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MORAL HAZARD AND THE POLITICS OF EUROPEAN ECONOMIC GOVERNANCE: AN INVESTIGATION OF THE CONCEPT'S RELATION TO POWER IN THE POST- 2007 PERIOD (2007-2022)

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For Djulica Nikolić Perčević

You left us too soon, but your love and support remain. Thank you.

Abstract

The concept of moral hazard has acquired political power in the European Union. Its main effects on policy are to limit public safety nets and to increase constraints on behaviour. Yet, despite the potential negative implications of such effects in terms of social welfare and social fairness, and that moral hazard is in the realm of empirical uncertainty, the politics of moral hazard's use in European economic governance has rarely been the subject of close scrutiny. The research puzzle at the heart of this dissertation is the following: why has an uncertain phenomenon, with costly counter mechanisms, become an important component of policy?

It is argued that to answer this question, one must investigate the relation of moral hazard to power. This dissertation considers three theories, each offering a different account of why moral hazard is influential. The first – the institutional theory (power *in* ideas) – gives primacy to the role of ideational consensus among the European policy elite. The second – the authoritative theory (power *over* ideas) – gives primacy to the role of authoritative voices, like those of the stronger Member States or monetary experts. The third – the instrumental theory (power *through* ideas) – gives primacy to the role of usefulness and agency.

This dissertation proposes a novel way to study the relationship between power and ideas empirically. The analysis of the relation of moral hazard to power is based on the assessment of the extent of contestation and variability of conceptions and moral hazard-based arguments among actors with arguably different policy goals and authority, using discourse analysis and interviewing. The analysis is conducted with reference to four case studies: Germany, Italy, the European Central Bank, and the European Commission.

Based on the findings of minor contestation and major variability of conceptions and arguments, this dissertation argues that the usefulness attached to moral hazard – more than ideational consensus or the power of authoritative voices – is the main factor explaining the political influence of the concept in relation to European economic governance after 2007. The thesis defended in this dissertation is that the political power of moral hazard lies in the minor contestation of moral hazard-based arguments in EU policy debates; this lack of contestation is not the result of internalized and/or shared beliefs but of the capacity of different actors to exploit moral hazard to their own advantage.

The moral hazard case provides two main insights to the more general question of why certain ideas influence policy more than others. First, it draws attention to the role of non-authoritative actors – and their need to establish credibility – in the dominance of ideas that should be subject to more contestation. Second, the moral hazard case shows the leadership role of economic experts in creating, diffusing, contesting, and eventually changing the conventional wisdom. The relatively important contestation by the ECB opens the door to the possibility of a new policy debate in which moral hazard is no longer taken for granted but subject to a rich discussion – that notably reflects the risk of creating injustice in the name of avoiding moral hazard.

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List of Abbreviations

BRDD	Bank Recovery and Resolution Directive
CCP	central counterparty
CNBC	Consumer News and Business Channel
COVID	coronavirus disease
DG	directorate general
DGS	deposit guarantee scheme
ECB	European Central Bank
ECFIN	economic and financial affairs
EDIS	European deposit insurance scheme
EFSF	European Financial Stability Facility
ELA	emergency liquidity assistance
EMU	Economic and Monetary Union
EP	European Parliament
ESCB	European System of Central Banks
ESM	European Stability Mechanism
ESRB	European Systemic Risk Board
EU	European Union
FED	Federal Reserve
G20	Group of Twenty
GDP	growth domestic product
GFMF	German Federal Ministry of Finance
GIIPS	Greece, Ireland, Italy, Portugal, and Spain
HIE	Health Insurance Experiment
IFA	international financial architecture
IFC	international financial crisis
IMF	International Monetary Fund
LOLR	lender of last resort
NBFI	nonbank financial institution
NGEU	NextGenerationEU
NPL	non-performing loan
OCA	optimum currency area

OMT	outright monetary transaction
OTC	over-the-counter
PEPP	pandemic emergency purchase programme
PSI	private sector involvement
QE	quantitative easing
RRF	recovery and resilience facility
SDC	sovereign debt crisis
SDR	special drawing right
SGP	Stability and Growth Pact
SIB	systemically important bank
SIFI	systemically important financial institution
SMP	securities markets programme
SRF	single resolution fund
SRM	Single Resolution Mechanism
SSM	Single Supervisory Mechanism
STS	simple, transparent, and standardised
TBTF	too big to fail
TEU	Treaty on European Union
TFEU	Treaty on the Functioning of the EU
TLTRO	targeted longer-term refinancing operation
TSCG	Treaty on Stability, Coordination and Governance
UK	United Kingdom
UMP	unconventional monetary policy
US	United States

1 Introduction

‘No, these traders were genuinely aggrieved, convinced that they were about to get screwed at the hands of the government. They thought they were the victims. One had even leaned into Santelli’s mic and declared our housing program a “moral hazard”—deploying an economic term that had entered the popular lexicon, used to explain how policies that shielded banks from their mounting losses might end up encouraging even more financial recklessness in the future. Only now the same term was being wielded to argue against help for families who, through no fault of their own, were about to lose their homes’ (Obama, 2020: 273-74).

This paragraph from the memoirs of the 44th President of the United States (US) Barack Obama illustrates the politics of moral hazard’s use. This excerpt is about an unanticipated and viral critique to the Obama Administration’s housing package aimed at dealing with the collapsing housing market in the aftermath of the subprime mortgage crisis that started in 2007 (ibid.: 272).¹ On 19 February 2009, during Rick Santelli’s CNBC on-air reporting live from the floor of the Chicago Mercantile Exchange, a trader used the concept of moral hazard to oppose the government’s assistance plan (CNBC, 2009). Obama’s narration of this episode summarises the origin of this dissertation: contrary to appearances, moral hazard is not just economic jargon but also an essential matter of politics. Moral hazard – ‘the effect of insurance on the likelihood of the insured event occurring; the lack of incentive to avoid risk where there is protection against its consequences, e.g. by insurance’ (Oxford English Dictionary) – relates to fundamental questions of state intervention, fairness and allocation of blame and victimhood, and the influence of economics over public debates. Wielded against and by bankers in the aftermath of the international financial crisis of 2007-9 (IFC), the concept of moral hazard also appears as a very useful political instrument.

¹ The housing package refers to the Home Affordable Modification Program and the Home Affordable Refinance Program.

Although the subprime mortgage crisis clearly illustrates the politics of moral hazard's use and its importance, it was another but closely related crisis that sparked the initial interest in writing this dissertation on the political influence of moral hazard, namely the euro area sovereign debt crisis (SDC). Arguably, the term 'moral hazard' entered the popular lexicon in the European Union (EU) when policymakers faced the question of how to deal with the Greek debt crisis. While the Obama Administration was in favour of the construction of a credible 'firewall' (i.e. a joint emergency loan fund) to guard against contagion effects, European policymakers had a different view of the appropriate policy response to the Greek crisis (Obama, 2020: 529):

'The desire to apply some of that Old Testament justice and discourage moral hazard was reflected in Europe's initial offer: a loan of up to €25 billion, barely enough to cover a couple of months of Greek debt, contingent on the new government enacting deep cuts in worker pensions, steep tax increases, and freezes on public sector wages' (ibid.).

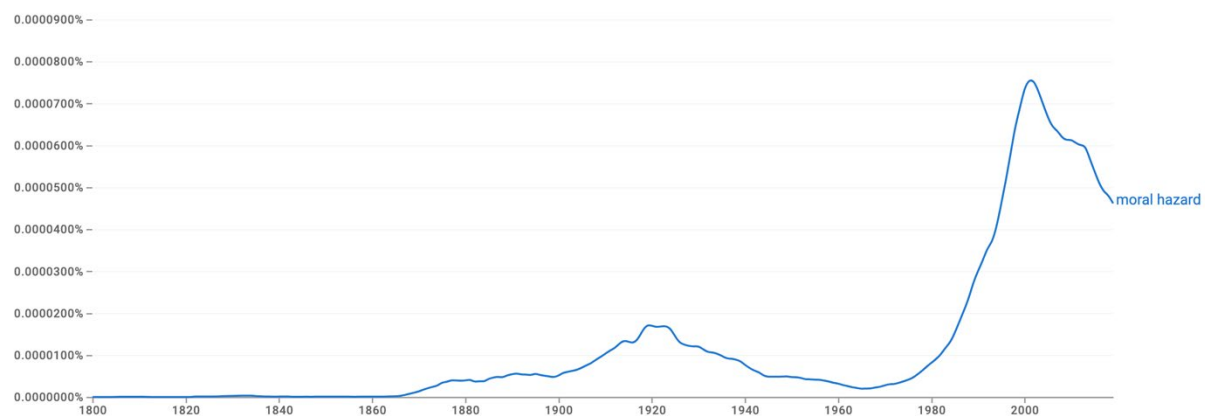
The concept of moral hazard was wielded to argue in favour of austerity and against financial assistance. The genuine starting point of this dissertation was the observation that moral hazard plays a particularly important role in European integration, and my desire to know why.

The introductory chapter is structured as follows. The first section further justifies why moral hazard should be studied in political science. Based on the influence of the concept on institutional arrangements and public policies, the consequences of this influence in terms of social welfare and social fairness, and the uncertainty attached to the phenomenon of moral hazard, I argue that the political influence of moral hazard is a puzzle that requires greater attention of political scientists. The second section presents the distinctiveness of the dissertation. The main distinctive features of this dissertation are its interpretivist methodology, its focus on the political discourse on moral hazard in the context of European economic governance, and its specific research design. The third and last section outlines the content of the chapters. This dissertation consists of two literature review chapters (chapters 2 and 3), a theoretical chapter and a methods chapter (chapters 4 and 5, respectively), four empirical chapters (chapters 6 to 9), and a concluding chapter (chapter 10).

1.1 Why Moral Hazard?

Why write a dissertation in political science about the concept of moral hazard? There are at least three overlapping reasons to offer moral hazard special academic attention in political science. First, because the concept of moral hazard acquired political influence or, in the words of the US-based political economist Peter Hall, the concept acquired ‘political power’ (Hall, 1989). Originally created and used by American fire insurers in the second half of the nineteenth century, the frequency of use of the term ‘moral hazard’ increased over time – particularly since the 1980s (see Figure 1). Moral hazard ceased to be a concept employed exclusively in the context of business insurance, and notably entered academic research and public policy. The concept of moral hazard had substantial impact on institutional arrangements and public policies – at least when it comes to the Western world.

Figure 1 Frequency of use of the term ‘moral hazard’ over time



Source: Google Books Ngram (English).

The most obvious effect of the concept of moral hazard on policy is to limit risk sharing between members of a political community.² Indeed, according to the logic of moral hazard: if the goal of a political community is to reduce the likelihood of an adverse event occurring, and that protection against its consequences increases its likelihood because people are less inclined to avoid it (moral hazard), the political community should reduce protection against its consequences. Moral hazard is a cognitive premise to conclude in favour of reducing protection against the consequences of adverse events. In the context of the modern state, the application of this policy prescription is the reduction of collective social insurance and welfare state

² In this dissertation, ‘risk sharing’ is understood as the assumption by several parties of shared responsibility for the risk. Risk sharing implies a reduced individual responsibility for the risk and therefore offers protection against its consequences. Insurance produces risk sharing. When the shared responsibility is equally assumed by the parties, risk sharing is a type of mutualisation. When the shared responsibility is mostly assumed by specific parties (e.g. the wealthiest), risk sharing is a type of redistribution.

provisions protecting against the consequences of, for example, sickness, unemployment, or poverty. A relatively well-known example of the influence of the moral hazard concept on collective social insurance is the case of American health insurance. According to the US-based political scientist Deborah Stone, the influence of moral hazard in American health economics transformed ‘health insurance from a social hero into a social villain’ and led to the public policy lesson that ‘society is better off with less insurance’ (Stone, 2011: 887-9).

Another acknowledged effect of the concept of moral hazard on policy is to increase conditionality and regulation. Indeed, increasing constraints on people’s behaviour is a second means to reduce the possibility of ‘people being less careful to avoid an adverse event’. Not allowing people to do something that increases the likelihood of an adverse event – via conditionality or regulation – is an additional policy prescription derived from the logic of moral hazard. Moral hazard is a behavioural mechanism, and the restriction of free action is an instrument to counter such a mechanism. Conditionality often applies to situations where there is protection. A common example of the causal relationship between moral hazard and conditional protection is the case of the International Monetary Fund (IMF). The causal relationship between moral hazard and IMF conditionality has been described notably by IMF officials (see, for example, Phillips and Lane, 2000). Policy adjustments are conditions for IMF loans. When a country borrows from the IMF, the government accepts temporarily to reduce its sovereignty over economic policies. As for regulation, the Basel III reforms in response to the IFC of 2007-9 illustrates the causal relationship between moral hazard and reinforced regulation. Basel III is an internationally agreed set of measures developed by the Basel Committee on Banking Supervision that strengthens prudential regulation and supervision of the banking sector. The ‘capital loss absorption at the point of non-viability’ clause and the additional loss absorbency requirements for systemically important banks (SIBs) have been explicitly described as measures to reduce moral hazard (see, for example, the Basel III Summary Table made by the Bank for International Settlements).

The case of the EU in general, and Economic and Monetary Union (EMU) in particular, is another example of the influence of the moral hazard concept on policy. Indeed, several major institutional arrangements and policies of the EU have been explained in relation to moral hazard, such as: the initial deficit of collective insurance mechanisms between the members of the euro area, the imposition of austerity in the aftermath of the SDC, Banking Union, or the inclination of EU social policy towards regulation with a weak redistributive

dimension (Blyth, 2015; Brunnermeier, James and Landau, 2016; Howarth and Quaglia, 2016; Crespy, 2022).³

The most noteworthy effects of moral hazard on policy are therefore to limit protection and to increase constraints. Thus, the concept of moral hazard is a relevant case to be studied by scholars who are interested in explaining why certain ideas – and not others – acquire political influence in a given context.

The second reason why moral hazard should receive more attention from political scientists and political economists relates to the implications of its political influence. Limiting risk sharing between members of a political community is not a neutral policy outcome; it entails a social welfare loss and distributional consequences. Indeed, risk sharing can present social welfare gains if people are risk averse, if it creates confidence, or if it acts as a stabilisation mechanism – thus reducing negative externalities when there is interdependence. Irrespective of the potential negative effects of limiting risk sharing on social welfare, it certainly favours the stronger member of the political community over the weaker. Indeed, the relative loss of limiting risk sharing is higher for those who are more in need of protection than for those who are less in need of protection. The influence of moral hazard on policy therefore raises a question of distributive justice. In addition, increasing constraints on people's behaviour (or government's policy) entails a loss of liberty (or sovereignty). This loss of liberty (or sovereignty) is particularly problematic when the social welfare gains of the behaviour (or the policy) incentivised by conditionality or regulation is open to contestation or when it creates unsustainable distributional consequences. Thus, dealing with moral hazard is intrinsically linked to essential political questions of social welfare, social fairness, and public intervention. There is no definite answer to the question of what the level of protection and constraint should be in a political community. The answer depends on various factors and, notably, on material interests and values.

Finally, the third reason why moral hazard deserves more scrutiny from political scientists – I argue – is its dual relation to economic expertise and uncertainty (Knight, 1921). If the meaning of moral hazard provided by the Oxford English Dictionary is taken, two empirical facts should be established to conclude that there is moral hazard: (1) protection against the negative consequences of an event correlates with an increase in the relative

³ It should be noted that the examples used to illustrate the effect of moral hazard on policy are cases where the causal relationship between moral hazard and the policy outcome has been explicitly acknowledged by the authors of the studies cited. However, this is not to say that the effect of moral hazard determined these policy outcomes, but that moral hazard was a factor of influence, among others.

frequency of the event occurring; and (2) protection against the negative consequences of an event has caused a growth in the number of actions that increase the likelihood of the event. The second is the explanation for the first. Moral hazard as defined in the Oxford English Dictionary is about the causal relationship between protection, action, and event. However, each of these three variables present difficulties when it comes to measurement and observation. Protection can be easily observed when there is an explicit contract but what about the cases of perceived and expected protection? Some actions are observable, others are not. Even when the action is observable, the causal relationship between protection and the action is difficult to establish given the complexity of the determinants of human behaviour. A statistically significant change of behaviour between situations with and without protection – *ceteris paribus* – must be observed. The event is usually assumed to be observable. However, the difficulty lies in measuring the causal effect of the action on the likelihood of the event occurring when the event is not determined by the action. In other words, to empirically conclude that there is, or not, moral hazard is relatively easy when there is an explicit contract for protection, the action is observable and determined by the fact of being protected, and the event is determined by the action. However, this is rarely the case in practice, especially in the context of political communities and social events. Most of the time, protection is not explicit, actions are not observable, and policies and social events are determined by many factors. Hence, the empirical conclusion in favour of moral hazard is often based, at best, on proxies and inferences and, at worst, on intuition. Notably, the response to whether protection has caused a growth in the number of actions that increase the likelihood of the event is often inferred from the occurrence of the event – if the event occurs, the response is positive; if the event does not occur, the response is negative. This inference overestimates the role of individual actions on the event and minimises the role of other factors.

The emphasis on the uncertainty of moral hazard in this introduction is not to deny its existence, the problem it may pose for political communities, or the technical progress achieved over time for its empirical investigation, but to point that – despite the intuitive strength of moral hazard and its close connection to the discipline of economics – there are important limits to its empirical knowledge:

‘Apart from the fact that the trade-off between moral hazard and cohesion and stabilisation constitutes a normative problem par excellence, there is less hard empirical science in this domain than one might wish, a fortiori when the issue at hand is not only

individual behaviour but the interaction of collective actors and political authorities’ (Vandenbroucke and Luigjes, 2016: 10-11).

This uncertainty matters for politics notably because it turns moral hazard into a subject widely open to interpretation, where a priori beliefs and underlying assumptions influence how moral hazard is perceived. For example, an individual with a system of beliefs that gives primacy to control over events is arguably more likely to overestimate moral hazard, while an individual with a system of beliefs that gives primacy to exogenous factors is more likely to underestimate moral hazard. The difficulty of quantifying moral hazard also makes it a subject open to political strategic manipulation: depending on policy goals, moral hazard can be exaggerated, attenuated, or ignored.

In sum, the main effects of the concept of moral hazard on policy are to limit protection and to increase constraints; these effects have negative implications in terms of social welfare and social fairness; and moral hazard is in the realm of empirical uncertainty, which creates an opportunity for interpretation and strategic manipulation. All these elements indicate that the political power of the moral hazard concept is not a necessity but a political phenomenon – it is determined by politics. Why has an uncertain phenomenon, with costly counter mechanisms, become an important component of policy? This dissertation aims to solve this puzzle and is guided by the following research question: how can we best explain the impact of the concept of moral hazard on European economic governance in the post-2007 period?⁴ I argue that the answer to this question lies in moral hazard’s relation to power, hence the relevance of political science.

Investigating the political power of moral hazard is important for the stability of political communities. Indeed, if the stability of a political community is considered as a function of social welfare and social fairness, and the impact of moral hazard on policy affects negatively these two variables, the political influence of moral hazard is a source of destabilization. A political community that seeks to survive over time and avoid its destruction should therefore pay attention to the political influence of the concept of moral hazard. By treating the impact of moral hazard on policy as a political phenomenon, this dissertation presupposes that this impact can be changed. Appearances to the contrary, it is a matter of politics. Creating knowledge on the relationship between power and moral hazard is not only

⁴ The choice of the post-2007 EU context will be further justified in the next section. In this dissertation, ‘economic’ is understood in a broad sense, that includes monetary, fiscal, competition, financial regulatory, and social policies. This broad meaning of ‘economic’ as ‘socio-economic’ is based on the close relationship between strict economic policies and the outcome of social policies.

of interest for the academic community but also for policymakers who want to change this impact.

1.2 The Distinctiveness of the Dissertation

This section presents the characteristics that distinguish this dissertation from the existing academic literature on moral hazard. One of the main distinctive features of this dissertation relates to its methodology – understood as ‘basic presuppositions about the aims of inquiry, ways of knowing (epistemology), and the nature of the reality being studied (ontology)’ (Schaffer, 2016: 1). Most of the academic research on moral hazard has been conducted in the discipline of economics: based on a search of academic journal articles with ‘moral hazard’ in the title and written in English in the JSTOR database, I estimated that approximately 67% of the academic literature on moral hazard belongs to economics.⁵ Positivism is the dominant methodology in economics. A positivist approach to social science is characterised by the presupposition that social phenomena are independent phenomena that can be directly and neutrally observed. The aim of inquiry of positivist research is usually to identify and measure social phenomena and to empirically verify or falsify theoretical propositions about their causes and consequences. Within the positivist tradition, concepts in social science represent a precise reality taken to be independently pre-existing (ibid.: 10); they are ‘tools for fact-gathering, data containers’ (Sartori, 1970: 64). Scientific concepts are instruments to identify and measure. They are supposedly free from the vagueness and ambiguity of ordinary language, and from value judgements. Within this methodology, the concept of moral hazard is a neutral analytical tool describing the pre-existing phenomenon of moral hazard. In academic research, positivism is the dominant methodology for the study of moral hazard.

Against this background, this dissertation adopts an alternative methodology, namely interpretivism. There is a rich tradition of interpretivist research in political science and political economy. However, the concept of moral hazard has rarely been studied through this lens. An interpretivist approach to social science ‘usually starts from the dual premises that there are no “real” social entities, only culturally mediated social facts, and that social science

⁵ The discipline of finance comes second, with 9% of the academic literature on moral hazard. The disciplines of political science and law account for around 3% each of the total academic journal articles on moral hazard. The advanced search in the JSTOR database, conducted on 24 August 2022, resulted in 410 articles (Appendix A). Using the software MAXQDA, the discipline of each article was manually coded based on the affiliation of the author(s).

is always perspectival and entwined with the pursuit of moral or material goals' (Schaffer, 2016: 2). Within the interpretivist tradition, concepts in social science are not instruments but objects of study (ibid.). Concepts are not considered as neutral analytical tools but as sources of information and political instruments that reflect and shape social reality. A particular shared conception may reflect shared interests, values, and paradigms. The way in which a phenomenon is conceptualised can determine the preferred courses of action and therefore shape social reality. The aim of inquiry is not to identify and measure social phenomena but to shed light on the range of meanings of concepts and to interrogate the relationship of concepts to power (ibid.). This dissertation adopts an interpretivist methodology insofar its object of study is not the phenomenon of moral hazard but the concept of moral hazard: its focus is on what moral hazard means to policymakers and how they use the concept in policy debates. This dissertation studies the politics of moral hazard's use. Arguably, all concepts in social science should be studied with an interpretivist methodology to deal with the problems of one-sidedness, universalism, and objectivism posed by a positivist approach (ibid.). However, I argue that, given the relation of moral hazard to uncertainty and the political influence of the concept, the study of moral hazard with an interpretivist methodology is all the more important. By studying the social construction of moral hazard and its relation to power, this dissertation contributes to the academic literature on moral hazard in reducing its bias in favour of positivist research. In doing so, it expands the kinds of research questions being asked in relation to moral hazard.

A second distinctive feature of the dissertation is its focus on policymakers of the EU. Indeed, there are a few studies of what moral hazard means in different social contexts and/or of the relationship of moral hazard to power (Baker, 1996; Stone, 2011; Rowell and Connelly, 2012; Leaver, 2015). The variation in the meanings of moral hazard has notably been studied over time, between business insurers of the nineteenth century and neoclassical economists of the twentieth century. The power of professional economists and the stronger member of the political community over moral hazard was acknowledged in the context of American social insurance. See, for example:

'By "proving" that helping people has harmful consequences, the economics of moral hazard justify the abandonment of legal rules and social policies that try to help the less fortunate; and, by providing a "scientific" basis for the abandonment of legal rules and social policies, the economics of moral hazard legitimate that abandonment as the result of a search for truth, not an exercise of power' (Baker, 1996: 240).

However, to the best of my knowledge, there is no study exclusively dedicated to the politics of moral hazard's use in the context of the EU.⁶ Given the political power of moral hazard in the EU and its harmful consequences, the diversity of social contexts present in the EU, and the rich academic literature on the role of ideas and discourse on the policy-making of the EU, this is particularly surprising (see, for example, McNamara, 1998; Dyson and Featherstone, 1999; Jabko, 2006; Blyth, 2015; Ban, 2016; Crespy, Moreira Ramalho and Schmidt, 2024). By studying how policymakers of the EU understand and use moral hazard in policy debates, this dissertation contributes to filling an important gap in the academic literature on the role of ideas in the EU.

A third distinctive characteristic of the dissertation is its specific research design. Notably, the dissertation differs from the three academic articles I co-authored in terms of scope. Compared to these academic articles, the dissertation covers a longer time frame, more EU policymakers, and/or more topics. The time frame of the empirical analysis of this dissertation covers 15 years – from 2007 to 2022. There are analytical and practical reasons to justify this time frame. While the political influence of moral hazard on European economic governance did not start in 2007 and was notably observable in the Treaty on EU (TEU) signed in Maastricht in February 1992, the public salience of the term ‘moral hazard’ increased significantly since the year 2007: the number of newspaper articles containing ‘moral hazard’ or ‘moral hazards’ multiplied by more than five between 2006 and 2007 (Leaver, 2015).⁷ Arguably, the IFC of 2007-9 increased the relevance of moral hazard in policy-making. In addition, while the political power of moral hazard in European economic governance prior to 2007 has been somewhat explained by the influence of the so-called ‘sound money’ paradigm among European elites in the 1980s, the explanatory power of this hypothesis is likely to be reduced in the post-2007 crises context, where the legitimacy of the previous dominant policy paradigm has been called into question. Finally, if the empirical analysis was to start in, for example, the 1990s, archival research would have been necessary. This time-consuming activity was made more difficult by the fact that I started my doctoral studies during the COVID-19 lockdowns. In this context, the time remaining for the analysis would have been considerably reduced by the extra time required to collect the data. Hence, the choice of 2007

⁶ This excludes the three academic articles I co-authored during my doctoral studies and that are directly linked to this dissertation (Pierret and Howarth, 2023, 2024; Chang, Howarth and Pierret, 2024).

⁷ See Figure 3 for the frequency of newspaper articles containing ‘moral hazard’ or ‘moral hazards’, 1982-2010, from *The Wall Street Journal*, *The New York Times*, *Financial Times*, and *The Guardian* (Leaver, 2015).

as the starting year. The end year (2022) has been chosen for feasibility purposes in the four-year time frame of the doctoral studies.

The scope of academic articles is by nature restricted compared to a PhD dissertation. While the articles I co-authored focused on a specific topic (e.g. Banking Union, unconventional monetary policy (UMP) measures) and/or on a restricted set of policymakers (e.g. central bankers, German policymakers), this dissertation does not discriminate in terms of topics and includes a large variety of EU policymakers. This dissertation focuses on four cases: Germany, Italy, the European Central Bank (ECB), and the European Commission. For country cases, both the national government and the national central bank are studied. This selection of cases is representative of politicians and central bankers, from Member States and EU institutions, from the north and the south of the EU. Thus, the scope of this dissertation is unique in that it allows us to study the relevance of three traditional lines of division in the euro area – the central banking/political division, the ‘northern’/‘southern’ division, and the national/supranational division – for the politics of moral hazard’s use (Dyson, 2000; Matthijs and McNamara, 2015; Schelkle, 2017). This relevance (or lack thereof) is crucial if one wants to unveil the relation of moral hazard to power in the EU.

The dissertation’s claim to distinctiveness also rests on its use of original data and diversified methods. For the empirical analysis of this dissertation, a corpus of 364 institutional press documents containing the term ‘moral hazard’ (2007-2022), coming from the German government, the Bundesbank, the Italian government, the Bank of Italy, the ECB, and the European Commission, was created. In addition, I conducted 12 interviews with EU policymakers who have used the term ‘moral hazard’ in press documents or publications. These interviews lasted around 30 minutes each and were recorded and transcribed. Interviewees include prestigious professional economists providing expert advice, former high-level politicians, and national and EU institution officials. The combination of documents intended for public communication and more private, spontaneous discussions provides a rich source of information to study how moral hazard is understood and used by a sample of EU policymakers. This data was analysed with mixed methods. The dissertation gives primacy to qualitative text analysis techniques (discourse analysis) and manual coding. The discourse on moral hazard is examined in terms of contestation, conceptions, and arguments. It is worth stressing that this specific analysis of discourse is an original way of empirically investigating the different relationships between power and ideas. Despite its bias in favour of qualitative methods, this dissertation also relies on some quantitative text analysis techniques: automated

content analysis is used for topic classification and word clouds. In doing so, this dissertation takes advantage of recent technical progress in the domain of text analysis.

To sum up, this dissertation has three main distinctive features: its interpretivist methodology, which allows us to ask a research question on the relationship of moral hazard to power; its focus on moral hazard in the context of European economic governance, which contributes to filling a gap in the academic literature on the role of ideas in the EU; and its specific research design, which notably allows us to interrogate the relevance of traditional euro area divisions to the politics of moral hazard's use.

Finally, the section on the distinctiveness of this dissertation should end with a summary of its purposes, which differ from most academic research on moral hazard. Apart from the objective of producing unprecedented knowledge on the political discourse on moral hazard,⁸ this dissertation has three main purposes: (1) to expose the limits of the economics of moral hazard and the subsequent strategy of depoliticization; (2) to unveil the relationship of moral hazard to power in the context of the post-2007 European economic governance; and (3) to encourage discussion on moral hazard and ultimately expand the range of policy options.

1.3 Outline of the Chapters

Following this introduction, Chapter 2 presents the academic history of moral hazard. First, it examines the origins of the term 'moral hazard'. This dissertation refrains from presenting moral hazard as an economic idea because the term originated outside the field of economics. It was coined by fire insurers of the nineteenth century to describe the danger arising from an individual's motives to destroy a property by fire or allow its destruction. Originally, moral hazard was understood as both the opposite of morality and carelessness (or negligence), depending on whether the feature of intentionality was present or not. Insurers of the nineteenth century used the concept to achieve two goals: to minimize the number of paid losses and to construct the legitimacy of the insurance business. Second, Chapter 2 reviews the theoretical history of moral hazard and highlights its close connection with neoclassical economic theory. In the twentieth century, neoclassical economists reinterpreted moral hazard as a rational

⁸ This dissertation adopts the view of Isabela Fairclough and Norman Fairclough of 'political discourse as primarily a form of argumentation, and as involving more specifically practical argumentation, argumentation for or against particular ways of acting, argumentation that can ground decision' (Fairclough and Fairclough, 2012: 1).

behaviour, thus emphasising intentionality but making it an incentive problem rather than a moral problem. Principal-agent models under moral hazard, with the aim of studying how imperfect information on individual actions affects optimal contractual arrangements, have multiplied. However, the result of these models relies on an assumption of rationality that is contested. Chapter 2 therefore illustrates the role of a priori beliefs about human nature on the expected empirical prominence of moral hazard. Finally, third, Chapter 2 reviews the empirical history of moral hazard – which starts later and is less extensive than its theoretical history. It finds that most contexts of the application of moral hazard present mixed results.

Chapter 3 reviews the academic literature on moral hazard and European economic governance. Although relatively little academic effort has been devoted to explaining the influence of moral hazard on European economic governance, this political influence has been widely acknowledged by scholars. First, Chapter 3 focuses on the role of moral hazard in the foundation of the EMU project. In doing so, it highlights the centrality of the concept of moral hazard in both *ordo-liberalism* and *neo-liberalism* and reinterprets the influential ‘sound money’ paradigm as a synthesis of these two ideologies. The chapter then reviews the specific policy outcomes in the design of EMU that have been explained in relation to moral hazard. These include the lack of protection against the risk of public default and the constraints on national fiscal policies. Second, Chapter 3 focuses on the role of moral hazard in post-2007 European economic governance. Notably, it presents the effects of moral hazard on policy responses to the IFC and the subsequent euro area SDC, among which: the delay of financial assistance to countries in distress, the imposition of austerity, the reduced national sovereignty over fiscal policies, strict conditionality attached to assistance mechanisms, and Banking Union.

Chapter 4 offers theoretical explanations of the political power of moral hazard in European economic governance in the post-2007 period. The theoretical framework of this dissertation is based on the distinction made by the political scientists Martin Carstensen and Vivien Schmidt to characterise the three broad relationships between power and ideas, namely: power *through*, *over* and *in* ideas (Carstensen and Schmidt, 2016). This dissertation presents three theories, each offering a different account of why moral hazard is influential. The first – the institutional theory (or power *in* ideas) – gives primacy to the role of ideational consensus among the European policy elite. The second – the authoritative theory (or power *over* ideas) – gives primacy to the role of authoritative voices, like those of the stronger Member States or monetary experts. The third – the instrumental theory (or power *through* ideas) – gives primacy to the role of usefulness and agency. Chapter 4 assesses the strengths and weaknesses of each

of these approaches to the power of moral hazard in the context of the post-2007 European economic governance. Based on this assessment, the dissertation expects the usefulness attached to moral hazard – more than ideational consensus or the power of authoritative voices – to be the main factor explaining its political influence in the post-2007 crises era. In doing so, the dissertation reinterprets moral hazard as a political resource at the disposal of all actors rather than a concept exclusively exploited by ordo-liberals or neo-liberals, the stronger members of a community, or economic experts. If the hypothesis based on the instrumental theory is true, the political power of moral hazard lies in the minor contestation of moral hazard-based arguments among European policy elites. This lack of contestation is not the result of established knowledge or internalized and/or shared beliefs but of the capacity of different policymakers to exploit moral hazard to their own advantage.

The method developed in the dissertation to investigate the relationship between power and moral hazard is presented in Chapter 5. After presenting and further justifying the scope of the dissertation, Chapter 5 offers a description of the data. It notably presents the distribution of the selected press documents in terms of institutions and speaker, and over time and across topics. In doing so, Chapter 5 informs – among other findings – that the press documents containing the term ‘moral hazard’ were particularly frequent between 2010 and 2012, and that, over the period under consideration, policymakers from EU institutions and central bankers of the Bank of Italy started to use the term in press documents prior to German policymakers (see Figure 2). Then, Chapter 5 presents the detailed operationalization of the hypotheses. In this dissertation, the verification of the instrumental hypothesis (and the falsification of the authoritative and institutional hypotheses) depends on the presence of two conditions: minor contestation and major variability of moral hazard-based arguments. The discourse on moral hazard is therefore first examined in terms of contestation. The dissertation asks to what extent the term is wielded by policymakers to refute or challenge a statement on moral hazard and studies the pattern of moral hazard contestation in each case study. Second, based on the assumption that variability of moral hazard-based arguments can result from variability as to what moral hazard means, this dissertation focuses on conceptions of moral hazard. Using grounding via textual analysis and interviewing, this dissertation aims to identify and compare key defining features of moral hazard and asks whether there is a common and dominant understanding of moral hazard among European policy elites. Finally, third, this dissertation conducts a discourse analysis of moral hazard-based arguments in the corpus of press documents. By examining the premises and conclusions of arguments with at least one statement on moral hazard, this dissertation aims notably to inform about the type of the

political discourse on moral hazard (normative or cognitive) and about the range of policy goals for which policymakers wielded the concept.

Chapters 6 to 9 examine the discourse on moral hazard over the 2007-2022 period in Germany, Italy, the ECB, and the European Commission, respectively. The empirical chapters present the findings as to moral hazard's contestation, conceptions, and arguments for each case study. In doing so, the empirical chapters reveal that moral hazard is not a subject of vivid contestation among European policy elites: policymakers do not tend to use moral hazard in their communications to question the legitimacy of the moral hazard-based arguments formulated by others. Despite this apparent consensus, and the fact that the concept of moral hazard is often not defined in press documents, the analysis of conceptions presents clear evidence of the ambiguity of moral hazard in EU policy-making. Policymakers under consideration in this dissertation disagree about the meaning of moral hazard. Moral hazard assumes different meanings, such as incentives for risk-taking, voluntarily creating a burden for others, the opposite of reciprocity, or the opposite of trust. At times, moral hazard is presented as an incentive problem, while at times it is presented as a moral, a fairness, or a trust problem. These different conceptions of moral hazard, which are not equally distributed among cases, inform about different shared social realities. Finally, the empirical chapters show the ubiquity and diversity of moral hazard-based arguments in EU policy-making. For example, moral hazard was wielded to argue in favour and against further risk sharing, in favour and against further centralisation at the EU level, or in favour and against stronger regulation of the financial markets. The dissertation finds that the concept has been exploited both by those seeking to change the initial model of European economic governance defined at Maastricht and by those seeking to preserve it.

The key findings of the empirical analysis and their implications for the relationship of moral hazard to power are discussed in the first part of the conclusion of the dissertation in Chapter 10. The dissertation argues that the lack of contestation of moral hazard-based arguments among European policy elites in the post-2007 period is not a sign of ideational consensus but of the usefulness of the concept. The relationships of moral hazard to morality, economics, and the past dominant policy paradigm can be exploited to increase the legitimacy of a variety of policy goals – be it the goals of liberals or interventionists, of conservatives or progressives, and of the stronger or the weaker members of the political community. Hence, the dissertation concludes in favour of power *through* moral hazard. Second, Chapter 10 explains how the results of the dissertation relate and contribute to the academic literature on the politics of ideas. It also acknowledges the limitations of the dissertation and suggests

avenues for future research. Finally, Chapter 10 ends with a discussion on the relation of moral hazard to justice and asks what political influence moral hazard should have on the institutional arrangements and public policies of a community.⁹

⁹ Although I am not a political theorist, I believe that a short analysis of the connection of moral hazard to justice contributes to shed light on the importance of the politics of moral hazard's use.

2 The Academic History of Moral Hazard

This chapter reviews the academic literature on moral hazard. Moral hazard has been a fertile source of scientific research, especially since the 1980s, and the subject of keen interest of neoclassical economists.¹⁰ Yet, ‘appearances to the contrary, moral hazard has never been a straightforward, purely logical or scientific concept’ (Baker, 1994: 239). Based on secondary sources, this chapter begins with a presentation of the origins of the term. Section 1 informs about the original ambiguity of moral hazard and its relationship to interests, prejudices, and values. Sections 2 and 3 provide overviews of the theoretical and empirical knowledge on moral hazard, respectively. In doing so, this chapter describes how moral hazard is conceptualised in academic research and exposes the limits of what is known about moral hazard. The final section concludes on the ambiguity of the concept and the uncertainty of the phenomenon. Whether intentional or unintentional, immoral or rational, pervasive or anecdotal, moral hazard is subject to different interpretations.

2.1 Origins of the Term ‘Moral Hazard’

The term ‘moral hazard’ is relatively new: it seems to have first been used in the nineteenth century in the context of American fire insurance. According to the genealogy of moral hazard conducted by the US-based Professor of law Tom Baker, the earliest written observation of the term is in 1862 by the late Secretary and Chief Surveyor of the Chicago Board of Underwriters Arthur C. Ducat (Baker, 1994: 248-9). He defined moral hazard as follows:

¹⁰ This dissertation labels ‘neoclassical’ those economists who work with the assumptions of rational preferences and utility-maximizing agents and aim to solve constrained-maximization problems. Here, neoclassical economics is not treated as synonymous to market fundamentalism.

‘Moral Hazard. – The danger proceeding from motives to destroy property by fire, or permit its destruction. The danger from friction, caused by high insurances and low depreciated stocks and property coming together; interested carelessness; the danger of fire from interest, mischief or revenge’ (Ducat, 1865: 164-65).

In his *Practice of Fire Underwriting*, Ducat seemed to define moral hazard in opposition to ‘inherent hazard’, that is ‘a danger inseparable from the risk, growing necessarily out of facts connected with it’ (ibid.). In contrast to inherent hazard, moral hazard is the opposite of something necessary. Instead of being an inevitable danger that threatens the destruction of property by fire, moral hazard depends on an individual’s motives. Based on Ducat’s definition of moral hazard, a person may want to destroy a property by fire for a number of reasons: to profit from the insured loss, to harm someone, or to obtain satisfaction in return for a wrong suffered. Moral hazard is therefore contingent on an individual’s moral qualities or character. In addition, an insured and careless person may allow a property to be destroyed by fire without having the intention to destroy it. The difference between intentional and unintentional fires has given rise to different uses of the term ‘moral hazard’ in the late nineteenth and early twentieth centuries. For example, when employed in the plural, moral hazard often described the danger of bad or dishonest character; while, when used in the singular, moral hazard frequently referred to the danger of relaxing care when being insured (Baker, 1996; Rowell and Connelly, 2012):

‘Lack of moral character gives rise to a class of risks known by insurance men as moral hazards. The most familiar example of this class of risks is the danger of incendiary fires. Dishonest failures, bad debts, etc. would fall in this class, as well as all forms of danger from the criminal classes’ (Haynes, 1895: 412).

The difference between intentional and unintentional fires is also used by Everett U. Crosby, the General Agent for the North British and Mercantile Insurance Company, to distinguish two types of moral hazard: direct moral hazard, ‘where a property is fired by the owner for gain’ (Crosby, 1905: 225); and indirect moral hazard, ‘where the owner... has little or no incentive for safeguarding hazards, keeping premises in repair and maintain fire appliances, thus allowing the physical hazard to become abnormally high’ (ibid.: 225-26).

The term ‘moral hazard’ therefore originally had a vague and dual meaning. Fire insurers used the term to describe the danger arising from an individual’s motives, but certain features of the concept varied. For some, moral hazard was exclusively centred on the danger

arising from the motives of the owner of a property; for others, it could also include the danger that other people might want to burn the owner's property. In addition, moral hazard referred to both factors explaining intentional fires (i.e. immoral persons) and to factors explaining unintentional fires (i.e. carelessness or negligence). It is worth mentioning that a disagreement among fire insurers of the late nineteenth century as to whether both situations should be labelled the same has been identified: according to John Haynes, moral hazard should be restricted to cases where the fire is intentional (Djelic and Bothello, 2013: 594). This disagreement indicates a difference in the importance attached to an individual's blame when talking about moral hazard. The intention to do something wrong was sometimes considered a necessary condition for moral hazard, sometimes not.

The few researchers who have investigated the etymology of moral hazard have found a connection between the dual meaning of moral hazard and different interpretations of the composing words: the word 'hazard' can mean both danger and chance; the word 'moral' could mean both good or ethical and subjective (Baker, 1996; Rowell and Connelly, 2012). For example, in the context of the probability theory, mathematicians used the phrase 'moral expectation' to describe the subjective value of uncertain outcomes (as opposed to a mathematical expectation) (ibid.). The probability literature that developed in the seventeenth century is considered to have played a major role in the emergence of the term 'moral hazard' (ibid.).

Against this background, moral hazard was certainly described by fire insurers as a danger that threatened them and from which they needed protection. While ethical progress was recognised as a means to 'remove more and more moral hazard' (Haynes, 1895: 449), it was not something that insurers could decree. Instead, they carefully selected insurance applicants on the basis of their proven moral quality and personal reputation ('Fire Insurance and Choice of Parties: The Vagaries of "Moral Hazard"', 1951; Pearson, 2002). People considered to be dishonest or deviant – the 'moral hazards' – were excluded from the insurance pool (Baker, 1994: 254; Rowell and Connelly, 2012: 1064). To discriminate between reliable and unreliable applicants, historical evidence suggests that insurers were influenced by class, racial, and religious prejudices (Pearson, 2002: 34).

In addition to this discrimination between designated good and bad people, fire insurers also developed clauses in insurance contracts to protect themselves against moral hazard, given that incendiarism is difficult to prove. These clauses were intended to avoid the payment of a loss related to a fire intentionally caused by the person insured. The so-called moral hazard clauses in the New York Standard Fire Policy in 1918 were as follows:

‘This entire policy shall be void, unless otherwise provided by agreement in writing added hereto,

"Ownership, etc. (a) if the interest of the insured be other than unconditional and sole ownership; or (b) if the subject of insurance be a building on ground not owned by the insured in fee simple; or (c) if, with the knowledge of the insured, foreclosure proceedings be commenced, or notice given of sale of any property insured hereunder by reason of any mortgage or trust deed; or (d) if any change, other than by the death of an insured, take place in the interest, title or possession of the subject of insurance (except change of occupants without increase of hazard); or (e) if this policy be assigned before a loss” (Goble, 1937: 415).

These conditions establish a causal relationship between the type of ownership and moral hazard. Notably, it is assumed that a property owned by more than one owner (e.g. a joint ownership of a married couple) creates motives to burn the property to get the insurance. The violation of a condition allowed an insurance company not to pay a loss, regardless of its cause, independently of the fact that the causal relationship between the situations enumerated in the New York Standard Fire Policy and an increase in fraudulent fires ‘is purely an unsupported assumption’ (Goble, 1937: 423), and that fraudulent fires are estimated to be a marginal part of the total loss of insurance companies (ibid.).

The context in which the concept of moral hazard originated suggests that two main goals were pursued by the actors who created the term. Fire insurers of the mid to late nineteenth century wanted to protect themselves against the danger of individual behaviour and to construct the legitimacy of insurance – the expanded use of which was controversial. Indeed,

‘... the mid-nineteenth century witnessed a cultural struggle over morality of the insurance enterprise in which insurance was attacked as a form of gambling, a handmaiden to crime, and, above all, a presumptuous interference with Divine Providence’ (Baker, 1994: 255).

Fire insurers had therefore to contend with somewhat contradictory interests. From a purely accounting point of view, an insurance company has an interest in maximizing the number of insured persons and minimizing the number of paid losses. By introducing the ‘moral hazard’ clauses in insurance contracts, insurers used the concept to minimize the number of paid losses – to a degree that has been declared unjust, as illustrated in the words of a Pennsylvania judge examining the old New York Standard Fire Policy:

‘Numerous provisions were put in, that the courts had declared void because they were so unjust and inequitable. The basis of the policy seems to be an assumption that every man who insures his property is necessarily a rogue and that the poor honest companies must be protected against the villainy of the people who pay their money and get insurance’ (in Goble, 1937: 411).

The so-called moral hazard clauses were biased in favour of the insurance companies’ interest and against the policy holders’ interest. However, moral hazard was also used by insurers to reduce the number of insured persons, despite the absence of evidence that excluded social groups presented an actual increased risk for insurers. While insurance companies had a potential financial interest in including such social groups in the insurance pool, not to do so provided legitimacy to their activity. By refusing to insure those who deviated from the norm, insurers of the nineteenth century framed insurance as a moral practice in conformity to moral standards (Baker, 1994: 256-59).

The origins of the term ‘moral hazard’ reveal the ambiguity of the concept and its relation to interests, prejudices, and values. Originally, moral hazard was understood by fire insurers as both the opposite of morality and carelessness or negligence, depending on whether the feature of intentionality was present or not. Insurers used this concept to achieve two goals: to minimize the number of paid losses (with the introduction of moral hazard clauses in insurance contracts) and to construct the legitimacy of the insurance business (with the exclusion from the insurance pool of those who deviated from the social norm and moral standards). Over time, and particularly since the 1980s, the use of the term ‘moral hazard’ significantly increased (see Figure 1) and stopped being exclusively employed in the context of actual insurance contracts and policies. Notably, moral hazard became an object of theoretical and empirical academic research – the subject of the next two sections.

2.2 The Theoretical History of Moral Hazard

2.2.1 Moral Hazard and Neoclassical Economic Theory

Moral hazard is closely connected to the concept of uncertainty, which became an important subject of research in neoclassical economic theory. Uncertainty has been famously defined by the American economist Frank Knight in 1921 (Knight, 1921). He distinguished uncertainty

from risk based on a measurability criterion and referred to ‘measurable risk’ and ‘unmeasurable uncertainty’ (ibid.: 20). Uncertainty, or ‘true’ uncertainty, is therefore restricted to cases of the non-quantitative type (ibid.). In his book *Risk, Uncertainty, and Profit*, Knight makes an explicit link between moral hazard and the degree of uncertainty in fire insurance: it contributes to the impossibility of objectively grouping and accurately measuring the chance of loss (ibid.: 249). Moral hazard is an indeterminate variable for fire insurers.

However, not uncertainty but certainty was initially at the heart of neoclassical theory – which became the dominant economic theory in the late twentieth century. This body of economic thought, operating under the assumptions of rational preferences, utility-maximizing individuals, and perfect information (or certainty), considers the market to be an efficient mechanism generating competitive equilibrium allocations that are Pareto optimal.¹¹ The fundamental theorem of welfare economics is as follows: ‘every competitive equilibrium is Pareto optimal, and every Pareto optimum can be sustained by a competitive equilibrium’ (Stiglitz, 1983: 24). This is a contemporary translation of Adam Smith’s invisible hand, which provided legitimacy for the reliance on markets and prices in modern economies (ibid.: 25).

From the 1970s, under the aegis of the Nobel Prize-winner Milton Friedman, neoclassical theory revived in opposition to Keynesian theory (Wolff and Resnick, 2012: 22). Modern neoclassical theory, based on mathematical reasoning and focused on solving so-called constrained-maximization problems, became the new orthodoxy of theoretical economics. Uncertainty became a fertile source of research in neoclassical theory when some leading US-based economists decided to extend the investigation of competitive equilibrium and Pareto optimality from cases of perfect information to cases of imperfect information (or uncertainty). Supposedly, the uncertainty attached to moral hazard led these prominent economists to develop a vivid interest in the concept (Arrow, 1963; Marshall, 1976; Holmström, 1979; Stiglitz, 1983; Prescott and Townsend, 1984).

Kenneth Arrow, the Nobel Prize-winner in economics in 1972, was a pioneer of the welfare economics of uncertainty. In 1963, he published an article in which he argued that there is a social welfare loss of poorly developed or non-existent markets for the bearing of risks involved in medical care (Arrow, 1963). Arrow described the medical-care industry as a special market, notably characterized by the importance of uncertainty and the relevance of social and ethical factors, which differs from the typical competitive model (ibid.). In order to make the

¹¹ Pareto optimality or efficiency in terms of allocation of resources is commonly defined as ‘the state of a system when there is no alternative in which there is at least one person better off and no one worse off’ (Oxford English Dictionary).

case for insurance against risks in medical care,¹² he presented a theory of ideal insurance. From the point of view of the individual, who is assumed to maximize her or his expected utility¹³ and to be risk-averse (that is, have a preference for certainty), insurance presents a welfare gain when offered at an actuarially fair premium.¹⁴ However, for this to be a social welfare gain it must not present a welfare loss for the insurance agent. According to Arrow, if individual medical risks are assumed to be independent, the pooling of risks considerably reduces the risk for the insurer; ‘in the limit, the welfare loss would vanish and there is a net social gain which may be of quite substantial magnitude’ (ibid.: 960). This is in theory. In practice, where there is a finite number of risks and that some interdependence among them might exist, slightly increase the level of the premium, a coverage with a deductible amount,¹⁵ or coinsurance,¹⁶ would be able to compensate potential welfare losses (ibid.). Based on this analysis, Arrow affirmed that ‘the welfare case for insurance policies of all sorts is overwhelming’ and concluded that ‘the government should undertake insurance in those cases where this market, for whatever reason, has failed to emerge’ (ibid.: 961). Moral hazard, defined in this article as ‘the effect of insurance on incentives’, is not considered by the author as a reason to change its conclusion (ibid.). Arrow described moral hazard in relation to the costs of medical care as being contingent on the behaviour of physicians. Coinsurance provisions, the social obligation for ethical behaviour on the part of physicians, and third-party control limit the costs of medical care that is not determined by the illness (ibid.: 961-62).

Arrow’s conclusion in favour of public insurance has been criticised by the American economist Mark Pauly (Pauly, 1968).¹⁷ The critique of Pauly is centred on the condition of randomness of the costs of medical care, which is a necessary condition for Arrow’s conclusion to be valid. Pauly argued that if insurance alters the demand for medical care services (that is, there is price elasticity in the demand for medical care), the optimality of complete insurance no longer holds. Moral hazard, the phenomenon of ‘demanding more at a zero price than at a positive one’ (ibid.: 535), therefore plays a central role in the welfare implications of insurance.

¹² Here, a risk refers to something unpredictable. Two risks in medical care are identified: the risk of illness (including the cost of medical care) and the risk of total or incomplete or delayed recovery (Arrow, 1963: 959).

¹³ In situations of uncertainty, an individual maximizes ‘expected’ utilities instead of simple utilities.

¹⁴ ‘That is, if the costs of medical care are a random variable with mean m , the company will charge a premium m , and agree to indemnify the individual for all medical costs’ (Arrow, 1963: 960).

¹⁵ A deductible is ‘the amount of a loss which must be borne by the policy-holder in the event of a claim upon insurance policy’ (Oxford English Dictionary).

¹⁶ Coinsurance is ‘a form of insurance in which responsibility for loss is shared by two or more parties; also, insurance in which the insured is jointly responsible with the insurance company’ (ibid.).

¹⁷ It should be noted that the research for this article has been partly conducted in the framework of a grant from the US Public Health Service under the supervision of James Buchanan, the Nobel Prize-winner in economics in 1986 who made a significant contribution to public choice theory.

According to Pauly, insurers were mistaken to present moral hazard as a moral or ethical problem: ‘the response of seeking more medical care with insurance than in its absence is a result not of moral perfidy, but of rational economic behaviour’ (ibid.). With this interpretation, moral hazard becomes something to be expected from an individual who acts as to maximize her or his (expected) utility and, thus, calls into question the social welfare gains of insurance.

Arrow responded to this critical article by stressing that Pauly’s analysis – exclusively focused on market incentives – is narrow (Arrow, 1968: 537). Arrow agreed that ‘because of the moral hazard, complete reliance on economic incentives does not lead to an optimal allocation of resources in general’ (ibid.: 538). However, precisely for this reason, Arrow emphasized the necessity of other types of incentives to achieve a successful economic system: ‘nonmarket controls, whether internalized as moral principles or externally imposed, are to some extent essential for efficiency’ (ibid.). He did not agree with the supposedly logical implication that because seeking more medical care with insurance is a rational action, it will necessarily be the dominant course of action (ibid.). According to Arrow, the professional ethics of physicians, the willingness of an individual to behave in conformity with accepted norms, and, more generally, relations of trust and confidence are relevant and important factors to consider that may be stronger than ‘rational economic behaviour’ (ibid.).

As illustrated by the initial discussion between Arrow and Pauly, moral hazard is a subject of academic debate in neoclassical economics. Apart from this difference in the expected empirical prominence of moral hazard, the main sources of disagreement among leading neoclassical economists relate to the questions of market efficiency in the presence of moral hazard (e.g. Shavell, 1979; Stiglitz, 1983; Prescott and Townsend, 1984), implications of market failure in terms of desirability of state intervention (e.g. Arrow, 1963; Pauly, 1968; Stiglitz, 1983), and how to remedy to moral hazard (e.g. Marshall, 1976; Holmström, 1979; Stiglitz, 1983). However, this group of neoclassical economists seemed to agree on how to characterize moral hazard in their theoretical models. In neoclassical economics, the theory of moral hazard, moral hazard models, the competitive equilibrium with or under moral hazard, or the so-called principal-agent problem, are synonyms to describe a situation in which (1) individual actions affect the probability distribution of the outcome, (2) individual actions cannot be observed, and (3) doing these actions produce a direct disutility for an individual. The common examples of such costly actions in the academic literature are the level of care or effort. Expected utility-maximisers will avoid undertaking costly actions; the decision of doing so will depend on the expected disutility attached to the realization of the outcome. It is worth mentioning that, since the famous article on the ‘Lemons’ of another Nobel Prize-winner

(Akerlof, 1970),¹⁸ neoclassical economists have distinguished moral hazard (hidden actions) from another kind of imperfect information: adverse selection (hidden attributes) (e.g. Stiglitz, 1983; Prescott and Townsend, 1984). The concept of adverse selection relates to different individual types (such as low risk people and high risk people). In models with adverse selection, individual types are private information. Moral hazard and adverse selection are therefore situations of imperfect information, where the unknown information (respectively actions or attributes) affects the probability of the outcome. However, while people are in control of their actions (endogenous choices), they are not in control of their attributes (exogenous parameters). Therefore, in neoclassical economics, the feature of intentionality is emphasized: moral hazard is exclusively about intentional actions.

When chosen actions or given attributes make the outcome more likely, and others suffer a disutility from the outcome, it becomes a social welfare problem. In the case of moral hazard, the problem is qualified as an incentive problem: if not doing the costly action maximises the expected utility of the individual, and that the individual cannot be forced to undertake the action (because it cannot be observed), the individual – as modeled in neoclassical economics – will not undertake such action. To avoid a welfare loss on the side of others, it is therefore necessary to create incentives that will turn doing the costly action into the action that maximises the individual's expected utility. Thus, neoclassical economists have identified a fundamental conflict between the welfare gain associated with risk sharing arrangements and the welfare loss resulting from the negative effect of these arrangements on individual incentives to avoid the realization of the risk. Indeed, if the individual disutility attached to the realization of the outcome is reduced (as with insurance), the relative utility of not undertaking the costly action is increased. The conventional answer of neoclassical economists to the trade-off between risk sharing and incentives is incomplete insurance (i.e. deductibles and coinsurance). However, some have also emphasized the value of specifying states of nature in contracts (that is, causes of events that are not a result of an individual's actions) (Marshall, 1976), monitoring and searching for additional information (Holmström, 1979), and, to some extent, social sanctions (Stiglitz, 1983).

Neoclassical economists not only offered a new interpretation of moral hazard but also broadened the scope of application of the concept. Moral hazard as an incentive problem is not confined to actual insurance markets but occurs 'whenever risk is present, individuals are risk-

¹⁸ It is worth noting that the distinction between moral hazard and adverse selection is not perfectly clear in this article. George Akerlof pointed to a strict sense of moral hazard, which excludes adverse selection, and a broader sense of moral hazard, which includes adverse selection (Akerlof, 1970: 493).

averse, and “effort” is costly to monitor’ (Arnott and Stiglitz, 1988: 2). The subsequent extensive body of theoretical research is mostly concerned with how imperfect information on individual actions in principal-agent relations impacts optimal contractual agreements.¹⁹ Neoclassical economists have aimed to find the best feasible contracts under moral hazard in a variety of contexts: the medical-care market, the labour market, agriculture, or the financial system, to mention just a few examples. Within these contexts, the study can focus on different topics, such as: unemployment insurance (e.g. Hansen and Imrohoroglu, 1992), unemployment and efficient wages (see, for example Strand, 1991, 1996; Costain and Jansen, 2010; Navarra and Tortia, 2014), safety in the workplace (e.g. Lanoie, 1991; Di Mauro, 1996), or teamwork (e.g. Holmstrom, 1982); sharecropping (e.g. Braverman and Stiglitz, 1986; Bardhan and Singh, 1987) or crop insurance (e.g. Vercammen and van Kooten, 1994; Smith and Watts, 2010); international lending (e.g. Atkeson, 1991; Jeanne and Zettelmeyer, 2005), bailouts (e.g. Jeanne *et al.*, 2001; Farhi and Tirole, 2012), or central banks’ provision of liquidity (see, for example, Martin, 2006). The study of moral hazard can also focus on different types of moral hazard, depending on who’s actions are under consideration: worker or employer moral hazard (e.g. Strand, 1996; Costain and Jansen, 2010; Navarra and Tortia, 2014), consumer or producer moral hazard (e.g. Dybvig and Lutz, 1993; Felder, 2004), debtor/borrower or creditor/investor moral hazard (e.g. Ghosal and Miller, 2003), etc.²⁰ Finally, the study of moral hazard as an incentive problem is also not exclusively restricted to the actions of an individual. In some cases, economists have also extended the study to the actions of collective bodies, such as banks (e.g. McKinnon and Pill, 1999; Hellmann, Murdock and Stiglitz, 2000; Farhi and Tirole, 2012) or governments (Persson and Tabellini, 1996). In these models, the assumptions of rational preferences and utility maximization apply to collective bodies, and no distinction is made between the private and public sectors. The lack of discussion about the potential problem of ontology in these contributions suggests an implicit epistemic agreement on the fact that applying the same assumptions to different levels of analysis or to actors with different functions is not a problem.²¹

¹⁹ There are many variations in the principal-agent model, notably in terms of number of interactions and number of principals or agents (i.e. moral hazard in teams) (e.g. Rasmusen, 1987). Dynamic moral hazard (as opposed to static moral hazard) refers to moral hazard in a repeated principal-agent problem (e.g. Biais *et al.*, 2010; Gershkov and Perry, 2012). Other research have studied the effect of moral hazard in relations other than principal-agent within game-theoretical frameworks (e.g. Pedersen, 2003).

²⁰ However, it is worth mentioning that most studies focus on worker, consumer, and debtor moral hazard.

²¹ The question of differences between actors in terms of function has been addressed by Jean Tirole, the Nobel Prize-winner in economics in 2014. Tirole argued that the differences in incentives between the public and private sectors are ‘differences in degree, not fundamental nature’ (Tirole, 1994: 3) and, therefore, should not prevent economists to study the case of government.

The large majority of theoretical contributions on moral hazard found in the academic literature have been conducted in the fields of economics and finance.²² Economists are, by far, the most productive scholars in terms of moral hazard models. However, it is of interest to note that this economic reasoning has also reached other disciplines. For example, in political science, some rational choice theorists investigating the role of imperfect information and relative protection on incentives, have applied moral hazard models to topics such as the public control of politicians (Dogan, 2010), the management of terrorist organizations (Shapiro and Siegel, 2012), or military alliances and aggressive behaviour (Benson, Meirowitz and Ramsay, 2014). In addition, it is worth mentioning that the emergence of the Responsibility to Protect doctrine in international relations has raised an interdisciplinary academic debate on whether humanitarian interventions are associated with moral hazard (see, for example, Pease, 2004; Kuperman, 2008a, 2008b; Reed, 2012).

In sum, the theoretical history of moral hazard is mostly a history of neoclassical economics. Although neoclassical economists did not necessarily agree on the implications of moral hazard in terms of market efficiency and state intervention, they largely agreed on what moral hazard is. In neoclassical economic models, moral hazard is a situation in which (1) individual actions affect the probability distribution of the outcome, (2) individual actions cannot be observed, and (3) doing these actions produce a direct disutility for an individual. The neoclassical assumptions of rational preferences and utility-maximizing agents turn hidden actions into actions to be expected. If one wants to avoid such actions, it must change the incentives of the individual. The conventional solution of neoclassical economists to the incentive problem posed by insurance is incomplete insurance.

2.2.2 Moral Hazard, Rationality, and Morality

The reinterpretation of moral hazard by neoclassical economists as rational behaviour has been a source of criticism. The implication of the assumptions of rationality and utility maximization in neoclassical economics is that the action which is beneficial to one but detrimental to others

²² Based on a search of journal articles with ‘moral hazard’ in the title and written in English in the JSTOR database, I estimated that approximately 85% of theoretical contributions are in the fields of economics and finance (approximately 75% and 10%, respectively). Using the software MAXQDA, the nature of each article (i.e. ‘theoretical’, ‘empirical’, or ‘other’) was manually coded.

is a dominant strategy.²³ The model predicts that the uncooperative action will prevail if no external economic incentives are introduced to change what maximize the expected utility of the economic agent. In some ways, neoclassical economists removed the original uncertainty attached to moral hazard. However, some scholars have questioned the value of neoclassical models in explaining and predicting human behaviour on the basis that the behavioural assumptions underlying such models are not supported by empirical evidence. The assumption of rationality in neoclassical economics is an assumption of substantive or objective rationality (Simon, 1985): the *Homo economicus* is omniscient and has no cognitive limits. In contrast, psychologists studying how the human brain works and takes decisions refer to bounded rationality to describe the rationality of human beings (ibid.). Our knowledge and cognitive capacities are limited, and our thinking is characterised by the interplay of two systems: ‘system 1’ is fast, intuitive, and emotional; ‘system 2’ is slow, deliberative, and logical (Kahneman, 2013). Our judgements are subject to biases. The combination of these elements results in decisions that are not (always) individually optimal. The refutation of the assumption of objective rationality by psychologists, notably under the aegis of Daniel Kahneman (the Nobel Prize-winner in economics in 2002), gave rise to a new field of research: behavioural economics.

The assumption of rationality in neoclassical economics is not only an assumption of the ‘mastery of reason’ but also of selfishness. The utility function of the *Homo economicus* excludes any consideration for others. Thus, the concept of rationality in neoclassical economics contradicts the classical idea that human beings are, by nature, social and political creatures (Aristote, 2012: 51). Rationality in neoclassical economics ignores the feature of natural sociability present in other conceptions of rationality (Freeden, 2015: 109) – and of utility (Mill, 2015).²⁴ The narrow conception of human nature in neoclassical models is at the heart of the disagreement previously described between Arrow and Pauly. Arrow defended the view that the decisions of human beings cannot be reduced to economic incentives; other factors, such as moral and social sentiments, must be considered. In line with this critique, and in conformity with experimental evidence of guilt aversion (e.g. Charness and Dufwenberg, 2006), some scholars have studied the effect of introducing moral sensitivity in principal-agent

²³ Moral hazard challenges Adam Smith’s invisible hand as it represents a case in which the maximization of individual welfare conflicts with the maximization of collective welfare (i.e. what is individually optimal is not collectively optimal). In game theory, such situations are referred to a Nash equilibrium (as opposed to a Pareto equilibrium).

²⁴ According to John Stuart Mill – one of the founding thinkers of utilitarianism, ‘the utilitarian morality does recognize in human beings the power of sacrificing their own greatest good for the good of others’ (Mill, 2015: 130).

models with moral hazard (e.g. Stevens and Thevaranjan, 2010). The assumption of moral sensitivity or moral preferences (that is, the agent suffers a disutility for doing something that is known to be detrimental to others) reduces the incentive problem in traditional principal-agent models (ibid.). The relation of moral hazard to morality is therefore ambiguous. The claim in neoclassical economics that ‘the problem of moral hazard in insurance has, in fact, little to do with morality, but can be analysed with orthodox economic tools’ is open to discussion (Pauly, 1968: 531). This is notably because, as pointed by Arrow, ‘rational economic behaviour’ and ‘moral perfidy’ are not mutually exclusive categories (Arrow, 1968: 538). In addition, it should be noted that some philosophers have studied the question of whether there is something inherently moral in moral hazard: their contrasting conclusions suggest that it depends on the level of risk that is socially accepted (Hale, 2009; Claassen, 2015).

The theoretical history of moral hazard reveals the crucial role of a priori beliefs about human nature on the expected empirical significance of moral hazard. Depending on whether individuals are considered as pure rational utility-maximisers or not, the theoretical result changes. This point is especially important given the effect of the expected empirical significance of moral hazard on the desirability of collective social insurance. The empirical study of moral hazard is a means to go beyond the limits of the theoretical knowledge on moral hazard.

2.3 The Empirical History of Moral Hazard

2.3.1 The Empirical Investigation of Moral Hazard: Crucial, Limited, and Difficult

The empirical investigation of moral hazard matters for two main reasons. First, because moral hazard is often described as a problem, it is of interest to assess the extent of this problem. Expressions like ‘the problem of moral hazard’ presuppose that moral hazard is significant – otherwise, why would it be a problem? However, the proposition ‘moral hazard is significant’ is not a theoretical proposition but an empirical one. Its empirical validity is all the more important that it has major implications: if true, moral hazard is an actual social welfare problem and deserves great political attention to be solved; if false, moral hazard is not an

actual social welfare problem and does not deserve much political attention. If moral hazard poses a real social welfare problem, to identify and measure it should not be the only aims of empirical inquiries. Empirical studies of moral hazard should also aim to explain and solve it.

The second reason why the empirical investigation of moral hazard matters is that factual knowledge of its causes is helpful to find effective responses. Most of the prescriptions enumerated in the previous sections of this chapter consist of limiting or eliminating the monetary sharing of risks. To limit or eliminate risk sharing has negative consequences for any risk-averse individual. But these negative consequences are not equally distributed among people – the welfare loss associated with less or no risk sharing also depends on one's luck and monetary capacity to bear the cost of being unlucky. Given the welfare loss attached to most measures adopted to deal with moral hazard and their problematic implications in terms of social fairness, it is crucial to ensure that the prescriptions work and do not pose a greater problem. In sum, the empirical investigation of moral hazard matters to guarantee that responses to moral hazard – if needed – are proportionate and effective.

Against this background, it is surprising that there is much less empirical than theoretical research on moral hazard.²⁵ Authors of empirical studies on moral hazard tend to present their work as a contribution to fill a gap in the academic literature, which clearly indicates that the theoretical assumption of moral hazard precedes its empirical validation. See, for example:

‘Moral hazard plays an important role in many theoretical economic models, but it has rarely been measured and there is often little more than anecdotal evidence of its importance’ (Horowitz and Lichtenberg, 1993: 926).

‘Despite the theoretical importance of moral hazard and the distinction between worker time and worker effort, however, there is little direct empirical evidence on worker shirking’ (Foster and Rosenzweig, 1994: 213).

‘Given the prominence of moral hazard in policy discussions – and the certainty with which its importance, or lack thereof, is often asserted – it is surprising that there has been so little research investigating its empirical relevance’ (Phillips and Lane, 2000: 3).

²⁵ Based on the results of the advanced search in the JSTOR database, I estimated that about 30% of the journal articles are empirical contributions.

The fact that theoretical academic contributions on moral hazard are more numerous and have existed before empirical ones is actually not so surprising. The empirical research of moral hazard is particularly difficult. In order to empirically prove that there is moral hazard as conventionally conceptualized in neoclassical models (that is, as an incentive problem), one has to demonstrate that: (1) the action in question has negative effects on others (i.e. it increases the probability distribution of an outcome that produces negative consequences for others); (2) the action in question takes place; and (3) the action in question would not have been taken if the agent expected to pay the full price of its action. Establishing causation is inherently difficult; but it is especially difficult in this case because researchers not only face the complexity of the determinants of human behaviour but also of the non-directly observable and easily measurable nature of the phenomenon. Remember, moral hazard in neoclassical economics is about hidden actions. The fact that the uncooperative action has taken place must therefore be inferred *ex post* from the outcome. However, most of the time, the outcome is not something that is determined by the agent's action: the agent's action is only one of the factors affecting the probability distribution of the outcome.²⁶ In other words, the agent rarely controls the outcome. In this context of hidden action and multifactorial outcome, to empirically distinguish between 'bad behaviour' and 'bad luck' is very challenging.²⁷ Notably, to empirically differentiate between moral hazard (hidden actions) and adverse selection (hidden attributes) in insurance markets has been described as 'probably the most significant and difficult challenge' (Cohen and Siegelman, 2010: 71). To further complicate the picture, let us not forget that moral hazard is about expected utilities and individual judgement: 'moral hazard is a probabilistic concept, centred on forward-looking behaviour and therefore hinging on beliefs and expectations' (Phillips and Lane, 2000: 28). In particular, the theoretical assumption that the agent anticipates support in cases where support has not been formally agreed is extremely hard to test. In general, Knight connected moral hazard to uncertainty because, in his view, it is impossible for an external entity to objectively describe the exercise of human judgement given that 'the decisive factors in the case are so largely on the inside of the person making the decisions' (Knight, 1921: 251).

²⁶ There is a distinction in the academic literature between pure and false moral hazard, depending on whether the observable outcome allows the principal to infer the agent's action perfectly or imperfectly (see, for example, Perrigne and Vuong, 2011).

²⁷ This is precisely the reason used by fire insurers in the nineteenth century to justify the so-called moral hazard clauses: because it is difficult to prove that someone is guilty of incendiarism, everyone is presumed guilty.

2.3.2 A Review of Empirical Results

Despite these difficulties, the number of empirical studies on moral hazard has increased over time and the development of more sophisticated statistical methods (such as econometrics). This sub-section reviews the main empirical findings on moral hazard by most frequent contexts of application.²⁸ Not surprisingly, the most frequent contexts in which moral hazard has been empirically investigated echoes the ones mentioned in the theoretical history section of this chapter, except for the case of the vehicles market – a context in which moral hazard has gathered more empirical than theoretical attention. Before reviewing the empirical results on moral hazard, it is worth stressing that two types of moral hazard have been distinguished in most empirical studies, namely: *ex ante* moral hazard, which refers to actions that increase the probabilities of outcomes; and *ex post* moral hazard, referring to actions that increase the costs of outcomes.

This review of empirical findings begins with the context of health insurance. Here, *ex post* moral hazard is the positive correlation between health insurance and the demand for medical care services; and *ex ante* moral hazard is the negative correlation between health insurance and the level of preventive activity to avoid illness. Most of empirical studies in the health insurance context focus on *ex post* moral hazard. The reference study on *ex post* moral hazard is the Rand Corporation's Health Insurance Experiment (HIE), a natural experiment conducted in the US which aims – among other things – to increase knowledge as to the price elasticity of demand for medical care (Newhouse, 1974; Manning *et al.*, 1987).²⁹ The authors estimated how different levels of cost sharing in insurance plans affect the use of medical services and found that 'the per capita expenses on the free plan (no out-of-pocket costs) are 45 percent higher than those on the plan with a 95 percent coinsurance rate' (*ibid.*: 258). *Ex post* moral hazard effects have also been studied across different medical care services and related conditions. The great variation in empirical results suggests that the level of moral hazard depends on the type of disease (see, for example, Joseph, 1972; Koç, 2011). There is consensual evidence in the empirical literature that *ex post* moral hazard in the context of the

²⁸ The aim of this review of empirical results is not to be exhaustive but to summarize and illustrate the main agreements and disagreements found in the empirical literature on moral hazard.

²⁹ The literature disagrees and presents elasticity estimates from -0.1 to -2.1 (*ibid.*: 251). The authors of the HIE estimated that the price elasticities of medical care services are between -0.1 and -0.2 (*ibid.*: 267). In other words, a 1% increase in price leads to a 0.2% decrease in demand. This result suggests that most of the non-experimental literature prior to the HIE has overestimated the price elasticity of medical care services.

medical-care market is statistically significant – although its degree depends on the type of disease.

However, there is a disagreement on the welfare implications of this moral hazard effect. For some, in contrast to what conventional theory suggests, not all moral hazard represents a social welfare loss to be reduced. Instead, some authors argue that there is inefficient and efficient moral hazard in the context of health insurance (Nyman and Maude-Griffin, 2001; Koç, 2005; Nyman, 2007; Nyman *et al.*, 2018):

‘... a large portion of moral hazard actually represents health care that ill consumers would not otherwise have access to without the income that is transferred to them through insurance. This portion of moral hazard is efficient and generates a welfare gain’ (Nyman, 2007: abstract).

This interpretation of ex post moral hazard suggests that moral hazard is not necessarily a problem to be solved. Efficient moral hazard creates a social welfare gain. In addition, while extensive evidence of ex post moral hazard has been established in the context of health insurance, there is little evidence of ex ante moral hazard in this context (see, for example, Qin and Lu, 2014: 627). The relatively limited number of studies on ex ante moral hazard in health insurance present mixed results. For example, Courbage and de Coulon (2004) find that, in the United Kingdom (UK), health insurance does not result in less prevention; Stanciole (2008) finds that health insurance increases the propensity to heavy smoking, lack of exercise and obesity but decreases the propensity of heavy drinking; Dave and Kaestner (2009: 385-6) find evidence that health insurance reduces prevention and increases unhealthy behaviours among elderly men but do not find consistent evidence of ex ante moral hazard for females. To conclude, the empirical literature on moral hazard in the context of health insurance agrees on the presence of ex post moral hazard (and finds that its significance depends on the type of disease) but disagrees on the interpretation of this moral hazard effect in terms of social welfare. In contrast, there is limited and inconclusive empirical evidence of ex ante moral hazard in this context.

The vehicles market is another context in which moral hazard has been empirically tested. In the context of automobile insurance, ex ante moral hazard is a negative correlation between automobile insurance and the level of care to avoid car accidents; and ex post moral hazard is a positive correlation between automobile insurance and the distribution of losses

associated with car accidents.³⁰ The empirical evidence of moral hazard in the automobile insurance market is not conclusive. Some studies find no evidence of (any) moral hazard (Chiappori and Salanie, 2000; Abbring, Chiappori and Pinquet, 2003). Some studies find mixed results: for example, Dionne et al. (2013) find evidence of ex ante moral hazard in France among policyholders with less than 15 years of driving experience but not for policyholders with more than 15 years of experience. Other studies find consistent evidence: for instance, Lee and Kim (2016) find evidence of ex post moral hazard in Korea (especially the inflated loss of claims) as a result of regulatory changes in the bonus-malus system.

Moral hazard has also been empirically tested in the context of the labour market. Most empirical studies in this context seem to focus on ex post moral hazard in workers' compensation schemes – which cover workers in case of work-related accidents. Notably, scholars have investigated the question of whether workers' compensation results in longer recovery time (i.e. work absences that are longer than what the true state of health would require). For example, Dionne and St-Michel (1991) find a positive and statistically significant correlation between the length of the recovery period and an increase in insurance coverage for injuries difficult to diagnose but not for other injuries. The connection of ex post moral hazard with injuries difficult to diagnose has also been established by Bolduc et al. (2002), except here ex post moral hazard refers to false reporting of injuries. Other studies have investigated moral hazard in the context of unemployment insurance. Traditionally, the positive correlation between the level and length of unemployment benefits and unemployment durations has been interpreted as evidence of moral hazard (e.g. Meyer, 1990): unemployment insurance, by subsidizing leisure – so the argument goes – reduces the incentive to search for a job. However, this interpretation has also been questioned. For example, Chetty (2008) presents evidence that the increase in unemployment durations caused by unemployment insurance is mainly due to a 'liquidity effect' rather than a distortion of incentives to search for a job.

In addition, some empirical studies on moral hazard in the labour market have also focused on the question of whether partnerships and teamwork reduce individual effort or productivity. Authors find contrasting results. For example, Gaynor and Gertler (1995) find substantial evidence of moral hazard, especially in large groups. In contrast, Chan (2016) finds evidence of teamwork as a way to reduce moral hazard. Similarly, the experimental literature

³⁰ There is ambiguity in the literature about what ex post moral hazard precisely is in the context of automobile insurance: an increase in the number of claims (falsified claims) and an increase in the amount of the claimed loss (exaggerated claims) (Cummins and Tennyson, 1996); or, an incentive to hide accidents (Robinson and Zheng, 2010).

presents evidence that social preferences in joint liability groups are effective in mitigating moral hazard (e.g. Biener *et al.*, 2018).

Agriculture is another context in which moral hazard has been traditionally investigated. Most of the empirical studies in this context relate to the effect of crop insurance on the behaviour of farmers. Particularly, scholars have wondered how crop insurance influences farmers' chemical use, such as fertilizer and pesticide. This approach, focusing on input use, presents mixed results. For example, Horowitz and Lichtenberg (1993) find evidence that insured farmers use significantly more nitrogen, pesticides and herbicides than those who did not purchase insurance. In contrast, and in conformity to what is said to be the conventional view, others find that insured farmers use fewer chemical inputs than uninsured ones (see, for example, Smith and Goodwin, 1996). It is worth stressing that both results (more and less chemical use) are interpreted as evidence of moral hazard. While some consider that an increase in chemical use is moral hazard because it leads to riskier agricultural practices in terms of health, others see a decrease in chemical use as moral hazard because it implies reduced yields and productivity. Empirical studies focusing on yields rather than inputs as an indicator of moral hazard also present mixed results: for example, Coble *et al.* (1997) find evidence of moral hazard in poor production years but not in years where conditions are favourable; Roberts *et al.* (2006) find little evidence of moral hazard. Apart from the context of crop insurance, moral hazard in agriculture has been studied in the context of sharecropping. The idea that the type of ownership affects the provision of effort is widespread and precedes the use of the term 'moral hazard' – as illustrated by the words of Adam Smith (Rowell and Connelly, 2012: 1066). While the number of empirical studies on sharecropping seems relatively limited, results suggest lower efficiency when the tenant's share of output is lower (see, for example, Laffont and Matoussi, 1995).

Finally, the last context under consideration in this review of empirical results on moral hazard is the financial system. Most of empirical studies in this context focus on deposit insurance. The relationship between deposit insurance and financial stability is ambiguous in the academic literature because two opposed effects may coexist: deposit insurance increases public trust in the financial system and reduces panic and bank runs (a positive effect); deposit insurance increases banks' risk-taking (i.e. moral hazard, a negative effect). The moral hazard effect therefore plays a crucial role in the desirability of deposit insurance from a financial stability perspective. The empirical literature on the effect of deposit insurance on risk-taking presents mixed results. For example, Grossman (1992) finds evidence of moral hazard in the Thrift industry (after being insured for approximately five years), especially in relatively

permissive regulatory regimes. Similarly, Kim et al. (2014) find evidence of moral hazard in Korea, which magnitude depends on the quality of regulation. Wheelock and Kumbhakar (1995) find mixed evidence of moral hazard, depending on the indicator used to assess risk-taking. Dam and Koetter (2012) find strong evidence that safety nets in the German banking industry lead to additional risk-taking for the largest group of mutually owned cooperative banks; but they find weak evidence of moral hazard for the group of large government-owned central savings banks. In contrast, Gropp and Vesala (2004) find evidence that explicit deposit insurance reduces moral hazard, as a commitment device that limits the safety net. Empirical studies have also investigated the case of IMF lending, where the moral hazard effect on both debtors and creditors is supposedly significant and has been a source of criticism towards the IMF (see, for example, Calomiris, 1998). The empirical results on this question are not conclusive: some conclude that there is weak evidence of moral hazard (e.g. Phillips and Lane, 2000; Noy, 2008); in contrast, others find strong evidence of IMF-related moral hazard (see, for example, Dell’Ariccia, Zettelmeyer and Schnabel, 2002).

To conclude, the empirical history of moral hazard reveals that there is no obvious answer to the question ‘is moral hazard significant’? The answer depends on various factors, such as the type of moral hazard (i.e. ex ante or ex post), the context of application, the indicator used to assess risk-taking, etc. Overall, the empirical literature on moral hazard presents mixed results. In addition, even in cases where there is conclusive empirical evidence in favour of the hypothesis of significant moral hazard (e.g. ex post moral hazard in the context of health insurance), scholars do not agree on whether moral hazard creates a loss or a gain in social welfare.

2.4 Conclusion: Moral Hazard, Ambiguity, and Uncertainty

This chapter on the academic history of moral hazard has revealed the ambiguity of the concept: moral hazard is open to more than one interpretation. For fire insurers in the nineteenth century, moral hazard referred to behavioural causes of fires – be they intentional or unintentional. The danger of intentional fires was understood as a moral problem: virtuous people would not do something illegal, although the chances to be proven guilty for incendiarism were low; but other people could not be trusted. Character and perceived moral quality were therefore crucial with regard to how fire insurers dealt with moral hazard. In contrast, for most neoclassical economists, moral hazard is not something that depends on morality but on economic

incentives. Individuals are not good or bad; they are rational. They will choose the action that maximizes their expected utility. If the uncooperative action prevails, it is because the incentive system is problematic.

There are two main differences between the moral and rational conceptions of moral hazard. First, there is a difference in terms of allocation of blame: in the morality-based conception, individual character is the main cause of moral hazard; in the incentive-based conception, the structure of incentives is the main cause of moral hazard. Thus, depending on how moral hazard is understood, it can serve to blame the individual or the system. Second, there is a difference as to the universality of moral hazard: in the morality-based conception, moral hazard is only expected from immoral people; in the incentive-based conception, moral hazard is expected from all rational agents. In addition, it should be noted that, by interpreting moral hazard as rational — rather than immoral — behaviour, neoclassical economists have turned the concept into an idiom – that is, ‘a group of words established by usage as having a meaning not deductible from the meanings of the individual words’ (Oxford English Dictionary). This point has rhetorical implications and is particularly important given the focus of this dissertation on the political discourse on moral hazard.

Independently of the conception of moral hazard, it is also worth stressing that moral hazard is not necessarily interpreted as a problem in the academic literature, as illustrated by the case of ‘efficient moral hazard’ – sometimes, the change of behaviour caused by insurance can be beneficial to social welfare. The case of chemical use by farmers described in the empirical section offers another example of how divergent interpretations of moral hazard can be – opposite results (i.e. more or less chemical use) are both interpreted as evidence of moral hazard. In sum, this chapter concludes that the concept of moral hazard is ambiguous – it means different things to different people – and, therefore, agrees with the proposition that it constitutes an example of fuzzy knowledge (Leaver, 2015).

Moral hazard is not only fuzzy knowledge (i.e. fuzzy meaning), but also imperfect knowledge. The conventional theoretical knowledge on moral hazard depends on an assumption of rationality that is contested and the empirical knowledge on moral hazard is relatively less extensive and inconclusive. Indeed, most of the contexts under consideration in this review present mixed results.³¹ Despite the intuitive strength of moral hazard and recent efforts to quantify it, relatively high uncertainty in relation to the phenomenon remains. The

³¹ This conclusion is all the more significant that ‘academic publication practices are biased against non-findings, however sound the underlying research’ (Schelkle, 2017: 257).

next chapter of this dissertation presents the political influence of this ambiguous concept and uncertain phenomenon on European economic governance.

3 Moral Hazard and European Economic Governance

This chapter aims to assess the impact of the concept of moral hazard on the EU's socio-economic institutional arrangements and policies over time. To achieve this aim, the chapter draws on academic literature that seeks to explain European economic governance in general, and Europe's Economic and Monetary Union (EMU) in particular.³² This chapter presents an overview of the cases in which a causal relationship between moral hazard and EU economic policy outcomes has been identified by scholars. The first section of this chapter focuses on the role of moral hazard in the negotiations on the EMU project leading to the Maastricht Treaty. The second section centres on the role of moral hazard in the post-2007 crises period, which includes the debates on EMU reforms. The final section concludes as to the relatively high impact of moral hazard on European economic governance.

3.1 Moral Hazard and the Foundation of EMU

3.1.1 EMU, Ideologies, and Moral Hazard

The agreement on EMU that was reached at Maastricht in December 1991 marks the beginning of an unprecedented social experiment (Schelkle, 2017). In particular, by agreeing to establish a single currency, the EMU negotiators substantially changed the institutional arrangements of the European community. The reasons for the creation and design of EMU are multiple and include the role of ideologies, defined here as 'an action-oriented set of ideas, beliefs, and

³² As a reminder, in this dissertation, 'economic' is understood in a broad sense, that includes monetary, fiscal, competition, financial regulatory, and social policies.

values that exhibit a recurring pattern’ (Freedden, 2015: 13). Indeed, the EMU negotiations have been conceptualized not only as a strategic process but also as a cognitive process – that is, a negotiating process in which the role of beliefs in defining interests and policy positions, and the transmission of ideas and knowledge are crucial (Dyson and Featherstone, 1999: 7). The extensive academic literature on the role of ideologies in the foundation of EMU points towards two main ideologies, namely: ordo-liberalism and neo-liberalism (see, for example, McNamara, 1998; Dyson and Featherstone, 1999; Dyson, 2000; Ban, 2016). As it will be demonstrated in this subsection, moral hazard can be described as a core concept of both types of liberalism.

Ideologies are not easy to define. Clearly, ‘there is no single, unambiguous thing called liberalism’ (Freedden, 2015: 1). In order to account for the distinctiveness of ordo-liberalism and neo-liberalism, this dissertation relies on prominent studies in which the morphological approach has been applied to these types of liberalism (see, notably, Freedden, 2015; Dyson, 2021). The morphology of an ideology is the result of a research process that answers two main questions: what are the ideas that characterize this ideology and what is the relative importance attached to these ideas? (Freedden, 2015: 56-7). Indeed, ‘all ideologies [...] appeal to central ideas and concepts they wish to promote or defend, but each ideology orders its ideas and concepts in a different, and distinctly identifiable, pattern’ (ibid.: 56). The morphological approach is used to detect this pattern and define boundaries between ideologies.

Ordo-liberalism has been described as ‘the most coherent and developed form [of conservative liberalism]’ (Dyson, 2021: 2). According to the political scientist Kenneth Dyson, the distinctive features of conservative liberalism are the following:

- ‘An austere and ascetic view of civic virtue.
- Intellectual hostility to utilitarianism, to materialism, and to philistine elites and publics.
- The paramount importance of law, order and morality, and personal conscience.
- The need for social hierarchy and respect for authority.
- An educated, cultivated, and disinterested elite that rules in the name of the general interest.
- The sacrosanct nature of private property and freedom of contract, qualified by a lack of equal regard for all kinds of property, notably unproductive capital, and by hostility to coercion in contract.
- Priority for the interests of savers and creditors.
- Distaste for those ‘unhealthy’ bourgeois values that undermine moral and social norms.

- Respect for trustworthy officials who serve the community; for independently minded, creative artisans; for small, independent family businesses; and for the social balance and solidity that farming and rural communities provide.
- Recognition of the interdependence of the economic with the social, legal, and political orders.
- Belief in the strong but limited state — strong in the face of mass and pluralistic politics but limited to market-conforming intervention.
- A cautious approach to democracy that protects both individual rights and public virtue from the political demagogue and from the excesses of public opinion' (ibid.: 42-3).

Conservative and ordo-liberals are therefore united in their opposition to a hedonistic consumer culture based on debt (Dyson, 2014: 186). Modern capitalism carries temptations that should be resisted if one wants to live what is considered a noble life by these liberals. For them, the absence of restraint in terms of desires is problematic. Conservative and ordo-liberals seem to share the view that it leads to the unwanted rise of what Ortega y Gasset called the 'mass-man' – that is, a person who basically shares the fundamental traits of a spoiled child (Ortega y Gasset, 1930). Thus, in contrast to other types of liberalism, the state has a central role in conservatism liberalism and ordo-liberalism: its function is to impose the necessary external discipline (Dyson, 2021: 19). There is an emphasis on the need to create a strong state able to establish a rules-based order to discipline not only individuals but also the market (Bonefeld, 2012). Dyson summarises conservative liberalism as 'a disciplinary revolution in liberalism' (Dyson, 2021: 77).

Ordo-liberalism is a specific form of conservative liberalism that developed in the inter-war period in Germany among circles of economists and lawyers. There are several variants of ordo-liberalism (ibid.). This dissertation focuses on the mainstream variant associated with the economist Walter Eucken and the 'Freiburg School'. At the heart of this ordo-liberalism lies the idea of the competitive market order as an ethical order, characterized by the absence of privilege and discrimination (ibid.: 116). The main goal of ordo-liberals is to establish this competitive market order. Indeed, ordo-liberals rejected the idea of the competitive market as a natural phenomenon (ibid.: 7). Instead of being something spontaneous and self-regulating, the competitive market is perceived as something to be constructed and contingent on specific conditions. In his book *Principles of Economic Policy* (Eucken, 1952) – one of the founding texts of ordo-liberalism – Eucken enumerated the seven constitutive principles of the competitive market order:

- 'Competitive prices
- The primacy of stable prices
- Open markets
- The primacy of private property rights
- The freedom of contract
- Unrestricted liability
- The long-term continuity of economic policies' (in Dyson, 2021: 108).

For ordo-liberals, private monopoly power and subsidies conflict with the ideal of the market as an ethical order. Free competition is considered as a necessary condition to achieve the economic order. Competition policy is therefore a key feature of ordo-liberalism. Stability is another core concept of ordo-liberalism, which characterized modern German economic culture. Indeed, the ordo-liberal principles of price stability and long-term continuity of economic policies informed the 'stability culture' that developed in Germany in the post-1945 period (Dyson, 2014: 275). The traumatic experience of the 1923 hyperinflation in Germany provided legitimacy to the stability culture, including the conservative aversion to excessive (public) spending and debt (ibid.: 272-75). The Bundesbank, an independent central bank with a narrow mandate focused on price stability, was at the centre of the institutionalization of this stability culture (ibid.: 214). Finally, Eucken's principle of unrestricted liability or avoiding moral hazard is another core concept of ordo-liberalism (Brunnermeier, James and Landau, 2016; Wilkinson, 2019) and, by extension, of the German stability culture. Unlimited liability for losses and debts is described as an essential institutional mechanism to ensure individual responsibility (Dyson, 2021: 108). Within ordo-liberal thought, individual responsibility meant accountability for one's action but also personal discipline, moderation. Moral hazard is the opposite of individual responsibility. It occurs when individual liability is restricted. In contrast to the academic literature in neoclassical economics, moral hazard in ordo-liberalism seems to be understood as a moral problem arising from the absence of appropriate constraints. In ordo-liberalism, rules are not only an instrument to ensure predictability and credible commitments; they are also a mechanism to enforce appropriate behaviour and avoid the risks associated with inappropriate behaviour.

The degree of ambiguity around what neo-liberalism means is particularly high (Ban, 2016: 6). For some, the introduction of the term is even 'one of the most prominent misrepresentations of liberalism' (Freeden, 2015: 109). According to the political scientist Michael Freeden, it is unfortunate that neo-liberalism is named neo-liberalism (ibid.: 54). This

opinion suggests that neo-liberalism has very little in common with liberalism. The ambiguity of the term ‘neo-liberalism’ is arguably due to a significant change in its meaning over time. Indeed, what neo-liberalism meant to conservative liberals in the 1930s is very different from ‘market fundamentalism’ – which became the dominant description of neo-liberalism (Dyson, 2021: 3). Freedman identifies two main defining features of neo-liberalism: an emphasis on a self-regulating economic market and the reinterpretation of rationality as maximizing economic advantage (ibid.: 109). Others defined neo-liberalism in relation to its specific goals. For example, the political economist Cornel Ban defines neo-liberalism as ‘a set of economic ideas and associated policies that have a constant goal (to enlarge the realm of the market) and a variable one (to carry out upwards redistributions)’ (Ban, 2016: 2). In neo-liberal thought, markets are always efficient and the state always pathological (Blyth, 2015: 154). In contrast to ordo-liberals, neo-liberals did not believe that the market needs discipline and limits. Instead, their main policy prescription was deregulation and *laissez-faire* (see, for example, Bonefeld, 2012).

Neo-liberalism has also been defined as a set of US-based economic theories used to ‘disembed liberalism’ (Blyth, 2002), namely: monetarism, rational expectations, and supply-side and public choice theories (ibid.; Ban, 2016: 8). These economic theories are of particular interest to our investigation of neo-liberalism and ordo-liberalism as they offer some overlapping features between the two ideologies. Notably, the emphasis on low inflation in monetarism and the distrust of democratic governments in public choice theory converge in an institutional framework characterised by an independent central bank with a narrow price stability mandate. In addition, moral hazard is also a core concept of public choice theory (Vaubel, 1992; Baker, 1994; Blyth, 2015). In this economic theory, moral hazard is perceived as a major policy problem (ibid.: 43). Moral hazard in neo-liberalism is close to the treatment of moral hazard in neo-classical economics described in the previous chapter of this dissertation – that is, moral hazard as an incentive problem. This conception of moral hazard lies in the assumption that individuals are in essence self-interested utility-maximisers. Moral hazard problems are therefore pervasive, notably in relation to elected politicians seeking to be re-elected. Although the objectives of price stability and of avoiding moral hazard are common to ordo-liberalism and neo-liberalism, it is worth mentioning that the source of legitimacy of such goals appears to differ between the two ideologies: ordo-liberals legitimize the objectives of price stability and of avoiding moral hazard based on ethics, whereas neo-liberals justify such objectives with reference to academic knowledge and supposedly value-free economic theories.

Based on this investigation of ordo-liberalism and neo-liberalism, we found three main differences between the two ideologies. First, in ordo-liberalism, the economic, social, legal, and political orders are described as interdependent and presumably equally important orders, whereas in neo-liberalism, the economic sphere is supreme. Second, ordo-liberalism is characterised by an emphasis on discipline and the need to construct external constraints on all actors to achieve an ethical order, while neo-liberals do not see the need to limit the pursuit of personal self-interest as they have faith in a spontaneous and self-regulated market. This difference results in opposed views on the role of the state in the economy: for ordo-liberals, the state has an important role to play to discipline the market and establish the economic order, while for neo-liberals the state should not intervene in the economy. Ordo-liberals believe in a limited but positive role of the state in the economy as ‘order provider’. Neo-liberals believe that market mechanisms are intrinsically efficient and that any interference with free market forces reduces market efficiency. Finally, third, there are different underlying assumptions about human nature in both types of liberalism. In ordo-liberalism, the elite is defined as a group of individuals capable of governing in the general interest. The governance of this group of people is perceived as an essential condition to achieve an ethical order. Neo-liberals do not seem to believe in the existence of individuals that do not exclusively seek to maximize their own advantage; or at least, do not see such elite as something essential to society thanks to the government of self-regulating market forces.

Ordo-liberalism and neo-liberalism also present several similarities. In particular, the shared distrust of democracy and emphasis on price stability leads to a common preference for independent central banks with a narrow mandate focused upon price stability. In addition, in both ideologies the need of constraints (or incentives) to avoid moral hazard is emphasized, especially in relation to the danger of excessive public debt. Ordo-liberals and neo-liberals are united in their belief that public spending and guarantees should be as limited as possible. The overlapping features between ordo-liberalism and neo-liberalism informed what has been called the ‘sound money’ paradigm – a policy consensus among European elites that emerged in the 1980s – which has been identified as a determinant factor in the creation and design of EMU (McNamara, 1998; Dyson and Featherstone, 1999; Dyson, 2000). The next subsection details the correspondence between the central idea of avoiding moral hazard in the sound money paradigm and the institutional design of EMU.

3.1.2 The Institutionalisation of Avoiding Moral Hazard in the Foundation of EMU

Most of the academic literature on moral hazard in the context of monetary unions investigates the (potential) effect of introducing a common currency on government deficits and debts. A number of scholars argue that there is, in theory, a negative correlation between monetary unions and budgetary discipline because of moral hazard (for a review, see Arestis, Khan and Luintel, 2002). The logic of the moral hazard argument in monetary unions is similar to the one of collective action problems (Schelkle, 2017; Rommerskirchen, 2019): because the stability of the single currency is a common good and each member of the monetary union has an interest in preserving the credibility of the common currency, there is an incentive to rescue insolvent members. It is argued that this situation creates an expectation of bailouts, thus an incentive for individual members to run large deficits. As a result, the probability of bailouts – and potentially inflation – increases. In other words, if a monetary union credibly protects its members against the risk of sovereign default, there is a danger that members will misuse their membership to overissue government bonds and thus create costs for others. The political economist Charlotte Rommerskirchen describes this potential phenomenon as ‘the ultimate moral hazard of stability free riding’ (ibid.: 34).³³ The fear of this moral hazard – ‘the moral hazard of governments abusing a common currency to free-ride on others’ (Landmann, 2019: 155) – is underpinned by pervasive distrust between the members of the monetary union, which has also been described as an attribute of the European integration process (Dyson, 2014: 578).

As a result, key elements of EMU have been introduced with the aim of avoiding moral hazard from sovereigns or ‘fiscal exploitation’ (Landmann, 2019: 155). The Maastricht Treaty of 1993 contains many provisions to prevent debtor moral hazard. There are two main mechanisms in the Maastricht model to constrain expansionary fiscal policies and ensure national budgetary discipline: market pressure and fiscal rules (Rommerskirchen, 2019). To avoid the moral hazard of fiscal profligacy in the euro area, the architects of the euro decided that the euro area should be characterized by a deficit of collective insurance mechanisms (Brunnermeier, James and Landau, 2016; Schelkle, 2017; Genschel and Jachtenfuchs, 2018). The so-called clauses of ‘no monetary financing’ and ‘no-bailout’ in, respectively, article 123

³³ Given the topic of this dissertation on the political influence of moral hazard in European economic governance, it is worth stressing that Rommerskirchen provides empirical evidence against the claim that there is rampant debtor moral hazard in the euro area (Rommerskirchen, 2019: 126).

and article 125 of the Treaty on the Functioning of the European Union (TFEU) aim to protect the Union against debtor moral hazard (Dyson, 2014; Blyth, 2015; Schelkle, 2017; Rommerskirchen, 2019; Wilkinson, 2019):

‘Overdraft facilities or any other type of credit facility with the European Central Bank or with the central banks of the Member States (hereinafter referred to as ‘national central banks’) in favour of Union institutions, bodies, offices or agencies, central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of Member States shall be prohibited, as shall the purchase directly from them by the European Central Bank or national central banks of debt instruments’ (Article 123(1), *TFEU*).

‘The Union shall not be liable for or assume the commitments of central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of any Member State, without prejudice to mutual financial guarantees for the joint execution of a specific project. A Member State shall not be liable for or assume the commitments of central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of another Member State, without prejudice to mutual financial guarantees for the joint execution of a specific project’ (Article 125(1), *TFEU*).

By agreeing on the prohibition of monetary financing of public debts, the EMU negotiators agreed to deprive the European System of Central Banks (ESCB) of a classical function of central banks, namely, to act as a lender of last resort for sovereigns. Neither the ECB nor national central banks are allowed to provide emergency funding to governments in financial difficulties. The ‘no-bailout’ clause further ensures that the liability of governments is unrestricted: the financial commitments of the government of a Member State must be honoured without the assistance of the Union institutions or of another Member State. The goal of prohibiting monetary financing of public debts and bailouts of governments is to deter the expectation that the members of the monetary union will protect other members from defaulting. Thus, articles 123 and 125 of the TFEU are instruments to achieve the policy goal of avoiding debtor moral hazard.

In the Maastricht model of macroeconomic governance, the financial markets are given the role of judges of sovereign creditworthiness: one of the function of markets is to reward fiscal discipline and punish fiscal profligacy by adjusting the price of public borrowing to the

perceived riskiness of such lending. In other words, lenders will demand a higher (lower) interest rate to lend to a government whose capacity to repay is (not) in doubt. Relatively high costs of public borrowing are supposed to constraint a government from incurring excessive debt.³⁴ Therefore, this market pressure acts as an additional economic constraint on national governments that should favour the sustainability of national public debts. In the Maastricht model, financial markets are assigned the role of the supreme arbiter: the judgement of the markets as to the creditworthiness of Member States should be accepted as fair, hence the consequences of such judgement should not be relieved by collective insurance or assistance mechanisms. The relief of market pressure is perceived as conducive to moral hazard.

In the Maastricht model, market discipline is combined with fiscal rules to protect against government moral hazard. The countries that signed the Maastricht Treaty accepted the obligation of budgetary discipline and the creation of legal constraints on national fiscal policies. The EMU negotiators agreed on a specific meaning of budgetary discipline, namely: not exceeding the reference values of:

- 3% for the ratio of the planned or actual government deficit to gross domestic product (GDP) at market prices;
- 60% for the ratio of government debt to GDP at market prices.

In the context of the foundation of EMU, budgetary discipline therefore meant complying with these fiscal rules and fiscal profligacy meant not complying with the agreed fiscal rules. This conception of what is a responsible government assumes that governments are in control of their deficit to GDP ratio and of their debt to GDP ratio (Schelkle, 2005: 384). To comply with the rules is perceived as a voluntary course of action and, therefore, governments are to blame for not keeping their commitment. At Maastricht, governments stated their commitment not to run excessive deficits and debts. This declaration serves as a guarantee against debtor moral hazard.

However, for some observers – such as a group of German economists who voiced their discontent in a public letter or the Bundesbank – the Maastricht Treaty provisions were not sufficient to ensure the stability of the European economic order (Heipertz and Verdun, 2010: 45; Dyson, 2021: 375). The creation of the Stability and Growth Pact (SGP) of 1997, proposed by the German Finance Minister Theodor Waigel, aimed at introducing additional precautions against free-riding or debtor moral hazard (Heipertz, 2003; Heipertz and Verdun, 2010; Schelkle, 2017: 141). Two main instruments were adopted by the SGP negotiators to reinforce

³⁴ Ultimately, a government may lose access to financial markets.

the limits of sovereignty on budgetary policies: fiscal surveillance and sanctions. The task of fiscal surveillance was (partially) delegated to the European Commission: each euro area Member State was required to submit an annual stability programme, which was to include a description of national policy measures to achieve the fiscal objectives agreed in the Maastricht Treaty. National budgetary policies were assessed and monitored at the European level under the so-called ‘preventive rules’ of the SGP. The preventive rules were adopted to avoid the occurrence of an excessive deficit. If an excessive deficit occurred, the so-called ‘corrective rules’ of the SGP applied. Under the Excessive Deficit Procedure, the Council of the EU could decide to impose sanctions if a euro area Member State did not act in compliance with the recommendations. The institutional design of EMU was therefore strongly influenced by the objective of avoiding debtor moral hazard from governments. The initial institutional architecture of the euro area was characterized by a lack of protection against the risk of public default (articles 123 and 125 of the TFEU) and by increased constraints on fiscal policy (with market pressure, fiscal rules, surveillance, and sanctions) to achieve the goals of budgetary discipline and price stability.

The initial features of EMU indicated a clear emphasis on preventing sovereign moral hazard. However, some elements also pointed towards the willingness of the founding fathers of the euro to avoid moral hazard in the private sector. For example, the original decentralized arrangements for banking supervision in the euro area was described as a way to prevent moral hazard (see, for example, Dyson, 2000: 20-22, 2016: 165; Schelkle, 2017: 219). Some, like the President of the Bundesbank Hans Tietmeyer, argued that a central bank with supervisory tasks and responsibility for financial stability creates an expectation of potentially unlimited liquidity provisions, thus an incentive for banks to take excessive risks (ibid). To prevent moral hazard in the financial sector, the policy prescription was to favour ‘constructive ambiguity’ as to the ECB’s role of lender of last resort to banks over explicit ex ante coordination at the EU level (Dyson, 2000: 12). Another example is the delegation of power to the European Commission to ensure that State Aids do not distort competition in the internal market (Article 108, *TFEU*). The European Commission, for example, investigates the relationship between State Aid measures and moral hazard prior to adopting a decision, and might request measures to solve or reduce the potential moral hazard problem.³⁵

³⁵ See, for example, 98/204/EC: *Commission Decision of 30 July 1997 conditionally approving aid granted by France to the GAN group*, 1997; 98/490/EC: *Commission Decision of 20 May 1998 concerning aid granted by France to the Crédit Lyonnais group [notified under document number C (1998) 1454]*, 1998.

To conclude, EMU was originally characterized by a lack of risk sharing mechanisms, especially in relation to governments. The goal of avoiding moral hazard was instrumental to this asymmetric institutional design of EMU, which reflected the supremacy of the objectives of budgetary discipline and price stability. The initial deficit of insurance mechanisms was therefore deliberate and, in retrospect, can be described as ‘flaws by design’ (Schelkle, 2017: 313).³⁶ The next section of this chapter reviews academic literature that informs about the causal relationship between the traditional goal of avoiding moral hazard and the proposed and adopted reforms of European economic governance in the post-2007 crises period.

3.2 Moral Hazard and the Reforms of European Economic Governance in the Post-2007 crises period

The international financial crisis (IFC) of 2007-9 and the subsequent euro area sovereign debt crisis (SDC) fundamentally undermined the stability of the euro area. For the first time since the launch of the euro in January 1999, the declared irreversible character of the adoption of the single currency was put in question and the ultimate risk of a euro area break-up became acute. During the decade 2007-2017, several EU Member States experienced unsustainable double-digit long-term interest rates — contrary to most other Group of Twenty (G20) members (see, *Interest rates - Long-term interest rates - OECD Data*).³⁷ Financial markets signalled strong doubts about the sovereign creditworthiness of some EU Member States – and notably, of some EU Member States whose currency is the euro. In turn, this situation questioned the integrity and survival of the euro area and forced changes in EMU’s institutional arrangements. EU leaders appeared united in the belief that EMU reforms were needed to avoid the breakdown of the euro area and restore stability. However, the question of what institutional changes were necessary to ensure the stability of the euro area was divisive. Competing narratives of the crises led to rival policy prescriptions.

³⁶ It is worth stressing that the decisions to create a common currency in the EU and to limit risk sharing mechanisms within the monetary union clash with the policy recommendations of the academic literature on optimum currency areas (OCAs) (see, for example, Mundell, 1961).

³⁷ Long-term interest rates refer to government bonds maturing in ten years. Based on the available OECD data, the four EU countries that experienced double-digit long-term interest rates are: Greece (in 2011, 2012, and 2013), Latvia (in 2009 and 2010), Lithuania (in 2009) and Portugal (in 2011 and 2012). Russia experienced double-digit long-term interest rates in the years following the annexation of Crimea (in 2015 and 2016).

Moral hazard was a central element of many explanations of the crises. Indeed, the variety of explanations for the IFC and the euro area SDC often shared one of these two features: either the phenomenon of moral hazard is described as a major problem, or the primacy given to the objective of avoiding moral hazard is perceived as a major problem. Narratives of the IFC that emphasized the phenomenon of moral hazard as a cause of the crisis often placed the blame on reckless bankers and favoured changes in banking regulation, supervision, and resolution (see, for example, Blyth, 2015). Narratives of the IFC that focused on the primacy given to the objective of avoiding moral hazard as a major problem placed the blame on the 2008 decision of the US authorities to not rescue the investment bank Lehman Brothers and recommended a change of priority towards the prevention of systemic risk and contagion in the financial sector over moral hazard. Similarly, narratives of the euro area SDC in which the phenomenon of moral hazard is presented as a major cause of the crisis placed the blame on ineffective market discipline and irresponsible governments and favoured changes to impose more stringent constraints on national fiscal authorities – this narrative of the SDC has been identified by several political scientists as the dominant narrative in the public discourse (Blyth, 2015; Matthijs and McNamara, 2015; Rommerskirchen, 2019; Wilkinson, 2019). Narratives of the euro area SDC that focused on the primacy given to the objective of avoiding moral hazard as a major cause of the crisis placed the blame on the lack of risk sharing mechanisms in EMU and supported the development of insurance mechanisms between national governments. Thus, whether these crises are primarily explained in relation to the behaviour of actors or in relation to the system, moral hazard is often a key element of the story and was therefore at the heart of the policy debate on EMU reforms.

One of the goals of EU leaders was to reverse the instability of public finances caused by the IFC and the euro area SDC. If the criteria to judge the sustainability of public finances is not exceeding the reference values agreed in Maastricht, there have only been three EU Member States with consistently sustainable deficit and debt ratios over the period 2007-2017, namely: Estonia, Luxembourg and Sweden (*Database - Eurostat*). While most EU Member States experienced budgetary difficulties during this period, some countries were in particularly extreme situations. For example, the deficit ratios of Ireland, Greece, Spain, and Portugal exceeded 10 per cent over a number of years, and their debt ratio rose above 100 per cent (ibid.). The reasons for these extreme fiscal difficulties are complex and different between countries, and the mismanagement of public finances seems relevant only for the case of Greece. Nonetheless, the fact that the majority of euro area national governments avoided similar fiscal problems served to present luck as merit and unluck as fault (Schelkle, 2017:

190). As long as the severe difficulties faced by some euro area national governments were not unanimously considered by the Council of the EU to be caused by ‘exceptional occurrences beyond [their] control’, EU financial assistance could not be granted (Article 122(2), *TFEU*). Moral hazard-based arguments were frequently used, notably by Germany, to discredit and delay the option of financial solidarity with countries in distress (Dyson, 2014; Jacoby, 2015; Matthijs *et al.*, 2015; Newman, 2015; Howarth and Schild, 2021).

The severe difficulties faced by a number of (mostly) euro area southern countries gave salience to the question of how to deal with country specific shocks in a monetary union. In the context of the euro area crisis, two main coalitions formed around this question, which promoted competing stabilization strategies: those blaming the behaviour of the government for the shock argue that the answer lies in more effective external constraints to enforce budgetary discipline; those considering that the shock was essentially beyond the government’s control, argue that the answer should be an expansion of risk sharing mechanisms in EMU. Solutions relying on ‘individual responsibility’ allocate the burden of adjustment mainly to the Member State in distress and solutions relying on ‘collective solidarity’ allocate the burden of adjustment primarily to the community of euro area countries. Policy responses to the euro area SDC were in line with the evolving position of the ‘individual responsibility’ coalition: proposals to mutualize public debts (the so-called Eurobonds) and to develop fiscal transfers (such as, the creation of a euro area budget with a stabilization function, that could notably serve to finance a European unemployment insurance scheme) were opposed by the coalition of ‘northern’ countries on the grounds that these proposals – regardless of its design – undermined the objective of avoiding moral hazard in EMU (Dullien and Fichtner, 2013; Dyson, 2014; Murlon-Druol, 2014; Matthijs and McNamara, 2015; Newman, 2015; Brunnermeier, James and Landau, 2016; Vandenbroucke, 2016; Pagoulatos, 2020; Crespy, 2022).

Initially, the significant growing disparities between long-term interest rates were not perceived by the ‘individual responsibility’ coalition as a problem to be solved but as the materialization of the intended market pressure necessary to force targeted Member States to ‘put their own house in order’. The coalition of northern countries led by Germany argued that austerity — that is ‘the policy of cutting the state’s budget to promote growth’ (Blyth, 2015: 2) — was the only policy option that would build credibility vis-à-vis the financial markets and relieve the market pressure that southern countries were facing. Ultimately and reluctantly, political leaders of the ‘individual responsibility’ coalition decided to reinterpret the ‘no bailout’ clause and to accept assistance programmes for distressed euro area countries to avoid

sovereign defaults and preserve the integrity of the monetary union. However, the bailout programmes of Greece (in 2010, 2012, and 2015), Ireland (in 2010), Portugal (in 2011), and Cyprus (in 2013) had to go hand in hand with strict conditionality to discourage moral hazard (see, for example, Verdun, 2015; Pagoulatos, 2020).³⁸ The ‘Troika’ – the European Commission, the IMF and the ECB – was in charge of monitoring that the austere conditions and the structural reforms agreed in the programmes were effectively implemented by governments. In addition, reforms to EU economic governance with the aim of reinforcing fiscal monitoring and coordination were introduced, namely: the ‘European Semester’ (2010), the ‘six-pack’ (2011), the Treaty on Stability, Coordination and Governance (the so-called Fiscal Compact) (TSCG, 2013) and the ‘two-pack’ (2013). The introduction of these ‘disciplinary mechanism[s]’ (De Grauwe and Ji, 2014), characterized by more rules, stronger sanctions, and increased European-level control over national fiscal policies, was a condition imposed by the northern coalition for the creation of financial assistance mechanisms for euro area countries. Otherwise, it was argued that the temporary European Financial Stability Facility (EFSF) and the permanent European Stability Mechanism (ESM) would be a new source of government moral hazard (see, for example, Dyson, 2014: 612). The objective of avoiding moral hazard was therefore crucial to the delay of financial assistance to euro area countries in severe difficulties and to justifying austerity programmes and reduced national sovereignty over fiscal policies.

The objective of restoring the stability of public finances was conditional on achieving another goal: EU leaders sought to find a way to break the so-called doom loop between banks and sovereigns and the mutually reinforcing banking and sovereign debt crises in the euro area. Notably, the public bailouts of private banks had significant cost for governments: in Germany, for example, bank bailouts between 2008 and 2011 represented a net cost of 16.56 billion euros (or 0.70% of GDP) for the German government (Howarth and Quaglia, 2016: 66). The IFC made evident that financial markets are not inherently stable and can put in jeopardy the order of modern capitalist economies. The IFC contributed to the emergence of a new international consensus among policymakers on the need for increased public intervention to create the conditions for a stable financial system. In continental Europe, the centrality and the specificity of the banking sector in terms of size and interconnectedness made the question of how to create a stable European financial system particularly difficult for EU leaders. According to

³⁸ In 2012, Spain received a financial sector assistance programme for the recapitalisation of banks. However, the implementation of this programme was not subject to the ‘Troika’ monitoring.

the political economist Mark Blyth, this situation had two main implications: it created a material constraint for European policymakers – a range of individual banks were ‘too big to fail’ and the system was ‘too big to bail’ and could not be allowed to fail – and an opportunity for European banks to engage in ‘moral hazard trades’ — i.e. to engage in riskier activities knowing that they would be bailed out in case of insolvency (Blyth, 2015: 74;81-2). The systemic risk posed by the banking sector was seen by many to be incompatible with financial stability and thus should be minimized.

In the context of EMU reforms, public intervention in the financial system took the form of ‘Banking Union’. European Banking Union is a series of institutional changes aimed at reducing the cost and likelihood of banking crises by constructing a single framework for banking supervision, a single framework for managing the resolution of banks, a common Deposit Guarantee Scheme (DGS), and a common fiscal backstop for temporary financial support (Howarth and Quaglia, 2016:1). The concept of moral hazard did not only play a central role in the explanations of the IFC that motivated the creation of Banking Union; it also played a major role in the negotiations and – ultimately – the policy outcomes of Banking Union (Howarth and Quaglia, 2016; Schäfer, 2016). Moral hazard was ubiquitous in the discussions and negotiations on the main elements of Banking Union. In terms of banking supervision, in contrast to earlier periods, the objective of avoiding moral hazard was used to justify the need for supranational supervision and was instrumental to the agreement on the creation of the Single Supervisory Mechanism (SSM) (Howarth and Quaglia, 2016: 89-90). EU-level supervision became a condition for EU-level financial support. The objective of avoiding moral hazard both facilitated and hindered the agreement on the SSM: while the concept of moral hazard served to justify the need for supranational supervision, it was also used to oppose the attribution of the ultimate institutional responsibility for the SSM to the ECB Governing Council (Schelkle, 2017: 219-20).

In terms of banking resolution, moral hazard-based arguments were instrumental to limit the sharing of resolution costs – be they between the national and European levels or between the private and public sectors. To be more specific, the goal of avoiding moral hazard was used to justify limiting the scope of the Single Resolution Mechanism (SRM) only to the largest banks in the euro area (Howarth and Quaglia, 2016: 130-31). In addition, to avoid moral hazard, EU-level financial support was designed as a resolution tool of last resort: a bail-in tool was introduced in the Bank Recovery and Resolution Directive (BRRD) to ensure that the shareholders and creditors of the bank under resolution bear first losses (Howarth and Quaglia,

2014: 129; Schäfer, 2016: 972).³⁹ Moral hazard-based arguments were also prominent in the discussion about the Single Resolution Fund (SRF). Although the creation of a joint fund was initially rejected by some negotiators because of moral hazard, the SRF was ultimately agreed. However, the objective of avoiding moral hazard served to justify its specific design, namely: the separation into national compartments and a mutualization period of eight years subject to national veto (Schäfer, 2016: 972). The limited amount of ESM funds made available to resolve national banks and the reluctance to create a common fiscal backstop if the SRF was insufficient can also be explained in relation to the focus of some Member State governments placed upon avoiding moral hazard (Howarth and Quaglia, 2016).

Finally, moral hazard-based arguments were used to oppose the creation of a European Deposit Insurance Scheme (EDIS) (ibid.: 146-7). At the time of writing, the EDIS remains a missing component of Banking Union. The objective of avoiding moral hazard was therefore a determining factor in Banking Union. The political economists David Howarth and Lucia Quaglia argue that the asymmetric and incomplete nature of Banking Union parallels the initial design of EMU, due in part to the efforts of some Member State governments to avoid moral hazard (ibid.: 23; Pierret and Howarth, 2023).

The ultimate goal of stabilizing the euro area required more instruments than those agreed by national governments. In addition to conditional sovereign and bank bailouts, additional rules, reinforced surveillance and supervision at the EU-level, and the creation of a permanent stability mechanism for countries whose currency is the euro, ECB monetary policy was crucial in mitigating the severity of the crises. The ECB did not restrict its monetary policy to interest rate manipulation. To be relevant in the macroeconomic context of the IFC and the euro area SDC, the ECB used new instruments of monetary policy – the so-called unconventional monetary policy (UMP) measures – including the provision of central bank liquidity at favourable rates and the purchase of private and public debt on secondary markets. A significant effect of these UMP measures has been the easing of financing conditions for banks and/or sovereigns. This characteristic and its relation to moral hazard is one of the reasons why UMP measures are controversial – and conditional (Fontan, 2018). The objective of avoiding moral hazard, in line with the argument made by Tietmeyer during the negotiations over the design of EMU, continues to be used to oppose that the ECB and the national central banks act as a lender of last resort for euro area-headquartered banks (see, for example, Dyson,

³⁹ It should be noted that while Banking Union applies to countries in the euro area (and the non-euro area countries who decided to join), the BRRD applies to all EU Member States.

2016). The argument being that a central bank's safety net of potentially unlimited liquidity provision increases imprudent behaviours from banks and, thus, the likelihood of banking crises.

The desirability of UMP measures was also questioned based on the relationship between these measures and government moral hazard. Some argue that by purchasing sovereign bonds, the ECB reduces market pressure on governments and, therefore, diverts governments from their fiscal commitments and from conducting the demanded structural reforms (see, for example, Pisani-Ferry, 2012; Chang, 2016; Chang, Howarth and Pierret, 2024). UMP measures in relation to governments were particularly controversial because of the constraint of EU primary law. Indeed, the purchase of government debt by the ECB can be considered as a violation of the prohibition of monetary financing of euro area national governments (Article 123(1), TFEU) – a treaty provision that was explicitly added with the aim of avoiding moral hazard (Issing, 2011). The question of the legality of the Outright Monetary Transaction (OMT) programme announced by the Governing Council of the ECB in September 2012 has been raised by Germany's Federal Constitutional Court.⁴⁰ The objective of avoiding moral hazard is therefore at the heart of a political and legal dispute over the development of the ECB's UMP measures. This dispute, which also existed within the ECB, delayed its actions in response to the IFC and the euro area SDC (Jabko, 2015). In sum, the IFC and the euro area SDC triggered an intense public debate about what institutional and policy changes were needed to ensure the stability of the euro area. Moral hazard was a prominent concept wielded by a number of policymakers during the negotiations on EMU reforms and shaped several key policy outcomes in the aftermath of these crises.

The COVID-19 pandemic that began in Europe in early 2020 is another event that forced changes in the economic governance of the EU. Notably, EU leaders agreed in November 2020 to create a temporary instrument – 'NextGenerationEU' (NGEU) – to help Member States manage the economic impact of and recover from the COVID-19 crisis. Apart from the fact that NGEU is described as a stimulus package, there are two other main characteristics of NGEU that constitute a significant change from the management of economic crises in the last decade: grants – not only loans – are provided via the Recovery and Resilience Facility (RRF) of NGEU, the central element of this stimulus package;⁴¹ and the program is

⁴⁰ See, for example, *Opinion of Advocate General Cruz Villalón delivered on 14 January 2015. Peter Gauweiler and Others v Deutscher Bundestag. Request for a preliminary ruling from the Bundesverfassungsgericht. Case C-62/14.*, 2014.

⁴¹ The total of the RRF amounts to 723.8 billion euros, of which 385.8 billion euros are loans and 338 billion euros are grants.

funded by the massive issuance of EU debt. These two elements of NGEU allocate adjustment costs mainly to the EU level and, thus, relieve Member States from some financial burden. Market pressure on euro area governments was also reduced by the actions of the ECB and the launch in March 2020 of its unconditional pandemic emergency purchase programme (PEPP). Finally, constraints on national fiscal policies were also relaxed by the activation of the general escape clause of the SGP (European Commission, 2020). Therefore, while the history of EMU and the previous decade were characterized by the construction of constraints around national government spending, this tendency changed in the context of the COVID-19 crisis. This shift in crisis response towards easing government constraints and collectively sharing costs goes hand in hand with a reduced explicit emphasis in the public debate on the objective of avoiding moral hazard. However, this is not to say that the effect of moral hazard on the EU's financial response to the COVID-19 crisis was null. For some observers, several characteristics of NGEU (such as its temporary nature) are directly linked to the fight against moral hazard (see, for example, Pierret and Howarth, 2023).

3.3 Conclusion: The Influence of Moral Hazard on European Economic Governance

There is a significant correlation between the institutional design of EMU and the objective of avoiding moral hazard. Many scholars have identified a causal relationship between the prohibition of monetary financing, the 'no bailout' clause, the fiscal rules of the Maastricht Treaty, the SGP, and the objective of protecting the Union against government moral hazard — which was perceived as a major source of instability. The design of the EMU project — originally characterised by a deficit of collective insurance mechanisms and constraints on national fiscal policies — aimed to avoid moral hazard.

The centrality of the objective of avoiding moral hazard in the foundation of EMU has been linked to the influence of ordo-liberalism and neo-liberalism. Indeed, moral hazard is a core concept of both ideologies. Although the understanding of moral hazard seems to differ between these two types of liberalism — a lack of virtue in ordo-liberalism versus the exercise of rationality in neo-liberalism — and its implication in terms of state intervention vis-à-vis the market is different, it is a common feature of both ideologies that has become part of the sound money paradigm. Scholars have documented that there was an ideational consensus among

EMU negotiators around the sound money paradigm, which includes the objective of avoiding moral hazard.

The financial and debt crises caused significant instability which led many to question the suitability of the initial institutional arrangements of EMU. The concept of moral hazard was a central element of the different narratives of these crises and, therefore, was prominent in the debates and negotiations over EMU reforms. Many policy responses to these crises have been explained in relation to moral hazard, *inter alia*: the delay of financial assistance to countries in distress, the imposition of austerity, the reduced national sovereignty over fiscal policies, Banking Union, the delay in UMP measures by the ECB, or strict conditionality attached to assistance mechanisms. In addition, some courses of action have been rejected because of moral hazard (such as, the mutualisation of public debts or the provision to the euro area of a fiscal capacity to conduct macroeconomic stabilization). The objective of avoiding moral hazard continued to be at the heart of the negotiations over EMU's institutional arrangements. However, in the context of the COVID-19 crisis, we observed a reduced explicit emphasis on the objective of avoiding moral hazard and a shift towards decreased constraints on national government spending. The post-2007 crises era, characterized by both periods of relatively high and low explicit emphasis on the need to avoid moral hazard in European economic governance, thus offers a unique opportunity to study the social construction of the concept of moral hazard and its relation to power.

In sum, the review of the academic literature presented in this chapter provides evidence to conclude that the influence of moral hazard on EU economic governance is relatively important. This dissertation argues that this political influence of moral hazard is puzzling and deserves closer attention from political scientists. The next chapter presents the justification for this argument and the theoretical framework used in this dissertation to formulate hypotheses to explain the political power of moral hazard in European economic governance after 2007.

4 Explaining the Influence of Moral Hazard on European Economic Governance

This chapter aims to present theoretical explanations of the observed major influence of the concept of moral hazard on the post-2007 socio-economic institutional arrangements and policies of the EU (Chapter 3). This dissertation argues that this phenomenon is puzzling for at least four reasons. First, moral hazard is in the realm of uncertainty (Chapter 2). Moral hazard is not certain or determined with regard to occurrence or extent and yet it is treated as an important policy problem. Why does an uncertain phenomenon attract relatively high policy attention? One might argue that it is because the possible consequences of moral hazard are costly and that EU policymakers are being prudent. However, second, the conventional treatment of moral hazard is costly: limiting collective insurance mechanisms creates a social welfare loss and potentially unsustainable distributional consequences;⁴² increasing constraints creates a loss of liberty (or sovereignty). Third, moral hazard influences risk sharing in some places more than others. For example, the impact of moral hazard on macroeconomic risk sharing appears greater in the euro area than in the US (Schelkle, 2017) or within EU Member States. Finally, fourth, because the IFC and the euro area SDC challenged the policy consensus around the sound money paradigm, one could have expected that the objective of avoiding moral hazard – a core element of this policy paradigm – loses influence. It did not lose influence: moral hazard was resilient in the aftermath of the 2007-9 financial crisis.

For all these reasons, this dissertation argues that the major influence of moral hazard with regard to the post-2007 economic governance of the EU is a political phenomenon and

⁴² It should be noted that given the uncertainty of moral hazard, it is difficult to assess precisely which of the two options – to treat or not to treat moral hazard – is the more costly. In relative terms, more public insurance favours the weaker members of the community and less public insurance favours the stronger members of the community.

deserves to be investigated using the tools of political science. This dissertation is guided by the following research question: how can we best explain the impact of the concept of moral hazard on European economic governance in the post-2007 period?

This dissertation treats the observed significant influence of moral hazard as an apparent puzzle that can be solved with the tools of political science. This dissertation is based on, and contributes to, the academic literature in political science that aims to explain why certain ideas (and not others) have political influence – or ‘political power’ (Hall, 1989) – in a given context. Political scientists interested in answering this question often examine the relationships between power and such ideas. The structure of this chapter is inspired by the distinction made by Carstensen and Schmidt to characterise the three broad relationships between power and ideas, namely: power *through*, *over*, and *in* ideas (Carstensen and Schmidt, 2016). This chapter reinterprets this conceptual distinction and applies it to the case of moral hazard in the EU.⁴³ The first section of this chapter presents an institutional approach to ideas (or power *in* ideas). The second section centres on an authoritative approach to ideas (or power *over* ideas). The third section focuses on an instrumental approach to ideas (or power *through* ideas). The three approaches are summarised in Table 1 at the end of this chapter. The last section concludes on which of the three approaches seem more appropriate to explain the case of moral hazard in the post-2007 European economic governance. This dissertation expects the instrumental theory to have the greatest explanatory power as to the political influence of moral hazard in the post-2007 period.

4.1 The Institutional Theory: Power *in* Ideas

This dissertation interprets power *in* ideas, that is ‘the authority certain ideas enjoy in structuring thought at the expense of other ideas’ (Carstensen and Schmidt, 2016: 329), as being characteristic of an institutional approach to the power of ideas.

Institutional theory in political science has a long tradition (with authors like Karl Polanyi, Thorstein Veblen, or Max Weber) but was revived in the 1980s and 1990s in opposition to the dominant behavioural theory (March and Olsen, 1984; Powell and DiMaggio,

⁴³ Although this dissertation employs the terms ‘power through’, ‘power over’, and ‘power in’ in a similar way to Carstensen and Schmidt, some features of the three relationships between power and ideas have been interpreted differently for the purpose of this investigation.

1991; Thelen and Steinmo, 1992; Peters, 2005). New institutional theorists reject the view that human behaviour is above all a matter of free choice and deliberate decision-making. In contrast to behavioural theory, the new institutional approach privileges the role of institutions in structuring behaviour. Individuals are not atomistic but embedded in various sorts of social contexts. The new institutionalism is a rich body of theoretical literature, with notably a calculus approach (rational choice institutionalism) and a cultural approach (historical and sociological institutionalism) (Blyth, Helgadottir and Kring, 2016).⁴⁴ One of the main differences between rational choice institutionalism and cultural or ‘normative’ institutionalism (Peters, 2005) is the treatment of interest or preference formation. In the cultural approach, interests are not given but derived from a process of interpretation (Powell and DiMaggio, 1991; Hall, 1997; Blyth, Helgadottir and Kring, 2016). The institutional context not only shapes agents’ strategies (rational choice) but also their preferences and goals (Thelen and Steinmo, 1992). Given the focus of this section on power *in* ideas and the interpretivist methodology of this dissertation, the rest of the section is centred exclusively on the cultural approach and reviews in greater detail historical and sociological institutionalisms.

Historical institutionalism stresses the impact of the legacy of the past (Peters, 2005) on present policy outcomes. ‘Path dependency’ is a core concept of this theoretical approach. According to the political scientist Paul Pierson, ‘this [path dependency] means focusing on the dynamics of self-reinforcing or positive feedback processes in a political system. Once a particular path gets established, however, self-reinforcing processes make reversals very difficult’ (Pierson, 2004: 10). The path-dependent view of the social world attributes particular significance to beginnings (ibid.). The initial stage produces important effects on future developments. Historical institutionalism can therefore be described as mainly a theory of institutional continuity over time (and variation across space) and constraint (Thelen and Steinmo, 1992; Campbell, 1998). In this literature, institutional change is difficult. Paths are altered only under ‘critical junctures’ – which ‘are often attributed to big, exogenous shocks’ (Pierson, 2004: 135). Although material factors play a key role in historical institutionalism, this theoretical approach also includes an ideational tradition. The work of Peter Hall on Keynesianism across nations and ‘policy paradigms’ is often considered the reference of this literature (Hall, 1989, 1997). The importance of ideas in historical institutionalism mostly lies

⁴⁴ Discursive and constructivist institutionalisms are additional types of new institutionalism. However, given they less structural character (Peters, 2005), this dissertation interprets discursive and constructivist institutionalisms as closer to an instrumental approach to ideas (or power *through* ideas) than to the institutional theory (or power *in* ideas) presented in this section.

in the ‘sticky’ nature of some ideas: certain ideas not only play a role in the foundation of institutions; institutionalised ideas tend to persist over time and constrain the range of what is considered as an acceptable course of action – to the point that it can be argued that institutional change is conditional on ideational change (Peters, 2005). The ideational tradition in historical institutionalism is closely linked to power *in* ideas as defined by Carstensen and Schmidt. Indeed,

‘Historical institutionalists, for example, occasionally theorize power in ideas when they consider the institutionalization of ideas in the rules that come to regulate the polity, or in the path dependencies by which ideational continuity appears as a defining characteristic of the trajectory of post-crisis institutions’ (Carstensen and Schmidt, 2016: 331).

Sociological institutionalism shares some similarities with historical institutionalism in terms of self-reinforcing processes (Pierson, 2004). However, this approach stresses the impact of collective norms rather than the past. The ‘logic of appropriateness’ is a core concept of this theory (ibid.; March and Olsen, 1984). Sociological institutionalists stress the constraining effect of collective norms and frames on human behaviour (ibid.: 743; Carstensen and Schmidt, 2016). Behaviour is constrained by what is defined as normatively appropriate in a given social context (March and Olsen, 1984: 743). This approach draws attention to the socially constructed nature of meaning and the power of common understandings (Powell and DiMaggio, 1991; Peters, 2005). The emphasis of sociological institutionalism is not only on common understandings but also on taken for granted understandings (ibid.). Sociological institutionalists are particularly interested in the study of shared beliefs that are accepted on trust rather than proof and deliberation. In this approach, intentionality is somewhat rejected and most human behaviour is considered unreflective, based on routines and taken for granted understandings (Powell and DiMaggio, 1991). Institutionalisation is a cognitive process by which social norms, values, and frames are internalised (ibid.). Institutions create consensus among the members of a social group. Thus, sociological institutionalism is particularly useful to explain situations characterized by the presence of agreement and the absence of conflict (see, for example, Marcussen, 1999). The close relationship between power *in* ideas and sociological institutionalism has been acknowledged by Carstensen and Schmidt when they noted that power *in* ideas concerns ideas that ‘become so accepted that their very existence may be forgotten, even as they may come to structure peoples’ thoughts about the economy, polity and society’ (Carstensen and Schmidt, 2016: 329).

Considered as a whole, the cultural approach (historical and sociological institutionalisms) treats the problem of explaining the influence of certain ideas on policy as a matter of self-reinforcing processes derived from the collective past or the norm. Ideas are embedded in established rules (for historical institutionalists) or frames (for sociological institutionalists) (Carstensen and Schmidt, 2016). Ideas are institutions. The effect of influential or institutionalised ideas is to constrain behaviours and homogenise beliefs. In the institutional approach or power *in* ideas, the power of ideas is structural and thus independent from who is using the idea. Conversely, in the next section of this chapter on power *over* ideas, the focus is upon whose ideas matter.

Before turning to the examination of other relationships between power and ideas, it is important to apply the institutional theory to the case of moral hazard in the EU and to assess the strengths and weaknesses of this theoretical approach in relation to the phenomenon to be explained. If this approach is taken, the power *in* moral hazard explains the influence of the concept on European economic governance in the post-2007 period (first hypothesis). In other words, moral hazard is a ‘received truism’ in the EU (Mill, 2015: 42). If the first hypothesis is true, the question of moral hazard should be open to minor contestation. Policymakers under consideration in this investigation should share a common and dominant understanding of what moral hazard is, agree on the problems and solutions related to moral hazard, and the objective of avoiding moral hazard should occupy the same rank in the hierarchy of policy objectives. In communications, efforts to explain what moral hazard is and justify positions in relation to moral hazard should be minimal since the phenomenon is supposed to be self-evident. If the past plays the main role in the taken for granted nature of moral hazard in the EU, the present view on moral hazard should align with the previous dominant policy paradigm, namely the sound money paradigm – notably in terms of bias against governments over financial institutions (Chapter 3). In addition, if the past is a major constraining force in today’s debate, references to the sound money paradigm, the Maastricht Treaty, or the foundation of EMU should be frequent and used to legitimize current positions. If the norm plays the main role in the taken for granted nature of moral hazard, the broad implicit agreement on moral hazard might evolve over time. Indeed, the reference is no longer the past but the present norm (which may be different from that of the past). Thus, the ideational consensus on moral hazard might change depending on the evolution of what is commonly considered appropriate at a given time. Social learning has been identified as a process explaining the evolution of norms over time (see, for example, Hall, 1993; Pierson, 2004; Saurugger, 2013). Therefore, policymakers examined in this dissertation might have learned something from the events of the post-2007

era and adapted their shared beliefs on moral hazard accordingly. In sum, what is essential to the verification of the first hypothesis is the presence of ideational consensus, which is a shared and dominant opinion on moral hazard among the policymakers investigated.

The institutional approach to the influence of moral hazard on the post-2007 European economic governance presents strengths and weaknesses. It suggests that moral hazard is influential because the idea is not subject to strongly clashing opinions. The idea that moral hazard is consensual and taken for granted by EU policymakers is plausible given the close relationship between the concept of moral hazard and the sound money paradigm that was institutionalised in the Maastricht Treaty (Chapter 3). Assuming that the policy consensus around the sound money paradigm that made the EMU project possible carries long-term effects seems reasonable (McNamara, 1998; Dyson and Featherstone, 1999; Marcussen, 1999). In addition, it should be added that the relationship between moral hazard and the discipline of economics is another factor that is likely to contribute to the lack of contestation of moral hazard-based arguments in the current policy debate (Chapter 2). The advent of the sound money paradigm correlates with an increase in the academic research on moral hazard (Chapters 2 and 3). Thus, if policymakers under investigation trust that their received opinions on moral hazard are the result of knowledge and not of political struggles, they will probably be less inclined to question them.

However, the institutional approach to the influence of moral hazard in the post-2007 context is problematic, in that the negotiations in the EU over how to deal with the IFC and the euro area SDC were far from consensual. Unlike the end of the 1980s when little controversy among EU policymakers was identified, the negotiations on EMU reforms were characterised by hard intergovernmental bargaining and brinkmanship between two main opposed coalitions of Member States (see, for example, Matthijs and McNamara, 2015; Schimmelfennig, 2015; Brunnermeier, James and Landau, 2016). In addition, phenomena such as the IFC, the SDC, or climate change have challenged the legitimacy of the previous dominant policy paradigm. The option of being conservative out of habit and without reflexivity has arguably become more difficult. If the post-2007 negotiating context was mainly characterised by collective problems (including moral hazard) and disagreement in solutions, disagreement in relation to moral hazard is also to be expected. Finally, while moral hazard was not in the background of the policy debate during the IFC and the euro area SDC, its explicit use decreased in the context of the COVID-19 crisis (Chapter 3). This variation in use over time and between different crises suggests a degree of agency from the part of EU policymakers when dealing with the concept of moral hazard.

The next section of this chapter presents an alternative to the institutional approach to the power of ideas that privileges the role of certain actors over others: the authoritative approach (or power *over* ideas). Here, the question of whose ideas is a central factor to explain the influence of ideas on policy. The condition under which ideas acquire and maintain political power is no longer ideational consensus but authority.

4.2 The Authoritative Theory: Power *over* Ideas

Carstensen and Schmidt conceptualised power *over* ideas as ‘the capacity of actors to control and dominate the meaning of ideas’ (2016: 326). Power *over* ideas is about the ability of actors to impose their views on others. The question of authority, and more precisely of who has authority, is central in this approach to explain the power of ideas. This is why this dissertation calls it the authoritative theory. The boundaries between the institutional theory and the authoritative theory are blurry given that institutionalised ideas are often the ideas of dominant actors. Indeed, according to the German philosopher Friedrich Nietzsche, the right to create values is an ‘externalisation of the power of the dominants’ (author’s translation) (Nietzsche, 1887: 68). The idea that the world-view of the dominants is the one ruling the world is also present in the concept of hegemony developed by the former General Secretary of the Italian Communist Party, Antonio Gramsci (Bates, 1975). In fact, Carstensen and Schmidt used Gramsci’s notion of hegemony as an example of power *in* ideas (2016: 330) – a case where power *over* ideas becomes power *in* ideas.

Against this background, the authoritative approach (or power *over* ideas) developed in this section concerns situations where the diffusion of the ideas of the dominants is not complete or stable – what tends to happen in periods of crisis. The ideas of dominant actors are not taken for granted by others. Instead, others have either no opinion on the matter or alternative opinions to that of the dominants.⁴⁵ In this dissertation, the authoritative theory applies mostly to cases where there is a present battle for hegemony: beliefs are not hegemonic but subject to contestation in the public debate. According to the authoritative approach, there is a winner of the battle. The expected winner – that is, the actor able to resist alternatives and

⁴⁵ The authoritative approach is about the capacity of actors to impose their views on others. Imposition implies that such views would not dominate without the power of authority. Thus, the a priori views of others must not be equal to the ones of the dominants (hence the ‘no opinion’ or ‘alternative opinions’).

translate its ideas into policy – is the actor who has authority over others. There are several sources of authority and different actors have the potential to win the battle. This dissertation focuses on two traditional sources of authority identified in EU studies: economic strength and expertise.

In the EU, the Member State with the greatest economic strength or material resources is most often seen as Germany. The question of German hegemony in Europe has been central to European integration studies (see, for example, Bulmer and Paterson, 2013; Bulmer, 2014; Schild, 2020). The concept of hegemony involves two main forms: it can refer to aggressive domination or benign leadership (Kindleberger, 1973; Keohane, 1980). The main difference between these two forms of hegemony is the absence or presence of choice from the non-hegemonic actor: is it force (domination) or consent (leadership) that allowed the hegemonic actor to impose its preferences on others? In EU studies, German hegemony has traditionally been investigated in terms of leadership – a conception in line with Gramsci's definition of hegemony (Bates, 1975) and the theory of hegemonic stability (Kindleberger, 1973; Keohane, 1980; in Schild, 2020). Notably, the German model has been identified as a key factor in the negotiations of EMU (see, for example, McNamara, 1998; Dyson, 2000). The perceived economic success of Germany vis-à-vis other European countries provided legitimacy to its institutional arrangements and policies, which served as an example for the design of EMU – especially of the ECB (e.g. Howarth and Loedel, 2005). However, the nature of the hegemonic role of Germany has been contested in the context of the IFC and the euro area SDC. For some, the power of Germany went from leadership to domination – see, for example:

‘The emergence of divisions amongst the eurozone states into what is sometimes seen crudely as a north–south split highlights the problem of establishing a set of hegemonic beliefs about how to resolve the crisis. Unlike the situation obtaining during the ‘fair weather’ conditions of the Maastricht negotiations, the preparedness of all other states to emulate German practice is now the product of necessity rather than a free choice’ (Bulmer, 2014: 1256).

‘In the context of the eurozone crisis, Berlin has been perceived as imposing its policy of austerity on eurozone states facing sovereign debt problems, notably Greece, Ireland, Portugal, Spain and Cyprus, thereby raising further concerns about an emerging German hegemony’ (Bulmer and Paterson, 2013: 1388).

The case of Germany in the EU illustrates the authority derived from economic power. Thanks to its economic performances at times of crucial European negotiations, Germany was able to impose its preferences, whether via leadership or domination.⁴⁶

Expertise, or control over knowledge and information within a domain, is another source of authority and political power in the EU (see, for example, Radaelli, 1999; Seabrooke and Wigan, 2016). The role of expertise in policy has been analytically developed in the epistemic community approach (Haas, 1992). The political scientist Peter Haas defined an epistemic community as ‘a network of professionals with recognized expertise and competence in a particular domain and an authoritative claim to policy-relevant knowledge within that domain or issue area’ (ibid.: 3). In other words, epistemic communities are networks of knowledge-based experts (ibid.: 2). The members of this type of community share a set of normative and causal beliefs, notions of validity that allows them to produce consensual knowledge, and a common policy enterprise (ibid.). According to this approach, the role of epistemic communities in policy-making tends to increase under conditions of complexity and uncertainty (ibid.). For example, Carstensen and Schmidt used the case of financial regulation to illustrate the power of experts *over* ideas (2016: 328). More generally, economic policy is a domain where the impact of expert advice is often significant (Hall, 1989). The question of whether central bankers are an epistemic community has received different answers in the academic literature (see, for example, Kapstein, 1992; Verdun, 1999). In the context of the EU, the political scientist Amy Verdun considered that the Delors Committee – a group composed of monetary experts – acted as an epistemic community in the creation of EMU (ibid.). At times, the authority of experts prevails in policy-making.

Considered as a whole, the authoritative approach treats the problem of explaining the influence of certain ideas on policy as a matter of whose ideas – who has the power *over* ideas in a given context. In this approach, ideas acquire political power because they are the shared ideas of actors with authority – be it thanks to their material resources or expertise.

If the authoritative approach is taken, the power *over* moral hazard explains the influence of the concept on the economic governance of the EU in the post-2007 period (second hypothesis). In other words, moral hazard is influential in this context because some actors have been able to impose their view that moral hazard should have this particular influence on policy. There are several conditions for this hypothesis to be true. First, the actor in question

⁴⁶ This is not to say that European policy outcomes equal perfectly German preferences. Compromise is inherent in EU negotiations.

must be an actor with authority. This dissertation focuses on economic strength and expertise as the main sources of authority and therefore expects a Member State with relatively significant economic strength or a group of experts in the domain of macroeconomic governance to be able to impose its preferences. Given the history of EMU, Germany and central bankers are the main suspects.⁴⁷ Second, the hypothesis based on the authoritative approach presupposes that the question of moral hazard is consensual among authoritative actors. Authoritative actors should share a common and dominant understanding of what moral hazard is, agree on the problems and solutions related to moral hazard, and the objective of avoiding moral hazard should occupy the same rank in the hierarchy of policy objectives. However, third, this agreement on moral hazard must not be hegemonic. For the authoritative actor to impose its opinion on others, there must be signs of either contestation or ignorance from others. Alternative opinions or the absence of opinion (but reliance on external authoritative claims) in relation to moral hazard must be expressed by non-authoritative actors. This condition is crucial in differentiating the hypothesis based on the institutional approach from the one based on the authoritative approach. Finally, fourth, there must be a correspondence between the preferences of the authoritative actor in relation to moral hazard and policy outcomes. In sum, what is essential to the verification of the second hypothesis is the presence of agreement among authoritative actors and the expression of major contestation by non-authoritative actors.

The authoritative approach to the influence of moral hazard on the post-2007 European economic governance presents clear strengths. It gives emphasis to the role of authority in contexts of uncertainty and complexity. Clearly, the post-2007 crises period is made of uncertainty and challenges to the tradition of macroeconomic thought and to the sound money paradigm.⁴⁸ In such a context, signs of ignorance and contestation are likely to increase, and united authoritative voices are expected to obtain significant influence over policy. The proposition that the main reason why moral hazard influences EU economic governance is the power of Germany and/or central bankers has intuitive force given the history of EMU, and the close relationships between, on the one hand, moral hazard and *ordo-liberalism*, and on the other hand, between moral hazard and economics (Chapters 2 and 3). Finally, this approach draws attention to the conflict between actors with divergent interests – as was the case during

⁴⁷ It should be noted that Germany and central bankers might share similar beliefs on moral hazard. If this is the case, the influence of moral hazard would be explained by the power of consensus among several authoritative actors.

⁴⁸ For example, the IFC was a crisis unrelated to high inflation and yet it had the power to destabilise much of the industrialised world.

the euro area crisis – and the battle for hegemony that is characteristic of politics. The authoritative approach ultimately reminds us to pay attention to the question of who has power over EMU.

Nevertheless, the authoritative approach has several limits. It favours imposition, but the nature of EU negotiations, which take place in a system of multi-level governance, makes it unlikely that one actor could ignore the views of others. Compromise rather than imposition tends to be the rule in EU negotiations. In addition, the structural asymmetry of negotiating power in favour of the stronger economic actor is arguably less important in the context of reform – where the exit strategy is less credible – than in the context of creation (see, for example, Dyson, 2014). Indeed, in situations of increased interdependence such as within a monetary union, the risk of contagion becomes more likely and the powerful more vulnerable to the implications of the exit strategy. In other words, the ‘northern’ coalition led by Germany was more likely to impose its preferences during the negotiations over the design of EMU than over its reform after 2007. Finally, the authoritative approach privileges the role of expertise and assumes that economic experts have the necessary knowledge to reduce uncertainty and complexity in times of economic crises. However, it ignores the possibility for a crisis of expertise, where economic experts like central bankers must cope with their own ignorance and the related challenges to their authority (see, for example, Best, 2022).

The next section of this chapter presents the third and the last theoretical approach to be developed in this dissertation: the instrumental theory (or power *through* ideas). Here, the main condition under which ideas acquire and maintain political power is not ideational consensus or authority but usefulness.

4.3 The Instrumental Theory: Power *through* Ideas

A third perspective on the political power of ideas emphasises the role of agency. In this approach, the political influence of ideas depends on how and for what purposes they are used by actors. Hence, in this dissertation, this approach is called the instrumental theory. Instead of being considered as institutions-like (power *in*) or the externalisation of authority (power *over*), influential ideas are regarded as exploited political resources (power *through*). Thus, this dissertation reinterprets power *through* ideas as something broader than persuasiveness (Carstensen and Schmidt, 2016). Here, the instrumental theory or power *through* ideas relates

to all types of actor-centred constructivism where ideas are (flexible) tools at the disposal of actors to help them achieve their moral or material goals (Saurugger, 2013).

Ideas can be rich and important political resources. There are different types of ideas: some operate primarily at the cognitive level, others at the normative level; some constitute the explicit arguments of policy debates, others the underlying assumptions of policy debates (Campbell, 1998: 378). Ideas are political resources when they help policymakers to pursue their goals.⁴⁹ Cognitive ideas (or programs) help policymakers to diagnose a situation, and define and justify specific courses of action (ibid.; Schmidt, 2008). For example, economic ideas may help policymakers to reduce uncertainty in periods of economic crisis by narrowing the number of possible interpretations of the crisis, and hence courses of action (Blyth, 2002: 34-5). Crisis narratives are important factors in explaining policy outcomes (see, for example, Hay, 2004; Blyth, 2015). Normative ideas (or frames) attach a value judgement to a situation and help policymakers to legitimize courses of action in terms of their appropriateness (Campbell, 1998; Schmidt, 2008). Ambiguous ideas – that is, ideas with different possible meanings – have also been identified by scholars as a key political resource (see, for example, Jabko, 2006; Schmidt and Thatcher, 2013; Crespy and Vanheuverzwijn, 2019). Indeed, the ambiguity of ideas can be exploited by policymakers to help them build coalitions in situations where underlying preferences are not aligned or to adapt to a changing environment. Ambiguous ideas are often resilient because of their potential ubiquity (Hall, 1989; Schmidt and Thatcher, 2013). In sum, ideas are political resources because they may help – in a variety of ways – policymakers to achieve their goals.

The instrumental theory or power *through* ideas is about the power created by the combination and interaction of ideas and agency. There are different forms of actor-centred constructivism in the academic literature, depending on the characteristics of ideas that are emphasized and how ideas are used by actors. For example, discursive institutionalism privileges the role of communication and stresses the impact of discourse to explain why certain ideas succeed and others fail to influence policy (Schmidt, 2008). In this approach, discourse refers not just to the content of ideas (what is said) but also to the discursive interactions by which ideas are conveyed (who said what to whom, where, when, how, and why) (ibid.: 2). Discourse relates to the ancient art of rhetoric – the art of using language effectively to convince others. A rhetorician or orator produces conviction thanks to discourses

⁴⁹ This section is focused on ideas as instruments and not on ideas as constraints and therefore ignores the cases of paradigms and public sentiments – which are underlying assumptions in the background of policy debates (ibid.).

(Plato, 2018: 137). Through discourse and the effective articulation of ideas, a speaker can persuade others that something is true – independently of the thing being true or not. Given that, as Milton Friedman noted, ‘what matter[s] in the world of ideas [is] not what [is] true, but what [is] believed to be true’, discourses are key political resources (cited in Blyth, 2002: 45). Discourse is a means to an end. Similarly, other forms of actor-centred constructivism – such as strategic constructivism (Jabko, 2006) or ‘bricolage’ (Carstensen, 2011) – emphasise the role of ideas as tools and the creativity of actors in using the available toolbox to pursue their goals. In this approach, actors do not use ideas according to a predefined and recurring pattern but do so strategically – that is, according to the needs of the project. Hence, a same idea may be deployed differently, or stop being used, depending on the goal to be achieved.⁵⁰

The instrumental approach to the power of ideas has been applied to several concepts in the context of European integration and governance. For example, the political scientist Nicolas Jabko argued that the ‘EU’s quiet revolution’ (i.e. the process of marketization and federalization that took place in the 1980s and the 1990s) was mainly the result of a political strategy: the European Commission exploited the fact that the concept of market meant different things in different issue areas and to different actors to build a large and heterogeneous coalition in favour of more European integration (2006). Howarth and Rommerskirchen (2013) examined how the concept of stability culture – a powerful idea in Germany – was used as a strategic resource by the Christian Democratic Union to legitimize, among other things, a range of EU-level policy decisions that were domestically controversial. Dyson (2014) exposed the centrality and the ambiguity of the concept of sovereign creditworthiness in shaping the European integration process. Blyth (2015) explained the political influence of the idea of austerity in the aftermath of the IFC of 2007-9 as the result of an ‘opportunistic rebranding’ of the crisis: the dominant narrative of ‘a crisis of the sovereign state’ created the perception that austerity was necessary. According to Blyth, this crisis narrative was invented to deal with a material constraint – the fact that many European headquartered banks were too big to be bailed out (ibid.). Another example is the study by the political scientists Amandine Crespy and Pierre Vanheuverzwijn (2019) of the concept of structural reform and the associated ‘constructive ambiguity’.

⁵⁰ It should be noted that, in this dissertation, the word ‘strategy’ does not relate to something dishonest. Here, strategy means a course of action designed to achieve a particular objective. The objective or goal to be achieved can be determined by both materialist and ideational factors. It is beyond the scope of this dissertation to explain why actors pursue the goals they do.

Considered as a whole, the instrumental approach treats the problem of explaining the influence of certain ideas on policy as a matter of their usefulness in relation to pursued goals. In this approach, ideas acquire political power because they help policymakers – the more useful an idea, the more political power it will have.

If the instrumental approach is taken, the power *through* moral hazard explains the influence of the concept on the economic governance of the EU in the post-2007 era (third hypothesis). In other words, the concept of moral hazard has political power in this context because it is a political resource that has been exploited by a variety of actors to help them achieve a range of different goals. Indeed, given the observed significant effect of moral hazard on policy, this dissertation expects moral hazard to have a relatively high degree of usefulness (measured in terms of the number of actors and goals that the concept helps).⁵¹ If the third hypothesis is true, the concept of moral hazard should not be used often by policymakers to contest or discredit moral hazard-based arguments but rather to help them justify or legitimize courses of action. Hence, as with the institutional approach, minor contestation of moral hazard should be observed among actors. However, in the instrumental approach this lack of contestation is not the result of ideational consensus. On the contrary, a diversity of opinions on moral hazard is expected. In this approach, the lack of contestation around moral hazard is the result of the usefulness of the concept. Instead of arguing against moral hazard-based arguments, policymakers should use the concept to their own advantage.

Moral hazard can potentially be used in a variety of ways to pursue a range of different goals. For example, actors who seek to limit European integration and the development of socio-macroeconomic risk sharing between the members of the euro area may use the causal relationship between collective insurance and moral hazard to justify being against the development of such mechanisms. Actors who seek to further European integration and the development of risk sharing in the euro area may use the negative relationship between external constraint and moral hazard to justify being in favour of greater centralisation at the EU level. In addition, actors who seek to increase their credibility (or the credibility of the euro area) may use the close relationships between, on the one hand, moral hazard and the discipline of economics, and on the other hand, moral hazard and the sound money paradigm to convince others that they are responsible actors. These are a few examples – and not an exhaustive list –

⁵¹ If moral hazard would be exploited only by authoritative actors, the hypothesis based on the authoritative theory rather than the one based on the instrumental theory would be verified.

of how moral hazard can be exploited by actors to help them pursue different goals.⁵² The aim of these examples is to show the potential ubiquity of moral hazard in policy debates. In sum, what is essential to the verification of the third hypothesis is the presence of minor contestation combined with the deployment of the term in relation to a variety of goals.

The instrumental approach to the impact of moral hazard on EU economic governance in the post-2007 period has several strengths. Given its characteristics, the concept of moral hazard appears as an ideal political resource. Moral hazard can be a cognitive idea that helps policymakers explain economic crises. Indeed, moral hazard can be a cause of a crisis when it has received too little or too much policy attention. Hence, the concept can be at the heart of opposed crisis narratives, as suggested by the cases of the IFC and the euro area SDC (Chapter 3). The origins of the term ‘moral hazard’ and its disputed relationship to morality also indicate that the concept can be used as a normative idea (Chapter 2). Notably, moral hazard can help actors legitimize not preventing or alleviating the burden of others. Considering the – arguably surprisingly – small amount of burden sharing between countries in the aftermath of the euro area crisis (Walter, Ray and Redeker, 2020), it is likely that moral hazard as a normative idea was exploited in this context. The fact that moral hazard can be used as both a cognitive and a normative idea in policy debates is not the only reason that makes moral hazard a key political resource. Its ambiguity is another characteristic that can be politically exploited. Moral hazard can be interpreted in more than one way (Chapter 2). This ambiguity offers policymakers an opportunity to adapt the meaning of moral hazard according to their needs and a changing environment. The exploited ambiguity of moral hazard might contribute to explain the resilience of the concept in the aftermath of the IFC and the euro area SDG. Finally, given the uncertainty but intuitive nature of moral hazard, it is reasonable to expect that the discourse on moral hazard in the post-2007 era played an important role with regard to its political influence. Whether or not moral hazard was a true major cause of the IFC and/or the euro area SDC, the discourse on moral hazard can create the conviction that it was.

There are a few limits to the instrumental approach to the influence of moral hazard in the post-2007 context. Why would moral hazard not be a political resource exploited by a variety of policymakers? One reason might be that actors in favour of change that goes in a different direction to that of the Maastricht model are arguably more likely to contest the legitimacy of avoiding moral hazard as a guiding principle – an objective closely associated

⁵² Given the assumptions of agency and creativity in the instrumental approach, it is difficult to provide an a priori list of goals for which moral hazard can be helpful. In this dissertation, the goals are identified inductively from the empirical analysis.

with the past dominant policy paradigm and with traditional figures of authority that shaped the design of EMU – than to exploit it to their own advantage. Another reason might be related to the power *in* moral hazard. The structural power of moral hazard derived from its previous institutionalisation might prevail in the present and limit the agency and creativity of policymakers in relation to moral hazard.

Table 1 Summary of the three theoretical approaches to the political power of moral hazard

	Key explanatory factor	Conditions for verification
Power <i>in</i>	Ideational consensus	Minor contestation and minor variability of moral hazard-based arguments between different actors
Power <i>over</i>	Authority	Minor contestation by authoritative actors and major contestation by non-authoritative actors
Power <i>through</i>	Usefulness	Minor contestation and major variability between different actors

Source: Author.

4.4 Conclusion

This chapter presents three theories to explain the political influence of moral hazard on the economic governance of the EU in the post-2007 period. Each of these approaches offers a different account of why moral hazard is influential in this context. The first gives primacy to the role of ideational consensus among the elite. According to institutional theory, the political influence of moral hazard lies in the absence of contestation and the presence of ideational consensus on the question of moral hazard. The second gives primacy to the role of authority. In the authoritative approach, the political influence of moral hazard is a matter of who has the capacity to impose its views on others. The question of moral hazard might be subject to contestation, but the voice of authoritative actors prevails. The third approach gives primacy to the role of usefulness and agency. The instrumental theory sees moral hazard as a

key political resource that has been exploited by a variety of policymakers. The question of moral hazard is subject to minor contestation not because it is taken for granted or consensual but because moral hazard is useful – it has the capacity to serve a range of different and important goals.

Hence, each of the theoretical approaches presented in this dissertation outline a different map of contestation and variability of moral hazard-based arguments. Power *in* moral hazard suggests the presence of minor contestation and minor variability between actors; power *over* moral hazard suggests the presence of major contestation by non-authoritative actors; and power *through* moral hazard suggests minor contestation but major variability of moral hazard-based arguments between actors.

This dissertation expects the usefulness attached to moral hazard (or power *through* moral hazard) to be the main factor explaining its political power in the post-2007 era. This expectation is based on the many strengths of the instrumental approach to moral hazard and the limited number of weaknesses that have been identified. The attractiveness of the instrumental approach also lies in the fact that the expectation of exploited usefulness does not deny the structural power of the concept of moral hazard or its relation to authority.⁵³ On the contrary. It poses that these are resourceful elements of moral hazard that can be exploited by policymakers to help them pursue their goals in present policy debates. The political power of moral hazard probably rests ultimately on the fact that – over time – it is a case at the intersection of the three theories.

The next chapter presents the methods employed to conduct the empirical analysis and determine whether the evidence speaks in favour or against the hypotheses based on the instrumental, authoritative, or institutional theories in the post-2007 period.

⁵³ Chapters 3 and 4 of this dissertation present evidence in favour of power *over* and *in* moral hazard in the context of European economic governance prior to 2007.

5 A Comparative Analysis of Discourse on Moral Hazard

This chapter aims to present the methods employed in this dissertation to empirically investigate the relationship between power and moral hazard. To characterise the relation of moral hazard to power, this dissertation relies on the presence or absence of the contestation and variability conditions presented in Table 1 (Chapter 4). The objective of the empirical analysis is therefore to assess the extent of contestation and variability of moral hazard-based arguments.

This dissertation expects the usefulness of the concept of moral hazard to be the main factor explaining its political influence on the economic governance of the EU in the post-2007 period (power *through* moral hazard). If the hypothesis based on the instrumental theory is true, the political power of moral hazard lies in the minor contestation of moral hazard-based arguments between different actors. This lack of contestation is not the result of established empirical knowledge or internalised and/or shared beliefs but of the capacity of different policymakers to exploit moral hazard to their own advantage. Hence, there are two necessary conditions for the verification of the instrumental hypothesis: i) there is minor contestation of moral hazard-based arguments between actors, and ii) there is major variability in how the concept is understood and exploited by different actors.⁵⁴ Although the dissertation expects the hypothesis of power *through* moral hazard to be verified, it is worth stressing that the proposed empirical analysis allows us to gather evidence in favour or against the three hypotheses formulated in the theoretical chapter (Chapter 4).

This chapter presents and justifies the scope of the study (where and when), the data, and the analytical techniques (how) used in this dissertation to verify or falsify the hypotheses of power *through*, *over*, and *in* moral hazard. The first section of this chapter develops the

⁵⁴ Major variability within cases will also be of interest to studying how moral hazard is exploited but it is not a necessary condition for the verification of the hypothesis based on the instrumental theory.

comparative perspective adopted in this dissertation. The second section provides a description of the data and how it was collected. The third section details the operationalisation of the verification conditions and presents the analytical techniques employed to conduct the empirical analysis. The final section concludes as to what empirical evidence plays in favour and against each of the three hypotheses.

5.1 Moral Hazard in Comparative Perspective

This dissertation employs the comparative method to study the spatial, temporal, and topical intensity of contestation as well as the extent of variability in the moral hazard-based arguments between European policy elites. The scope of this dissertation is therefore conceived to allow a comparison of how and for what goals the concept of moral hazard is used between different actors, over time, and across topics. However, for feasibility purposes in the time frame of four-year doctoral studies, the scope of this dissertation must be restricted. This section presents and justifies the scope of this dissertation.

The first and central line of comparison is between actors. This dissertation is interested in comparing the political discourse on moral hazard of authoritative and non-authoritative actors, and of actors with arguably different policy goals. The case studies of this dissertation were therefore selected on the basis of three main lines of division that have been identified in the politics of the euro area: the central banking/political division, the ‘northern’/‘southern’ division, and the national/supranational division (see, for example, Dyson, 2000; Matthijs and McNamara, 2015; Schelkle, 2017).

The central banking/political division can be described as a separation between, on the one hand, expertise and independence, and on the other hand, ideology and election. As members of what is often described as a technocratic institution, the policy goals pursued by central bankers are expected to be consistent with economic knowledge. In contrast, the policy goals pursued by politicians are expected to be largely independent from academic knowledge, but highly dependent on their ideology and the preferences of their constituencies. In this dissertation, central bankers are considered as authoritative actors (authority derived from expertise).

The ‘northern’/‘southern’ division is ambiguous. It refers to opposed coalitions of Member States mainly composed of, on the one hand, countries in the northern part of Europe, and on the other hand, countries in the southern part of Europe. However, the geographical

location is not the variable which actually explains the opposition of positions. The north/south divide in the euro area is often used to describe a separation between countries that are more prone to debt and balance of payment crises and those that are less prone to such crises (see, for example, Walter, Ray and Redeker, 2020).⁵⁵ One of the most influential explanations for these imbalances relates to a difference in growth models ('export-led' versus 'domestic demand-led').⁵⁶ However, the north/south divide can also be used to describe a cultural difference between Member States (as for example, in terms of economic culture, language origin, or religion). For example, the negative attitude towards debt in some cultures gave rise to an opposition in Europe between 'northern saints' and 'southern sinners' (Dyson, 2014; Matthijs and McNamara, 2015). In this dissertation, the 'northern'/'southern' division is understood as a division between Member States traditionally – that is, at least in the last decade – against interstate risk sharing and Member States traditionally in favour of it. Often, the position of Member States in relation to risk sharing correlates with the perceived need of protection. In this dissertation, members of the northern coalition (or the 'individual responsibility' coalition) – who are presumably less in need of protection – are considered as authoritative actors (authority derived from economic strength).

Finally, the national/supranational division is mostly a division over the depth and nature of European integration. National institutions are expected to be less inclined to delegate powers to EU institutions, while EU institutions are expected to be more inclined to pursue policy goals that limit national sovereignty and increase the powers of supranational institutions. In addition, national institutions are expected to pay more attention to the distribution of benefits and costs among Member States, while EU institutions are expected to pay more attention to the aggregate social welfare of the EU.

The empirical analysis is conducted with reference to four case studies that are representative of these traditional divisions, namely: Germany, Italy, the ECB, and the European Commission. For Member State cases, both the national government and the national central bank are studied (see Table 2 for a review of case studies and their relation to traditional divisions). The representativity of euro area traditional divides is crucial for the investigation of this dissertation since the answer to what is the relationship between power and moral hazard

⁵⁵ The balance of payment summarises all the transactions between residents and non-residents. It consists of the current account (including the accounts for goods and services trade), the capital account, and the financial account.

⁵⁶ Countries with an 'export-led' growth model (mostly in the north) tend to have a surplus in the current account and countries with a 'domestic demand-led' growth model (mostly in the south) tend to have a deficit in the current account.

is closely linked to whether moral hazard is subject to such divisions or not. If not, the evidence will speak in favour of power *in* moral hazard; if the division is between authoritative actors versus others, the evidence will speak in favour of power *over* moral hazard; and if there are variations without a clear pattern in terms of authoritative/non-authoritative actors, the evidence will speak in favour of power *through* moral hazard.

If the main divisions in the politics of the euro area directly justify the selection of central banks, political institutions, Member States from the north and the south, and EU institutions, the selection of the executive as representative of the ‘political’, of Germany as representative of the ‘north’, and of Italy as representative of the ‘south’ requires further explanation. The choice of the executive over the legislature to represent the ‘political’ side of the central banking/political divide is based on the criterion of who has more power between the two branches over EU economic governance: whether at EU or national level, the response is the executive.⁵⁷ Indeed, EU economic governance has been widely understood as predominantly intergovernmental – that is, the balance of power plays in favour of national governments (Puetter, 2012). In European economic governance, the power of parliaments is closer to the rights of consultation and information than to making, changing, or repealing EU law (see, for example, Fasone, 2014).⁵⁸ Some argue that the answer to the question of whether the European Parliament (EP) has gained or lost power in the post-2007 European economic governance regime is nuanced (e.g. Rittberger, 2014). However, there is no doubt that the distribution of power between the European Commission and the EP in European economic governance continues to be in favour of the European Commission – which arguably was a ‘winner’ of the IFC and the euro area SDC (Bauer and Becker, 2014). Hence, in this dissertation, the executive (national governments and the European Commission) has been chosen over the legislature (national parliaments and the EP) as representative of the ‘political’.⁵⁹

The choice of Germany as representative of the ‘north’ is based on three main reasons. First, the conventional position of German governments in EU economic governance has been to limit interstate risk sharing and to promote individual (national) responsibility.⁶⁰ Second,

⁵⁷ This is not to say that the study of parliaments is devoid of interest for the investigation of the politics of moral hazard’s use in the EU. However, it should be the subject of future research.

⁵⁸ Although the Bundestag has been identified as an exception to this rule (ibid.:165).

⁵⁹ It should be noted that the distinction between the executive and the legislature is blurred at the EU level since the Council of the EU (composed of national government ministers) and the European Commission also have legislative powers.

⁶⁰ The support of the German government for NGEU in response to the COVID-19 crisis has been qualified as exceptional and surprising – which confirms that this position is not in line with the ordinary position of the

Germany possesses relatively significant authority in EU negotiations (Chapter 4). Finally, third, moral hazard has been identified as a key element of the German economic tradition – to the point that moral hazard is sometimes described as a ‘German obsession’ (see, for example, Brunnermeier, James and Landau, 2016: 16).

The choice of Italy as representative of the ‘south’ is less obvious. Indeed, France rather than Italy is often depicted as the leader of the coalition of Member States opposing the one led by Germany (see, for example, Schimmelfennig, 2015). However, France can be considered as a borderline member of the southern coalition. The ‘south’ is better represented by Greece, Ireland, Italy, Portugal, and Spain (also referred to as the GIIPS). The choice of Italy among the GIIPS is based on three main reasons. First, Italy is the only founding Member States of the EU and the euro area. This means that one would expect that the Italian policy elite was subject to the ideational change which allowed the emergence of a consensus on the sound money paradigm. Indeed, despite the rhetoric about ‘profligate’ southern states, Italy has been identified as a place in which conservative liberalism is influential (Dyson, 2021). Hence, one could expect that German and Italian policymakers share a similar opinion on moral hazard (which would reinforce the significance of a potentially different empirical result). Second, elucidating how Italian policymakers understand and use the concept of moral hazard is of particular relevance to the question of euro area stability. Indeed, Italy plays an important role in the (in)stability of the euro area: Italy is the biggest economy of the southern countries (in terms of GDP) and consistently one of the Member States with the highest ratio of general government sector debt to GDP. Finally, third, as the only country of the GIIPS not having been directly or indirectly financially assisted by the EFSF/ESM, Italian policymakers may have more room of manoeuvre to contest or exploit the objective of avoiding moral hazard.⁶¹

German government in EU economic governance (see, for example, Mallet and Khalaf, 2020; Schmidt, 2020; Howarth and Schild, 2021; Waas and Rittberger, 2023; Pierret and Howarth, 2024).

⁶¹ These are the three main reasons to justify the selection of Italy as the representative of the ‘south’ in this dissertation. There are additional reasons. For example, the case of Mario Draghi – who served as Governor of the Bank of Italy, President of the ECB, and Prime Minister of Italy – offers the opportunity to investigate the use of moral hazard by the same individual in different institutional positions (a key aspect for empirically studying the usefulness of moral hazard). Another reason relates to data: compared to the case of Spain (the second country in the ranking of countries to represent the ‘south’ in this dissertation), the case of Italy resulted in more data points (72 press documents against 12).

Table 2 Case studies and traditional lines of division in the euro area

	Germany		Italy	ECB	European Commission
	Government	Bundesbank	Government	Bank of Italy	
Central banking (= authoritative)		X		X	X
Political	X		X		X
Northern (= authoritative)	X	X			
Southern			X	X	
National	X	X	X	X	
Supranational				X	X

Source: Author.

In this dissertation, the temporal scope of the empirical analysis is from 2007 to 2022. The effect of moral hazard on the economic governance of the EU was observable prior to 2007 (Chapter 3). However, the pre-2007 political influence of moral hazard has already received some academic attention: the centrality of the objective of avoiding moral hazard in the foundation of EMU has been linked to the influence of the sound money paradigm (ibid.). In contrast, little academic attention has been devoted to explaining the political influence of moral hazard after 2007 and the start of the IFC. And this, despite the facts that the public salience of the term ‘moral hazard’ increased significantly since the year 2007 (Leaver, 2015), and that the legitimacy of the previous dominant policy paradigm has been called into question in the post-2007 crises context. In addition, given the uncertainty associated with periods of economic crisis, it is all the more important to study the role of ideas in such context (Blyth, 2002; Hay, 2016). Finally, if the empirical analysis was to start in, for example, the 1990s, archival research would have been necessary. This time-consuming activity was made more difficult by the fact that I started my doctoral studies during the COVID-19 lockdowns. In such context, the time remaining for the analysis would have been considerably reduced by the extra time required to collect the data. Hence, the choice of 2007 as the starting year. The end year (2022) has been chosen for feasibility purposes in the time frame of the doctoral studies. The 2007-2022 period is of particular relevance for the study of the influence of moral hazard on

European economic governance. Indeed, over this time, the political influence of moral hazard is visible but presents variability: for example, moral hazard influenced policy in the contexts of the IFC and the euro area SDC more than in the context of the COVID-19 crisis (Chapter 3). Conducting the empirical analysis on the 2007-2022 period therefore allows the investigation of why the political power of moral hazard varied over time and between crises.

Finally, this dissertation is interested in comparing the extent of contestation and variability of moral hazard-based arguments between topics. A dictionary is used to deductively identify topics associated with the term ‘moral hazard’. The known categories (and sub-categories) of the dictionary correspond to the list of topics present in the academic literature review on moral hazard and European economic governance (Chapter 3), namely: austerity; Banking Union; common borrowing; competition policy; deposit guarantee; financial assistance\IMF\EFSF/ESM\NGEU; fiscal rules; lender of last resort; Maastricht Treaty; monetary policy\UMP; mutualisation; regulation; resolution; structural reforms; supervision; too big to fail; and transfers. Table 3 presents the search items for each known category (and sub-category). Using a deductive automated technique for topic classification has the advantage of reducing subjectivity and increasing the replicability of the results. In addition, this dictionary allows us to empirically test the pertinence of the topics identified in the academic literature to the political discourse on moral hazard. However, this dictionary-based topic classification has the disadvantage of not detecting topics that were absent from the academic literature on moral hazard and European economic governance. To detect potential additional topics in the political discourse on moral hazard, this dissertation supplements the dictionary’s known categories with unknown categories. Unknown categories are inductively and manually identified from the collected data and will be presented in the next section of this chapter.

Table 3 Dictionary for topic classification (search items of known categories)

Category	Search item
Austerity	auster; sparmassnahmen; effort; aufwand; sforzo; reduce; reduzieren; ridurre
Banking Union	banking union; bankenunion; unione bancaria
Common borrowing	joint borrowing; gemeinsame ausleihe; prestito congiunto; EU borrowing; EU-Kreditaufnahme; prestito

	dell'UE; common borrowing; gemeinsame kreditaufnahme; prestito commune; EU debt; EU-schulden; debito UE; common debt; gemeinsame schuld; debito comune
Competition policy	state aid; competition policy; wettbewerbspolitik; politica di concorrenza
Deposit guarantee	deposit; einlagengarantie; EDIS
Financial assistance	assist; unterstützung; help; hilfe; aiuto; support; emergen; notfall; diffic; schwierig; collapse; zusammenbrechen; crollo; survival; überleben; sopravvivenza; Troika; crisi; krise; condi; konditionalität; solidari
Financial assistance\EFSF/ESM	EFSF; ESM; MES; european stability mechanism; Europäischer Stabilitätsmechanismus; meccanismo europeo di stabilità; permanent crisis; permanente krise; crisi permanente
Financial assistance\IMF	IMF; IWF; FMI; international monetary fund; internationaler währungsfonds; fondo monetario internazionale
Financial assistance\NGEU	RRF; ARF; recovery and resilience facility; aufbau- und resilienzfazilität; dispositivo per la ripresa e la resilienza; next gen; NGEU; NextGenerationEU
Fiscal rules	SGP; SWP; PSC; stability and growth pact; Stabilitäts- und Wachstumspakt; patto di stabilità e di crescita; fiscal rules; fiskalregeln; regole fiscali; deficit; defizit; debt; schulden; debito; semest; six pack; two pack; TSCG; fiscal compact; fiskalpakt
Lender of last resort	LOLR; lender of; lenders of; kreditgeber letzter instanz; prestatore di; ELA; emergency liquidity assistance; notfall-liquiditätshilfe; di assistenza di liquidità
Maastricht Treaty	maastricht; treaty; treaties; vertr; trattat; TFEU; AEUV; TFUE; mandat; schicken; independen; unabhängig; no-bailout; moneti; monetarisierung; monetary financing;

	monetäre finanzierung; finanziamento monetario; 123; 125
Monetary policy	interest rate; zinsrate; tasso d'interesse; monetary policy; geldpolitik; politica monetaria
Monetary policy\UMP	UMP; non-standard; new tools; new instruments; neue werkzeuge; neue instrumente; nuovi strumenti; unconventional; non convenzionale; unkonventionel
Monetary policy\UMP\Negative interest rates	negative interest; negativzinsen; interesse negativo
Monetary policy\UMP\OMT	OMT; outright; whatever it takes; was auch immer notwendig ist; a ogni costo
Monetary policy\UMP\QE	QE; quantitative easing; quantitative lockierung; purchas; buyin; kaufen; acquis; SMP; securities markets programme; programm für die wertpapiermärkte; balance sheet; bilanz; bilanci; PEPP; pandemic emergency purchase programme; pandemie-notkaufprogramm
Monetary policy\UMP\TLTROs	TLTRO; GLRGs; OMRLT; targeted long-term; gezielte längerfristige refinanzierungsgeschäfte; operazioni mirate di rifinanziamento a più lungo termine
Mutualisation	mutual; risk-sharing; risk sharing; risikoteilung; condivisione del rischio; eurobond; coronabond; stability bond; euro bond
Regulation	regulation; verordnung; regolamento; rulebook; basel; G20; macroprudent; makropruden; microprudent; mikropruden; capital; kapital
Resolution	resolu; auflösung; risolu; resolv; lösen; resolver; SRM; SRF; BRRD; bail-in; bail in; fail; scheitern; fallire; orderly; ordentlich; ordinat; PSI; private sector involvement; beteiligung des privaten Sektors; coinvolgimento del settore privato
Structural reforms	structural reforms; strukturreformen; riform; reform

Supervision	supervision; aufsicht; SSM; MVU; single supervisory mechanism; einheitliche aufsichtsmechanismus; meccanismo di vigilanza unico; surveillance; überwachung; sorveglianza; monitor
Too big to fail	too big; too-big; zu groß; troppo grande; SIFI systemic; systemisch; systemrelevant; sistematica transfer; unemployment; arbeitslosigkeit;
Transfers	disoccupazione; fiscal capacity; finanzkapazität; capacità fiscal; budget; haushalt; bilancio

Source: Author. The dictionary allows the identification of topics in documents written in English, German, and Italian.

5.2 Data

This section presents the data used to conduct the empirical analysis of this dissertation and how it was collected. To examine the extent of contestation and variability of moral hazard-based arguments, this dissertation relies on published documents and transcripts of interviews. The selection of published documents – available (open access) on the respective institutional websites⁶² – is based on the following cumulative criteria:

- (i) The document is a press document which aims to express, justify, or legitimize positions and opinions (i.e. speeches, interviews, or press conferences).⁶³
- (ii) The date of the document is equal or superior to 01.01.2007 and inferior to 31.12.2022.

⁶² List of institutional websites for each institutional actor:

- European Commission: <https://ec.europa.eu/commission/presscorner/home/en>;
- Bank of Italy: <https://www.bancaditalia.it/media/interviste/index.html>;
- Deutsche Bundesbank: <https://www.bundesbank.de/en>;
- ECB: <https://www.ecb.europa.eu/press/pubbydate/html/index.en.html>;
- German federal government: <https://www.bundesregierung.de/breg-de/service/newsletter-und-abos/bulletin> ; a number of speeches made by Wolfgang Schäuble were collected from his personal website (<https://www.wolfgang-schaeuble.de>).
- Italian government: <https://www.governo.it/en/interventi-en> ; <https://www.sitiarcheologici.palazzochigi.it/index.html?page=1>; <https://www.governo.it/en/i-ministeri>.

⁶³ This dissertation focuses exclusively on press documents because it is interested in the communication strategies of European policy elites, especially argumentation. In addition, it should be noted that press releases were excluded from the corpus because this type of press documents aims to provide specific and summarised information to the media and is therefore less likely to contain (new) arguments.

- (iii) There is at least one utterance of the term ‘moral hazard’ in the press document (other than within the reference list).⁶⁴

The selection of potential interviewees is based on the following inclusion criterion:

- (i) The interviewee is the speaker of a selected press document; or an author of a publication published on the institutional website that contains at least one utterance of the term ‘moral hazard’ (other than within the reference list).⁶⁵

The result of the data collection strategy is a corpus of 364 press documents and 12 transcripts of interviews.⁶⁶ The corpus of moral hazard press documents can be found in the appendices to this dissertation (Appendix B).⁶⁷ The transcription of interviews was made using the computer software MAXQDA, based on the audio or video recording of the interview (all the interviewees gave their consent for the interview to be recorded and the study received the approval from the Ethics Review Panel of the University of Luxembourg). Each interview lasted around 30 minutes. Table 4 presents the list of interviews that have been conducted between February 2022 and January 2023 (transcripts of interviews can be found in Appendix C).

Table 4 List of interviews

Date of the interview	Position	Case study	Place of interview
22.02.2022	Member of the advisory board to the German Federal Ministry of Finance	Germany	Online
21.03.2022	Member of the advisory board to the German Federal Ministry of Finance	Germany	Online
22.03.2022	Member of the advisory board to the German Federal Ministry of Finance	Germany	Berlin
22.03.2022	ECB official	ECB	Online

⁶⁴ For documents in German or Italian, a translation of moral hazard has also been used: ‘rischio morale’ and ‘azzardo morale’ in Italian; ‘subjektives Risiko’ and ‘moralisches Risiko’ in German.

⁶⁵ Ibid.

⁶⁶ In total, 61 invitations for an interview have been sent and 12 received a positive answer. The number of invitations sent was limited by the availability of contact details.

⁶⁷ Out of the 364 documents, 53 are in German and 15 are in Italian (the others are in English). Translation tools are used to conduct the empirical analysis on documents that are not in English. It is worth mentioning that even if the document is not in English, policymakers often do not use a translation of moral hazard: ‘moral hazard’ appears in English in 36 documents of the 68 documents that are not in English.

24.03.2022	Bundesbank official	Germany	Frankfurt am Main
24.03.2022	Member of the advisory board to the German Federal Ministry of Finance	Germany	Online
25.03.2022	ECB official	ECB	Online
25.03.2022	ECB official	ECB	Online
22.11.2022	Former commissioner	European Commission	Online
30.11.2022	Economist offering expert advice	European Commission	Online
26.01.2023	Former minister	Italy	Online
26.01.2023	European Commission official	European Commission	Online

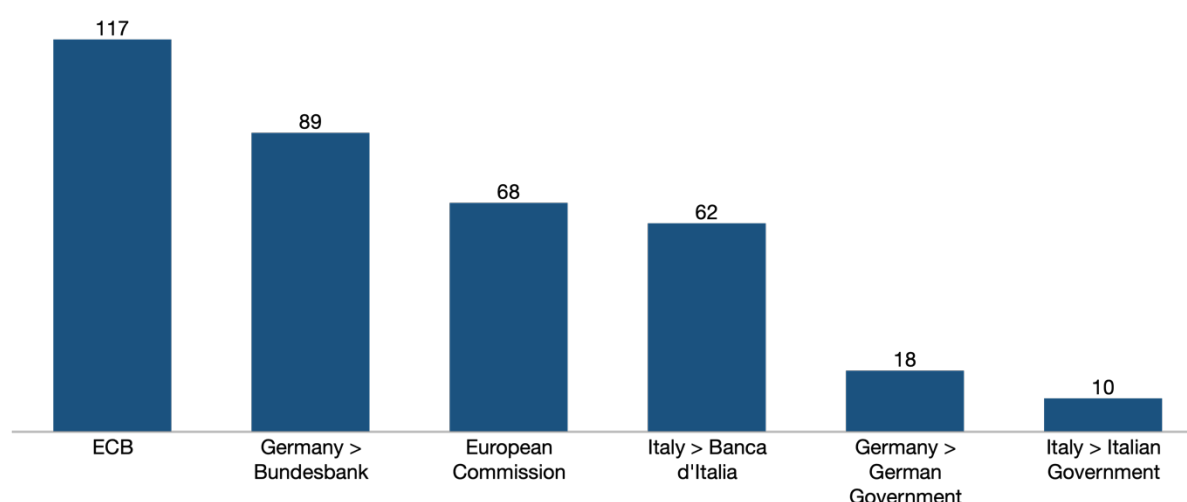
NB: Information that could permit the identification of people was removed to respect the anonymity of the interviewees.

The selected press documents were imported (in PDF format) into the software MAXQDA.⁶⁸ Using the Data Editor function, a list of document variables has been created to facilitate the analysis of the corpus: Document group [Germany\German Government\Bundesbank; Italy\Italian Government\Bank of Italy; ECB; European Commission]; Speaker; Location; Date\Year; Language; Political/Central banking; National/Supranational; and North/South. A preliminary analysis of the corpus in terms of distribution of the 364 documents by institution (Figure 2) and speaker (Table 5), over time (Figure 3), and between topics (Table 6) offers an overview of by whom, when, and in relation to what the term ‘moral hazard’ is most frequently used by European policy elites. The political/central banking division is the most significant in this corpus: 74% of the selected documents are from central banks. The north/south division is also visible, with 60% of Member State documents from Germany. In contrast, the national/supranational division is not apparent when looking at the distribution of selected documents between institutional actor: the number of documents is similar between national institutions (49% of the selected documents) and EU institutions (51% of the selected documents). The distribution of selected documents over time indicates that the term ‘moral hazard’ was more frequently used in communications between 2010 and 2012. This time frame of frequency of moral hazard press documents suggests that European policy elites were more prone to use the concept in the context of the euro area SDC than in the contexts of the IFC and the COVID-19 crisis. Figure

⁶⁸ The PDF format has been chosen over other formats to maintain the structure of the press document.

3 also indicates that, over the period under consideration, German policymakers were not the first to employ the term ‘moral hazard’ in their communications. Contrary to the European Commission, the ECB, and the Bank of Italy (for which the corpus starts in 2007), the first press document from the Bundesbank and the German government with an utterance of the term ‘moral hazard’ is from 2008 and 2009, respectively. Finally, the distribution of selected documents between topics reveals that in more than 70% of the documents, the topic of financial assistance is present in the context of term ‘moral hazard’ (Table 6). It is worth mentioning that the empirical analysis of the dataset of moral hazard utterances in terms of topics resulted in the identification of five categories that were absent from the literature review on moral hazard and European economic governance (Chapter 3), namely: inequalities, housing policy, natural disaster, pension system, and migration.

Figure 2 Distribution of selected documents, by case study and institution



Source: author.

NB: In the case of the Italian government, the data for prime ministers Renzi and Gentiloni were not available. The written transcripts of the official communications made by these two Presidents of the Council of Ministers are not published on the institutional website of the Italian government (when an official communication is made available, it is in a video format).

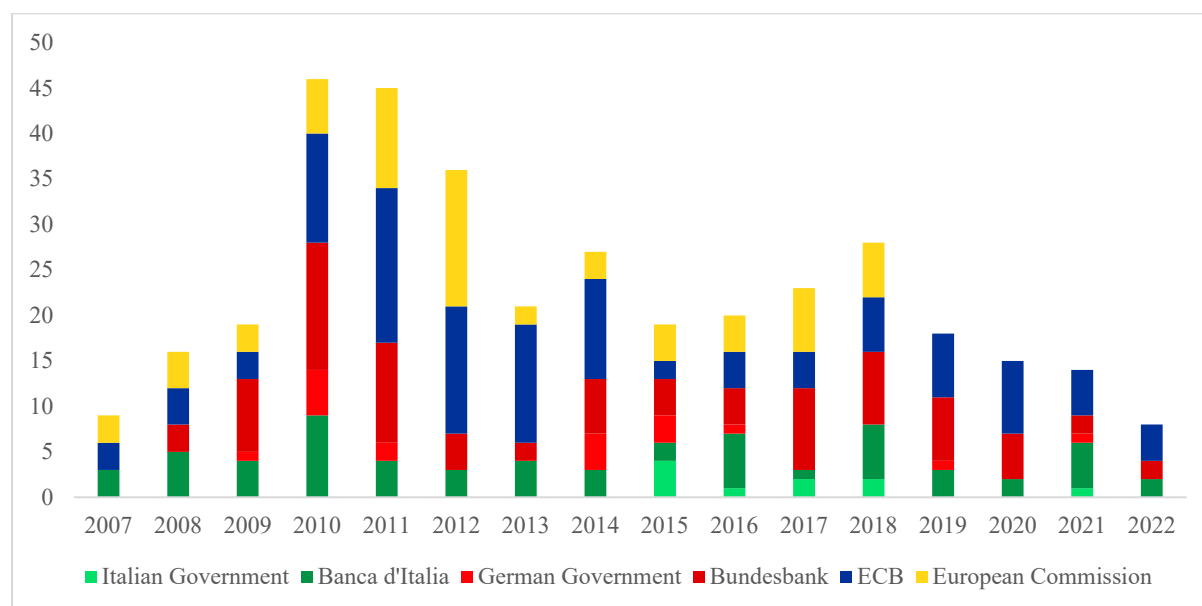
Table 5 Distribution of selected documents, by speaker

Speaker	Number of documents	Percentage of total documents
Draghi	30	8,2
Weber	25	6,9
Weidmann	20	5,5
Dombret	19	5,2
Buch	18	4,9
Rehn	17	4,7
Visco	17	4,7
Schäuble	17	4,7
Coeuré	16	4,4
Almunia	14	3,8
Stark	13	3,6
Praet	12	3,3
Dombrovskis	11	3,0
Schnabel	10	2,7
Trichet	9	2,5
Constâncio	8	2,2
Bini Smaghi	8	2,2
Mersch	7	1,9
de Guindos	7	1,9
Rossi	7	1,9
Padoan	6	1,6
McGreevy	5	1,4
Kroes	4	1,1
Signorini	4	1,1
Sacomanni	4	1,1
Tumpel-Gugerell	4	1,1
Hill	4	1,1
Lautenschläger	3	0,8
Barbagallo	3	0,8
Timmermans	3	0,8

González-Páramo	2	0,5
Barroso	2	0,5
Tria	2	0,5
Zeitler	2	0,5
Sannucci	2	0,5
Panetta	2	0,5
Passacantando	2	0,5
Asmussen	2	0,5
Wuermeling	2	0,5
Gobbi	1	0,3
Della Vedova	1	0,3
De Polis	1	0,3
Sestio	1	0,3
Tarantola	1	0,3
Perrazzelli	1	0,3
Semeta	1	0,3
Brüderle	1	0,3
Andor	1	0,3
Moedas	1	0,3
Georgieva	1	0,3
Nagel	1	0,3
Franco	1	0,3
Jourová	1	0,3
Mieli	1	0,3
Papademos	1	0,3
Katainen	1	0,3
Thyssen	1	0,3
Tajani	1	0,3
Remsperger	1	0,3
Lane	1	0,3
 TOTAL ANALYSED	 364	 100,0
DOCUMENTS		

Source: Author.

Figure 3 Distribution of selected documents, by year and institution



Source: Author.

Table 6 Dictionary-based topic classification

Topic and sub-topic	Number of documents	Percentage of total documents
Financial assistance	263	72,3
IMF	28	7,7
EFSF/ESM	26	7,1
NGEU	3	0,8
Resolution	145	39,8
Monetary policy	86	23,1
UMP	13	3,6
Quantitative easing (QE)	63	17,3
Outright Monetary Transaction (OMT)	14	3,8
Targeted longer-term refinancing	0	0,0

operations (TLTROs)		
Negative interest rates	0	0,0
Regulation	126	34,6
Too big to fail	101	27,7
Supervision	94	25,8
Fiscal rules	93	25,5
Structural reforms	92	25,3
Maastricht Treaty	75	20,6
Transfers	65	17,9
Mutualisation	46	12,6
Deposit guarantee	41	11,3
Austerity	27	7,4
Banking Union	26	7,1
Lender of last resort	15	4,1
Competition policy	10	2,7
Inequalities	6	1,6
Common borrowing	4	1,1
Housing policy	4	1,1
Natural disaster	4	1,1
Pension system	3	0,8
Migration	3	0,8
TOTAL ANALYZED	364	100,0
DOCUMENTS		

Source: Author

NB: The topic classification has been made using the Dictionary function of the software MAXQDA. The 364 documents have been automatically coded with dictionary categories. The dictionary was not applied to the entire document but to a dataset of moral hazard utterances (with a textual context of one paragraph before and after). Five out of the 22 topics have been manually and inductively identified (unknown categories), namely: inequalities, housing policy, natural disaster, pension system, and migration. The reading of the table is as follows: in 263 of the 364 documents examined, the topic of financial assistance is present in the textual context of the term 'moral hazard'.

This section aimed to describe the data used to conduct the empirical analysis of this dissertation. The next section presents in more details how the hypotheses are operationalised.

5.3 Operationalising the Investigation of the Relationship Between Power and Moral Hazard

There are two necessary conditions for the verification of the hypothesis that is expected to have the greater explanatory power as to the political influence of moral hazard in the post-2007 period: i) there is minor contestation of moral hazard-based arguments between actors, and ii) there is major variability of moral hazard-based arguments between actors. To determine whether these conditions are present, this dissertation must assess the extent of contestation and variability of moral hazard-based arguments. To do this, this dissertation mainly employs inductive qualitative text analysis techniques (discourse analysis) and interviewing. Manual coding is preferred to automated coding given the subtlety of the inquiry and the reasonable size of the corpus.⁶⁹ The analysis of text is made using the software MAXQDA.⁷⁰

The first part of the empirical analysis is focused on contestation. In this dissertation, contesting moral hazard means using the term to refute or challenge a statement on moral hazard. The code ‘Contestation’ is created to indicate if a statement on moral hazard is contested. Each utterance of the term ‘moral hazard’ in the corpus (in its textual context – here, one sentence before and after) is manually coded.⁷¹ The condition of minor contestation between actors is present (and absent otherwise) if, for each case, the number of coded segments with ‘Contestation’ is lower than the number of moral hazard utterances not coded

⁶⁹ The ‘bag of words’ assumption of most automated (or quantitative) text analysis techniques reduces the usefulness of such techniques for the inquiry of this dissertation. However, automated content analysis is used for topic classification and word clouds.

⁷⁰ The Codebook can be found in the appendices of this dissertation (Appendix D).

⁷¹ Two datasets of moral hazard utterances are used to conduct the empirical analysis of the corpus: a restricted dataset with a context of one sentence before and after the search items; and an enlarged dataset with a context of one paragraph before and after the search items. The datasets have been created on MAXQDA using the Lexical Search function: Search items: moral hazard moral-hazard subjektives Risiko moralisches Risiko rischio morale azzardo morale (In documents OR Find whole words Only in activated documents) – Run search – Autocode search results with a new code – Moral hazard dataset – 1 Sentence before and after – Autocode.

NB: The 2020 MAXQDA version initially used did not allow the automated coding of PDF documents in terms of paragraph. Therefore, the paragraph coding of moral hazard utterances has been made manually. The textual context of one paragraph before and after the search items has been chosen over the simple paragraph because some PDF documents present paragraphs of one sentence.

with ‘Contestation’. The presence of minor contestation in the corpus means that the term ‘moral hazard’ is primarily used by policymakers to express, justify, or legitimize an opinion and not to refute or challenge an argument that involves moral hazard. Segments coded with ‘Contestation’ – if any – are not without analytical interest. This dissertation expects cases where moral hazard is contested to be a minority but the investigation of moral hazard as an exploited political resource gains from studying cases where the concept is contested (i.e. not exploited). Segments coded with ‘Contestation’ are analysed in terms of which statement about moral hazard is being refuted, by whom, when, and in relation to what. Mapping the contestation of moral hazard statements allows to delineate the limits of the political usefulness of moral hazard.

The condition of minor contestation is not sufficient to verify the instrumental hypothesis (power *through*) and falsify the others. Indeed, the presence of minor contestation in the corpus is evidence against the authoritative hypothesis (power *over*) but not against the institutional hypothesis (power *in*). Indeed, the lack of contestation can result from agreement between different actors and the absence of a diversity of moral hazard-based arguments. However, the instrumental hypothesis gives primacy to usefulness and agency over ideational consensus to explain the political power of moral hazard in the post-2007 period. Major variability between actors in terms of moral hazard-based arguments is therefore another necessary condition to verify the hypothesis of power *through* and falsify the hypothesis of power *in* moral hazard. As a reminder, ‘an argument is a set of statements (explicit or implicit), one of which is the conclusion (claim) while the others are the premises’ (Fairclough and Fairclough, 2012: 36). A moral hazard-based argument is an argument composed of at least one statement on moral hazard. For example, following the motivational-cognitive structure developed by Robert Audi (Audi, 2006 in *ibid.*: 40):

1. The motivational premise: I want to avoid moral hazard;
2. The cognitive premise: limiting risk sharing would contribute to avoiding moral hazard;
3. Conclusion: I should limit risk sharing.

This moral hazard-based argument helps policymakers to justify limiting risk sharing. This dissertation expects major variability between actors in terms of moral hazard-based arguments. Variability of moral hazard-based arguments can result from different premises and conclusions, but also from different meanings of moral hazard. Indeed, if the meaning of moral hazard varies between different actors, the goal premise ‘I want to avoid moral hazard’ changes accordingly. The condition of major variability is present (and absent otherwise) if there are

noteworthy differences between actors in at least one of the two elements under consideration – conceptions (i.e. how the concept is understood), and arguments (i.e. premises and conclusions). Noteworthy differences between actors as to the conception of moral hazard is empirical evidence against power *in* moral hazard (in this dissertation, ideational consensus requires an agreement about the meaning of ideas); noteworthy differences between actors as to the conclusions of moral hazard-based arguments is empirical evidence in favour of agency and power *through* moral hazard (differences in most frequent conclusions are necessary to conclude that different policymakers exploited moral hazard to their own advantage).

The second part of the empirical analysis is therefore focused on conceptions. The empirical analysis of the variability condition begins with the investigation of how policymakers understand the concept of moral hazard and asks whether there is a shared and dominant conception of moral hazard among European policy elites in the post-2007 period. Do European policymakers in the post-2007 period agree about the meaning of moral hazard? To identify how moral hazard is understood, this dissertation is inspired by ordinary language philosophy and employs grounding and content analysis techniques. Notably, this dissertation builds on the close relationship between application and understanding of words, emphasized by the philosopher Ludwig Wittgenstein (see, for example, Wittgenstein, 2009: 64). Although the term ‘moral hazard’ is not everyday use, there is an application of the concept in policy-making. This dissertation is not interested in the metaphysical meaning of moral hazard but in its empirical meaning. Following Wittgenstein’s imperative ‘don’t think, but look!’, this dissertation surveys how policymakers use the term ‘moral hazard’ (ibid.: 36). The aim of surveying how moral hazard is described by policymakers is to identify similarities and differences. According to Wittgenstein, a concept is not bounded by something that is common to all its applications but by ‘a complicated network of similarities overlapping and criss-crossing’ (ibid.: 36). He thought of the expression ‘family resemblances’ to characterise these similarities; ‘for the various resemblances between members of a family’ (ibid: 36). Here, a concept forms a family, and this dissertation seeks to identify the various features of the ‘moral hazard family’. There is a close relationship between ordinary language philosophy and the practice of grounding. Indeed, ‘grounding is the mode of elucidation that aims to identify how people themselves understand a concept’ (Schaffer, 2015: 26). This dissertation relies on textual analysis and interviewing to elucidate how a sample of policymakers themselves understand the concept of moral hazard. This part of the empirical analysis focused on conceptions of moral hazard is largely inspired by the lessons for grounding provided by the political scientist Frederic Charles Schaffer in his book *Elucidating social science concepts*:

an interpretivist guide (ibid). Schaffer's lessons for grounding are to investigate the grammar of a term and notably to pay particular attention to the differences in how close synonyms are used and to examine opposites and negations (ibid.).

The textual analysis of how policymakers present the concept of moral hazard in their press documents is conducted on the one sentence before and after dataset of moral hazard utterances. To infer meaning from these utterances, first this dissertation examines the semantic fields of moral hazard. In this dissertation, the semantic field of a search item refers to three types of word-relations: words having the same sense as the search item (synonyms); words having an opposite meaning to the search item (antonyms); and words most frequently used next to the search item (word clouds).⁷² Synonyms and antonyms for moral hazard are manually coded. In contrast, word clouds are automatically generated by MAXQDA thanks to the Word Cloud function.⁷³

Second, in addition to investigating grammar, this dissertation looks for text that provides direct or indirect definitions of moral hazard and information about its cause-and-effect relationship. The strategy of looking at the cause-and-effect relationship is not based on a given lesson for identifying the meaning of words but is derived from the intuitive idea that understanding something often involves a judgement on its causes and effects. When moral hazard is described or explained, the segment is manually coded with the code 'What it is'; segments providing information about the cause of moral hazard are manually coded with 'What causes it', and segments providing information about the effect of moral hazard are manually coded with 'What it does'. This textual analysis of moral hazard utterances in a restricted context (one sentence before and after) allows us to draw inferences about key features of moral hazard and to compare them across institutional space, over time, and between topics. This part of the empirical analysis aims to offer a contemporary conceptual map of moral hazard in EU policy-making.

⁷² The word cloud of a term is considered a valuable source of information when it comes to inferring meaning since it informs about the adjectives, verbs, and subjects most frequently employed in relation to the search term. Such information helps to reveal how a term is interpreted.

⁷³ Word clouds are created based on a series of datasets of moral hazard utterances with a context of five words before and after. Three datasets were created, based on the language of the document (an English dataset, a German dataset, and an Italian dataset). To create the English dataset, the following steps have been made: using the Keyword-in-context function: Search items: moral hazard Moral hazard Moral Hazard moral-hazard (In activated documents Find whole words Context 5 words before and after) – OK – Autocode search results with a new code – Moral hazard dataset – 5 words before and after – Autocode. To create the word cloud, the code 'Moral hazard dataset – 5 words before and after' is activated. In the Retrieved Segments window, the Word Cloud function is used: 75 Words Lemmatize words Minimum Frequency 2 Case Sensitivity Ignore Numbers. The Stop Lists can be found in the appendices to this dissertation (Appendix E).

The elucidation of how policymakers interpret the concept of moral hazard is complemented by interviewing. The aim of the interview is to identify how the interviewee understands moral hazard. While each interviewee is related to a case study/institution, the interviews represent the interviewee's opinion and not an institutional opinion. However, individual opinions are considered as sources of information to shed light on potential shared meanings. In addition, even though the interviews are not representative, they present – among other things – ostensive explanations of what moral hazard is (see Table 7 for the list of questions). This information is of great value as it provides direct meaning of moral hazard (no inference needs to be drawn). The information from the interviews is used to see if patterns of similarities and differences emerge. The way interviewees understand moral hazard is also compared with how moral hazard is presented in the corpus. Major variability in terms of conception is present if there are differences in the key features of moral hazard between actors.

Table 7 Grounding interviews: list of questions, by type of question

Judgment questions [This type of question requires the interviewee to express opinions and to discriminate which reveals standards implicit in a term]	1. Is moral hazard the main cause of the international financial crisis that started in 2007? 2. Is moral hazard the main cause of the euro area sovereign debt crisis? 3. Does the EU's response [NGEU financed with common debt] to the COVID-19 crisis create moral hazard? 4. Is moral hazard more present at the European level than at the national level? 5. Is moral hazard under or over-estimated?
When-else questions [Look at the use of the same word in different contexts]	6. We have discussed moral hazard mostly in relation to banks and governments. Do you see moral hazard in the context of family?

What-can't-be-said questions

[Learn the limits of applicability]

7. A person vaccinated against the COVID-19 who becomes less careful to not spread the virus. Is this an example of moral hazard?

Difference questions

[Examine differences in how close synonyms are used]

8. What is the difference between moral hazard and irresponsibility?
9. What is the difference between moral hazard and egoism (or selfishness)?

Direct questions

[Ask explicitly what the interviewee understands the meaning of the concept to be]

10. To you, what is moral hazard?

Source: Author.

NB: The question types are from Schaffer's guide to interviewing (Schaffer, 2015: 45-7).

The third and final part of the empirical analysis is focused on arguments. The empirical analysis of the variability condition ends with a discourse analysis of moral hazard-based arguments in the corpus. The discourse analysis is conducted on the enlarged dataset of moral hazard utterances (one paragraph before and after) and aims to detect and compare premises and conclusions of arguments with at least one statement on moral hazard. Notably, this dissertation distinguishes between two types of premises: a cognitive premise is a statement that relates to knowledge or that helps to explain or justify something (cognitive premises are manually coded with 'Cognitive'); a normative premise is a statement that relates to values or that helps to legitimize something (normative premises are manually coded with 'Normative'). The analysis of premises pays special attention to the relationships between moral hazard and economics, morality, and the sound money paradigm (Chapter 4). The study of premises allows the determination of whether, when, and in relation to what policymakers use moral hazard to formulate cognitive, normative, or mixed arguments (in other words, how moral hazard is exploited). The conclusions of moral hazard-based arguments are particularly important to the investigation of this dissertation because they are indicative of what should be done. Segments where policy prescriptions are present are coded with 'Conclusion'. The results of the

‘Conclusion’ code indicate for what purposes moral hazard is exploited and hence present a great source of information to infer policy goals (that is, the policy outcomes that policymakers want to achieve). Finally, the discourse analysis of moral hazard-based arguments is complemented by a contextualisation of the discourse on moral hazard. In addition to time and topics, this dissertation also looks at ‘whose moral hazard’ and notably asks whether the political discourse on moral hazard is biased in favour of banks or governments. Moral hazard utterances are coded with ‘Whose moral hazard?’ (when there is no available information about whose moral hazard, the utterance is coded with the sub-code ‘indeterminate’). Major variability in terms of arguments is present if there are differences in the most frequent conclusions between actors.

5.4 Conclusion

In this dissertation, the verification of the instrumental hypothesis depends on the presence of two conditions: minor contestation and major variability. The condition of minor contestation in the corpus must be present if one wants to conclude that the term ‘moral hazard’ is not mostly used by policymakers to refute or challenge a statement on moral hazard (what would be the opposite of exploiting moral hazard); the condition of major variability in conceptions and conclusions between actors must be present if one wants to conclude that policymakers disagree about moral hazard but use the concept to their own advantage. If these two conditions are present, moral hazard is an exploited political resource, which suggests that usefulness – more than authority or consensus – is the main source of its political power.

The presence of the condition of minor contestation constitutes empirical evidence against the hypothesis based on authoritative theory (and in favour of hypotheses based on institutional and instrumental theories). In contrast, the absence of the condition of minor contestation is empirical evidence in favour of the authoritative theory (and against the other two theories). Indeed, according to the authoritative theory, moral hazard is politically influential because it is exploited by authoritative actors. However, if this dissertation finds evidence that moral hazard is used by non-authoritative actors for something else than contesting moral hazard-based arguments, the political power of moral hazard cannot be restricted to the power of authoritative voices.

The presence of the condition of major variability constitutes empirical evidence against the hypothesis based on the institutional theory and in favour of the hypothesis based on the instrumental theory. Notably, major variability in the conceptions of moral hazard would be evidence against the proposition that there is a consensus on moral hazard among European policy elites in the post-2007 period. Indeed, this dissertation considers that a real ideational consensus requires at least agreement on the meaning of ideas. In addition, major variability in the conclusions of moral hazard-based arguments implies a degree of strategic agency as to how policymakers use the concept – variability in conclusions means that different policymakers exploited moral hazard to achieve different policy goals. In sum, the combination of minor contestation and major variability of moral hazard-based arguments would reveal the instrumental power of moral hazard in policy debates.

The next four chapters of this dissertation are the empirical chapters: the extent of contestation and variability of moral hazard-based arguments is assessed with reference to the four case studies. Each empirical chapter is structured in three parts: a section on contestation, a section on conceptions, and a section on arguments. The outline of the empirical chapters is as follows. The empirical analysis begins with the study of the Member State cases: Chapter 6 and 7 are on, respectively, Germany and Italy. The empirical analysis ends with the study of the EU institutional cases: Chapters 8 and 9 are on, respectively, the ECB and the European Commission. The last chapter of this dissertation (Chapter 10) reviews the main findings and concludes on whether the conditions of minor contestation and major variability of moral hazard-based arguments are present.

6 Germany

This chapter presents the findings of the empirical analysis of the German case – the representative of the authoritative northern coalition. In doing so, this chapter provides answers to key empirical questions as to the political influence of moral hazard: is the condition of minor contestation present in the case of Germany? Do German policymakers agree about the meaning of moral hazard? And what are the main characteristics of the moral hazard-based arguments formulated by the German policy elite? In this dissertation, ‘German policymakers’ or ‘the German policy elite’ is limited to persons working for or with two institutional actors: the Deutsche Bundesbank (hereafter, Bundesbank) and the Federal government (hereafter, German government). This division between German central bankers and politicians allows us to study the relevance of the central banking/political division on the question of moral hazard in Germany.

The German case alone is not sufficient to conclude on the relationship between power and moral hazard in the post-2007 European economic governance. However, if the power of Germany over moral hazard is what mainly explains the political influence of the concept, the voices of the German policy elite in relation to moral hazard should be united. The political discourse of German policymakers on moral hazard should therefore be characterised by minor contestation; German policymakers should share a common and dominant conception of moral hazard; and the concept should be exploited by the German policy elite to defend the legitimacy of the Maastricht model of economic governance that was inspired by the German model. Notably, given the position of Germany as the leader of the ‘individual responsibility’ coalition during the euro area SDC, we expect German policymakers to exploit moral hazard to help them blame the members of the southern coalition for their fiscal problems, limit protection against sovereign default, and increase constraints on governments.

This chapter is structured as follows. The first section is dedicated to contestation. The second and third sections focus on moral hazard’s conceptions and moral hazard-based arguments, respectively. In these three sections, the results for the Bundesbank and the German

government are compared. The final section summarizes the main results and provides the answers to the key empirical questions presented above.

6.1 On Contestation

In this dissertation, contestation means the action of refuting or challenging a statement. Moral hazard is contested when the term is used in a press document to refute or challenge a statement on moral hazard. Contesting moral hazard is therefore the opposite of exploiting moral hazard. For moral hazard to be considered an exploited political resource in a given case, there must be minor contestation of moral hazard by the policymakers of that case. This section presents the results of the ‘Contestation’ code for the members of the authoritative northern coalition, i.e. the German government and the Bundesbank.

There are 144 utterances of the term ‘moral hazard’ (one sentence before and after) in the corpus of Germany’s press documents (107 documents). The total number of coded segments with ‘Contestation’ is three. Over the period under consideration, German policymakers contested moral hazard three times and exploited it 141 times (i.e. the number of ‘moral hazard’ utterances not coded with ‘Contestation’). Clearly – and as one might expect – the condition of minor contestation is present for the northern coalition case.

In the corpus of German government press documents, the contestation of moral hazard is null.⁷⁴ On no occasion have the two federal ministers who used the term ‘moral hazard’ in their communications – Wolfgang Schäuble (Finance Minister, 2009-2017; President of the Bundestag, 2017-2021) and Rainer Brüderle (Minister for Economics and Technology, 2009-2011) – done so to refute or challenge a statement on moral hazard.⁷⁵ The rare contestation of moral hazard by German policymakers is exclusively from central bankers. Axel Weber (President of the Bundesbank, 2004-2011) used the term ‘moral hazard’ to refute a statement on moral hazard twice in a speech at Financial Services Ireland (Dublin, 10 March 2010):

⁷⁴ It is worth noting that the corpus of German government press documents (18 documents) is composed of 17 documents from Schäuble and one document from Brüderle. Thus, in this dissertation, the German government or German ministers’ discourse on moral hazard must be understood as being primarily Schäuble’s discourse.

⁷⁵ In the corpus, there is no document from the Federal Chancellor. Between 2007 and 2022, the head of the German government did not use the term ‘moral hazard’ in press documents. However, it should be noted that there is empirical evidence of Angela Merkel making indirect references to moral hazard when proxies of the term (such as ‘wrong incentives’) are taken into account (Pierret and Howarth, 2024).

‘First, it [a European Stabilisation Fund] would drain capital from banks. But, more importantly, it would not solve the moral hazard problem. As the fund would act as lender of next-to-last resort for failing banks (the government would still have to step in if the fund’s resources were exhausted in a crisis), the problem would merely be shifted from the level of government to the level of the fund’ (Weber, 2010a).

‘The banks, in fact, would still have an incentive to take on too much risk, while relying on the fund to cover potential losses. In the case of a European fund, the moral hazard problem might even be amplified, since costs that would normally occur at the national level could be shifted, at least partially, to the supranational level. A systemic crisis might even provoke a rat race among national governments for the fund’s limited resources’ (ibid.).

In 2010, when addressing the group that represents the interests of the financial sector in Ireland, the President of the Bundesbank argued against the proposal of a European Stabilisation Fund to reduce the likelihood of bank failures. The proposal of the German Council of Economic Experts (among others) was to create an obligation for banks to contribute to a fund based on their risk structure and their systemic relevance (ibid). According to Weber, this proposal is equivalent to a corrective tax (or Pigouvian tax) on risk-taking and aims to internalize the negative effects of risky activities on financial stability (ibid). To argue against the creation of such a fund, the President of the Bundesbank did not only argue that this proposal is against banks’ individual interests (i.e. ‘it would drain capital from banks’), but he also refuted the statement that a European Stabilisation Fund is an effective means to achieve the goal of solving the moral hazard problem in the banking sector. According to Weber, the fund would not solve the problem and might even amplify it (ibid).⁷⁶

Claudia Buch (Member of the German Council of Economic Expert, 2012-2014; Deputy President of the Bundesbank, 2014-) also used the term once to refute a statement on moral hazard during a speech for the fifth European Systemic Risk Board (ESRB) annual conference (online, 8 December 2021):

‘Ex ante insurance mechanisms for the private sector were hardly available. Supporting the real economy and, indirectly, the financial system did not raise moral hazard

⁷⁶ It is worth stressing that by 2014, the German government and the Bundesbank argued in favour of a European Resolution Fund in their communications – which eventually became the Single Resolution Fund (SRF).

concerns, at least not on impact. When the pandemic hit in early 2020, the liquidity and solvency of many firms in the corporate sector was put at risk' (Buch, 2021).

Here, the Deputy President of the Bundesbank argues that the COVID-19 crisis is different: 'It was a truly global shock that hit rather unexpectedly' (ibid: 3). In such a context, the public support of the private sector does not create moral hazard.⁷⁷ She therefore refuted the statement that public support or financial assistance necessarily creates moral hazard.

In sum, the contestation of moral hazard by German policymakers in the corpus is very low (approximately 2% of moral hazard utterances). The rare cases of contestation are from German central bankers: in 2010, addressing a financial interest group in Ireland, the President of the Bundesbank refuted that a European Stabilisation Fund (i.e. a European resolution fund) would solve the moral hazard problem in the banking sector; in 2021, in the context of the COVID-19 crisis, the Deputy President of the Bundesbank refuted that public support to the private sector necessarily creates moral hazard. It is worth stressing that the objective of avoiding moral hazard is never directly questioned in the corpus of Germany's press documents.⁷⁸ The results of the empirical analysis of contestation indicate that German policymakers mostly use the term 'moral hazard' in their communications to exploit it. The next sections of this chapter investigate the elements that can be a source of variability as to how and for what purposes moral hazard is exploited: conceptions and arguments.

6.2 On Conceptions

This section aims to elucidate what moral hazard means to a sample of German policymakers. The various features of the 'moral hazard family' in the case of the Bundesbank and the German government are identified from the analysis of moral hazard's semantic fields and the results

⁷⁷ The nuance added with 'at least not on impact' is unclear and difficult to interpret. It might suggest that the Bundesbank is careful not to completely negate the relevance of moral hazard in the context of the COVID-19 crisis and the policy response to such crisis.

⁷⁸ Although, there are a few elements in the corpus which suggest that the objective of avoiding moral hazard should not always take precedence. See, for example:

'It had already become apparent the weekend before that it could be close for Lehman. But I believed until the end that the Americans would save the bank. It was simply inconceivable to us that they would take the risk of letting a bank of this size fall.

A few months earlier, the Americans had rescued Bear Stearns. Afterwards, the situation calmed down a bit, but at the same time the American public discussed the danger of "moral hazard" (author's translation, Lautenschläger, 2013: 1).

of the codes ‘What it is’, ‘What causes it’, and ‘What it does’. The key features of moral hazard derived from the textual analysis of the corpus are complemented by and compared with the results of the interviews.

In this dissertation, the semantic field of moral hazard refers to its synonyms, antonyms, and word cloud. These moral hazard-word relations for the corpus of German press documents are presented in Table 8 and Table 9, and Figure 4 and Figure 5 (in the appendices to this chapter). In their communications, both German central bankers and ministers describe the term ‘moral hazard’ as having the same sense as ‘problematic incentives’ or ‘disincentives’ and having an opposite meaning to ‘appropriate incentives’ (Table 8 and Table 9). This description of moral hazard as an incentive problem corresponds to that of neoclassical economics. It presupposes that individuals are rational agents who seek to maximize their utility and respond to a series of external incentives. Moral hazard is a situation where agents have an incentive to act against the principal’s interest. If the analysis is restricted to common synonyms and antonyms between the corpus of the Bundesbank and the German government, one might conclude that these German policymakers share a common and single understanding of what moral hazard is, namely the conception developed by neoclassical economists (Chapter 2).

However, the analysis of the other synonyms and antonyms offers additional information and allows us to specify and nuance the previous conclusion. In the corpus of the Bundesbank’s press documents, most of the other synonyms and antonyms relate to risky actions (‘excessive risk-taking’, ‘appetite for risk’, ‘gambling’ for synonyms, and ‘prudence’ for antonyms). Hence, these results suggest that for central bankers from the Bundesbank, moral hazard is not about all situations where agents have an incentive to act against the principal’s interest but a situation where agents have an incentive to take more risks. For example, Jens Weidmann (President of the Bundesbank, 2011-2021) described the ‘Greenspan put’ as moral hazard:⁷⁹

‘Monetary policy has to avoid the markets’ perception that the central bank is only willing to counter downward pressure on financial markets with an accommodative policy stance but refrains from tightening the reins in times of higher price stability risks due to the fear of triggering market turbulences. The so-called "Greenspan put"

⁷⁹ The ‘Greenspan put’ refers to the Federal Reserve (Fed)’s monetary policy response to the stock market crash on 19 October 1987.

illustrates the moral hazard that can come of such an asymmetrical approach’ (Weidmann, 2017: 4).

In the corpus of German government’s press documents, the other synonyms and antonyms indicate a close relationship between moral hazard and morality. Indeed, moral hazard has been described by German ministers as being similar to ‘temptation’ and the opposite of ‘proper behaviour’ (Brüderle, 2010; Schäuble, 2010, 2021). Here, moral hazard does not exclusively concern risk-taking (which can be interpreted positively in certain contexts) but any wrong conduct. Moral hazard is a situation where the moral quality of a person is tested. Not all people succumb to temptation, only those who lack self-discipline. The interpretation of moral hazard as temptation reminds us of the morality-based conception of moral hazard of fire insurers in the nineteenth century (Chapter 2).

The analysis of moral hazard’s semantic fields in the corpus of Germany ends with the examination of words used most commonly in the context of the term ‘moral hazard’. These words are less explicit in terms of meaning than synonyms and antonyms, but they are nevertheless of interest to our inquiry. Indeed, to know the words most frequently used next to moral hazard provides information about the adjectives of moral hazard and about the subjects, verbs, and objects of moral hazard-sentences. This information contributes to a more precise picture of how moral hazard is presented in the corpus.

In the case of the Bundesbank, the five most common words next to the term ‘moral hazard’ in press documents written in English are: ‘risk’, ‘systemic’, ‘problem’, ‘reduce’, and ‘systemically’ (see Figure 4). In documents written in German, the most common words are: ‘taxpayers’, ‘burden’, ‘leads’, ‘goes’, ‘succeed’, ‘problem’, and ‘cause’ (author’s translation, see Figure 4).⁸⁰ Again, risk appears as a core concept associated with moral hazard in the Bundesbank’s corpus. However, instead of referring to risky actions, here the word ‘risk’ is most probably used to describe the phenomenon of moral hazard (i.e. ‘the risk of moral hazard’). If Knight’s distinction between uncertainty and risk is taken, describing moral hazard as a risk implies that the phenomenon is measurable. Presenting moral hazard as a risk (rather than as a danger – as fire insurers did in the nineteenth century) suggests greater control over the phenomenon. In English language documents, moral hazard is also strongly associated with the question of systematicity. This result (and the list of synonyms presented in Table 8)

⁸⁰ In the English language corpus, the top five words correspond to words with a frequency of 10 or more. In the German corpus, there is one word with a frequency of 4, six words with a frequency of 3, and the rest have a frequency of 2. The list provided in the text corresponds to the seven words with a frequency of 3 or more.

indicates that German central bankers understand moral hazard and the so-called ‘too big to fail’ (TBTF) problem as closely related.⁸¹ This interpretation is reinforced by the frequency of the word ‘problem’ next to moral hazard. However, the word ‘problem’ is also often used by German central bankers to form expressions such as ‘the moral hazard problem’ or ‘the problem of moral hazard’ which do not necessarily relate to the TBTF problem. Indeed, such formulations rather aim to exaggerate the phenomenon of moral hazard. Finally, in English language documents, the verb ‘reduce’ is often used next to moral hazard. This suggests that Bundesbank officials want to reduce moral hazard. The objective of reducing moral hazard implies that German central bankers seek to bring down moral hazard to a lower degree but not to eliminate it (this might be either because moral hazard is considered something necessary that cannot be eliminated or because eliminating moral hazard is not perceived as the best policy option). It is worth stressing that the word cloud for documents written in German is different from the one of English language documents. When addressing a German-speaking audience, Bundesbank officials often use the words ‘taxpayers’, ‘burden’, and ‘cause’ next to the term ‘moral hazard’ (in addition to the word ‘problem’). These results indicate that central bankers from the Bundesbank are more likely to emphasize a negative relationship between moral hazard and taxpayers’ interest when addressing a domestic audience than an international one.

In the case of the German government, only one word has a frequency greater than two in the English language corpus: ‘problem’ (see Figure 4). In documents written in German, there are seven words with a frequency greater than two (six when translated to English): ‘economists’, ‘problem’, ‘disincentives’, ‘man’, ‘avoidance’, and ‘who’ (author’s translation, Figure 4). These results signal that for German ministers (or mostly Schäuble), moral hazard is an economic concept – a phenomenon studied by economists. In addition, it should be noted that, contrary to German central bankers, German ministers more often use the verb ‘avoid’ than ‘reduce’ next to moral hazard. The objective of avoiding moral hazard is more ambitious than the one to reduce it: this points to a lower tolerance level of moral hazard from the part of the German government than the Bundesbank (or the belief that moral hazard is not inevitable and can be eliminated).

To conclude, the examination of semantic fields allows us to draw some preliminary conclusions in terms of how moral hazard is presented in Germany’s corpus. In documents from both the Bundesbank and the German government, moral hazard is associated with the

⁸¹ The TBTF problem relates to institutions the failure of which (or bankruptcy) poses a systemic risk.

concept of rationality. Indeed, the understanding of moral hazard as an incentive problem is present in the corpus of German central bankers and ministers. In addition, in both cases, moral hazard is often described as a problem, which tend to exaggerate the phenomenon. In documents from the Bundesbank, moral hazard is about incentives for risk-taking (such as, being a TBTF financial institution). The objective of German central bankers in relation to the risk of moral hazard seems to be ‘to reduce it’ in order to protect (German) taxpayers. The German government appears more ambitious in its communications and rather it pursues the goal of avoiding moral hazard. Finally, it should be stressed that, although the conception of moral hazard as an incentive problem is present in the corpus of the German government, and its relation to the discipline of economics is clearly emphasized, morality is another core concept associated with moral hazard. For German ministers (Schäuble, to be more precise), moral hazard is not only a matter of external economic incentives but also of moral quality and character.

In addition to semantic fields, this dissertation examines how German policymakers explain moral hazard in their communications. The results for the code ‘What it is’ are presented in Table 10 (in the appendices to this chapter). It should be noted that out of these results, there are 16 coded segments where moral hazard is directly defined by German policymakers: six from the Bundesbank (out of 89 documents) and 10 from the German government (out of 18 documents). Clearly, German ministers are more likely to provide a direct definition of moral hazard when using the term than German central bankers. This finding indicates that German central bankers tend to take the concept for granted and assume that their audience is familiar with what moral hazard is more often than German ministers.

In total, 14 subcodes have been created to take into account the variety of moral hazard’s descriptions in the corpus of Germany’s press documents. Some subcodes are more similar than others but all have a distinctive feature – they are not exactly the same. For example, the subcode ‘when there are incentives for a reckless action’ is similar to the subcode ‘when insurance encourages to take more risks’ but the former is open to any incentive while the latter is restricted to insurance. Several key distinctive features have been used to classify moral hazard’s descriptions into these 14 subcodes. Notably, whether the undesirable action is an expected outcome (as in ‘when there are incentives for a reckless action’) or an actual outcome (as in ‘a situation where a reckless action is rewarded’), or whether the cause of the undesirable action is something certain and known by the individual (as, for example, in ‘being reckless because you know that others will rescue you’) or something expected or perceived (as in ‘when the expectation of support causes a reckless action’).

Out of the 14 subcodes, four are common to the Bundesbank and the German government: ‘when there are incentives for a reckless action’, ‘when benefits are privatized and costs are socialized’, ‘when insurance encourages to take more risks’, and ‘being reckless because you know that others will rescue you’. Some of these descriptions of moral hazard emphasize the effect of external incentives on behaviour (and so, reduce individual blame), others stress the unfair distribution of benefits and costs between the individual and society, or the voluntary burden created for others.

In the case of the Bundesbank, most subcodes relate to the core concepts of rationality and/or risk-taking. During the years 2008-9, German central bankers drew special attention to the case where ‘there is no incentive for the originator of a loan to monitor the debtor’, explaining what moral hazard is in the context of securitisation. See, for example:

‘The downside of this separation is, however, that once the credit risk is forwarded there is no incentive for the originator to monitor the debtor. This is what we call moral hazard and what has ultimately resulted in an erosion of credit standards not only in US subprime but also in other credit market segments. In general, the ultimate risk-taker does not have the necessary information to monitor the debtor and the transfer process unnecessarily complicates the default risk assessment of the securitised assets’ (Weber, 2009: 3).

This description of moral hazard is centred on the behaviour of lenders (rather than borrowers) and stresses the responsibility of risk-takers to assess credit risks (although securitisation makes this task complicated). This description is absent from the corpus of the German government.

In the case of the German government, the most frequent description of moral hazard is ‘when risk and liability are separated’. This description makes direct reference to Eucken’s principle of unrestricted liability (Chapter 3) and illustrates the influence of ordo-liberalism on Schäuble. Although many subcodes in the case of the German government also relate to incentives and risk-taking, the question of morality is somewhat more present than in the case of the Bundesbank. Indeed, several descriptions of moral hazard stress the issue of ‘voluntarily taking advantage at the expense of others’. See, for example, the case of ‘moral political hazard’ described by Schäuble:

‘They [debt relief and permanent transfers] would weaken the incentives to carry out reforms. And they would create a problem of moral hazard in political terms, namely the experience and expectation that others will bear the costs of a country’s own actions,

or failure to act. We in Europe must pay close attention to this problem of moral political hazard. We have to make sure that European solidarity does not weaken a country's motivation to take responsibility for what needs to be done' (Schäuble, 2015: 7).

The analysis of the code 'What it is' confirms the preliminary conclusion from the examination of semantic fields that in the corpus of the German government the feature of morality is more prominent than in the corpus of the Bundesbank.

Finally, the textual analysis of how moral hazard is presented in the corpus of Germany's press documents ends with the examination of its cause-and-effect relationship. The results for the codes 'What causes it' and 'What it does' are presented in Table 11 and Table 12, respectively (in the appendices to this chapter). What causes moral hazard is rarely discussed in the corpus of the German government. In contrast, German central bankers discussed a large range of things that can produce moral hazard. By far, the most frequent cause of moral hazard in the corpus of the Bundesbank is the systemic nature of some financial institutions and the obligation to rescue them that it entails. Indeed,

'As the institution in question would most likely be aware of the fact that it cannot be allowed to fail, it would have every incentive to engage in risk-prone behaviour and gamble on being bailed out as soon as it gets into trouble' (Weber, 2010b: 4).

The moral hazard created by SIFIs was particularly stressed by the Bundesbank in 2010 (15 out of the 28 coded segments for 'TBTF/SIFIs' are from 2010 press documents).⁸² Although the most prominent cause of moral hazard in the Bundesbank's corpus, systemic relevance is not the only source of moral hazard. Initially (in 2008 and 2009), the Bundesbank emphasized 'securitisation' as the main cause of moral hazard. Thus, the political discourse of German central bankers on what causes moral hazard shifted over time from securitisation – a process of risk transfer that involves a large variety of financial actors – to systemic relevance – something that concerns only a few financial institutions. Another relatively frequent cause of moral hazard discussed by German central bankers is monetary policy, that is central bankers' own actions. Notably, the Bundesbank drew attention to the moral hazard that can result from UMP measures (especially in 2017), an accommodative monetary policy stance, or an

⁸² It should be noted that there are no coded segments for 'TBTF/SIFIs' in the Bundesbank's corpus before 2010. This result indicates that the moral hazard problem posed by the systemic nature of some financial institutions is not a constant element of German central bankers' discourse. The Bundesbank started to publicly and explicitly discuss the causal relationship between systemic relevance and moral hazard in its press documents only in 2010.

asymmetrical monetary policy. In doing so, the Bundesbank presented central banks as a great potential source of moral hazard. Finally, it is worth stressing that the causal relationship between restricted liability and moral hazard is present in the corpus of the Bundesbank's press documents. For German central bankers, 'when the principle of liability does not apply' is not a definition of moral hazard (as in the case of the German government); moral hazard is a consequence of the absence of unrestricted liability. See, for example:

'A principle that Walter Eucken summarised in one sentence: "who has the benefit must also bear the loss". This principle of liability is the basis of a functioning market economy. If it does not apply, the behaviour of the actors changes and moral hazard arises' (author's translation, Dombret, 2014: 3).

The influence of ordo-liberalism on how central bankers from the Bundesbank understand moral hazard is made evident here.

Studying the effects of moral hazard present in the corpus of Germany's press documents is crucial to our investigation because it reveals (among other things) information as to why – according to German policymakers – we should reduce or avoid moral hazard. There is no positive effect of moral hazard. The most frequent effect in the corpus of Germany's press documents is 'crises'. Both German central bankers and ministers agree that moral hazard produces crises. Notably, German policymakers used moral hazard to explain the IFC of 2007-9. On several occasions, they presented moral hazard as the main cause of the financial and banking crises that started in 2007. See, for example:

'We knew many pieces of the mosaic, but failed to recognise the explosive nature and dynamics of the resulting whole. On the microeconomic level, it is above all wrongly set incentives that have contributed to the emergence of the financial crisis, be it due to a lack of transparency, insufficient regulatory framework conditions or the phenomenon of moral hazard so familiar to us economists. Prominent among these are the developments in the securitisation market, through which the distortions in the US housing market spread to the global financial markets' (author's translation, Weber, 2009a: 3).

'Many underestimate the "moral hazard problem": anyone who separates decision from liability, opportunity from risk, will fail. This was the main cause of the banking crisis' (author's translation, Schäuble, 2014: 4).

For the Bundesbank, reducing moral hazard matters if one adopts a long-term perspective and wants to reduce the likelihood of future crises (this is particularly stressed in 2010). Another common and frequent effect of moral hazard present in Germany's press documents is the cost for taxpayers. According to German policymakers, reducing or avoiding moral hazard equals protecting taxpayers. Finally, another relatively frequent effect of moral hazard found in the corpus is the negative impact on what is presented as needed adjustments and reforms. Moral hazard discourages politicians to do 'what needs to be done'. Thus, German policymakers understand moral hazard as closely linked to the concept of responsibility: moral hazard can result in irresponsible governments, failing to act in accordance with their long-term obligation. See, for example:

'Governments, too, are exposed to the problem of moral hazard, which can cause them to become greedy and dampen their efforts to reform. The dramatic waning of enthusiasm for reform on the part of the Berlusconi government following SMP purchases of Italian government bonds shows how quickly a country's will to reform can evaporate when budget constraints are eased' (Weidmann, 2015: 7).

Based on the analysis of semantic fields, explanations of moral hazard, and descriptions of its cause-and-effect relationship, various features of the 'moral hazard family' have been identified. In the case of the Bundesbank, moral hazard is mainly about incentives to increase risk-taking. Moral hazard is primarily understood as a rational response to restricted liability. Moral hazard is problematic because it discourages cooperative actions, producing crises and collective costs. Reducing moral hazard is a means to achieve long-term stability. In the case of the German government, moral hazard is problematic for similar reasons and therefore should be avoided. Although the relationship between moral hazard and the discipline of economics is strongly emphasized by German ministers (and moral hazard as an incentive problem is present in the corpus), moral hazard is often about voluntarily taking advantage at the expense of others. Moral hazard is understood as the temptation of restricted liability. Thus, morality is a more prominent feature in the German government's conception of moral hazard than the Bundesbank.

In addition to the textual analysis of the corpus of press documents, five interviews have been conducted with German policymakers: one with a Bundesbank official and four with members of the advisory board to the German Federal Ministry of Finance (GFMF). The objective of the interviews was to elucidate what moral hazard means to the interviewees. According to the interviewee from the Bundesbank, excessive risk-taking is a key feature of

moral hazard (Interview 1). This excess is rational: risk-taking increases because actors know that they are protected in the event of failure (ibid.). When directly asked ‘to you, what is moral hazard?’ at the end of the interview, this interviewee answered as follows: ‘moral hazard is when risk-taking and liability are not fully aligned. So, when you can take the benefits of your risk-taking but do not have to account for possible adverse consequences’ (ibid.). This answer confirms the centrality of the principle of liability in how central bankers from the Bundesbank understand moral hazard.⁸³ Despite the emphasis on moral hazard as a rational behaviour – ‘a reaction to incentives, a reaction to the rules and the system’, ‘when it makes sense to be irresponsible’ – it should be noted that the interviewee from the Bundesbank stressed ‘reciprocity’ or ‘mutuality’ as something able to counter moral hazard. Indeed, this interviewee said: ‘I cannot come up with an example where I would see this [moral hazard] with my family or with close friends...’ (ibid.). In other words, when you have social or moral sentiments, there is no moral hazard.

The four members of the advisory board to the GFMF stressed different features of moral hazard during their interview. One of these interviewees clearly understands moral hazard as a moral problem (Interview 2). For this interviewee, ‘moral hazard always relates to personal wrong doings’; ‘moral hazard is about actions you take that would create harm to others’, ‘knowing it harms others and doing it anyway’ (ibid.). Here, ‘voluntarily creating harm to others’ was presented as the key defining property of moral hazard. This understanding of moral hazard contrasts with the conception of another member of the advisory board to the GFMF, who described moral hazard as a situation where maximizing your own utility creates negative consequences for others (Interview 3). For this interviewee, the negative consequences for others are an externality that is not necessarily known by the agent (ibid.). For example, when discussing moral hazard in relation to sovereign indebtedness (question 3), this interviewee said: ‘It does not mean that they are mean politicians who will think “how can we bend the rules and get some money?”. No! They feel completely to be on the right side’ (ibid.). Their behaviour is a rational response to market prices (ibid.). Another interviewee was somewhat in the middle of this morality-rationality spectrum of moral hazard conceptions and said that ‘not every moral hazard behaviour has to be condemned in the moral sense’ (Interview 4). This member of the advisory board to the GFMF drawn attention to hidden action as the main defining property of moral hazard. Indeed, according to this interviewee: ‘moral hazard is the change of behaviour because one believes that the principal cannot perfectly observe my

⁸³ Although the term ‘liability’ appeared only in the response to the last question of the interview.

behaviour' (ibid.). Finally, this dissertation considers the conception of moral hazard of the last German interviewee to be the broadest. For this interviewee, 'moral hazard is a behaviour that you must fear occurs in a relationship' (Interview 5). This interviewee described moral hazard as a form of opportunism, as ex-post cheating on what was agreed (ibid.). For example, shirking on marital obligations constitutes a case of moral hazard (ibid.). This understanding of moral hazard stresses the importance of agreed rules (explicit or implicit contracts); what was agreed is the reference to determine whether moral hazard is present or absent in a given situation.

These five interviews illustrate the variety of moral hazard conceptions among the German policy elite. Clearly, their criteria to assess whether a given situation is moral hazard or not differ. The responses to question 7 ('A person vaccinated against the COVID-19 who becomes less careful to not spread the virus. Is this an example of moral hazard?') constitute additional and direct empirical evidence of it: two interviewees answered 'yes' (Interviews 1 and 3), one answered 'it depends' (Interview 2), and two answered 'no' (Interviews 4 and 5). These results highlight the ambiguity of moral hazard, even among a small group of prestigious German economists who advises the Federal Ministry of Finance.

To conclude on the conceptions of moral hazard in the German case study, the textual analysis of press documents revealed similarities and differences in terms of key moral hazard features. In both the cases of the Bundesbank and the German government, liability and responsibility are core concepts associated with moral hazard, moral hazard is understood as an incentive problem, the causal relationship between moral hazard and the IFC is emphasized, and moral hazard threatens the interest of (German) taxpayers. The centrality of the principle of unrestricted liability in the conceptions of moral hazard of German policymakers – and the direct references to Eucken – provide evidence that *ordo-liberalism* continues to be influential among the German policy elite in the post-2007 period. However, the empirical analysis also found differences. Notably, the feature of morality (i.e. 'taking advantage at the expense of others') is most prominent in the case of the German government than the Bundesbank. The question of whether moral hazard should be understood in moral terms divides German policymakers, as evidenced by the interviews. German policymakers do not share a common and dominant conception of moral hazard – even within the Advisory Board to the GFMF, members would disagree on what moral hazard is. Despite the clear influence of *ordo-liberalism* on how German policymakers understand moral hazard, the variability in terms of conceptions (i.e. morality versus rationality-based conceptions) within the German case is evidence against the hypothesis of power *in* moral hazard.

The section on conceptions provided empirical evidence of the ambiguity of moral hazard in German policy-making. However, it does not sufficiently inform about how and for what purposes moral hazard is exploited in policy debates. The next section is dedicated to the examination of moral hazard-based arguments (i.e. premises and conclusions) in Germany's press documents.

6.3 On Arguments

This chapter has established that German policymakers mostly use the term 'moral hazard' in their communications not to contest it but to exploit it. This section aims to investigate how moral hazard helps German central bankers and ministers to justify or legitimize their policy goals. This section begins with the analysis of the German government's political discourse on moral hazard and ends with that of the Bundesbank. First, the discourse is contextualised in terms of distribution over time and between topics. Second, moral hazard-based arguments are examined in terms of conclusions and premises. Finally, third, a selection of moral hazard-based arguments is analysed in more detail.

Over the 2007-2022 period, not only did German ministers never use the term 'moral hazard' in their communications to refute or challenge a statement on moral hazard, they also never used the term in a press document where the topic of the EU was absent.⁸⁴ This finding indicates that moral hazard is a political resource exploited by the German government mostly in the context of EU politics than in national politics. Most frequently, the concept was exploited in relation to structural reforms, financial assistance, resolution, fiscal rules, too big to fail, and the Maastricht Treaty (see Table 13 in the appendices to this chapter). The first press document of the German government with an utterance of the term 'moral hazard' during the period under consideration is a speech from Schäuble at the London School of Economics on 18 February 2009, but moral hazard was particularly wielded in 2010 and 2014-15 (see Figure 3).

To what ends, and how, was moral hazard exploited by German ministers in their communications? The results from the 'Conclusion' code bring valuable information about policy goals (see Table 14 in the appendices to this chapter). Moral hazard has been used by the German government to argue in favour or against 23 policy options:

⁸⁴ Search items to identify the topic of the EU in documents: EU; euro.

- For ‘bail-in’;
- For (more efficient) supervision/surveillance;
- For (stricter) rules;
- For insolvency procedures/resolution regimes;
- For revised manager remuneration systems;
- For austerity;
- For (stricter) sanctions in the SGP;
- For stricter capital requirements;
- For a European Resolution Fund;
- For Banking Union;
- For risk reduction before risk sharing;
- For temporary financial assistance;
- For conditional financial assistance;
- For structural reforms;
- For the SGP;
- For stricter budgetary discipline;
- For a European institution with powers to enforce compliance with agreed rules;
- For ‘help for self-help’;
- Against collective liability;
- Against transfers;
- Against permanent transfers;
- Against debt relief;
- Against new debt programmes.

These conclusions of moral hazard-based arguments indicate that moral hazard continues to be used by the German government in the post-2007 period to defend key elements of the Maastricht model, such as fiscal rules and the SGP. It has also been exploited to increase constraints on both private and public entities and to limit risk sharing. Although German ministers explicitly used moral hazard to explain the IFC (and not the euro area SDC), these policy prescriptions derived from moral hazard-based arguments are not restricted to banks and the stability of the financial system. It is worth stressing that the discourse of the German government on moral hazard over the period is equally distributed between financial institutions and governments (see Figure 6 in the appendices to this chapter). In fact, the answer to ‘whose moral hazard?’ is often indeterminate (*ibid.*). This means that German ministers tend

to discuss moral hazard in general terms – a discursive strategy that allows the generalisation of conclusions to any actor. The analysis of the premises of moral hazard-based arguments provides further information about how the concept is exploited. Although the relationship between moral hazard and economics is emphasized by German ministers, normative premises are more frequent than cognitive ones in the moral hazard-based arguments formulated by the German government (see Figure 7 in the appendices to this chapter). This finding confirms once again the prominent role of morality and values in the German government’s discourse on moral hazard.

The detailed analysis of a selection of moral hazard-based arguments allows us to identify the premises which helped German ministers to legitimize or justify their conclusions. Arguments in favour of ‘bail-in’ are the most frequent moral hazard-based arguments formulated by the German government. See, for example:

‘Last but not least the ESM will provide for private sector involvement [*Conclusion*]. This is of very high priority to the German government. And for good reason: We have to deal with the problem of moral hazard [*Goal premise*]. Risks and rewards should not be separated from each other. Investors – and that includes European bond holders – ultimately have to bear the rewards as well as the risks of their decisions. But during the previous crises it was almost exclusively European taxpayers that ultimately bore the risks of investors’ decisions [*Circumstantial and normative premises*]. That is inadmissible. Sure, it was right to stop financial markets from disintegrating in the past, but it would be wrong to cushion their losses in the future [*Normative premise*]. In the long run a division between risks undermines the foundations of capitalism – which needs risks and rewards to be inseparably – to function properly [*Goal and cognitive premises*]. Perhaps even worse it erodes the legitimacy of our democratic societies as citizens trust in the basic fairness if the system crumbles, when they see their governments and parliaments, their representatives, bailing out investors time and time again [*Goal and normative premises*]. Sustaining such a policy would be driving a permanent rift between the electorate and the elected and alienate voters from the democratic process, as they see their representatives as beholden to special – not voters’ – interests’ [*Normative premise*] (Schäuble, 2011: 6).

This argument for private sector involvement in debt restructuring programs formulated by Schäuble in May 2011 at the ‘Economic Forums’ in Brussels is rich in terms of premises. Here, ‘to deal with the problem of moral hazard’ is presented as a necessary goal and ‘private sector

involvement' as an instrument to achieve this goal. The necessity to deal with moral hazard comes from an unfair distribution of benefits and costs between investors and taxpayers. This unfair distribution is seen as undermining both capitalism and democracy. Hence, if one wants to preserve capitalism and democracy, the government must deal with moral hazard by 'bailing in' private creditors. The primacy of normative premises over cognitive ones in the moral hazard-based arguments formulated by the German government is illustrated in this argument.

The second text segment selected for a detailed examination of premises is of particular interest because it presents several arguments. Here, moral hazard is used to argue in favour of stricter capital requirements, revised managers' remuneration systems, more efficient supervision, and against collective liability at the EU level:

'And so money always shows the Janus face of our human nature. In excess we destroy everything. That is why cleverness is something other than intelligence. That is the motto of this Church Congress. "Teach us to remember that we must die, that we may become wise" [*Normative premises*]. Man cannot endure without limits, not in the long run [*Goal premise*]. And that is why we need standards, values, institutions or orders that provide orientation [*Normative premise*]. Economists are familiar with the problem of moral hazard, the seduction caused by false incentive systems when risk and liability diverge. This is considered the main cause of the financial and banking crisis [*Cognitive premise*]. In the short term, exorbitant profits without regard to long-term risks - and when these are then realised because a bubble of ever more speculative increases in value bursts at some point, the general public has to step in to ensure survival [*Circumstantial and normative premises*]. Too big to fail. To reduce the risk of a repetition [*Goal premise*], we financial policymakers are looking at issues such as stricter capital requirements for banks, remuneration systems for managers to limit disincentives, more efficient disincentives, more efficient supervision, etc., etc. [*Conclusions*]

The impact of incentive systems is not limited to the financial sector. Zoologists show us that animals in the wild develop differently from animals in a cage. Educators and psychologists teach us this. Development workers know about the problems of food aid [*Cognitive premises*]. In the short term, it is essential to ensure the survival of people in need, but in the long term it becomes dangerous, because societies lose the ability to feed themselves [*Goal and normative premises*]. Therefore always "help for self-help" [*Conclusion*]. In development aid, this is widely undisputed, in euro rescue policy

obviously not so clear. But the basic structures are the same [*Cognitive premise*]. As long as in Europe the member states remain essentially responsible for financial and economic policy, for taxes and the budget - and the willingness to change this is rather limited everywhere, including here in Germany - liability for the respective debts cannot simply be communitised, others cannot pay indefinitely for the consequences of decisions in each individual country' [*Conclusion and normative premises*] (author's translation, Schäuble, 2015b: 3-4).

This segment comes from a speech made by Schäuble at the 2015 Evangelical Church Congress in Stuttgart. The premises to argue in favour of greater constraints on banks lie on the assumption that limits are necessary given the human nature. Without appropriate limits, human activities result in excess and cannot be sustained over time. This is illustrated by the role of moral hazard in the IFC. If one wants to avoid a repetition of the IFC, it needs to solve the problem of moral hazard and impose limits on banks. The causal relationship between moral hazard and the IFC is used to justify more public intervention in the financial sector (although this conclusion is derived from a cognitive premise, moral hazard is understood here in normative terms).

The moral hazard-based argument made to justify greater constraints on banks is then generalised to argue against collective liability among EU Member States. The implicit goal premise in this argument is to achieve independent societies (understood as societies not dependent on external help). In the long term, it is argued that external help does not contribute to responsibility (i.e. "in the short term, it is essential to ensure the survival of people in need, but in the long term it becomes dangerous, because societies lose the ability to feed themselves"). Hence, external help must be limited. According to Schäuble, this is a consensual argument in the context of development aid but not in the context of the euro area. This is presented as a contradiction, given the similarity between the two contexts. The argument ends with the conclusion that national debts cannot be socialised, based on a normative premise: it is unfair to bear the burden of a decision that is not yours. To avoid the creation of an unfair system, collective liability must go hand in hand with collective decision-making (which is presented as something unwelcomed).⁸⁵

⁸⁵ It should be noted that the influence of the European Commission on national fiscal policies is not considered sufficient in Schäuble's view. The proposal to assign the supervision of national budgets to an independent fiscal council reflects the German Finance Minister's distrust of the European Commission's capacity to enforce compliance with collectively agreed fiscal (see, for example, Padoan, 2015; Schäuble, 2021).

To summarize, the German government exploited moral hazard to legitimize or justify 23 policy goals – the participation of private creditors in debt restructuring being the most frequent policy goal. The conclusions of moral hazard-based arguments illustrate the usefulness of the concept: from bank bonuses to fiscal policy, the concept can be exploited in relation to a large variety of topics. The flexibility of policy prescriptions aimed at avoiding moral hazard is another characteristic contributing to the usefulness of the concept: moral hazard can serve to argue for temporary and/or conditional financial assistance, or against all sort of transfers, or only permanent ones. This flexibility allows politicians to adapt their discourse according to circumstances. Moral hazard continued to be used by the German government to defend the Maastricht model and policy prescriptions in line with ordoliberalism and the sound money paradigm.⁸⁶ The discourse on moral hazard of the German government relates equally to banks and governments. There is evidence to conclude that the argumentation in relation to banks has been generalised to governments. Notably, the narrative of the IFC as a result of bankers' moral hazard served to draw attention on the causal relationship between a policy response to the SDC that favours risk sharing and moral hazard. More than a punishment for past moral hazard, the German government presented austerity as a preventive measure to avoid future government moral hazard (Schäuble, 2014b, 2016). In terms of premises, the German government formulated mixed arguments, with a primacy of normative premises. In particular, fairness (i.e. the unfairness of bearing the burden of a decision that is not yours) plays a prominent role in the moral hazard-based arguments formulated by German ministers.

The discourse of the Bundesbank on moral hazard started earlier than that of the German government. The first press document with an utterance of the term 'moral hazard' is a keynote speech from Weber at the European Money and Finance Forum in Munich, on 12 June 2008 (Weber, 2008). Although moral hazard was used every year in press documents between 2008 and 2022, the concept was particularly wielded by German central bankers in 2009-11 and 2017-19 (see Figure 3). The most frequent topics in the corpus of the Bundesbank are financial assistance, regulation, resolution, too big to fail, and supervision. Structural reforms, the Maastricht Treaty, quantitative easing, monetary policy, and fiscal rules are also relatively frequent topics (see Table 13 in the appendices to this chapter). The distribution of most frequent topics over time is similar between the periods 2009-11 and 2017-19, except for

⁸⁶ Although, it should be noted that there is a tension between the principle of unrestricted liability and the primacy given to the interest of creditors in conservative liberalism. In his press documents, Schäuble attached more importance to the former than the latter.

one: the co-occurrence of moral hazard and fiscal rules became particularly salient in the communications of the Bundesbank in 2017 (out of the 15 press documents where the topic of fiscal rules is present in the context of moral hazard, 6 are from 2017).⁸⁷

To what ends, and how, was moral hazard exploited by German central bankers in their communications? Moral hazard has been used by the Bundesbank to argue in favour or against 47 policy options, and to argue that the COVID-19 crisis is different (see Table 14 in the appendices to this chapter). The most frequent conclusions of moral hazard-based arguments are the following:

- For insolvency procedures/resolution regimes;
- For stricter capital requirements;
- For ‘bail-in’;
- For (more efficient) supervision/surveillance;
- For TBTF reforms;
- For conditional financial assistance;
- For centralisation at the EU level;
- For increased transparency of over-the-counter (OTC) trading;
- For risk reduction before risk sharing;
- For purchasing bonds in proportion to the ECB capital key;
- For a European Resolution Fund;
- For distinguishing between rescuing an institution and protecting its owners;
- For the principle of liability;
- For the ‘no-bailout’ clause;
- For symmetrical monetary policy;
- Against permanent transfers;
- Against unregulated securitisation;
- COVID-19 crisis is different.

A number of the most frequent conclusions relate to the financial system. The Bundesbank often wielded moral hazard to increase constraints on financial institutions – notably TBTF institutions – and to regulate securitisation. In addition, it is worth stressing that, from 2014,

⁸⁷ It is worth noting that there are 7 press documents from the Bundesbank where the topic of the EU was absent (out of 89 documents). This finding indicates that the Bundesbank is more likely to use the term ‘moral hazard’ outside the context of EU politics than the German government. For example, in the context of national politics, the Bundesbank acknowledged the causal relationship between Germany’s financial market stabilisation act and moral hazard (Dombret, 2010).

the statement that a European Resolution Fund is an effective means to solve the moral hazard problem in the banking sector is no longer refuted. On the contrary, a resolution fund with risk-based contributions is now presented by German central bankers as a solution to moral hazard (Dombret, 2014b; Nagel, 2014).⁸⁸ In contrast to the German government, the discourse of the Bundesbank on moral hazard over the period is largely about financial institutions (see Figure 6 in the appendices to this chapter). However, the question of governments' moral hazard is not absent and became the most salient in 2017. German central bankers exploited moral hazard to defend various elements of the Maastricht model, which aim – among other things – at budgetary discipline: the ‘no-bailout’ and the ‘no monetary financing’ clauses, market discipline, central bank independence, and price stability as the main objective of monetary policy (see Table 14 in the appendices to this chapter). These policy goals are in line with the sound money paradigm. The analysis of premises reveals that these policy goals are most often pursued by the Bundesbank through a cognitive discourse. Indeed, there is a clear primacy of cognitive premises over normative ones in the moral hazard-based arguments formulated by German central bankers (see Figure 7 in the appendices to this chapter).

The detailed analysis of a selection of moral hazard-based arguments allows us to identify the premises which helped German central bankers to justify or legitimize their conclusions. As previously noted, most of the Bundesbank's political discourse on moral hazard is focused on systemically important financial institutions. See, for example:

‘The difficulties do not stop there. Once an institution is defined as systemically relevant, moral hazard problems might occur. As the institution in question would most likely be aware of the fact that it cannot be allowed to fail, it would have every incentive to engage in risk-prone behaviour and gamble on being bailed out as soon as it gets into trouble [*Cognitive premises*]. Any measures aimed at systemically important institutions must therefore take into account the moral hazard dimension [*Goal premise*].

The reform of the Basel II framework is certainly part of the solution to this problem, as it will help to improve the capacity of systemically important institutions to absorb losses without creating moral hazard [*Cognitive and goal premises*]. However, what is required is a more comprehensive approach which specifically ensures that accountability is brought back into the game [*Normative premise*]. Major proposals that

⁸⁸ In 2014, the German government also welcomed the creation of a European Resolution Fund mostly funded by systemic financial institutions (Schäuble, 2014c).

go beyond the reformed capital and liquidity framework include capital surcharges for systemically important institutions, better resolution regimes and a strengthening of the financial infrastructure. Commissioned by the G20, the FSB is already working towards that goal' [*Conclusions*] (Weber, 2010b: 4).

The causal relationship between systemic relevance and moral hazard is at the heart of the Bundesbank's discourse. Indeed, this argument in favour of increased constraints on TBTF financial institutions is constructed as follows: 'to take into account the moral hazard dimension' is presented as a necessary goal and systemic relevance is described as a cause of moral hazard. To reduce the causal relationship between systemic relevance and moral hazard, accountability needs to be ensured. The reforms of Basel II, capital surcharges for SIFIs, better resolution regimes, and a strengthening of financial infrastructure are instruments to achieve this goal.⁸⁹

Another characteristic feature of the Bundesbank's discourse on moral hazard is the emphasis on cognitive premises and economic knowledge. See, for example:

'Moreover, the financial crisis and thus the recent past hold important lessons for monetary policy. One example is an asymmetric monetary policy that strongly counteracting the bursting of speculative bubbles. As a result, this can increase the risks to financial stability [*Goal premise*]. If, in the case of a risky investment, market participants collect the full return in the event of a success, but only have to bear part of the costs incurred in the event of a loss, their risk-taking can take on a damaging dimension for the economy [*Cognitive premises*].

So when it comes to the question of the future role of monetary policy and its relationship to other policy areas, we do not have to start from scratch, but can draw on a fair amount of experience and evidence backed by economic science [*Cognitive premises*]. We can, and we should. For although the outstanding political significance of monetary union was and is indisputable - a political project must also be economically viable, and in the long run it cannot be enforced against economic realities. Economic mechanisms such as the moral hazard problem are not laws of

⁸⁹ It is worth noting that this segment presents a paradox in the Bundesbank's discourse on moral hazard and TBTF financial institutions: for systemic relevance to cause moral hazard, awareness of systemic relevance by SIFIs is an implicit necessary condition. Yet, Weber's words imply that before 2010 institutions were not defined as such and therefore might not be aware of their systemic relevance. Could systemic relevance have caused moral hazard and the IFC – as claimed by the Bundesbank – if institutions prior 2010 were not aware of their systemic relevance?

nature. They are, however, relevant constraints that cannot be permanently overridden by politics [*Cognitive and goal premises*].

To overcome the crisis and prevent a recurrence [*Goal premise*], a coherent approach is therefore essential: the short-term emergency measures and institutional changes must not run counter to the long-term stability objective [*Goal premise*]. And the interplay of monetary policy, financial stability policy and fiscal policy must be compatible with the special conditions of the monetary union' [*Conclusions*] (author's translation, Weidmann, 2012: 3).

Here, the President of the Bundesbank explicitly described moral hazard as an economic mechanism and presented a division between those who want to create a monetary union in accordance with economic science and others. Implicitly, it is argued that if economic realities such as moral hazard continue to be ignored, Europe's monetary union cannot survive. Not ignoring moral hazard means respecting the 'special conditions of the monetary union' (i.e. the Maastricht model). With this moral hazard-based argument, Weidmann presents himself as a pragmatic central banker who wants to achieve long-term stability and distance himself from politicians focused on the short-term and lacking economic expertise.

Finally, the last selected text segment for a detailed analysis of premises illustrates the centrality of the ordo-liberal principle of liability in the Bundesbank's discourse on moral hazard:

'However, the true challenge consists in striking a balance between actions and liability [*Goal premise*]. That means the decision-making power and responsibility for the effects of the decision have to be placed on the same level [*Conclusion*]. Responsible decisions are taken only if the decision-makers also bear the consequences. Why, for example, should a government refrain from risky policies if, at the end of the day, the community has to pay the bill [*Normative premises*]?

In the 2010 sequel to the classic movie "Wall Street" the fictional character Gordon Gekko, played by Michael Douglas, explains the problem more eloquently than I ever could: "Moral hazard is when somebody takes your money and is not responsible for it" [*Cognitive premise*].

Rebalancing actions and liability by no means rules out a greater sharing of risks. In order to maintain the balance [*Goal premise*], however, the relevant powers would have to be transferred along with the risks to the European level' [*Conclusion*] (Weidmann, 2018: 6).

The principle of liability is used by the President of the Bundesbank to argue in favour of centralisation at the EU level. Indeed, if one wants to achieve ‘the balance between actions and liability’ in order to limit moral hazard and promote responsible decisions, a transfer of powers from the national to the European level is required. This transfer of sovereignty is presented as a necessary condition for greater risk sharing. Contrary to the German government, the Bundesbank does not describe this evolution as something unwelcomed but as something unlikely given the preferences of many Member States (ibid.) – especially after the ‘Greek drama’ (Weidmann, 2015b). The moral hazard-based argument in favour of greater centralisation at the EU level appeared relatively late in the Bundesbank’s discourse (in 2015 and 2018) and seems to be a new strategy to implicitly argue against further risk sharing.

6.4 Conclusion

The empirical analysis of the German case found the presence of the condition of minor contestation: over the period under consideration, the German government never refuted a statement on moral hazard and the Bundesbank has done so on very few occasions. It is worth stressing that out of the two statements on moral hazard that were contested by the Bundesbank, one was only temporally contested: by 2014, the Bundesbank accepted that a European Resolution Fund was an effective means to solve the moral hazard problem in the banking sector. However, the presence of minor contestation in the corpus of the northern coalition does not constitute sufficient evidence against the hypothesis of Germany’s power over moral hazard. Indeed, based on the authoritative theory, minor contestation by members of the northern coalition (an authoritative actor) is expected. To conclude against the power of authoritative voices as the main source of moral hazard’s political influence, evidence of minor contestation by non-authoritative actors is necessary (e.g. the southern coalition).

The examination of the condition of variability in the case of Germany resulted in similarities and differences between German ministers and central bankers. In terms of conceptions, there are four main common features of how German policymakers understand moral hazard: (1) moral hazard is understood as an incentive problem (a conception that gives primacy to the feature of rationality and serves to blame the system rather than the individual); (2) the *ordo-liberal* concept of liability is central; (3) moral hazard is presented as a main cause of the IFC; and (4) moral hazard is against the interest of taxpayers. However, noteworthy differences were also identified. Notably, despite an emphasis on the relationship between

moral hazard and economics, the feature of morality is prominent in the corpus of the German government (a morality-based conception of moral hazard allocates blame to the individual). The results of the interviews also constitute empirical evidence of conceptual variability of moral hazard in German policy-making.

In terms of arguments, the analysis of the German policy elite's discourse on moral hazard found two main similarities: German policymakers exploited moral hazard to increase constraints on banks and allocate the burden of bank bailouts on private creditors ('bail-in'), and to resist significant changes from the Maastricht model in terms of interstate risk sharing mechanisms ('risk reduction before risk sharing'). In addition, there is evidence that moral hazard is a political resource exploited often in EU politics but rarely in German politics. However, differences were also detected. For example, while the German government placed strong emphasis on fiscal rules, the Bundesbank's discourse was particularly focused on TBTF financial institutions. Clearly, moral hazard was exploited by German policymakers to help them achieve a large range of policy goals – 56 in total. The Bundesbank's discourse on moral hazard mainly concerned financial institutions and went from an initial emphasis on the moral hazard of lenders in the context of securitisation to the question of the systemic relevance of some financial institutions. In contrast, the German government's discourse on moral hazard was mainly indeterminate. There is evidence that the discourse on banks was generalized to governments. Finally, there is a clear difference in the type of moral hazard-based arguments formulated by German policymakers: the discourse of German ministers was mainly normative (with an emphasis on the value of fairness), while that of German central bankers was mainly cognitive.

The differences in terms of moral hazard's conceptions and arguments among German policymakers and within sub-cases demonstrate the analytical relevance of agency and usefulness (power *through*) over internalized and/or shared beliefs (power *in*) in the German case. The next empirical chapters will determine whether the main differences between German politicians and central bankers are characteristic of a political/central banking division or whether the similarities are specific to the case of Germany.

6.5 Appendices

Table 8 Moral hazard's synonyms in German press documents

	Bundesbank	German government	Total
Problematic incentives	9	2	11
Appetite for risk	2	0	2
Temptation	0	2	2
Disincentives	1	1	2
Excessive risk-taking	1	0	1
Too big to fail problem	1	0	1
The 'Greenspan put'	1	0	1
Gambling	1	0	1
TOTAL ANALYSED DOCUMENTS	89	18	107

Source: Author. The numbers indicate the number of coded segments for each synonym (i.e. the frequency of the synonym).

Table 9 Moral hazard's antonyms in German press documents

	Bundesbank	German government	Total
Appropriate incentives	3	2	5
Prudence	1	0	1
Proper behaviour	0	1	1
TOTAL ANALYSED DOCUMENTS	89	18	107

Source: Author. The numbers indicate the number of coded segments for each antonym).

Figure 4 Moral hazard's word clouds in the corpus of the Bundesbank's press documents

Figure 4.1 Word cloud in English



Figure 4.2 Word cloud in German



Source: Author. MAXQDA Word Cloud function (minimum frequency: 2).

Figure 5 Moral hazard's word clouds in the corpus of the German government's press documents

Figure 5.1 Word cloud in English



Figure 5.2 Word cloud in German

Source: Author. MAXQDA Word Cloud function (minimum frequency: 2). 3 out of the 18 German government's press documents are in English.

Table 10 'What it is' in German press documents

	Bundesbank	German government	Total
When there are incentives for a reckless action	7	1	8
When risk and liability are separated	0	5	5
When there is no incentive for the originator of a loan to monitor the debtor	5	0	5

When benefits are privatised and costs are socialised	2	2	4
When insurance encourages to take more risks	3	1	4
Being reckless because you know that others will rescue you	1	2	3
A situation where a reckless action is rewarded	2	0	2
The calculation that the state will save you if needed	2	0	2
The experience and expectation that others will bear the costs	0	2	2
When the expectation of support causes a reckless action	1	0	1
When there are perverse effects on incentives	1	0	1
When risk-taking is overstimulated	1	0	1
To set the wrong incentives	0	1	1
To succumb to a temptation at the expense of others	0	1	1
TOTAL ANALYSED DOCUMENTS	89	18	107

Source: Author. The numbers indicate the number of coded segments for each code.

Table 11 ‘What causes it’ in German press documents

	Bundesbank	German government	Total
TBTF/SIFIs	28	0	28
Securitisation	8	0	8
UMP	5	0	5
Asymmetrical monetary policy	5	0	5
When the principle of liability does not apply	5	0	5
Bailouts	4	0	4
Public support/intervention/measures in times of crises	2	1	3

Government policy	3	0	3
Low interest rates/accommodative monetary policy stance	3	0	3
A European (resolution) fund	3	0	3
Expectation/assumption/perception of assistance or support	2	0	2
Monetary policy	1	1	2
Insufficient risk and liquidity management	2	0	2
Ill-designed remuneration schemes	2	0	2
(European) Deposit Insurance Scheme	1	0	1
Permanent crisis management mechanism/ESM	1	0	1
State/government support in times of crises	1	0	1
LOLR	1	0	1
IMF	1	0	1
Implicit or explicit bailout guarantee	1	0	1
Financial dominance	1	0	1
When the burden of individual bad policy can be shifted to all	1	0	1
The state as a full-coverage insurer of all risks	1	0	1
The uneven distribution of costs	1	0	1
Issuing blank cheques	1	0	1
Common exposure to aggregate or macroeconomic risks	1	0	1
Risks from housing loans assumed by public authorities	1	0	1
Risk sharing when legacy risks are not contained	1	0	1
The German Financial Market Stabilisation Act	1	0	1
The competitive market	1	0	1

TOTAL ANALYSED DOCUMENTS	89	18	107

Source: Author. The numbers indicate the number of coded segments for each code.

Table 12 ‘What it does’ in German press documents

	Bundesbank	German government	Total
Crises	9	3	12
Cost for taxpayers	4	2	6
Long-term instability	5	1	6
Discourages needed adjustments/reforms	1	3	4
Promotes risk-taking/induces excessive risk-taking	3	0	3
The expansion of the 'originate-to-distribute' business model	2	0	2
Unsustainable public finances	1	0	1
European solidarity paralyzes individual responsibility	0	1	1
Deficiencies in risk and liquidity management	1	0	1
Economic unviability	1	0	1
Erosion of credit standards	1	0	1
A financial sector not serving the real economy	1	0	1
Greedy governments	1	0	1
Distort investment decisions	1	0	1
TOTAL ANALYSED DOCUMENTS	89	18	107

Source: Author. The numbers indicate the number of coded segments for each code.

Table 13 Dictionary-based topic classification in German press documents

Topic and sub-topic	Bundesbank	German government	Total
Financial assistance	51	7	59
IMF	6	2	8
EFSF/ESM	3	1	4

NGEU	0	0	0
Resolution	44	7	51
Monetary policy	15	1	16
UMP	0	0	0
QE	16	2	18
OMT	1	0	1
Negative interest rates	0	0	0
TLTROs	0	0	0
Regulation	45	3	48
Too big to fail	42	5	47
Structural reforms	26	8	34
Fiscal rules	15	6	21
Supervision	30	4	34
Deposit guarantee	7	0	7
Maastricht Treaty	20	5	25
Transfers	12	3	15
Mutualisation	3	1	4
Banking Union	2	4	6
Austerity	5	2	7
Lender of last resort	3	0	3
Competition policy	1	0	1
Pension system	0	0	0
Housing policy	3	0	3
Inequalities	1	0	1
Natural disaster	1	0	1
Common borrowing	0	0	0
Migration	0	0	0
TOTAL ANALYSED DOCUMENTS	89	18	107

Source: Author.

Table 14 ‘Conclusion’ of moral hazard-based arguments in German press documents

	Bundesbank	German government	Total
For insolvency procedures/resolution regimes	19	3	22
For ‘bail-in’	13	7	20
For stricter capital requirements	18	1	19
For (more efficient) supervision/surveillance	10	4	14
For TBTF reforms	10	0	10
For conditional financial assistance	4	1	5
For risk reduction before risk sharing	3	1	4
For (stricter) rules	0	4	4
For centralisation at the EU level	4	0	4
For purchasing bonds in proportion to the ECB capital key	3	0	3
Against collective liability	0	3	3
For a European Resolution Fund	2	1	3
For increased transparency of OTC trading	3	0	3
Against permanent transfers	2	1	3
For distinguishing between rescuing an institution and protecting its owners	2	0	2
For the principle of liability	2	0	2
For structural reforms	1	1	2
For Banking Union	1	1	2
For temporary financial assistance	1	1	2
COVID-19 crisis is different	2	0	2
For stricter budgetary discipline	1	1	2
For austerity	0	2	2
For revised manager remuneration systems	0	2	2
For (stricter) sanctions in the SGP	0	2	2
Against unregulated securitisation	2	0	2
For 'no-bailout' clause	2	0	2
For symmetrical monetary policy	2	0	2
For 'help for self-help'	1	1	2

For reducing the need for governments to act as LOLR	1	0	1
Against a European Resolution Fund	1	0	1
For balance between financial stability and housing policy objectives	1	0	1
For IMF exit strategy of crisis policies	1	0	1
For "living wills"	1	0	1
Against fiscal dominance	1	0	1
For CCP for OTC derivatives	1	0	1
For 'no monetary financing' clause	1	0	1
For strict separation between management of liquidity conditions and the determination of monetary policy stance	1	0	1
For one main objective: price stability	1	0	1
For exceptional public support	1	0	1
For separating banking functions	1	0	1
Against low interest rates	1	0	1
Against the fall of Lehman Brothers	1	0	1
For market discipline	1	0	1
For macroprudential policies	1	0	1
Against transfers	0	1	1
For automatic maturity extension for government bonds if financial assistance	1	0	1
Against new debt programmes	0	1	1
For limiting the financial aid to the current deficit	1	0	1
Against the state becoming a full-coverage insurer of all risks	1	0	1
For a European institution with powers to enforce compliance with agreed rules	0	1	1
For microprudential regulation	1	0	1
For the SGP	0	1	1
For Pfandbriefe	1	0	1

For following Walter Bagehot advises	1	0	1
Against debt relief	0	1	1
For central bank independence	1	0	1
Against LOLR for governments	1	0	1
TOTAL ANALYSED DOCUMENTS	89	18	107

Source: Author. The numbers indicate the number of coded segments for each code.

Figure 6 ‘Whose moral hazard?’ in German press documents

Figure 6.1 German government

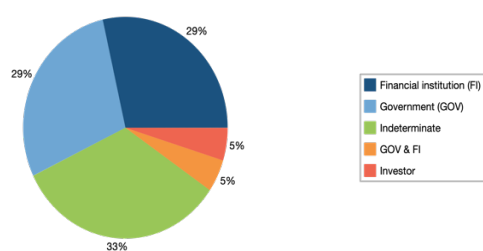
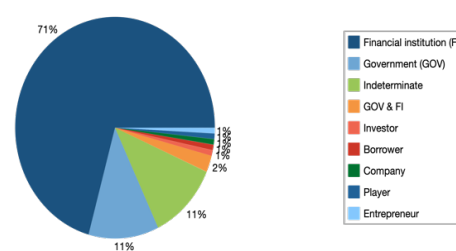


Figure 6.2 Bundesbank



Source: Author.

Figure 7 Distribution of normative and cognitive premises in the moral hazard-based arguments formulated by the German government and the Bundesbank

Figure 7.1 German government

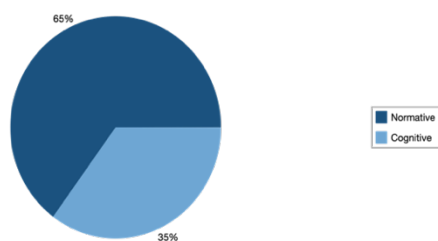
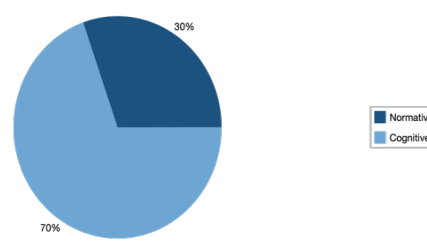


Figure 7.2 Bundesbank



Source: Author.

7 Italy

This chapter presents the findings of the empirical analysis of the Italian case – the representative of the non-authoritative southern coalition. The key questions guiding the empirical analysis remain the same as those used in the previous empirical chapter: is the condition of minor contestation present in the case of Italy? Do Italian policymakers share a common and dominant understanding of what moral hazard is? And what are the main characteristics of the moral hazard-based arguments formulated by the Italian policy elite? In this dissertation, ‘Italian policymakers’ and ‘Italian policy elite’ are used interchangeably and refer to persons working for or with the Italian government or the Bank of Italy.

The results of the Italian case are crucial to characterise the relationship between power and moral hazard in the context of the post-2007 European economic governance. Indeed, as a non-authoritative actor, the presence of minor contestation in the Italian case would be interpreted as evidence against power *over* moral hazard and in favour of power *in* and *through* moral hazard, and vice versa. Given the expectation of this dissertation in favour of the instrumental hypothesis, we expect Italian policymakers (both politicians and central bankers) to exploit rather than contest moral hazard in their communications. If the empirical analysis finds major contestation by Italian politicians and minor contestation by Italian central bankers, the evidence will speak in favour of central bankers’ power *over* moral hazard. The analysis of what moral hazard means for a sample of Italian policymakers after 2007 will provide additional information as to the relevance of the political/central banking division for the conception of moral hazard. Indeed, the German case informed about the presence of two broad interpretations of moral hazard: a morality-based conception of moral hazard that is most prominent among politicians and a rationality-based conception of moral hazard that is most prominent among central bankers. We expect this conceptual map to be present in the Italian case. Such result would indicate that the central banking culture has more influence on the conception of moral hazard than national cultures. Finally, the analysis of how Italian policymakers use moral hazard in policy debates to justify or legitimize policy goals – when

compared to the German case – will allow us to conclude on the relevance of the northern/southern division for the exploitation of moral hazard. Based on the hypothesis of power *through* moral hazard, we expect a clear difference between how German and Italian policymakers exploit moral hazard. In particular, we expect Italian policymakers to be less conservative in relation to the Maastricht model and to exploit moral hazard in a way that is compatible with the advance of risk sharing policy goals.

This chapter is structured as follows. The first section is dedicated to contestation. The second and third sections focus on conceptions of moral hazard and moral hazard-based arguments, respectively. In these three sections, the results for the Italian government and the Bank of Italy are compared. The final section summarizes the main results and concludes on the relevance of the northern/southern division for the politics of moral hazard's use and its implication for the relationship between power and moral hazard.

7.1 On Contestation

This section presents the results of the 'Contestation' code for the members of the southern coalition, namely: the Italian government and the Bank of Italy. These results are crucial for the verification of the hypothesis based on the instrumental theory and the falsification of the one based on the authoritative theory. Indeed, the presence of minor contestation by non-authoritative actors constitutes empirical evidence in favour of power *through* (and power *in*) and against power *over* moral hazard.

There are 96 utterances of the term 'moral hazard' (one sentence before and after) in the corpus of Italian press documents (72 documents). The total number of coded segments with 'Contestation' is eight. Over the 2007-2022 period, Italian policymakers contested moral hazard eight times and exploited it 88 times. The condition of minor contestation is therefore present for the southern coalition case. The political discourse of the Italian policy elite on moral hazard was not mainly a discourse of opposition to the one, for example, of German policymakers. However, in none of the sub-corpus the contestation of moral hazard is null and signs of opposition to the German discourse are present.

In the corpus of the Italian government's press documents (10 documents), the total number of coded segments with 'Contestation' is 2 (out of 10 moral hazard utterances). Among the four ministers who used the term 'moral hazard' in their communications between 2007 and 2022 – Pier Carlo Padoan (Finance Minister, 2014-2018), Benedetto Della Vedova

(Deputy Minister of Foreign Affairs, 2014-2018), Giovanni Tria (Finance Minister, 2018-2019), and Mario Draghi (Prime Minister, 2021-2022) – only Padoan done so to refute or challenge a statement on moral hazard. The Italian Finance Minister contested moral hazard on two occasions in 2015. The first was in July, during an interview with Marco Valerio for *Il Foglio*, and the second was in September, during an interview with Osvaldo De Paolini for *Il Messaggero*:

‘Again: There are today two theories on the functioning of a monetary union. The first is that of ‘moral hazard’, i.e. preventing some states from taking advantage and therefore basing everything on rules that prevent deviant behaviour. The second position is that of a necessary sharing of risk, be it on banks, fiscal policy or labour. If the first view prevails, monetary union will become more rigid’ (author's translation, Padoan, 2015: 1).

‘What do you think of Wolfgang Schäuble’s plan to assign the supervision of government budgets to a third party, i.e. decoupled from the European Commission? I often find myself in agreement with the German finance minister, but his concerns about Europe are mainly about moral hazard, whereas I attach more importance to the ability to share risks. I believe that a European finance minister capable of defining a budgetary policy of the eurozone, accountable to a parliament legitimized by a vote, can be part of the solution’ (author's translation, Padoan, 2015a: 3).

In the first text segment, Padoan exposed two factors that contribute to a functioning monetary union: preventing moral hazard and risk sharing. He claimed that if preventing moral hazard prevails over risk sharing, the result is a rigid monetary union. If a more rigid monetary union means a monetary union more vulnerable to shocks, this outcome is not a positive one. Thus, the Italian Finance Minister refuted the statement that solely preventing moral hazard necessarily produces positive effects. In the second text segment, Padoan challenged a statement attributed to Schäuble that moral hazard should be the main concern about Europe: he expressed his disagreement and said that risk sharing was more important. In both segments, the primacy of the goal of preventing moral hazard is implicitly contested.

In the corpus of the Bank of Italy’s press documents (62 documents), the total number of coded segments with ‘Contestation’ is six (out of 86 moral hazard utterances). Among the 15 central bankers (the Governor and other members of the Directorate) who used the concept in their speeches and interviews, three did so to refute or challenge a statement on moral hazard:

Mario Draghi (Governor of the Bank of Italy, 2006-2011), Ignazio Visco (Deputy Director General, 2007-2011; Governor of the Bank of Italy, 2011-2023), and Stefano Mieli (Managing Director for Banking and Financial Supervision). The refuted statements on moral hazard relate to banks and the means-goal relationship. Bank of Italy officials did not question the goal of preventing moral hazard in the financial sector but the instruments to achieve this goal. See, for example:

‘Furthermore, it is no longer true that the threat to let a financial institution fail is the most effective weapon against moral hazard. When implications of defaults are systemic, and in a global world this is the case much more often than in the past, this threat is not credible to say the least’ (Draghi, 2008: 6).

‘Better mechanisms should be devised to limit the costs of failure, but widely shared solutions are still to be found. Resolution plans and a stronger capitalisation may mitigate but will not eliminate the financial fallout of the bankruptcy of one of these institutions and the related moral hazard’ (Visco, 2009: 6).

‘With regard to the risk of moral hazard that the different treatment of smaller banks could generate, the argument that uninsured depositors or senior bondholders should participate in absorbing losses in order to fend off this risk seems a feeble one. In the case of smaller banks, in fact, these are often individual households and small firms, who are not able to adequately monitor financial intermediaries’ (Visco, 2021: 4).

In these text segments, Italian central bankers questioned the effectiveness of the threat of default in an interconnected world, resolution plans and stronger capitalisation alone, and bail-in in the context of smaller banks against moral hazard. In addition, referring to the academic literature, Mieli refuted the conventional statement that deposit insurance necessarily raises moral hazard:

‘According to this literature, before adopting DGSs governments should improve banking regulation and supervision, protect property rights, strengthen contract enforcement, as well as upgrade accounting and disclosure rules. These prerequisites help to contrast the traditional accusation flung at deposit insurance, that of raising moral hazard. When regulation and supervision are effective, public action is able to punish bank shareholders and managers for their risky behaviour, thus decreasing the ex-ante incentives to moral hazard. Lastly, the view that deposit insurance is

complementary to public supervision was well expressed in the “Core Principles for Effective Deposit Insurance Systems” issued in June 2009’ (Mieli, 2010: 9).

To sum up, the contestation of moral hazard by Italian policymakers in the corpus is limited (approximately 8% of moral hazard utterances). However, it is worth stressing that the pattern of contestation differs between the Italian government and the Bank of Italy. Italian ministers (i.e. Padoan) are more likely to use the concept in their communications to refute or challenge a statement on moral hazard than Italian central bankers (20% of contestation in the sub-case of the Italian government versus approximately 7% of contestation in the sub-case of the Bank of Italy). Another difference relates to the subject of contestation: the Italian government contested the primacy of the goal of preventing moral hazard over risk sharing while the Bank of Italy contested the effectiveness of certain instruments to achieve the goal of preventing moral hazard and not the goal *per se*. Despite this evidence of contestation, the results of the ‘Contestation’ code indicate that Italian policymakers mostly use the term ‘moral hazard’ in their speeches and interviews not for contestation but for exploitation (which is evidence against power *over* moral hazard). The next sections of this chapter examine the conceptions of and arguments about moral hazard to assess the extent of variability in how and for what purposes the concept is exploited by the Italian policy elite.

7.2 On Conceptions

The empirical analysis of the variability condition begins with the investigation of how moral hazard is understood in the corpus and by the interviewees. Indeed, if the meaning of moral hazard varies, the meaning of preventing moral hazard also changes. Before examining premises and conclusions of moral hazard-based arguments, it is therefore important to clarify the content of the concept of moral hazard. This section aims to identify what moral hazard means to a sample of Italian policymakers. The various features of the ‘moral hazard family’ in the case of the Italian government and the Bank of Italy are derived from the analysis of moral hazard’s semantic fields and the results of the codes ‘What it is’, ‘What causes it’, and ‘What it does’. The key features of moral hazard drawn from the textual analysis of the corpus are complemented by and compared with the results of the interview.

The results for the semantic fields of moral hazard in the corpus of Italian press documents – synonyms, antonyms, and word clouds – are presented in Table 15 and Table 16,

and Figure 8 and Figure 9 (in the appendices to this chapter). In the corpus of Italian government press documents, there are no antonyms and only one synonym: ‘deviant behaviour’. A deviant behaviour is a behaviour that deviates from normal social or moral standards. This interpretation of moral hazard gives primacy to the question of appropriateness. Moral hazard depends on social standards and moral principles. In the corpus of the Bank of Italy’s press documents, the question of appropriateness and conformity to moral principles is also present. Indeed, Italian central bankers have described moral hazard as having the same meaning as ‘unethical behaviour’, ‘malpractice’, ‘fraud’, and ‘laxity’. These results indicate that there is a common understanding of moral hazard as wrong behaviour among the Italian policy elite. However, this conception of moral hazard is not the only nor the most frequent one in the case of the Bank of Italy. While Italian central bankers also understand moral hazard as an incentive problem that relates to ‘excessive risk-taking’, the most prominent feature that can be derived from the analysis of synonyms and antonyms is ‘caring for the future’ or, more precisely, the opposite of caring for the future. Indeed, moral hazard has been described as similar to ‘hyperbolic discounting’ and opposed to ‘prudence’, ‘preventive behaviour’, and ‘foresight’. See, for example:

‘Since in all probability we are not descended from the Medici family, or one of similar wealth, we cannot afford Lorenzo [de Medici]’s hyperbolic discounting, which borders on moral hazard. We must, instead, plan for our future’ (Visco, 2007: 1).

The analysis of moral hazard’s semantic fields ends with an examination of words used most commonly in the context of the term ‘moral hazard’. In the case of the Bank of Italy, the most frequent words next to moral hazard in press documents written in English are: ‘risk’, ‘reduce’, ‘address’, ‘bank’, ‘institution’, ‘pose’, ‘avoid’, ‘important’, ‘problem’, and ‘systemically’ (see Figure 8 in the appendices to this chapter).⁹⁰ In documents written in Italian, the most common words are: ‘phenomenon’, ‘avoid’, and ‘not’ (author’s translation, Figure 8 in the appendices to this chapter). Similarly to the Bundesbank, moral hazard is presented as a risk and the question of systematicity is strongly associated with moral hazard in the Bank of Italy’s corpus. However, the frequency of the word ‘bank’ in the English language corpus suggests that Italian central bankers are more prone to think about moral hazard as a problem concerning banks in general and not only TBTF financial institutions. ‘Reduce’ is the verb with

⁹⁰ In the English language corpus, there is one word with a frequency of 21, one word with a frequency of 11, four words with a frequency of 8, four words with a frequency of 6, and the rest have a frequency of less than 6. This list corresponds to the 10 words with a frequency of 6 or more.

the highest frequency, which indicates that most often central bankers from the Bank of Italy seek to reduce moral hazard (as for the Bundesbank, this implies that moral hazard is considered as something that cannot be eliminated or that eliminating moral hazard is not perceived as the best policy option). ‘Address’ and ‘avoid’ are also verbs frequently used next to moral hazard in the Bank of Italy’s press documents. A closer look at the data reveals that ‘avoid’ is most frequently used next to moral hazard when governments’ moral hazard is discussed, and ‘reduce’ is most often used next to moral hazard when financial institutions’ moral hazard is discussed.⁹¹ This finding implies that Italian central bankers are more optimistic as to the capacity to eliminate moral hazard in relation to governments than banks (or, that their tolerance level of moral hazard is higher in relation to banks than governments). Finally, it is worth stressing that the words ‘phenomenon’ and ‘not’ are frequently used next to moral hazard in documents written in Italian. This result suggests that central bankers from the Bank of Italy are more likely to negate the phenomenon of moral hazard when addressing an Italian-speaking audience than an English-speaking audience.

In the case of the Italian government, only one word has a frequency greater than two in the English language corpus: ‘transfer’ (see Figure 9 in the appendices to this chapter). In documents written in Italian, there are nine words with a frequency greater than two: ‘avoid’, ‘expectation’, ‘balance’, ‘contain’, ‘create’, ‘duty’, ‘need’, ‘intervention’, and ‘state’ (author’s translation, see Figure 9). The result from the English language corpus signals that Italian ministers often associate moral hazard with transfers when addressing an English-speaking audience – this is probably in response to the moral hazard-based argument of the northern coalition against transfers. The frequency of the word ‘balance’ suggests that the Italian government often considers opposing forces in the context of the term ‘moral hazard’ and looks for an equilibrium. Finally, the objective of avoiding or containing moral hazard – something which is often associated with the concept of expectation – seems to be used to help Italian ministers justify or legitimize the necessity of public intervention. The Italian government appears relatively optimistic about the capacity to control moral hazard – the frequency of the verb ‘create’ next to moral hazard suggests that moral hazard is not perceived by Italian ministers as something necessary or inevitable.

⁹¹ This finding is obtained by comparing the word clouds of, on the one hand, English language documents from the Bank of Italy containing the sub-code ‘Financial institution’ (‘Whose moral hazard?’ code), and on the other hand, English language documents from the Bank of Italy containing the sub-code ‘Government’ (‘Whose moral hazard?’ code).

In sum, the examination of semantic fields allows us to draw some preliminary conclusions in terms of key features of moral hazard in the Italian corpus. In documents from both the Bank of Italy and the Italian government, moral hazard is associated with the question of appropriateness in relation to social or moral standards. Indeed, the interpretation of moral hazard as wrong behaviour is present in the corpus of Italian central bankers and ministers. Central bankers from the Bank of Italy also understand moral hazard as an incentive problem and as being the opposite of caring for the future. Most frequently, they discuss moral hazard in relation to banks. Moral hazard is a risk (that is, a measurable phenomenon) that Italian central bankers seek to reduce. Similarly to the German case, the Italian government appears more ambitious and more optimistic about the capacity to control moral hazard and rather tends to pursue the goal of avoiding it. The analysis of synonyms and antonyms provided little information as to the meaning of moral hazard in the corpus of the Italian government. However, the analysis of word clouds suggests several key characteristics of the Italian government's discourse on moral hazard: moral hazard is often associated with the question of transfers; moral hazard is at the heart of a trade-off for which a balance needs to be found; and the objective of avoiding moral hazard appears to be used to argue in favour of state intervention.

In addition to semantic fields, this dissertation looked at how Italian policymakers explain moral hazard in their communications. The results for the code 'What it is' are presented in Table 17 (in the appendices to this chapter). It should be noted that from these results, there is only one coded segment where moral hazard is directly defined – 'the moral hazard of counting on help from others so as to persevere in the bad policies of the past' (Visco, 2012: 15). This finding indicates that Italian policymakers tend to take the concept for granted and assume that their audience is familiar with what moral hazard is.

In total, 9 sub-codes have been created to take into account the variety of descriptions of moral hazard in the corpus of Italian press documents. There is no dominant sub-code or common sub-code between the corpora of the Bank of Italy and the Italian government. However, several sub-codes present in Italian press documents indicate that 'voluntarily creating a burden for others' is a key feature of moral hazard, which brings moral hazard into the realm of morality: 'being reckless because you know that others will rescue you', 'to take advantage at the expense of others', 'when risks are transferred to others', and 'to count on the help of others to persevere in bad policies'. Another key feature of moral hazard that can be derived from the descriptions made by the Bank of Italy is the (expected or actual) protection from negative consequences or outcomes (e.g. 'to take risks when feeling sheltered from the

risk of failure’, ‘when you believe you will be supported in bad times’). Apart from the effect of external incentives on risk-taking, the voluntary burden created for others, or the protection against negatives consequences or outcomes, the results presented in Table 17 also indicate another key defining feature of moral hazard: the absence of trust. Indeed, with regard to fiscal rules, Visco described moral hazard as the opposite of trusting each other:

‘Moreover, you have to maintain conditions to avoid the fiscal free lunch and moral hazard. We may say that the Germans are fixated with moral hazard, but it is something important, we need to trust each other as Europeans and therefore we need ways to avoid moral hazard’ (Visco, 2016: 9).

This text segment is of particular analytical interest for at least two reasons. First, it points to the fact that while the goal of avoiding moral hazard may be perceived as a German goal, it is shared by the Bank of Italy. However, second, the feature of moral hazard that is emphasized in this segment – a lack of trust – is absent from the German case (Chapter 6). This reinforces one of the claims of this dissertation: it is crucial to look in detail at the content of moral hazard. Indeed, the objective of avoiding moral hazard might be shared between policy elites, but if what moral hazard means is not the same, ideational consensus on moral hazard is arguably not present.

Finally, the textual analysis of how moral hazard is presented in the corpus of Italian press documents ends with the examination of its cause-and-effect relationship. The results for the codes ‘What causes it’ and ‘What it does’ are presented in Table 18 and Table 19, respectively (in the appendices to this chapter). Similarly to German central bankers, Italian central bankers most often discussed the causal relationship between the systemic nature of certain financial institutions and moral hazard. However, in contrast to the case of the Bundesbank, the question of systematicity and moral hazard is present in the discourse of the Bank of Italy since 2007. Another distinction between the Bundesbank and the Bank of Italy in relation to systematicity and moral hazard is that Italian central bankers present a broader view of what constitute a SIFI than German central bankers. Indeed, the criterion for assessing whether a financial institution is systemic is not restricted to size (‘too big’) but also includes complexity and interconnectedness. See, for example:

‘Last but not least, we must reduce the moral hazard posed by institutions that are too large, or too complex, or too interconnected to fail. The large-scale support we provided in this crisis to stave off systemic collapse has materially worsened moral hazard risks.

Why should our financial firms now believe that authorities will not stand behind them if conditions were to turn again to the worse?’ (Draghi, 2009: 5).

This text segment also suggests a distinctive characteristic of the Bank of Italy’s discourse on moral hazard compared to that of Germany: Italian central bankers tend to consider moral hazard mainly as a consequence of the policy responses to the IFC and the euro area SDC rather than as a cause of these crises. Indeed, there is no evidence in the dataset of moral hazard utterances (one sentence before and after) of Italian central bankers presenting the IFC or the euro area SDC (or another crisis) as the result of moral hazard (see Table 19) but evidence of Italian central bankers discussing several policy responses to these crises as a cause (or potential cause) of moral hazard (see Table 18). See, for example:

‘Governments and central banks intervened to mitigate its impact; in so doing, at times they supported and protected the very institutions that had triggered the crisis in the first place. Moral hazard was compounded by the crisis: financial institutions have felt sheltered from the risk of failure and the fear this inspires, they have been taking new risks and, thanks to the extraordinary market conditions that have been created, are reaping enormous profits. Reducing moral hazard is a shared objective’ (Draghi, 2010a: 4).

‘Just as in the case of American private debt, political indecision and the absence of crisis resolution mechanisms aggravated the situation. In the Greek case the difficulty of finding a European accord on a rescue plan, but also the unavailability of a process permitting orderly management of the debt crises of sovereign states, amplified the damage and the contagion and at the same time heightened moral hazard’ (Draghi, 2010: 5).

It is worth stressing that when it comes to UMP measures – one of the most frequent policy responses in terms of ‘what causes moral hazard’ in the corpus of the Bank of Italy’s press documents – Italian central bankers often presented the causal relationship as potential rather than necessary. The causal relationship between UMP and moral hazard depends on how such measures are designed. See, for example:

‘Communication was essential: we had to explain that the OMTs were legitimate and compatible with the Treaty, since their aim was to preserve the functionality of markets and thus restore the monetary policy transmission mechanism. The conditionality and

enforcement mechanisms were such as to prevent moral hazard for both borrowers and investors' (Rossi, 2013: 8).

Finally, it should be noted that the issue of the IMF's role in terms of moral hazard is not insignificant in the corpus of the Bank of Italy. Notably, Fabrizio Saccomanni (Director of the Bank of Italy, 2006-2013) discussed the causal relationship between IMF bailouts or the expansion of Special Drawing Rights (SDRs) and moral hazard (Saccomanni, 2008, 2011).⁹²

In the corpus of the Italian government's press documents, the primary cause of moral hazard is 'expectation/assumption/perception of assistance or support'. This result indicates that Italian ministers emphasized the causal relationship between beliefs and moral hazard. Moral hazard is understood as a matter of *ex ante* beliefs, that is of confident anticipations. For example, Tria described the expectation of bailouts as a source of moral hazard (Tria, 2018a, 2018b). This interpretation of moral hazard privileges the role of expectations over what truly happens. In other words: a bailout expectation can create moral hazard, independently of whether the bailout takes place. Italian ministers also discussed the moral hazard implications of a European scheme against cyclical unemployment and common debt. However, in both cases, the causal relationship is presented as potential rather than necessary:

'The instrument [a European scheme against cyclical unemployment] would be triggered by severe employment shocks (independent from structural factors), providing a stabilization function. It would build on an appropriate incentive structure in order to limit moral hazard and avoid permanent transfers from some countries to others – i.e. no net losers and net winners in the long run' (Padoa, 2016: 6).

'Debt can unite us if it helps achieve our goal of sustainable prosperity, both in Italy and in Europe. However, debt can also divide us if it increases the spectre of moral hazard and budgetary transfers, as was the case after the financial crisis. Let us take, for example, the common debt being used to finance NextGenerationEU' (Draghi, 2021: 6).

The effects of moral hazard present in Italian press documents are all negative. These negative consequences justify the goal of reducing or avoiding moral hazard. In particular, the Italian policy elite agrees with the German policy elite that moral hazard creates a burden for taxpayers. Taxpayers are presented as victims of moral hazard. The cost for taxpayers is the

⁹² 'The SDR is an international reserve asset created by the IMF to supplement the official reserves of its member countries' ([IMF website](#)).

only common effect of moral hazard between the corpus of the Bank of Italy and that of the Italian government. While Italian central bankers mentioned several other negative effects – which mainly relate to the increased probability of future negative outcomes – the Italian government only discussed another negative effect of moral hazard: actual crises. The proposition that moral hazard caused the IFC, or the Greek crisis, is not explicit in the corpus of the Italian government but implicit in two moral hazard utterances:

‘The financial crisis has brought back with great intensity the need to identify investors’ contribution to crisis management, avoid moral hazard and bail out and preserve financial stability, protect the taxpayer’ (author’s translation, Padoan, 2017: 10).

‘In recent years, Greece has taken some very heavy and important steps, but the chapter must not be closed for good. Let’s say that moral hazard as far as Athens is concerned has undoubtedly been sanctioned. From here on, the EU will have to take charge of Greece’s future without allowing previous mistakes to be repeated with reasonable measures and demands’ (author’s translation, Della Vedova, 2017: 1).

Based on the analysis of semantic fields, explanations of moral hazard, and descriptions of its cause-and-effect relationship in Italian press documents, various features of the ‘moral hazard family’ have been identified. In terms of similarities, there is a common understanding of moral hazard as wrong behaviour among the Italian policy elite. For both Italian central bankers and ministers, moral hazard is a behaviour not conforming to social standards or moral principles. More specifically, moral hazard is about ‘voluntarily taking advantage at the expense of others’. Moral hazard is an unfair situation where others – taxpayers – must bear the burden. However, in their communications, Italian policymakers appear relatively optimistic about the capacity to control moral hazard. Indeed, most causes of moral hazard are presented as potential but not necessary.

Some differences in how moral hazard is presented in the corpora of the Bank of Italy and the Italian government were also detected. In the case of the Bank of Italy, moral hazard is also about incentives for increased risk-taking to the point of excess. Moral hazard is understood by Italian central bankers as a lack of care for the future and, therefore, as something that increases the probability of future negative outcomes. This incentive problem is often associated with SIFIs (‘systemic’ being understood broadly as opposed to restricted to TBTF institutions). Despite the emphasis on the causal relationship between systematicity and moral hazard, the Bank of Italy did not present moral hazard as a main cause of the IFC. Instead,

Italian central bankers discussed moral hazard as a consequence of policy responses to crises. In the case of the Italian government, the main distinctive feature identified is the emphasis on the role of *ex ante* beliefs in moral hazard. Finally, it should be noted that moral hazard as a cause of the IFC and the Greek crisis is not absent from the corpus of Italian government press documents.

This dissertation compares the key features of moral hazard identified from the textual analysis of press documents with the key features obtained from interviewing selected policymakers. In the case of Italy, one interview with a former minister has been conducted (Interview 6). According to this interviewee, ‘moral hazard is a behaviour that implies risk-taking on the expectation that I will not be caught by whatever watching of bad behaviour’ (ibid.). This definition of moral hazard confirms the role of *ex ante* beliefs, and the understanding of moral hazard as wrong behaviour identified in the corpus. During the interview, the former Italian minister emphasized breaching the social contract as a key defining feature of moral hazard (ibid.). In addition, the interviewee clarified that this breach comes from an informed decision: ‘moral hazard is the result of a rational behaviour. I know that I am taking a hazard, I know I am damaging others, I will do it anyway’ (ibid.). For example, a child coming home later than the hour agreed because he/she knows that the parents are sleeping – at the risk of waking up the parents and being punished – was described as a case of moral hazard by the interviewee (ibid.). Finally, it is worth stressing that, contrary to the other interviewees of this dissertation, the former Italian minister did not necessarily think of selfishness as a key defining feature of moral hazard. According to this interviewee, moral hazard can be to benefit someone else. The former Italian minister used the examples of stilling food on the expectation of not being caught to feed my children or the tales of Robin Hood to illustrate cases of altruistic moral hazard (ibid.). This interpretation points to the fact that the clash of interests when it comes to moral hazard is not necessarily between the individual and society but can be between different social groups. It highlights the question of distributional consequences within a political community. To sum up, the key defining properties of moral hazard for this interviewee were: (1) a behaviour that is against the law (or, more generally, the social contract); (2) the knowledge on the part of the individual that the behaviour is against the social contract; and (3) doing it on the expectation of not being caught. This understanding of moral hazard minimises the role of protection – what causes moral hazard is not the fact of being protected against the consequences of one’s actions but the hope that the consequences will not materialise.

To conclude on conceptions, moral hazard as wrong behaviour is present throughout the Italian case. This conception privileges the role of moral standards. In contrast to the German case (Chapter 6), the question of whether moral hazard should be understood in moral terms does not seem divisive among the Italian policy elite. The expected conceptual map of a morality-based conception of moral hazard mostly associated with politicians and a rationality-based conception mostly associated with central bankers is not present in the Italian case. However, some differences between the cases of the Bank of Italy and the Italian government were also detected. Notably, a conception of moral hazard focused on incentives to take excessive risks and not caring about the future is also present in the corpus of the Bank of Italy (and absent from the case of the Italian government). Another key feature of moral hazard identified in the case of the Bank of Italy is the absence of trust between parties. In contrast, the feature of *ex ante* beliefs is emphasized in the corpus of the Italian government. Finally, the interview with a former Italian minister revealed a new type of moral hazard that was absent from the corpus – for some, moral hazard can be an altruistic behaviour.

This section on conceptions provided empirical evidence of the ambiguity of moral hazard in Italian policy-making. Despite the meaning of moral hazard being often taken for granted in communications, the concept assumes different meanings, such as voluntarily creating a burden for others, not caring about the future, or the absence of trust between parties. This section provided information as to how a sample of Italian policymakers understand moral hazard. However, this section does not focus upon how and for what purposes moral hazard is exploited in policy debates. The next section is dedicated to the examination of moral hazard-based arguments in Italian press documents.

7.3 On Arguments

The first section of this chapter has established that, contrary to what the authoritative theory predicts, Italian policymakers mostly use the term ‘moral hazard’ in their speeches and interviews not to contest it but to exploit it. This section aims to investigate how moral hazard helps Italian ministers and central bankers to justify or legitimize their policy goals. This section begins with the analysis of the Italian government’s political discourse on moral hazard and ends with that of the Bank of Italy. First, the discourse is contextualised in terms of distribution over time and between topics. Second, the conclusions and premises of moral

hazard-based arguments are examined. Finally, third, a selection of moral hazard-based arguments is analysed in more detail.

The first press document of the Italian government with an utterance of the term ‘moral hazard’ in the 2007-2022 period is an article by Padoan published on 11 June 2015 (Padoan, 2015a). Clearly, moral hazard is not a constant element of the Italian government’s discourse and appeared relatively late compared to the other cases examined in this dissertation. Moral hazard was wielded most frequently by Italian ministers in 2015 (see Figure 3). The concept was used principally in relation to financial assistance, transfers, mutualisation, and quantitative easing (see Table 20 in the appendices to this chapter). As for the case of the German government, there is no press document in the corpus of the Italian government where the term ‘moral hazard’ is present, and the topic of the EU was absent. Here again, moral hazard appears to be a political resource exploited by ministers mainly in the context of EU politics rather than national politics.

The conclusions of moral hazard-based arguments provide valuable information as to the policy goals pursued by policymakers when using the concept in their communications (see Table 21 in the appendices to this chapter). Moral hazard has been used by the Italian government to argue in favour of seven policy options:

- a European unemployment insurance scheme;
- risk sharing;
- Banking Union;
- a common budget for the euro area;
- increased ability of the state to deal with market failures;
- ‘sticks and carrots’;
- using debt wisely, productively and honestly.

These conclusions of moral hazard-based arguments indicate that moral hazard can be wielded not only to defend but also to reform key elements of the Maastricht model. Indeed, the concept has been exploited by Italian ministers to help them increase interstate risk sharing and public intervention in the market. Although moral hazard has been exploited to intensify constraints on the financial system, most of these conclusions relate to EU Member States. Indeed, the discourse of the Italian government on moral hazard over the period is mainly focused upon governments (see Figure 10 in the appendices to this chapter). Finally, it is worth stressing that, despite the prominent role of social standards and moral principles as to how Italian ministers understand moral hazard, cognitive premises are more frequent than normative ones in the

moral hazard-based arguments formulated by the Italian government (see Figure 11 in the appendices to this chapter). Contrary to the case of the German government, the discourse of the Italian government on moral hazard is more cognitive than normative. This finding indicates that the Italian government tends to justify rather than legitimize the policy goals it seeks to achieve. This discursive strategy can be interpreted as a means to increase the perceived credibility of the Italian government.

The detailed analysis of a selection of moral hazard-based arguments allows us to identify the premises which helped Italian ministers to justify or legitimize their conclusions. Notably, it allows the identification of the precise role of moral hazard statements in the argumentation of the Italian government. Arguments in favour of a European unemployment insurance scheme are one of the most frequent moral hazard-based arguments formulated by the Italian government. See, for example:

‘In addition, such a scheme [a European scheme against cyclical unemployment] reduces the probability that a cyclical downturn would produce a long lasting impact on growth potential, smoothing the fluctuations of the economic cycle and generating positive spillovers across the area [*Goal and cognitive premises*].

The introduction of this system would not imply any treaty change. The instrument would be triggered by severe employment shocks (independent from structural factors), providing a stabilization function. It would build on an appropriate incentive structure in order to limit moral hazard and avoid permanent transfers from some countries to others – i.e. no net losers and net winners in the long run [*Goal and cognitive premises*]. Every country is from time to time exposed to cyclical shocks – for example recent research has shown that, the tool having been in place from 2002 to 2008, Finland and Germany would have been among the biggest beneficiaries’ [*Cognitive premise*] (Padoan, 2016: 5).

This argument in favour of a European unemployment insurance scheme formulated by Padoan in October 2016 during a Lecture at Goethe University in Frankfurt is based on goal and cognitive premises. First, the scheme is presented as an instrument to achieve several – and arguably shared – policy goals: reducing the negative effect of a cyclical downturn on growth potential, smoothing the economic cycle, and creating positive spillover effects across the euro area. Second, the Italian minister noted that the scheme is not against the treaties, thus contradicting a traditional and pragmatic argument against the creation of new European insurance mechanisms. In addition, thanks to ‘an appropriate incentive structure’, the scheme

is described as being in line with the goals of limiting moral hazard and avoiding permanent transfers. Speaking to a German audience, the Italian minister decided to frame the scheme as being in conformity with the goal of limiting moral hazard instead of contesting the primacy of this goal – as he did twice in 2015 (see section 7.1). The goal is not contested but the causal relationship between a European unemployment insurance scheme and moral hazard is presented as non-necessary (depending in particular on the type of transfers – permanent or not). Accepting the claim that permanent transfers create moral hazard is a way of implicitly rejecting the causal relationship between non-permanent transfers and moral hazard. These argumentative choices (i.e. not contesting the primacy of the goal of limiting moral hazard and accepting the moral hazard-based argument against permanent transfers) allowed Padoan to reduce the apparent distance between the policy goals of the Italian government and the goals of the German government. Finally, the Italian minister ended his argument for a European unemployment insurance scheme by pointing to its universal character. Based on research, Padoan refuted the claim that such a scheme would only benefit some EU Member States. Here again, the Italian minister seeks to reduce the apparent conflict of interests regarding EMU reforms between the northern and the southern coalitions.

The second argument selected for a detailed analysis of premises is the one in favour of risk sharing (in general), given its relative frequency in the discourse of the Italian government. See, for example:

‘The country and the banking system have shown that they are moving with determination and conviction in the direction of reducing sectoral risks [*Circumstantial premise*]. With equal conviction, however, I stress that Italy does not demand risk-sharing instruments at any price [*Conclusion and normative premise*].

The institutional framework on crisis management should balance the need to contain the risk of moral hazard, created by the expectation of bail-out interventions, with that of safeguarding financial stability, which in some circumstances may be threatened by bail-in interventions [*Goal and cognitive premises*].

Although Italy is not against an evolution of the European Stability Mechanism (ESM) it is important to emphasise that some interventions would profoundly affect institutional arrangements, with overlaps and possible negative repercussions on financial markets, also because these interventions would not be offset by corresponding progress on the risk-sharing front’ [*Cognitive premise*] (author’s translation, Tria, 2018a, 2018b).

This text segment can be found in two press documents of Minister Tria – a speech delivered on 10 July 2018 at the Associazione Bancaria Italiana and a speech made on 17 July 2018 at the Senate Finance Committee. The argument made by the minister is based on a normative premise: the Italian government is moderate – ‘Italy does not demand risk sharing at any price’. The Italian government wants to achieve two goals: ‘contain the risk of moral hazard’ (which is not contested but described as a necessity) and ‘safeguarding financial stability’. However, these two goals are presented as potentially conflicting since ‘bail-in’ – one of the preferred instruments of the German government to contain moral hazard in the financial sector – may contribute to financial instability. Increased risk sharing is framed by the Italian minister as a necessary counterpart: if one wants to contain moral hazard and safeguard financial stability, bail-in interventions need to go hand in hand with further risk sharing. The goal of containing moral hazard is therefore exploited to argue in favour of increased risk sharing.

To summarize, moral hazard has been exploited – although relatively late compared to the other cases of this dissertation (from 2015 versus 2007-9) – by the Italian government mainly to argue in favour of changing a key element of the Maastricht model: the lack of risk sharing among EU Member States. By framing risk sharing mechanisms as in conformity with the objective of limiting moral hazard or as a necessary counterpart to instruments aimed at avoiding moral hazard, the Italian government seeks to increase support for its policy goals. The Italian government formulated mixed arguments, with a primacy of cognitive premises. Italian ministers often emphasized causal mechanisms and referred to academic knowledge to justify the conclusions of their moral hazard-based arguments. However, the value of moderation also plays a central role in the argumentation of the Italian government. By presenting itself as moderate and by using a mostly cognitive discourse, the Italian government is arguably seeking to enhance its perceived credibility in the policy debate.

Unlike the Italian government, the Bank of Italy wielded the concept of moral hazard over the entire 2007-2022 period. The first press document with an utterance of the term ‘moral hazard’ is a speech on ‘Monetary Policy and New Financial Instruments’ by Draghi at the Central Bank of Argentina, on 4 June 2007 (Draghi, 2007). Although the concept of moral hazard was used every year in press documents between 2007 and 2022, the peak year for Italian central bankers wielding the concept was 2010 (see Figure 3). The most frequent topics in the corpus of the Bank of Italy are financial assistance, regulation, resolution, too big to fail and, structural reforms. UMP measures, fiscal rules, supervision, and deposit guarantee are also relatively frequent topics (see Table 20). There are two press documents in the corpus of the Bank of Italy where the term ‘moral hazard’ is present, and the topic of the EU was absent (out

of 62 documents). In these two documents, the Governor of the Bank of Italy discussed the questions of moral hazard, too big to fail, and resolution without referring to the EU (Draghi, 2009a; Visco, 2021a). However, as with the other national institutions examined in this dissertation, this finding suggests that moral hazard is a political resource exploited mainly in the context of EU politics rather than national (or international) politics.

Moral hazard has been used by the Bank of Italy to argue in favour or against 51 policy options, to refute that the threat of failure is the most effective instrument against moral hazard,⁹³ and to conclude on the centrality of uncertainty in policy-making – ‘there is no way to know either ex ante or ex post whether one made the right choice’ (Draghi, 2008: 7) (see the conclusions of moral hazard-based arguments in Table 21 in the appendices to this chapter). Most frequently, moral hazard was wielded to argue in favour of the following policy options:

- TBTF reforms;
- insolvency procedure/resolution regimes;
- ‘bail-in’;
- centralisation at the EU level;
- regulation of the nonbank financial institutions (NBFIs);
- Outright monetary transaction (OMT);
- increased transparency of OTC trading;
- one main objective: price stability;
- more international coordination;
- a reform of pension systems;
- European Deposit Insurance Scheme (EDIS);
- limits and risk-based premiums in deposit guarantee schemes;
- instruments to deal with crises of non-systemic banks;
- reducing the centrality of any one institution to the system’s stability.

Several of the most frequent conclusions relate to the goal of achieving financial stability. Indeed, contrary to that of the Italian government, the discourse of the Bank of Italy on moral hazard over the period is mainly focused upon financial institutions (see Figure 10 in the appendices to this chapter). In 2008, the arguments of the Bank of Italy in favour of increasing the transparency of over-the-counter (OTC) trading and for reducing the centrality of any one

⁹³ While Draghi concluded that the threat of letting a financial institution fail is no longer the most effective weapon against moral hazard, Visco argued in favour of a federal budget combined with the threat of defaults on national debts to avoid moral hazard (Draghi, 2008a; Visco, 2016).

institution to the system's stability were relatively frequent (Draghi, 2008b, 2008c). These arguments concerning the general functioning of finance and of the financial system are absent from the Bank of Italy's discourse on moral hazard after 2008. As for the Bundesbank, the discourse of the Bank of Italy on moral hazard changed focus over time – from a general perspective to TBTF financial institutions. Indeed, the conclusion in favour of TBTF reforms is particularly salient in the corpus in 2010. When it comes to 'bail-in', the position of the Bank of Italy is nuanced compared to that of German policymakers: it argued in favour of 'bail-in' but mentioned that such mechanisms should have been introduced more gradually (Barbagallo, 2018). In addition, the discourse of the Bank of Italy contains arguments in favour of further risk sharing – notably, in favour of OMTs and EDIS – and for a fiscal union (i.e. the centralisation of fiscal policy at the EU level). However, the Bank of Italy also exploited moral hazard to defend key elements of the Maastricht model, such as fiscal rules and price stability as the main objective of monetary policy (see Table 21). This finding might indicate that the sound money paradigm is more influential among Italian central bankers than Italian politicians and/or that Italian central bankers are more attached to the Maastricht model than Italian politicians. Finally, it is worth stressing that from 2019, the discourse of the Bank of Italy on moral hazard changed focus again. Instead of focusing on TBTF reforms, the Bank of Italy began to exploit moral hazard to argue in favour of instruments to deal with the crises of non-systemic banks and, from 2020, for the regulation of nonbank financial institutions (NBFIs). The moral hazard-based argument in favour of regulating NBFIs is the most frequent moral hazard-based arguments in the corpus of the Bank of Italy in 2020. The analysis of premises reveals that, similarly to the Italian government, the Bank of Italy tends to pursue its moral hazard-related policy goals through mostly a cognitive discourse. Indeed, there is a primacy of cognitive premises over normative ones in the moral hazard-based arguments formulated by the Bank of Italy (see Figure 11 in the appendices to this chapter).

The detailed analysis of a selection of moral hazard-based arguments allows us to identify the premises which helped Italian central bankers to justify or legitimize their conclusions. This detailed analysis begins with the most frequent argument in the corpus of the Bank of Italy, that is: in favour of reforming the financial system to solve the TBTF problem. See for example:

'The Basel agreement, for all its importance, does not however exhaust the need of reform in the financial system [*Conclusion and cognitive premise*]. An urgent step is to solve the moral hazard problems associated with systemically important financial

institutions (SIFIs), also known as the “too-big-to-fail” (TBTF) problem [*Goal premise*].

These problems have increased as a consequence of the extraordinary public interventions during the crisis and probably represent the most daunting legacy that regulators must now confront [*Cognitive premise*]. If we do not address this issue with determination, SIFIs will continue to have incentives to engage in excessively risky activities; accurate monitoring by investors will be much weaker than desirable, with the result that future crises may be more likely’ [*Cognitive premise*] (Tarantola, 2010: 2).

This argument formulated by the Deputy Director General of the Bank of Italy is based on goal and cognitive premises. ‘To solve the moral hazard problems associated with SIFIs’ is presented as an urgent goal given a daunting legacy. Instead of emphasizing the causal relationship between the moral hazard created by SIFIs and the IFC, Tarantola stressed the causal relationship between the policy response to the IFC – ‘the extraordinary public interventions’ – and moral hazard. The conclusion for TBTF reforms is underlined by two additional cognitive premises: the first is that the Basel agreement is not a sufficient instrument to achieve the goal of solving the TBTF problem; the second enumerates the negative consequences of not achieving this goal (e.g. the increased likelihood of crises).

Another frequent argument in the aftermath of the IFC formulated by the Bank of Italy is the one in favour of bail-in. However, the Bank of Italy was most often nuanced in its argumentation for bail-in. It is therefore of interest to examine in more detail the premises of such arguments. See, for example:

‘As regards bail-in, we appreciate its introduction in the resolution toolkit now enshrined in the EU Bank Recovery and Resolution Directive proposal [*Conclusion*]. On one hand, by making creditors – rather than taxpayers – bear losses, the bail-in tool would help ensure that any failing bank can be restructured and resolved in a way that preserves financial stability and protects the public finances, and would contribute to fighting moral hazard as well [*Cognitive and goal premises*]. On the other hand, bail-in should be implemented in a co-ordinated and gradual way, to avoid legal risks and unintended consequences [*Cognitive and goal premises*].

To this end, bail-in should apply only when resolution conditions are met (and not when the bank is still viable). Adequate disclosure should also be ensured so as to increase the awareness of investors and legal certainty’ [*Cognitive premise*] (Visco, 2014: 5-6).

In this interview with Global Capital on March 2014, the Governor of the Bank of Italy shared his nuanced view on bail-in. On the one hand, the bank resolution tool is welcomed because it contributes to preserving financial stability, protecting public finances, and fighting moral hazard (it is worth stressing that this argumentation in favour of bail-in is not based on normative premises – as opposed to that of the German government). On the other hand, the Italian central banker stressed the risks associated with the implementation of bail-in and how to minimize these risks. If the positions of the German government and the Italian government on bail-in are two extremes, the Bank of Italy would arguably be in the middle.⁹⁴

The next text segment selected for a detailed analysis of premises is an argument in favour of OMT that illustrates the tendency of the Bank of Italy to argue in favour of both reform and the defence of the Maastricht model:

‘However the key turning point was the announcement by the ECB Governing Council in September 2012 of the Outright Monetary Transactions (OMTs) programme. Central bank action was necessary and legitimate for a number of reasons [*Conclusion*]. First, ample resource availability is crucial to restoring market confidence [*Goal and cognitive premises*]. Second, the origin of the problem is not a question of sovereign solvency but a liquidity strain on the sovereign borrower, which in fact has not lost access to the markets. Therefore, the OMT program is totally different from the standard bail-out programs designed for countries that lost market access [*Cognitive premise*]. Third, the epicentre of the crisis is the secondary securities market, a key component of the monetary policy transmission mechanism [*Cognitive premise*]. Belying the critics, central banks’ interventions in these markets, by providing the necessary lubricant, actually restore rather than suppress the important signalling function of prices in financial markets [*Goal and cognitive premises*]. And since the objective is to preserve the functionality of markets, bond purchases cannot be considered as monetary financing of deficits [*Goal and cognitive premises*]. Furthermore, conditions and enforcement mechanisms have been designed to prevent and manage moral hazard for both borrowers and investors [*Goal and cognitive*

⁹⁴ The interview conducted in this dissertation with a former Italian minister provided additional evidence of the (initial) Italian government’s opposition to private sector involvement. See, for example: ‘There were policy attitudes which generated more fragility than expected. Famously, one of these was the interpretation of the beach walk with Merkel and Sarkozy who agreed that if there is a crisis the creditors had to suffer from the fact that they had done the wrong things. So, this generated a mistrust in the system and eventually the system collapsed’ (Interview 6). The interviewed former Italian minister presented the bail-in proposal as a cause of financial instability rather than a solution.

premises]. Outright Monetary Transactions have been made conditional on compliance with an appropriate European programme managed by the EFSF or ESM. The IMF will also be involved in the design of country-specific conditionality and monitoring [*Cognitive premises*].

Are there risks for central bank independence? The main concern regards the participation of the European Central Bank, together with the Commission and the IMF, in the so-called Troika set up to interact with countries in crisis. It is feared in some quarters that the participation of a non-elected institution in political negotiations with governments may encourage political pressures on the Bank [*Normative premises*]. But the ECB's role is mainly to provide expertise in the assessment of the country programmes and to exercise its independent judgment in evaluating the risks it takes [*Cognitive premise*]. Again, collaboration with governments in times of crisis should not be viewed as a threat to central banks' independence if the limits of this collaboration are properly defined and disclosed. In fact, the market has reacted very positively to the approval of Outright Monetary Transactions. Had it considered the OMT as a prelude to debt monetization or a risk for central bank independence, the reaction on interest rates would have been diametrically opposite' [*Goal and cognitive premises*] (Passacantando, 2013: 12-13).

Indeed, this argument formulated by Passacantando on 23 April 2013 at the World Bank is a defence of the OMT programme mainly based on its conformity with key elements of the Maastricht model, namely: the 'no monetary financing' clause, the objective of avoiding moral hazard, and central bank independence. The goal of preventing moral hazard is not contested but exploited to increase the legitimacy of the OMT programme.

Finally, the detailed analysis of premises of moral hazard-based arguments in the corpus of the Bank of Italy ends with the argument in favour of regulating the NBFIs. Indeed, this argument is relatively new – it appeared for the first time in the corpus in 2020 – and became the most frequent moral hazard-based argument formulated by the Bank of Italy between 2020 and 2022. See, for example:

'Thanks to the reforms implemented after the global financial crisis, the banking sector has been able to face the financial stress produced by the pandemic with stronger capital and liquidity buffers, and has managed to provide critical lending support to the economy [*Cognitive premise*]. Post-financial crisis regulatory reforms had touched on

the non-banking financial intermediation sector to a much lesser extent [*Cognitive premise*].

We feel that our position was vindicated during last year's turmoil [*Cognitive premise*]. Some segments, such as money market funds (MMFs), experienced significant trouble in March, with a liquidity stress (the 'dash-for-cash') that caused an increase in redemptions [*Cognitive premise*]. The pandemic crisis has therefore exposed certain structural vulnerabilities in non-bank finance that should have been obvious to start with, including excessive liquidity transformation and potentially procyclical mechanisms [*Cognitive premise*]. Orderly conditions were re-established thanks to extraordinarily massive central bank intervention [*Goal and cognitive premises*]. Preventive safeguards seem to us to be required in order to lessen the need for such intervention and avoid moral hazard' [*Conclusion and goal premise*] (Signorini, 2021: 5).

The Deputy Governor of the Bank of Italy formulated this argument in October 2021 at an insurance summit in Rome entitled 'Ensuring a prosperous future for people and the planet'. Signorini argued that – contrary to what is often claimed – moral hazard is not irrelevant in the context of the pandemic. He stressed the moral hazard in the non-banking financial intermediation sector. A parallel is made between the IFC and the reforms implemented in the banking sector, and the COVID-19 crisis and the regulatory reforms of the NBFIs. If one wants to avoid the moral hazard caused by massive central bank intervention to support NBFIs, preventive safeguards are required. It is worth stressing that this moral hazard-based argument in favour of regulating the shadow banking system was only found in the corpus of the Bank of Italy.

7.4 Conclusion

The empirical analysis of the Italian case found the presence of minor contestation. There is evidence of moral hazard contestation (especially by the Italian government), but this evidence is limited. On the one hand, in 2015, the Italian Finance Minister contested the primacy of the goal of preventing moral hazard over risk sharing during interviews with Italian newspapers. On the other hand, Italian central bankers did not contest the goal of preventing moral hazard but the means-goal relationship. Indeed, the central bankers questioned the effectiveness of

some instruments to prevent moral hazard (such as, the threat of default or bail-in for small banks) and refuted the necessary causal relationship between deposit insurance and moral hazard. However, in both cases, contestation is not a major feature of the discourse on moral hazard. Despite some signs of opposition to the German discourse, the corpus of Italy's press documents is characterised by minor contestation. The finding of minor contestation by the representative of the southern coalition (a non-authoritative actor in this dissertation) constitutes evidence against the predictions of the authoritative theory and the hypothesis of power *over* moral hazard. This result suggests that contrary to what one might think, the political influence of moral hazard in EU economic governance after 2007 is not a story of Germany's power over moral hazard. Members of the southern coalition also exploited moral hazard to help them achieve their policy goals.

The examination of the condition of variability in the Italian case resulted in similarities and differences between Italian ministers and Italian central bankers. In terms of conceptions, there are three main common features: (1) the concept of moral hazard is taken for granted by Italian policymakers (there is only one direct definition of moral hazard in the entire corpus); (2) moral hazard is understood as wrong behaviour (a conception which privileges the role of social standards and moral principles); and (3) moral hazard is against the interest of taxpayers. However, some differences were also identified. Notably, several additional key features of moral hazard are present in the corpus of the Bank of Italy and absent from the corpus of the Italian government, such as: moral hazard as incentives for excessive risk-taking, not caring about the future, or the opposite of trust. In contrast, the role of *ex ante* beliefs is emphasized in the corpus of the Italian government and not in the one of the Bank of Italy. Finally, the interview of a former Italian minister informed about an additional type of moral hazard – altruistic moral hazard. This type of moral hazard implies that the conflict of interests is not necessarily between the individual and society but can also be between different social groups. The findings of the empirical analysis of what moral hazard means for a sample of Italian policymakers after 2007 questions the relevance of the political/central banking division for the conception of moral hazard. Indeed, the results of the analysis suggest that Italian politicians and central bankers share the view that moral hazard should be interpreted in moral terms. This finding is against the expectation that central bankers agree about the meaning of moral hazard. In addition, the Italian case presents more variability than that of Germany in terms of broad conceptions of moral hazard, with notably the interpretation of moral hazard as a trust problem present in the corpus of the Bank of Italy.

In terms of arguments, the analysis of the Italian policy elite's discourse on moral hazard found three main similarities. First, moral hazard is a political resource exploited mainly in the context of EU politics. Second, Italian policymakers exploited moral hazard to help them reduce the deficit of risk sharing in the Maastricht model. Instead of contesting the primacy of the goal of avoiding moral hazard, most often they presented the goal as something shared and framed risk sharing proposals as in conformity with this goal. Notably, the Italian government strategically accepted the causal relationship between permanent transfers and moral hazard to implicitly reject the claim that risk sharing in the form of non-permanent transfers creates moral hazard. Another identified strategy of exploiting moral hazard to argue in favour of increased risk sharing is to frame risk sharing as a necessary counterpart to instruments aimed at avoiding moral hazard (e.g. bail-in) and that threaten other important policy goals (e.g. financial stability). Not contesting moral hazard allows the reduction of the apparent distance between the proposals of the southern coalition and the preferences of the northern coalition and thus, increases the legitimacy of such proposals. Finally, third, the discourse of Italian central bankers and ministers on moral hazard is mostly cognitive. However, differences were also detected. For example, while moral hazard is a constant element of the discourse of the Bank of Italy over the 2007-2022 period, it only appeared in the discourse of the Italian government in 2015. Another significant difference is the focus of the discourse: the discourse of the Bank of Italy is mainly about financial institutions (notably, SIFIs), whereas that of the Italian government is mainly about governments. Finally, the Bank of Italy appears more conservative than the Italian government when it comes to the Maastricht model since it also wielded moral hazard to defend key elements of the initial institutional design of the euro area.

The inconsistent pattern of contestation by the Italian government and the variability within the Italian case and between the cases of Germany and Italy constitute evidence in favour of agency and usefulness (power *through*) and against structural forces and ideational consensus (power *in*). Indeed, at times the Italian government contested the primacy of the goal of avoiding moral hazard, while at times also exploited it. The understanding of moral hazard as an incentive problem is present in all sub-cases except in the Italian government sub-case. While the interpretation of moral hazard as a moral problem appears consensual among Italian policymakers, this interpretation is divisive among German policymakers. The concept of liability, while central in the German discourse on moral hazard, is absent from the Italian discourse. Contrary to the others, the Bank of Italy did not present moral hazard as a main cause of the IFC in its communications. While German policymakers exploited moral hazard to resist the development of risk sharing mechanisms, Italian policymakers did so to argue in favour of

further risk sharing. This crucial difference between the German case and the Italian case illustrates the relevance of the northern/southern division for the exploitation of moral hazard. Finally, the Bank of Italy developed a new moral hazard-based argument from 2020 – the one in favour of regulating the shadow banking system – that is absent from the German corpus. All these elements speak towards the capacity of different national actors to exploit moral hazard to their own advantage. The next two empirical chapters are dedicated to EU institutional cases and will allow us to add information as to the political/central banking division and the national/supranational division.

7.5 Appendices

Table 15 Moral hazard’s synonyms in Italian press documents

	Bank of Italy	Italian government	Total
Excessive risk-taking	3	0	3
Problematic incentives	2	0	2
Too big to fail problem	1	0	1
Recklessness/imprudence	1	0	1
Malpractice	1	0	1
Fraud	1	0	1
Laxity	1	0	1
Unethical behaviour	1	0	1
Deviant behaviour	0	1	1
Hyperbolic discounting	1	0	1
TOTAL ANALYSED DOCUMENTS	62	10	72

Source: Author. The numbers indicate the number of coded segments for each synonym.

Table 16 Moral hazard’s antonyms in Italian press documents

	Bank of Italy	Italian government	Total
Prudence	1	0	1
Preventive behaviour	1	0	1

A lack of confidence between parties	1	0	1
Being reckless because you know that others will rescue you	1	0	1
To take advantage at the expense of others	0	1	1
When risks are transferred to others	1	0	1
To take risks when feeling sheltered from the risk of failure	1	0	1
When you believe you will be supported in bad times	1	0	1
To count on the help of others to persevere in the bad policies	1	0	1
To invest without knowing that I may lose everything	1	0	1
TOTAL ANALYSED DOCUMENTS	62	10	72

Source: Author. The numbers indicate the number of coded segments for each code.

Table 18 ‘What causes it’ in Italian press documents

	Bank of Italy	Italian government	Total
TBTF/SIFIs	15	0	15
UMP	4	0	4
Expectation/assumption/perception of assistance or support	1	2	3
Securitisation	2	0	2
(European) Deposit Insurance Scheme	2	0	2
Firewalls/safety nets/public insurance	2	0	2
Confusion of roles	2	0	2
IMF	2	0	2
Government policy	1	0	1
Public support/intervention/measures in times of crises	1	0	1
Central bank crisis measures	1	0	1
Asymmetrical monetary policy	1	0	1

Joint issuance of public debt	0	1	1
A European (resolution) fund	1	0	1
State/government support in times of crises	1	0	1
Support in the context of endogenous shock	1	0	1
Wrong timing of crisis measures	1	0	1
Implicit or explicit bailout guarantee	1	0	1
Central bank insurance	1	0	1
Unemployment (re)insurance scheme	0	1	1
Fiscal free lunch	1	0	1
Greater disclosure of emergencies tools	1	0	1
The difficulty of finding a European accord in the Greek case	1	0	1
Increased risk capacity	1	0	1
Partnership between bank and insurance company	1	0	1
TOTAL ANALYSED DOCUMENTS	62	10	72

Source: Author. The numbers indicate the number of coded segments for each code.

Table 19 ‘What it does’ in Italian press documents

	Bank of Italy	Italian government	Total
Cost for taxpayers	2	1	3
Promotes risk-taking/induces excessive risk-taking	3	0	3
Crises	0	2	2
Long-term instability	2	0	2
Discourages needed adjustments/reforms	2	0	2
Increases the probability of systemic meltdown	2	0	2
Affects or hampers price stability	1	0	1
Poses a threat to the maintenance of a market-based system	1	0	1

Source: Author. The numbers indicate the number of coded segments for each code.

Table 20 Dictionary-based topic classification in Italian press documents

Topic and sub-topic	Bank of Italy	Italian Government	Total
Financial assistance	54	7	61
IMF	6	0	6
EFSF/ESM	3	2	5
NGEU	0	1	1
Resolution	37	2	39
Monetary policy	10	0	10
UMP	15	0	15
QE	12	4	16
OMT	3	0	3
Negative interest rates	0	0	0
TLTROs	0	0	0
Regulation	38	0	38
Too big to fail	29	0	29
Structural reforms	26	1	27
Fiscal rules	14	1	15
Supervision	24	0	24
Deposit guarantee	14	0	14
Maastricht Treaty	11	2	13
Transfers	11	5	16
Mutualisation	5	4	9
Banking Union	3	1	4
Austerity	8	0	8
Lender of last resort	3	0	3
Competition policy	4	0	4
Pension system	2	0	2
Housing policy	1	0	1

Inequalities	2	0	2
Natural disaster	1	0	1
Common borrowing	0	1	1
Migration	0	0	0
TOTAL ANALYSED DOCUMENTS	62	10	72

Source: Author.

Table 21 ‘Conclusion’ of moral hazard-based arguments in Italian press documents

	Bank of Italy	Italian government	Total
For TBTF reforms	13	0	13
For insolvency procedures/resolution regimes	5	0	5
For 'bail-in'	4	0	4
For centralisation at the EU level	4	0	4
For regulation of the nonbank financial institutions (NBFIs)	4	0	4
For a European unemployment insurance scheme	0	3	3
For risk sharing	0	3	3
For OMT	3	0	3
For increased transparency of OTC trading	2	0	2
For Banking Union	1	1	2
For one main objective: price stability	2	0	2
For more international coordination	2	0	2
For a reform of pension systems	2	0	2
The threat to let a financial institution fail is no longer the most effective weapon against moral hazard	2	0	2
For limits and risk-based premiums in deposit guarantee schemes	2	0	2
For EDIS	2	0	2

For instruments to deal with crises of non-systemic banks	2	0	2
For reducing the centrality of any one institution to the system's stability	2	0	2
For stricter capital requirements	1	0	1
For (more efficient) supervision/surveillance	1	0	1
For conditional financial assistance	1	0	1
For (stricter) rules	1	0	1
For a European Resolution Fund	1	0	1
Against unregulated securitisation	1	0	1
For a gradual introduction of bail-in	1	0	1
For "living wills"	1	0	1
For CCP for OTC derivatives	1	0	1
For macroprudential policies	1	0	1
For the SGP	1	0	1
Against the IMF's Special Drawing Rights (SDR)	1	0	1
For a common budget for the euro area	0	1	1
For increased ability of the State to deal with market failures	0	1	1
For finding a balance between conflicting objectives	1	0	1
For 'sticks and carrots'	0	1	1
For using debt wisely, productively and honestly	0	1	1
Against usury of criminal origin	1	0	1
For a European public investment stabilisation function	1	0	1
For an assessment of the creditworthiness of businesses by insurance companies	1	0	1
Uncertainty: there is no way to know if one made the right choice	1	0	1
For restrictions on activities/size/structure	1	0	1

Against the reform of the ‘international financial architecture’ (IFA) in the 1990s	1	0	1
For planning for future	1	0	1
Against some of the BRRD solutions	1	0	1
For a federal budget with the threat of defaults	1	0	1
Against a currency without a state	1	0	1
For UMP	1	0	1
For partial risk sharing	1	0	1
For venture capital	1	0	1
For strong political and regulatory pressure	1	0	1
Against political indecision	1	0	1
For reducing the risks of the shadow banking system	1	0	1
For greater discipline by market participants	1	0	1
The inevitable nature of crises	1	0	1
For private insurance against natural disasters	1	0	1
For a series of conditions before adopting deposit guarantee schemes	1	0	1
For knowing that I may lose everything when I invest	1	0	1
For a unified European response to crisis	1	0	1
TOTAL ANALYSED DOCUMENTS	62	10	72

Source: Author. The numbers indicate the number of coded segments for each code.

Figure 10 ‘Whose moral hazard?’ in the corpus of Italian press documents

Figure 10.1 Italian government

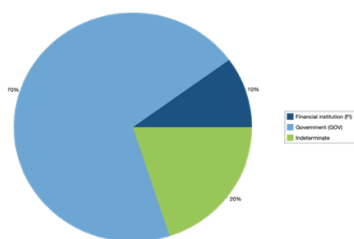
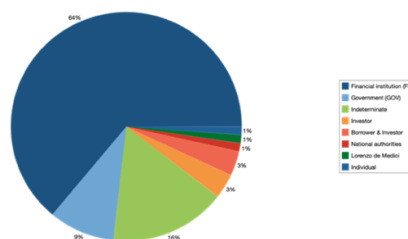


Figure 10.2 Bank of Italy



Source: Author.

Figure 11 Distribution of normative and cognitive premises in the moral hazard-based arguments formulated by the Italian government and the Bank of Italy

Figure 11.1 Italian government

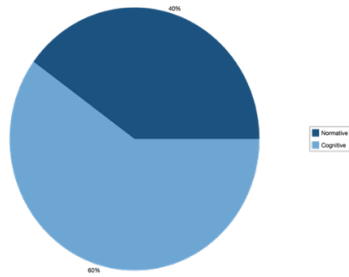
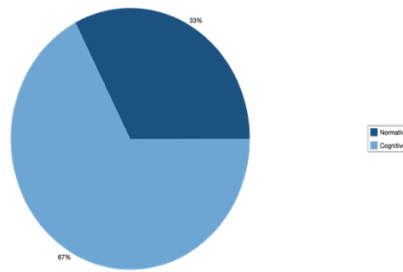


Figure 11.2 Bank of Italy



Source: Author.

8 ECB

This chapter presents the findings of the empirical analysis of the ECB case – a supranational and authoritative actor (i.e. central bank). Similarly to the previous empirical chapters on Member States, this chapter provides answers to the following key questions: is the condition of minor contestation present in the ECB case? Do ECB officials share a common and dominant understanding of what moral hazard is? And what are the main characteristics of the moral hazard-based arguments formulated by these supranational central bankers?

The results from this chapter, when compared to the results of the Bundesbank and the Bank of Italy, will allow us to draw conclusions on the role of central bankers' authoritative voice on the political influence of moral hazard. Although the previous empirical chapters presented variability of conceptions and arguments between the Bundesbank and the Bank of Italy, some expectations as to how ECB officials use moral hazard can be formulated based on the similarities of the national central bank cases and the supranational nature of the ECB. For example, this dissertation expects minor contestation of moral hazard by ECB officials. Notably, the primacy of the goal of avoiding moral hazard seems relatively uncontested by central bankers. When it comes to conceptions of moral hazard, this dissertation expects the rationality-based conception to be prominent among ECB officials. This expectation is based on the close relationship between central banking and economics. Finally, given the hypothesis of power *through* moral hazard, this dissertation expects the Executive Board members of the ECB to exploit the concept in a way that helps them to achieve supranational policy goals – such as, greater competences for EU institutions or the stability of the euro area.

The structure of this chapter is the same as the previous empirical chapters. The first section is dedicated to contestation. The second and third sections focus on the conceptions of and arguments about moral hazard, respectively. The final section summarizes the main results and concludes on the relevance of the national/supranational division among central banks and its implication for the relationship between power and moral hazard.

8.1 On Contestation

The examination of contestation aims to establish whether there is a present battle for hegemony among European policy elites when it comes to opinions on moral hazard. This section presents the results of the ‘Contestation’ code for the ECB – the final central bank case under consideration in this dissertation. In doing so, it will allow us to conclude on whether moral hazard is a shared belief among central bankers.

There are 161 utterances of the term ‘moral hazard’ (one sentence before and after) in the corpus of ECB press documents (117 documents). The total number of coded segments with ‘Contestation’ is 20. Thus, the condition of minor contestation is present in the case of the ECB: over the 2007-2022 period, when ECB officials used the concept in their communications, they did so primarily to exploit it and not to refute or challenge a statement on moral hazard. Moral hazard is subject to little contestation by the monetary policymakers examined in this dissertation. However, although limited, the contestation of moral hazard by ECB officials is not insignificant – notably when compared to the extent of contestation estimated in the other central bank cases of this dissertation. Indeed, the extent of contestation in the corpus of ECB press documents is approximately 12%, while it is around 2% in the corpus of the Bundesbank and 7% in the corpus of the Bank of Italy (Chapters 6 and 7). In this dissertation, Europe’s supranational monetary policymakers are more likely to publicly contest moral hazard than national monetary policymakers.

Among the 17 Executive Board members of the ECB who used the term ‘moral hazard’ in their communications between 2007 and 2022, five did so to refute or challenge a statement on moral hazard: Lorenzo Bini Smaghi (Member of the Executive Board of the ECB, 2005-2011), Mario Draghi (President of the ECB, 2011-2019), José González-Páramo (Member of the Executive Board of the ECB, 2004-2012), Peter Praet (Member of the Executive Board of the ECB, 2011-2019), and Isabel Schnabel (Member of the Executive Board of the ECB, 2020-). It is worth stressing that from the 14 documents containing at least one coded segment with ‘Contestation’, half are of Schnabel. 2020 is the year in which contestation is the most frequent in the corpus of ECB press documents. Indeed, from May 2020, Schnabel refuted several times the relevance of moral hazard in the context of the COVID-19 crisis. See, for example:

‘This is why the European initiative is absolutely crucial, because it must not happen that certain countries cannot react properly because they simply do not have the fiscal space. This situation is politically easier than what we had in the past because there is

little concern of moral hazard, which played such a prominent role in earlier times. Bundestag president Wolfgang Schäuble also stressed that particular point and very strongly supports the European response' (Schnabel, 2020a: 2).

'Fast and decisive fiscal policy intervention – across all countries – is essential in order to alleviate the health, social and economic consequences of this crisis. So moral hazard plays a minor role during the current crisis: it is desirable that governments increase their borrowing so as to mitigate the adverse effects of the crisis on the people and the economy.

The ECB's measures – and in particular the PEPP – have prevented the disruptions in financial markets from jeopardising the urgently needed fiscal response to this crisis' (Schnabel, 2020: 4-5).

'The announcement of the PEPP in March of this year operated similarly: it built a bridge for the historical response of euro area governments to this crisis and supported market functioning at a time of exceptional uncertainty (see right chart slide 11).

In such situations, when yields are largely reflections of panic rather than fundamental factors, risks of moral hazard are negligible and should not prevent the central bank from acting forcefully' (Schnabel, 2020c: 4).

Like Buch, Schnabel refuted the relevance of moral hazard in the context of the pandemic to argue that the COVID-19 crisis is different and thus justifies public support in response to this crisis (Chapter 6). However, while this argument was exceptional in the corpus of the Bundesbank and focused upon public support to the private sector, it is relatively more frequent in the corpus of the ECB and focused upon European public support to Member States. It should be noted that these selected coded segments are not only of analytical interest because they illustrate the contestation of moral hazard in the context of the pandemic but also because they indicate that, according to Schnabel, interpretation plays a crucial role when it comes to moral hazard. Indeed, the judgment on moral hazard depends on whether increased borrowing by governments is interpreted as desirable or undesirable, and on whether yields are interpreted as fair or unfair.

Contestation of moral hazard in the corpus of the ECB is not limited to the relevance of moral hazard in the context of the COVID-19 crisis. Similarly to the other central bank cases examined in this dissertation, several refuted statements on moral hazard relate to the means-goal relationship. See, for example:

‘Still, one cannot generally conclude from this that central banks should not re-act and support the system in the case of severe tensions. To rigorously analyse moral hazard issues relating to financial crisis management by central banks, one first needs to distinguish between different but interrelated types of policy interventions. The reason for this is that the possible effects on incentives of different measures can be very diverse. However, this differentiation has often been missed when criticising central bank actions on the grounds of moral hazard considerations’ (González-Páramo, 2007: 5).

‘The second alleged dichotomy is the notion that public insurance creates moral hazard, and therefore risks have to be reduced before they can be shared. But this overlooks both the theoretical and empirical evidence we have on the incentive-effects of risk-sharing. There is a wealth of evidence that moral hazard depends on the appropriate design of insurance schemes.

And what we see in practice is that the absence of insurance does not lead to lower risks, either for individual countries or for the euro area as a whole’ (Draghi, 2019: 3).

‘Nor have the side effects of our novel measures been as drastic as the public debate at times suggests. For example, there is no evidence that purchases of government debt have undermined the disciplinary function of financial markets or created moral hazard. Lower interest rates did not lead governments to take on more debt’ (Schnabel, 2020b: 2).

González-Páramo is the first ECB Executive Board member to refute a statement on moral hazard in the corpus. On 3 December 2007, during a speech at the European Money and Finance Forum in Milan, he contested the rigorous nature of most analyses on central bank crisis actions and moral hazard. Indeed, he argued in favour of more nuanced analyses that allow the distinction of moral hazard effects (or lack thereof) of different measures (González-Páramo, 2007). Notably, González-Páramo refuted that lowering the monetary stance as a reaction to macroeconomic developments creates moral hazard and that the moral hazard effect of aggregate liquidity injection through open market operations or of a reduction of the penalty rate associated with the recourse to a central borrowing facility is obvious (*ibid.*). More generally, during a speech at the Academy of Athens, the President of the ECB refuted the statement that public insurance necessarily creates moral hazard (Draghi, 2019). Draghi’s contestation of the premise of the ‘risk reduction before risk sharing’ conclusion is based on

academic knowledge (ibid). This is a direct opposition to the German discourse on moral hazard (Chapter 6). The third coded segments selected to illustrate the contestation of the means-goal relationship by ECB officials is from a speech delivered by Schnabel in Frankfurt at the Interparliamentary Conference on Stability, Economic Coordination and Governance in the EU (Schnabel, 2020b). In this speech, Schnabel refuted that purchases of government debt have created moral hazard. The reason to justify this claim is the absence of empirical evidence in favour of the causal relationship between government debt purchases and moral hazard. This contestation of moral hazard aims to increase the legitimacy of UMP measures.

Finally, it is worth stressing that, contrary to the other central bank cases examined in this dissertation, there is some contestation of the primacy of the goal of avoiding moral hazard in ECB press documents (3 coded segments). See, for example:

‘One reason for debt restructuring – which is often made by some theoretical economists – is that it helps financial markets to function better and it eliminates moral hazard. The problem with this view is that it totally omits the broader impact on the markets. Trying to eliminate moral hazard in the middle of a systemic crisis is like shooting yourself in the foot. Think about it: did the failure of Lehman Brothers make markets work better, or worse? Did it reduce moral hazard?’ (Bini Smaghi, 2011: 2).

‘There is always a risk that others will say “Thank you, you act and I take the benefit” – and that they then don’t act on their own. Moral hazard is an issue for monetary policy, I don’t deny that. At the same time, it cannot be an excuse not to act if you come to the conclusion that this is needed, given your mandate’ (Praet, 2014: 2).

‘In such situations [when risks of self-fulfilling price spirals threaten to undermine stability in the euro area as a whole], risks of moral hazard should not condemn the central bank to a course of inaction. These risks should be governed by other institutions outside crisis times’ (Schnabel, 2021: 4).

On 17 June 2011, during an intervention at the Swedish central bank, Smaghi refuted that the goal of avoiding moral hazard should have primacy over systemic stability (and questioned the efficiency of the failure of Lehman Brothers as an instrument to reduce moral hazard). Almost ten years later, in the context of the pandemic and during a keynote speech at an annual conference organised by the European Fiscal Board, Schnabel also refuted the primacy of avoiding moral hazard over systemic stability. This contestation of moral hazard is of particular interest since it somewhat contradicts other elements of Schnabel’s discourse on moral hazard

since 2020. Indeed, instead of refuting the relevance of moral hazard in the context of the COVID-19 crisis, on 26 February 2021, she argued that the goal of avoiding moral hazard should not be the responsibility of the central bank and that it should be achieved outside crisis times – thus, implying that moral hazard was not irrelevant in the context of the pandemic. Finally, during an interview with the German newspaper *Börsen-Zeitung* on 11 December 2014, Praet refuted the primacy of the goal of avoiding moral hazard over price stability (i.e. the mandate) (Praet, 2014).

To sum up, the contestation of moral hazard in the corpus of ECB press documents is minor but relatively more frequent and diversified compared to the contestation of moral hazard in the cases of the Bundesbank and the Bank of Italy. ECB Executive Board members have refuted statements on the relevance of moral hazard in the context of the COVID-19 crisis, on the causal relationship between certain central bank measures and moral hazard, and on the primacy of the goal of avoiding moral hazard over systemic or price stability. It seems that most of the contestation of moral hazard is knowledge-based and aims to increase the legitimacy of UMP measures, especially the most controversial ones involving government debt purchases. Despite this evidence of contestation, exploitation is the major characteristic of the ECB's political discourse on moral hazard. The following sections of this chapter investigate the elements that can be a source of variability as to how and for what purposes moral hazard is exploited: that is, conceptions and arguments.

8.2 On Conceptions

As in the other empirical chapters, the analysis of the variability condition begins with the investigation of how moral hazard is presented in the corpus and understood by the interviewees. This section aims to identify what moral hazard means to a sample of ECB officials after 2007. The various features of the 'moral hazard family' in the case of the ECB are derived from the analysis of moral hazard's semantic fields and the results of the codes 'What it is', 'What causes it', and 'What it does'. The key features of moral hazard drawn from the textual analysis of press documents are complemented by and compared with the results of the interviews.

The results for the semantic fields of moral hazard in the corpus of ECB press documents are presented in Table 22 (synonyms) and Table 23 (antonyms), and Figure 12 (word clouds) (in the appendices to this chapter). As in the other central bank cases (and the

German government), moral hazard is presented by ECB officials as an incentive problem. Indeed, it was described as having the same meaning as ‘problematic incentives’ and an opposite meaning to ‘appropriate incentives’. Similarly to the Bundesbank and the Bank of Italy, this incentive problem relates to risk-taking (‘recklessness/imprudence’, ‘appetite for risk’), and particularly concerns ‘excessive risk-taking’. Presenting moral hazard as closely linked to the ‘too big to fail problem’ and to ‘have (one’s) skin in the game’ also points towards the key feature of ‘being indifferent to the (potential) negative consequences of one’s action’. In the language of neo-classical economics, if external incentives are such that excessive risk-taking is not expected to produce disutility for an individual but utility, rational expected utility-maximisers will take excessive risks. The interpretation of moral hazard as an incentive problem removes the blame from the individual and places it in the system of external incentives. The individual is as it is – an expected utility-maximiser (no value judgment is attached). The solution to this problem lies in a change to the system of external incentives.

Against this background, there are several synonyms and antonyms in the corpus of ECB press documents that suggest a blame placed on the individual. Words like ‘irresponsibility’, ‘misconduct’, ‘dependence’ (for synonyms), and ‘discipline’, ‘trust’ or ‘due diligence’ (for antonyms) point towards a lack of moral character resulting in an individual that cannot be left alone. It is worth stressing that out of the seven coded segments for synonyms and antonyms implying a lack of moral character, five have been used in relation to governments. See, for example:

‘Why should taxpayers support countries which have lived beyond their means, and even cheated on their accounts? Won’t all this money create moral hazard and be an incentive for similarly irresponsible behaviour?’ (Bini Smaghi, 2011b: 1).

‘What Theo Waigel understood is that a union of separate nations, with different histories, traditions and cultures, but bound together by common interests and common needs, could only be built on mutual trust.

Trust was the key ingredient for countries take further steps towards integration without fear of moral hazard. But trust had to be earned’ (Draghi, 2016: 1).

‘At the European level, concerns about moral hazard are addressed via the EU fiscal framework. It’s the responsibility of the European Commission and the European Council to monitor and discipline Members States, not that of the ECB’ (Lane, 2019: 3).

The analysis of moral hazard's semantic fields ends with an examination of words used most frequently next to the term 'moral hazard'. In documents written in English (113 out of 117), the most frequent words are: 'bank', 'create', 'risk', 'not', 'issue', 'avoid', 'concern', 'financial', 'mitigate', 'problem', 'reduce', and 'need' (Figure 12 in the appendices to this chapter).⁹⁵ In addition, there are four documents written in German in the corpus of ECB press documents. In German language documents, the most frequent words are: 'government', 'misbehaviour/misconduct', 'occasion/event/cause', 'give', 'can', 'my', and 'become' (author's translation, Figure 12 in the appendices to this chapter).⁹⁶ These word clouds provide information as to the subjects, adjectives, verbs, and objects of sentences that contain the term 'moral hazard'. The word clouds indicate that, when addressing an English-speaking audience, ECB officials tend to discuss the moral hazard of banks. Moral hazard is most often described as a risk but also as an issue, a concern, and a problem, which suggest different levels of gravity. Indeed, formulations such as 'the moral hazard issue' or 'moral hazard concerns' attenuate moral hazard, whereas formulations like 'the problem of moral hazard' or 'the moral hazard problem' exaggerate moral hazard.⁹⁷ The interpretation of most frequent verbs next to moral hazard is ambiguous: 'create' and 'avoid' suggest control over moral hazard and its non-necessary nature, while 'mitigate' and 'reduce' imply that moral hazard cannot (or should not) be eliminated. However, since 'create' is the most frequent verb (frequency of 19, versus 11 for the other verbs), one can infer that, most often, ECB officials seek not to create moral hazard (this is also suggested by the frequency of the word 'not'). Finally, it is worth stressing that the word cloud of moral hazard in German language documents is different from that of English language documents. Notably, when addressing a German-speaking audience, ECB officials tend to discuss the moral hazard of governments and to associate moral hazard with wrongdoings.

In sum, the examination of semantic fields allows the drawing of some preliminary conclusions in terms of key features of moral hazard in the corpus of the ECB. Two broad conceptions of moral hazard seem to coexist in the ECB's press documents: moral hazard as incentives for excessive risk-taking and moral hazard as a lack of moral character. The first is devoid of value judgement and privileges the role of rationality and external incentives (e.g. not suffering a disutility for taking excessive risks). The second implies a value judgement as

⁹⁵ This list corresponds to the words with a frequency of 10 or more.

⁹⁶ This list corresponds to the words with a frequency equal to 2.

⁹⁷ It is worth noting that 'issue' has a frequency of 16, while 'concern' and 'problem' have a frequency of 11. Thus, ECB officials are more likely to attenuate moral hazard than to exaggerate it.

it refers to wrong behaviours that could be avoided with moral qualities. The normative interpretation of moral hazard seems to be more present when discussing governmental moral hazard and when addressing a German-speaking audience. However, the English language discourse on moral hazard seems to be mainly about banks. ECB officials appear relatively optimistic about the capacity to not create moral hazard and tend to attenuate the phenomenon in their communications.

In addition to semantic fields, this dissertation examines how ECB officials explain moral hazard in their communications. The results for the code ‘What it is’ are presented in Table 24 (in the appendices to this chapter). It should be noted that out of these results, there are five coded segments (out of 117 documents) where moral hazard is directly defined by ECB Executive Board members as: ‘a situation in which asymmetric information can lead borrowers to take action that erodes the value of the loan’ (Trichet, 2010); ‘when there are incentives for misconduct’ (Stark, 2010a); ‘the expectation of being protected from ‘tail events’ in bad times’ (Stark, 2010a); ‘the risk of encouraging opportunistic behaviour’ (Bini Smaghi, 2011b); and ‘when the public sector backstops private risk-taking’ (Praet, 2016). The lack of direct definitions of moral hazard in the corpus indicates that Europe’s monetary experts tend to take the concept for granted and assume that their audience knows what moral hazard is.

Yet, 15 subcodes were created to take into account the variety of moral hazard’s descriptions in the ECB’s press documents. The most prominent feature from these descriptions of moral hazard is the negative effect of external incentives on appropriate behaviour (‘when incentives for being responsible are weakened’, ‘when there are incentives for a reckless action’, ‘when there are incentives for misconduct’). In other words, moral hazard is often understood in the corpus as a situation where inappropriate behaviour becomes more likely. In contrast, other descriptions presuppose that the undesirable action has materialised (‘when the expectation of support causes a reckless or irresponsible action’, ‘when crisis responses cause undesirable actions’, ‘when those who behaved improperly are not punished’). The difference between expected and actual negative outcome matters because it changes the universality of moral hazard – the condition of materialisation of the undesirable action restricts the applications of moral hazard and thus helps to negate the phenomenon of moral hazard. In ECB press documents, the condition of materialisation is often used in relation to central bank crisis responses (like UMP). In addition, other descriptions emphasise the question of social fairness (‘when benefits are privatised and costs are socialised’, ‘when the public sector backstops private risk-taking), or the protection from negative consequences or outcomes (‘when losses stemming from recklessness are suppressed’, ‘the expectation of being protected from ‘tail

events' in bad times'). However, contrary to previous cases examined in this dissertation, 'voluntarily taking advantage at the expense of others' does not appear as an explicit key feature of moral hazard in the corpus of the ECB.

Finally, the textual analysis of how moral hazard is presented in the corpus of ECB press documents ends with the examination of its cause-and-effect relationship. The results for the codes 'What causes it' and 'What it does' are presented in Table 25 and Table 26, respectively (in the appendices to this chapter). Contrary to the cases of the Bundesbank and the Bank of Italy (in which the systemic nature of some financial institutions is by far the most frequent cause of moral hazard discussed in press documents), ECB officials most often discussed the causal relationship between UMP measures and moral hazard. The discussion of this causal relationship became particularly salient in ECB's communications in 2012 and from 2020. However, as already noted in the contestation section of this chapter, the UMP-moral hazard causal relationship is presented as potential rather than necessary – notably, thanks to conditionality. See, for example:

'This is also the reason why strict and effective conditionality and adherence to an appropriate EFSF or – later hopefully – ESM programme is a necessary condition to activate the OMT purchases. For the ECB, conditionality is key in order to ensure long-term sustainability of the fiscal, structural and macroeconomic adjustment path and to minimize concerns of moral hazard. Let me elaborate on the main elements of the Outright Monetary Transactions programme' (Asmussen, 2012: 3).

'The ECB has perhaps been more acutely aware of this feature of non-standard measures than other central banks because of the multi-country nature of the euro area. Consistently with the results of the academic literature, offering partial insurance has been our guiding principle to mitigate moral hazard concerns. The conditionality associated with our OMT programme, can be viewed as direct applications of this principle' (Coeuré, 2013: 2).

Although the systemic nature of certain financial institutions is not the most frequent cause of moral hazard discussed in the corpus of the ECB, 'TBTF/SIFIs' is also relatively frequent (i.e. the second most frequent result). As for the Bundesbank, the moral hazard created by SIFIs was particularly stressed by ECB officials in 2010 (and was absent from the ECB's discourse on moral hazard before that year). Before 2010, ECB officials rather discussed the causal relationship between low interest rates and moral hazard. To conclude on the (potential) causes

of moral hazard in ECB press documents, it is worth stressing that contrary to German central bankers, central bankers from the ECB did not emphasise the causal relationship between securitisation and moral hazard in their communications.

Surveying the effects of moral hazard discussed in the corpus is crucial to the identification of moral hazard conceptions since it constitutes additional information that helps to recognise – according to ECB officials – the presence of moral hazard. As in the previous cases of this dissertation, there is no positive effect of moral hazard, which explains why ‘not to create moral hazard’ should be a policy goal. The most frequent negative effect relates to undesirable actions (‘discourages needed adjustments/reforms’ or ‘induces excessive risk-taking’). ‘Crises’ are also a relatively frequent effect of moral hazard in the corpus. Notably, moral hazard was used to explain the IFC. See, for example:

‘The deployment of the central bank balance sheet as a stabilising instrument was a novelty, and immediately met substantial scepticism. First, there were concerns about moral hazard, given the unprecedented expansion of ECB credit to banks at a time when banks were under scrutiny for their mismanagement of risk in the pre-crisis period and for having precipitated the crisis in the first place’ (Praet, 2017:2).

Although moral hazard was not used by the ECB to explain the euro area SDC (at least in the textual context of one sentence before and after), the potential causal relationship between moral hazard and the Greek crisis has been acknowledged once:

‘Those tensions were compounded by the third phase, which began when the Greek crisis shattered the impression that public debt was risk-free, triggering a rapid repricing of sovereign risk. To those who saw the crisis as a consequence of moral hazard, this represented a required return of market discipline vis-à-vis sovereigns – a view that was reflected in the Deauville agreement in October 2010’ (Draghi, 2018: 1).

This coded segment is of particular interest because it explicitly presents the causal relationship between moral hazard and the Greek crisis as a matter of interpretation – some observers saw the crisis as a consequence of moral hazard, others did not. In May 2018, at the European University Institute, the President of the ECB implied that the German and French governments believed that moral hazard was a cause of the Greek crisis.⁹⁸ If moral hazard was not used to explain the euro area SDC by ECB officials, the negative effect of moral hazard on the

⁹⁸ Here, it should be noted that – in the textual context of one sentence before and after – the causal relationship between moral hazard and the Greek crisis is absent in the German government’s press documents (Chapter 6).

sustainability of public finances is present in the corpus. Similarly to the previous cases of this dissertation, not creating moral hazard matters if one wants to avoid long-term instability and future crises. Finally, it is worth stressing that, while the negative impact of moral hazard on taxpayers is emphasized in Member State cases, this effect is not prominent in the corpus of the ECB.

Based on the analysis of semantic fields, explanations of moral hazard, and descriptions of its cause-and-effect relationship, various features of the ‘moral hazard family’ in the corpus of the ECB were identified. In the case of the ECB, moral hazard is mainly about incentives to take excessive risks or other undesirable actions. Moral hazard is primarily presented as a rational response to the absence of disutility attached to the undesirable action. There is a broad and a restricted conception of moral hazard – at times, the condition of materialisation of the undesirable action is present (restricted moral hazard, which includes a ‘backward-looking’ element), while at times it is absent (broad moral hazard, which includes a ‘forward-looking’ element). Although some findings point to a lack of moral character resulting in an individual that cannot be left alone, the feature of morality is relatively less present than in other cases of this dissertation. Indeed, ‘voluntarily taking advantage at the expense of others’ is not a feature emphasized in ECB press documents. Moral hazard is an issue for ECB officials because it increases the likelihood of undesirable actions, producing crises. However, ECB Executive Board members appear relatively optimistic about the capacity not to create moral hazard.

The key features of moral hazard identified from the textual analysis of press documents are now compared with the key features of moral hazard derived from the interviews. Three interviews have been conducted with ECB officials (who are not Executive Board members). For two of the three interviewees, moral hazard is a behaviour that goes against moral principles (Interviews 7 and 8). Indeed, moral hazard was described as ‘something that you consciously do, knowing that you may hurt someone or something’ (Interview 7). For this interviewee, moral hazard is a type of intentional exploitation or abuse that involves negative externalities (ibid.). The feature of ‘intentionally or voluntarily taking advantage at the expense of others’ is prominent in how this interviewee understands moral hazard. In addition, it is worth stressing that the word ‘incentive’ was not mentioned once by this interviewee (a sign indicating that the individual is to be blamed for the inappropriate behaviour). In contrast, the other interviewee that used the criterion of ‘against ethical and moral standards’ to assess whether something is moral hazard emphasized the role of adverse incentives (Interview 8). For this interviewee, ‘moral hazard is an inappropriate behaviour which is triggered by a set of adverse incentives’ (ibid.). This understanding of moral hazard is similar to the case of restricted moral hazard

identified in the corpus. Finally, the third interviewee refrained from attaching a value judgment to moral hazard (Interview 9). This interviewee defined moral hazard in terms of a principal-agent relationship: moral hazard is ‘when you give liquidity, and then you use the liquidity for purposes which are not aligned with those of the person giving you the money’ (ibid.). According to this interviewee, this is what moral hazard is to an economist (ibid.). Yet, the claim that economists agree on the meaning of moral hazard is again challenged by the material from the interviews. For example, in addition to the evidence that has already been presented, it is worth stressing that these three economists working at the ECB did not agree on whether moral hazard caused the IFC and the euro area SDC (questions 1 and 2): two interviewees answered ‘yes’ for the IFC (Interviews 7 and 8) and one answered ‘no’ (Interview 9); two interviewees answered ‘no’ for the SDC (Interview 7 and 9) and one answered ‘yes’ (Interview 8). These results highlight the ambiguity of moral hazard, even among a small group of ECB economists.

To conclude, the empirical analysis of how moral hazard is understood in the ECB case finds that moral hazard is mainly presented as an incentive problem, causing excessive risk-taking and crises, such as the IFC. The conception of moral hazard as an incentive problem is in line with the neo-classical economics literature. However, the material from the interviews also indicates that this conception of moral hazard is not consensual among ECB officials. Indeed, some economists at the ECB clearly understand moral hazard as a moral problem, emphasising the feature of ‘intentionally taking advantage at the expense of others’. The difference between how moral hazard is described in press documents and by interviewees suggests a deliberate effort from the part of ECB Executive Board members to abstain from presenting moral hazard in moral terms in their communications. The next section is dedicated to the examination of moral hazard-based arguments in ECB press documents.

8.3 On Arguments

This chapter has established that ECB officials mostly use the term ‘moral hazard’ in their communications to exploit it. This section aims to investigate how moral hazard helps ECB Executive Board members to justify or legitimize policy goals. The political discourse of the ECB on moral hazard is first contextualised in terms of distribution over time and between topics. Second, moral hazard-based arguments are examined in terms of conclusions and premises. Finally, third, a selection of moral hazard-based arguments is analysed in more detail.

Moral hazard is a constant element of the ECB's discourse in the 2007-2022 period (i.e. ECB officials wielded the concept every year in their communications). The first press document with an utterance of the term 'moral hazard' during this period is a speech by the President of the ECB at a hearing of the European Parliament on 11 June 2007. In this speech, Trichet discussed the management of potential financial crises and argued that the responsibility of the private sector must be maintained (i.e. the primacy of private sector solutions for crisis resolution) to avoid moral hazard (Trichet, 2007). Although moral hazard was wielded every year in press documents between 2007 and 2022, the concept was particularly wielded by ECB Executive Board members in 2010-14 – with a peak in 2011 (see Figure 3). The most frequent topics in the corpus of the ECB are financial assistance, monetary policy (notably QE), fiscal rules, resolution, regulation, and the Maastricht Treaty (see Table 27 in the appendices to this chapter). When looking at the distribution of topics over time, it should be noted that austerity became one of the most frequent topics in 2012 and transfers in 2018-19.

Moral hazard was used by ECB Executive Board members to draw 123 policy conclusions (see Table 28 in the Appendices to this chapter). The most frequent conclusions of moral hazard-based arguments in ECB press documents are the following:

- For conditional financial assistance;
- For insolvency procedures/resolution regimes;
- For stricter capital requirements;
- For OMT;
- For UMP;
- Against bailouts;
- For TBTF reforms;
- For a European Resolution Fund;
- For a euro area fiscal capacity;
- For a permanent crisis management mechanism;
- For PEPP;
- For temporary UMP.⁹⁹

⁹⁹ The moral hazard-based argument in favour of temporary UMP formulated by ECB officials is not that UMP measures should be a temporary instrument at the disposal of central banks but that UMP measures should be used by central bankers to supply a passing need until financial conditions improve (see, for example, Tumpel-Gugerell, 2011; Coeuré, 2013a; de Guindos, 2021).

The argument in favour of conditional financial assistance is the most frequent moral hazard-based argument in the corpus of the ECB. However, it became particularly salient only in 2012. The year 2012 marks a shift in the political discourse of the ECB on moral hazard. Indeed, before 2012, ECB officials most often wielded moral hazard to defend and preserve key elements of the Maastricht model: ‘against bailouts’, ‘for (stricter) rules’, ‘for the ‘no-bailout’ clause’, ‘against transfers’, ‘for market discipline’, and ‘for individual responsibility’ were among the most frequent conclusions during the 2007-11 period. It is worth stressing that half of the coded segments for these conclusions are of Jürgen Stark (Member of the Executive Board of the ECB, 2006-2011; Vice President of the Bundesbank, 1998-2006). In contrast, after 2012, the discourse of the ECB is mainly about changes to the Maastricht model. Indeed, the most frequent conclusions of moral hazard-based arguments in the corpus of the ECB post-2012 are ‘for OMT’, ‘for UMP’, ‘for a euro area fiscal capacity’, ‘COVID-19 is different’/‘for PEPP’, and ‘for temporary UMP’.¹⁰⁰ Moral hazard was wielded over time to argue both for and against reform of the Maastricht model. Another characteristic of the ECB’s discourse on moral hazard is that it is more or less equally distributed between financial institutions and governments (see Figure 13 in the appendices to this chapter). In contrast to the other central bank cases examined in this dissertation, the discourse of the ECB on moral hazard is not strongly biased in favour of banks. Finally, similarly to the Bundesbank and the Bank of Italy (and the Italian government), the ECB tends to pursue its moral hazard-related policy goals through a cognitive discourse. Indeed, there is a clear primacy of cognitive premises over normative ones in the moral hazard-based arguments formulated by ECB officials (see Figure 14 in the appendices to this chapter).

The detailed analysis of a selection of moral hazard-based arguments allows us to identify the premises which helped ECB Executive Board members to justify or legitimize their conclusions. This analysis begins with the argument in favour of conditionality – the most frequent moral hazard-based argument in the corpus of the ECB. The argument in favour of conditionality in ECB press documents is mainly about governments: out of the 11 segments coded with ‘for conditional financial assistance’, two relate to financial institutions and 9 to governments. Conditionality appears as the ECB’s preferred policy instrument to deal with government moral hazard.¹⁰¹ The rise of the moral hazard-based argument in favour of

¹⁰⁰ It should be noted that, on 9 September 2011, Stark resigned from his position as member of the Executive Board of the ECB prior to the end of his term (on 31 May 2014).

¹⁰¹ When it comes to financial institutions, the most frequent policy instruments to deal with moral hazard are ‘insolvency procedures/resolution regimes’, ‘stricter capital requirements’, and ‘TBTF reforms’.

conditionality in the discourse of the ECB goes hand in hand with the announcement and legitimisation of OMT ('OMT' is one of the most frequent code co-occurrences). See, for example:

'Question: Back to the OMT, you mentioned that there are steps that need to happen before the ECB would activate it. It is in the governments' hands. Does that weaken the effectiveness of the OMT because you make yourselves part of the political process, which can be time-consuming and complicated? And my second question is [...].

Draghi: The first question is about conditionality. We view conditionality as an essential part of the activation of the OMT [*Conclusion*]. I have made this point since the very beginning. Conditionality will actually have several roles. First of all it will reduce the moral hazard by governments [*Goal and cognitive premises*]. The second role it will have is that it protects the independence of the ECB. Without conditionality you would certainly have what people call fiscal dominance. With conditionality the independence of the ECB is protected [*Goal and cognitive premises*]. There is also a third angle to this. You can look at conditionality as a way to create credit enhancement on the bonds of the country that is actually the object of conditionality [*Goal and cognitive premises*]. So, it is an incentive to pursue the right economic policies, which have benefits for all parties concerned [*Cognitive and normative premises*]. Now, there are going to be, and rightly so, some political processes, but look at this from another angle. You know that one of the conditions is the signing of a memorandum of understanding with the Eurogroup. Once you have that, you have unanimity. And you have the whole of Europe that is supporting this programme politically. By itself, this is an extremely forceful ingredient in the programme' [*Normative premises*] (Draghi and Constâncio, 2012: 4).

'FT All the top financiers were saying that they've got to have unlimited ECB capacity. Of course, but the conditionality was crucial for winning support within the Governing Council, but even more important in Berlin.

MD The decision was taken in total and full independence [*Normative premise*]. Certainly, conditionality, in a set-up like ours, is essential for two reasons [*Conclusion*]. One is that it's a form of a credit enhancement in the bonds issued by the country that applies for OMT because the more it will comply with conditions, the more creditworthy will be its bonds [*Goal and cognitive premises*]. The second reason is that with any type of intervention, moral hazard has to be avoided and fiscal discipline, in

particular, has to be ensured [*Goal premise*]. That's why conditionality is crucial, but it is only a necessary condition because in any event the Governing Council assesses independently the state of monetary fragmentation [*Cognitive premise*]. Let's not forget our objective is fight financial fragmentation and deliver price stability [*Goal premise*]. FT Let me just go back to the political element. I respect what you're saying about the ECB's paramount independence, but, at the same time, you're not monks in cells. You don't sort of deliberate within the monastery and come up with something' (Draghi, 2012: 2).

'Later in 2012, a renewed confidence crisis, in part reflecting unwarranted investor fears about the reversibility of the euro, caused a severe deterioration in financial markets. Sovereign bond and bank lending rates in some countries increased dramatically, thereby impairing access to financing of the real economy [*Circumstantial and cognitive premises*].

To safeguard the singleness of monetary policy and to ensure an effective transmission of the ECB's policy intentions to the broad economy, in August, the Governing Council announced its readiness to undertake Outright Monetary Transactions (OMT) [*Goal and cognitive premises*]. OMTs have proven to be an effective backstop against unfounded fears of reversibility [*Cognitive premise*]. Strict conditionality contains moral hazard on the side of governments [*Goal and cognitive premises*]. It ensures that they will adopt the reforms that are necessary to secure their solvency and to foster conditions of steady growth for their economies [*Cognitive premise*]. As I said before, the repair of the transmission channel cannot be done by the central bank alone, governments need to do their part' [*Goal and cognitive premises*] (Draghi, 2013: 1-2).

As these three text segments illustrate, the argument of the ECB in favour of conditionality is mainly a cognitive argument. Conditionality is presented as a means to achieve a variety of policy goals, namely: reduce, avoid, or contain moral hazard; protect the independence of the ECB and avoid fiscal dominance; ensure fiscal discipline; enhance the creditworthiness of countries; and foster conditions of economic growth. These goals are in line with the sound money paradigm, just like the other goal premises used to justify OMT (i.e. safeguard the singleness of monetary policy/fight financial fragmentation, deliver price stability, and ensure the effective transmission of monetary policy). Clearly, the President of the ECB justified novel instruments – OMT and conditionality – in terms of the past policy paradigm. This discursive

strategy suggests continuity with the Maastricht model and arguably aims to increase the legitimacy of financial assistance to countries from the central bank.

Prior to 2012, the discourse of the ECB on moral hazard was rather focused upon justifying alternative instruments to financial assistance to countries from the central bank. Indeed, although central bank financial assistance to the financial system was somewhat justified in the context of the IFC (see the first text segment below), in 2010-11, the discourse of the ECB was rather about arguments in favour of individual responsibility and a permanent crisis management institution (second and third text segments below) than in favour of conditional financial assistance from the central bank to Member States. See, for example:

‘However, as a policy maker myself, I recognise the need to act in a practical and pragmatic manner, particularly in periods of stress [*Normative premise*]. Adherence to these general principles must be complemented by effective and prompt responses in the face of unanticipated events with uncertain consequences. No principle can provide concrete guidance for how to deal with all the contingencies we may face in a complex and uncertain world, in particular with those uncertainties labelled “unknown unknowns” – a phrase that has no doubt resonated with economic policy makers in recent months [*Circumstantial premises*].

In this context, it is important to clearly distinguish between, on the one hand, acting in a pragmatic manner to support the functioning of the market as a whole and, on the other hand, bailing out individual institutions and thus generating moral hazard by creating the impression that such institutions will not be held responsible for their earlier actions [*Goal, cognitive and normative premises*]. The former is clearly desirable, whereas the latter only sows the seeds of later and more costly crises’ [*Conclusion*] (Stark, 2007: 3).

‘Thirdly, there is the question of whether and how to create a new, permanent institution for crisis management [*Circumstantial and goal premises*]. If the institutional reforms in the areas of fiscal policy and economic policy coordination are successful, such a new institution would be redundant [*Cognitive premise*]. Admittedly, no set of rules is without its flaws, and we have seen the speed at which seemingly isolated crises can take on forms that are systemically difficult to control [*Cognitive premise*]. Should considerations lead to the establishment of a permanent crisis management institution, we must, however, be very careful not to create false incentives that could give rise to moral hazard on the part of governments [*Goal premise*]. Under no circumstances

should institutionalised crisis management lead to financial transfers and the undermining of the no-bailout rule' [*Conclusion*] (author's translation, Stark, 2010c: 8).

'The costs of such hedging instruments [a further expansion of the IMF's instruments or easier access to loans], on the other hand, can be considerable. The granting of financial assistance within the framework of the discussed mechanisms is hardly conceivable without the involvement of the central banks, as only they can provide the necessary liquidity [*Cognitive premises*]. The central bank cannot and must not commit itself in advance to providing liquidity always and everywhere [*Conclusion*]. This would encourage moral hazard and ultimately undermine the authority of the central bank [*Goal premises*]. The credibility and independence of the central bank would be damaged and an efficient and stability-oriented implementation of monetary policy would no longer be possible [*Goal premises*].

The guiding principle must therefore be to avoid any incentives for moral hazard. It must be clear that only a balanced domestic orientation of economic policy can also guarantee external stability' [*Conclusion*] (author's translation, Stark, 2011: 4).

These text segments from press documents of Stark illustrate the main characteristics of the political discourse of the ECB on moral hazard during the 2007-2011 period. The first segment indicates how the ECB justified financial assistance to the financial system in the context of the IFC. The argument is based on the value of pragmatism and a subtle distinction: acting to support the functioning of the market as a whole is welcomed on the basis of pragmatism and presented as something different from bailing out individual financial institutions. The ECB exploited the goal of not generating moral hazard to argue against the bailout of individual banks and in favour of supporting the market as a whole (Stark, 2007; Trichet, 2008). With regard to central bank financial assistance to countries (second and third text segments), the argument was rather in favour of 'individual responsibility' – structural reforms and 'keeping its own house in order'. The ex ante commitment of the central bank to provide the necessary liquidity to countries in need of financial assistance was presented as being against the goals of 'not encouraging moral hazard', 'not undermining the authority of the central bank', 'ensuring the credibility and independence of the central bank', and 'a stability-oriented implementation of monetary policy'. Here, pragmatism ('admittedly, no set of rules is without its flaws, and we have seen the speed at which seemingly isolated crises can take on forms that

are systemically difficult to control') does not serve to justify central bank financial assistance but the creation of a permanent crisis management institution (the European Stability Mechanism will be established in 2012). However, to achieve the goal of avoiding moral hazard, this institution for crisis management cannot lead to financial transfers and the undermining of the 'no-bailout' clause. Clearly, avoiding moral hazard was a paramount objective for Stark.¹⁰²

After 2012, the ECB's discourse was not limited to the argument in favour of conditional financial assistance. In 2019, the most frequent moral hazard-based argument in the corpus is 'for a euro area fiscal capacity'. See, for example:

'Then second question: if there's one thing you could fix about the way that the eurozone functions, what would that be? [...]

[President Draghi] You had a second question about what to fix in the eurozone. There is one thing that all the successful monetary unions have, and that's a central fiscal capacity [*Goal and cognitive premises*]. In other words, whether this should be a budget or should be a system of insurance... So it's very important to have something of that nature of an adequate size, something that can be used counter-cyclically, something that basically would take care of the fact that the national fiscal policies have, in my view, limited spill-overs on the rest of the eurozone [*Cognitive premise*]. So one needs to have a central fiscal capacity and of course this should be designed in a way that doesn't create moral hazard [*Conclusion and goal premise*]. I think that's one of the main reasons for the slow progress on that front: it is the risk that the mechanisms would be used for increasing moral hazard. So the design of the rules is very important. I think that's the main thing' [*Cognitive premises*] (Draghi and de Guindos, 2019: 9).

This argument in favour of a euro area fiscal capacity is based on a shared goal premise: to achieve a successful monetary union. The President of the ECB argued that a central fiscal capacity is a necessary instrument to achieve this policy goal. Although the potential causal relationship between a euro area fiscal capacity and moral hazard is acknowledged by Draghi (and even presented as one of the main reasons for the slow progress on this matter), he argued that this causal relationship is non-necessary: it depends on how the rules are designed. According to Draghi, it is possible to create a central fiscal capacity that will not result in moral

¹⁰² There is some evidence in ECB press documents of a disagreement between Executive Board members as to the importance that should be attached to the objective of avoiding moral hazard in times of crisis, notably between Stark and Bini Smaghi (see section 8.1 on the contestation of the primacy of the goal of avoiding moral hazard over systemic stability). This disagreement might be a cause of Stark's resignation.

hazard. Framing a euro area fiscal capacity as being in line with the goal of not creating moral hazard arguably aims to increase the support for such policy proposal.¹⁰³

8.4 Conclusion

The empirical analysis of the ECB case found the presence of the condition of minor contestation: moral hazard is contested by about 12% in the corpus of ECB press documents. However, the contestation of moral hazard by ECB Executive Board members is more frequent and more diversified than in the national central bank cases of this dissertation. Notably, the contestation of moral hazard – which is often based on academic knowledge and empirical evidence – was used to reject the German conclusion of ‘risk reduction before risk sharing’ and to increase the legitimacy of UMP measures. Finally, the ECB case is the only central bank case of this dissertation where the primacy of the goal of avoiding moral hazard was contested (although rarely).

The examination of conceptions of moral hazard in the ECB case resulted in similarities and differences. In ECB press documents, the empirical analysis found that ECB Executive Board members share a common and dominant understanding of what moral hazard is, namely an incentive problem leading to excessive risk-taking. This rationality-based conception of moral hazard is in line with the neo-classical economics literature. The main difference identified in the corpus is between a broad and a restricted conception of moral hazard – depending on the presence or absence of the condition of materialisation of the undesirable action. Although the feature of morality was relatively less present in the corpus of the ECB than in other cases, moral hazard was clearly understood as a moral problem by some interviewees. The difference between how moral hazard is presented by ECB Executive Board members in press documents and how it is understood by some interviewees suggests a deliberate effort from ECB Executive Board members to avoid the construction of a morality tale so as to present the discourse of the central bank as close as possible to the economic literature. Thus, this difference suggests the presence of a discursive strategy to increase the credibility of the ECB as a technocratic institution.

¹⁰³ In addition, it should be noted that, in this argument, Draghi refuted a key premise of the literature that was used to justify the policy goal of avoiding government moral hazard: namely, the negative spill-over effects of national fiscal policies. Here, the President of the ECB argued that the spill-over effects of national fiscal policies on the other members of the euro area are limited. One might then wonder why avoiding moral hazard should be a policy goal?

The examination of the moral hazard-based arguments in ECB press documents resulted in variability. Over time, moral hazard was wielded by ECB Executive Board members to argue both in favour and against reform to the Maastricht model. In particular, a shift in the discourse of the ECB on moral hazard was detected pre- and post-2012. However, the justification for changes to the Maastricht model (e.g. ‘for conditional financial assistance’) is made in terms of the past policy paradigm. ECB Executive Board members exploited the goal of avoiding moral hazard to suggest continuity with the past and increase the legitimacy of novel proposals. Instead of contesting the primacy of avoiding moral hazard, more often, they presented the causal relationship between novel measures and moral hazard as non-necessary and a simple matter of design. Finally, it should be noted that, contrary to what was expected, the ECB has not often exploited moral hazard to obtain more competences (e.g. responsibility for European banking supervision).

At this stage of the empirical analysis, it is possible to draw conclusions on moral hazard and central bankers. The condition of minor contestation is present in the central bank cases of this dissertation. The central bankers examined in this dissertation mainly wielded moral hazard in their communications to exploit it and not to contest it. However, the pattern of contestation in the ECB case nuances the evidence in favour of the hypothesis of central bankers’ power *over* moral hazard. For example, the voices of central bankers were not united when it comes to the primacy of the goal of avoiding moral hazard: in this dissertation, supranational monetary experts were more likely to contest the primacy of this goal than national monetary experts. In addition, the condition of minor variability within central banks is absent. Indeed, the empirical analysis found differences in the key features of moral hazard and in the most frequent conclusions of moral hazard-based arguments formulated by these central bankers. In terms of how moral hazard is presented, here is a non-exhaustive list of differences: the role of social standards and moral principles is presented as a key feature of moral hazard in the Bank of Italy case but not in the other central bank cases; national central bankers emphasized the negative effect of moral hazard on taxpayers’ interest (the ECB did not); the Bundesbank and the ECB used moral hazard to explain the IFC (the Bank of Italy did not). In terms of arguments, the Bundesbank most often exploited moral hazard to argue in favour of ‘bail-in’, the Bank of Italy to argue in favour of TBTF reforms, and the ECB to argue in favour of conditional financial assistance. While the Bundesbank exploited moral hazard to resist changes to the Maastricht model, the Bank of Italy and the ECB (after 2012) exploited moral hazard to justify changes to the Maastricht model. The variability within central bank

cases is evidence in favour of power *through* moral hazard and against power *in* and *over* moral hazard.

8.5 Appendices

Table 22 Moral hazard's synonyms in ECB press documents

Problematic incentives	6
Excessive risk-taking	3
Too big to fail problem	2
Recklessness/imprudence	2
Appetite for risk	1
Irresponsibility	1
Misconduct	1
Dependence	1
 TOTAL ANALYSED DOCUMENTS	 117

Source: Author. The numbers indicate the number of coded segments for each synonym.

Table 23 Moral hazard's antonyms in ECB press documents

Discipline	2
Appropriate incentives	1
Trust	1
Due diligence	1
'To have (one's) skin in the game'	1
 TOTAL ANALYSED DOCUMENTS	 117

Source: Author. The numbers indicate the number of coded segments for each antonym.

Figure 12 Moral hazard's word clouds in ECB press documents

Figure 12.1 Word cloud in English



Figure 12.2 Word cloud in German



Source: Author. MAXQDA Word Cloud function (minimum frequency: 2).

Table 24 ‘What it is’ in ECB press documents

When incentives for being responsible are weakened	3
When there are incentives for a reckless action	2
When the expectation of support causes a reckless or irresponsible action	2
When crisis responses cause undesirable actions	2
When benefits are privatised and costs are socialised	1
When the public sector backstops private risk-taking	1
When there are perverse effects on incentives	1
A situation in which asymmetric information can lead borrowers to take action that erodes the value of the loan	1
When there are incentives for misconduct	1
When those who have behaved improperly are not punished	1
When losses stemming from recklessness are suppressed	1
To become permanently dependent on external support	1
The expectation of being protected from 'tail events' in bad times	1
The risk of encouraging opportunistic behaviour	1
The risk that others will take the benefit of your action and do not act on their own	1
TOTAL ANALYSED DOCUMENTS	117

Source: Author. The numbers indicate the number of coded segments for each code.

Table 25 ‘What causes it’ in ECB press documents

UMP	17
TBTF/SIFIs	8
Public support/intervention/measures in times of crises	5
Low interest rates/accommodative monetary policy stance	5
Euro area fiscal capacity	5
Expectation/assumption/perception of assistance or support	4
Permanent crisis management mechanism/ESM	4
Central bank crisis measures	4
Government policy	3
Bailouts	3
LOLR	3
Support in the context of endogenous shock	3
Wrong timing of crisis measures	3
Fiscal dominance	3
Automatic right to central bank liquidity	3
Securitisation	2
Firewalls/safety nets/public insurance	2
Confusion of roles	2
Monetary policy	2
Central bank insurance	2
Emergency liquidity assistance (ELA)	2
Absence of market discipline	2
(European) Deposit Insurance Scheme	1
Financial dominance	1
Benefiting from common resources	1
Prevent fragmentation	1
Widening of the set of eligible collateral	1
Reduction of penalty rate in central bank borrowing	1
The Jackson Hole consensus	1
To buy according to the outstanding debt	1
Banking consolidation	1
'Non-aggression pact' between potential offenders of the SGP	1

The institutional design of the euro area	1
Transfers between euro area Member States	1
Conflict of incentives	1
Central clearing	1
TOTAL ANALYSED DOCUMENTS	117

Source: Author. The numbers indicate the number of coded segments for each code.

Table 26 ‘What it does’ in ECB press documents

Discourages needed adjustments/reforms	6
Crises	3
Long-term instability	3
Promotes risk-taking/induces excessive risk-taking	3
Unsustainable public finances	3
Financial instability	2
Cost for taxpayers	1
Increases the probability of systemic meltdown	1
Affects or hampers price stability	1
Makes failure more likely	1
Creates situations that are politically difficult	1
Undermines the authority of the central bank	1
Adverse economic consequences	1
Negative impact on the resource allocation process	1
TOTAL ANALYSED DOCUMENTS	117

Source: Author. The numbers indicate the number of coded segments for each code.

Table 27 Dictionary-based topic classification in ECB press documents

Topic and sub-topic	Number of documents	Percentage of total documents
Financial assistance	94	80,3

IMF	12	10,3
EFSF/ESM	12	10,3
NGEU	2	1,7
Resolution	38	32,5
Monetary policy	56	47,9
UMP	10	8,5
QE	26	22,2
OMT	10	8,5
Negative interest rates	0	0,0
TLTROs	0	0,0
Regulation	32	27,4
Too big to fail	25	21,4
Structural reforms	24	20,5
Fiscal rules	39	33,3
Supervision	27	23,1
Deposit guarantee	9	7,7
Maastricht Treaty	30	25,6
Transfers	25	21,4
Mutualisation	9	7,7
Banking Union	8	6,8
Austerity	10	8,5
Lender of last resort	9	7,7
Competition policy	0	0,0
Pension system	1	0,9
Housing policy	0	0,0
Inequalities	2	1,7
Natural disaster	2	1,7
Common borrowing	1	0,9
Migration	0	0,0
 TOTAL ANALYZED	 117	 100,0
DOCUMENTS		

Source: Author.

Table 28 ‘Conclusion’ of moral hazard-based arguments in ECB press documents

For conditional financial assistance	11
For insolvency procedures/resolution regimes	8
For stricter capital requirements	5
For OMT	5
For UMP	5
Against bailouts	5
For TBTF reforms	4
For a European Resolution Fund	4
For a euro area fiscal capacity	4
For a permanent crisis management mechanism	4
For PEPP	4
For temporary UMP	4
For centralisation at the EU level	3
For (stricter) rules	3
COVID-19 crisis is different	3
For 'no-bailout' clause	3
Against transfers	3
For market discipline	3
For appropriate safeguards against moral hazard	3
For individual responsibility	3
Against an automatic right to central bank liquidity	3
For following the example of the IMF	3
Against too large financial sectors	3
For bail-in	2
For (more efficient) supervision/surveillance	2
For Banking Union	2
For risk sharing	2
For the SGP	2
For austerity	2
For temporary financial assistance	2
For 'no monetary financing' clause	2
For following Walter Bagehot principles	2

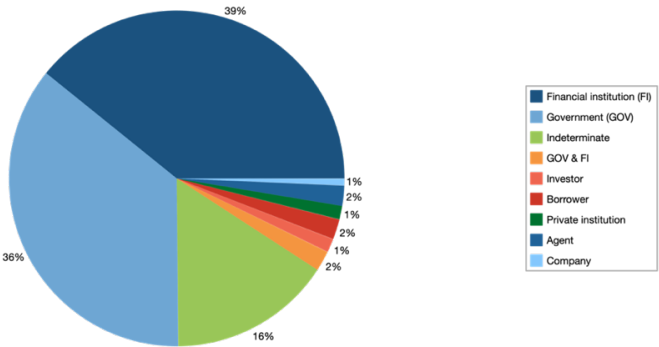
Against the previous consensus view of monetary policy	2
For 'leaning' against financial imbalances	2
Fiscal discipline is not the responsibility of the ECB	2
Risks of moral hazard should not condemn the central bank to inaction	2
For distinguishing between different policy interventions when discussing moral hazard	2
For CCP supervision by central banks	2
Structural reforms and low interest rates complement each other	2
For exceptional central bank intervention	2
For ABS market in Europe	2
For maintaining the momentum for regulatory reform in the financial sector	2
For reforming EMU	2
The normalisation of monetary policy should go hand in hand with the normalisation of the economy	2
For a fiscal backstop to the SRF	2
The Franco-German proposal falls short	2
Central banks cannot solve all problems	2
For prudential policies	2
For the right balance between ex-post and ex-ante efficiency	2
For structural reforms	1
For revised manager remuneration systems	1
For symmetrical monetary policy	1
For CCP for OTC derivatives	1
For macroprudential policies	1
The inevitable nature of crises	1
Against the fall of Lehman Brothers	1
Against LOLR for governments	1
Against financial dominance	1
For long-term relationships	1
Stalemate on the issue of CCPs	1
Aspects of the Simple, Transparent and Standardised (STS) Regulation for which the ECB has concerns	1
For judging the performance of portfolio managers against certain benchmarks	1

For forceful action	1
For SRM	1
Conditions to be met for UMP to be effective	1
For discretion in ELA	1
For public interventions that penalise shareholders and managers	1
For public bailouts as the ultimate resource	1
For disintermediation	1
For replacing public burden-sharing by private burden-sharing	1
For taking over a failing bank before its capital is fully depleted	1
For maintaining a level playing fields and coordination between Member States	1
For measures like enforceable netting agreements, segregation of clients	1
For bail-in with other restructuring or resolution measures	1
For fast and decisive fiscal policy intervention during COVID-19 crisis	1
For sound national macroeconomic policies and strengthened economic governance	1
Against Eurobonds	1
For a single supervisory with an integrated framework for bank resolution	1
For CCPs sound liquidity self-insurance	1
Responsibility for crisis resolution lies outside the domain of monetary policy	1
Any schemes of cross-border liquidity need to involve central banks	1
For a safety net for countries with sound fundamentals hit by exogenous shocks	1
For rethinking the allocation of losses in bank resolution	1
For central bank intervention in times of crises	1
The dilemma between moral hazard and systemic stability merits closer attention	1
Against reducing interest rates to strengthen asset prices and banks' balance sheets	1
Moral hazard in a reduction of the penalty rate not obvious	1
For widening the set of eligible collateral only under certain conditions	1
For a specific design of individual banks' emergency liquidity assistance	1
For a forceful response by authorities to the crisis	1
Against responding to calls on monetary authorities to act more	1
For a system of bank levies and taxes on financial institutions	1
Against using monetary policy to manage macroeconomic risk	1
Adjusting the monetary stance to macroeconomic developments can never be rejected on the basis of moral hazard	1

For acknowledging the current institutional distribution of responsibilities between home-country and host-country authorities	1
For countercyclical fiscal policy	1
For central bank interventions only when the market fails	1
For the primacy of private sector solutions as regards crisis resolution	1
For completing the Banking Union	1
For strengthening the ESM	1
For deepening the capital markets union	1
Against debt restructuring	1
For mitigating but not eliminating the externalities of a liquidity crisis	1
Central banks must be closely involved in addressing financial tensions	1
For preventing fragmentation	1
Against entering the terrain of allocative policies	1
For pragmatism	1
For NGEU	1
PEPP and OMT are different	1
No fundamental differences between monetary policy in normal and crisis times	1
Revise the regulatory framework to restrain excessive risks during expansion and dampen costs in contraction	1
Redistribution of risk is not a zero-sum game	1
For buying according to the outstanding debt	1
The issue of moral hazard is very important	1
For protecting those who have behaved properly	1
For the possibility of direct bank recapitalisation by the ESM	1
For independence, accountability, operational effectiveness and decision-making capacity of an institutional mechanism	1
Conditions under which separation between fiscal and monetary authorities is optimal	1
The premature withdrawal of stimulus should be avoided	1
Against extreme solutions in times of crises	1
Not sure I see moral hazard in the context of aggregate liquidity injections through open market operations	1
For an agreement on the Directive on Alternative Investment Fund Managers	1

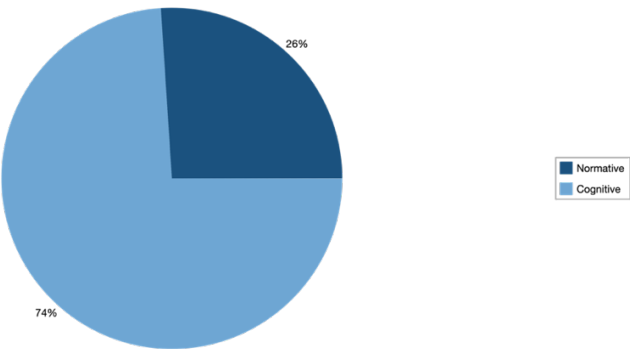
Source: Author. The numbers indicate the number of coded segments for each code.

Figure 13 ‘Whose moral hazard?’ in ECB press documents



Source: Author.

Figure 14 Distribution of normative and cognitive premises in the moral hazard-based arguments formulated by the ECB



Source: Author

9 European Commission

This chapter presents the findings of the empirical analysis of the European Commission case (hereafter, the Commission). In this dissertation, the Commission is considered as a non-authoritative actor. Similarly to the previous empirical chapters, this chapter provides answers to the following questions guiding the empirical analysis: is the condition of minor contestation present in the Commission case? Do Commission officials share a common and dominant understanding of what moral hazard is? And what are the main characteristics of the moral hazard-based arguments formulated by these supranational politicians?

Given the expectation of this dissertation against the hypothesis of power *over* moral hazard, we anticipate the finding of minor contestation in the Commission case. In terms of conceptions, we expect more variability in the identified key features of moral hazard between the Commission case and the central bank cases examined in this dissertation, than between the Commission case and the other executive cases examined in this dissertation (i.e. the sub-cases of the German and Italian governments). In this regard, the morality-based conception of moral hazard should be most prominent in the Commission case than the rationality-based conception. Finally, based on the expectation of this dissertation in favour of the hypothesis of power *through* moral hazard, we expect the Commission's political leadership to exploit the concept to its own advantage, i.e. to help the Commission achieve supranational policy goals (such as greater competences for EU institutions). The results from this chapter, when compared to the results from the ECB case, will allow us to conclude as to the relevance of the political/central banking division within EU institutions for the politics of moral hazard's use.

This chapter is structured in the same way as the previous empirical chapters. The first section is dedicated to contestation. The second and third sections focus upon the conceptions of and arguments about moral hazard, respectively. The final section summarizes the main results and concludes as to their implication for the relationship between power and moral hazard.

9.1 On Contestation

This section presents the results of the ‘Contestation’ code for the Commission case. As a non-authoritative actor, these results are crucial for the verification of the hypothesis based on the instrumental theory and the falsification of the hypothesis based on the authoritative theory. As a reminder, the presence of minor contestation in the corpus of non-authoritative actors is empirical evidence in favour of power *through* (and power *in*) and against power *over* moral hazard.

There are 72 utterances of the term ‘moral hazard’ (one sentence before and after) in the corpus of the Commission’s press documents (68 documents). There is one segment coded with ‘Contestation’. Clearly, the condition of minor contestation is present in the case of the Commission. Over the 2007-2022 period, when the Commission’s political leadership used the concept in press documents, it did so rarely to refute a statement on moral hazard.

Among the 16 members of the College of commissioners who used the term ‘moral hazard’ in their communications between 2007 and 2022, only one did so to contest moral hazard: Frans Timmermans (Vice President of the European Commission, 2014-2019; Executive Vice President of the European Commission, 2019-2023). The contestation of moral hazard by Timmermans is somewhat different from the previous evidence of contestation found with regard to the other cases examined in this dissertation. Indeed, the Vice President of the Commission did not refute a statement on the means-goal relationship, on the relevance of moral hazard in a given context, or on the primacy of the goal of avoiding moral hazard. Instead, Timmermans deplored the pervasiveness of moral hazard in EU negotiations – moral hazard being understood as the absence of mutual trust:

‘We are slow to find common answers not because there are no answers, but because we do not trust the word “common”. What was branded “moral hazard” in the financial crisis has all too often become part and parcel of every European approach: can I rely on my neighbour to hold up his part of the deal? Can I risk my success on his willingness to do what is necessary for the common good?’ (Timmermans, 2015: 4).

In a speech titled ‘De facto solidarity’ at the Netherlands Institute of International Relations (Brussels, 18 September 2015), Timmermans implicitly opposed the application of the discourse on moral hazard during the IFC to other contexts – notably, to the migration crisis

(ibid.). This contestation of moral hazard is of particular analytical interest because it signals the political influence of the discourse on moral hazard in the aftermath of the IFC.

Despite some evidence of moral hazard being contested in the context of the migration crisis, the results of the ‘Contestation’ code indicate that commissioners almost always wielded the term ‘moral hazard’ in their communications for exploitation rather than contestation. The next sections of this chapter examine the conceptions of and arguments about moral hazard and ask how and for what purposes the concept was exploited by the Commission.

9.2 On Conceptions

As in the other empirical chapters, the analysis of the variability condition begins with the investigation of how moral hazard is presented in the corpus and understood by the interviewees. This section aims to identify what moral hazard means to a sample of Commission officials. The various features of the ‘moral hazard family’ in the case of the Commission are derived from the analysis of moral hazard’s semantic fields and the results of the codes ‘What it is’, ‘What causes it’, and ‘What it does’. The key features of moral hazard drawn from the textual analysis of press documents are complemented by and compared with the results of the interviews.

The results for the semantic fields of moral hazard in the corpus of Commission press documents are presented in Table 29 (synonyms) and Table 30 (antonyms), and Figure 15 (word cloud) (in the appendices to this chapter). Two main defining features of moral hazard can be derived from the analysis of synonyms and antonyms: (1) moral hazard is something incompatible with a long duration of existence, and (2) moral hazard involves taking advantage at the expense of others. Indeed, most often, commissioners described moral hazard as having the same meaning as ‘excessive risk-taking’ and having an opposite meaning to ‘sustainability’ and ‘prudence’. The meaning of moral hazard as ‘a situation where there are incentives for excessive risk-taking’ appears in the Commission’s corpus. However, it is worth stressing that, unlike in other cases, ‘free-riding’ is one of the most frequent synonyms of moral hazard employed by commissioners. Originally, free-riding meant ‘the practice of traveling on a train without paying’ (Oxford English Dictionary). From the mid-twentieth century, the verb to free-ride was given a more general meaning, namely: ‘to (seek to) benefit in some way from the effort, sacrifice, financial outlay, etc., of others without making a similar contribution’ (ibid.). The concepts of reciprocity and fairness are emphasized in this conception of free-riding. If

moral hazard is similar to free-riding, moral hazard is the opposite of reciprocity and fairness. The moral feature of ‘taking advantage at the expense of others’ is stressed in this understanding of moral hazard. Thus, the conceptions of moral hazard as an incentive problem and as a moral problem seem to co-exist in the corpus of Commission press documents.

In this dissertation, the semantic field of moral hazard includes not only synonyms and antonyms, but also words frequently used next to the term ‘moral hazard’. For the Commission case, since all documents are written in English, there is just one word cloud. The most frequent words next to moral hazard in the corpus of the Commission are: ‘address’, ‘avoid’, ‘issue’, ‘safeguard’, ‘against’, ‘minimise’, ‘ensure’, ‘public’, and ‘risk’ (Figure 15).¹⁰⁴ The results of moral hazard’s word clouds often inform about whether policymakers tend to perceive moral hazard as a necessary phenomenon or not, and whether they tend to exaggerate or attenuate it. Verbs like ‘to address’, ‘to avoid’, and ‘to safeguard against’ suggest that moral hazard is something undesirable (a problem or a danger) but evitable. It is worth stressing that the frequency of the verb ‘to safeguard against’ next to moral hazard is particular to the Commission case. Often, commissioners want to achieve the goal of safeguarding against moral hazard. Moral hazard is framed as a danger. This framing aims to positively portray the Commission as a protector. However, the frequency of the verb ‘to minimise’ suggest that moral hazard cannot be completely avoided but only reduced to the smallest possible amount, extent, or degree. ‘To minimise’ is the most frequent verb used next to moral hazard when the moral hazard of government is discussed. When it comes to the question of exaggeration or attenuation, the Commission appears to be among the group of policymakers that tend to attenuate the phenomenon of moral hazard (as suggested by the frequency of the word ‘issue’ as opposed to the word ‘problem’).

In sum, the examination of semantic fields allows the drawing of some preliminary conclusions in terms of key features of moral hazard in the corpus of the Commission. Two conceptions of moral hazard seem to coexist in Commission press documents. On the one hand, moral hazard is about incentives for excessive risk-taking or actions that are incompatible with something sustainable. On the other hand, moral hazard is about free-riding, the absence of reciprocity, and the opposite of fairness. The two conceptions of moral hazard identified in previous cases of this dissertation, that of an incentive problem and a moral problem appear to be present in the Commission case. Commissioners seem relatively optimistic about the

¹⁰⁴ The list corresponds to the words with a frequency of 8 or more.

capacity to safeguard against moral hazard and tend to attenuate the phenomenon in their communications.

In addition to semantic fields, this dissertation examines how commissioners explain moral hazard in their communications. The results for the code ‘What it is’ are presented in Table 31 (in the appendices to this chapter). It should be noted that out of these results, there are three coded segments (out of 68 documents) where moral hazard is directly defined by the Commission’s political leadership: ‘the danger that an agent may take excessive risks if it considers that it will not have to pay for the consequences itself’ (Kroes, 2009), ‘when there are free-riders’ (Andor, 2014), and ‘when you need to share with someone who does not care about you’ (Timmermans, 2017). Despite the differences between these three definitions, the lack of direct definitions of moral hazard in the corpus indicates that commissioners tend to take the concept for granted and assume that their audience knows what moral hazard is.

Yet, nine subcodes were created to take into account the variety of moral hazard’s descriptions in the Commission’s press documents. The most frequent description of moral hazard in the corpus is ‘a lack of confidence between parties’, which presents moral hazard as a trust problem. See, for example:

‘I have been listening very carefully to the debate on migration, and having dealt with this issue over the last four years, I try and formulate for myself why it has been impossible to find a solution so far at the European level. I think the answer lies in the concept of moral hazard. I think there is a lack of confidence between the Member States that the other state will do what they agreed to do to find a solution’ (Timmermans, 2018: 3) .

‘Unprecedented migration is one of the challenges that is extremely divisive and puts our values to test. I think the answer lies in the concept of moral hazard. There is a lack of confidence between the Member States that the other state will do what they agreed to do to find a solution’ (Jourová, 2018: 3).

The description of moral hazard as a trust problem is present in the corpus of the Commission since 2015 and appears in the context of the migration topic. When commissioners use the concept of moral hazard in the context of migration, they are referring to the negative expectations that Member States have of the intentions or behaviour of another Member State. While positive expectations are a crucial element of trust, negative expectations are a key defining feature of moral hazard. The description of moral hazard as the opposite of trust is

relatively new in the dissertation's corpus (it was only detected once in the Italian case). Moral hazard in the context of migration means a different thing to commissioners than in other contexts.¹⁰⁵ Indeed, most of the other descriptions of moral hazard relates to the positive causal relationship between risk-taking itself and being indifferent to the negative consequences of risk-taking (e.g. 'when there are incentives for a reckless action', 'the danger that an agent may take excessive risks if it considers that it will not have to pay for the consequences itself', 'when risk has no price'). As mentioned in the previous chapters, there is a restricted and a broad conception of moral hazard, depending on the presence or absence of the materialisation condition (e.g. 'a situation where a reckless action is rewarded' presupposes that the undesirable action has materialised and is therefore a restricted moral hazard). Finally, it is worth stressing that the description of moral hazard as free-riding – of which the moral feature of 'taking advantage at the expenses of others' is inherent – is exclusively used in relation to governments:

'In the financial circles, few doubt that it makes economic sense to create a deep, liquid and stable market for government bonds with the joint issuance of public debt. But this process has provide an answer to the concerns about moral hazard, or a possible free-riding on the budgetary prudence and economic strength of others. To make it rational for all to agree to further risk sharing, further reinforced economic governance must ensure fiscal prudence and minimise moral hazard, which will require a fundamental debate about the pooling of fiscal sovereignty' (Rehn, 2012: 5).

'Sharing a currency really in many ways means sharing a destiny, and the euro is meant to be irreversible. However, it would be of course important to mitigate the risk of possible 'moral hazard', namely to ensure that there are no free-riders in the scheme, i.e. countries that would be net beneficiaries most of the time' (Andor, 2014: 13).

The analysis of the code 'What it is' confirms the preliminary conclusion from the examination of semantic fields that moral hazard assumes more than one meaning in Commission press documents. In some cases, moral hazard is about incentives for excessive risk-taking (a conception where the feature of rationality is emphasized). In others, moral hazard is the opposite of trust or the fact of taking advantage of the effort of others (conceptions where the question of moral character is emphasized).

¹⁰⁵ The similarity between the text segments from the speeches of Timmermans and Jourová suggest that, despite the fact that the statements are in the first person, this discourse on moral hazard is not a personal opinion but a discursive strategy of the Commission.

Finally, the textual analysis of how moral hazard is presented in the corpus of the Commission ends with the examination of its cause-and-effect relationship. The results for the codes ‘What causes it’ and ‘What it does’ are presented in Table 32 and Table 33, respectively (in the appendices to this chapter). The most frequent causes of moral hazard present in the corpus of press documents are Eurobonds, EDIS, and the joint issuance of public debt. In contrast to other cases, the Commission’s discourse on what causes moral hazard was not focused upon systematicity, securitisation, or UMP. Instead, the discourse of the Commission focused upon the potential causal relationship between interstate risk sharing mechanisms and moral hazard. The discussion of these potential causal relationships is not constant over time. Indeed, commissioners discussed the mutualisation of the debt-moral hazard relationship in 2011-2013, the EDIS-moral hazard relationship in 2015-2018, and the joint issuance of public debt-moral hazard relationship in 2012 and 2017. It is worth stressing that while the potential causal relationship between common debt issuance and moral hazard was acknowledged and discussed in 2012 and 2017, this discussion is absent from the discourse of the Commission in the context of the COVID-19 crisis and NGEU.

When it comes to the effects of moral hazard, as in the other cases examined in this dissertation, there is no positive effect – hence, the goal to safeguard against the danger of moral hazard. The most frequent effect of moral hazard present in the corpus is the cost for taxpayers. Avoiding moral hazard in the policy response to the IFC is presented as a means to protect taxpayers. When it comes to governments, the most frequent effect of moral hazard is unsustainable public finances. Avoiding moral hazard is a means to achieve the goal of sustainable public finances. Contrary to what was found with regard to most cases examined in this dissertation (i.e. the German government, the Italian government, the Bundesbank, and the ECB), the Commission did not use moral hazard to explain crises. Like the Bank of Italy, the Commission discussed the implications of crisis responses that might cause moral hazard: if, for example, bank bailouts or Eurobonds cause moral hazard, the effect would be a cost for taxpayers or unsustainable public finances. Although most of the effects of moral hazard present in the Commission’s corpus relate to public finances, some commissioners (i.e. Timmermans) also discussed the political implications of moral hazard. For example, in the context of the migration crisis, Timmermans described moral hazard as the cause for not having found a timely solution to the crisis at the EU level (Timmermans, 2015, 2018). Moral hazard – understood as the opposite of trust – makes political agreements more difficult. He also discussed the negative effect of moral hazard on what he calls one of the fundamental principles of the EU, namely ‘I will make my success dependent on your success’:

‘Apart from all the other discussions about the Judeo-Christian roots of Europe, I think this would be the fundamental principle that we can share also with many other religions and beliefs. This is now under pressure, because of the phenomenon that they call in the financial sector ‘moral hazard.’ In other words: now I need to share with my neighbour, but my neighbour doesn’t care about me’ (Timmermans, 2017: 2).

According to Timmermans, moral hazard – understood as a situation where I am dependent on someone who does not care about me – puts the core value of reciprocity at stake. Thus, in the Commission’s corpus, the negative effects of moral hazard are not only about economic welfare but also about sociability.

Based on the analysis of semantic fields, explanations of moral hazard, and descriptions of its cause-and-effect relationship, various features of the ‘moral hazard family’ have been identified. In the Commission’s corpus, three broad conceptions of moral hazard have been found. First, in the context of financial institutions, moral hazard is understood as a situation where there are incentives for excessive risk-taking. Moral hazard is an incentive problem insofar it creates cost for taxpayers, and it is incompatible with a sustainable system. Second, with regard to governments, moral hazard is understood as the fact of taking advantage of the effort of others (i.e. free-riding). Here, moral hazard is presented as a moral and a fairness problem (against the value of reciprocity) resulting in unsustainable public finances. Finally, third, in the context of migration, moral hazard is understood as a lack of confidence between parties. This conception of moral hazard as a trust problem makes timely political agreements difficult or impossible.

In this dissertation, the investigation of how moral hazard is understood by policymakers is not limited to what moral hazard means in press documents. In addition to the textual analysis of press documents, interviews were conducted. In the Commission case, three interviews have been conducted: one with a Commission official (Interview 10), one with an economic expert working in association with the Directorate General for Economic and Financial Affairs (DG ECFIN) (Interview 11), and one with a former commissioner (Interview 12). The objective of the interviews was to elucidate what moral hazard means to the interviewees. There are similarities and differences in how moral hazard is understood by these three interviewees. In terms of similarities, moral hazard is defined in relation to increased risk-taking by all interviewees. They also agreed that moral hazard was not a cause of the IFC and that the EU’s response to the COVID-19 crisis is unlikely to create moral hazard in the future

(ibid).¹⁰⁶ However, each of the interviewees emphasized different features when defining moral hazard. For one of the interviewees, moral hazard must involve negative consequences for others: ‘moral hazard is always about negative consequences for others’; ‘moral hazard is when you increase your risk-taking behaviour [because there is a change in the incentive structure] taking only into account the advantage for yourself and not the disadvantages for others’ (Interview 10). For another interviewee, ‘moral hazard is a behaviour of individuals that decide to be less concerned about a risk when that risk is insured’ (Interview 11). For this economic expert, the negative consequence for others is not a necessary feature of moral hazard. Instead, what matters is the question of being insured (or the belief of being insured) against the risk – that is, of not suffering from the materialisation of the risk – and the effect of this insurance on risk-taking (ibid.). According to this interviewee, if the individual suffers a disutility from the materialisation of the risk, there is no moral hazard (ibid.). Finally, the third interviewee emphasized the question of accountability. For this interviewee, ‘moral hazard is to create risks or consequences because of your behaviour, without being ready to assume these consequences yourself’; ‘the word “moral” means that you need to be responsible of your acts’ (Interview 12). Moral hazard was described as a situation where ‘one agent takes risks, and others assume the consequences’ (ibid.). According to this interviewee, this separation is the key defining feature of moral hazard. Therefore, for this former commissioner, risk sharing, or the mutualisation of risks, is the opposite of creating moral hazard (ibid.). If everybody is co-responsible for the risk (i.e. the separation no longer applies), there is no moral hazard (ibid.). This understanding of moral hazard is worth stressing because it goes against most views on moral hazard. Indeed, most often risk sharing is perceived as a (potential) cause of moral hazard. In contrast, this former commissioner perceived risk sharing as a way to avoid moral hazard. Depending on how moral hazard is understood, a same mechanism – risk sharing – is described as a cause of or a solution to moral hazard.

To conclude on the conceptions of moral hazard in the Commission case study, the empirical analysis found noteworthy differences. In press documents, the meaning of moral hazard varies from free-riding, to the opposite of sustainability, to the opposite of trust. The moral conception of moral hazard as free-riding is used in relation to governments, the rational conception of moral hazard as incentives for excessive risk-taking is mostly used in relation to financial institutions, and the conception of moral hazard as mistrust was created in the context

¹⁰⁶ With regard to the euro area SDC, one of the interviewees answered that moral hazard was not a cause of the crisis (Interview 11), the others answered that it was not a main cause of the crisis (Interviews 10 and 12).

of the migration crisis. In interviews, moral hazard is strongly associated with risk-taking. However, each interviewee emphasized a different key defining feature of moral hazard: the presence of negative consequences for others, not suffering a disutility from the materialisation of the risk, or the absence of accountability.

This section on the conceptions of moral hazard provided additional empirical evidence of the ambiguity of moral hazard in policy-making – evidence against *power in* moral hazard. However, it does not sufficiently inform about how and for what purposes moral hazard is exploited by the Commission in policy debates. The next section is dedicated to the examination of moral hazard-based arguments in Commission press documents.

9.3 On Arguments

This chapter has established that commissioners mostly use the term ‘moral hazard’ in their communications to exploit it rather than to contest a statement on moral hazard. This section aims to investigate how moral hazard helps the Commission’s political leadership to justify or legitimize its policy goals. First, the Commission’s political discourse on moral hazard is contextualised in terms of distribution over time and between topics. Second, moral hazard-based arguments are examined in terms of conclusions and premises. Finally, third, a selection of moral hazard-based arguments is analysed in more detail.

Moral hazard is not a constant element of the Commission’s discourse during the 2007-2022 period. After 2018, commissioners stopped using the term ‘moral hazard’ in their communications (see Figure 3). However, between 2007 and 2018 the concept was wielded every year – with a relatively high frequency in 2011 and 2012 (*ibid.*). It is worth stressing that the first press document of the dissertation’s corpus is from the Commission. The first policymaker to use moral hazard in a press document over the period under consideration was neither a German nor a central banker, but a commissioner: Charlie McCreevy (Commissioner for Internal Market and Services, 2004-2010). On 6th March 2007, during a speech at the US Chamber of Commerce in Washington, McCreevy wielded moral hazard to argue in favour of ‘good, slim-line, principles-based regulation’ and against ‘prescriptive, rules-based, heavy-handed regulation’ of capital markets (McCreevy, 2007: 2).¹⁰⁷ Most frequently, the concept

¹⁰⁷ This moral hazard-based argument against heavy regulation of the financial sector will be analysed in more detail later in this chapter insofar it contrasts with frequent moral hazard-based arguments developed by European policy elites in the aftermath of the IFC.

was used in relation to the topics of financial assistance, mutualisation, fiscal rules, and resolution (see Table 34 in the appendices to this chapter). The distribution of topics over time indicates that mutualisation and fiscal rules became relatively salient at the same time (in 2011-2012) in the Commission's discourse on moral hazard, which suggests that the two should go hand in hand.

Moral hazard was used by commissioners to draw 35 policy conclusions (see Table 35 in the appendices to this chapter). Most frequently, moral hazard was wielded to argue in favour of the following policy options:

- centralisation at the EU level;
- gradual EDIS;
- burden-sharing conditions;
- Eurobonds/Stability bonds;
- (more efficient) supervision/surveillance;¹⁰⁸
- the right balance between risk sharing and risk reduction.

The argument in favour of centralisation at the EU level or 'deeper integration' is the most frequent moral hazard-based argument in the corpus of Commission press documents. Commissioners, especially Olli Rehn (Vice President of the European Commission and Commissioner for Economic and Monetary Affairs and the Euro, 2010-2014; Governor of the Bank of Finland, 2018-),¹⁰⁹ exploited moral hazard to advance the policy goal of deeper integration of fiscal policies. The argument for centralisation at the EU level appeared in 2011 in the Commission's corpus and was particularly salient in 2012. Another relatively frequent argument in the 2011-2012 period formulated by Rehn is the one in favour of Eurobonds. Clearly, Rehn exploited moral hazard to argue in favour of significant changes to the Maastricht model, i.e. in favour of the mutualisation of debt and centralisation of fiscal policies. The Commission's political discourse on moral hazard is not restricted to arguments in relation to governments. Indeed, the discourse is equally applied to governments and financial institutions (see Figure 16 in the appendices to this chapter). Notably, the most frequent moral hazard-based argument in 2011 was the one in favour of 'burden-sharing conditions'. This argument, mostly formulated by Joaquín Almunia (Vice President of the European Commission and

¹⁰⁸ It should be noted that 'supervision' is used in relation to financial institutions and 'surveillance' is used in relation to governments. This is not specific to Commission press documents. It is a general pattern throughout the corpus of the dissertation. This distinction matters because 'surveillance' carries a pejorative connotation: it implies that, contrary to financial institutions, governments are considered a suspected group.

¹⁰⁹ 9 out of the 10 segments coded with 'For centralisation at the EU level' are from Rehn's press documents.

Commissioner for Competition Policy, 2010-2014; Commissioner for Economic and Financial Affairs, 2004-2010), refers to the contribution of share and bondholders to the rescue of failing banks. For example, ‘burden-sharing conditions’ include not paying dividends and coupons (Almunia, 2012). This argument aims to increase the acceptability of public bailouts. From 2015, Valdis Dombrovskis¹¹⁰ and Jonathan Hill (Commissioner for Financial Stability, Financial Services and Capital Markets Union, 2014-2016) exploited moral hazard to argue in favour of a gradual EDIS. This moral hazard-based conclusion emerged in the Commission’s discourse as an attempt to help reach an agreement between the southern and the northern coalitions on EDIS. Indeed, the Commission’s political discourse on moral hazard in the 2015-2018 period is mostly about advancing EDIS and ‘for the right balance between risk sharing and risk reduction’. The analysis of the premises of moral hazard-based arguments indicates that, most often, the Commission pursued its policy goals through a cognitive discourse. Indeed, there is a clear primacy of cognitive premises over normative ones in the moral hazard-based arguments formulated by commissioners (see Figure 17 in the appendices to this chapter).

The detailed analysis of a selection of moral hazard-based arguments allows us to identify the premises which helped commissioners to justify or legitimize their conclusions. The first selected argument is the one formulated by McCreevy in March 2007 against heavy regulation of capital markets. This argument is of special analytical interest insofar as it arguably illustrates the dominant policy discourse prior to the IFC:

‘I was in a banker's office a few years ago. His job was to assess risk and then to underwrite it. He had a poster up on his wall. It said: "Hide from risk and you hide from its rewards": an appropriate poster for someone whose job was to get the balance right between assessing and underwriting risk [*Circumstantial premises*]. Some regulators might think that it is possible to hide or insulate people from risk [*Goal premise*]. It isn't. Every transaction on every capital market in the world contains risk [*Cognitive premise*]. For anyone working in the capital markets - whether in the front office or the back office, hiding from risk means putting your own job at risk. And so it should [*Cognitive and normative premises*]. Without risk-takers, there would be no rewards,

¹¹⁰ Valdis Dombrovskis, European Commission Vice President for the Euro and Social Dialogue (2014-2016); Vice President for the Euro and Social Dialogue, also in charge of Financial Stability, Financial Services and Capital Markets Union (2016-2019); Executive Vice President responsible for an Economy that Works for People (2019-present); Executive Vice President responsible for an Economy that Works for people, also in charge of Trade (2020-).

and without rewards there would be no risk-takers. It is risk takers who provide liquidity, finance innovation, back new ideas, create new opportunities – for more jobs, better living standards, higher growth [*Cognitive premise*].

My approach to regulation is this: we cannot and should not try to prescribe rules for every conceivable situation [*Conclusion*]. In accounting – as in other fields of regulation – there will always be room for interpretation and there will always be risk. Trying to eliminate risk is not only impossible; it invariably leads to unintended consequences. I have mentioned some of them: less innovation and growth [*Cognitive premises*]. But it can also create a false sense of security, increase moral hazard, and reduce pressure on people to exercise their own judgement and to behave responsibly [*Cognitive and normative premises*]. If people believe that they can insulate themselves from risk, then instead of doing what they believe to be right or sensible they take no chances – they simply follow the rules, tick the boxes, and let someone else take the blame for the outcome [*Normative premise*]. Much of the regulation that has been so damaging in recent times is that which imposes the heaviest burdens and restrictions on those who should need them least: those who are paid to – and should be able to – make sound judgements about what makes commercial sense, about what is the difference between right and wrong, about what will be the consequences of their actions – auditors, accountants, CEOs and company chairmen. They are paid to think and make sound judgements – "Is this right and correct?" – in the spirit of the basic principle' [*normative premises*] (McCreevy, 2007: 2-3).

McCreevy's conclusion that 'we cannot and should not try to prescribe rules for every conceivable situation' is based on a contested goal premise: to hide or insulate people from risk. The Irish commissioner presented this goal as both impossible and undesirable: impossible, because risk is inherent in capital markets; undesirable, because risk-taking produce positive effects that contribute to collective goods, such as better living standards and higher growth. McCreevy argued that 'heavy' regulation aiming at eliminating risk creates moral hazard and reduces responsible behaviours. Here, the meaning of 'to behave responsibly' is close to courageousness and opposed to cowardous (e.g. 'to take no chances'). In March 2007, at the US Chamber of Commerce, McCreevy presented risk-takers in a positive light and heavy regulation of capital markets as a cause of moral hazard. This moral hazard-based argument contrasts with future moral hazard-based arguments formulated by European policy elites in the aftermath of the IFC, where risk-takers are portrayed negatively, and stronger

regulation of the financial sector is presented as an instrument to avoid moral hazard. Although the moral hazard-based argument against heavy regulation of financial markets is not frequent in the corpus, its study matters because it clearly demonstrates the ubiquity and usefulness of moral hazard: over time, the goal of avoiding moral hazard helped European policy elites to argue both in favour and against strong regulation of financial markets. The concept of moral hazard can be exploited by both market liberals and interventionists. Ultimately, it depends on what responsibility means in a given social context.

The argument in favour of burden-sharing conditions imposed upon stakeholders that became particularly salient in 2011 illustrates the discursive shift as to how risk-takers are presented in the Commission's corpus before and after the IFC. See, for example:

‘Sharing the burden would also affirm a sense of justice. We cannot accept a system that rewards recklessness and punishes prudence. We cannot accept a system that privatises profits and socialises losses [*Normative premises*].

Sharing the burden would address the moral-hazard issue, because we all agree that we need to send clear signals and build incentives for more prudent behaviour in the future’ [*Conclusion; cognitive and normative premises*] (Almunia, 2011: 6).

This text segment comes from a speech entitled ‘Landesbanken and the EU competition rules’ delivered by the commissioner for competition policy at the 9th Handelsblatt annual conference (Berlin, 2 February 2011). The argument in favour of sharing the burden of bailouts in general, and of Landesbanken in particular, is mainly based on a normative premise: it is a matter of social fairness. Without burden sharing, bailouts of banks would be unfair. With burden sharing, bailouts of banks become compatible with social fairness since it addresses the moral-hazard issue. Thus, the argument in favour burden-sharing conditions implicitly aims to increase the legitimacy of bailouts. In addition, the value of prudence plays a central role in this argument. According to Almunia, an acceptable system is a system that promotes prudence over recklessness. Addressing moral hazard is a constant policy goal. However, moral hazard no longer means the opposite of courage but the opposite of prudence. Despite this difference in what moral hazard means, the goal of addressing moral hazard maintained its privileged status over time. Almunia proudly stated: ‘To the best of my knowledge, we are the only institution that explicitly imposes burden-sharing conditions on bailouts; a decision that addresses the moral-hazard issue and contains public outlays’ (Almunia, 2011b: 3). Framing bailouts as being in conformity with addressing moral hazard helps to increase the legitimacy of bailouts.

When it comes to the Commission's moral hazard-based arguments in relation to governments, the detailed analysis of premises is conducted on the arguments in favour of Eurobonds and greater centralisation at the EU level – which are often intertwined. Two of Commissioner Rehn's speeches provide examples:

‘Our present task is to bring the stability culture also to fiscal policy [*Goal premise*]. Market discipline alone does not have a good track-record on this. Before the financial crisis hit in 2008, markets did not anticipate the risks that were building up. Now they react with great exaggeration. Policymakers do not have a good track-record, either [*Cognitive premises*]. The Maastricht criteria have been consistently broken and so far without consequences, including by some unnamed Member States with a tradition in Stabilitätskultur [*Normative premise*]!

I am aware that there are currently rather high expectations on – and likewise opposition to – how Eurobonds could help solve the debt crisis euro-area member states [*Goal and cognitive premises*]. For me, it is clear that any type of Eurobonds – or better called stability bonds – would have to be accompanied by a substantially reinforced fiscal surveillance and policy coordination as an essential counterpart, so as to avoid moral hazard and ensure sustainable public finances [*Conclusion, goal and cognitive premises*]. This would necessarily have implications for fiscal sovereignty, which calls for a substantive debate in euro area member states to see if they would be ready to accept it [*Normative premise*].

Last night, the euro-area leaders committed to further reinforcement of economic governance. They are ready to introduce debt brakes into national legislation and call for prior examination of draft national budgets by the Commission and the Council for such countries that violate the rules on the excessive deficit and/or macroeconomic imbalances [*Cognitive and normative premises*]. The Commission should monitor budget execution and, if necessary, suggest amendments’ [*Conclusion*] (Rehn, 2011: 4).

‘Finally, looking beyond immediate fire-fighting and economic crisis management, we need to focus on tomorrow's challenges and consider next steps in strengthening the euro-area governance, its institutions and instruments [*Goal premise*]. Therefore, the Commission presented the Green Paper on Stability Bonds last November [*Cognitive*

premise]. It opened up a useful public debate, not least thanks to the European Parliament [*Circumstantial premise*].

We underline the basic principle of sustainability: Further sharing of risk would have to be balanced by provisions that ensure sustainable public finances and minimize the moral hazard [*Goal and cognitive premises*]. Stability Bonds would have to go hand in hand with a substantially reinforced fiscal surveillance and policy coordination, that is with deeper fiscal and economic integration' [*Conclusion and cognitive premise*] (Rehn, 2012b: 5).

The first text segment is extracted from a speech of the commissioner for economic and Monetary affairs and the euro at the German Bundestag entitled 'The Roadmap to a new Stability Culture in Europe' (Berlin, 27 October 2011). Rehn's argument in favour of Eurobonds and reduced national fiscal sovereignty is based on several goal premises: 'to bring the stability culture also to fiscal policy', 'to solve the SDC', and 'to avoid moral hazard and ensure sustainable public finances'. Clearly, these policy goals are in line with the sound money paradigm in general, and ordo-liberalism in particular. Eurobonds – 'or better called stability bonds' – are presented as an instrument contributing to solve the SDC. Greater centralisation of fiscal policies at the EU level is presented as 'an essential counterpart' to make Eurobonds compatible with the goal of avoiding moral hazard and the stability culture. In other words, if one wants to solve the SDC without challenging the stability culture, one needs to accept increased power of the Commission over national fiscal policies. When addressing the members of the Bundestag, Rehn implicitly described the Commission as the true guardian of the stability culture in the EU.

Although this strategic framing seems tailor-made for a speech in Germany, it is worth stressing that the framing of deeper European integration as the solution to the apparent trade-off between risk sharing and the stability culture is a key and general element of Rehn's political discourse on moral hazard. This is illustrated by what he calls 'the basic principle of sustainability', explained notably in the second text segment (which comes from a speech made in Brussels in May 2012): for risk sharing to be compatible with the goals of sustainable public finances and the minimisation of moral hazard, deeper fiscal and economic integration is necessary. In addition, in 2012, Eurobonds or Stability Bonds are no longer simply presented as an instrument to solve the euro area SDC but as an instrument to achieve the long-term goal of strengthening euro area governance. This implies that Eurobonds and fiscal centralisation should become permanent attributes of the euro area, even if the SDC is solved. Similarly to

the ECB, the Commission justified significant changes to the Maastricht model in terms of the past policy paradigm. The goal of avoiding moral hazard is not contested but exploited to justify reforms of the Maastricht model.

Finally, the last moral hazard-based argument selected for a detailed analysis of premises is the one in favour of a gradual EDIS. Similarly to Eurobonds, the Commission's justification in favour of EDIS is based on solving the apparent trade-off between risk sharing and risk reduction. See, for example:

‘In our proposal, we have to find the right balance between reducing risk and sharing risk [*Goal premise*]. We want a system that ensures proper safeguards against moral hazard and avoids abuse of the system [*Goal premise*]. We want to move forward gradually, starting with a system based on reinsurance, and one that is built on existing national deposit guarantee systems [*Conclusion*]. A reinsurance scheme would only provide support when national schemes have been exhausted. And we will make sure that EDIS will not be an excuse for Member States to avoid building up national deposit guarantee schemes required by the rules [*Cognitive premises*].

Recently the Commission launched infringement proceedings against a number of Member States that had not transposed the new DGS and BRRD Directives on time. We will continue to monitor progress on implementation once the EDIS proposal is on the table [*Circumstantial premises*]. If properly designed, EDIS can actually increase incentives to build up national schemes [*Cognitive premise*]. No-one should benefit from a European-wide system if existing national schemes are not being filled up as they should [*Normative premise*]. The reinsurance system would evolve gradually, over time, towards a more mutualized approach. It is important that EDIS does not increase the overall costs for the banking sector, as compared to current obligations under the 2014 Deposit Guarantee Scheme Directive’ [*Goal premise*] (Dombrovskis, 2015: 1).

‘EDIS is a good example of how risk-sharing and risk-reduction can work hand in hand [*Goal premise*]. Following our proposals, we listened carefully to the stakeholders. And we have taken account of their legitimate concerns about moral hazard [*Normative premises*]. Based on this feedback, we recently presented our ideas to move more gradually towards a European Deposit Insurance Scheme, step by step [*Conclusion*]. One idea is to restrict EDIS to providing temporary liquidity support in a first phase [*Cognitive premise*]. This would not involve any mutualisation of losses [*Goal premise*]. Then, in a second phase, we could move to co-insurance. But this move

would be conditional on a banking sector health check, in the form of an asset quality review [*Cognitive premises*]. In this way, we would confirm that legacy risks from the crisis – such as NPLs - have been dealt with' [*Goal premise*] (Dombrovskis, 2018: 2).

EDIS was proposed by the Commission in November 2015. More precisely, the Commission proposed 'to move forward gradually, starting with a system based on reinsurance, and one that is built on existing national deposit guarantee systems'. This specific design was presented as 'the right balance between reducing risk and sharing risk' and as a means to 'ensure safeguards against moral hazard'. Despite this argumentation the objective of which might have been to reduce the opposition of the northern coalition to the EDIS proposal, no agreement was reached. The causal relationship between EDIS and moral hazard continued to be used against the proposal.¹¹¹ The response of the Commission to these persistent 'legitimate concerns about moral hazard' was to 'move more gradually towards EDIS'. Although the initial discourse of the Commission was characterized by an implicit refutation of the necessary causal relationship between EDIS and moral hazard thanks to the appropriate design of the scheme, the Commission's discourse changed over time. In 2018, the Commission seemed to have accepted that, as long as legacy risks from the crisis remain, the moral hazard-based argument against EDIS will be present and powerful enough to prevent an agreement between Member States – independently of how the scheme is designed. The fact that the design of the scheme is, in certain speeches, presented as sufficient to safeguard against moral hazard, while, in others, as insufficient, is another example of the social construction of the risk sharing – moral hazard causal relationship in policy debates.

9.4 Conclusion

The empirical analysis of the Commission case found the presence of the condition of minor contestation. The contestation of moral hazard by the College of commissioners between 2007 and 2022 is rare (approximately 1% of moral hazard utterances). Moral hazard was contested only once by Timmermans in the context of the migration crisis. It is worth recalling that the kind of contestation found in the Commission case is somewhat different from that of the other cases of this dissertation. Indeed, the refutation was not about the means-goal relationship, the

¹¹¹ Howarth and Quaglia (2018) explain this persistent opposition to the EDIS proposal in relation to the structure of existing national DGS and the configuration of national banking systems.

relevance of moral hazard in a given context, or the primacy of the goal of avoiding moral hazard, but about the pervasiveness of moral hazard in EU negotiations. Timmermans deplored the absence of mutual trust among Member States and its negative effect on the capacity to find a timely solution to the migration crisis. In this dissertation, after the German government sub-case, the Commission is the case with the lower extent of contestation. The finding of minor contestation in the corpus of a non-authoritative actor constitutes evidence against the predictions of the authoritative theory. This result suggests that contrary to what one might think, the political influence of moral hazard in EU economic governance is not a story of the northern coalition's or central bankers' power over moral hazard. Non-authoritative actors also exploited moral hazard to help them achieve their policy goals.

The examination of the conceptions of moral hazard in the Commission case resulted in noteworthy differences. In Commission press documents, the empirical analysis found that commissioners do not share a common and dominant understanding of what moral hazard is. Understandings of moral hazard vary according to contexts: in relation to financial institutions, moral hazard is mainly understood as incentives for excessive risk-taking; in relation to governments, moral hazard is mostly understood as the fact of taking advantage of the effort of others; and in the context of the migration crisis, moral hazard is often understood as a lack of confidence between parties. Different key features are emphasized in these three conceptions of moral hazard, namely (and respectively): rationality, fairness and reciprocity, and trust. The results from the interviews provided additional empirical evidence of the ambiguity of moral hazard in the Commission case. Each person interviewed focused on a different defining property – the presence of negative consequences for others, not suffering a disutility from the materialisation of the risk, or the absence of accountability. The variability of moral hazard's conceptions in the Commission case is evidence against the hypothesis based on the institutional theory that moral hazard is an internalized and/or shared belief.

Commissioners exploited moral hazard to their own advantage. Notably, the concept was wielded to advance several key policy goals, such as: deeper EU centralisation of national fiscal policies, mutualisation of public debts, increased acceptability of bailouts, or EDIS. The objective of 'addressing moral hazard' or 'safeguarding against moral hazard' was never contested by commissioners but exploited as a premise to justify or legitimize significant changes to the Maastricht model. Similarly to the ECB case, reforms to the Maastricht model were justified in terms of the past policy paradigm. However, commissioners stopped using the term 'moral hazard' in their communications after 2018. The absence of a Commission's discourse on moral hazard between 2019-2022 suggests that the framing of the Commission as

a devoted institution in the fight against moral hazard was a strategic framing aimed at building an agreement between Member States on the Commission's proposals. In the context of the COVID-19 crisis, in which moral hazard was not wielded by others to formulate salient arguments against its proposals, the necessity to safeguard against moral hazard disappeared from the Commission's discourse. These findings are evidence in favour of the hypothesis based on the instrumental theory and the usefulness of moral hazard.

At this stage of the empirical analysis, it is possible to draw conclusions on the relevance of the political/central banking division among EU institutions for the politics of moral hazard's use. There are noteworthy differences between the ECB case and the Commission case. In terms of contestation, the ECB presents one of the highest levels and the Commission one of the lowest. This finding clashes with the expectation based on the authoritative theory of higher contestation by non-authoritative actors.¹¹² If the political power of moral hazard is principally a story of central bankers' power over moral hazard, we should not find more contestation in the case of the ECB than in that of the Commission. In terms of conceptions, we found a common and dominant understanding of moral hazard as incentives for excessive risk-taking in ECB press documents. In Commission press documents, we found alternative conceptions to the neo-classical interpretation of moral hazard. Commissioners at times presented moral hazard as the opposite of reciprocity or the opposite of trust. Despite a mainly cognitive discourse on moral hazard in both cases, the understanding of moral hazard in the Commission case is more normative than in that of the ECB. In terms of policy goals, we found that both supranational institutions exploited moral hazard to advance different policy goals. For example, the ECB exploited moral hazard to argue in favour of conditional financial assistance and UMP, and the Commission exploited moral hazard to conclude in favour of Eurobonds and EDIS. It is worth stressing that, contrary to the Commission, the ECB did not often wield moral hazard to advance centralisation at the EU level. Finally, both EU institutions justified changes to the Maastricht model in terms of the past policy paradigm.

This chapter is the last empirical chapter of this dissertation. While the empirical chapters mainly presented the contestation and variability results by case study, the next chapter reviews the main findings in terms of actors and traditional divisions. This general review will allow us to conclude on whether the conditions in favour of power *through* moral hazard are present and on the relevance of the political/central banking, northern/southern, and

¹¹² According to the authoritative theory, authoritative actors impose their views, and non-authoritative actors contest the views of authoritative actors.

national/supranational divisions for the politics of moral hazard's use in European economic governance.

9.5 Appendices

Table 29 Moral hazard's synonyms in Commission press documents

Excessive risk-taking	4
Free-riding	4
Problematic incentives	3
Temptation	1
Irresponsibility	1
Abuse	1
TOTAL DOCUMENTS ANALYSED	68

Source: Author. The numbers indicate the number of coded segments for each synonym.

Table 30 Moral hazard's antonyms in Commission press documents

Sustainability	5
Prudence	3
Fairness	2
Soundness	2
Responsibility	2
Appropriate incentives	1
Discipline	1
TOTAL ANALYSED DOCUMENTS	68

Source: Author. The numbers indicate the number of coded segments for each antonym.

Figure 15 Moral hazard's word cloud in Commission press documents



Source: Author. MAXQDA Word Cloud function (minimum frequency: 2).

Table 31 ‘What it is’ in Commission press documents

A lack of confidence between parties	3
When there are incentives for a reckless action	2
When benefits are privatised and costs are socialised	2
When there are free-riders	2
A situation where a reckless action is rewarded	1
When there is no price to pay for doing things badly	1
When you need to share with someone who does not care about you	1
The danger that an agent may take excessive risks if it considers that it will not have to pay for the consequences itself	1
When risk has no price	1
TOTAL ANALYSED DOCUMENTS	68

Source: Author. The numbers indicate the number of coded segments for each code.

Table 32 ‘What causes it’ in Commission press documents

Eurobonds/Stability bonds	9
(European) Deposit Insurance Scheme	8
Joint issuance of public debt	4

Government policy	2
Permanent crisis management mechanism/ESM	2
Central bank crisis measures	2
Firewalls/safety nets/public insurance	2
State/government support in times of crises	2
TBTF/SIFIs	1
Securitisation	1
Expectation/assumption/perception of assistance or support	1
Bailouts	1
Euro area fiscal capacity	1
Implicit or explicit bailout guarantee	1
Unemployment (re)insurance scheme	1
When Member States benefit from higher credit quality of others	1
Convergence and Competitiveness Instrument	1
The wrong balance between reducing and sharing risk	1
TOTAL ANALYSED DOCUMENTS	68

Source: Author. The numbers indicate the number of coded segments for each code.

Table 33 ‘What it does’ in Commission press documents

Cost for taxpayers/social welfare loss	6
Unsustainable public finances	4
Makes it difficult/impossible to agree on solutions	2
Puts pressure on fundamental principles	1
Long-term instability	1
TOTAL ANALYSED DOCUMENTS	68

Source: Author. The numbers indicate the number of coded segments for each code.

Table 34 Dictionary-based topic classification in Commission press documents

Topic and sub-topic	Number of documents	Percentage of total documents
Financial assistance	49	72,1
IMF	2	2,9
EFSF/ESM	5	7,4
NGEU	0	0,0
Resolution	17	25,0
Monetary policy	2	2,9
UMP	0	0,0
QE	3	4,4
OMT	0	0,0
Negative interest rates	0	0,0
TLTROs	0	0,0
Regulation	8	11,8
Too-big-to-fail	0	0,0
Structural reforms	7	10,3
Fiscal rules	18	26,5
Supervision	9	13,2
Deposit guarantee	11	16,2
Maastricht Treaty	7	10,3
Transfers	9	13,2
Mutualisation	24	35,3
Banking Union	8	11,8
Austerity	2	2,9
Lender of last resort	0	0,0
Competition policy	5	7,4
Pension system	0	0,0
Housing policy	0	0,0
Inequalities	1	1,5
Natural disaster	0	0,0
Common borrowing	2	2,9

Migration	3	4,4
TOTAL ANALYZED DOCUMENTS	68	100,0

Source: Author.

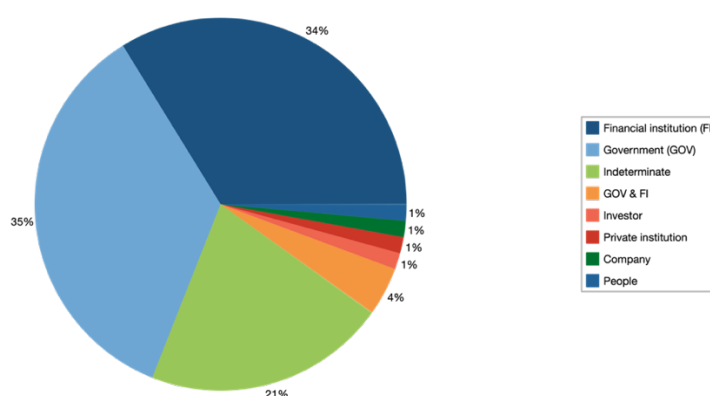
Table 35 ‘Conclusion’ of moral hazard-based arguments in Commission press documents

For centralisation at the EU level	10
For gradual EDIS	7
For burden-sharing conditions	7
For Eurobonds/Stability bonds	6
For (more efficient) supervision/surveillance	4
For the right balance between risk sharing and risk reduction	4
For bail-in	3
For conditional financial assistance	3
For banks paying back the public aid received	3
Why it has been impossible to find a timely solution to the migration crisis at the EU level	2
For the introduction of special rules for State aid to banks	2
For the Reform Delivery Tool	2
For insolvency procedures/resolution regimes	1
For stricter capital requirements	1
For Banking Union	1
For a euro area fiscal capacity	1
For a permanent crisis management mechanism	1
For revised manager remuneration systems	1
For EDIS	1
For finding a balance between conflicting objectives	1
For partial risk sharing	1
What ails Europe is a lack of mutual trust and self-confidence	1
The contribution of the financial sector to public revenues is a debate	1
The net contributor versus net beneficiary question should be secondary	1

We should not try to prescribe rules for every conceivable situation	1
For the quiet resolution of a problem/against gold-plated transparency	1
For a possible new European safe asset	1
For EU borrowing capacities	1
For a Convergence and Competitiveness Instrument	1
For guarantees to improve cost effectiveness	1
For expert consultation groups	1
There is no silver bullet to solve the SDC	1
For finding solutions that reflect the need for both stability and solidarity	1
The fundamental principle 'I cannot be happy without my neighbour being happy' is now under pressure	1
For convergence of national unemployment benefit schemes	1
TOTAL ANALYSED DOCUMENTS	68

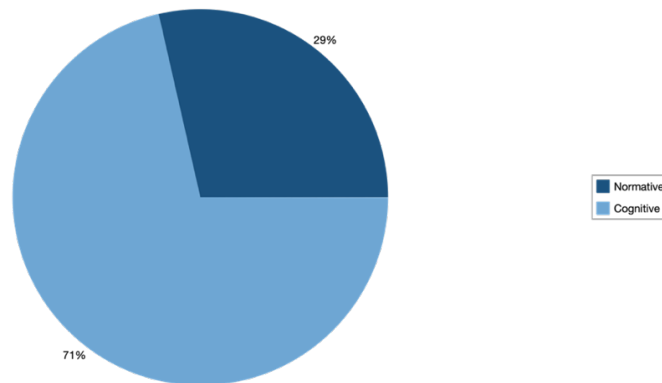
Source: Author. The numbers indicate the number of coded segments for each code.

Figure 16 ‘Whose moral hazard?’ in the corpus of Commission press documents



Source: Author.

Figure 17 Distribution of normative and cognitive premises in the moral hazard-based arguments formulated by the Commission



Source: Author.

10 Conclusion

This chapter summarises the main empirical findings of the dissertation and their implications for the relationship between power and moral hazard in the context of European economic governance after 2007. The first section of this chapter presents the main results in terms of contestation, conceptions, and arguments, as well as their consequences for the validity of the hypotheses of power *over*, *in*, and *through* moral hazard. The thesis defended in this dissertation is that the political influence of moral hazard in the post-2007 European economic governance lies in the lack of contestation of moral hazard-based arguments among European policy elites; this lack of contestation is not a sign of ideational consensus but of the usefulness of the concept. The second section of this chapter discusses the contribution of the dissertation to the academic literature on the politics of ideas, acknowledges the limitations of this dissertation, and suggests avenues for future research. Finally, the third section of this chapter concludes with a discussion on the relation of moral hazard to justice and asks what influence moral hazard should have on the institutional arrangements and public policies of a community.

10.1 The Relationship of Moral Hazard to Power in the post-2007 European Economic Governance

10.1.1 On Contestation

In this dissertation, the extent to which moral hazard is wielded for contestation is a crucial element to characterize the connection between power and moral hazard. Notably, major contestation by non-authoritative actors is considered as evidence in favour of power *over* moral hazard; and minor contestation by non-authoritative actors is regarded as evidence in favour of power *in* and *through* moral hazard. Indeed, the hypothesis to explain the political power of moral hazard based on the authoritative theory – that is, the capacity of authoritative

voices to impose their view on moral hazard on others – implies opposition to this view by non-authoritative actors and relative consensus among authoritative actors. In this dissertation, there are two authoritative actors – the northern coalition (of which the German government and the Bundesbank are members) and central banks (the Bundesbank, the Bank of Italy, and the ECB). The other actors considered in this dissertation are non-authoritative (i.e. the southern coalition and politicians).

The empirical analysis found the presence of minor contestation in the corpora of non-authoritative actors. Indeed, the extent of contestation by the members of the southern coalition is approximately 8% and 3% by politicians. In both cases, the contestation is driven by the Italian government: in 2015, Padoan wielded the term ‘moral hazard’ in Italian newspapers to refute the primacy of the goal of avoiding moral hazard over risk sharing. The Italian government is the only non-authoritative actor to have (occasionally) questioned the importance that should be given to the objective of avoiding moral hazard. This finding reveals that the goal of avoiding moral hazard maintained its privileged status in the policy-making of the EU after 2007. In addition, the empirical analysis found that only left-wing politicians have used the term ‘moral hazard’ for contestation: while Padoan (Democratic Party) occasionally contested the primacy of the goal of avoiding moral hazard over risk sharing, Timmermans (Party of European Socialists) once deplored the influence of the moral hazard concept on EU negotiations in the context of the migration crisis of 2015. However, this evidence of contestation by Socialist policymakers is limited. Most often (80% and 99% of the times, respectively), the Italian government and the Commission did not use the term in their press documents to refute or challenge a statement on moral hazard.

Unsurprisingly, the empirical analysis found the presence of minor contestation in the corpora of authoritative actors: the extent of contestation by the northern coalition is approximately 2% and 8% by central bankers. In this dissertation, members of the northern coalition (i.e. German policymakers) are the least likely to use the term ‘moral hazard’ for contestation. While the Bundesbank temporarily refuted that a European Resolution Fund was an effective means to solve the moral hazard problem in the banking sector, and the relevance of moral hazard in the COVID-19 crisis, the German government never wielded the term to refute or challenge a statement on moral hazard. It is the only institutional actor under consideration in this dissertation where the contestation of moral hazard is null. However, it is worth reminding that German policymakers, unlike others, did not use the term in press documents in 2007. This result signals that there was a political discourse on moral hazard in the aftermath of the IFC independent of German policymakers. The fact that German

policymakers did not start the political discourse on moral hazard in the post-2007 period indicates that the political influence of moral hazard in European economic governance after 2007 cannot be simply reduced to the power of the stronger Member State.

In addition, the pattern of contestation by central bankers constitutes evidence against the hypothesis of central bankers' power *over* moral hazard. Indeed, the contestation of moral hazard in the ECB case is one of the most important (12%) and diversified. The contestation by central bankers was mainly about the means-goal relationship and the relevance of moral hazard in the COVID-19 crisis. For example, the Bank of Italy refuted the effectiveness of the threat of default and bail-in for smaller banks to counter moral hazard in the financial sector, and the necessary causal relationship between deposit insurance and moral hazard. Similarly, the ECB refuted the proposition that UMP measures (especially OMT) necessarily create moral hazard, and the relevance of moral hazard in the context of the COVID-19 crisis. However, ECB Executive Board members are the only central bankers under consideration in this dissertation to have explicitly refuted the primacy of the goal of avoiding moral hazard over systemic and price stability. The finding of relatively high contestation by an authoritative actor is against the expectation based on the authoritative theory. If the political power of moral hazard was mainly derived from the power of central bankers' authoritative voices, its contestation by central bankers should not be relatively frequent. In this respect, it is worth stressing that Draghi – the policymaker with the highest number of press documents with the term 'moral hazard' in this dissertation – only wielded the term to refute or challenge a statement on moral hazard as a central banker and not as a politician. In this case, authority appears as a license to contest moral hazard. The contestation of moral hazard based on economic knowledge reveals the varieties of economic expertise. In this respect, neo-Keynesian economists – like arguably Draghi or Lawrence H. Summers – seems more likely to contest the primacy given to the goal of avoiding moral hazard than others (see, for example, Summers, 2007).

To sum up, the empirical analysis of the discourse on moral hazard in terms of contestation found evidence against the hypothesis of power *over* moral hazard. The contestation of moral hazard among European policy elites is minor. Notably, the goal of avoiding moral hazard maintained its privileged status in the post-2007 period. On few occasions, the primacy of this goal has been publicly questioned by the policymakers under consideration in this dissertation. The objective of avoiding moral hazard is presented as a shared objective among European policy elites. The presence of minor contestation in the corpus of non-authoritative actors, the relatively high contestation in the ECB case, and the fact

that German policymakers did not initiate the political discourse on moral hazard in the aftermath of the IFC, all work against the power of Germany and/or central bankers over moral hazard.

The extent of variability in moral hazard-based arguments is the other crucial element considered in this dissertation to characterize the relationship of moral hazard to power. Minor variability is considered as evidence in favour of power *in* moral hazard (the hypothesis based on the institutional theory); and major variability is regarded as evidence in favour of power *through* moral hazard (the hypothesis based on the instrumental theory). In other words, is the justification of minor contestation in the post-2007 period primarily a question of ideational consensus among the European policy elite or of the usefulness of the concept? The examination of the variability condition is less straightforward than that of the contestation condition and is based on a qualitative judgement rather than a quantitative threshold. Assuming that variability in moral hazard-based arguments can result from variability in how moral hazard is understood by policymakers, the examination of the variability condition first focuses on conceptions of moral hazard and looks for potential differences in the defining features of moral hazard. Second, the analysis of the variability condition focuses on the main characteristics of the political discourse on moral hazard, including premises and conclusions of moral hazard-based arguments.

10.1.2 On Conceptions

The empirical analysis of conceptions found that the meaning of moral hazard is mostly taken for granted in the corpus examined in this dissertation. Of the 364 press documents, there are 25 direct definitions of moral hazard. This finding suggests that there is an implicit consensus among European policy elites about the meaning of moral hazard.¹¹³ However, this dissertation created 37 different sub-codes to account for the variety of descriptions of moral hazard in the corpus ('What it is' code) and did not find a broad conception of moral hazard that is common to all sub-cases. Indeed, the conception of moral hazard as an incentive problem, in which the features of intentionality and rationality are emphasized and the allocation of blame is placed on the system rather than the individual, is present in all cases

¹¹³ In addition, it should be noted that the meaning of moral hazard was not a subject of explicit contestation in the corpus (i.e. no coded segment with 'Contestation' is about the meaning of moral hazard). This finding reinforces the claim that there is an implicit consensus among European policy elites about the meaning of moral hazard.

except for the Italian government sub-case. The interpretation of moral hazard as rational behaviour made by neoclassical economists was influential among most policymakers of the EU under consideration in this dissertation but not all. Given the variety of descriptions of moral hazard found in the corpus and the absence of a broad conception of moral hazard that is common to all cases, this dissertation concludes that there is not a common or dominant understanding of moral hazard among European policy elites. This conclusion is against the hypothesis of power *in* moral hazard, as in this dissertation the presence of an ideational consensus about something requires at least a consensus about its meaning. If there is no consensus on the meaning of moral hazard among European policy elites in general, what about among specific institutional actors? As a reminder, this dissertation considers concepts as intersubjective conventions that provide insight into a shared social reality (Schaffer, 2016). Thus, the conception of moral hazard is expected to be more similar within a group with shared beliefs and interests than outside this group.

In this dissertation, the conception of moral hazard as an incentive problem is common to all cases of central banks (the Bundesbank, the Bank of Italy, and the ECB). This finding demonstrates the influence of neoclassical economics in central banking. In central bank press documents, moral hazard is often about incentives for risk-taking. One of the main incentives for risk-taking discussed by central bankers was systemic relevance (sub-code ‘TBTF/SIFIs’ of ‘What causes it’ code). Systemic relevance is considered as a protection against the risk of failure: if one wants to avoid the collapse of the system, a systemic institution will not be allowed to fail. Thus, according to the logic of moral hazard, systemic relevance increases risk-taking and thereby the likelihood of failure of systemic institutions. While this understanding of moral hazard is present in the corpora of all the central banks under consideration in this dissertation, it is worth stressing that differences nevertheless exist. For example, while the Bundesbank and the ECB started to emphasize systemic relevance as a cause of moral hazard from 2010, the Bank of Italy did so from 2007. In addition, while the Bundesbank and the ECB used moral hazard to explain the IFC of 2007-9 and reduce the associated uncertainty, the Bank of Italy did not (instead presenting moral hazard as a consequence of the policy response to the crisis). These findings suggest that, unlike the Bank of Italy, the Bundesbank and the ECB inferred the causal relationship between systemic relevance and moral hazard from the IFC as occurring, arguably overestimating the systemic relevance-moral hazard relationship as a cause

of the IFC.¹¹⁴ Another noteworthy difference as to how moral hazard is understood in the central banks' corpora of this dissertation relates to the question of risk-taking. While in Bundesbank press documents moral hazard is mostly focused upon increased risk-taking, in Bank of Italy and ECB press documents, moral hazard is mostly about excessive risk-taking. This difference might seem trivial, but it points to different interpretations of risk-taking and changes the universality of moral hazard. Indeed, moral hazard as excessive risk-taking implies that risk-taking is not problematic per se but only when exceeding what is right. Thus, the Bank of Italy and the ECB present a more positive view of risk-taking than the Bundesbank and therefore, a more restricted understanding of moral hazard. Moral hazard is open to interpretation and notably depends on what is considered acceptable risk-taking.

The conception of moral hazard as a moral problem is common to the corpora of executive actors (the German government, the Italian government, and the Commission). This understanding of moral hazard is characterized by an emphasis on the features of intentionality and doing harm to others. Here, the allocation of blame is placed on the individual rather than the system. Irrespective of the structure of incentives, voluntarily doing harm to others is morally condemned. This finding indicates that one of the original understandings of moral hazard as the opposite of morality did not disappear from the current policy debate. However, it is more likely to be found among politicians than central bankers, where the influence of neoclassical economics is arguably less important.¹¹⁵ Another similarity in how moral hazard is understood by the executive actors examined in this dissertation is that moral hazard is presented as something not existing by an inherent necessity: most often, politicians seek to avoid or not to create moral hazard (as opposed to the less ambitious goal of reducing moral hazard). Finally, in all the executive cases of this dissertation, taxpayers are presented as the victims of moral hazard (this is also the case in national central banks). Politicians aim to avoid moral hazard to protect taxpayers.

Similarly to the case of central banks, differences as to how politicians understand moral hazard also exist. One of the most noteworthy differences relates to the conception of moral hazard as the opposite of trust, which was present in the corpus of the Commission and

¹¹⁴ However, it should be noted that the systematic relevance-moral hazard relationship is not the only type of moral hazard that was presented as a cause of the IFC. Notably, in 2008-9, the Bundesbank emphasized the role of the securitisation-moral hazard causal relationship in the IFC. The shift from securitisation to systemic relevance in the discourse of the Bundesbank over time can be interpreted as a reflection of deliberate strategy to limit supranational banking supervision to SIFIs.

¹¹⁵ However, it should be noted that the understanding of moral hazard as carelessness or negligence (the other original understanding of moral hazard, in which the feature of intentionality is downplayed) was absent from the corpus of this dissertation.

absent from the others.¹¹⁶ In the context of the migration crisis of 2015, moral hazard was not described in terms of a causal relationship between protection and risk, or of disregard for the harm caused to others, but in terms of the negative expectations one has of the intentions or behaviour of others. The role of preconceived opinions about others is emphasized in this understanding of moral hazard. This conception of moral hazard informs about the Commission's responsibility to deal with the distrust among Member States. Finally, it is worth stressing that the Italian government is the only executive actor under consideration in this dissertation who has used moral hazard in press documents to explain the Greek crisis. Surprisingly, this dissertation found evidence that moral hazard was wielded to blame the Greek government for its fiscal problems by another member of the southern coalition rather than by the leader of the northern coalition.

There are certain elements as to how moral hazard is understood that are specific to the members of the northern coalition (the German government and the Bundesbank). Notably, the concept of liability is a core concept associated with moral hazard in the German discourse. The principle of liability generally refers to a situation where decision and liability are in close conjunction: who takes the decision must be liable for it. Being answerable for a decision taken by others and thus restricting the liability of others is presented as unfair. Moral hazard is the opposite of the principle of liability (for the German government) or the effect of not applying this principle (for the Bundesbank). The principle of liability makes a direct reference to the seven constitutive principles of the competitive market order enumerated by Eucken (Chapter 3) and illustrates the influence of *ordo-liberalism* in German policy-making in the post-2007 period. Another distinctive feature of the German discourse in terms of how moral hazard is presented is that, unlike others, German policymakers tend to exaggerate moral hazard. Indeed, German policymakers are more likely to describe moral hazard as a problem ('the moral hazard problem' or 'the problem of moral hazard' are frequent expressions in the German corpus) than others. Others (i.e. Italian policymakers, ECB, and Commission officials) tend instead to attenuate moral hazard by describing it as a concern or an issue. This framing of moral hazard indicates that, despite the fact that avoiding moral hazard is often described as a shared objective, German policymakers attach more importance to moral hazard than the other policymakers under consideration in this dissertation.

When it comes to the other actors (the southern coalition, the Member States, and the EU institutions), the specificities as to how moral hazard is understood in the corpus are less

¹¹⁶ Moral hazard as the opposite of trust is also present in the corpus of the Bank of Italy.

obvious than for central bankers, politicians, or the northern coalition. Nevertheless, it is worth pointing to two elements that relate to the moral conception of moral hazard: this conception is common to the corpora of the Italian government and the Bank of Italy (unlike the German case, where moral hazard as an incentive problem is the common broad conception); and EU institutions (the ECB and the Commission) are more likely to use the moral conception of moral hazard in relation to governments than financial institutions. In particular, the conception of moral hazard as free-riding – in which the feature of taking advantage at the expense of others is emphasized – is used by the Commission exclusively in relation to governments. This conception turns moral hazard into both a moral and a fairness problem (against the value of reciprocity). The fact that EU institutions are more likely to use the moral conception of moral hazard in relation to governments and the rational conception in relation to banks suggests a prejudice against governments that might be related to the influence of neo-liberalism.

In this dissertation, the empirical analysis of conceptions of moral hazard is not limited to the corpus of press documents. Interviews have been conducted to complement the results of the discourse analysis. The material from the interviews is characterized by differences among interviewees rather than similarities. One noteworthy similarity that emerged from the interviews is the centrality of the concept of liability in the German case: the term ‘liability’ was only used by German interviewees – which confirms the influence of *ordo-liberalism* in terms of how German policymakers understand moral hazard. However, the list of defining properties of moral hazard is varied and does not present a clear pattern in terms of case studies. Interviewees emphasized different of the following defining properties of moral hazard: against the social contract, against moral principles, against the interest of the principal, intentionality, doing harm to others, hidden action, the expectation of not being caught, not suffering from the materialization of the risk, separation between decision and accountability for its consequences. The question of whether moral hazard is a moral problem was divisive among the interviewees, also within a small group of prestigious professional economists. The variability of responses to the judgement questions (such as, ‘is moral hazard the main cause of the IFC?’ or ‘is moral hazard the main cause of the SDC?’) or to question 7 (‘a person vaccinated against the COVID-19 who becomes less careful to not spread the virus. Is this an example of moral hazard?’) clearly indicates that interviewees do not share the same criteria to describe something as moral hazard or not. Thus, the interviews present direct empirical evidence of the ambiguity of moral hazard – even among a small group of EU policymakers – which challenges the assumption that economic experts share a common understanding of moral hazard.

To sum up, the empirical analysis in terms of conceptions found evidence against the hypothesis of power *in* moral hazard. Even though the meaning of moral hazard is often taken for granted in press documents (and not the subject of direct contestation), policymakers under consideration in this dissertation do not share a common and dominant understanding of moral hazard. Although the objective of avoiding moral hazard is mostly presented as a shared objective by European policy elites, the detailed examination of how moral hazard is understood by policymakers reveals the ambiguity of the concept and its contested nature. What moral hazard is precisely is not consensual among European policy elites. Conceptions of moral hazard are socially constructed and depend in particular on the topic of negotiations and the influence of neoclassical economics, ordo-liberalism, and neo-liberalism.

The ambiguity of moral hazard is part of its usefulness as this ambiguity contributes to the ubiquity of the concept in policy debates. However, in this dissertation, a ‘useful’ concept is one that helps policymakers achieve their goals. Thus, an examination of the political discourse on moral hazard, notably in terms of how policymakers used moral hazard in the public debate to argue for or against particular ways of acting, is crucial to fully assess the usefulness of the moral hazard concept.

10.1.3 On Arguments

This dissertation found evidence that the term ‘moral hazard’ is not often wielded in press documents by the selected policymakers of the EU for contestation. In this dissertation, exploitation is understood as the opposite of contestation. If the term is not wielded for contestation, it is wielded for exploitation. In other words, policymakers tend to use moral hazard in their communications not to question the legitimacy of the moral hazard-based arguments formulated by others but to increase the legitimacy of their own arguments. This dissertation found that moral hazard is a political resource exploited in all the selected cases. Notably, the concept was exploited by those who seek to preserve the essential elements of the Maastricht model of European economic governance and by those who seek to change them. This sub-section summarizes the main results in terms of variability of moral hazard-based arguments. First, it reviews the main similarities of the political discourse on moral hazard between and within actors. Second, it highlights the idiosyncratic elements of each case (and sub-case) study.

There are similarities and differences in the main characteristics of the political discourse on moral hazard between the actors considered in this dissertation. This dissertation found that in all cases except that of the German government, the discourse on moral hazard is essentially cognitive. Schäuble's mainly normative discourse on moral hazard (focused on the value of fairness) is an exception in the corpus of this dissertation. In addition, this dissertation found that moral hazard is a relatively regular element of central bankers' discourse over the period under study and a relatively irregular element of politicians' discourse. Another identified similarity is between national discourses on moral hazard: the concept was mainly exploited in the context of EU politics. The number of press documents where the term 'moral hazard' is present while the topic of the EU is absent is low in the Member States' corpora and equal to zero when it comes to national governments. Moral hazard is a political resource rarely exploited in the context of national politics. Policymakers of the northern coalition exploited moral hazard to limit further risk sharing at the EU level and policymakers of the southern coalition exploited moral hazard to increase risk sharing at the EU level. Those who exploited moral hazard to argue in favour of changes to the Maastricht model of European economic governance did so to suggest continuity with the past and mitigate the opposition of conservative forces. Changes to the Maastricht model were justified in relation to the past policy paradigm. Finally, this dissertation found that the discourses on moral hazard of EU institutions were not biased in favour or against financial institutions or governments (contrary to that of most national institutions): the ECB and the Commission equally discussed moral hazard in relation to banks and governments.

In the German case, moral hazard was exploited to limit protection and increase constraints, for both banks and governments. The conclusions in favour of 'bail-in' and 'risk reduction before risk sharing' can be described as German conclusions.¹¹⁷ In addition, unlike most other cases, the Maastricht Treaty is a relatively frequent topic in the German discourse on moral hazard, indicating the crucial importance that German policymakers attached to it. While the political discourse of the Bundesbank on moral hazard was mainly about financial institutions and went from arguing against unregulated securitisation to arguing in favour of the so-called TBTF reforms (composed of resolution, prudential regulation, and supervision), the discourse of the German government presented a distinctive feature in terms of 'Whose moral hazard' was mainly discussed. Indeed, the German government is the only case of this

¹¹⁷ The conclusion in favour of private sector involvement in debt restructuring programs ('bail-in') is present in other cases but is more nuanced. The German case is the only case under consideration in this dissertation where the conclusion in favour of 'bail-in' appears clearly consensual.

dissertation where the discourse on moral hazard was mainly indeterminate: German ministers (essentially Schäuble) most often discussed moral hazard in general terms. This dissertation interprets this finding as a discursive strategy aimed at generalising the discourse on moral hazard about banks to governments. Indeed, for example, this dissertation found evidence that the moral hazard-based argument formulated by Schäuble to justify greater constraints on banks was generalised to argue against collective liability among EU Member States. Contrary to the IFC, Schäuble did not explicitly use moral hazard in press documents to explain the euro area SDC. However, he certainly used the causal relationship between moral hazard and the IFC to argue that it was necessary to prevent government moral hazard – thus, limiting protection at the EU level against the risk of sovereign defaults. Finally, it is worth reminding that the idiosyncratic nature of the German government's discourse on moral hazard also lies in the primacy of normative premises: the discourse of the German government is the most normative of all the cases examined in the dissertation, and yet it is also the case where the relationship of moral hazard to economics is the most emphasized. This finding illustrates Schäuble's strategy to depoliticise moral hazard-based arguments.

In the Italian case, moral hazard was exploited to increase interstate risk sharing and constraints on banks (with Banking Union). Most often, Italian policymakers exploited rather than contested the goal of avoiding moral hazard. For example, the Italian government presented further risk sharing as a necessary counterpart to bail-in instruments, if one wants to achieve the goals of containing moral hazard and safeguarding financial stability. Another relatively frequent moral hazard-based argument formulated by the Italian government is the one in favour of a European unemployment insurance scheme. The causal relationship between the scheme and moral hazard is presented as non-necessary thanks to an appropriate design. The framing of the scheme as being in line with the goal of avoiding moral hazard aims to increase its legitimacy. Not contesting the primacy of the goal of avoiding moral hazard but presenting it as a shared objective allows the Italian government to present itself as moderate, thus increasing its credibility. Similarly, the Bank of Italy often exploited the goal of avoiding moral hazard to increase the legitimacy of OMT measures and European Deposit Insurance Scheme (EDIS). The discourse of the Bank of Italy on moral hazard also presented distinctive features. For example, the Bank of Italy is the only institution under consideration in this dissertation that has clearly exploited the goal of avoiding moral hazard to argue in favour of reducing the centrality of a financial institution to the financial system (although temporarily) and, more recently, to regulate non-systemic banks and NBFIs. Unlike the other central bank cases, the Bank of Italy did not refute the relevance of moral hazard in the context of the

COVID-19 crisis. Instead, the Bank of Italy emphasized the causal relationship between the financial response to the COVID-19 crisis and moral hazard in the shadow banking system.

The distinctive feature of the ECB case as to the political discourse on moral hazard relates to internal divisions and discursive shifts. Indeed, the ECB is the only case examined in this dissertation of a clear shift as to how moral hazard is exploited over time. Before 2012, moral hazard was mainly exploited to defend essential elements of the Maastricht model (i.e. limit protection and increase constraints on governments). Notably, Stark exploited the goal of avoiding moral hazard to argue in favour of the no-bailout clause, market discipline, stricter fiscal rules, austerity, and against transfers. Unlike central bank financial assistance to banks, central bank financial assistance to governments was clearly controversial. The ECB argued in favour of alternatives (such as the ESM). After 2012, moral hazard was mainly exploited to justify increased protection against the risk of sovereign defaults. In particular, the ECB presented UMP measures (e.g. OMT) as being in line with the goal of avoiding moral hazard, thanks to conditionality. This framing aimed at increasing the legitimacy of such contested proposals. In addition, the ECB also argued in favour of a euro area fiscal capacity, arguably to reduce the reliance on UMP measures.

In the Commission case, moral hazard was mainly exploited to argue in favour of further centralisation of economic policies at the EU level. The broad narrative can be summarised as follows: increased risk sharing – such as Eurobonds – is necessary to solve the euro area SDC and/or strengthen the euro area; reinforcing the powers of the Commission over national economic policies is presented as an effective instrument to deal with the moral hazard created by increased risk sharing; thus, if a government wants to solve the SDC and/or strengthen the euro area without challenging the stability culture, it must accept the reduction of its control over economic policies. This is what Rehn called ‘the basic principle of sustainability’. The goal of avoiding moral hazard was exploited by the Commission to increase the legitimacy of further centralisation at the EU level. Similarly to the case of the Italian government, it allows the Commission to present itself as moderate and to increase its credibility vis-à-vis the members of the northern coalition.

To sum up, the empirical analysis in terms of arguments found evidence in favour of the hypothesis of power *through* moral hazard. The moral hazard-based arguments present in the corpus of this dissertation display great variability. The concept was used by policymakers to help them achieve diverse policy goals. In general terms, moral hazard was wielded by most policymakers to explain the IFC and increase the constraints on the banking sector. This suggests a new policy consensus away from the neo-liberal belief of a self-regulating market.

It was wielded by the members of the northern coalition and by the ECB (before 2012) to argue against increased risk sharing and in favour of individual responsibility. It was wielded by the members of the southern coalition and by the ECB (after 2012) to argue in favour of increased risk sharing and by the Commission to argue in favour of further centralisation at the EU level. The relationships of moral hazard to morality, economics, and the past dominant policy paradigm were exploited by policymakers to increase the legitimacy of their different arguments.

10.1.4 Conclusion on the connection between power and moral hazard

Given the empirical findings in terms of contestation, conceptions, and arguments, this dissertation concludes in favour of the hypothesis based on the instrumental theory: power *through* moral hazard mainly explains the political influence of the concept in relation to European economic governance after 2007. The justification of minor contestation is primarily a question of the usefulness of the concept rather than ideational consensus. If moral hazard was an important component of policy because it is an internalized and/or a shared belief among the European policy elite, a shared and dominant understanding of what moral hazard is would have been found, the contestation of moral hazard would have been consistent, and the application of moral hazard concerns would have been symmetric. However, this dissertation found noteworthy variability in the defining features of moral hazard; inconsistency as to the contestation of the primacy of the goal of avoiding moral hazard, the means-goal relationship, and the relevance of moral hazard in the COVID-19 crisis; and an asymmetric application of moral hazard concerns. Indeed, on this last point, this dissertation found evidence that moral hazard concerns are greater in relation to the central bank acting as a lender of last resort to governments than to banks, or that the moral hazard of the shadow banking system has been largely ignored. Instead, this dissertation argues that moral hazard is an important component of policy because it is a useful instrument. Notably, it helps authoritative actors to depoliticize the debate or to suggest continuity with the past, and it helps non-authoritative actors to be perceived as moderate and credible. Moral hazard is a frame that helps to increase the legitimacy of policy proposals in EU negotiations. Thus, most of the time, policymakers in the post-2007 period have decided to exploit rather than contest moral hazard, reinforcing its political power.

The conclusion on the relationship of moral hazard to power as power *through* implies that the political influence of the concept depends on its usefulness. Although this dissertation has mostly presented moral hazard as a ‘common-pool resource’ – that is, a resource that is available for exploitation to all policymakers – it is worth stressing that moral hazard also presents the characteristics of a limited resource. Indeed, the political discourse on moral hazard during the IFC and the euro SDC, where the concept was arguably over-exploited, seems to have reduced its usefulness in the context of the COVID-19 crisis.

10.2 Academic Contribution, Limitations, and Avenues for Future Research

This dissertation contributes to the existing academic literature on the political power of ideas in several ways. The moral hazard case provides three main insights to the more general question of why certain ideas influence policy more than others. First, it highlights the fact that minor contestation and being taken for granted (factors of political influence) are not necessarily equal to ideational consensus. This dissertation makes a distinction between apparent ideational consensus (characterized by minor contestation and ideas being taken for granted) and real ideational consensus, which at least requires agreement on the meaning of ideas. Thus, the moral hazard case reminds us about the importance of looking at the content of ideas when assessing whether an idea is consensual or not, even among a group of professional economists. Second, it draws attention to the role of non-authoritative actors in the influence of ideas over policy. Indeed, this dissertation argues that the political power of moral hazard in the post-2007 European economic governance cannot be reduced to the roles of the stronger Member State or economic experts. Non-authoritative actors – such as Italian policymakers (as members of the southern coalition) and the Commission’s political leadership – played a part in the dominance of moral hazard in the aftermath of the IFC. Similarly to other studies, this dissertation explains the contribution of non-authoritative actors to the political power of ideas that seem to be ideal candidates for contestation (e.g. austerity) in relation to the need to establish credibility and form agreements with authoritative actors (see, for example, Bremer, 2023). Finally, third, the moral hazard case shows the leadership role of economic experts in creating, diffusing, contesting, and eventually changing the conventional wisdom. Indeed, while the influence of neo-classical economics strongly contributed to the

political power of moral hazard, this dissertation found that one of the most salient cases of contestation of moral hazard is that of the ECB. In line with the finding of the political economist Manuela Moschella, (from 2012) central bankers of the ECB can be described as ‘unexpected revolutionaries’ in relation to moral hazard (Moschella, 2024). If central bankers’ discourse on moral hazard becomes characterized by major contestation in the future, the political power of moral hazard will certainly be reduced.

The contribution of this dissertation to the academic literature on the political power of ideas is not limited to the insights of the moral hazard case. In addition, this dissertation contributes to this academic literature by proposing an original method for empirically studying the relationship between power and ideas. Indeed, this dissertation claims that by assessing the extent of contestation and variability of conceptions and arguments in different social contexts, a researcher can provide evidence for or against the hypotheses of power *in*, *over*, and *through* ideas. This proposed operationalization of hypotheses based on ideational power hopes to help solve the problems associated with the empirical study of the role of ideas in politics.

Finally, this dissertation makes a specific contribution to the academic literature on the politics of European economic governance. Through the concept of moral hazard, this dissertation offers an overview of the main policy debates on European economic governance since 2007. Thanks to the exceptional ubiquity of the concept, studying the politics of moral hazard’s use provides significant insight as to the politics of European economic governance. Notably, it informs about the positions of key Member States and EU institutions on fundamental questions of public intervention in markets, centralisation, and mutualisation at the EU level. It also informs about the influence of past dominant ideologies in the post-2007 period. For example, this dissertation provides evidence that the neo-liberal belief of self-regulating markets has lost influence among the European policy elite, and that the ordo-liberal principle of unrestricted liability maintained its influence in Germany. However, there is also evidence of the primacy of the goal of avoiding fiscal dominance over financial dominance, which points to the resilience of neo-liberalism. The study of the politics of moral hazard’s use also informs about the strategic use of the sound money paradigm. This dissertation confirms the finding of the political economist Jens van’t Klooster that policymakers justify significant policy changes to the Maastricht model in terms of the past dominant policy paradigm (van ’t Klooster, 2022). Lastly, this dissertation nuances the conventional finding of a dominant narrative of ‘northern saints versus southern sinners’ in the context of the euro area SDC (e.g. Matthijs and McNamara, 2015). At least, this narrative was not prominent in the discourse on moral hazard. Indeed, this dissertation found that the causal relationship between moral hazard

and the euro area SDC was not a pronounced element of the German political discourse (the narrative of the Greek crisis as a matter of moral hazard was rather found in the Italian case). More than presenting themselves as ‘saints’ and others as ‘sinners’, German policymakers used moral hazard in their press documents to present all governments as potential sinners and austerity as a preventive measure that was successful in Germany rather than a punishment (see, for example, Schäuble, 2014, 2016). The normative nature of the discourse on moral hazard of the German government is more about the unfairness of bearing the burden of a decision that is not yours than a distinction between good and bad national characters.

However, there are limitations to the analysis presented in this dissertation that should be acknowledged. Apart from the obvious limitations in terms of the number of Member State cases, this dissertation is limited in three main respects. First, the empirical analysis of this dissertation was conducted on a restricted discourse on moral hazard: proxies of moral hazard were not considered to collect press documents or focus the analysis, and the analysis was confined to the textual context of one sentence or one paragraph before and after the term. This strict focus on the term ‘moral hazard’ in published press documents leaves out a broader discourse that limits the generalizability of the findings of this dissertation. The analysis of this broader discourse on moral hazard might nuance or even challenge the main findings of this dissertation. Second, this dissertation is directly affected by the limitations of manual coding. Although manual coding offered clear advantages over automated coding for the inquiry of this dissertation, the technique is not without flaws – notably in terms of greater subjectivity and reduced replicability. A conventional solution to limit the problems of manual coding is to check the intercoder agreement.¹¹⁸ However, such procedure was not possible in the framework of an individual PhD research project. Instead, I conducted an iterative coding process to improve the coding quality and made a report with the coded segments for each code available to the reader. Finally, third, this dissertation is subject to the limitations of translation tools. While working in part on the subtlety of language and grammar, this dissertation had to accept a loss of nuance and detail when it comes to the analysis of texts written in German and Italian.

The limitations of this dissertation naturally create avenues for future research. Apart from examining the broader discourse on moral hazard (e.g. including proxies of the term), future studies could focus on additional Member State cases. Acquiring knowledge on the

¹¹⁸ The intercoder agreement involves two or more coders processing the same document independently and coding it according to mutually agreed code definitions. The MAXQDA software has an Intercoder Agreement function for comparing code assignments. The aim is to achieve the highest possible level of agreement between independent coders.

political discourse on moral hazard of other members of the northern and southern coalitions will confirm or nuance the findings of this dissertation, such as the limited evidence of the ‘northern saints versus southern sinners’ narrative or the minor contestation by the southern coalition. In addition, it would be of analytical interest to examine the discourse on moral hazard of Member States that are not part of these two coalitions. For example, studying small Member States could bring additional information as to how and for what purposes the concept of moral hazard can be exploited by non-authoritative actors. The United Kingdom (UK) – before Brexit – also appears to be a case of particular interest for the study of the politics of moral hazard’s use in the context of European economic governance. Indeed, as a country with a relatively important financial sector and a strong tradition of liberalism, the moral hazard-based argument in favour of increased constraints on the financial sector is likely to be less prominent than in other cases. This potential diversity in terms of political discourses on moral hazard would reinforce the claim of this dissertation that moral hazard is a political rather than a technical concept. Investigating the political discourse on moral hazard of more Member State cases will also confirm or nuance the finding of this dissertation that moral hazard is a political resource rarely exploited in national politics. Further research could then seek to explain this phenomenon or explain the potential variations between national contexts. In addition to studying a larger number of Member States, the knowledge on the political influence of moral hazard in European economic governance could also be improved if scholars paid attention to parliaments and newspapers. Indeed, an examination of the discourse of members of parliaments could add information on the relevance of the right/left division to the politics of moral hazard’s use. The understanding of the political power of moral hazard in European economic governance would also be improved by an analysis of how moral hazard is used by different mainstream media.

Future research on the politics of moral hazard’s use could also be conducted beyond the context of the EU. Mapping and explaining the political influence of moral hazard in other political communities or international organizations, with notably different cultures and influential ideologies, would bring valuable knowledge as to the political nature of the phenomenon. A communist country like China appears as an ideal candidate. The US case, where the political influence of moral hazard seems more important in the context of social insurance than macroeconomic risk sharing arguably deserves greater academic attention. Another case that appears particularly relevant is that of the IMF. Indeed, an examination of the IMF’s discourse on moral hazard could notably help trace the evolution of conventional macroeconomic wisdom over time.

The academic knowledge on the political influence of moral hazard would also benefit from an historical perspective. For example, comparative historians could map the political power of moral hazard in different countries since the end of the second world war and the development of the welfare state. Political theorists and historians of economic thought could help draw a more precise picture of the influence and meaning of the concept of moral hazard in various schools of thought and on founding thinkers.

Finally, this dissertation creates avenues for future research beyond the case of moral hazard. Indeed, by proposing a method to empirically examine the relationship of ideas to power, this dissertation invites political scientists to use this method to study other politically influential ideas – especially those that are taken for granted.

10.3 Concluding Remarks: Moral Hazard and Justice

This dissertation found that the opinion that avoiding moral hazard should be a primary policy goal is largely unquestioned by policymakers in the EU. This dissertation argues that this is not so much because the proposition that the phenomenon of moral hazard is pervasive in the EU is true, but rather because of the political usefulness of the goal of avoiding moral hazard. The concluding remarks of this dissertation discuss the position that avoiding moral hazard should be a governing principle based on its relation to justice.

Discussing the relationship of moral hazard to justice would require an analysis of the concept of justice. This challenging task has occupied many philosophers and political theorists over time. Justice is a concept with many interpretations, and it is beyond the scope of this dissertation to offer an exhaustive account of all its meanings. However, the proposition that justice is about the distribution of benefits and burdens among people seems relatively uncontroversial. Indeed, according to the political theorist David Miller, ‘the most valuable general definition of justice is that which brings out its distributive character most plainly: justice is *sum cuique*, to each his due’ (Miller, 1979: 20). Social justice concerns the distribution of benefits and burdens among the members of a society (ibid: 22). Miller identified three principles of justice – that is, three criteria to determine which benefits and burdens are due to each individual – namely: to each according to his/her rights; to each according to his/her deserts; to each according to his/her needs (ibid: 27). The primacy given to the principle of rights, deserts, or needs to judge if a situation is just or unjust varies across social contexts and reflects different world views. For example, the historian of ideas Samuel

Fleischacker (2009) traced and explained a shift over time in the conception of distributive (or social) justice, from distributive justice based on deserts or merits (i.e. Aristotelian sense) to distributive justice based on needs (modern notion).¹¹⁹ Independently of which principle of justice is used to describe the distribution of benefits and burdens among the members of a society as just or unjust, the classical view that injustice is the greatest evil for a polis seems stable over time (see, for example, Platon, 1987: 176). According to the ancient Greek philosopher Plato, injustice is the greatest evil for a society because it prevents its members from acting in common with each other (Platon, 1993: 87). The corollary of the conclusion of injustice as the greatest evil is that avoiding injustice should be the primary goal of a political community. The answer to the question of whether avoiding moral hazard should be a primary policy goal of the EU therefore depends on whether moral hazard can be described as unjust. Avoiding moral hazard should be a primary policy goal only when it creates benefits and burdens that violate the principle of rights, deserts, or needs.

If the primary goal of a political community is to avoid injustice, and that moral hazard is unjust, then the political community should seek to avoid moral hazard. However, the means to this end should not create injustice. Thus, the discussion about the relation between moral hazard and justice should not end with the analysis of moral hazard as just or unjust. It must also include the question of how to deal with unjust moral hazards – especially if committing injustice is considered worse than suffering it (Platon, 1987: 188). Three principles must be satisfied if one wants to avoid committing injustice when dealing with unjust actions:

- (1) The preventive function of government should not be abused (Mill, 2015: 93).
- (2) The amount of punishment inflicted should be proportional to the gravity of the offense which has been committed (the principle of proportion) (Miller, 1979: 21).
- (3) Equals should be treated in the same way (the principle of impartiality) (ibid.; Mill, 2015: 158).

The preventive function of government, as opposed to the punitory function, is forward-looking. Its purpose is to prevent the occurrence of undesirable actions. For example, limiting protection against the risk of sovereign default and increasing constraints on fiscal policies are measures said to prevent the occurrence of government moral hazard. The preventive function is abused when it causes injustice. Preventive measures should not be against the three

¹¹⁹ Fleischacker dated the birth of the modern notion of distributive justice in the eighteenth century and the change in attitudes towards poverty (ibid.). The modern belief that the state can and should raise people out of poverty is explained in relation to the influence of the ideas of Jean-Jacques Rousseau, Adam Smith, Emmanuel Kant, Gracchus Babeuf, Karl Marx, and John Rawls (ibid.).

principles of justice. The case of austerity as a preventive measure against moral hazard can be described as an abuse of the preventive function. There are arguably several justifications of the conclusion that austerity as a preventive measure against moral hazard is unjust. One of them is based on the principle of needs: for example, given the effect of austerity on child poverty (e.g. Cantillon *et al.*, 2017), austerity violates some children's needs.

Unlike the first principle, the second principle is backward-looking. The principle of proportion applied to the case of punishment is about how those responsible for unjust actions should be sanctioned. According to the principle of proportion, for sanctions to be consistent with justice, the amount of punishment must be proportional to the gravity of the offence. For example, not paying back creditors can be described as an unjust action based on the principle of rights. If this injustice is the result of the debtor's voluntary action (what some observers would call moral hazard), the debtor deserves to be punished in proportion to the burden caused to the creditor. It is difficult to quantify the burden caused to the creditor in the abstract and therefore to define what constitutes a proportional punishment for this injustice in general. The task of judging if the punishment for not paying back creditors is proportional to the gravity of the offence is easier when looking at a particular case. For instance, if austerity is considered as a punishment for the Greek government's moral hazard, the punishment can be described as contrary to the principle of proportion. Indeed, the imposed austerity in Greece has aggravated the social costs of the crisis and has caused particular harm to children and poor people (see, for example Matsaganis, 2017). The Greek government not paying back its creditors has arguably not had an equivalent effect on the populations of the creditor countries. Thus, the harm inflicted on the Greek people with austerity is greater than the burden caused by the Greek government to private creditors and public providers of bailouts.

Lastly, the third principle applies to both cases of prevention and punishment. To be consistent with justice, the treatment of moral hazard must be impartial. The principle of impartiality – that is, 'treat equals equally' (Miller, 1979: 20) – implies the absence of favour or preference to one member of the society over another, where there are no relevant differences between them. For example, if the application of moral hazard concerns favours banks over governments,¹²⁰ the shadow banking system over banks, or is simply ignored in some cases and not in others, the treatment of moral hazard would be unjust. Indeed, although this dissertation found that moral hazard was exploited by EU policymakers to help them achieve

¹²⁰ Especially if the premise used by economists to conclude that the case of the government should be studied similarly to other cases is accepted, namely that the public and the private sectors are not fundamentally different in nature.

a large variety of goals, it was not exploited to achieve all possible goals. For instance, one could formulate a moral hazard-based argument to help achieve the goal of reducing economic inequality: if moral hazard is about doing harm to others because one is protected against the consequences, if economic wealth protects against the consequences, and if a political community wants to avoid moral hazard, then economic wealth should be limited by the political community. This moral hazard-based argument against economic inequality – that seems particularly relevant in the context of the climate crisis – was not formulated by the policymakers under consideration in this dissertation. The absence of this moral hazard-based argument from the corpus of this dissertation suggests an implicit bias in favour of the stronger members of the political community over the weaker members – which would be inconsistent with justice since members of the political community are equals.

In sum, this short analysis of the relationship of moral hazard to justice reveals that, while the primacy of the goal of avoiding moral hazard is rarely questioned by EU policymakers, moral hazard is not necessarily unjust. This dissertation argues that the importance attached to avoiding moral hazard should depend on whether moral hazard creates injustice or not. Contesting the proposition that the goal of avoiding moral hazard should be absolute is all the more important given the risk of committing injustice when dealing with it. Indeed, if the policy response to moral hazard does not satisfy the three principles of not abusing the preventive function of government, of proportion, and of impartiality, the policy response can be worse than moral hazard. There is evidence to argue that the EU policy response to moral hazard in the post-2007 period includes unjust elements. Notably, it is worth stressing the case where the moral hazard of the stronger members of the community is ignored (which is against the principle of impartiality). In focusing upon this case, ironically, this dissertation ends by concluding that moral hazard is an under-exploited political resource in the EU.

Appendices

A.Dataset of Articles with ‘Moral Hazard’ in the Title and Written in English, JSTOR Database

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C. Transcripts of Interviews

Interview 1: Bundesbank official

Question 1: Is moral hazard the main cause of the IFC that began in 2007?

I: Yes, certainly a major cause.

LP: How did moral hazard materialize in this context?

I: So, what I understand is that what we observed in the run up to the financial crisis was excessive risk taking by certain actors in financial markets, where the crisis originated. And at the same time, these actors knew that in case of failure they would be protected against the downsides of... the bearing of the failure would be limited to them, while they could at the same time win all the benefits from the risk taking.

LP: So here, the source of moral hazard would be an implicit assumption that you would be bailed out if things go wrong?

I: Yes, absolutely.

Question 2: Is moral hazard the main cause of the euro area sovereign debt crisis?

I: This is something I am less familiar with. With my limited knowledge about this, I would say that it certainly played a role but maybe a less prominent one than for the IFC.

LP: And what would have been moral hazard in this context?

I: Basically, it is the same as for the IFC but on a different level. Certain risk taking or certain decisions were taken where deciders expected to win benefits but felt hedge against the possible failure.

LP: Here, are you talking about governments or financial institutions?

I: Here I am talking more about political decisions, political institutions. But this is really something that I have not studied.

Question 3: Does the EU's response to the COVID-19 crisis create moral hazard?

I: I am not sure where I should look for moral hazard there... because it was an exogenous shock that was not endogenous from decisions or economic or financial developments. Countries were hit to different extends, degrees... They certainly could not influence, based on random economic ties. So, I do not see where I should see moral hazard in this crisis.

LP: If you do not think about the cause of the crisis but about the financial response (EU debt, financial help etc.).

I: Ah ok, you are thinking of the joint EU response. I have not studied this response in detail but if I broadly remember... If I remember correctly, it is related to some conditionality which is certainly important in this context. I suspect that the response has very limited moral hazard mechanisms.

LP: Thanks to conditionality?

I: Yes.

Question 4: Is moral hazard more present at the European level than at the national level?

I: I think it is present on both levels, maybe to different degrees. My understanding is that, for many the nationality plays a more pronounced role than the European identity. The national identity is more pronounced than the European identity.

LP: And so, this identity would increase or decrease moral hazard?

I: It would decrease moral hazard on the national level. Like thinking about the German system with different states and the federal government, there is certainly some kind of moral hazard there... but I would say it is less pronounced.

LP: The fact of feeling that you belong to a certain community would decrease the risk of moral hazard?

I: Yes, certainly the identity idea, but maybe also that national institutions exist for very long, there are many processes and mechanisms. While on the European level, processes and mechanisms are newer and maybe less well developed. But this is a mere assumption.

LP: Processes and mechanisms of what exactly?

I: Of how financial flows... of which level is responsible for covering which kind of costs, how funds are allocated and used, how this is monitored... Because I think political deciders/politicians are under more scrutiny at the national level, there is more news coverage, people maybe pay more attention to what is happening within a country compared to what is happening across Europe.

Question 5: Is moral hazard under or over-estimated?

Missing data.

Question 6: Do you see moral hazard in the context of family?

I: Hum... I never thought about this before... But I personally would not see... I cannot come up with an example where I would see this with my family or with close friends... Because there is more reciprocity or mutuality.

LP: So, to you, reciprocity or mutuality is something that will counter moral hazard?

I: Yes.

LP: Why?

I: Because you care about the other side and not only about your own profit and well-being.

LP: So, you are saying that there are contexts where people can care about others?

I: Yes, sure.

LP: You are the first one!

I: Oh really? ha-ha that is scary. So other people you talked to, they say that even in private life...

LP: Yes. They see moral hazard everywhere!

I: Can you give me an example? Maybe I just do not understand...

LP: For example, they talked about parents that will financially help their children... and if it is not well monitored it would lead to irresponsibility from the part of the children... or this kind of...

I: Ah ok, well I agree. It is like you go to the casino and it makes a difference whether you play with your own money or your parents' money or someone's money. Of course. This certainly shapes spending behaviours. But I would still argue that it is maybe less excessive. You feel more responsibility. So, I see that, I think it is there, but the ties, the relationships shape the degree of moral hazard.

Question 7: A person vaccinated against the COVID-19 who becomes less careful to not spread the virus. Is this an example of moral hazard?

I: Yes, that is certainly moral hazard because being vaccinated you are insured against the downsides to quite a large extent and this encourages or incentivizes to take higher risks.

Question 8: What is the difference between moral hazard and irresponsibility?

LP: Moral hazard is often described as being close in meaning to irresponsibility. Do you agree?

I: Yes, I think so. Because moral hazard is related to excessive risk taking and this can be related to irresponsibility.

LP: And what would be the difference between moral hazard and irresponsibility?

I: You are asking me many questions that I never thought about... This is like it kind of makes sense to be irresponsible in the situation of moral hazard because you are insured. While you can also be irresponsible when you are not having this kind of insurance that it is associated with the case of moral hazard.

LP: In the case of moral hazard, is it the insurance that triggers the irresponsible behaviour? So, to you, in this case, moral hazard would be something that we are conscious about, right? It makes sense to have this behaviour, and we do it consciously?

I: People being in this situation, for them economically it makes sense to act like that.

Question 9: What is the difference between moral hazard and egoism (or selfishness)?

LP: Another concept often described as being close in meaning to moral hazard is egoism or selfishness. Do you agree?

I: I would say yes, because if you are not caring the downsides someone else has to carry them - which is not yourself. Few years ago, with the financial crisis it was like that. Gains were privatized while losses were socialized. This can be related to the concept, but I am not sure whether this is like fully understood by the actors being in this situation. Because for them, the scope of view that this people have, it makes sense to act in a moral hazard kind of way.

LP: If it is the expected bailout that triggers your excessive risk taking, there you know that public bailout will be borne by taxpayers... So, in this case you are conscious, right?

I: I think that individual actors, not necessarily. Relating this to the IFC, individual actors were not necessarily conscious about it. But taking a systemic kind of view, I think it was clear. I mean, before the IFC, the term 'too big to fail' already existed for like 20 years. So, the concept was understood certainly in the academic world and probably also in the political world. But the individual actors that kind acted like a herd during the IFC, these actors I do not know whether they...

LP: Do people working in TBTF financial institutions know that they are working in a TBTF financial institutions?

I: I have to guess... And I would assume not all. But people react to the system and the culture, and the culture is certainly affected by the TBTF status.

LP: And so, what would be the difference between moral hazard and egoism?

I: The difference would be to align the risks and returns which are not aligned in a moral hazard situation... The difference maybe is that in a moral hazard situation, thinking about the financial sector, you react to the incentives that you have, you kind of react to the rules and the system you are in, while maybe not being fully aware about the consequences for others. While, when you act egoistically or selfishly, you are aware of the consequences.

Question 10: To you, what is moral hazard?

I: Moral hazard is when risk taking and liability are not fully aligned. So, when you can take the benefits of your risk taking but do not have to account for possible adverse consequences.

Interview 2: Member of the advisory board to the German Federal Ministry of Finance

Question 1: Is moral hazard the main cause of the IFC that started in 2007?

I: It is certainly one aspect of it, but it is not the only one. So, there are other parts: lack of regulation, lack of equity buffers... So many institutional features that have not been or that had not been correctly reformed.

LP: So, it was a cause, but not the main...

I: Let's say it was one of them but far not the only one. So it was, in the sense, you could say that moral hazard part always relates to personal wrongdoing but there was also a lot of institutional stuff that was simply not well regulated.

[Audio recording failed – written notes]

Not because assumption of public bail-out but because of securitization of loans - allowing to pass on risks (do not care about the risk anymore). Ex ante profit without ex post consequences because the risk has been passed on to others.

Question 2: Is moral hazard the main cause of the euro area sovereign debt crisis?

I: One element. Bank-sovereign nexus (e.g. Ireland, Spain). But in general, moral hazard came from banks not from governments. Except for Greece: not reporting, lying about the actual levels of debt and deficit was moral hazard.

Question 3: Does the EU's response to the COVID-19 crisis create moral hazard?

I: NextGen EU was the right response. Case of force majeure, no one's fault. External shock - no one could have predicted the crisis. Bad luck that the countries most affected by this crisis are again mostly in the south (e.g. Italy, Spain).

Conditionalities to prevent moral hazard. Limited in time and amount. Here, moral hazard would be related to the use of the funds: rather it will reduce incentives for structural reforms and long-term investment remain to be seen.

Question 4: Is moral hazard more present at the European level than at the national level?

I: Less present in Europe than Germany (in terms of incentives). In Germany, we have automatic mechanisms between the federal level and landers. This automaticity, compared to the EU level, lowers incentives. So, the incentives at the national level in Germany are worst than at the EU level (more room for moral hazard).

But at the same time, at the national level we know better thanks to media scrutiny. At the EU level, we lack a joined public sphere, so we have less information about what others are doing. More rumours than at the national level.

LP: So you are not saying that because you know people better you want to be more cooperative in your behaviour...

I: I would rather like to say that if there is moral hazard indeed happening and that you have a joint public discussion space, which is also triggered by joint media, then it might be easier for the media to spot certain misbehaviour and also put public discussion on it. I would argue that on the European level, we do not have yet a common European public space so we simply would not know too much what is happening in country X, Y, Z, rather than just say rumours or pieces of observation without much evidence.

LP: And do you think that the fact that in Germany you have this automatic mechanism and a lot of discussions around the risk of moral hazard, this is an experience that makes Germany fear more moral hazard at the European level than other countries?

I: I certainly think, but this has probably not so much to do with the media part but the fact overall I think is that Germany has a very strong fiscal position, and thus the demands on the European level seem to come more from say southern Europe. And given say the abundance of demands from those countries it probably creates a certain feeling that there is a lot of demands being directed to us Germany and Germany not always being very clear on whether it should satisfy those demands or not.

Question 5: Is moral hazard under or over-estimated?

I: I would say it is probably over-estimated in public discourse, given that there are many other things as we saw with the financial crisis, we see that there is so much else that went wrong, and regulation was not in place. So therefore, I would say it is probably over emphasized. At

the same time, it is a very important element of human behaviour and so therefore it should not be ignored either. So it is just to find the right assessment, the right balance of moral hazard in this context.

Question 6: Do you see moral hazard in the context of family?

I: For sure. I mean moral hazard is a very common theme, you can find it in many ways and probably could come up with a lot of examples. So, for example, if you rent a car versus you own it. Then if you rent a car, you may be tempted to really accelerate, ignore speed limits that are maybe not given externally but rather say given by technical means, simply because you do not care about what is going to happen with that car in the long run. While if you, when you own it, you may actually behave in a different way.

LP: So here, the cause of moral hazard would be that you do not care about the long-term consequences.

I: Yes, exactly.

Question 7: A person vaccinated against the COVID-19 that becomes less careful to not spread the virus. Is this an example of moral hazard?

I: I would say it depends here on what the vaccinated person believes, and this is a little bit a matter of debate. If the person believe that vaccination leads to a reduced risk for infecting someone else, I would not call it moral hazard. I would simply say it is reasonable, it is a rational behaviour. If this person says I know that the vaccination does not reduce my infection risk to others and I just pretend it reduces it and I do not care, then I would see it as moral hazard. So, I would say it is dependent on what is the belief you have on what is actually the risk reduction that comes with the vaccination.

Question 8: What is the difference between moral hazard and irresponsibility?

LP: Do you agree that irresponsibility is close in meaning to moral hazard?

I: Yes, I do.

LP: What is the difference between moral hazard and irresponsibility?

I: Let me think maybe of examples. I would think that irresponsibility is more in the context of when you also hurt yourself and only yourself. So, for example, if you get completely drunk and drive a car - oh no driving a car is a bad one because it may affect others - you do something that only harms yourself - and get completely drunk and then you start swimming in the sea. So then again you may get some people in trouble but something that is only related to your own risk because then in the end it is irresponsible, but you do not involve others and I think that is where moral hazard really comes in, where your behaviour actually triggers a negative effect for others.

Question 9: What is the difference between moral hazard and egoism (or selfishness)?

LP: Do you agree that egoism or selfishness is close in meaning to moral hazard?

I: Yes.

LP: What would be the difference between moral hazard and egoism?

I: Let me again think of an example. It is very hard to find one. I would say it this way: egoism is whenever you try to find advantages for yourself no matter where. So, you really try to look into situations in which you find advantages for you. But the moral hazard also always implies that you think of someone else bailing you out if something goes wrong. And there might be cases in which you can have the one without the other. So, you still are searching for your own benefit, for your own advantage but it will not imply that you have actually an expectation of others to bail you out. You rather are just taking advantage of others but not really asking them to bail you out in case something goes wrong.

LP: So, you would not call moral hazard a situation where you take advantage of others but without this expectation that they will save you?

I: Yes. I think irresponsibility is more clearly to differentiate. You could say that moral hazard is one form of egoistic behaviour.

LP: Is there a behaviour that could be consider moral hazard without being selfish or egoist?

I: That is a good question, which direction does it go? Moral hazard as we discussed before also has a certain... this is a question of how we define egoistic. I mean it could also be that on the country level that you behave that way right so it might not be egoistic, but it is rather that the all group behave that way so that might be one aspect. I would say certainly, the moral hazard part, in my view, I could not think at the moment of an example in which you are in a moral hazard situation, and you are not egoistic. I could not think of something where you show moral hazard and you would be thinking in an altruistic way.

Question 10: To you, what is moral hazard?

I: Moral hazard is about actions you take that would create harm to others by not taking into account the consequences of your behaviour on the effects it creates for others.

Interview 3: Member of the advisory board to the German Federal Ministry of Finance

Question 1: Is moral hazard the main cause of the IFC that started in 2007?

I: No, I would not say this is the main cause, but I think it was the trigger. Moral hazard was part of the moment that made a very complex interconnected system realize that it has over depended on trust that was not actually justified to a certain extend. And moral hazard is, in that sense, one of the most basic principles that governs solid architecture in markets, in financial markets in particular, which distinguishes solid from fragile structures.

LP: So, in this context, what was the moral hazard?

I: Well, in terms of the trigger event in the financial crisis, it was basically the fact that there was a misconception of the riskiness of particular portfolio investments that banks in Europe had been doing. So, they were buying basically parts of real estate loan portfolios from the US and they trusted that particular risk patterns would be stationary, would be stable over time,

which they were not. And when you really dig down why these risk characterizations that were attached to these portfolios early in their life did not materialize, did not really survive, you find an element of moral hazard that plays a big role. And the element of moral hazard is that, in this particular case, when you engage in lending, in providing loans, you typically are careful as a bank, as a financial institution, because if you do not do it right you will lose part of your loans. Maybe more than what you recoup from the interest rates that you charge. And then you make real losses, you lose your capital. For that reason, you are very careful in only extending loans to parties from which you believe they will repay. And what happened in the financial crisis was that banks sold these loans in big parts, actually they sold all the loans they had been giving. And since they knew in advance that they will sell these loans, they were basically less careful in selecting the right and credible costumers. And this incentive conflict that when you sell the loan you are no longer liable for the losses. That was not, I would say, properly reflected in the processes that were used in this securitization chain.

LP: So, to you, the source or the cause of this moral hazard was the securitization of loans?

I: The securitization which was done in an improper way. Securitization per se is not the problem because you can do it properly. The legal efforts in that market, since the crisis, have been to rectify that. So today, if you want to secure a portfolio of loans, you have to obey to certain standards that did not exist before the crisis and these standards force you as the bank, as the issuer, to retain part of the risk. So, you retain some expected losses basically and by doing so, your incentives are realigned. Because since you retain part of the expected losses, you actually again start to think about the losses, and you will be more careful. That is the construction, and many people, most people, before the crisis believed that this would be practiced anyway, and it was really the surprise to find out that banks had been willing to do securitization without retention. That was not known to anybody I would say at the time. And the consequence was that because you have no retention, you have no incentive alignment so moral hazard can really prevail.

Question 2: Is moral hazard the main cause of the euro area sovereign debt crisis?

I: Well, again, I would say it is not the main reason, but it is an element that makes the sovereign debt crisis more pressing, more urgent to deal with and it makes it more serious. Moral hazard issues in sovereign debt relates to the fact that in Europe you are in a close community with

other countries, you are bind together in various dimensions: not only economically but also politically and militarily etc. so there is a lot of dependency. On the side of public debt, it is not easily conceivable that one country really is defaulting, goes into bankruptcy and is cut off funding from other countries, with all the consequences for the population in that country. Given all the other lines of dependency, you will probably not let it happen. And we saw this in the case of Greece. Greece was nearing default but then a big rescue effort was undertaken by other countries, partly because there is a risk that if a country falls too deep, there is a certain likelihood that people will vote for extremist parties, and with the extremist parties to get troubles on all the other levels - on the political side, on the militarily side, on the cultural side, whatever. You get suddenly veto players that want to destroy rather than build. And in that sense, there is a threat point that makes it very difficult to let a default happen properly. If you can anticipate that defaults are costly for others, because of the political fallout that goes along with it, then you can basically try to achieve a higher level of indebtedness than otherwise would be acceptable because you know, eventually there will be something like a bail out by other countries. And this bail out expectation is the root of higher indebtedness, and higher indebtedness is then the reason why you come in this sovereign debt crisis, which is not resolved as it should be in a collection of independent countries in free markets.

LP: So, you are saying that the excessive debt of Greece at that moment was related to the expectation of being saved by the others?

I: Well, it is not in a way that policy makers would decide on more debt, make this argument openly, they may not even think about it. But they are in a way allowed to achieve higher debt level and still feel comfortable about it. Say we will never be in deep trouble because we expect that there are partners that will... then comes the terms solidarity and all of that. Basically, rather than making all efforts to reduce the debt level which has become very high, they may be more relaxed, they may pay more attention to other areas of problem that they may face like voters of extremist parties, maybe in the case of Greece there were other problems in parallel with Turkey... And they were in a recession anyway. So, they had all good arguments on their side to these rescue measures in our economy rather than reducing our debt. Maybe in a way, the culprit of all of this is that the pricing of sovereign debt is not functioning as it should be in a free market. If you have high debt levels you typically pay high spread, so it becomes so costly to increase your debt that you can just simply not afford it. In the European setting, where you have the expectations that you will be rescued eventually, the spreads do not move

anymore and do not signal over indebtedness to policy makers. So, they are basically left in the dark about the true state of their country in terms of indebtedness.

LP: At some point you said that they may even not be thinking about these expectations of bailouts when taking decisions...

I: I am pretty sure they do not. They just look at the market price and they say, "look at our price, the market allows us to get on more debt at roughly the same price as Italy, or Spain or other countries, so why should we be more worried than them?". The market signal is no longer a true signal.

LP: So moral hazard can be something that it is not conscious?

I: Absolutely. It does not mean that they are mean politicians who will think how can we bend the rules and get some money? No! They feel completely to be on the right side. They look at the markets, see that they can still get indebted very cheaply, so the market trusts us and so do we.

LP: Would you call the fact of Greece not revealing the true level of its indebtedness moral hazard?

I: No. I do not think that Greece did not reveal the true level of indebtedness any more or less than other countries. It is a matter of measurement: what is really public indebtedness? You have the bonds that everybody knows, and you have some implicit debt, like for instance pensions.

Question 3: Does the EU's response to the COVID-19 crisis create moral hazard?

I: I mean, you can see in the way the NGEU has been set up that there is moral hazard. Because a lot of the construction that has been established to manage NGEU is really to fight moral hazard. There are various dimensions of moral hazard here. One of course concerns the fact that you make certain provisions on 'how the money should be spent'. You should not spend it for consumption for instance, for just paying your salaries, which is a moral hazard issue of course. Because that is the fear, money is simply spent and then how can you repay it later if

there is no investment dimension, nothing that triggers return in the next period. Secondly, there is a process of surveillance, you can discuss how serious it is, but there is a process with enforcement power that looks at how the money is spent and that it is spent according to the original application that was submitted. Again, that would not be there if there were no reasons to believe that it could be used elsewhere or otherwise. And that is also moral hazard. And lastly, there is a strong legal provision that should rule out that the debt is rolled over, meaning extended forever and being a permanent source of indebtedness. So, there is a lot of provisions, at least in the current set up of the NGEU that should ensure that eventually the money is paid back.

LP: So, there is the expectation that moral hazard could happen but not that it has already happened? It is in order to avoid moral hazard happening?

I: Yes, exactly. I mean they made certain provisions to make it a meaningful programme and the rules or the ideas that go along with, ideas that are translated into rules, they are monitored. Whether this is credible or strong enough that can be debated but I think moral hazard is an important aspect here. By the way, interestingly, you typically find those countries, or people from those countries, be they politicians or economists like me, who are living in that part of Europe which is mostly contributing to the NGEU but not receiving much, they argue that there is moral hazard. While if you talk to, I am not sure if you will find that, but it would be my hypothesis, policymakers or academics in the countries that mostly are on the receiving hand, in particular Italy, you will find that they tell you there is no moral hazard because it was an exogenous shock. Which is, pretty much, a nonsense. The moral hazard is not the event, rather the event is exogenous or not, but how you deal with it. That is where moral hazard evolves, not on the event side.

LP: I will talk to policymakers and economists in Spain to try to have both sides.

I: But Italy is the more... Spain is more like Germany in that respect. Italy is not.

Question 4: Is moral hazard more present at the European level than at the national level?

I: In general, I would say no: it is everywhere. I think it is the most, I should not say the most, but it is a very strong driver of the design in policy. If you think about how laws are being

drafted, how institutions at the European or national level are set up, there is always an element of moral hazard control that may explain how these things are set up. And the reason is that moral hazard is not something that you can basically tolerate easily. Actually, if you have an institution which invites moral hazard, which allows, which does not counter the revelation of moral hazard, this institution will die. If you ask for a sustainable institutional architecture, the most important thing you have to control for is moral hazard. The reason being that if moral hazard can survive, or even thrive, then there is a strong incentive to maximize on that part, to do something more and more because it is allowed, because it is accepted, because it is not countered by some measures. For the party who exercise this moral hazard driven activity it is pure enrichment. You have income without cost. That is why I think if you want to construct something that last in Europe you have to have a clear eye on the moral hazard issue and have to think of provisions that minimize or at least limit the extend of moral hazard.

LP: From your answer I understand that the provisions that we put in place to avoid moral hazard are not really efficient?

I: No, I would not say they are not credible. People try to make it credible and if it is not credible enough, they sharpened it. Because as I said, if you do not, if you are not successful these institutions will eventually die because they lose, in a system theoretical sense, the support of the people that basically have to come up with support activities like voting. If that vanishes, the institution itself will vanish.

LP: To you, the most efficient way to counter moral hazard is legal provisions?

I: You may say is legal provisions, it is also organizational in a sense, it is not only law. It is mostly how you implement things, so it is implementation in a way that produces 'skin in the game' - emphasize that people who take decisions should also face, personally or in their functions that they represent, at least part of the consequences that are triggered by their decisions. If you decoupled decision making and responsibility, then you are in the perfect moral hazard maximizing environment. And that will not work. Then you are doing everything on trust, and it is trust that is not being underpinning so to speak by personal liability of any sort, this will not typically survive.

Question 5: Is moral hazard under or over-estimated?

I: I think, in a sense, there is not a simple answer possible. I think that in many policy visions it is highly underestimated, and in many policy reservations, in issues that are not done, it is over estimated. So, to reconcile these two views... I think in many discussions, take the example of the green transformation of the taxonomy that the European Commission is doing or things like that, people completely underestimate that there is a lot of moral hazard here, that will come about once you set a rule. But then, if you find out that there is moral hazard, that is not the end of the story. It is the beginning of a regulatory process in which going back and forth you always refine your rules to match the revealed strategy of moral hazard. Moral hazard will reveal itself, will be traced, you can see it over time only as it develops. You set a rule, the people in your community respond, and this response you will observe that moral hazard is building up. So, you refine your rule so moral hazard will be either lower or will be shifted to other areas and you re-regulate again... So, I think that much of the regulatory process that we see is this dynamic process of refining ways of how to deal with moral hazard. But it never comes to an end, because there are always new areas where moral hazard can develop. So, it is not that it is getting less and less. But still, you are trying through the regulatory process to limit it.

Question 6: Do you see moral hazard in the context of family?

I: Oh yes, definitely. I mean, it is a rather general concept in that sense. You can observe it on a family level. If you give your kids basically free access to your wallet, there is a moral hazard that they take more than what would be good for them and you. And of course you can train them to make this not happen, you can counter it, you can create a sense of responsibility, I mean there are many ways, you can create trust, which are all ways to counter moral hazard. So, I think it is a general principle of mankind that it takes in a way politics or culture to go beyond maximizing your own utility. By just following your own utility you get moral hazard. Because you may do things that are detrimental to others, but you do not care. As soon as you start to think in group wise, in larger responsibility for others, the moral hazard should become smaller.

Question 7: A person vaccinated against the COVID-19 that becomes less careful to not spread the virus. Is this an example of moral hazard?

I: So, you mean that somebody who is vaccinated does not wear a mask, while the rule or regulation advise to...?

LP: Yes, since the virus will be less dangerous for yourself, you will be less careful.

I: Yes, in that sense, absolutely. You would be less careless if you would not be vaccinated. But I mean, this is only true if I want to get vaccinated. Let us think about the people who do not get vaccinated. For them, this statement would not be true. So, it is a conditional thing.

Question 8: What is the difference between moral hazard and irresponsibility?

LP: Moral hazard is often described as being close in meaning to irresponsibility. Do you agree with this?

I: I think there are situations when taken from the lending side, where moral hazard is basically showing its face in a way that through the lens of prudent banking would be qualified as irresponsible lending. But because in that sense, the issue of responsibility is about what I talked earlier with skin in the game. Skin in the game is about creating responsibility. That is why in the design of financial instruments and regulation you try to re-introduce responsibility. Remember I said that there is this distinction between decision making and responsibility and you want to have them symmetric, somehow consistent. And that is what the regulation tries to achieve.

LP: But also, when you were talking about moral hazard in the context of family, you said that responsibility could help reduce the moral hazard. So here it is a different kind of responsibility. It is not liability.

I: That is right, you can phrase like this.

LP: What would be the difference between moral hazard and irresponsibility?

I: The term irresponsibility is used in a sense of not facing and not taking into consideration the consequences of one's undertaking. And that makes it irresponsible, you are not responsible for everything. And that is why it is very close to not being liable. But there is another meaning

of irresponsibility: I do things which are dangerous let us say, maybe in the family context I do things that are irresponsible - I take my kids on a bike ride without helmet or something like that on a highway - so that would be irresponsible. Is this moral hazard? Probably not. So that is another meaning of responsible - I do not really take all the care that I am supposed to do because I am such a fan of riding bicycle on highway let us say. That is different, it is not moral hazard.

Question 9: What is the difference between moral hazard and egoism (or selfishness)?

LP: Do you agree that moral hazard and selfishness are close in meanings?

I: No, I would not. I would assume that people are always selfish. It is almost a tautology. Selfish means they maximize, under the constraints that they face. And the point of moral hazard is that the constraints that they face do not address the disutility that you produce for others. It is not part of your constraints set. If you want to remedy this, you make it part of your constraints set. So, one way of how you can get rid of this is for instance by forming a family to use your example. Within the family, it is a constraint that is automatically embedded. I always think about the fate of my kids, of my wife, as something that is very close to myself, my own objective. While, if it is somebody completely remote, I do not care that much. I care much less. So, there is much more discrepancy. But it is not that I pursue my own interest, the point is how my own interest is defined and how it is connected to others, and thereby constrained. And the more I free people, in an economic context - I have not much of family ties, solidarity and friendships - I have completely everybody pursues their own interest, so I can really by regulation reconcile the reach of my decision and the consequences of that, the responsibility.

Question 10: to you, what is moral hazard?

I: Well, I think moral hazard is the incongruence of decision making and responsibility taking. The more congruent they are, the less reason to expect inefficient decisions or unfair decisions. It is related to the concept of externalities in economics.

LP: So, it must be a negative impact on others to be moral hazard?

I: Yes. The moral hazard is, absolutely. With respect to myself, if I am the only person who has bear the consequences then there is no moral hazard.

Interview 4: Member of the advisory board to the German Federal Ministry of Finance

Question 1: Is moral hazard the main cause of the IFC that started in 2007?

I: Certainly, a very important one. We should define what we mean by moral hazard. If we mean that things that are hard to contract are carried out... Then, yes, let us say yes, that it is one of the most important reasons.

LP: How this moral hazard materialized in the financial crisis?

I: The starting point should be the American subprime crisis and there was definitely too much lending by banks. It is a question whether you call that moral hazard or... there is a kind of gambling because there is a lower bound of what you can lose and so part of the downside risk was borne by the taxpayers and that has always been clear. So, in that sense, there was a kind of moral hazard - unobservable to the regulators, unobservable to voters, to politicians. The banks increased the risk too much.

LP: It would be a moral hazard from the side of the banks?

I: In that case, yes. Too much lending. I do not know... lending out loans that were higher than even the current value of the house that was purchased.

LP: Do you think that the reason why the banks were lending too much is important or it is just the fact that they were lending too much? Do we need to know the reason why the banks were lending too much to talk about moral hazard or it does not matter?

I: Yes, absolutely, we have to know. This debate is still going on. One explanation could be that the banks were not sufficiently regulated, so there could be an incentive for too much lending because the shareholders of the banks knew that if things go well, they earned high

profit and if things go badly someone else has to pay the bill. This could be one explanation. Another one is that the excessive lending was not even in the interest of the shareholders, but it might have been in the interest of the management of the banks. And then the answer is a different one. In that case you do not need more regulation from the government side but rather you need better supervision within the bank and different incentives. So, I do not know: different incentive contracts for the top management, better educated supervisors and so on. Probably it was a mix of both, therefore it really matters, yes.

Question 2: Is moral hazard the main cause of the euro area sovereign debt crisis?

I: Again, it depends on how you define moral hazard. In the strict sense, it is probably not moral hazard. I started a chair for insurance economics, there you would say that moral hazard is the adjustment of behaviour because you know that the insurance company cannot observe your individual behaviour. So, I do not know, you drive a little bit more risky because you know your car is insured and it is never perfectly observable how you behave. Or you live a bit more dangerously, drink a bit more or do dangerous sport activities because you know that the insurance company cannot observe that. It is therefore not contractable because it is unobservable. It makes no sense to write a contract on something the insurance company can never observe, even not ex post.

And that is probably not the case here. Of course we can observe the deficit of governments, more or less. There was some cheating maybe in the Greek case, but it was the exception. Other countries were also affected, say Ireland and so on. In that case it is more or less perfectly observable what politicians do and their national government, but it is not contractable. So here is more the problem that we do not have a supervising institution, a super government. A European government that can really force national governments to do what they had promise to do. So, in the literal sense it is not moral hazard because it is observable, but it is a very similar effect just because we do not have an institution that can enforce this kind of contracts.

LP: So, I understand that to you, whether you can observe or not a behaviour is crucial in terms of moral hazard?

I: Yes, that is the original, the hidden action definition. The one we would use in insurance economics. This moral hazard slogan has become very prominent and is often used in other contexts and it is not the same as in the original sense.

LP: So, if a government promise that the debt will be increased for example, then it would not be a kind of moral hazard anymore. If you do what you promised to do?

I: You mean if they announce that the deficit will be higher than 3 percent and the debt level will be over 100 percent... so above the 60 percent and then they actually do it... Then it is not moral hazard, yes, sure then it is not moral hazard. If countries have agreed to do that, I would not call it moral hazard.

Question 3: Does the EU's response to the COVID-19 crisis create moral hazard?

I: Well, it is hard to say because the potential moral hazard will be in the future, is not it?

LP: Yes. But do you see a potential for it?

I: It is hard to say, I do not know. To be honest, I do not know. First of all, I am no expert on the details. How it was contracted. What did the countries exactly promised? Therefore, I cannot say whether there is leeway for moral hazard. I would say it was a compromise: how to make transfers to countries even though we always had said that there would be no transfer scheme in Europe, at least not this type of transfer scheme. So, it was a way of...I do not know, support for countries that are under stress due to COVID. I do not know, I could not say.

Question 4: Is moral hazard more present at the European level than at the national level?

I: I think it is very similar. I think there are two differences. First of all, we have very different national schemes. So, for example, at least Spanish colleagues told me that one of the reasons for the Catalan movement is that there is no fiscal transfer scheme in Spain. So, the Catalan region being very rich always argues why do we have to give all the money to the centre. There is always a discretionary policy in Madrid: who gets which money, there are no rules. We would not mind to give some money to the centre if it is distributed according to some rules. Whereas in Germany we have a very fixed rules-based system - maybe even too fixed with too little leeway. And so there are very different systems. Therefore, it is hard to say whether it is more at the European level than at the national level because there is so many different national systems.

And secondly, within a country, you have a national institution that can change things. In each country you have a national government and if you do not like the system as it is you can elect a government that changes things. And that is very different in the EU because there everything is done by a bargaining by nation states. So, the procedure is different, therefore it is much more difficult to reform there.

LP: You do not see differences in incentives for government whether it is vis-à-vis European colleagues or within the national context?

I: In principle no. I think that if you get the incentives wrong, people will behave or move in the wrong direction whether it is on the European level or the national level.

Question 5: Is moral hazard under or over-estimated?

I: I think it is underestimated, at least if you think of moral hazard in its broader sense, right, so not in its literal sense. I think it is underestimated, even within economics. I think you see different directions. When I talk to the colleagues in macroeconomics, they usually stress the advantages of a let us say a transfer system in Europe. If I talk to the public finance colleagues, so that is more my field, they would always stress the moral hazard or the problem of non-contractable efforts. You never know for what the money is used for... is it really used for growth purposes or is it used in the end as a transfer to some subgroups of the population because the next elections are ahead. And so, even within economics there are different views here. And I think, in public, this idea that government behave in a way that is not, say, maximizing the total surplus, is not very prominent. Is not only a European problem, it is the same in Germany. We have regions like Bremen, some of the states were in severe troubles, and then there were big efforts to bailed them out, to give them transfers, and they had to promise that in the future they would save money, but they basically had used the money, and the debt level was still the same after this consolidation period. And to save formally money they for instance, they had - so in Germany we have two types of public employees, permanent and others - and so they just hire more people in permanent employment because that saved some money in social insurance expenditures. So, there were all these accounting tricks... That happens all the time. And I think that is very prominent in public economics but not so much in other fields.

LP: So, when you talked about the differences between macroeconomics and others... do you think it is because they do not look at the same thing, the advantages and disadvantages are the same depending on the level you look at it?

I: I think it is not so much the perspective: all economy versus just some sub parts. It is just basically your experience. When you are a macroeconomist, you have dealt with some business cycle crises and you wonder how you can stabilize the economies during a shock period: whether you use, I do not know, rules or discretion, whether you use fiscal or monetary impulses and so on. As a public finance economist, you often ask how do governments behave? And you have all this experience of periods where it has gone wrong. As I have just said, we have this German experience. Even though we always have promised that there would be no bailed out for states, we did that once and it did not work at all. So, it is just different types of experience.

Question 6: Do you see moral hazard in the context of family?

I: Within the family? Could you say a little bit more what do you have in mind? I do not see anybody noticed that I did not clean the bath or the kitchen, something like that?

LP: Yes, I am trying to see if, to you, moral hazard is specific to a situation where you do not know the people directly or... So, in the context of family, for example, if my parents are paying my studies, I do not have to bear this cost, if this influences my behaviour in terms of how seriously I take my studies, would you qualify this as moral hazard?

I: Good point. I was a bit hesitant because most things are observable within the family. But you just gave an example where it is difficult to observe. So, your parents do not know how hard you work at the university. If you are lazy and just enjoy your life, do not attend the courses then this would be a kind of moral hazard. But it is a repeated interaction. In the end, it is not perfectly observable but, in that case, you will probably fail the exams so at least ex post it becomes obvious. I mean if you fail once, just one exam, it could be bad luck, but if you fail all exams, it cannot be bad luck anymore. Then it is clear that this also has to do with effort. And then it is in a way contractable: parents could say if you fail all the exams in the first two years then we stop paying. At least ex post there can be some punishment. Whereas, if you

have, I do not know, if you break your leg, even ex post the insurance company cannot tell whether it was negligence, your type of activity, or just bad luck.

LP: To be moral hazard, it has to do with effort?

I: Effort, behaviour. Another word is hidden action.

LP: So, if I study hard and fail all my exams, it would not be moral hazard?

I: It could be a hidden type. You are not very good in studying, you go in the wrong field... so it could be type, which makes it hard to contract because I could have told my parents that it was bad luck. This would not be moral hazard.

LP: And would you qualify as moral hazard a case where my parents are supporting me in my studies, and I will do extra efforts to succeed because they are supporting me?

I: I would not call that moral hazard. I think this is reciprocity: you want to give something back.

LP: So moral hazard is related to a negative impact?

I: Hum... yes, in the sense that it is individually rational to deviate from the collectively best effort level. You need some kind of welfare function because we talk about utilities and not just about money, it is much more complicated. And there you also benefit because you can give your parents something back. You increase both utilities if you pass the exam with excellent results.

Question 7: A person vaccinated against the COVID-19 who becomes less careful to not spread the virus. Is this an example of moral hazard?

I: No, I would not call it moral hazard.

LP: Why?

I: I mean it is rational right? So where is the externality there?

LP: Potentially you can spread more the virus...

I: Ah ok, so it is spread more. But the first... the person at risk that is me in the first place, right?

LP: But you are less at risk because you are vaccinated. So, this would change your behaviour and it can have negative consequences on others...

I: Yes, it can. But it is also optimal to change my behaviour. Is it not?

LP: Yes. So, when it is optimal to change my behaviour, it is not moral hazard?

I: The critical question is how important are the externalities? I mean, I agree, it is not fully clear. But in the first place I would say, suppose that I am not vaccinated and then it is probably optimal not to go to the pub because I have a high risk of becoming infected. But when I am vaccinated, the risk is much lower and so there is a trade-off: I like to go to the pub but on the other hand there is a bit more risk but that the risk is very small, so the optimal behaviour has changed. And so, the question is how important is the externality? If the externality is huge, then it could be moral hazard. No no, even then I would not call it moral hazard because it is observable whether you go to the pub. Is it not? It has to be a non... Maybe from an insurance perspective: the insurance company would say 'do not go to the pub because this is a high-risk place' and afterwards is never observable where I contracted the COVID... in that case one could say from an insurance perspective yes, it is kind of moral hazard. It is a borderline case.

Question 8: What is the difference between moral hazard and irresponsibility?

I: Moral hazard is an econ concept. Irresponsibility does not exist in economics at least as far as I know - as a concept.

LP: So moral hazard would be irresponsibility translated in economics?

I: Irresponsibility is tougher. Someone who behaves in a moral hazard way, I would not call this person irresponsible. Just incentives are not aligned with the principle. So, it is a principle-agent problem. The principle wants that everyone works very hard in the factory, but you cannot observe everyone at every point in time and so people might occasionally have a short break. Is moral hazard yes, but is it irresponsible? No. Irresponsible is a moral category and it is very tough, very negative. Not every moral hazard behaviour has to be condemned in the moral sense. Some could, sure. If you have a car race in the city and you think no one would notice and you do not get caught this is absolutely irresponsible.

Question 9: What is the difference between moral hazard and egoism or selfishness?

I: Difficult question, because usually we have selfish players in these tenets' models of moral hazard, but I think even if you integrate something like reciprocity, others regarding behaviour, altruism whatever you can think of... all these types of utility function that have come up in behavioural economics in the last 30 years, I think they still would not eliminate moral hazard. Because even if you have others regarding preferences, they might mitigate a little bit the moral hazard problem compared to a selfish person, but you still do not have the same incentives or the same utility function as the principal as an agent. So, I do not think it would vanish. Write on a model with typical others regarding preference and still have moral hazard in such an insurance model for instance.

Question 10: To you, what is moral hazard?

I: Another word is hidden action. So, it is the change of behaviour because one believes that the principal (the insurance company, the employer...) cannot perfectly observe my behaviour. And this leads to deviation in the end of the outcome between what the principle wants and what I achieved.

Interview 5: Member of the advisory board to the German Federal Ministry of Finance

Question 1: Is moral hazard the main cause of the IFC that started in 2007?

I: Regarding the financial crisis, yes.

LP: Why?

I: Well, in literal terms, moral hazard to me is that people, so subjects making economic decisions behave as you can fear they behave because of the incentives they have. In the financial crisis, we observed that banks in particular incurred higher risks because they could speculate on being bailed out by the government, by the state. And this leads to too high risks being allocated in the banking sector. And finally, the speculation was right, and they got this bail out.

LP: So, to you, moral hazard is not just about taking more risks, but it depends on the cause of this behaviour?

I: Moral hazard can occur in any relation that we observe and therefore I found this general description of it... moral hazard is a behaviour you can fear that occurs because of wrong incentives is a good description.

LP: So, if there are no wrong incentives but still you observe a similar behaviour, would you call it moral hazard?

I: Well, the sense of moral hazard is meaning that you have an ex post cheating on what is agreed upon in an economic relation. Also more generally, this might be a contract, but usually contractual relations are not necessarily complete. Usually, they are not. Usually, you have incomplete contracts, and you are uncertain about whether the parties of this contract stick to what is the content that is agreed upon. And therefore, of course it depends on the general incentives that are provided but it is something... moral hazard behaviour is a type of ex post cheating that occurs.

Question 2: Is moral hazard the main cause of the euro area sovereign debt crisis?

I: This is more complicated. Partly yes, partly no. When you take the example of Greece, I would say yes. When you take the example of Ireland, I would say no. Because I would

distinguish in the case of Ireland the incentives that the banking sector had - and this was your previous question - and on the other side the incentives of the Irish government. Ireland was not excessively indebted when they entered the financial crisis. They got a very high indebtedness from one day to the other because they took over part of the private indebtedness of its banking system. And as far as I remember the discussions then the Irish government was even urged by the European partners to make this step, to take over some of this private debt of his banking system. Similarly, in the case of Spain, it is a bit more mixed than in the Irish case, but also there it is much more a problem of the relation between the financial sector, real estate and so on than it is the high indebtedness. Spain was not highly indebted. In the case of Portugal, it is even more mixed. Italy is, of course, too heavily indebted. So, I would say it depends on the country you look at.

LP: So here, you said yes for Greece. So, do you think that Greece had different incentives than the other governments?

I: Greece did not have any problems with its real estate sector. This was not problematic. But Greece had hidden a lot of its public debt, of its deficit to the others. Well, I would say that this is a clear form of cheating with respect to the fiscal rules that we have and then finally leading to a default situation in Greece.

LP: What would be the incentives of the Greek government? Was it related to the EU fiscal rules and architecture, or it was something else?

I: I would also say partly. It is due, it can be characterized as a cheating within the fiscal rules because some deficit was not reported although it should have been. And on the other side, it is also the incentives from the overall seemingly favourable economic development in Greece before its particular problems, fiscal problems, that lead to excessive spending in Greece to a large extend.

LP: How would you explain that Greece... the economic environment was the same in most of the countries.

I: No, I would not say so because Greece enjoyed much lowered interest rates by joining the European monetary union. The economic development was much much stronger. I remember

the day when the Economist wrote about Germany as being the sick men of Europe and in the same year was talking about Greece as the new economic powerhouse of Europe, with very high growth rates. And, well, actually, it was not like that.

Question 3: Does the EU's response to the COVID-19 crisis create moral hazard?

I: Well, your questions get more and more complicated. So, first of all, the COVID-19 crisis in 2020 could not have been forecasted by anyone. It came really as an exogenous natural shock. And I would also say that being prepared for a pandemic of this extension that occurred the last time a 100 years earlier during the Spanish flue. You cannot be prepared for that to a sufficient extend. I would not say this was a bad preparation to it. Although, from the German context I know that there was a discussion in Parliament after the SARS pandemic - so the first COVID virus - in China and the Arabic countries, there was a preparing report send to the German parliament and nothing happened there afterwards. But still, I would say, well, what should there be such an intensive preparation if something like this only occurs every 100 years. So, this is the first part of my answer: no moral hazard in this regard. The second part is, in the first phase, the reaction of European governments was more or less the right one. Less because, an immediate reaction was shutting down borders, closing borders. This was a mistake. Within Europe, this should not had happened. But all the other decisions taking directly afterwards were quite right. The third answer is, we do not know yet what the Next Generation EU will provide as incentives. Perhaps it is working. Perhaps it is working by saying European governments realized that, in this situation we were in, countries most heavily affected by the COVID-19 crisis needed to have some support. By the ECB on the one side, but also by the EU with this new programme on the other side. And, in exchange for this programme, governments need to show that they also start to have particular structural reforms. And when we look at say Spain or Italy, a lot is going on in that regard. In the case of France, I am a bit more hesitant to say that the government is already going in the direction of reform. So let us wait and see what Next Generation provide. And then, when you next continue on that next steps of the second, third, fourth, fifth ways of COVID-19 until this beginning of this year, this winter, well I would not say that all the governments in Europe responses in the right direction. It might have been in one or other instance of moral hazard problem. But I am also reluctant to say that the governments made big mistakes. In situations of high uncertainty sometimes you make wrong decisions and sometimes you make right decisions. Well, I can say that I am satisfied with what they are doing.

Question 4: Is moral hazard more present at the European level than at the national level?

I: I would also say it depends on the different countries but of course, my experience from multi-level governance is that it is very important to have proper incentives on each level of government. Because otherwise, there will be an incentive for moral hazard. When you look at the structure we have at the EU level, there is some incentives for moral hazard there.

LP: Like what?

I: Well, when you think about what we have just described regarding the European debt crisis: the fiscal rules do not properly work to prevent government from incurring excessive public debt, perhaps Next Generation EU will not work because the possibilities of the European Commission to enforce the part of structural reforms are too restricted... so we do not know that yet. I have the experience from the German type of fiscal federalism, and I would say that we have strong incentives for moral hazard in that case. Always, the regional level, the *lander* of Germany, they have an incentive to incurring excessive spending and ask the federal government for being financed for this excessive spending. And this is what occurs from long long time. And there is also empirical evidence in that regard that shows this more systematically. And there I cannot say that it is stronger at the EU level than at the national level because of my experience in Germany. It is always difficult to have a proper alignment of incentives at each level of government.

Question 5: Is moral hazard under or over-estimated?

I: Neither. It could be rightly estimated. It always depends on what you look at. Moral hazard is usually working rather in the medium and longer term. And when you think about the discussions that we are always having in the short term, it is underestimated. But those who emphasized the long-term effects, they may not sufficiently take into account what are the necessities that occur from each step of short-term decision making. So, the long term is the result of many short-term decisions. And therefore, I could say sometimes it is underrepresented in the short-term decision debates that we have.

Question 6: Do you see moral hazard in the context of family?

I: There is an implicit contract. I am talking as an economist, there need not be an official formal contract. You also have implicit contracts going on. So, for example, if you think about marriage as a kind of contract. Usually, I would say, well at least in the case of Germany or Switzerland I know this more exactly, normally if you have a former marriage this is already a kind of formal contract going on. And usually, it is a kind of default contract that is provided by the government. So, if you do not like to have this default contract given the legal environment of marriage you have to have your own individual marriage contract. And of course you can agree in that regard. And each party can of course shirk on this contract.

LP: And what about the relationship between parents and children? There is no contract...

I: Within the family, to some extent you are right because the legal environment is very restricted to particular forms of bad behaviour of parents towards their children and vice versa. But when you think about inheritance, we have clear environment also for the children.

LP: And what would be an example of moral hazard in this context?

I: Well, when you think about this inter temporal considerations, inheritances, from an economic point of view, can be provided to children in order to give them an incentive to take care of their parents to some extent. And of course they can shirk in that regard. You have a kind of moral hazard going on. But as I said, this can occur on both sides.

LP: But so here it would be moral hazard because the children change their behaviour towards their parents, but the behaviour is positive for the parents. So, it would be moral hazard?

I: Well, when the expected inheritance provides positive incentives for children to take care of their parents, I would not say it is a kind of moral hazard. Moral hazard occurs when parents expect a positive behaviour, and it does not occur and children inherit something anyway.

LP: So that the incentive is not working?

I: Then the incentive is not working properly. But also, from parents to children. When children need to be cared of, when they are still young, or when you expect that parents invest in the

human capital of their children, so these are two possibilities where you could say parents have a kind of obligation towards their children that they have to follow. And it is not clear to me what their incentives are and what can be provided from public policies to live up to these obligations. So that is not clear to me. We do not have proper incentives in that regard. And many parents do not feel this obligation to invest in the human capital of their children and therefore this is a kind of moral hazard that is occurring.

Question 7: A person vaccinated against the COVID-19 who becomes less careful to not spread the virus. Is this an example of moral hazard?

I: No, I would not. Given all the discussions that we had about vaccination and COVID-19, that someone who is fully vaccinated is becoming less careful and could continue to spread the virus to some extent, I think this is something we must accept given the incentives to vaccinate.

LP: So moral hazard is relative.

I: Yes, it is relative, I would say so. Of course it depends, what is the implicit assumption your question is, the vaccination works for this person. But on the other hand, you want to provide incentives for vaccination in a pandemic. And one of the incentives is that they can be less careful. You would like to allow people being vaccinated to go to events with larger number etc.

Question 8: What is the difference between moral hazard and irresponsibility?

LP: Moral hazard is often described as being close in meaning to irresponsibility and egoism. Do you agree?

I: I would say that moral hazard is a kind of behaviour that follows from selfishness. Well, you said egoism, I prefer selfishness. But it is more than that. When you are deciding in a selfish way, you are purely deciding economically. Moral hazard is going beyond that in a form of opportunism that occurs. So, it is worse than pure selfishness. Opportunism is really something you must fear. When you have opportunist behaviour, moral hazard is a part of it, then you have someone who is exploiting the incompleteness of a certain relation. And exploitation is not necessarily pure selfishness. Because you could also say it is a kind of selfish behaviour

thinking in reciprocal terms. Reciprocity is important for a relation inter temporally. And selfishness takes care of this kind of reciprocity. Whereas moral hazard is renegeing on that.

I: I would not say irresponsibility because in the case of responsibility it is always the question of what. If this is individual rationality it can be simply responsible. But when you think about social responsibility or in the broader sense, I would not argue that people who decide purely selfishly and do not take into account the effects of their behaviour on society can really be accused of having a kind of cheating behaviour or moral hazard. So, put it differently, selfish is something you must expect. Moral hazard is worst, it is bad behaviour.

LP: And bad behaviour is not irresponsibility?

I: Bad behaviours can be a kind of irresponsibility, but selfishness is not necessarily irresponsible.

LP: So, to you, moral hazard is not really an economic behaviour? Because some economists describe moral hazard as something that has nothing to do with morality, the maximization of the self-interest is something rational and that we have to expect. So, they do not see moral hazard has something wrong. But when you say it is bad behaviour, to you, it is something wrong?

I: Well, actually, I do not want to be moralistic on that. Although the term is moral hazard. I do not want to extend this to ethical norms.

LP: Why not?

I: Because ethical norms are difficult to be enforced when there is no clear decision on what the ethics should be. And this is extending on many many questions of social responsibility that are going beyond pure individual decision-making. I would distinguish a pure individual decision-making that is only selfish and an individual decision-making that is going beyond selfishness and increases towards opportunism. Moral hazard is part of opportunistic behaviour. Of course, when you are discussing environments, also from a policy point of view that avoid moral hazard, then you have to think about these relations carefully and have to expect moral hazard as an outcome that occurs. But from purely selfish behaviours moral

hazard does not necessarily need to come up. If the proper inter-temporal decision-making, think about reciprocity and reciprocal terms. I would not say that reciprocity is a clear ethical behaviour. I would think reciprocity is in a sense part of economic selfish behaviour because you have to think about the inter temporal relation that occurs. Usually, you do not meet the person only once, you meet the person necessarily twice and you need to think about what you are doing when this possibility emerges, when you meet again.

Question 10: To you, what is moral hazard?

I: Moral hazard is a behaviour that you must fear occurs in a relationship, between different parties.

LP: But what would be the difference between this behaviour and other behaviours that you can fear occurs?

I: Well, fearing that it occurs, is say something opportunistic might come up. Expecting it and taking it into account that something like opportunistic behaviour might occur is necessary in order to find the general legal and political environment that is important for a society. But it is going beyond what I would denote as selfish behaviour. It is more than that.

Interview 6: Former Italian minister

Question 1: Is moral hazard the main cause of the IFC that started in 2007?

I: Not the most important one. It is one of the causes but not the only one. Not the only one among the major causes.

LP: But it's a major cause?

I: It is a major cause to the extent that it explains the behaviour of the agents/of the actors involved in the crisis. So financial markets, also policy authorities.

LP: Can you describe what would be moral hazard in this context?

I: The fact that some lending takes place while not having full *connaissance* of the sustainability and creditworthiness of the borrower from the side of lenders. So, lenders are to some extent responsible for the fact that they increase fragility by lending without having full knowledge of what the debtor positions will be. Or, even if they have knowledge, they disregarded and probably count on being free riders with regard to the market... sort of to run away and be safe as individual operators with respect to the aggregate of the market. Which is of course... sometimes it can work but most of the time it does not work.

LP: To you, whether they have knowledge or not of the risks they are taking it is still moral hazard?

I: It's moral hazard if, in spite of coming to the conclusion that they may be taking more risks than they see, they do the operation all same.

LP: To you, is it important the reason why they are taking more risks? You were talking about free riding etc. Are you thinking about the expectation of bailouts?

I: Because either they don't fully understand the risks and in spite of not fully understanding the risks they take the risk because they expect higher gains and/or even if they know that they might be running a risk higher than expected or tolerable they count on bail outs. Someone would come to the rescue so I will not suffer the losses I am now seeing as possible.

Question 2: Is moral hazard the main cause of the euro area SDC?

I: Well, in a way, this was already my initial answer. It is not the major source but certainly a source that has at least amplified the consequences of that crisis. The consequences of that crisis have to go deeper into how the eurozone worked at the time of the crisis. The crisis exposed major flaws in the architecture. So, it's not the moral hazard part but it's the architecture part that was major responsible for the crisis.

LP: What specific aspects of the architecture are you thinking of?

I: The fact that it was not clear to what extent financial fragility build up in some countries was sustainable, so a macro policy aspect. And the fact that, once the crisis broke out, the system clearly showed that rules were inconsistent with financial stability, and there were also policy attitudes which generated more fragility than expected. Famously, one of that was the interpretation of the famous beach walk with Merkel and Sarkozy who agreed that if there going to be a crisis the creditors had to suffer from the fact that they had done the wrong things. So, this generated a mistrust in the system and eventually the system collapsed.

LP: And would you say that this was aimed to avoid moral hazard?

I: Well... this was actually, paradoxically, a way to avoid moral hazard so that people will be more careful in assuming their decisions. But at the same time, ignoring the fact that, paradoxically, by doing so they increase fragility rather than decrease fragility. It's the so-called private sector involvement - which is an elegant name for saying 'if you make a mistake, you have to pay for it'. Since we are talking about this, it's similar to the decision in the US to let Leman Brothers go rather than support it. Because the idea was 'let's teach them a lesson' so the next time they will not do it. That was a terrible mistake because it ignored the systemic consequences of that.

LP: When you said financial fragility, you are talking about the private sector or the public sector?

I: It's both, it's the famous in the case of Europe debt credit, banks debts interactions - doom loop. By which the banks held a lot of public debt in their balance sheets and therefore they were very careful in getting rid of these assets on the expectation that they will lose from the operation but at the same time they did not want to keep those assets because they knew that they will be eventually losing value. And the fact countries, that were creditor countries, requested to be repaid, even if an early repayment proved to be worthening the situation rather than improving the situation.

Question 3: Does the EU's response the COVID-19 crisis create moral hazard?

I: No. First of all, I think NexGenerationEU was a very powerful response to the crisis because it involves very much a strong collective action by the European countries. This is exactly one

major difference with respect to the previous crises where collective action was not available. In the COVID crisis, they, countries and governments, recognized that they needed to act together because with the insight we know that there is a positive externality which reduce significantly the impact of the COVID crisis. This shows the distance that was covered in 10 years. Everything changed. Although now we are facing other crises as well, so we have an additional set of problems.

LP: Would you say it was a lesson from the previous crises?

I: Yes. It was both a lesson from the previous crises and the recognition that this was not the responsibility of any individual Member State but was an outside huge external shock. All the countries were affected, more or less, with the same intensity. So, it was no one's fault, and it was better for everybody to have a common response to the negative shock.

LP: So, having this collective action creates moral hazard if the shock is the responsibility of some actors but not if not their responsibility? Depending on the shock, a same response creates or not moral hazard?

I: Well... you are right in pointing out this aspect. There is moral hazard when the perception of the shocks is different. And also, there is moral hazard when there is a propensity to free ride on a public good. Whenever there is a public good around, one of the problems, as you know, there will be some agents - individuals, companies, countries - that decide to behave generating moral hazard because they can count on being bailed out. So, in that case, collective action is difficult to implement because some of the members fear that there's going to be moral hazard. But in the case of COVID, there is no moral hazard because there is a clear benefit from having a collective response to the pandemic. Because a pandemic is something that hits you even if you say I change my policy. So, it's better to be on the same side fighting pandemic than being on separate sides.

LP: To you, is moral hazard synonymous to free riding?

I: It's not synonymous. The two things are two behaviours. Moral hazard is willing to take a behaviour which could go wrong but it's, so to speak, justified by the fact that there is the expectation of being bailed out. Free riding is something which implies the existence of a

collective good somewhere, which you as an individual can exploit and pay zero or much less than its price to benefit from it. So, they are similar concepts, but they are not identical.

Question 4: Is moral hazard more present at the European level than at the national level?

I: Oh, well. Moral hazard is present in all levels. It depends on the historical situation. Things can change and we just discussed two historical situations where you have on the one hand, a lot of moral hazard and on the other hand much less moral hazard because there were different perceptions of costs and benefits.

LP: Do you have the impression that these talks on moral hazard are more prominent in the European context than in Italy, for example?

I: They are more present in the European context because it's different sovereigns that have to get together to agree. While, within a country, the moral hazard situation is something that relates to the institutions, the government, with the citizens. So, if there is tax evasion phenomenon which is widespread, that has implications of providing moral hazard and free riding with respect to the fact that a taxpayer who pays its tax correctly generates the possibility of the government providing public goods. Those public goods can be exploited by the tax evaders not being caught while at the same time enjoying the benefits. So, there is moral hazard from that point of view because there is an agent and the principle that interact. While at the European level there is the interaction between two countries or two groups of countries that are differently placed. In that case, from an analytical point of view, I would say it's more of a game theory problem rather than a public choice problem.

LP: What do you mean by that?

I: Public choice implies the production of collective goods and of the different attitudes of members that benefit from that public good. We benefit from defence, because if someone provides security for me, I don't have to pay for it. Game theory is a situation where there are two subjects, each one with the same level of moral hazard, which interact, and they interact possibly in a less optimal way because they don't have a full knowledge of what the other subject can do or would do or not do... so it's a different relationship between individuals.

LP: To you, tax evasion is an example of moral hazard?

I: It's an example of free riding.

LP: But not of moral hazard?

I: Well... There is moral hazard to the extent that tax evasion is generating by the fact that I expect or hope that I will not be caught by the police. So, if I'm caught, I have taken a moral hazard before that have generated negative externalities because there is budget deficit, generates further impact on me because I will get taxed even more because someone else does not pay its taxes. So, it's a different sequence.

Question 5: Is moral hazard under or over-estimated?

I: It depends on the situation. Certainly, during a crisis it's not over estimated. Possibly it's underestimated as we move towards a crisis because we don't perceive the weakening situation. And it's overestimated during a crisis and even when a crisis is about to finish but people don't see the improvement coming up.

LP: Do you see differences in estimation between countries?

I: Moral hazard is also a function of the social contract which exist in a country. If people in the majority think tax evasion is bad, not just from the financial point of view but also from the reputational point of view, there will be less moral hazard. If, on the other hand, there is a country where tax evasion is diffused and sometimes even tolerated, there is more moral hazard because people say, 'we can do it because I will not be punished'.

LP: Moral hazard depends on the norms that are in a given society?

I: The norms and their application.

LP: And values?

I: Well, values are also important because it means that behaviour is not dictated by short term incentives but preserving values, like transparency, collective support... where there is less individualism and more collective conscience.

Question 6: Do you see moral hazard in the context of family?

I: Yes, because families are social contracts. Where some people may decide to break the contract. If I have a son or a daughter who goes out and I said you have to be home by midnight and the daughter says I will and then because I'm sleeping at 1am she can come back at 2am because she knows I'm sleeping. That's moral hazard because she's risking the fact that I wake up and punish her.

Question 7: A person vaccinated against the COVID-19 who becomes less careful to not spread the virus. Is this an example of moral hazard?

I: Yes, it is. And we had a lot of that during the COVID crisis.

Question 8: What is the difference between moral hazard and irresponsibility?

I: Moral hazard is the result of a rational behaviour. Because I know I'm taking a hazard, I know I'm damaging others, I will do it anyways. Irresponsibility may be the result of the fact that I don't know, ignore, I don't care about ignoring... even if this hurts me rather than the others. I can be irresponsible and hurt me. While moral hazard is something that damages the others, not me.

LP: Moral hazard requires a consciousness of what you are doing?

I: Yes. I am knowledgeable of the fact that I try to benefit myself at the expense of someone else.

LP: So negative consequences on others is also a condition for moral hazard?

I: Possible negative consequences. Because if there are always negative consequences sooner or later there will be a change in behaviour.

Question 9: What is the difference between moral hazard and selfishness?

I: It's not necessarily selfishness because I may be acting with some moral hazard implications because I want to benefit someone else. I may decide to go and still food on the expectation of not being caught - so that's moral hazard - because I want to feed my children. It can have positive motivations. To become an outlaw because I can become Robin Hood in the story. Robin Hood is good if you are a poor but the sherif will not consider it good.

LP: So, you can act in a moral hazard way with good intentions?

I: With good intentions, or the fact that my preferences are different from other preferences, and I belong to a community which benefit from my moral hazard.

Question 10: To you what is moral hazard?

I: It's a behaviour that implies risk taking on the expectation that I will not be caught by whatever watching of bad behaviour. To turn around the rules if you want to put it this way.

Interview 7: ECB official

Question 1: Is moral hazard the main cause of the IFC that started in 2007?

I: Moral hazard as excessive risk taking in the banking sector: yes.

LP: Why?

I: Because the crisis started in the real estate sector but with behind some sort of new financial innovations that promoted excessive risk taking in the financial industry with the safety valve of being rescued by the government once the big defaults would start. Because in the end is always the government that would have to intervene in order to save the broader economy.

LP: If governments would not have bailed out the banks, would there be moral hazard?

I: If no implicit bailout... of course the bailouts of governments are not explicit in law or in regulation, but they are implicit in the thinking of the financial agents. This assumption implied that excessive risk taking was having place.

LP: Moral hazard has to do with actors' assumptions rather than actual guarantee. What about financial innovation? A mix of financial innovation and implicit bailout?

I: Hum... Yes, simplifying a bit. CDS have played a big role in the widespread impact of the crisis. And this, in combination with the moral hazard, is underpinning all of this risk taking.

Question 2: Is moral hazard the main cause of the euro area sovereign debt crisis?

I: No, I would not say so. That is a difficult question. I would say that the fear of... the mistrust that is implicit in the Treaties of the EU... mistrust among the governments implied that we had to have the no bailout clause - means that the central bank cannot buy on the primary market government securities which was a unique case in the central banking/financial architecture around the world: only the ECB explicitly could not bailout the government. So this initial mistrust implied that we have this no bailout clause which meant that the moral hazard was a fear at the beginning of the stipulation of the Maastricht Treaties... and if you think in that way, we can think that the underlying mistrust – a mistrust of moral hazard – meant that we do have this no bailout clause that when the markets attacked the bonds, when Greece was about to default and contagion risk was high, the central bank could not intervene explicitly or could not save or calm the markets immediately and that cause the worsening of the sovereign debt crisis in Europe.

But I would not say that moral hazard by Greece was the cause of the sovereign debt crisis in Europe because the Greek government of course had a huge debt, but it did not have any guarantee that someone will come into the rescue because it was explicit in the Treaties that there is this no bailout clause, and that the ECB cannot intervene.

LP: It would be the attempt to avoid moral hazard that caused the crisis?

I: Hum... I would say that it was the presence of this no bailout clause in the Treaties which meant that markets knew that the ECB would not buy government debt on the market... if we did not have this no bailout clause, the ECB could have intervened earlier without hesitation instead of having to engineering the OMT to safeguard sovereign debt in Europe. So, I would say that that was the cause of the sovereign debt crisis.

LP: But you justified this clause in relation to the fear of moral hazard.

I: Yes, but that is back in the 90s when the Treaties were signed. The fact that there was mistrust - Germany, for example, was afraid that Italy could morally abuse the framework and increase the risk and their debt which in the end would be paid by the Germans. The fear of moral hazard was enriched in the Treaties - this is all legalized in this no bail out clause.

LP: This phenomenon that you described where governments could abuse the Treaties would be moral hazard to you?

I: No. Treaties are legislations so they cannot be circumvented.

LP: Sorry, the fear of abusing the common currency. This would be moral hazard?

I: The fear of moral hazard itself. The fear of excessive risk taking by some governments, the fear of exploiting the fact that without this no bailout clause they would have been an implicit bailout of other governments by the ECB. Something similar to the IFC: the financial actors were not explicitly relying on the fact that someone would save them but implicitly they are because they are too big, negative effects on the real economy. So, similarly in the 90s, when the Treaties were drawn, some governments were fearing that other governments may exploit this implicit bailout by the central bank - meaning moral hazard - meaning that some government would have taken excessive risks, excessive hazards, in exploiting the legal framework to issue too much debt, then they would default, and other governments would have to pay within the EMU. For this reason, the no bailout clause was drawn where explicitly in the Treaties, written down that the central bank cannot buy sovereign debt on the primary market.

LP: To you, the fact that it is explicit in the Treaties makes it credible? Some will argue that there is still implicit guarantee of intervention...

I: Yes, if it is in the Treaty, it is explicitly forbidden for the central bank to bailout some governments directly, which means that these governments cannot exploit moral hazard. If it was not written, they could implicitly rely on the moral hazard to... Of course, no one knows if they would do so in the end but that was the fear.

Question 3: Does the EU's response to the COVID-19 crisis create moral hazard?

I: No, because it is limited - at least for the moment. Given that we have a limited amount this puts a cap, and every country gets a share on that, this puts a cap on how much you can exploit any type of moral hazard in that respect.

LP: Earlier you said that doing something not on purpose you would not call it moral hazard. So, to you, moral hazard is a conscious behaviour? Is not something that you do but you do not know...?

R: Of course.

Question 4: Is moral hazard more present at the European level than at the national level?

I: It depends on the context of course. If strictly speaking about the debt, I would say that at the European level moral hazard is contained within the rules, within the fiscal rules that we have. At the national level, moral hazard can take a lot of different type of behaviours by everyone of us. And of course, I think that some parts of the financial sector in particular... but also in the latest period we have seen that some of the utilities that are traded (gas, oil) with Russia they are recently being bailed out in a way by government - liquidity. I am not saying that they were doing that on purpose, taking excessive risk, because they could not foreseen what would happen but in a way is still the financial engineering (derivative contracts etc.) that imply wider spread of the crisis than on a single institution.

Then, if you think about COVID for example, all the airline companies, the touristic companies that have been bailed out by government money... I would not call that moral hazard at the national level even though these companies have been provided with huge liquidity by their

government. But I would not call this moral hazard. COVID was an external shock, unexpected, not premeditated.

Question 5: Is moral hazard under or over-estimated?

I: It is underestimated, of course.

LP: Why?

I: Because people are not aware of how much damage some industries might cause - financial sector (banks, shadow banks, hedge funds, funds, crypto) - there is too much money flying around. And with that money people want to make even more money and they end up taking some excessive risks that when these industries, for example crypto now, become too big, even if it is not written anywhere that we have to bail out those, if one of these big crypto actors goes down and then some banks have direct exposure to that and risk to default and that bank is financing 1/4 of the economy of one country: we go into trouble. So, I think it is overly underestimated actually. I mean is not the fault of the central bank is the fault of the common set of rules that we have - how a central bank can finance the real economy (which always goes through financial intermediaries like banks) and cannot go directly to companies or households. This intermediation role of the banks...

LP: All the reforms regarding TBTF financial institutions are not really effective?

I: No. Very little has been done in that respect. If one of the biggest banks today goes down, we are back in 2007-8. These institutions are too big, and they do not have enough own resources to absorb the losses that they may have. Something has been done of course, maybe I am exaggerating a bit. But I do not think it is enough.

Question 6: Do you see moral hazard in the context of family?

I: It depends on the families, but I can imagine situations where you may have some sort of actor that exploits the others or take advantage of the other members of the family. It can be financial, but it can also be psychological exploitation.

LP: It is not something restricted to public areas. We can find moral hazard in private relationships?

I: Of course. I mean, it is when anytime you are doing something that can hurt the others in any way, you are taking some risks that can morally abuse the others.

LP: So moral hazard is always, to you, about negative consequences for others?

I: Yes. How I see it is negative consequences either to others taking the family or to the society at large. It is something that you do consciously, knowing that you may hurt someone or something.

Question 7: A person vaccinated against the COVID-19 who becomes less careful to not spread the virus. Is this an example of moral hazard?

I: Of course. That is a good example in the COVID situation.

Question 8: What is the difference between moral hazard and irresponsibility?

I: I agree that they are close in meaning. I never thought about it, but I agree that they are close and interrelated. It depends on how we define irresponsibility, if it has legal repercussions or not but yes, I would associate those two.

LP: And do you see any difference?

I: It really depends on the context but for example in the context of hurting someone physically or on the ground of health concerns I would call it more irresponsibility than moral hazard. So, in a way, in my mind, I see individual irresponsibility as more severe than moral hazard.

Question 9: What is the difference between moral hazard and egoism or selfishness?

LP: Do you agree that moral hazard is related to egoism or selfishness?

I: Yes, but not as strictly as individual irresponsibility.

LP: And what is the difference?

I: For example, I can imagine situations where people are egoistic or selfish but do not have moral hazard underpinning their decisions. So, it is not necessarily true that every time that you are egoistic you are taking some moral risks or behaviours that can morally hurt.

Question 10: To you, what is moral hazard?

I: To me, having studied economics and finance for years in my life, moral hazard as a concept is strictly connected with economic agents (it can be governments, households, firms, banks...) that in a way use their power in a sense, or their actions, for the sake of their own profit, their own benefit, but with the risk of so called externalities in economics - meaning that their actions can have negative effects and negative consequences on other actors within the sphere of the economy. That is to me moral hazard: I learned that concept in that context.

Interview 8: ECB official

Question 1: Is moral hazard the main cause of the IFC that started in 2007?

I: It is difficult to give a yes or no answer. It is one of the causes, for sure. Whether this is the main one... to be honest it is a bit difficult to say. So, I would say is one of the causes.

LP: What would be moral hazard in this context of the IFC?

I: When I think about moral hazard I think about adverse incentives. Therefore, probably, you know, investors behave according to adverse incentives. Investors' behaviours that were not appropriate according to ethical and moral standards, I would say.

LP: What were these incentives?

I: Profit, if you think about the US subprime market that was clearly a matter of making more money out of these financial derivatives; lack of regulation plus greedy behaviour by investors.

LP: So, it is a mix of external incentives and the nature of the actor?

I: I mean, it was relatively easy to make profit in that market until 2008 which provided very strong incentives to those investors to behave according to non-appropriate moral or ethical standards. Which in concrete means that they were not behaving according to state of the art corporate and business standards. They were granting loans to people that was obvious they were not able to repay. Show of financial engineering hiding financial risks. You can call it moral hazard; you can call it... I mean, this is certainly something that was allowed because of the lack of regulation for example, so it was also on the side of the regulators. It is always a mix: when there is something which goes wrong, also in our normal lives, lack of regulation - what you defined before like external constraints - and lack of appropriate behaviour or values or moral standards from the side of the person who commit the act or behave inappropriately.

LP: So, you are saying that not everyone behaves in the same way when they face the same incentives?

I: Yes, indeed. However, I would say that in a context of lack of regulation and rules broadly speaking it is... Men tend to adopt behaviours which are typically oriented to making profit in the shorter time. And this in the financial market or in economics in general cause the problem at some point. This is about private sector and financial market, but one can also think of that for government.

Question 2: Is moral hazard the main cause of the euro area sovereign debt crisis?

I: Yes. I mean, that is maybe the more clear because there on the side of government, and in particular of Greece for example, there was clearly misbehaviour in terms of accounting, data reporting, and transparency. So, there were a number of statistical and accounting rules which were not respected. That is moral hazard in the sense that there was a lack of view and lack of responsibility for future generations because they spent a lot of money without any principle of sustainability. And in that case the external constraints were even weaker because the government itself is the regulator. There were European authorities, and of course also

European authorities had responsibility, but there was less power... I mean if you think about the IFC, public authorities had in principle more power to enforce rules, transparency, prudential behaviour etc. Whereas on the side of nations and governments, it is very much up to the sense of responsibility of the people who are in power. There are some external constraints, but institutional constraints are relatively weak, and then there are financial markets of course who punish you. There, I see more clearly a sort of irresponsibility on the side of the actors themselves. For the IFC, I think it is a more balanced mix between lack of regulation and misbehaviour from private actors.

Question 3: Does the EU's response to the COVID-19 crisis create moral hazard?

I: When we talk about European initiatives, and sort of European public good... initiatives in terms of transfers or loans from Brussels or from a set of countries to another set of countries there is always a moral hazard discussion. It was also the case in the sovereign debt crisis. There were loans and financial assistance programmes to countries under financial stress. And the argument is that if countries which receive the money from Europe, or the richest countries, do not implement... I mean, if they receive this money, they sort have less incentives to implement reforms which would allow them to grow more in the future, to repair they public finances and so on... Which I think is a valid argument in a sense... although one should not over do it. There is certainly a risk of moral hazard but there are other risks which are maybe bigger in some circumstances. Like for the European sovereign debt crisis the bigger risk was the dissolution of the Eurozone. For the pandemic crisis, the bigger risk was that countries faced very serious financial problems - not to talk about the health-related problems. So, in the face of this situation, one has to put things into perspective and to give the right weight to different problems. I also think that in general there are ways to mitigate moral hazard. For example, sharing responsibility, sharing power... related to the discussion about political union and the construction of a true federation which would alleviate a lot the moral hazard problem. Because once you share power, you share also responsibility, and therefore... I mean, moral hazard problems emerge when power and responsibility are in a sense detached from the use of funds and resources. If you can use money but do not have responsibility, then... you have a moral hazard problem. If you put responsibility and power together, then you are accountable to the same citizens.

LP: So here, when you talk about power it would be the power to make decisions?

I: I mean political power in general. Sovereignty, power of taxation. 'No taxation without representation'. If you want to use public money you have to be sure that there is control, that there is responsibility. Politicians or governments who use this money need to be accountable to the public. If Italy receives money from Germany and use this money without responsibility and knowing that this money comes from external sources then there is a big risk of moral hazard because there are no incentives to use well this money, there is no incentives to implement these reforms which are useful to make the country more prosperous and more robust for the next crisis. Ideally, I think that moral hazard problems could be solved if there is a true federation of states which share common spending (like the NGEU) but that also share sovereignty, meaning that there is a European Parliament that is truly powerful, like in the US.

Question 4: Is moral hazard more present at the European level than at the national level?

I: Not necessarily. I am Italian and we have big problems between the north and the south. The south has been less developed than the north and therefore there have been transfers from the north to the south. And this has caused also moral hazard problems. Italy is a sort of transfer federation. Adverse incentives for southern regions to grow and to develop. The problem now is to avoid that these situations and moral hazard problems arise at the European level. In Germany there is also the issue between West and East Germany. In the German debate there is probably this, back in the head of the public opinion. I am not sure whether it is more or less serious but certainly the big difference is that nations have centralized political power. Europe has very weak central government. Therefore, at the national level, I think problems could be solved more easily. But at the same time, Europe has a much smaller common budget. Therefore, moral hazard problems are by definition much smaller because there is less money flowing between countries. In countries like Italy or Germany the flows in terms of GDP are much bigger so there are bigger moral hazard problems in a sense.

Question 5: Is moral hazard under or over-estimated?

I: I think that in some countries it is overestimated, in others it is underestimated. Typically, countries who pay money are more attentive to this issue whereas countries who receive money are less. The debate is very complex because EMU is not only about transfers from richest to poorest but is also about... also the richest countries benefited from EMU in other forms. For

example, Germany benefited a lot in terms of exchange rate competitiveness. So, this is also a moral hazard problem in a sense because you can benefit from a situation which due to the common exchange rate or to the very low interest rate this has positive repercussions for northern countries. The problem is more complex than what is often depicted in the public debate for example in Germany. When you think about moral hazard it is typically about money flowing from the north to the south or to weaker regions, but it is also... it has different dimensions.

LP: So, you are saying that we pay more attention to specific types of moral hazard and ignore other forms of moral hazard?

I: Yes.

LP: Everything that can make your life a bit easier is a source of moral hazard?

I: No. I mean, one should give a definition of moral hazard. It is a general concept. I would say that moral hazard is a situation in which agents (governments or private agents) have adverse incentives to behave in a way that is contradicting ethical or moral standards. This is how I would define moral hazard.

LP: So here, it is not the actual behaviour but a situation where you have incentives?

I: I mean, indeed. If you follow the debate, there is a lot of discussion on moral hazard because there is indeed a discussion on adverse incentives. To make a concrete example: there is discussions about the fact that if we help Greece with money, then Greece will not implement the reforms which are necessary. So, this was the main criticisms from Nordic countries to financial help to Greece. This is something which one can agree or not. But then, one has to check the behaviour of Greek people and Greek authorities against these risks. So, this is another step of the analysis. Greece actually implemented a lot of reforms during the sovereign debt crisis. The question is whether it could have implemented even more reforms in absence of moral hazard? The argument is that Greece receives this money so in a sense relaxed. But there was also a very strong conditionality, which is another way to address moral hazard. I give you the money under conditions. Another way to address moral hazard is by political elections: if politicians do not use the money appropriately, they would not be elected in the

next elections. When one think about pro and cons of EMU, it is not only about money flowing from Germany to Greece. It is more complex. Germany also benefited a lot, and this could have also created adverse incentives. For example: very low interest rates created moral hazard in the real estate market. This is also moral hazard, a situation of adverse incentives that you see very clearly in Germany now. People invested a lot - this is a bit replicating the situation of the IFC. There are probably inappropriate behaviours from private investors which used cheap money to make investments (in the financial markets but also in the real estate market). I would also define that as a situation of potential moral hazard.

Question 6: Do you see moral hazard in the context of family?

I: I think moral hazard can affect every aspect of our life. Family life... I have 2 children if I think of the education of children, it is a matter of incentives, behaviours, and values. So just to make a maybe naive example: if I give every week 50 euros to my 7 years old son, he will think that money is very easy to get, and he can spend this money on video games or sweets... so it is a situation of adverse incentives.

Question 7: A person vaccinated against the COVID-19 who becomes less careful to not spread the virus. Is this an example of moral hazard?

I: Yes. Yes because... Well, it is a bit complex. One has to put this in the context of the last two years and the communication that people received. At first, the communication was that vaccinated people do not transmit the virus. So, in that context it is difficult to blame the person who behave according to social standards, to what has been communicated by authorities. But when it became clear that even vaccinated people can spread the virus then this is a situation of misbehaviour. Call it moral hazard or in other way I do not know. But certainly, is not an appropriate behaviour. The situation of the pandemic is complex because there were different phases and the information we receive from public authorities changed over time. And if you look at different countries, the information varies a lot. I travelled to the Netherlands, I live in Germany, the way the pandemic is dealt by public authorities is quite different. In the Netherlands, like in the UK, they are much more relaxed about restrictions and so on. So, it changes from place to place, and over time.

Question 8: What is the difference between moral hazard and irresponsibility?

LP: Moral hazard is usually described as being close in meaning to irresponsibility. Do you agree?

I: Yes.

LP: What would be the difference between the two concepts?

I: Difficult question. I am more familiar to think about moral hazard in terms of adverse incentives which cause deliberate misbehaviour by an agent. Irresponsibility is not necessarily linked with deliberate behaviour. A person who is irresponsible, who behave irresponsibly, because he does not understand rules or values who would prevent a certain type of behaviour. I am thinking about a child who takes the car of his father and goes in the street. This is irresponsible but he does it sort of because he does not understand the set of rules that we have in our society that he should not do that. Instead, a situation of moral hazard, to me, is a situation in which someone understand the set of rules or values but decides on purpose to take advantage of a certain situation in order to benefit himself. One can think of a situation where a country receives money from another country and deliberately is not doing good use of this money because it is for free.

Question 9: What is the difference between moral hazard and egoism or selfishness?

LP: Another concept that is usually described as being close in meaning ot moral hazard is egoism or selfishness. Do you agree?

I: Yes. There are aspects of egoism and selfishness that pertain to moral hazard behaviour because it is about increasing your own personal benefit. But egoism can also be seen as not sharing with others something that you own in a legitimate way. For example, if I am a rich person and people around me are poor and I do not share my money with them or do not help them: this is a situation of selfishness and egoism, but it is not a situation of moral hazard if this money was gained in a legitimate way.

Question 10: To you, what is moral hazard?

I: Moral hazard is an inappropriate behaviour which is triggered by a set of adverse incentives or rules (laws or regulations).

LP: So, if you observe the same behaviour but in one case there are adverse incentives and in the other, there are not, one will be moral hazard and the other not?

I: Well, it depends how we define adverse incentives. In a context in which we have a set of rules or values or ethical standards. If one behaves in an inappropriate way given this background of values/rules/ethical standards, I would call it moral hazard. Then, if this behaviour is observed in a situation in which the set of rules, ethical standards is absent, I would not qualify that of moral hazard. If the same situation is observed in Europe or in Africa, the set of values, rules, regulation, is different. The cultural background is different. Therefore, I am not sure we can qualify the same behaviour as triggered by moral hazard in the two different environments. Adverse incentives, broadly speaking is also related to... I was also thinking about rules, ethical standards and regulations. So, it is sort of the external world that we have in which we operate as human beings made of all these things (values, ethical standards and so on). Then, if one behaves intentionally, knowing that you are operating in an environment where stealing money is not ethically acceptable, this behaviour can be qualified as moral hazard. But again, if a child steal money in this environment, it is irresponsibility I would say because his set of moral or ethical values is still undefined in a sense. Or if we think about another culture, another situation in Amazonia or Africa, the set of values and ethical standard is different there.

Interview 9: ECB official

Question 1: Is moral hazard the main cause of the IFC that started in 2007?

I: No.

LP: Why?

I: The reason for the IFC was an excess of... so banks basically were giving more credit that they could give. That is a good question. I mean... It depends on what do you understand with moral hazard. Normally, we understand for moral hazard when you give liquidity or when you are expected to give liquidity, and then you use the liquidity - in this case of a central bank - and you use it for purposes which are not aligned with those of the person giving you the money - no? Like an economist... there is a model for moral hazard since the 1970s for an economist. So, we define moral hazard in a very specific way. So no, I think the excess of credit is not due to... the excess of credit that gave way to the crisis was mostly because of financial deregulation in the 90s. There was an excess of credit in the 90s ... so it is not because of moral hazard. Moral hazard played a role during the crisis but not as a cause.

LP: What is the role it played?

I: Moral hazard played a role in the sense that when sometimes when banks are very close to bankruptcy and you give them liquidity they might have incentives to take more risks, making the crisis worst. So, when you are a central bank, there is a dilemma: if you do not give liquidity you might be having a huge crisis but if you give liquidity and the banks that are close to insolvency are not being closed down, they might have an incentive to take more risks. So, you have to choose between the two devils.

Question 2: Is moral hazard the main cause of the euro area sovereign debt crisis?

I: It is a good question... No, I do not think so.

LP: Why?

I: So, what were the causes of the European sovereign debt crisis? I would say the opposite in a way. What happens in Spain, Greece, Italy, and other countries, is that they have different natural rates of interest than other countries. So, if the interest rate is very low you might have an incentive to put money into an excess of debt or a lot of lending which gives way to crises.

LP: And this is not moral hazard to you?

I: No. It is not moral hazard. Then, you could argue whether the ECB at times was giving credit/liquidity it could have given way to certain amount of moral hazard. And I think, in that case, it is probably true that maybe moral hazard could have compounded the crisis, but I do not think it was the cause.

Question 3: Does the EU's response to the COVID-19 crisis create moral hazard?

Missing data.

Question 4: Is moral hazard more present at the European level than at the national level?

I: It is more present at the national level.

LP: Why?

I: Well, because if you are for instance a minister of finance in Cyprus or in Greece you might have an incentive to give credit to your banks or to your government to a larger extend than somebody from the outside who might be more objective all the things being equal. That applies also to the IMF. Is not that we are free of moral hazard but definitely I think there is less of it.

Question 5: Is moral hazard under or over-estimated?

I: It depends. In periphery countries it is underestimated, in core countries it is overestimated.

LP: Do you see this in relation to the interest that you have...? Or how would you explain this difference?

I: Politicians play around to their advantage. Easier for German politicians to exacerbate that. I think it is a political thing.

LP: And are there actors that have the right estimation?

I: To be honest with you, I think even academics are not very good at that. To be honest with you, I think institutions like the IMF has a more accurate assessment of the amount of moral hazard because they have more experience, they have been doing it for years and years.

Question 6: Do you see moral hazard in the context of family?

I: I have not thought about that. But yes of course. The moment you give money to somebody... If I give money to a cousin of mine, then the possibility of moral hazard arises. Or if you give a room now to somebody from Ukraine, the possibility of moral hazard applies.

LP: What would be moral hazard in this case?

I: Well, you might give somebody a room because you think that they need it - and they do - but then they might have an incentive to overextend they stay in that room because it is for free.

LP: So here, moral hazard would be related to taking advantage of a situation - more than what you need.

I: Yes.

Question 7: A person vaccinated against the COVID-19 who becomes less careful to not spread the virus. Is this an example of moral hazard?

I: Yes. That is moral hazard.

Question 8: What is the difference between moral hazard and irresponsibility?

LP: Do you agree that irresponsibility is close in meaning to moral hazard?

I: Yes, it is very close.

LP: What would be the difference between irresponsibility and moral hazard?

I: To exercise control on your acts, it is an effort. To control the volatility of your acts, to force yourself to... I do not know, to eat well, not to do certain things, or in my case to be here at 5 o'clock instead of 5:15 it is an effort... so if I know that nothing will come out of it you could increase the volatility of the outcomes - meaning, I am less careful because I see there is a net. You may also risk more. Think about it... the Portuguese kids going to Luxembourg in the 1960s, they would be very happy if they stopped being cleaner houses in Luxembourg if they could be... policemen. But now, the kids of the second generation they might have already a house from their parents so they would be thinking of doing something that they enjoy with their lives or that they find creative or whatever it is.

LP: And this would be moral hazard to you?

I: It would be closer to irresp... it would be closer to... you increase the volatility of the outcome so maybe it goes great but maybe it goes very bad. The expected outcome on your life, it changes. Once you have needs covered, and somebody is paying for their cost, you could risk. You could risk through irresponsibility, or you could risk thinking 'I'm gonna try to...!'

LP: So, the difference would be that risking more is a case of moral hazard but irresponsibility is when risk are...

I: So, the final outcome in both cases: you have an increase in the volatility of the possible outcome. So it could be that what happen goes very very well or very very bad. And it could happen because you do it on purpose or it could happen because you are simply irresponsible. You do it on purpose because you think I got my needs covered or you are simply irresponsible. You could argue that in one case, there is an element of awareness. You could say that irresponsibility is the stupid child of moral hazard. Because at least, somebody who exercises moral hazard is actually mature enough to recognize that he is actually risking.

LP: Moral hazard is then a conscious behaviour?

I: C'est ça. Voilà.

Question 9: What is the difference between moral hazard and egoism or selfishness?

LP: Another concept described as being close in meaning to moral hazard is egoism or selfishness. Do you agree?

I: On the part of the person doing the moral hazard behaviour, yes. Self-centred people, somebody who is very self-centred, or somebody who has very little empathy, would be more prone to moral hazard. Also, I think there is a cultural component. So, I think there is a cultural component and a psychological component. Psychologists they do not know why but they have these 5 characteristics at work: empathy, conscientiousness, extroversion... and then, if you score very highly on risk linked to neuro decisions or you have very little empathy for others you are much more likely to exercise moral hazard. That also applies to regions and provinces. Somebody in the south of Italy for instance is much more likely to exercise moral hazard than say somebody in the north of Italy because they think less about public goods. Probably this has a religion component as well: if you are a protestant, you are probably less likely to... well, I do not know. That is interesting, I do not know the literature very well.

LP: And what would be the difference between moral hazard and egoism?

I: It is totally different. In the case of moral hazard, it is very clear, there is a framework: you take a good, and then you use it ex post for your own purposes. In the case of egoism, you think does this person need - there is a moral component - does the person need the money I am stealing. Egoism you get into the realm of morality.

Question 10: To you, what is moral hazard?

I: For an economist?

LP: To you

I: For me, moral hazard is take the money and run. You stop being responsible.

LP: So, it is stealing?

I: Yes. Deep down it is stealing.

Interview 10: European Commission official

Question 1: Is moral hazard the main cause of the IFC that started in 2007?

I: No. I think the main issue was hidden information. In economics, there are many different potential issues. One is moral hazard, but the other is hidden information. So, I think, that's the main cause. It was related to opacity. Opacity as regard risk characteristics of some products or the financial situation of some countries etc. More than moral hazard.

LP: To you, moral hazard has nothing to do with hidden information?

I: It has to do with hidden information but it's not the same thing. Moral hazard, in my view, has to do with risky behaviour where the agent is not taking into account the negative consequences of his/her risky behaviour on other agents. So, it's sometimes related to the idea of hidden action in the sense that the agent is acting in a certain manner that is not observed. But in economics, there are also problems of hidden information, which are related to the concept of adverse selection. These two situations can lead to suboptimal outcomes. There are not exactly the same. That's why I was referring more to the fact that there was opacity as regard risk characteristics of some countries and products. Probably there was certainly a component of moral hazard. But if you make me choose between the two, I choose the issue of hidden information.

LP: So, with hidden information, agents are not aware of the risks they are actually taking, right?

I: Yes.

Question 2: Is moral hazard the main cause of the euro area SDC?

I: No. Again, I think it could be part of the causes, but I would not say it's the main cause. There are many factors involved. Large external macroeconomic shocks are a factor, also lack

of understanding of the economic situation or even of the role of the financial sector might be a factor. And moral hazard is also one of the components in the sense that some countries could have followed more prudent fiscal policies in the past, in the years leading up to the crisis. But I would not single it out as the main factor.

LP: Is it important to consider the reasons why they did not conduct such prudent fiscal policies to talk about moral hazard?

I: Yes. So, in a monetary union if you do not follow prudent fiscal policies it may have negative consequences not only on yourself as a country but also on other countries participating in the monetary union. And I think some countries benefited from the stability that euro membership allowed and benefited from the fact that they could borrow at very low interest rates and did not have sufficient fiscal buffers. That's one issue. But that cannot explain the crisis because very large shares of the debt increased during the crisis. There are cases of countries that were not that indebted and it is only when the crisis started that the debt spiked. It's one element among several elements.

LP: To you, a crucial element of moral hazard is the negative consequences on others.

I: Yes. I think that is the crucial element. The crucial element is that an agent, be it corporation, country, person, the agent is not taking into account the negative consequences of risk taking on other agents.

LP: Do you need to have the materialization of the negative consequences, or not?

I: In my view, you have a behaviour that constitutes moral hazard the moment you start increasing the riskiness of your behaviour taking only into account your own situation and not the impact on others. The negative consequences might materialize or not. But the behaviour itself is I think what matters for defining moral hazard.

LP: So, to you, you need to actually have these risky actions taking place; is not just the possibility that these risky actions will arise?

I: Hum... very often in the policy debate, we try to anticipate whether that risky behaviour can occur. Now, whether that is part of the definition of moral hazard or not, there I'm not so certain. Whether moral hazard can only be identified when the risky behaviour occurs or if just the possibility of it occurring already constitutes moral hazard. I think, the way this thing is framed in policy debate, I think the possibility already constitutes moral hazard.

Question 3: Does the EU's response to the COVID-19 crisis create moral hazard?

I: Hum... The programme was designed in such a manner as to avoid creating moral hazard. There are safeguards and the large reason behind these safeguards is precisely to avoid the creation of moral hazard. The money that is being disbursed to countries either as grants or loans has to be used to meet certain targets and certain goals. It has to be used for investment purposes or reforms. That's a way to avoid the misuse of this money so that countries would let's say invest the money poorly. There are controls, audits... so in this sense, moral hazard in the sense of gambling with that money: for that we have safeguards. If you want to think about moral hazard in the sense that we are bailing out countries with this money and so that may create, may distort incentives for the future, that is also not the case in my view. Because the crisis was not the consequence of the actions of the Member States. It was a purely external factor, over which Member States had no control. It's not like you are creating a precedent where bad policies or imprudent policies will prompt. So, you don't want to bail them out in the first place in order to avoid this kind of situation. So, I think it's very important here to take into account that this was a situation beyond the control of Member States, the pandemic. And so, the general view, and also my view, is that there is no risk of moral hazard.

LP: Do you think that the argument about moral hazard in the SDC was wrong?

I: It was partially correct. It's wrong if one assumes that it's the main factor or the only factor. In a constellation of factors, it's true. Because indeed, some countries had debt levels that were too high. That's one of the factors. I think it all depends on the emphasis that you place on that factor.

Question 4: Is moral hazard more present at the European level than at the national level?

I: Moral hazard is a situation that can occur at many different levels. At the individual level, let's say in the context of insurance, it can occur at corporate level, national level, European level... If you think about national governments... we need to define the scope of the question. Within a country, there are moral hazard questions in the economic realm. For instance, banks. And this can be national banks. The idea that banks can be bailed out if they made investments that are too risky and these investments turn out to be unprofitable, that generates moral hazard. It is also implied in the banking context with the idea of deposit insurance. In that sense, depositors, if they know they are insured - which may also be a good thing - but they will not monitor so much the risks of the bank. At the level of the government, we can also have situations of moral hazard. But this is limited by the fact that in democracies, governments need to respond to the population and so let's say, outcomes can be punished in democracies. That's a factor limiting moral hazard. And in the EU, when moral hazard is discussed is very much about the interplay between governments. Since at least the 80s, when the monetary union started being discussed, the question of moral hazard was there, namely with regard the conduct of fiscal policy. Because it was understood that imprudent fiscal policy could have spill over on others. A country might gain from increasing its debt level (political benefit, or investment) but the benefit would stay within the Member State while the negative effect would be shared via inflating the euro area or other forms of economic disruption. So, it has been there from the beginning. This was the intergovernmental take on the issue. But also, between governments and EU institutions there may be some elements of moral hazard type of reasoning in the sense that governments may not wish to confer too much power to the institutions because they don't know for what power will be used for...

LP: This would be moral hazard?

I: Not necessarily. It can be an element of the debate but let's say that if you confer additional power to the institutions, they may use it in a way that is not necessarily in the interest of the Member States. There is not necessarily a risk element here, risk taking element. So, it can be an important question that is not necessarily related to moral hazard.

LP: So, a conflict of interests would be related to moral hazard?

I: Hum... I think the concept is very much linked to the idea of risk taking. So, if it's not linked to increased risk taking it's hard to define it as moral hazard.

LP: And would you say that a situation of a Member State conducting imprudent fiscal policy before the currency union and after the currency union is moral hazard? The behaviour does not change but in one case you have negative consequences on others and in the other case not.

I: If the Member State has not changed its behaviour, it's hard to argue that's an issue of moral hazard. Because usually moral hazard implies changing your behaviour or at least the possibility of changing your behaviour because there is a change in the incentive structure. The incentive structure has changed because you move from being outside to being inside the monetary union, but if you did not change your behaviour, I think it's difficult to argue that it's an instance of moral hazard. Potentially it may increase in the sense that the incentive for changing your behaviour may have increased so... so the risk of moral hazard has increased but the Member State cannot be accused of increasing its risk behaviour so it's only potential risks not actual risks.

Question 5: Is moral hazard under or over-estimated?

I: I think it's certainly not under because it's very much debated and it's very much on the mind of policymakers and of politicians. So, it's not underestimated, certainly not nowadays and in the post global financial crisis context. Now, whether it is over... hum... that's more difficult to say because, indeed, I think in policymaking one always needs to take into account how the policies will affect or change the behaviour of Member States or agents. So, one cannot discard that dimension of the analysis. One thing that is often said is that in the post financial crisis there was a lack of trust between governments, which may point to the notion that perhaps there is too much emphasis on the concept of moral hazard.

LP: Do you mean that the emphasis on moral hazard creates distrust?

I: Or perhaps the reverse: a lack of trust creates too much emphasis on moral hazard. Or perhaps it goes both ways. I think there is a perception, and I agree with that, that policies in the post financial crisis context as regard to sovereigns were too much preoccupied with the idea of preventing moral hazard so they were too weak and too late and that prolonged the crisis. That does not mean that one should ignore the concept of moral hazard, but it means that... the ideal policy response in a crisis, one that is strong and timely, and that also comes with safeguards

that keep moral hazard in check. I think, what we observed in the past, not in the COVID crisis but in the global financial crisis, was a situation where we turned down the policies to prevent moral hazard, so we made them weaker and less timely whereas we should have acted with more potent policies but with safeguard to prevent moral hazard.

LP: To you, this situation was mainly due to a lack of trust?

I: It was due to a lack of trust largely, but also due to a lack of institutional framework that all the agents or governments could trust that it would limit moral hazard. Let me give you an example from the COVID crisis. We created some powerful instruments via the ESM and the ECB that can intervene very strongly in the market but under certain conditions and these conditions help to limit moral hazard. So, you need trust but trust alone is not sufficient if the institutional framework allows moral hazard to occur easily. And I think what is being witnessed in the past few years is also an improvement in the institutional framework.

LP: So, to you, the difference in response to the COVID-19 crisis compared to the euro crisis has more to do with the institutional framework rather than the fact that we trust more each other?

I: It has to do with the improved institutional framework, and it has also to do with the fact that countries cannot be blamed for the COVID-19 crisis, it does not follow from their own actions while in the IFC, countries could be blamed, at least partly, for their own actions.

Question 6: Do you see moral hazard in the context of family?

I: That's almost a question from psychology but let's say it can happen. Here I recall the issue of raising a child. If a child feels their parents will over cover their backs in whatever situations they may increase their risky behaviour. Let's say if I go out at night and do something risky, if something wrong happens to me, I can call my parents and they can come and pick me up. It can increase moral hazard. So indeed, I think one can think about several examples of moral hazard in the context of family, mostly about children. So, I think the concept is relevant.

LP: It's about feeling protected against the consequences of your actions.

I: Feeling too much protected. Protection is important but if that protection distorts your behaviour and makes you take riskier actions, yes.

Question 7: A person vaccinated against the COVID-19 who becomes less careful to not spread the virus. Is this an example of moral hazard?

I: I think we need to think a bit about the consequences of that behaviour on others. If the consequences are clearly negative, so let's say there is a large share of the population that it's not vaccinated or it is vaccinated but the vaccine does not protect that share of the population, then I will describe that as moral hazard. Now, if you believe that in our societies now almost everyone is vaccinated and the vaccine offers sufficient protection, then it's hard to accuse that person of engaging in moral hazard because even their careless behaviour will not have big consequences. So, it's an assessment of the effects of these actions.

Question 8: What is the difference between moral hazard and irresponsibility?

I: There are many behaviours that can be irresponsible, but they not necessarily reflect moral hazard. Let's say, an example from the textbooks: several fishermen are fishing in a lack, and I decide to fish all the fishes. That means there will be no fish in the future because there was excessive fishing. So that's irresponsible behaviour towards the others and the future but is not moral hazard because I already know, there is not a risky element here, I know what will happen there is no uncertainty. So, moral hazard and irresponsible behaviour are not the same thing. Moral hazard has to do, in my view, with risk taking, with increasing risk taking.

LP: But this situation creates risks for the future.

I: No because you can be absolutely certain that the fishes in that lack will disappear. There is no risk, it's certain. If you do that, that will happen. Moral hazard has to do with situations of uncertainty.

LP: You don't know the outcome.

I: Yes.

Question 9: What is the difference between moral hazard and selfishness?

I: Again, I think it is part of moral hazard but it's not identical. Because you can be selfish in a way that is not about moral hazard. Let's say you are a child; you are with another child, and you have a candy, and the other child has nothing, and you don't want to share. You are being selfish but that has nothing to do with moral hazard in the sense that there is no uncertainty, you're not increasing your risk-taking behaviour, you are not reacting to a change in the incentive structure. So not the same concept although there is an element of selfishness in moral hazard in the sense that you don't care about the consequences for others.

Question 10: To you, what is moral hazard?

I: in my view, moral hazard is... it happens when you increase your risk-taking behaviour taking only into account the advantage for yourself and not the consequences for others.

LP: So, if you do a risky action that can have potentially good consequences for others and you do it thinking that it will have good consequences, but then it's not the case, would you call it moral hazard?

I: In my experience, when one discusses moral hazard it's always about the negative consequences for others is not about the positive consequences. So, my tendency would be to ignore cases of positive consequences and not call them moral hazard.

LP: So, for example, in the context of the eurozone crisis, countries with weak fiscal positions had their interest rates increasing a lot, and countries like Germany, they became a safe heaven with very low interest rates. This, in the end, can be described as a positive consequence for others. Would you call this situation moral hazard?

I: On that very narrow effect, it's not moral hazard.

Interview 11: Economist offering expert advice to DG ECFIN

Question 1: Is moral hazard the main cause of the IFC that started in 2007?

I: No.

LP: Why?

I: Because there is an alternative explanation that is more convincing, which is that it was a classical 'boom bust' scenario that we have seen in capitalism quite often and which has the following characteristics: there is at a certain moment a series of developments that led to boom conditions in the economy, optimism about the future, which reflects itself in investors who expect large returns, they buy assets, asset prices increase, this leads to euphoria and bubbles, banks are involved because they lend. For example, in real estate market in Spain it was very strong, right? Nobody was concerned about moral hazard there; it was just optimism about Spain... Spain is fantastic... and this attracted investors and there was over investment in real estate for example. And then, at a certain moment realization that all this has gone too far and then comes the crash. And since the banks were involved, the banks got into trouble. And then you have big difficulties and the recession and all that. So, it's a classical boom bust scenario that we have seen so many times. Then, I am not saying that throughout this scenario there were not moments where moral hazard may have played a role. I don't want to say that this is not important. For example, the fact that some banks might have thought that they were too big to fail, that creates moral hazard risk. You know that you cannot fail and therefore you will take more risks. So, banks at a certain moment might have been motivated by that. But on the all, the dynamics of this all thing had relatively little to do with moral hazard.

LP: In your answer you emphasized optimism. To you, moral hazard cannot be a form of optimism?

I: Moral hazard is... we have to be clear about this... it comes from the fact that you feel insured against certain risks, and therefore you will take more risks. You take more risks because you believe you are insured against that risk. While the story I am telling is that people did not see the risks. It was euphoria. I mean in Spain when people invested in real estate, these people who invested in real estate did not think in terms of moral hazard because most of these investors would just lose their money, there would be no bailout for them. But they did not see the risk. There was euphoria. They thought is splendid, fantastic, I can only make money.

LP: But the banks could see the risks?

I: Yeah. There were mixed motives. I think most of them just underestimated the risks. Because everybody was euphoric. Even the regulators, the supervisors, were euphoric. They did not see the risks. That is typical in a boom bust scenario. During the boom, people don't see the risks. They are euphoric. You are like 'yeah, nothing can happen, it's fine, it's great, it's fantastic'.

Question 2: Is moral hazard the main cause of the euro area SDC?

I: Again, I don't think so. Do you think that the Greeks did all the stupid things they did because they were hoping that the Germans will bail them out? You cannot possibly hope to be bailed out by the Germans. That's not nice. So, I don't think so. They did foolish things. Also, Greece experienced a boom, like Spain, during the period 2007-2008. And there the Greek government even intensified the boom. In contrast with Spain. Spain at that moment had budget surpluses and the debt to GDP ratio of Spain declined very fast actually. So, at the start of the crisis, the debt to GDP ratio of Spain had declined a lot. Not so in Greece. There it increased. They have done pro-cyclical policies. You think they did that because they thought 'oh, the Germans will bail us out'? No, come on! They did not think of that. This was just a big policy mistake, excessive debt accumulation, weak political system that could not control public finances even during a boom. That then led to the crisis.

LP: We heard a lot about moral hazard as a cause of these crises. To you is more like an ex post explanation?

I: Yes, that's right. Of course it did play a role. Politically in Germany, when the discussion went on about what should we do? Should we support the Greek government? Then, this idea of moral hazard played a big role and then many German economists were saying, for example 'don't do that, we should not support the Greek government because if we do that, they will do it again'. This was a moral hazard argument, because they will feel insured. That played a role at that moment, but it was after the crisis.

Question 3: Does the EU's response to the COVID-19 crisis create moral hazard?

I: The fact that we started this programme may create moral hazard risks in the future. Well, yeah, I know. Personally, I don't think so. This is a programme that is full of conditions.

Governments get money to spend on certain things. But it's all very conditional on doing a number of things. So, I think the moral hazard risk is relatively weak for that reason. And also, again, in my experience with Portugal, where I am in the fiscal Council, Portugal has also been hit by a programme, a bailout programme. I think the view in Portugal among the political elite is 'we don't want to experience that again'. This humiliation of being supervised by foreigners who come to tell us what we should do. I feel that very strongly. The Portuguese government now follows very often orthodox budgetary policies, wanting to reduce the debt to GDP ratio precisely because they do not want to experience that a second time. So, I think this moral hazard thing is in Germany and in the Netherlands overrated.

Question 4: Is moral hazard more present at the European level than at the national level?

I: Hum... no, I don't think so. If there are moral hazard risks, it's a matter of insurance. At the national level, certain activities are insured and therefore we will have some moral hazard risks. And to the extent that there are such insurance mechanisms at the European level you will also have that. But actually, we don't insure that much at the European level. So, it might actually be the other way around, that it is less so at the European level than at the national level. It's still true for example that banks are basically insured at the national level. Of course, we have started the Banking Union but it's very incomplete. Surely if there were a banking crisis again, then suppose it emerges in Germany, well the German government will insure the big banks. So, in other words, there might be moral hazard risks, but it is within Germany. And the same is true in France and in other countries. So, I think you might actually argue that there is more moral hazard risks domestically because there are more powerful mechanisms of insurance than at the European level where all of this is weaker.

LP: And do you see a role of the idea of identity in moral hazard or not?

I: Maybe, yes. I mean you are willing to insure, to bail out, those who you consider to be your family. Clearly, in the SDC much of the risks had to do with the fact that for example big French and German banks had provided lots of credits to Southern countries, to Greece, through the interbank system. There was no discussion in Germany and in France that the banks were bailed out. And if there was support for the Greek government it was mainly to keep the balance sheets of the German banks. It was defending the German banks so that their own portfolio won't deteriorate too much. Why? Well because they are Germans.

Question 5: Is moral hazard under or over-estimated?

I: It depends on the country where you are. But in Germany, in the Netherlands, it is certainly overrated. And certainly, in Germany, I talk to German economists and often for them this is the most important risk. I disagree with this.

LP: Why do you think there is this focus on moral hazard in Germany?

I: I don't really know. I think it has a little bit to do with... you know they have this theory 'ordo-liberalism' that they invented in Germany. Which is a kind of liberalism free market but there are risks and moral hazard looms there as the most important risk and therefore you need discipline, governments should impose rules, they discipline people, so they do not take all these risks. So that's very much embedded in their economic views. Where that's come from? I don't really know. It's just a theory that has become very popular in Germany.

LP: And in the Netherlands?

I: Also. There is also a combination of moral hazard and the moralising attitudes of seeing the world consisting of two types of people: those who save a lot, responsible, and the spend drift - those who don't do that. They have classified Europe as consisting of two classes of people: in the north you have the savers, those who are disciplined, and in the south it's the spend drift. And they want to get our money the Dutch think, and we should not allow this.

Question 6: Do you see moral hazard in the context of family?

I: What do you mean?

LP: In the relationships between members of a family.

I: Yeah. Like the kids taking risks because they know that the parents would step in to provide support or something.

Question 7: A person vaccinated against the COVID-19 who becomes less careful to not spread the virus. Is this an example of moral hazard?

I: So, somebody who takes more risks because is vaccinated?

LP: Yes.

I: Hum... Technically I would not call that moral hazard because this person will... if hit will suffer from it and cannot count on any... except the social security system can... if there is health insurance, then... I'm just thinking loudly. I restrict moral hazard to the insurance thing. That is, you take more risks because you are insured against the risk. So, you will not suffer.

LP: But the vaccine protects...

I: With the vaccine, the guy would take more risks, ok. He or she, if hit by the virus will suffer. So, it's not moral hazard. With the vaccine the risk declines, it actually declines, and therefore since the risk declines you adjust your behaviour but it's not moral hazard.

Question 8: What is the difference between moral hazard and irresponsibility?

I: Moral hazard is rational. It's rational behaviour. You are insured and therefore you take less precautions to avoid the risk. So that's just rational agent. I don't know what is meant with irresponsible behaviour. I think these are different notions. Irresponsible behaviour, I don't really think...

LP: To you, it's not close in meanings?

I: No. I think it's not related at all. I have actually difficulties understanding what it means having irresponsible behaviour. You are not responsible for what you do. Mora hazard you are perfectly responsible. You just act rationally. I'm insured so I can take more risks.

Question 9: What is the difference between moral hazard and selfishness?

LP: The other synonym is selfishness. You don't agree?

I: it's rational behaviour. Of course, rational behaviour is selfish. It's based on the idea that individuals max their utility. And you can say that is selfishness. But homoeconomicus is about selfishness. You optimise, you maximise, your individual utility. So, in that sense yes, moral hazard is selfishness. But the same as a consumer who goes to the shop with a given budget and tries to max its utility. That's also selfishness, right? No difference there.

LP: So, to you, with this framework, selfishness is not something that we should morally condemn?

I: Do you condemn the fact that as a consumer you max your utility, your individual utility?

LP: But in the idea of moral hazard are there not negative consequences for others in this selfish behaviour?

I: Because you take more risks. Ok, then... we take one interesting step further. Sometimes, individual behaviour leads to negative externalities. And then, you can say that this indeed harms others. But that is a very general notion. So, if moral hazard leads to these externalities and must be that because you take more risks the insurance company will have to raise the premium and others, who do not take more risks will have to pay a higher price. That's harmful. These are external effects of individual behaviour. But again, when I take my car, and drive around with my car because I think that is the best way for me to go to A to B, I create harm for others. Because I add to congestion, and second, my car emits toxic fuels. So, I also harm others. So, in that sense, driving around my car is also to be condemned morally.

Question 10: To you, what is moral hazard?

I: Moral hazard is a behaviour of individuals that decide to be less concerned about a risk when that risk is insured. So, you have insured a particular activity and therefore you will be less concerned about the risk.

LP: So, it has to be an actual insurance; it's not just perceived insurance?

I: That's a good point. Take the banks again. A big bank perceives that it will be bailed out because it's too big. Although there is no explicit contract. I would also qualify that as moral hazard. You have explicit insurance contracts (fire insurance, house, death), we know that well if you have such a contract, you will be less concerned about the risks and you may take more risks. But sometimes the contract is not explicit, it can be implicit and that can also lead to moral hazard, yes.

LP: And you mentioned the behaviour of individuals, but it can be extended to banks or governments etc.?

I: Yes, sure.

Interview 12: Former commissioner

Question 1: Is moral hazard the main cause of the IFC that started in 2007?

I: No. I think that the causes were of an economic nature and also the regulatory failure of the financial system activities.

LP: When you said of an economic nature, does it mean that, to you, moral hazard is not of an economic nature?

I: Well, moral hazard can play a role in the bad functioning, market participants taking risks that are not covered by their own insurances. But I think the big failures of the economic system in 2007-8 were on the one hand the failure to adequately regulate financial markets, financial products, such as subprime mortgages in the US, structural products, financial assets that were incorporated in bad risks, that were not clear, not transparent. And on the other hand, at the time, the existence of big macro imbalances in our economies.

Question 2: Is moral hazard the main cause of the euro area SDC?

I: Hum... well, there were some causes, but of course moral hazard played a role. In particular, in Member States that built very high ratios of public debt to GDP, in particular in Greece but not only in Greece, also in other economies belonging to the euro area, such as Ireland, Portugal, Cyprus, Spain. And yes, in the big imbalances built in these economies, moral hazard played a role because they were not aware about the risks, of treasuries that can issue public debt without controlling the all economy. Because in a monetary union, you are not the owner of your currency. You belong to the euro, to the common currency of the monetary union, but your fiscal policy cannot trust, only in the fact that you are a member of the monetary union.

LP: So, if I understand correctly, you are saying that moral hazard played a role in the rising debts of some...

I: Yes. At the macro level, talking about the public debt assets, yes indeed. If Greece, that was the worst country from this point of view. If Greece would have been a country with its own currency, it would have had a much more careful management of the public debt issuance and the relation between public debt and GDP. They trusted the fact that the currency of Greece was the euro, and they trusted the strength of the euro to allow them to manage the public imbalances, the public debt imbalances. At the same time, the financial markets, public debt markets, were not taking into account for years the risks involved in the indebtedness of some euro areas countries and the spreads, until the beginning of the financial crisis in 2008, the spreads were very very low. The markets were also convinced that the risk would have been absorbed by the strength of the euro and of the EMU.

LP: At some point you said that the governments were not aware of the risks that they were taking.

I: Yes. They were confident that because their countries belong to the monetary union, the solvency of the treasury would benefit from this shared currency.

LP: But because they were expecting that they would be saved by others or for other reasons...

I: Well, I don't know this needs to be answered by the protagonists. But probably they thought that because the EMU was a very strong system, the consequences of their indebtedness will be absorbed one way or another.

LP: Also, when you talked about the actions of the financial markets, do you see that politicians were adapting to the conditions of the market, so the primary cause would be in the financial markets...

I: Yes, if you are the minister of finance of Greece for instance, given that the financial markets are not asking you higher interest rates when issuing your debt, you can issue with less negative consequences from the point of view of the cost.

LP: With this logic it would be the case of all countries that saw their interest rates decreased with the introduction of the euro, right?

I: Well, the question is that if you need to issue more debt as a treasury, the cost of this issuance is not as high as what it would have been if you were a country not belonging to the euro area for a while. Up to a moment, the market woke up and the spread started to rise and at that moment the solvency of the country was put into question.

LP: So, you see the financial markets as a way to minimize moral hazard on the side of government?

I: I think there were market failures in the financial markets also. The pricing of the debt was not correct, the price of the debt was under-priced.

Question 3: Does the EU's response to the COVID-19 crisis create moral hazard?

I: No. I think it was a very correct response because if you mutualize the debt issuance you are sharing the risks. Is not that one agent takes the risk, and another agent guarantees the consequences or the materialization of the risk. In the case of a common issuance, of mutualization of debt, I think it is a shared risk that the all EU is strong enough to guarantee this. Sharing the risk is a way to avoid the consequences of moral hazard.

LP: But then how would you answer to people arguing that actually the mutualization of risks produce moral hazard?

I: Well, I don't agree. I think if you have a correct mechanism to share the risks, with common issuance of public debt, I think it is a good insurance mechanism or co-insurance mechanism, where everybody is taking risks but the fact that the risks are shared by the 27 Member States is a good balance of risks. I think it is much better than to avoid mutualization of risks, of debt, and to let one country to take the risks that will be suffered by the others. In this case if you mutualized the system, everybody is co-responsible. I think it's a good system.

LP: So, to you, if I understand correctly, moral hazard is a situation where there is an unfair distribution of risks.

I: Yes: one agent takes the risks and others will assume the consequences. This is my conception... I don't know if it's the philosophical concept or...

LP: I investigate the different understandings of the concept, so there is no wrong or right answers.

I: This is good.

Question 3: Is moral hazard more present at the European level than at the national level?

I: Well, it depends on the sectors where you analysed the existence or not of moral hazard and the risks associated to this. In the EU, some of the responsibilities are fully mutualized so the EU is a quasi-federal system in some aspects. In other aspects, the competences and the responsibilities remain national and in this case the distribution of risks is more complex. And this can create, or in fact, has created tensions because some Member States of the EU consider that other members are taking risks that will not be assume by themselves but by others within the EU. It depends on the degree of... To what extent this exist also within a particular country? Well in decentralized countries such as Spain or Germany or other federal or quasi federal Member States, these problems exist within our borders.

LP: I had the impression that the moral hazard argument seems to be more prominent in the European context than at the national level.

I: Well, if you follow the discussions within a particular country, you can find also discussions related to the moral hazard concept.

LP: Also, I was wondering about the fact of feeling belonging to the same identity... some authors see this as a way to avoid uncooperative behaviours.

I: Yes. This is in theory. In practice, in Spain for instance, it's obvious that the question of identity opens a window for many doctoral works. Where is the Spanish identity? In some areas, in some groups of the population, in some regions, it is very very strong, in other regions it's much weaker, more complex...

LP: But do you think this plays a role in moral hazard?

I: Yes, it can play a role. Why not. For instance... I don't know if it is a question of moral hazard but here in Madrid the regional government is clearly in favour of lowering taxes. This affects, according to my view, the financing of the health system in Madrid region. Yesterday we had a strike of medical doctors and employees of the health system because of the lack of human resources, the lack of means... At the same time, the Madrid government is asking the central government to send them more resources. Why Madrid, the richest region in Spain, with the lower level of financing for the health system and the lower level of taxes in some figures, why at the same time it would have the right to ask for more resources to the central government that is financed by all the Spaniards? I don't know if it's a question of moral hazard but... more or less.

Question 5: Is moral hazard under or over-estimated?

I: This question has to be answered case by case.

LP: In the context of EMU?

I: In the context of EMU, there are still some questions about risk sharing that are not fully solved. For instance, this issuance of common debt is not settled for the EMU architecture and toolbox. Some of us, would like to see in the EMU fiscal capacity that will complement or supplement the national fiscal capacities in an EMU where the treasuries are national. We don't

have an EU or euro area treasury. This question of sharing of risks applies also to the way the capital markets function at the EU level. I would like to see in the coming years a Capital Market Union, so a further integration of capital markets in all the areas where capital markets function at the EU and this would allow sharing risks beyond the public sector. Also, in the functioning of private agents and agents operating in capital markets. These instruments to mutualize the risk sharing both in public and private sectors are still to be developed, needs to be developed further in EMU.

LP: And how is the question of moral hazard being under or over estimated plays in these developments?

I: Well, I don't know. I don't have a clear answer to this. I don't know. I don't know what you mean by under or over estimated...

LP: Since moral hazard seems to be something very difficult to measure or quantify, some actors will...

I: This is why I cannot answer your question.

Question 6: Do you see moral hazard in the context of family?

I: Wahoo. I don't know. I never thought about this. What do you mean? Give me an example.

LP: Well, for example, parents are supposed to protect their children and this might change the behaviour of children into more or less responsible...

I: This is a very difficult question.

LP: Also, there are studies of moral hazard in relation to education and the financing of studies...

I: I never thought about this. As a parent, I never thought about the moral hazard question.

LP: Many Germans said yes immediately!

I: Yes, but the Germans are Germans...

Question 7: A person vaccinated against the COVID-19 who becomes less careful to not spread the virus. Is this an example of moral hazard?

I: Hum... I don't know. Probably. Moral hazard for a citizen that is against vaccines that has the same risks that all the other people to have the virus and to transmit the virus to other people. Yes, this can be an example, I don't know... It's irresponsibility, but I don't know if it's irresponsibility linked with moral hazard questions or not.

LP: But in my example is a person that is vaccinated and that becomes less careful.

I: Well, probably it happens yes.

Question 8: What is the difference between moral hazard and irresponsibility?

I: These are philosophical questions... Maybe the difference is that you can be irresponsible but without putting at risk others. You can put at risk your own future because you are irresponsible. Whereas in the case of moral hazard, you are not able, you don't want to assume the risks with the trust that others will assume the consequences of your irresponsibility.

LP: So, you are saying that you are aware that you put at risk others, or not necessarily?

I: Yes.

LP: You are aware?

I: Maybe. I don't know, this is very philosophical. I'm not a philosopher. I never thought about moral hazard from the philosophical point of view.

Question 9: What is the difference between moral hazard and being selfishness?

I: To some extent, the two concepts are linked. If you don't care who will take the risk that you are not able to assume, yes, it is a question of selfishness. More or less conscient.

LP: So, you cannot behave in a moral hazard way if you are thinking about the others?

I: If I understand, moral hazard has something to do with your lack of will to assume your own responsibilities or the consequences of your behaviour and take for granted that others will assume those risks. In a more or less conscient way.

LP: But the consciousness is about attributing blame on the actors if they are conscious about their behaviour, right. It can be moral hazard whether you do it intentionally or unintentionally?

I: I think regardless your degree of conscious, you are provoking the consequences.

Question 10: To you, what is moral hazard?

I: To create risks or consequences because of your behaviour, without being ready to assume these consequences yourself.

LP: So, if you behave in a certain way and you realized it creates negative consequences for others, but you are willing to bear the cost of these consequences, is not moral hazard?

I: If you want to assume yourself the consequences of your behaviour, probably there is no moral hazard, or at least you are reducing a lot the negative consequences on others or the negative risks that you are transferring to others. The word 'moral' means that you need to be responsible of your acts.

D.Codebook

Code System

Contestation

Synonyms

Antonyms

What it is

What causes it

What it does

Whose moral hazard?

Conclusion

Cognitive

Normative

Contestation

Coded segments in which a statement on moral hazard is refuted or challenged.

Synonyms

Words having the same sense as moral hazard.

Antonyms

Words having an opposite meaning to moral hazard.

What it is

Description or explanation of moral hazard.

What causes it

Segments providing information about the cause of moral hazard.

What it does

Segments providing information about the effect of moral hazard.

Whose moral hazard?

Segments providing information about the subject of moral hazard.

Conclusion

Statements providing information about solutions or policy prescriptions.

Cognitive

Premises that relate to knowledge or logic and that help to explain or justify something.

Normative

Premises that relate to values or appropriateness and that help to legitimize something.

E. Stop Lists for Word Clouds

Dies	which	le	and
been	moral-hazard	can	sull
Es	auf	dem	being
Thus	hazard	im	doesn
does	wird	ad	s
my	morale	Risiko	The
8	they	7	è
But	while	for	we
il	als	che	It
della	einen	forms	so
was	there	us	At
For	ein	Moral-Hazard-	This
If	There	Problemen	that
bei	di	therefore	Moral-Hazard-
-	or	12hazard	Pro-
did	a	dass	Moral-Hazard-

Per	you	do	thus
Moral-Hazard-	doe	from	der
Problem	Moral-Hazard-	could	by
should	Probleme	2	den
What	en	Did	such
des	D	mit	6
l	me	These	Does
I	up	with	Is
Let	To	would	are
the	it	io	risiko
la	La	Moral-Hazard-	And
have	ist	Kalkül	—
l	They	und	dall
as	da	when	eine
e	In	o	than
4	all	an	durch
azzardo	più	dell	http
□	die	delle	Moral-Hazard-
J	be	form	Problematik
is	M	this	moral
sp111110	to	Die	von
zu	on	has	das
re	html	of	ve
https	moralisches	also	www
t	un	at	
L	if	in	

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