many ethical dilemmas. For example, how can companies such as multinationals afford to pay taxes in countries where tax evasion is the norm, without endangering their profits? The answer is difficult to understand for people who cannot imagine doing business without breaking the fiscal law (this is a dilemma for them). Managers of ethical firms, however, count on taxes from the start and prepare their plans in such a way that being fiscally conscious is not a burden but an advantage.

(7) Precisely the fact that regulations must be respected by everyone in an industry in order to be effective provides a further argument in favor of the presumption that regulations must be observed: because they give rise to an external effect (a public good) that is beneficial for everyone. And although each participant in the industry may have an incentive to not observe the regulations (the free rider effect), in the final analysis the observance of the regulations benefits everyone (which is the reason why they are accompanied by a certain degree of coercion).

This is the case, for example, of the pharmaceutical industry: given the nature of the products, it is important for the entire industry that the image for high-quality, safe products be maintained. This explains why *Johnson & Johnson* immediately withdrew *Tylenol* from the market when it received threats of poisoning the drug, and the greater protection it subsequently incorporated into the packaging of its products. This enhanced the image of the company and of the industry as a whole.

(8) What should one do when there is a conflict between regulations? For example, when a national or supranational agency issues standards that conflict with those of a regional or local agency, or when a multinational company has to cope with requirements in the country it operates in that are different from those of its home country. The distinction between legality and morality will be helpful in this case: if the company follows an ethical criterion of care for the common good, it will consider the various regulations as (partial) indicators of this common good, not as definitive criteria.

Consider, for example, the case of the United States *Foreign Corrupt Practices Act*, which has sometimes been presented as an example of legislation in one country that contradicts cultures and regulations (or, more exactly, the lack of regulations) in other countries. From an ethical viewpoint, the problem is simple: a company must not use methods of corruption in any country, whatever the legislation of either the foreign country or its home country may say on the matter. And if there are sometimes reasons for utilizing ethically questionable methods (for example, to accept an extortion, but never offer a bribe), there are ethical rules for resolving the dilemma (which, in this case, would perhaps be more flexible than the above-stated Act).

Let us sum up the previous paragraphs:

- (1) take regulations seriously if you want to be ethical in business;
- (2) make positive efforts to obey regulations in the spirit in which they were intended and in a wide sense;
- (3) take regulations not just as tedious duties, but as business opportunities;
- (4) do not feel obliged to obey regulations when there are serious reasons for believing that they are not compelling in a specific case (but be careful when appraising these reasons); and
- (5) always put ethics above regulations as a guide to your behavior.

The right to privacy versus direct marketing

Every person has the right to privacy: the right not to have his or her life's details disclosed. But as a social being, he has also the duty to disclose information to other people, and the right to know other persons' data that are of interest for him. The problem is where to draw the boundaries between the right to privacy and the right to information, and what to do when this information is used for arguable goals (blackmail, extortion, etc.).

The restrictive European position on the right to privacy contrasts with the more liberal American position, when confronted with the supply of databases for direct marketing purposes. Thus, a conflict arose recently as a result of the European Commission's Draft Umbrella Directive on Data Protection, which, according to the American firms in the sector, would harm their commercial activities in Europe (and in the long run in the United States, too). The projected Directive on Data Protection will mean: «(1) Data use is prohibited without authorization of the subject (consumer). (2) Data subjects must be personally notified about whom information has been passed on to and for what use. (3) Data subjects can claim compensation if data is 'misused and causes damage'. (4) European Community data can only be transferred out of the European Community if the receiving country can guarantee the same level of protection» (N. di Talamo, «Private secrets», *Direct Marketing*, April 1991, p. 42). And point (4) means that the US must pass legislation as restrictive as Europe's.

According to the American *Direct Marketing Association* (DMA), the protection provided by the Draft Directive is excessive and seriously damages direct marketing. Its European counterparts are less concerned because less developed techniques and methods are used here. The Americans defend the free use of databases where it is not inappropriate (illegal? immoral?), but the Europeans are more worried about the nuisances of unwanted mail. The nuisance disappears when the potential customers state *a priori* the use they want to be made of their data, but this may mean that useful advertising information is lost; information that, if a broader criterion were applied, could reach them.

The *European Direct Marketing Association* (EDMA) proposes an alternative solution: the interested person (consumer) would authorise the direct marketing use of his or her data, but with the right to the suspension of that use at his or her request.

Consumer protection European style

The protection of the consumer from the damage caused by the products he buys, uses or consumes has economic, legal and ethical consequences. Unlike the seller, the buyer may not know the good in detail: its quality and strength, the possible risks of using it, etc. He is thus at a disadvantage, so that the seller has a duty to provide the buyer with the relevant information and, increasingly, to guarantee that the good fulfils the terms implicit in the contract.

The European Commission's Directive 7/88 compels member states to adapt their laws on product liability to the European standards. This means that a supra-national law is imposed on the national legislators in order to extend consumer protection to the whole Community with common provisions. The Directive bears only on the results of the legislation, the member countries being free to search for the best way to attain it. This is an important step towards the harmonization of this regulation inside the EC, with the aim of guaranteeing consumers that the goods they buy, whether produced in the EC or imported, comply with specified safety standards, and that there is always one person or firm to complain to in case of a defective good.

In the past, consumer protection was based first on the law of contracts (a contract of sale recognizes the buyer's rights regarding the quality and characteristics of the product, so that their non-fulfilment gives rise to a right to compensation), and later on the general laws concerning damages for negligence (these recognize the duty of the seller to guarantee the safety of the product, but the consumer has to prove the damage, the negligence of the manufacturer and the causal link between the two). The EC Directive goes further than this when it states that «the producer will be liable for damage caused by a defect in his product» (art. 1), even if there were no negligence in the manufacturing or handling of the product, although the manufacturer can try to prove that the product did not have the defect that is blamed for the damage when it was first put into circulation (art. 7).

«A product is defective when it does not provide the safety which a person is entitled to expect, taking all circumstances into account, including: (a) the

presentation of the product; (b) the use to which it could reasonably be expected to be put; and (c) the time when the product was put into circulation» (art. 6). This includes defects of design as well as of manufacturing and handling, and also the warnings the manufacturer must provide regarding the risks of using the product. The liability takes in the manufacturer of the good, of its parts and raw materials, and «any person who by putting his name, trademark, or other distinguishing feature on the product presents himself as its producer» (art. 3), and also the importers of products from outside the European Community.

The Directive is an important step forwards in making manufacturers, importers and dealers more aware of their social responsibility in relation to the goods they produce and sell.

Ethical problems of regulation: The relationships between the regulatory agency and the regulated company

Interesting ethical problems are frequently raised in the relationships between those who regulate and those who are regulated. Here are some ideas:

(1) It is desirable that a relationship of fair cooperation be created between the regulatory agency and the regulated company, enabling the latter to provide information, offer solutions, point out the drawbacks of the norms proposed, etc. This may be in the interest of both the agency and the regulated firm if they wish to further the common good (although there is no lack of cases in which this supposition is not reasonable).

This cooperation will not be easy, as the two parties may have conflicting interests (at least in the short term) and mistrust one another. A company's managers demonstrate their ethical intentions by striving to foster this attitude and make it part of the culture of the company. Nevertheless, we cannot forget that there is a legitimate discrepancy of interests between regulator and regulated party, as well as different points of view about what is good for the company and for society, so that cooperation has obvious limits.

(2) The regulated company usually has more information than the regulator. This may give rise to a biased flow of information or to the capture of the regulatory agency by the regulated firm; the further removed this is from the principle of cooperation in the pursuit of the common good, the more reprehensible it will be from a moral point of view.

(3) Ethical (and organizational) problems are often raised regarding the control of the process, when the regulated company's managers are faced with several external sources of control (regulatory agency, government, judges, etc.) in addition to the internal ones (board of directors, shareholders, etc.) and the presence of other stakeholders. This very plurality of controls can reduce the managers' freedom of decision and ability to exercise their responsibility.

(4) Can the regulated company try to change a regulation? Obviously, yes, if it considers that the regulation is unnecessary, inefficient, arbitrary or unjust, or if it thinks that the same goal could be achieved more effectively and more cheaply by other means. It could be a very laudable effort, morally speaking, but it could also be reprehensible if it is done with hidden intentions (to drive a competitor out of business, to establish entry barriers for

new competitors, or to gain more pricing power, etc.) or using illicit means (falsification or non-disclosure of information, bribery, false accusations, etc.).

(5) Regulations will have inevitable redistributive effects. Except in cases of blatant injustice, the agency should not mitigate these effects because of the protests they generate, since the market can usually solve the “disastrous consequences” that industry forecasted. For example, when steps were taken to reduce the use of CFCs, the companies involved responded that they had no suitable replacement. However, faced with the need to comply with the regulation, they put their research machinery into motion and soon found one.

(6) Regulations may also change the relationships between competitors, or between clients and suppliers, etc. This creates new opportunities and risks for companies, and poses new ethical challenges. For example, a firm whose prices are fixed by a regulatory agency may take it for granted that the agency will also take charge of assuring the quality of the goods and services, or introducing innovations, etc. But this is more than can be expected of a regulatory agency. The fact that there are regulations cannot free the company from its duties towards consumers (unless the regulations make it very difficult for the company to carry out these duties).

Here is another interesting case of changing relationships between suppliers and clients: the owner of a telephone network has to rent the use of the network to suppliers of value added services, but in doing so it may discriminate in favor of certain users and against others (or even in its own favor if the owner is itself a supplier of such services). It therefore needs high ethical standards if it is to act with justice when short-term profits would argue for immoral behavior.

A different case of tax evasion

Tax fraud, concealment and evasion are, from the point of view of social ethics, serious social ills, which in some societies reach scandalous proportions. They also produce significant social ills, ranging from depriving the State of the resources it needs in order to play its part in the common good, to placing unfair comparative burdens on honest citizens, or encouraging a process of imitation that makes immoral conduct general, etc.

In 1991 a new case was uncovered in Spain, one that posed special ethical problems. A number of large companies were accused of using false invoices to avoid having to pay VAT, and investigators discovered several companies whose principal and even only business was writing out these false invoices, charging a price for their “service”. The ethical problem arose from the fact that the main motivation of the companies involved was not VAT evasion, but the need to justify to the auditors certain large payments that could not be justified by any other means, because these payments were made to political parties in order to win public works and public procurement contracts.

The ethical dilemma lay in that the companies had to pay a certain percentage of the value of the public contract to the political party, not for immorally winning a contract by illegal means, but simply for being awarded a contract that they had fairly won. It was therefore a case of extortion, but a very special one, in that it was an indirect contribution to public, semi-official corruption.

Greed versus health

In January and February 1991 more than 200 persons in various parts of Spain suffered poisoning as a result of consuming the liver of cows treated with chlembuterol. This is an anabolic steroid that increases the appetite and sleeplessness of cattle, and thus also the economic profits of the stockbreeder. Chlembuterol poisoning is generally mild, but can be serious in some cases.

The economic reasons for using chlembuterol are obvious: more meat, less fat, better presence of the food, faster growth of the cattle, and more profits. In Spain, as in the other EC countries, the use of chlembuterol is forbidden (although in the United States it is permitted in very low doses), and this prohibition is well known to feed producers, cattle dealers and vets. Therefore, there is no other justification than greed for the use of chlembuterol (except in some respiratory diseases).

This is a case of illegal and unethical behavior, endangering the health of consumers, and disregard of the law with no positive outcome other than higher profits. The chlembuterol case revealed the existence in Spain of a network of laboratories and plants that manufactured animal feed containing illegal drugs. The case heightened public awareness of the quality of food, made the health authorities start to take their control responsibilities more seriously, and prompted the cattle dealers to take joint action to defend themselves against the greedy and unethical members of the profession.

Self-regulation

Regulation is a necessary process but it is also expensive, often inflexible, and inefficient. It has therefore been suggested that it should be replaced by self-regulation, a process whereby the company itself, or an association of firms, takes responsibility for establishing criteria, setting rules and enforcing them. Self-regulatory bodies are common in the professions, in which an ethical committee deals with the complaints of the clients and of the members of the profession, or even acts on its own initiative to preserve the customs of the profession and to develop new norms when new circumstances require it. And the same occurs in firms, industries and sectors where reputation is an important asset, and where the costs and consequences of distrust and litigation may be high.

When a company or a whole industry uses certain internal criteria to set limits on some of its actions, in the absence of any regulation imposed from outside (or beyond that regulation), it could be applying ethical criteria or not. An association of advertising agencies that decides to apply strict criteria of honesty in its business, in the absence of any law that requires it to do so (or that decides to go beyond the requirements of the law), may be acting in compliance with the moral will of its members, but it could also be motivated by aesthetic or cultural considerations, a wish to avoid official intervention or improve public relations, etc.

The main economic justification for collective self-regulation is to reduce transaction and agreement costs. If someone wishes to object to an advertisement that is untruthful or morally offensive, he can take legal action, but it is time-consuming and expensive. It may be simpler and cheaper, and less irksome for the claimant, if the offending advertiser and media appear before a private court created by the leading advertisers, the media and the advertising agencies, which will give a quick decision. The authority of this

self-regulatory agency or body will depend on the agreement reached by the parties interested in self-regulation. Insofar as it is in their interest to promote their good name, flawless advertisements and good quality work, they will be the first to see to it that the agreements are put into practice and nobody acts as a free rider.

That is how self-regulation works. Its effectiveness will therefore depend on setting up simple, cheap, efficient and unanimously accepted mechanisms, accompanied, if need be, by coercive measures, either through the association itself or because the government backs the decisions taken by the self-regulating body.

This brings us to a very common problem in ethics: the lack of coordination between the actions of a group of agents and that of each individual agent (somewhat similar to the prisoner's dilemma). Each advertising agency, for example, considers that untruthful advertisements are harmful because they make the public view all advertisements with scepticism and distrust all agencies. Therefore, if all of them were to observe this moral rule, all would readily accept it. However, there is then the incentive for one firm to break this rule, sheltering under the good name of the whole but benefiting from a favorable situation due to its lack of truthfulness. Hence the interest in having regulations to prevent this and, if it is expensive, a self-regulating body.

Self-regulation raises a number of other interesting questions: how does one attain and enforce the agreement? Should minimum criteria be established or should one set requirements that exceed those of currently existing or possible future regulations? Should they be confirmed by an appropriate authority? Self-regulation also runs the risk of nullifying its efficacy and becoming a mere instrument for confabulation between member companies for less noble ends.

Self-regulation is more and more common in individual companies or groups of firms. Companies often draw up ethical codes, statements of principle or letters of intent to state the ethical goals they wish to attain in their business, either inside the firm (as regards managers, workers, shareholders, etc.) or in relation to its outside stakeholders (clients, suppliers, financial institutions, local communities, the State, etc.), as well as the means to this end. The codes usually contain a statement of goals (and/or the so-called «mission» of the company), the basic ethical principles and the specific means to be employed, and a certain specification of those goals and means in several areas of special interest. They often include rules about how to deal with ethical complaints, the procedures for solving conflicts, etc.

An ethical code is usually a means to attain a number of different objectives: to engage the managers in the fulfilment of the company's ethical duties; to motivate its managers and employees to do their duty towards other members of the company and outsiders (suppliers, customers, local community, etc.); to define these duties in a precise way; to contribute to the creation of a corporate culture; to homogenize different cultures in the firm (for example, after a takeover); to create an image of responsibility, credibility and excellence; to improve the professional attitude of managers and employees; to raise the performance of the workers and to prevent opportunistic attitudes; to provide criteria for times of emergency or crisis; to reduce uncertainties regarding the expected behavior of the firm and its employees; to motivate the clients and suppliers to act ethically in their dealings with the company, and many others.

Given this long list of potential benefits, an ethical code may be an opportunity for a company to build a moral capital, to raise ethical standards in the company and its environment, and also to secure financial or economic benefits. However, the company may

also use the code to obtain short-term profits, exploiting a reputation for strict morality that does not correspond to reality. Therefore, the fact that a company has an ethical code does not necessarily mean that it has a moral outlook, nor do external regulations guarantee moral behavior.

There are two different ways to ensure that an ethical code produces ethical results. The first is to «oblige» the company to behave always according to the rules: for example, by referring ethical affairs to a senior body within the company, or by creating an internal authority specialized in ethical affairs, or by giving full powers to an *ombudsman* or ethical director, or by submitting the company to an ethical audit, etc., so that any opportunistic behavior is penalized. Nevertheless, all these measures cannot guarantee that the company and its managers and employees will always behave ethically.

The second way to support a code is by having the reputation of being a morally responsible corporation or, at least, of conforming to moral rules of behavior. Such a reputation is more than a mere public relations exercise, since a person (or company) is morally well regarded when his convictions and values are not only compatible with ethics, but are rooted in ethics; when in his behavior he not only abides by the rules of ethics, but attempts to obey them to the fullest extent; when he does not wash his hands of other people's behavior, but tries to help them to improve their ethical standards, while respecting their freedom.

Thus, a company can have a strong ethical reputation, gained day by day through the efforts of its managers and employees (even if some of them are not totally ethical), and its errors will not damage its reputation so long as it acknowledges them, apologizes for them and makes amends. In this case, the ethical code is backed by the moral capital of the company, *i.e.*, by the attitudes of managers and employees who are ethically trained, committed and motivated.

An ethical code, therefore, is a manifestation of morality and a means to attain it. Here are several features of a good code:

- (1) It is not necessarily the result of a consensus among those involved in drafting it, but must be accepted by them (because nobody can be obliged to act against his conscience).
- (2) It should contain clear and well-founded ethical rules.
- (3) It must be internally consistent, and also coherent with the company's mission, goals, strategy and policies.
- (4) A good code cannot be all-inclusive or too detailed.
- (5) It must balance rights and duties, internal and external stakeholders.
- (6) It should provide for exceptions (giving the moral criteria to use in these cases).
- (7) The code must deal with the mechanisms for solving conflicts in the interpretation and application of its rules.
- (8) It must be very respectful of the freedom of the individual.
- (9) It cannot be a means of indoctrination.

(10) The omissions in a code are more important than its precepts.

(11) It must be easy and inexpensive to apply.

To sum up, an ethical code is not a panacea, but a useful tool, especially if it expresses a demanding moral climate in the company and if it is designed to foster such a climate.

Conclusion: ethics or regulations or both, or neither?

Regulation is an expensive and often inefficient process. If everyone were to behave morally, regulation would still be necessary, but much less so. Ethics is not a replacement for regulation. Ethics fulfils a function that is much higher than regulation: it guides people towards their goal, it makes them «better» people, and this is well beyond the scope of regulation. With or without regulation, man needs ethics, and so do companies.

Ethics should also be part of the observance of regulations: to obey regulations for fear of punishment may achieve the desired external results but will not improve people. To obey regulations because by doing so one contributes to the common good – that is ethics. The external results may be the same, but the internal ones (the process of learning and self-improvement) also count.

Ethics goes beyond regulation because regulation cannot reach everywhere (and, if it does, it makes the situation worse, because it destroys the economic agents' initiative and freedom).

It is true that some regulations would not be necessary if we were all ethical (*e.g.*, it would not be necessary to prohibit and persecute prostitution, pollution, or discrimination on the grounds of race or religion). However, this should not lead us to fall into utopian beliefs: regulation will always be necessary, at least for that minority (sometimes, a large majority) who would prefer to act otherwise. And, in any case, someone has to decide whether we drive on the right or the left.

A more ethical society would have fewer regulations, fewer conflicts and lower observance costs. The fact that men learn from their own actions and those of others can lead us into a downward spiral when people's behavior starts to become immoral: because there are thieves, we have to spend part of our income on measures to protect and defend ourselves, and pay higher taxes to maintain police, judges and prisons. If this leads us to protest at the lack of freedom and the reduction of after-tax income and induces us to adopt a more individualistic and less cooperative attitude, then we will be giving one more turn to the screw of immorality, which will soon manifest itself in the form of new social and private costs (*e.g.*, higher social security contributions to pay for more old people's homes because their families no longer accept them, and so on).

Our conclusion, therefore, is that regulation is good and necessary, but ethics is quite simply indispensable – and urgently needed. □

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