

Liability and Economic Regulation

Should our economy become more just and crisis-resistant, responsibility and liability must be brought better into harmony. A fundamental reform of the companies law and an effective global regulation is necessary.

Today there is a considerable discrepancy between moral responsibility and legal liability out of which many economic actors are making profit at the expense of others. This discrepancy is the real root of the more and more visible damages caused by our financial and economic system.

The recent financial crisis has made clear that the absence of juridically sueable liability tempts economic actors to behave in an irresponsible way. Of course the term „irresponsible” does not mean that anyone could evade moral responsibility, but that someone neglects it hoping for some material advantage.

This circumstance should be enough to convince us that the self-regulation of the economy is nothing more than a myth. Self-regulation of single branches or of the entire economy is as unlikely to happen as the voluntary moderation in consumption of individuals.

One decisive advantage of market economy – compared with communism for example – consists in the fact that it does not count on the goodwill of people but on their self-interest or greed in order to achieve an adequate distribution of goods. Adam Smith in the 18th century nicely formulated this. The proponents of economic self-regulation, however, try to deny this firm, anthropological foundation of market economy.

Without effective regulation that makes liability enforceable our economy can neither be just nor can it even function. As the German classic of political economy, Walter Eucken, pointed out, liability is a precondition for healthy competition since economically sensible actions must be rewarded and mistakes punished, also by insolvency. In market economy a „too big to fail” cannot hold. Moreover, it is important to extend liability to social and ecological damages eventually caused by corporate action. Only within such a strong framework competition may have a positive impact.

Currently, however, insolvency of a company may not only be a punishment for mistakes made by the management but also a means to avoid liability. The most common type of business entity in our economy is namely the – private or public –

limited company that in general limits the liability of its owners for the company's debts and obligations to the amount of money they invested in the past, i.e. in the majority of the cases to their investments in shares. The company's owners are not further liable with their private assets for the company's debts and obligations.

So our current companies law involves a great asymmetry between a company's almost unlimited possibility to make profits and its limited liability. Moreover, this asymmetry stands in flagrant contradiction to the moral and legal principle of equality since it enables people who are acting through or in certain types of companies to avoid full liability for their actions while other people generally are fully liable for what they do.

The diffusion of the responsibility of companies on several levels including the owners, the management and the employees makes the allocation of corporate liability even more difficult and contributes to the asymmetry just described.

All this results in the limitation of liability of the entire economy and makes it possible for the economy to externalize costs by damaging the biosphere without adequate compensation and by transferring the costs to the parts of society not directly involved in business.

Now, politics has already made some steps in order to combat this deplorable state of affairs, above all in the field of the financial system where the allocation of liability caused severe problems in the past years. After the financial crisis the USA was first to implement a financial regulatory reform, the Dodd–Frank Wall Street Reform and Consumer Protection Act signed into law by President Obama this summer. In Germany the government some weeks ago agreed upon a reform that particularly serves the stability of the financial system and is much smaller than the US reform even if it contains a bank tax. And recently in Basel an agreement on more severe bank regulation has been reached that, hopefully, will be confirmed on the G20 Summit in November and then adopted worldwide.

These reforms are surely important milestones on the way to an adequate regulation of the financial sector and of the entire economy but they are certainly not far-reaching enough. To fairly bring moral responsibility and legal liability into harmony requires more fundamental reforms, especially a significant extension of liability in companies law.

It is obviously more desirable to have a small set of fundamental rules defining the right framework for corporate activity than to have a multitude of secondary rules

trying to rectify a bad framework. In order to be effective and to promote a fair international competition, the right framework for the economy based on extended corporate liability should be applied globally.

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