

# License to cheat

Strengthening financial regulations to rebuild trust is necessary. Roberto Weber, Professor in Behavioral Economics at the Department of Economics, has studied with colleagues how individuals decide to do something unethical and how regulations affect people's decisions to this. Their study shows that when one has the opportunity to avoid being regulated, the result is a «license to cheat» that facilitates unethical conduct. Aileen Zumstein



*«Easily avoidable regulations can yield outcomes that are worse than simply having no regulations at all.»*

Prof. Dr. Roberto Weber

Unethical behavior is widespread in the headlines of newspapers. It is a fact that people have always cheated and are cheating still. When we think of regulations then we think of something that is absent or present, and if it is present it influences the behavior in question. But that's not always the case.

## **Imperfect or partial regulations**

In the presence of imperfect regulations people focus on trying to find ways around them if they can benefit from doing so. Once they find a way to circumvent regulations, they behave highly unethically. They feel licensed to cheat and entitled to exploit loopholes as much as they can.

The presence of avoidable regulations diminishes internal concerns for ethical acts. If there is no regulation in place then people often have the moral sense that certain things are wrong because no regulation exists to protect other people or free competition. The study shows that easily avoidable regulations can yield outcomes that are worse than simply having no regulations at all. This, in turn, produces more unethical conduct than situations in which regulation is either exogenously imposed or entirely absent.

## **Designing effective regulation**

To design effective regulations requires a clear understanding of not only what regulations do but also what effect they have. Weber and collaborators show that imperfect regulations that allow people to cheat, strongly affect behavior in settings where regulation is absent, something they term a «spill over» effect.

Regulatory effectiveness can be enhanced by people observing others' behavior. When they see examples of ethical behavior, this can help convince people that such behavior is widespread. Having prominent firms publicly buying into regulations, at an early stage, can influence subsequent adoption or compliance with those regulations by others.

Ethical behavior can also be facilitated by making people's decision to comply with regulations public. It potentially legitimizes other people's decisions to adopt the regulations as well. Conversely, knowing that loopholes are being exploited makes people adopt a similar behavior. The public effect of a person choosing to comply or not comply with regulations is an important influence on the effectiveness of regulation. ●