HOW CAN LAW CONSTRAIN *HOMO ŒCONOMICUS* IN SITUATIONS OF FINANCIAL CRISIS?

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1. INTRODUCTION

There is, nowadays, no satisfactory answer to the question which titles this paper. It is, however, possible to explain why that is the case, and provide some clues for further elaboration and thought.

Section 2 details the theory of "*homo œconomicus*", which experts on economics claim to have been invented by John Stuart Mill, even though he did not name it. After this introductory section, which serves essentially to explain why, and under what conditions, this theory is applicable to organizations, section 3 deals with the question of how companies behave in relation to moral and legal rules. The conclusion reached is that such rules act as restrictions that have to be considered as factors in the economic model of behaviour. In section 4, I argue that those restrictions are felt, by companies, the same way one feels contractual clauses: a fine is just a price to be paid as a way out of the obligation of fulfilling a given duty. Finally, in section 5, *homo œconomicus* is considered under situations of financial crisis. In this section, I explore the ways in which a government can use the criminal law in order to deter undesired conduct by companies, and what the legal limits of that utilization are.

2. HOMO ŒCONOMICUS

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Since at least John Stuart Mill, *homo œconomicus* has pervaded much of economic theory and thought. The theory has been severely modified since its inception in order to accommodate critics who have pointed out that people do not behave as Mill suggests, as it is simply wrong to regard "mankind as occupied solely in acquiring and consuming wealth" (Mill, 1967: 322). It is noteworthy that Mill himself did not think that human beings' sole concern is to acquire and consume wealth; indeed, this objective is permanently thwarted by "perpetually antagonizing principles to the desire of wealth, namely, aversion to labour, and desire of the present enjoyment of costly indulgences"; these principles have, due to their very nature, to be taken, "to a certain extent", into Political Economy's "calculations, because these [principles] do not merely, like other desires, occasionally conflict with the pursuit of wealth, but accompany it always as a drag, or impediment, and are therefore inseparably mixed up in the consideration of it." (Mill, 1967: 321-2) In fact, Mill acknowledges that no "political economist [has] ever imagine[d] that real men had no object of desire but wealth, or none which would not give way to the slightest motive of a pecuniary kind" (Mill, 1967: 327); nevertheless, "Political Economy presuppose[s] an arbitrary definition of man, as a being who invariably does that by which he may obtain the greatest amount of necessaries, conveniences, and luxuries, with the smallest quantity of labour and physical self-denial with which they can be obtained in the existing state of knowledge." (Mill, 1967: 326)

This characterization of human beings is, therefore, artificial, and its purpose is to lay out the object of scrutiny of Political Economy, a branch of knowledge which Mill defines as "[t]he science which traces the laws of such of the phenomena of society as arise from the combined operations of mankind for the production of wealth, in so far as those phenomena are not modified by the pursuit of any other object." (Mill, 1967: 323) Political Economy is thus concerned with that part of people's behaviour in society that has to do with the production of wealth, and not with "the whole of man's nature as modified by the social state, nor of the whole conduct of man in society." (Mill, 1967: 321)

"Political economy" is, nowadays, known as "economics" (Persky, 1995: 222). Along with the change in terminology came an enlargement in scope, as economics is no longer circumscribed to questions concerned with the production of wealth *per se*. Its scope has, in fact, increased so much that, as Gary S. Becker correctly perceives, "what most distinguishes economics as a discipline from other disciplines in the social sciences is not its subject matter but its approach." (Becker, 1976: 5) This means that economics shares its subject matter, which is societal human behaviour, with other social sciences as, for example, sociology, political science or law. The "production of wealth" or, to use the contemporary term, the "economy" is just one among many features of societal human behaviour that is studied by economics and the other social sciences.

The economic approach, as Becker sees it, consists in assuming

> maximizing behavior more explicitly and extensively than other approaches do, be it the utility or wealth function of the household, firm, union, or government bureau that is maximized. Moreover, the economic approach assumes the existence of markets that with varying degrees of efficiency coordinate the actions of different participants – individuals, firms, even nations – so that their behavior becomes mutually consistent. (Becker, 1976: 5)

The economic approach is, therefore, a predictive behavioural model, as it is fashioned out of assumptions and, as Becker makes clear, stable preferences which "are assumed not to change substantially over time, not to be very different between wealthy and poor persons, or even between persons in different societies and cultures." (Becker, 1976: 5) These stable preferences, however,

> do not refer to market goods and services, like oranges, automobiles, or medical care, but to underlying objects of choice that are produced by each household using market goods and services, their own time, and other inputs. These underlying preferences are defined over fundamental aspects of life, such as health, prestige, sensual pleasure, benevolence, or envy, that do not always bear a stable relation to market goods and services (…). The assumption of stable preferences provides a stable foundation for generating predictions about responses to various changes, and prevents the analyst from succumbing to the temptation of simply postulating the required shift in preferences to "explain" all apparent contradictions to his predictions. (Becker, 1976: 5)

It might be argued that *homo œconomicus* met an untimely end with the realization that economics is not just about the production of wealth, as it does not make sense, the objection would run, to employ the model of the "economic man" in order to reach, or explain (*a posteriori*) decisions which, albeit economic (in the contemporary sense, which is broader than in Mill's time), do not have the production of wealth as their sole, or even main, aim. In other words, people's behaviour might be predicted through an economic model of behaviour, but this model of behaviour is supported by preferences, which might or might not include the goal of wealth maximization. However, according to Gebhard Kirchgässner this does not entail the end of *homo œconomicus* for the simple reason that "the basic structure of the model [of behaviour] remains the same" (Kirchgässner, 2008: vii), despite the fact that it is no longer circumscribed to the production and maximization of wealth:

> Many results from psychological research and – more recently – from the new emerging field of Neuroeconomics show that the simple model of homo oeconomicus as it is used, for example, in many introductory microeconomic textbooks, has severe limitations. (…) But, on the other hand, this whole new research is still – almost always – founded on the basic model of homo oeconomicus, the economic model of behav-

> iour. (Kirchgässner, 2008: vii)

As Kirchgässner makes clear, "*homo œconomicus*" is a concept which has evolved along with the concept of "economics". Nowadays, economics does not focus solely on the economy, which means that the economic man can no longer be regarded simply as a "walking computer which is fully informed and always decides as quickly as a flash of lightning." (Kirchgässner, 2008: 25) Since economics is to be seen as "an attempt to explain human behaviour, employing the assumption that individuals behave 'rationally' (…) by making rational choices among the alternatives which are at their disposal (…) independently of the field where a decision is made" (Kirchgässner, 2008: 1-2), it stands to reason that individuals who are economic agents, and therefore "economic people", can no longer be appraised as wealth maximization fiends. As Kirchgässner asserts,

> [i]n contrast to the traditional textbook version, the 'modern' homo oeconomicus is not always an 'optimiser' as already pointed out above. Therefore, the economic model of behaviour is also compatible with the concept of 'bounded rationality' developed by HERBERT A. SIMON (1955). There, the individual behaves as a 'satisficer' and not as an optimiser, he searches so long among the alternatives at his disposal until he meets a 'sufficiently' acceptable one, and then he decides in favour of it. If after a long search, however, no such alternative is to be found, the individual reduces his aspiration level and then looks for an alternative that according to this lower level is acceptable. (Kirchgässner, 2008: 28)

The language has thus shifted from Political Economy's "model for the production of wealth" to economics' "model for predicting human behaviour according to individual preferences". This means that the scope of economics has been enlarged because it has been realized that the production of wealth is but one amongst a host of preferences that individuals have, which entails a corresponding redefinition of the concept of "*homo œconomicus*".

As William H. Meckling observes, "the Western World economic tradition [takes] the individual as the unit of analysis" (Meckling, 1976: 547), which explains the reason *homo œconomicus* is a theory tailored for the individual, not for organizations. In fact, Meckling goes on to argue, "Marxist theorists [who] press for an "organizational" or "social class" approach to the study of society" engage in the fiction of using "concepts such as exploitation, conflict, etc." when talking about organizations, which is plainly wrong as

> [o]rganizations can no more be exploited than machines can be exploited. Only *individual* human beings can be exploited, can suffer or engage in conflict (at least, human conflict), can be the object of compassion, etc. Organizations, are not animate objects; they are pure conceptual artifacts, even when they are assigned the legal status of individuals. In the end, we can only do things *to* and *for* individuals though, of course, sometimes each individual in a group will be affected (qualitatively, at least) in the same way. (Meckling, 1976: 547-8)

Organizations are, therefore, fictitious entities, "conceptual artifacts", which not only cannot be made to suffer but cannot as well act *by themselves*. *Homo œconomicus* is thus always, for Meckling, the "purposeful individual", that is, "one who is resourceful, evaluative, and maximizing. He stands in relation to organizations as the atom in relation to mass. (…) I shall refer to him as REMM – Resourceful, Evaluative, Maximizing Man." (Meckling, 1976: 549) In other words, whenever organizations act, they act through purposeful individuals. It is the individuals' actions that are imputed to the organization on whose behalf they are acting. Consequently, organizations have no purposes:

> We tend to think of organizations as having a purpose, and for many important problems, e.g., analyzing the operation of competitive markets, that view not only causes no problems, it is very convenient. But focussing on organizational purpose also can be and often is very misleading. Organizations are artifacts. They cannot really have purposes. What is done in organizations, on behalf of organizations, or to organizations

> is actually done by individuals, on behalf of individuals, or to individuals. If we want to understand those organizations, i.e., explain why individuals who are part of organizations or who represent them do what they do, or explain why organizations develop, or explain why they take the form they take, we have to begin with the individuals involved – individuals who will have their own purposes – REMM's. What organizations do, if we can slip back into that language, depends on the coalescence or fusion of these REMM's, brought about largely through formal and informal agreements or contracts. (Meckling, 1976: 559)

Meckling is, of course, absolutely right. Nevertheless, as he himself notes, people "tend to think of organizations as having a purpose." Even though the idea of purposeful organizations is false, people (tend to) guide their actions as if it were an unshakable dogma. This is particularly clear in the case of companies. Everyone who works for a company in any capacity guides their conduct in order to maximize the company's profit; this behaviour is based not only on the perception that profit maximization is the proper goal of a company but also on the fundamental assumption that companies have the capacity to have a purpose. On the other hand, the recognition that this (or any other kind of) purpose is a fiction would not entail a change in paradigm. Whether profit maximization is perceived as a real or fictitious purpose the conduct of administrators and other employees is not bound to change at all. The labour of these individuals is directed at profit maximization, regardless of the fact that the company and its purposes are a fiction and that the ultimate destination of the profits made is the bank accounts of other individuals, i.e. shareholders.

The views of both Meckling and Becker are far from being contradictory; they are, in fact, complementary, as individuals who are resourceful, evaluative, and maximizing act upon their preferences, which, as has been asserted, are far from being exclusively financial. The fact that administrators and other employees are self-interested REMM's with preferences and purposes of their own raises the possibility of a very special case of "conflict of interests" that can be described as follows: people are moral agents. This means that the preferences of REMM's who work for companies may include respect for (certain aspects of) morality, which, in certain circumstances, may collide with the perceived purpose of the company they work for, profit maximization. It is tempting to conclude that, if administrators and other employees were to fully realize that the company they work for does not actually have any preferences, purposes or goals, they might start acting in ways not totally conducive to the maximization of profit, as the preferences of each one of them would take precedence over the company's now completely understood as fictitious goal of profit maximization. In reality, however, this could never happen. If every individual who works for a given company were to orient their conduct in order not to maximize the company's profit but, say, to promote the realization of their own self-interest the hierarchical structure of the company would collapse and, with it, the company itself. Some individuals might be inclined to selfishly promote their own well-being; others might adopt environmental measures well above what is required by law, which inherently would bring extra costs; others still might donate substantial parts of the company's income to charity. All these actions, as well as others, if done randomly, i.e. simply as satisfaction of the self-interest of individual administrators or employees, would deplete the company's funds and plunge it into bankruptcy. The point is, no company or organization can remain functional if the individuals who act on its behalf do not strive to reach a common goal.[1]

[1] It is assumed throughout this argument that the actions of the individuals mentioned in the text are legally binding and imputable to the company on whose behalf they act. Cf. regarding this question MacCormick, 2009: 83-99, with references. MacCormick implicitly disputes the notion that groups' (as he calls them) "acts, decisions and intentions" are fictitious, as "[a]cting corporately, or groupwise, is entirely natural to human beings, although indeed it is dependent on human conven-

The fact that this goal, because it is the goal of the organization, is fictitious, and therefore not real, is of no importance for the success of the common enterprise. Whether an organization's fictitious goal is profit maximization, as is the paradigmatic case of companies, or help some minority group of the population, as is the case of foundations, or provide fun and entertainment to its members, as is the case of local associations, this goal is fundamental to the very existence of the organization. It is, therefore, completely impossible for the REMM's who act on behalf of a given organization to act with a view to exclusively realise their own self-interest. The realisation of an employee's self-interest which is simultaneously detrimental to the organization they work for may happen on occasion but, were it to happen as a rule, the organization would inevitably collapse.

The fact that every organization has of necessity to have a goal in order to function makes it possible to apply the *homo œconomicus* theory to companies, foundations, local associations and other organizations. Regardless of the particular objective of a given organization, they all have (fictitious) preferences that guide the conduct of the people whose acts are imputed to the organization. Thus, a charity set up to help the homeless will not knowingly provide them with tainted food in order to cut down costs. A local association will not sell their pool table (without acquiring another one) if that causes dissatisfaction among its members because they are fond of shooting pool. In the former case, the prestige of the charity (which is a

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tion, contrivance and organization. Convention, contrivance, and organization are also natural to human beings." (MacCormick, 2009: 84) In my opinion, the fact that human beings naturally act as MacCormick says they do does not mean that the collective entities they create have *real* intentions, or purposes, which exist on their own, i.e. independently of the intentions, or purposes, of the individuals who act on the group's behalf. Whatever independent intentions and purposes organizations may be considered to have, those are fictitious, even though they generate some real effects. Quite apart from this, MacCormick's explanation of how individuals' acts are legally imputable to juristic persons is very clear.

possible preference [of its founders or administrators] that can co-exist with the objective of helping homeless people) would suffer. In the latter situation, ignoring this preference of the REMM's who are members of the association (which makes it a preference of the association) is a step away from the fulfilment of the association's goal, namely to promote fun and well-being for its members.

3. THE BEHAVIOUR OF COMPANIES

Respect for at least certain moral and legal rules is a part of the preferences of most people. In fact, only in a reduced number of people, who suffer from some sort of mental impairment (e.g. psychopathy), is respect for the most basic precepts that can be derived from natural justice, which are respect for the life, liberty and dignity of every human being, lacking amongst their preferences. Every other person not only follows these precepts as a part of their preferences but they usually follow some other moral and legal rules as well, which, even though they are not as fundamental as those derived from natural justice, are, nevertheless, considered important by people. Among such rules one can find respect for other people's property, for telling the truth or for keeping promises. This is what it means to have "a full commitment to some judgmental point of view such as that of law or of morality" (MacCormick, 2009: 104). When people are fully committed to such rules,

> [a]n act's being wrong is a reason not to do that act, a reason for choosing not to do it, but to do something else, or to do nothing. (…) The wrongness of an act is a reason not to do it even though it would get you something you want. (…) An act's being wrong places what has been called a 'side constraint' on our acting. (…) Whatever we do, for whatever reasons we are acting, we must act without straying into committing any wrongful act or omission. We, as it were, 'draw a line' separating what is wrong from every other possible action, and then set ourselves to avoid crossing that line in all

> that we do. Not to cross the line is categorically required, regardless of the balance of our wishes apart from this consideration. Crossing it cannot be excused by the strength of our desire for whatever motivates us to cross it. (MacCormick, 2009: 103-4)

Therefore, "from the fully committed standpoint (…) the act's being wrong is an overriding or 'peremptory' reason for not performing it." (MacCormick, 2009: 104) However, under certain circumstances people who are fully committed to these rules may break them. This invariably happens in situations in which there is a conflict of interests, or of preferences. One can hold the life of every human being as inviolable, but may nevertheless kill someone in self-defence. In cases like this, the preference "respect for the life of other individuals" collides with the preference "remaining alive". Being a predictive behavioural model, *homo œconomicus* is a theory that attempts to anticipate how people act and react under both normal and abnormal circumstances. The two assumptions that the theory makes, i.e. that every individual acts both rationally and with a view to realise self-interest have to be considered also under circumstances which are not optimal. In other words, situations of crisis, i.e. situations in which a conflict between two or more preferences arises have to be included under the scope of the *homo œconomicus* theory, so far as it is a predictive behavioural model.

Having this in mind, I want to discuss the behaviour of companies (through the actions of their administrators and other employees) in the midst of situations of financial crisis. Crises in general, and financial crises in particular, provide a context in which a company's fictitious purposes and preferences necessarily clash. Before endeavouring to do that, however, it is necessary to define the role moral and legal sanctions play on the behaviour of companies. In the remainder of this section it is argued that sanctions are restrictions. In the next section it is shown that those restrictions are akin to contractual clauses.

After this, in section 4, the "behaviour under situations of financial crisis" thread is resumed.

In applying the *homo œconomicus* model to companies, I assume that the individuals who run them behave rationally and seek to realize the (perceived) goals of the company they work for. Companies, therefore, behave rationally and want, just like individuals do, to realise their self-interest. The fact that it is a fictitious self-interest does not influence the conduct of the individuals who act on behalf of the company they work for. In other words, these individuals act as if the company's self-interest were a real one.

I assume, moreover, that the fictitious self-interest of any and all companies is profit maximization, which emanates from the very real self-interest of the individuals who are the owners, i.e. the shareholders. Profit maximization may be anchored on a variety of different sets of preferences which certainly vary from company to company. Some companies may want to be perceived as honourable as a result of the preferences of the REMM's who run them or of the REMM's who, as shareholders, exert influence over the administrators. Other companies may want to actually be honourable, not just to be perceived as such. Some other companies pride themselves on protecting the environment, sometimes by adopting measures that go well beyond what is required by law.

Whatever the specific set of preferences which supports the way to profit maximization, this set of preferences is not to be seen, under normal circumstances, as a hindrance. Being honourable, or environmentally friendly, for instance, brings with it an additional flow of business which would not exist otherwise. Partners prefer to deal with entities that keep their promises. Companies which show respect for the environment can glean more from that reputation than from a number of media adverts, for instance. As a result, more and more contracts are made, sales increase, profit maximizes.

The point is simply that companies which follow moral rules, by e.g. keeping promises and respecting the environment, do that not because they are fully committed to them, which they cannot be due to the fact that they are not moral agents, as their agency is a fictitious one, but because they want to maximize profit. Respect for morality and the law (e.g. compliance with regulations, paying taxes, etc.) is something that companies observe because, in most circumstances, doing the opposite would entail a cut on the margin of profit. From this perspective, abiding by certain moral and legal rules can be seen as an incentive, as a way to maximize profit, but never as a categorical imperative.

It is, therefore, helpful to personify companies by speaking of them as behaving as human beings do (as *homo œconomicus* does), so long as one remembers that respect for morality and the law are never an objective *per se*. Companies that pride themselves in being honourable will definitely stop being so in exigent circumstances, i.e. in circumstances in which doing the honourable thing entails incurring in massive losses or the commencement of liquidation. Likewise, respect for the law is achieved totally by fear of sanctions, unlike what happens with people. Whenever the law's rules coincide with moral rules (prohibition of killing, stealing, breaching promises, etc.) these rules are followed mainly because people's conscience dictates that that is the right thing to do. The case of companies is, for the reasons I have mentioned, different, as companies, simply because they are not human agents, do not have a conscience to follow. Under normal circumstances, companies keep their promises, for instance, by not breaching contracts because, at least in the long run, breaching contracts harms future business which, naturally, hinders the goal of profit maximization. Therefore, companies' respect for morality and the law is due not to the fact that that is the right thing to do, but to the fact that disrespect for morality and the law, under normal circumstances, undermines profit maximization. Moral and legal *sanctions*, and not moral or legal *imperatives*, is what prevents companies from breaking the rules that make up these normative orders.

As Kirchgässner rightly observes, legal rules are, from an economic standpoint, to be seen as "restrictions" (cf. Kirchgässner, 2008: 12). Thus,

> [f]rom the economist's view (…) it is irrelevant whether a certain person keeps to a law or not. The economist asks whether, or under which conditions, a rational individual will keep to such a law. This individual will weigh the utility and the costs of a legal offence against each other: On the utility side there is, for example, the saving of costs by not purifying certain sewages. On the side of the costs there is the expected punishment: the amount of the fine and the trouble connected with a penalty, multiplied by the probability that punishment will be imposed. It should be plausible that *a fine smaller than the cost savings which can be achieved by the criminal offence will not prove to be very effective in most cases. This holds even more the smaller the probability is that a fine will actually be imposed*. What is economic in such an analysis is just the consistent application of the economic model of behaviour. The individuals concerned by a legal regulation are assumed to behave rationally in the above mentioned sense. The introduction of a legal regulation changes their action leeway and, therefore, generally, also their behaviour. But this does not imply that individuals will observe the law according to its meaning or even literally. (Kirchgässner, 2008: 120. My emphasis)

I disagree with Kirchgässner when he says that "[t]he individuals concerned by a legal regulation are assumed to behave rationally" when the *sole* reason they follow the law is the fact that it is cost-effective to do so. As I argued above, most people follow the law, especially when legal rules protect moral values (as is the case with Kirchgässner's example, the purification of sewages), because their conscience inclines them to do so. This is what having preferences which are not financial means, and, as Becker has shown, those preferences have at least as much weight, if not more, as financial preferences do. Some people certainly behave in the way Kirchgässner describes, but this is a far cry from demonstrating that such conduct can be asserted as a general rule.

On the other hand, for the reasons I have mentioned above, if one were to apply Kirchgässner's assertion exclusively to companies, I believe that one would be describing exactly the type of influence which the law exerts over companies' behaviour *under exigent circumstances*. If one wants to describe the law's influence on the conduct of companies under circumstances which are deemed normal, that is, when companies are not facing a situation of financial crisis, Kirchgässner's idea is incorrect. My assertion can be grounded on the following rationale: since companies are not moral agents, moral and legal regulations *are* restrictions, and nothing but restrictions on conduct. In this I agree with Kirchgässner. However, unlike people, who follow *certain* moral and legal rules because these are included amongst their preferences *as imperatives* (which means that people do not actually feel these rules as restrictions), companies follow *all* moral and legal rules when the financial benefits of an increased reputation justify following them, because that is part of their preferences *as a means* to achieve profit maximization. Cost-effectiveness in the short-term is a (very) secondary factor. This is why Kirchgässner's assertion cannot be applied with the intention of describing situations of normalcy in the world of business. It must therefore be rejected and substituted with the following assertion: *when the risk of being caught does not justify the damage made to the company's reputation*, as such damage may harm future business and, with it, reduce profit, companies will follow moral and legal rules. This point is further elaborated below in section 4. For now, it is important to note that, unlike what happens in relation to human beings, who usually include, among their preferences *per se*, respect for morality and the law for their own sake, respect for these *may* be included in the set of preferences which anchors companies' pursuit of profit maximization, but they will certainly be disregarded in situations in which there is a conflict between the company's ultimate goal, profit maximization, and the preferences which anchor it, which almost always include respect for morality or the law. This can only be seen under exigent circumstances. Under normal circumstances respect for morality and the law is a part of the path to the maximization of profit, as earning a reputation as a law-abiding company, equally respectful of the moral values of the community in which it operates, attracts partners, which leads to the closing of more deals, increase of sales, etc. Therefore, sometimes companies respect morality and follow the law, other times they disregard them completely. The former tends to happen under normal circumstances, the latter under dire situations. In both cases, however, the decision to either follow or disregard morality and the law has to do *solely* with what is more convenient, given the concrete situation, in order to maximize profit *in the long run*, and not on a short-term basis.

From this one can conclude that, regardless of the particular circumstances in which business is undertaken, companies see moral and legal rules either as restrictions or as incentives that lead to profit maximization, but never as imperatives. "Incentive", in this case however, simply means that following certain rules earns a good reputation, and a reputable company is more likely to do more business than a less reputable company. Nevertheless, "incentive" is just one face of the coin which, on its other side, has a moral sanction. In other words, companies follow certain moral and legal rules because that increases their reputation, and also because failure to respect those rules works as a moral sanction in the form of a breakdown in the flow of business. Current partners may stop being partners with the company with a tainted reputation, while consumption of the goods that that company puts on the market may decrease. Therefore, regardless of it being considered a tactic to increase business or to avoid the moral sanction which comes in the form of decreased business, the reason companies follow moral and legal rules has to do with profit maximization. From this perspective, an "incentive" is no more than a special type of restriction.

It may seem paradoxical to argue that, despite being run by people, companies do not follow moral and legal rules as imperatives when the people who run them do have a conscience which makes them respect moral and legal rules for their own sake. In order to try to dissolve this paradox, one could interpret my argument as meaning that companies' administrators are unscrupulous people whose individual preferences do not include respect for morality or the law. This, however, would amount to trying to create a general rule out of a few exceptional, albeit real, cases. There certainly are administrators who are unscrupulous people; nevertheless, unscrupulous people can be found in all areas of human enterprise. There is no direct relation between the function of administrator and the kind of psychological makeup of the individual who fulfils that function. The dissolution of the paradox has thus to be made through a different alternative. I believe that that alternative is a fairly simple one: people can, and do act, in a professional capacity differently than they do in their personal lives. This means that administrators, in most cases, are just regular people who have to shed some of their moral beliefs and preferences in order to fulfil their professional obligations. All of this, however, is done within certain limits. An environmentalist administrator may have to go against their ethical preferences if, as Kirchgässner exemplifies, the realisation of their company's self-interest is better achieved by not purifying certain sewages. It would, however, be a totally different matter if the self-interest of the company were to be realised through, for instance, murder. One can imagine a situation in which a former employee may be willing to testify against their former company in a civil suit in which the plaintiff demands damages in the amount of seven or eight figures. If *homo œconomicus* were still to be seen as a pure financial theory, it would be rational, from a financial point of view, to silence this particular witness by killing them. The fact that this sort of action is rather infrequent shows that individuals who act on behalf of companies do not altogether shed their moral beliefs and ethical preferences. Some of these have to be ignored in order for their professional activity to be performed. Actions as, for instance, murder, are, however, beyond everything that is required of a professional administrator.

4. LEGAL RULES AS CONTRACTUAL CLAUSES

In discussing the dependence of morality on law, Tony Honoré observes that morality

> has to be based on values that can be defended as worth pursuing. But these values are so general that they do not by themselves determine how people should behave in a given instance. We can seldom proceed by a process of deduction from the values to the required behaviour. (Honoré, 1993: 4)

Generally speaking, this means that moral rules are so abstract that they usually only indicate the desired result, not the path to achieve that result. Honoré exemplifies this idea by stating that “apart from the law no one has a moral obligation to pay any particular amount of tax”. (Honoré, 1993: 5) In other words, paying taxes is a moral obligation since it contributes to the welfare of society as a whole and “free-loading” behaviour is seen as a moral wrong, but specific questions such as amount, periodicity, deductibles, etc. cannot be answered by moral rules. Only legal rules are apt to deal with such questions. Examples such as this one show why legal rules need to be expressly formulated and a great deal more concrete than moral rules. Unlike moral rules, legal rules are determinate or, at least, determinable by the judiciary whenever a contentious point of law is put before a judge. As morality lacks institutionalized courts, most moral rules cannot be made as concrete as legal rules can. This leads one to conclude that moral rules show the desired result to be achieved, but do not show how to get there. It is moral to protect the environment, to pay taxes and to care for one's children and parents. These moral results, however, can only be reached if a highly institutionalized normative system with a legislature, courts and enforcement-agencies defines the particular steps that have to be taken in order to guarantee the desired moral result. Law is one such system.[2]

Because the specific content of legal rules enjoys a certain amount of certainty, these rules can be seen by those who are subjected to them as contractual clauses. This is not an allusion to the contractarian doctrines on the origin of the State. It is irrelevant, for the purposes of this paper, to discuss the political and legal legitimacy of legal rules, i.e. whether their validity depends on the tacit or express consent of those who are subjected to them. My argument is rather that legal rules which enjoin or forbid certain conducts by imposing a sanction for breach of the prescribed behaviour work exactly the same way as contractual clauses do, as both legal rules and contractual clauses show to those who are subjected to them exactly what to do, and what are the consequences of not doing it. From a moral standpoint, one knows that one ought not to pollute because that endangers the environment and therefore life on

[2] This, of course, does not mean that law is bound by morality. There are certainly many areas of the dominion of morality which are not (and should not) be regulated by law. The point is merely that, so far as a moral rule is to be followed by society, society has to enact into law the procedures necessary to follow that moral rule. Sometimes, however, law's rules do go against the perceived social morality. In this case, the point is to achieve the opposite result to the one which would be achieved if the moral rule were to be followed.

Earth, but morality alone cannot say what the immediate, short-term consequences of polluting the environment are. Legal rules which exact fines as sanctions for polluting the environment state in very clear terms the consequences of breaking the law, just like contractual clauses state exactly the consequences of breach of contract. This point deserves further elaboration.

A contractual clause is no more than a private law mechanism to create rights and duties between the parties to a contract, the breach of which duties makes the party responsible for it liable to pay damages to the other party. In both cases, someone enjoys a right while somebody else bears the corresponding duty, the breach of which makes the duty-bearer liable to a sanction. There is a difference between legal rules and contractual clauses as to their creation. The former are created by custom, judicial precedent or through legislation, whereas the latter are voluntarily created by the parties to a contract. If one sees past the creation stage, however, one realizes that the attitude of those who bear duties is remarkably the same whether the duty is created voluntarily or by law: the decision to fulfil or breach the duty is the result of economic ponderation. This is even clearer when the sanction for breach of a contractual clause is itself stipulated as a contractual clause in the form of a penalty clause. It is perfectly possible, from an economic point of view, to either regard a penalty clause as a fine or, conversely, a fine as a contractual penalty clause because, even though fines and contractual clauses are two different legal concepts, they amount, from an economic standpoint, to the same thing. Finally, it is possible to see a fine under a somewhat different light, that is, as something which provides an alternative between fulfilling a particular duty or "buying" one's way out of that duty, as if this way out were a commodity. In this instance, as Uri Gneezy and Aldo Rustichini correctly observe, "a fine is a price":

> Suppose you are the manager of a day-care center for young children. The center is scheduled to operate every day until

> four in the afternoon, when the parents are supposed to come and collect their children. Quite frequently, however, parents arrive late, and force you to stay after working hours. You have considered a few alternatives in order to reduce the frequency of this behavior. A natural option is to introduce a fine: every time a parent comes late, she will have to pay a fine. Will that reduce the number of parents who come late? (Gneezy and Rustichini, 2000: 1)
>
> After the introduction of the fine we observed a steady increase in the number of parents coming late. At the end of an adjustment period that lasted 2–3 weeks, the number of late-coming parents remained stable, at a rate higher than in the no-fine period.
>
> The fine was removed at the beginning of the seventeenth week. In the following 4 weeks the number of parents coming late remained at the same high level of the previous period, higher than in the initial 4 weeks. (…)
>
> What this field study teaches us, we believe, is that the introduction of the fine changes the perception of people regarding the environment in which they operate. In particular, we argue that the environment in our study, as in many real-life situations, is defined by an incomplete contract. In the specific situation under examination, the exact consequence of coming late was not specified in the contract between the parents and the day-care center. For instance, there was no precise set of clauses specifying the consequence of one, two, or several occurrences of a delayed pickup of a child. Parents could form any belief on the matter, as they probably did, and act accordingly. The introduction of the fine into this incomplete contract, however, reshapes the parents' perception of this environment. (Gneezy and Rustichini, 2000: 3)

The field study conducted by the authors purports to analyse the behaviour of certain individuals (parents) before a very specific situation (lateness in picking up their children from a day-care centre). The general conclusion which can be drawn from this study is that people perceive fines the way they perceive a contractual clause: as imposing an obligation the violation of which is met with a certain consequence. It is indifferent whether the fine is unilaterally imposed by one of the parties to the contract, as it happens in the day-care centre case, or the sanction for the breach of a legal rule, as the same (economic) rationale can be applied in both cases: a fine is no more than a price to be paid as the consequence of a given conduct. To call the fine a breach of legal duty or a contractual clause is certainly conceptually important from a legal point of view, but it is irrelevant as far as economics is concerned. Furthermore, whether that clause is seen by duty-bearers as a penalty clause or as a commodity to be bought is equally immaterial from an economic standpoint (albeit, again, very important from a legal one, given that penalty clauses are null and void in certain jurisdictions, whereas in other jurisdiction they are not totally enforceable),[3] as the decision to either breach the clause or fulfil the obligation emanated thereof rests on economic grounds, which include not only financial reasons but also every other relevant preference, including moral ones, as has been asserted in sections 1 and 2 of this paper. One can even go so far as to say that a penalty clause is itself, after all, no more than a commodity from a pure economic standpoint, i.e. the amount contractually set to be paid in the event of breach of contract is the price that releases one from having to endure the inconvenience of fulfilling a given obligation. Gneezy and Rustichini's day-care centre situation provides a striking example of this:

> The introduction of the fine changes the perception into the following: ''The teacher is taking care of the child in much the same way as she did earlier in the day. In fact this activity has a price (which is called a 'fine'). Therefore, I can buy this service as much as needed.'' Parents feel justified in their behaviour by a social norm that states, approximately: ''When

[3] Legal restrictions on the admissibility of penalty clauses are certainly a factor in economic ponderation, but the point is merely that the decision to either fulfil or breach duty ultimately rests on economic grounds. If penalty clauses are illegal, one knows that breach of contract will not entail the payment set by the clause, but one knows that one is still liable for damages resulting from breach of contract. From an economic standpoint, it is irrelevant to call the amount of money to be paid by the duty-bearer "penalty clause" or "damages awarded as a result of breach of contract".

> help is offered for no compensation in a moment of need, accept it with restraint. When a service is offered for a price, buy as much as you find convenient." (…)''A fine is a price.'' The two labels of the payment as price or fine are equivalent. (…) No guilt or shame (depending on the degree of internalization of the social norm) can be attached to the act of buying a commodity at will. (Gneezy and Rustichini, 2000: 14)

This rationale is applicable in any and all circumstances: for instance, a ten year prison sentence may be felt just as a price to be paid for a crime the commission of which provides gains which the actor values more than their own freedom. Such a person acts as *homo œconomicus* does, i.e. as a rational being whose actions are aimed at realising their self-interest. In this example, self-interest is realised because the subjection to a period of incarceration is outweighed by the gains (whatever they are) resulting from the commission of that crime. The point is simply that sanctions provided by rules, moral or legal, administrative, civil or criminal work as a price, as commodities to be bought whenever breaking a rule makes sense for *homo œconomicus*. For certain people, it may make no sense to ever break a rule. Such mind-set is a result of their individual preferences. For these people, sanctions cannot be seen as commodities, but this is only because these people do not need sanctions at all in order to motivate them to fulfil their duties. Their own conscience inclines them to follow the rules under almost every circumstance, with the obvious exception of conflict of interests under abnormal situations, i.e. circumstances in which all possible courses of action involve breaking at least one rule. Companies, however, for the reasons stated in section 2 of this paper, do not have a conscience to follow and, therefore, whatever reasons they may find to respect morality or the law are economic and always stem from restrictions. Moral rules, legal rules and contractual clauses are restrictions on the companies' course of action. Usually, people follow moral rules because they are afraid of moral sanctions, legal rules as they are afraid of legal sanctions, and contractual clauses because they fear the financial consequences which breach of contract entails. Companies, on the other hand, have no such fears. Companies are driven to maximize profit. Thus to respect or not to respect morality, law or contract is something to be decided on a case-by-case basis, with the decision resting on economic grounds.

5. FINANCIAL CRISES

Having in mind that fines are, for companies, no more than a price to be paid in order to buy the company a way out of a duty which is cost-ineffective to fulfil (section 3), it may seem paradoxical that most companies actually follow moral and legal rules (and contractual clauses) instead of opting for this way out, especially because that is done in circumstances where that decision is not *primafacie* financially sound. The financial unsoundness of such decisions is certainly beyond discussion in the short-term but, as argued in sections 1 and 2, *homo œconomicus* is a rational being who seeks to realise self-interest, and this realisation goes well beyond short-term satisfaction. This means that companies, so far as they behave the way *homo œconomicus* does, do not exclusively compute short-term financial gains when deciding whether or not to follow morality, law or contract. As mentioned in section 2, one of the ways to profit maximization is to behave, or to be perceived as behaving, honourably, and that means that respect for morality, law and contract is an unavoidable necessity. This is the reason why companies do fulfil their duties even when doing so results in a short-term financial loss. Today's financial loss, incurred in by following the rules, maintains the company's honourable reputation which allows for long-term profit maximization. The reverse, i.e. to constantly breach duty with the intention of saving as much money as possible considering only short-term goals is a sure-fire way to guarantee bankruptcy sooner rather than later.

I believe it has been made clear why rules do not function as checks on companies' behaviour the same way they do regarding the behaviour of people. For starters, companies' agency is something fictitious. From this, it is easy to conclude that moral preferences cannot be included amongst the preferences of a company. The individuals whose acts are imputed to the company they work for may have moral qualms regarding the way business requires them to act; nevertheless, as I argued above, people can, generally speaking, set aside their own moral constraints and act, if it is necessary, against them in pursuit of their professional duty. Companies are thus fictitious agents unconstrained by moral preferences. This means that the only thing preventing them from breaking the law or breaching moral rules is the fact that business partners and clients tend not to associate with ill-reputed organizations. Failure to build successful business links over time entails, at best, loss of income and, at worst, liquidation and bankruptcy.

Under normal circumstances it is in every company's best interest to follow moral and legal rules. The risk of being caught breaking those rules is not worth running, even if that risk is minimal. Companies may save pennies by not treating waste, but will lose millions if their partners and clients find out that they are not environmentally friendly. One exposé may easily be much more costly than treating waste on every single occasion waste is produced. Specialised literature shows that environmental ethics is nowadays an important part of social morality,[4] which makes companies unwilling to break the law[5] by leaving waste untreated, despite the fact that the cost of fines may be lower than the cost of treatment. If one applies this rationale to other situations (bribery of officials, withhold-

[4] Cf. e.g. Johnston, 1996, Guerrier *et al.*, 1995, Singer, 1999: 264-88, Taylor, 2011.

[5] This is one of those cases in which morality needs the law in order to protect its values.

ing salaries, purposely manufacturing faulty goods) one can easily see that breaking moral and legal rules is not something that companies do lightly or regularly.

It is therefore interesting to see whether or not this holds in situations of financial crisis. In the remainder of this essay I argue that the more acute a financial crisis is, the more the probabilities of companies throwing caution to the wind by breaking the rules increase. If that is the case, one has to wonder how it is possible to use the law to deter undesired conducts, especially if the legislature is under constitutional constraints which stop it from enacting statutes which exact sanctions that may be deemed too severe.

As is rather obvious financial crises tend, at best, to undercut profit and, at worst, to bankrupt companies. Companies whose situation becomes precarious as a result of a financial crisis naturally start setting their goals in a short-term basis and tend to neglect their long-term objectives. In fact, the more acute a company's specific crisis is, the more its long-term existence is forgotten. This means that the usual incentives to sacrifice short-term financial gains in favour of long-term stability conducive to profit maximization tend to disappear. Just as a lung-cancer patient who is terminally ill may actually adopt a purely hedonistic stance on life and start smoking more than they have hitherto done simply because their future is non-existent and only the present counts, companies which are severely hit by a financial crisis may start breaking moral and legal rules whenever that proves financially efficient in the short-term. Losing their reputation is a more than likely possibility, but the fact is that keeping their reputation intact may not do them any good in the long-term; if income is not increased somehow, reputation alone will not keep the business open.

If one adds the fact that companies regard legal sanctions as contractual clauses to a situation of financial crisis which makes companies ignore their long-term projects in order to focus on their immediate survival, it should come as no surprise that companies, under these circumstances, will invariably act as is more lucrative for themselves in the short-term. The law however has to deal with one difficulty which does not come up in contracts, and that is detection of the breach of duty. Whenever a contract is breached, the aggrieved party becomes aware of it, and usually reacts by using the legal mechanisms at their disposal. Law-enforcement agencies, on the other hand, do not always detect breach of a legal duty shortly after the occurrence of the breach, not to mention that sometimes breaking the law goes completely undetected. If, under normal circumstances, it is not worth it to run the risk of detection, even if it is minimal, because of the inherent damage to the company's reputation, under situations of financial crisis the more acute a company's crisis is, the more worthwhile the running of the risk of detection becomes, since short-term survival will matter more than maintaining reputation.

Kirchgässner's assertion regarding the impact fines have on the economic model of decision, quoted above in section 2,[6] is completely adequate to describe the behaviour of companies under critical conditions.[7] Thus, if purifying sewages costs 100, and the fine for not purifying sewages is 80, companies will invariably choose the latter alternative, since maintaining an honourable reputation stops being a priority during financial crises. Immediate survival is all that matters. Moreover, given the inherent difficulties of law-enforcement agencies

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[6] "… a fine smaller than the cost savings which can be achieved by the criminal offence will not prove to be very effective in most cases. This holds even more the smaller the probability is that a fine will actually be imposed."

[7] This, however, does not seem to be the author's intention, since his point is to describe the model of economic decision individuals (and not just companies) utilise when pondering whether or not to break the law. I disagree with Kirchgässner for the reasons already mentioned *supra* in section 2, but his idea seems to me to actually describe the criteria used by companies when deciding their course of action under situations of financial crisis.

in detecting when the law is broken, fines which impose a higher cost than the cost of following the law will still be unable to deter unlawful conduct. Turning once again to the example of purification of sewages, if the fine for leaving sewages unpurified is 100 and the cost of purification is 80, companies under financial difficulties will run the risk of detection, knowing that detection will be evaded most of the time. From a pure financial standpoint, the risk is definitely worth running even if the breach of the law is detected on occasion, as the fine exacted on that occasion will not be enough to counterbalance the profit made from all the times law-enforcement agencies have failed to detected unlawful conduct.

So far, these considerations have shown that the criminal law is incapable of deterring companies from acting in an undesired manner. Under normal situations, companies do not break the law because they want to at least be perceived as honourable; this means that morality, unlike the law, actually plays some part in deterrence, despite the fact that the motives that lead companies to respect moral rules are economic, not moral. Under situations of financial crisis, on the other hand, the criminal law is also incapable of deterring undesired conduct either because it is too lenient or because detection does not happen most of the time.

Nothing needs to be changed as far as normal circumstances are concerned. The motives that lead those who are subjected to the law to respect its rules are irrelevant from the legal perspective. If governments want, however, to use the criminal law as an effective mechanism to deter undesired conduct when financial crises arise at least one of two things need to happen: 1) Detection has to be made much more efficient. 2) Fines need to be increased to a point where they are no longer felt as a (reasonable) price to be paid as a way out for the duty-bearer. In the first case, if detection is near 100%, and the cost of fines is superior (whether slightly or heavily) to the costs of following the law, breach of the law will be drastically decreased, as all incentives to break the law disappear. On the one hand, a fine will not be seen in this instance by companies as a price because the commodity bought for this "price" is more expensive than following the law. On the other hand, the risk of being caught breaking the law increases significantly to the point it simply stops being a worthwhile financial alternative. The second solution is preferably to be applied only if the first one proves to be impossible. Thus, if it is the case that securing a near 100% rate of detection is unfeasible, governments will have to resort to exacting fines the amount of which counterbalances all the profit made from the countless times detection has been avoided. Both solutions come with their own set of problems.

Governments are not immune to financial crises. This means that the reasons which explain lack of efficiency in detection on the part of law-enforcement agencies (want of sufficient funding) apply all the more strongly during financial crises. It simply is impossible to increase detection-efficiency whenever a financial crisis arises, as funding tends to be cut, not increased. Thus, the first solution cannot be implemented in practice.

The second solution faces the following legal difficulty: States which operate under the rule of law, respect the fundamental rights of those who are within their borders, and have a written constitution which specifies (the way contracts do) what those rights (and inherent governmental duties) are, cannot just enact statutes whose provisions set exorbitant amounts of money to be paid as fines. It is important to realise that, absent an effective system of detection of breach of legal duties, the only way to deter companies from gambling and running the risk of detection in situations of financial crisis is by exacting a fine so big that it automatically counterbalances all profit made from the times detection has been avoided. It is easy to understand that such fines may cripple a company found guilty to the point of liquidation and bankruptcy. Since companies tend to run such risks only under exigent circumstances, those circumstances will, more likely than not, make them invest the profits garnered from breaking the law immediately in an attempt to stave off the effects of the crisis. In other words, under situations of financial crisis, whenever the time comes for the company to pay the big fine which counterbalances all profit hitherto made illegally companies will not have that money available, since it has necessarily been reinvested. This means that, in all likelihood, one detected offence and the respective imposition of the big fine which comes with it would be enough to send the company into liquidation.

The problem thus is whether or not this is admissible under the rule of law. All highly developed legal systems attribute legal personality to companies, i.e. a juridical fiction which allows companies to be regarded, under the law, as if they were physical persons. This means that fundamental rights, liberties and duties are enjoyed as much by people as by organizations which have legal personality.

It is equally important to realise that the extension of the application of fundamental rights to organizations such as companies do not necessarily need to be inscribed in formal documents commonly called "constitutions". In fact, they are not. Most recent Western constitutions simply acknowledge a right to "free enterprise", which is a right of physical persons, leaving the protection of the rights of the juridical person "company" to ordinary legislation. Nevertheless, in order to be effective the right to free enterprise carries with it the extension of certain fundamental constitutional rights applicable to juridical persons, such as the right to privacy or the right to property. Whether these and other rights of juridical bodies should be protected through the constitution or through ordinary legislation is a legal question which need not bother us here. What is important is to understand that, due to the fact that they enjoy legal personality, companies do have rights akin to those enjoyed by physical persons. Otherwise, companies could not be legally considered as autonomous (fictitious) agents from those who own them.

There are obviously certain fundamental rights which cannot be extended, even analogously, to companies (i.e. the right to marry). However, one can extend, through analogy, the right to life to companies. In fact, a fine big enough to cripple all the operations of a given company and send them into liquidation and bankruptcy is analogous to the death penalty, as such a fine is like a death sentence. It is not possible to discuss here whether or not the death penalty should exist under the rule of law. However, it is consensual that the death penalty should be reserved to punish ignominious crimes. The question thus is whether or not there are crimes which may be imputed to the juridical person "company" that are serious enough to warrant its dissolution through the application of hefty fines.
Let us assume that there are. They would necessarily be one or other form of homicide (attempted or consummated). One can imagine some examples: an airline which disregards security measures because the cost of proper maintenance would be enough in itself to cripple it financially under a crisis, which makes it a viable financial alternative to run the risk of detection and hope that no planes fall. The construction of a building using cheaper, sub-par materials in order to pocket the savings, once again disregarding the very real possibility that the building may collapse (while hoping it does not). In cases such as these, hefty fines aimed at discouraging such reckless conduct may certainly be legitimate from a constitutional point of view, even if they entail the "death" of the guilty company. The problem is that these examples, extreme as they are, cannot be used in order to formulate a general rule, only an exceptional one. Can the law be so harsh when protecting values other than hu-

man life? If the legislator wants to protect the natural habitat of a certain animal species (say, an endangered maritime species that lives in a certain river), is it possible to try to prevent the destruction of that habitat, which would entail the extinction of that species, by using very hefty fines as deterrence, overcompensating for the lack of efficiency in detection? If the answer is affirmative, one would be saying that the killing of an animal species justifies the punishment of "killing" a company, which certainly is a far cry from current paradigm, as the law is clearly biased toward protecting human values and actions (among which the right to free enterprise is certainly included),[8] even when that is detrimental for the environment or other animal species.[9] Under the rule of law, therefore, those responsible for the creation and application of legal rules have to find some middle ground where fines are not so small as to incentivise the breach of legal rules, as in this case sanctions are seen as no more than a price to be paid as an alternative to the fulfilling of a legal duty, or so big that immediately put companies out of business in the event their breach of duty is detected. This is the challenge that the law has to face whenever financial crises arise.

[8] Law veers off from morality in this respect, as the law is clearly biased toward the human species, which, from a moral point of view, is a case of speciesism. Cf. Singer, 1999: 55-82.

[9] If humans were to attribute to the environment the same importance we attribute to civilizational development, then civilization would have to progress without polluting the environment at all. This is what an unbiased attitude would require. The fact that the protection conferred to the environment by existent positive moral and legal systems is aimed at reducing, but not eliminating, pollution, shows that our positive moral and legal systems are biased towards the progress of civilization. An impartial system would require that neither humans, other animals nor nature in general would be harmed in any way whatsoever.

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