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The Hazards of Moral Hazard

People see economic issues through moral frames and people think there's an extent to which recessions are punishment for sins—mainly sins of excess—and you don't expiate sins by binges.

—Lawrence H. Summers, former White House economic adviser (2011)

Liquidate labor, liquidate stocks, liquidate farmers, liquidate real estate.... It will purge the rottenness out of the system.... People will work harder, live a more moral life.

—Andrew Mellon, US Treasury secretary, as reported by President Herbert Hoover in his memoirs (1952)

European leaders responded with condescension to the bankruptcy of the US financial services firm Lehman Brothers in September 2008 and the ensuing global financial crisis. Gathering in Paris, they went out of their way to deplore US-style excesses and express nervous confidence that Europe had set a better example. "We want a capitalism of entrepreneurs, we don't want speculators," declared President Nicolas Sarkozy of France. Prime Minister Gordon Brown of Britain claimed that the crisis "has come from America." Prime Minister Silvio Berlusconi of Italy insisted that "Europe is not facing and never faced the risks in the American system."[1] American capitalism fostered selfishness and misconduct, they suggested. European capitalism promoted self-discipline and virtue.

The self-satisfaction did not last long. The shock that originated in the United States soon exposed many European banks to the vulnerability of their own investments and loans. In 2010 Greece's government debts and deficits were revealed to be greater than previously thought. Unbeknownst to incurious creditors, including many leading European banks, the debts and deficits had been covered up for years by deceptive accounting practices. Meanwhile, rescue programs had to be launched, not only for Greece but also for Ireland, Portugal, and Cyprus, and the financial contamination spread to Italy and Spain. Only after Mario Draghi, president of the European Central Bank (ECB), pledged to do "whatever it takes" in 2012—just as the Federal Reserve had done in the United States in 2008–09—was the situation stabilized. By early 2015, after rounds of tough austerity in many European budgets, most of the continent was still struggling to lift itself out of the worst economic downturn since the 1930s. The notable exception to that stability was Greece, which was compelled to accept a tough new regimen of budget cuts, tax increases, privatizations, and reforms of its labor, product, and business regulations in return for a third program of loans from Europe and the International Monetary Fund (IMF) following earlier loan rescues in 2010 and 2012.

This chapter introduces the concept that modern capitalism, including capitalism on a global scale, rests on the widely shared premise that such a system cannot survive without the encouragement of virtuous behavior by participants—whether they are individuals, businesses, financial institutions, or governments. From the European crisis, the chapter traces some of the origins of this fixed idea that capitalism depends on ethical conduct.

The European Fallout of the Global Financial Crisis

Like the aid provided by the Bush and Obama administrations for insolvent or troubled financial institutions, homeowners, and auto companies in 2008–09, Europe's efforts to stabilize its financial system after 2010 left a pungent residue of moral unease. That unease has grown in recent years.

A generation of Europeans grew up under the rift between East and West during the Cold War—a rift that was revived somewhat by Europe's concerns about Russia's intervention in Ukraine beginning in 2013. The newest significant rift in Europe, however, is between North and South—that is, the stable countries of northern Europe, most prominently Germany, and the supposedly errant debtor countries of southern Europe such as Italy and Spain, and especially Greece.

The financial lifeline preventing a Greek collapse after 2010 involved the transfer of many of its liabilities from banks onto the shoulders of European taxpayers, who in turn—through the institutions of the European Commission, ECB, and IMF—imposed harsh requirements that Greece return to balanced budgets. "One really must question whether we can go on receiving less than we spend, so that our debts keep on growing," German chancellor Angela Merkel observed in 2014, saying "we" when she clearly meant "they," and adding, "Indeed, a whole crisis of confidence has grown out of that."[2]

To understand the European crisis, it is important to remember that the Economic and Monetary Union, when creating the euro as a common currency, required member countries to harmonize their fiscal policies. The commitment to fiscal balance was not always honored, but in the case of Greece its failure to reach that goal was compounded by deception—that is, the discovery in 2009 that Greece had covered up its massive deficits with dubious bookkeeping. In 2015 German loss of confidence and Greek defiance led to a nerve-wracking showdown between European and IMF creditors and the leftist government in Athens of Prime Minister Alexis Tsipras. Voted into office in January 2015 with a promise to ease his country's years of economic hardship, Tsipras quickly repudiated many of the fiscal and structural reforms accepted by the leaders he had ousted. His election gave him a mandate to demand relief, Tsipras contended. But Germany and other European countries countered that they also had a mandate from voters and taxpayers—who were, after all, providing the loans that Greece needed. Their obligation, they said, was to ensure that Greece would take steps toward fiscal balance, enabling it to pay back its creditors. (Without further loans, Greece would have faced default, the collapse of its banking system, and an exit from the euro area, which most analysts said would have brought inflation, massive unemployment, and economic ruin.)

The confrontation ended in mid-2015 with an agreement by Europe and the IMF to extend €86 billion to Greece for three more years. In return, Tsipras convinced Greek lawmakers to approve a tough regime of fiscal, budgetary, and structural measures—steps he had previously termed unacceptable. Neither side was happy with the accord. Sullen Greek citizens faced the possibility of many more years of hardship, although European officials said they were willing to consider an IMF proposal for additional debt relief for Greece in order to ease what the Fund called an unsustainable debt burden exceeding 175 percent of Greece's GDP (in part because its economy had shrunk so dramatically). Germans were unhappy that Merkel seemed to be rewarding the Greeks for their record of reckless fiscal and financial failures. All sides were unhappy that European banks—which had extended loans in the first place but were saved by intervention from European government institutions—had not been punished for their own improvident conduct. Europe had become a festival of moral hazard accusations on all sides.

Even before the latest crisis, Germans had developed a habit of seeing aggressive financial institutions as a predatory arm of capitalism suitable for the City of London and Wall Street perhaps, but not Frankfurt, and of seeing the scourge of debt as a moral issue. Indeed, they often referred to private investment firms as parasites that preyed on companies and spat them out while firing workers. In 2005 German labor minister Franz Muntefering, a Social Democrat, compared private equity investors to "swarms of locusts that fall on companies, stripping them bare before moving on."[3] The term *locusts* in fact became quite popular, and German politicians became fond of using it to refer to the financial sector that had enabled countries to pile up mountains of debt.

Underlying the moral concern about paying debts was the parallel concern that if creditors were forced to write off part of their loans, such "haircuts" would rattle the credit markets and force up interest rates for everyone else. Indeed, after ensuring that European banks were spared the worst of the crisis, including their reckless loans to Greece, French president Sarkozy and German chancellor Merkel met at Deauville in October 2010 and called for *future* costs to be imposed on creditors of the troubled countries. That pledge alarmed bondholders and drove up Spain and Italy's interest rates, compounding their difficulties in closing their fiscal deficits.

A mixture of almost religious fervor and cultural disdain infused the discussion, underscored by Germany's particular scorn for anyone accumulating debts—an attitude that stemmed from history, culture, and even language. For example, the German word for debt, *Schuld*, is also used for the concept of "sin" or "fault."[4] Chancellor Merkel, the daughter of a Lutheran pastor in East Germany, appeared to uphold a traditional attitude that debts are an invitation to irresponsible conduct and that even poor people must take responsibility for themselves. Her apparent belief was traced by some to her Lutheran education. "She admits that austerity is the toughest road home but hastens to add that it is also the surest and quickest way to recover the economy and gain full emancipation from the crisis," wrote Steven Ozment, a historian of the Protestant Reformation in Europe. "Luther would agree. According to the polls, so do Ms. Merkel's fellow Germans."[5] In 2015 two German economists asserted in an academic paper that countries with Catholic majorities had a tendency to run into fiscal problems, whereas countries with Protestant majorities such as Germany avoided those problems. After all, they noted, it was a sociologist and philosopher, Max Weber, who coined the term *Protestant work ethic* to explain the hypothesis that "Protestants were more hard-working than Catholics."[6]

It was not hard to see that some of these attitudes bordered on ethically and religiously tinged contempt. Throughout the confrontation with Greece, it was often suggested in Germany, for example, that Greece should auction the Acropolis to meet its loan obligations.[7] "Why should we help rescue the Greeks from their sham bankruptcy?" asked the German playwright Rolf Hochhuth. "Ever since Odysseus, the world has known that the Greeks are the biggest rascals of all time."[8] The Obama administration told Germany's leadership that Berlin's support of only minimal lending to Athens—combined with harsh demands for tax hikes, spending cuts, and wage freezes—was both parsimonious and risky for the region's financial system, and for the NATO alliance as well. But Chancellor Merkel and her cabinet were hardly ready to listen to advice from Americans, who, in their view, caused the crisis in the first place.[9] Later, an American economist attending a conference in Munich in 2015 wrote in the *New York Times* that he was shocked to hear German officials portray themselves as dupes of the corrupt, incompetent, tax-evading, and even irreligious behavior of Greeks.[10]

Greeks responded to German tight-fistedness with invective of their own. They routinely evoked Germany's notorious history, comparing Merkel and German finance minister Wolfgang Schäuble to Otto von Bismarck and even Adolf Hitler. Posters depicted the finance minister with a Hitlerian mustache and Twitter comments called the chancellor "Angela Lecter," after the flesh-eating movie villain Hannibal Lecter. Opponents of Tsipras's concessions to Germany likened him and his team to Nazi collaborators.[11] More soberly, Greek leaders and others pointed out that Germany benefited itself from generous bailout terms by the victors in World War II, avoiding the mistake of the post–World War I victory of imposing on Germany what John Maynard Keynes described as a "Carthaginian Peace" (a term arising from the time legions of the Roman Empire burned Carthage to the ground, seized its armies, forced its citizens into slavery, and exacted huge sums of tribute). It was a fair point. Following World War II, US president Franklin Roosevelt rebuffed US Treasury Secretary Henry Morgenthau Jr. and his plan for a deindustrialized—a "pastoralized"—Germany. Instead, he and other Western leaders launched the Marshall Plan, cancelling large amounts of Nazi-era debt, fearing that a destitute Germany would become vulnerable to Soviet influence.[12] Thus faced with whether to rescue Greece and relieve its debts, at least some Germans argued that doing so would be "morally justified" in light of their own history. "After all, Germany also benefited once from public-sector debt relief," said an editorial in the daily *Handelsblatt*. "At the start of the 1950s, the US wrote off a large part of Germany's war debts, making Germany's famous 'economic miracle' possible."[13]

The debt crisis in Cyprus in early 2013 provoked similar anguish, compounded by Cyprus's dubious business model as a tax haven for foreign depositors, many of them Russians using Cyprus to launder money gained from crime and corruption. Yet the distaste of "rewarding" Cyprus for its bad behavior had to be balanced against destabilizing the system. "At what point does a debt-ridden country endanger the entire financial system, and how can allowing it to go bankrupt still be the right approach?" asked the German magazine *Der Spiegel*.[14] To many, the enmities exposed by these questions were frightening.

"The way some German politicians have lashed out at Greece when the country fell into the crisis has left deep wounds there," concluded Jean-Claude Juncker, at the time prime minister of Luxembourg before he took office as president of the European Commission in 2014. "I was just as shocked by the banners of protesters in Athens that showed the German chancellor in a Nazi uniform. Sentiments suddenly surfaced that we thought had been fully relegated to the past. . . . I am chilled by the realization of how similar circumstances in Europe in 2013 are to those of 100 years ago."[15]

Former German chancellor Helmut Schmidt, a champion of the "European project" of ever-greater economic and political union, also counted himself among the chilled. European unity was a vital German objective to reassure a continent with a blood-soaked history that it must never again worry about German ambitions. Now German economic success, driven by its export-based economy and trade surpluses, was provoking envy and fear in the rest of Europe, especially the countries in the southern tier, Schmidt said. "This time the issue at stake is not a central power that is exceedingly strong in military and political terms, but a centre that is exceedingly powerful in economic terms," he noted in a speech in 2011. German willingness to help those less fortunate—including Greece, Portugal, and Ireland—had become essential: "We must have a compassionate heart for our neighbours and partners."[16]

Is Virtue Essential to Capitalism—or Antithetical to It?

Get money, money still! And then let virtue follow, if she will.

—Alexander Pope, *An Essay on Man* (1734)

Philosophers divide the process by which humans elucidate the rules of moral conduct into three major schools of thought. The first, known as deontology, emphasizes the purity and power of moral reasoning, which is associated with its most important historical practitioner, Immanuel Kant (1724–1804). The second school of thought is utilitarianism, supposing that moral behavior can be understood in terms of the consequences of a set of actions—for example, whether such behavior enhances the social welfare of the greatest number of people. And the third school of thought is virtue ethics, which emphasizes the virtues, or moral character, of an individual in behaving benevolently toward fellow humans. This approach was promoted by, among others, Jesus, Confucius, and the Buddha. Of the Golden Rule, for example, the deontologist would say that doing unto others as you would have them do unto you derives from moral reasoning. A utilitarian would say it flows from the obvious practical need for a society to function. And a virtue ethicist would say it stems from the honorable and virtuous behavior of an individual.[17]

All three schools of thought contribute to the enduring idea that a society cannot function successfully if its citizens do not cultivate virtuous behavior—and to its corollary, that market economies also depend on virtuous conduct by those engaged in commercial transactions. Adam Smith viewed markets as dependent on self-interest, as previously discussed. But his writings also argued that markets and society in general depend as well on trust. He regarded commercial society as having evolved from the earliest phase of hunting and gathering to the domestication of animals, agriculture, and finally market transactions. Economic progress for each of these stages depended on the assumption, or at least the goal, that participants would not deliberately hurt or cheat one another, he wrote. For Smith, an important guarantor of trust in the commercial stage was found in agreed-on rules, in many cases established or arbitrated by government.[18] The need for trust and virtuous behavior in commercial transaction is evident in the use of the word *credit*, derived from the Latin word for belief, as in credibility. Thus as American sociologist Daniel Bell asserts, "No moral philosopher, from Aristotle and Aquinas, to John Locke and Adam Smith, divorced economics from a set of moral ends or held the production of wealth to be an end in itself; rather it was seen as a means to the realization of virtue, a means of leading a civilized life."[19]

What Is Moral Hazard?

Probably since Noah and the flood humans have tended to believe—rationally or not—that disasters in life occur because of sinful behavior, and that the path out of crisis is to return to the straight and narrow road of virtue. The challenge of Western religions has long been to reconcile the belief in a God of justice with the fact that the innocent and sinful suffer alike in a fallen world. Yet the powerful idea of punishment and reward based on one's conduct has endured. It was one of the original definitions of justice in Greek philosophy and scripture. It is thus no surprise that the financial crises of the modern era, as opposed to natural disasters, are no exception, although some argue that the extreme weather being experienced in the era of global warming is a natural punishment for a sinful, profligate, and energy-wasting civilization.

Rescues of banks, institutions, homeowners, or other people who get themselves into financial trouble because of their misjudgments or reckless behavior produce what economists call "moral hazard"—the idea that long-term adverse consequences can result from short-term protections from those consequences. Moral hazard holds that immoral or destructive behavior is encouraged when it is not punished, and that debts incurred must be repaid to discourage people from taking on irresponsible debts in the future. A corollary is that lenders must on occasion accept less than the full value of their loans to discourage reckless *lending* in the future. Debts thus become a symbol of moral values, which is one reason why the outsized scale of US deficits and debts during the financial crisis also took on a morally pejorative aspect in the eyes of critics.

The term *moral hazard* appears to derive from the insurance industry in the mid-19th century and the question of whether insuring against risk encourages risky behavior. Just as one might ask whether fire insurance encourages someone to be careless about fire, does health insurance encourage risky behavior or even hypochondria—or does unemployment insurance discourage people from looking for jobs?[20] In a larger sense, moral hazard implies that well-intentioned efforts to help can actually backfire. For example, a famous study of this paradox by Sam Peltzman, a University of Chicago economist, asserted that laws requiring seat belts in cars appeared to have produced a larger number of accidents because drivers felt they could drive more carelessly knowing they were protected by safety belts (the study also showed that seat belts did reduce the number of fatalities, however).[21]

Behind the idea of moral hazard is a rich history of philosophical and religious meditation on charity and welfare assistance for the needy—and whether extending such benefits encourages dependence, laziness, and antisocial behavior. In addition, in contemporary American discourse concern about moral hazard extends to criticism by many conservatives of open-ended social safety net programs—welfare, health assistance, and unemployment insurance, for example—that may help people in the short run but encourage dependence or loss of initiative in the long run. A powerful example of this view was voiced by House Speaker Paul Ryan, the 2012 Republican vice presidential candidate who declared in 2011 that unchecked spending on Medicare and other government programs "will transform our social safety net into a hammock, which lulls able-bodied people into lives of complacency and dependency."[22]

The ancient fundamental beliefs about "moral hazard" can be found in how modern economics is discussed in the era of globalization.

Role of Virtue in the Economic Sphere

Liberty and justice are abstract principles that can guide or motivate an individual or a whole society. Virtue, by contrast, implies an aspirational code of conduct for an individual, community, or nation. Throughout much of history, including that of the United States, laws requiring certain "virtuous" codes of behavior in private were not challenged. It was commonplace in the United States, for example, to require salutes to the flag, prayers in school, sexual abstinence outside marriage, and heterosexual conduct only. Over the last few decades, attitudes toward such practices have changed. Except for certain segments of social conservatism, it is presumed that the goal of the state is not to require virtuous private behavior but rather to let people determine their own codes of social conduct. The acceptance of gay marriage by a majority of Americans, and by the US Supreme Court in June 2015, exemplifies this evolution of attitudes.

In the economic sphere, however, encouraging virtuous behavior is where liberals, social conservatives, and even libertarians meet. A consensus among these disparate groups accepts the notion that capitalism and prosperity can succeed only when practitioners adhere to certain upstanding modes of behavior. What are these codes of conduct? Essentially, they hold that social and economic cohesion depends on individuals becoming self-sufficient and self-disciplined, avoiding dependency on others, engaging in hard work, and displaying industriousness, reliability, honesty, thrift, and behavior worthy of trust. In the business world, one would add the importance of innovation, creativity, and ingenuity, and, when risk is necessary, that it be bold but prudent. Parallel to this set of behaviors is the belief that such behaviors, while worthy in themselves, are also deserving of reward—what philosophers call "moral desert."

Whether these codes of virtuous conduct are honored in the breach or in the observance, they have been a long-standing feature of thinking about human behavior. However, a peculiar progression has arisen with the advent of modern capitalism, particularly on a global scale. For example, in his book *The Moral Consequences of Economic Growth* (2006) Benjamin Friedman, an economist at Harvard, argues that capitalism fosters a healthy reciprocity between moral behavior and prosperity, in that virtuous conduct—"hard work, diligence, patience, discipline, and a sense of obligation to fulfill our commitments clearly"—produces economic growth. The resultant rising living standards in turn "make our society more open, tolerant and democratic."[23] Martin Wolf of the *Financial Times* has also contended that success in a market economy requires "trustworthiness, reliability, effort, civility, self-reliance and self-restraint," enabling those not motivated by material gain—such as doctors, teachers, policemen, or anticapitalist activists—to flourish.[24]

The earliest political philosopher to discern the importance of virtue as an ingredient in capitalism was no doubt the German philosopher and political economist Max Weber. In his seminal work *The Protestant Ethic and the Spirit of Capitalism*, Weber argued that the very origins and success of the market system derived from an inflection point as religious tenets moved away from their historic rejection of striving for material gain and into the spirit of achieving prosperity through commerce and markets by adhering to the dignity of work and the ability to measure that hard work by the amount of wealth it achieved.[25] Weber cited Benjamin Franklin, with his many proverbs about work, thrift, trustworthiness, and saving, as an example of this emerging ethic.

Weber's analysis has been widely challenged. Marcus Noland of the Peterson Institute for International Economics has noted that Weber mischaracterized not only Protestant theology but also Catholicism and many other religious traditions while too easily dismissing other factors nurturing capitalism in Protestant northern Europe.[26] In addition, with the rise of economic powers in Asia, many scholars have challenged Weber's implicit suggestion that hierarchical cultures and religious traditions cannot encourage the hard work, discipline, and other so-called Protestant virtues that make capitalism work in their non-Protestant societies. Confucian and Hindu societies such as China, Japan, and India have certainly done well with their brands of market economies, these scholars note, demonstrating that "Protestant" values are not essential to hard work, discipline, and the achievement of economic success. Indeed, Japan's postwar success is one of many such examples.[27] So, too, is the spirit of entrepreneurship in authoritarian China, unleashed in the late 1970s by the supreme leader Deng Xiaoping, who turned away from communism and revised Confucianism with the notorious slogan, "To be rich is glorious."[28]

One of the most interesting rebuttals of Weber's Protestant-oriented thesis has been mounted by conservative, free market–oriented Catholics. Their critique of Weber derives from a long-running debate among Catholic intellectuals around whether capitalism depends on selfish or virtuous impulses. One side of this debate was articulated by Pope Leo XIII in his 1891 encyclical *Rerum Novarum* (On Capital and Labor), which condemned the selfish drives and depredations of unfettered capitalism and called for worker rights and social welfare programs amounting to a welfare state.[29] Another exponent of this point of view was Pope Paul VI, whose 1967 encyclical, *Populorum Progressio* (Progressive Development of Peoples), raised such pointed questions about the value of free markets that some critics blamed the encyclical for encouraging violent revolution in Latin America and elsewhere. On the other side of the spectrum was the landmark 1991 encyclical of Pope John Paul II, *Centesimus Annus* (Hundredth Year), which was intended to be a modern response to Leo's socialist-leaning pronouncements of a century earlier. In his encyclical, John Paul, the anticommunist prelate from Poland, spoke positively of "the fundamental and positive role of business, the market, private property, and the resulting responsibility for the means of production, as well as free human creativity in the economic sector."[30] Pope Benedict and Pope Francis are more in the tradition of Leo XIII and Paul VI.

The author Michael Novak in his 1993 book *The Catholic Ethic and the Spirit of Capitalism*—a title consciously evoking Weber—saw *Centesimus Annus* of Pope John Paul II as a lodestar for Catholic market-oriented conservatives. "The complex of attitudes that Weber identified as Protestant actually was shared by many others besides Calvinists," Novak wrote.[31] "Capitalism is not a set of neutral economic techniques amorally oriented toward efficiency. Its practice imposes certain moral and cultural attitudes, requirements, and demands. Cultures that fail to develop the required habits cannot expect to eat broadly of capitalism's fruits."[32] Those economically conservative Catholics in agreement with Novak on this score include Reverand Richard John Neuhaus, a Lutheran pastor turned Catholic priest and author of several books on religion in the

United States, and George Weigel, a Catholic theologian and scholar at the Ethics and Public Policy Center in Washington. By contrast, these market-oriented writers have been disappointed with Pope Francis's view of the world, especially his rejection of the idea that economic self-interest can produce progress. "Francis doesn't seem to have practical strategies for a fallen world," wrote the *New York Times* columnist David Brooks. "He neglects the obvious truth that the qualities that do harm can often, when carefully directed, do enormous good."[33]

Few would dispute that success in a market economy also flows from extraneous factors that have nothing to do with moral behavior. Luck, access to natural resources, and monopolistic or oligopolistic advantages (what economists call rent-seeking) have a big role to play in determining one's success in a market economy. A landowner fortunate enough to be sitting on oil reserves or able to impose a toll on a road going through his property does not win praise for his industriousness or hard work. The idea that one "deserves" the consequences of behavior, good or bad, underpins Robert Nozick's critique of Rawls (see chapter 4). To recapitulate that argument, Nozick asserts that a morally based economic or political system should permit a person to be rewarded for his or her industriousness, whereas Rawls's emphasis was on ensuring a just distribution of arbitrarily earned wealth, especially for those at the bottom.[34] Part of Rawls's argument was that in the real world no one fully "deserves" unique credit for his or her success. Luck and other factors make the distribution of gifts to individuals haphazard and capricious.

But for all of the disagreements that continue over "moral desert," Weber's idea that capitalism rests on virtuous and industrious behavior has penetrated consciously and unconsciously the way in which many Americans think about their economic system. This attitude has survived as a mainstream tenet despite critics on the left complaining about the excesses of consumer society, notably John Kenneth Galbraith (*The Affluent Society,* 1958), the Marxist scholar Herbert Marcuse, and Christopher Lasch (*The Culture of Narcissism,* 1979). Their well-known critiques of the consumer culture helped inspire those young dissidents in the 1960s and 1970s who disdained materialist goals. These "New Left" intellectuals proclaimed a different kind of spiritual fulfillment characteristic of the musical, artistic, and drug culture of the era.

What is interesting about the left-of-center critique, however, is that it has been echoed by critics on the right warning that materialism and hedonism have *undermined* capitalism and the virtues that it supposedly encourages. Daniel Bell (1919–2011), a Harvard sociologist, self-described socialist, and latter-day neoconservative, was one such critic. Invoking Weber, Bell argued in *The Cultural Contradictions of Capitalism* (1976) that although virtuous behavior had contributed to the success of capitalism and to the establishment of a successful bourgeois society, the hedonism of the so-called counterculture and obsessive consumerism of the present day was bringing about the downfall of capitalism by undermining its distinctive culture of self-control.[35]

Bell's book served as an influential jeremiad against the self-indulgence of the 1960s and 1970s that he believed was undermining the cohesion of American society and culture. Capitalism, in other words, had become so materialist that it was destroying itself at a time of maximum peril, the battle against communism. Its adherents, he feared, had become obsessed with social liberty bordering on licentiousness, on the one hand, and reliance on government to impose equality, on the other. Capitalism, he maintained, could still serve as a basis of freedom, rising living standards, and even the defeat of poverty, but its "cultural, if not moral, justification" had been lost, replaced by "state-directed economies" and "state-managed societies."[36] Gone was a public willing to sacrifice for the common good. In short, capitalism may rest on virtuous behavior, but its excesses had led to the abandonment of virtue.

The writings by Bell and other so-called neoconservatives of the 1970s may seem dated by today's standards. The decline of the business ethic at the hands of hedonism does not seem to be at hand. But the idea of the culturally negative repercussions of market economics persists in other guises. For example, a novel theory that capitalism causes dangerous resentment in developing economies has been proposed by Amy Chua, a law professor at Yale. Chua, perhaps best known for her popular (and controversial) parenting memoir, *Battle Hymn of the Tiger Mother* (2011), has studied a range of ethnically diverse market economies, concluding that free markets aggravate sectarian hatreds within them. The system, she asserts, causes enmity to be directed at wealthy "market-dominant minorities," who are begrudged by others because of their success and perceived selfishness rather than any sort of virtuous model of behavior. This provocative thesis derives from the author's personal experience growing up in a family of ethnic Chinese who migrated to the Philippines and became wealthy, acquiring a large estate and many servants. In 1994 Chua's aunt was murdered by her chauffeur, an ethnic Filipino. Although the murderer stole money and jewels, the police listed the motive as revenge. Based on her study, Chua links market economics to past and present hatred of ethnic Chinese in Southeast Asia, Jews in Europe and the Middle East, ethnic Tamils in Sri Lanka, ethnic Tutsis in East Africa, and whites in South Africa and Zimbabwe. "Market-dominated minorities are the Achilles' heel of free market democracy," she asserts, adding "that the global spread of markets and democracy is a principal, aggravating cause of group hatred and ethnic violence throughout the non-Western world."[37]

Until this point, all of these reflections about the virtues of capitalism have been discussed in a vacuum in which public policy has been conspicuously absent. That raises a question: What is the role of government in ensuring that incentives for virtuous behavior are preserved?

The history of the United States suggests that a strong strand of belief has long existed around the idea that government must foster virtuous behavior or at least allow virtuous behavior—such as hard work, frugality, and discipline—to be rewarded without interference by government. The philosophy professor Michael Sandel has found that the role of government in promoting "virtuous" behavior has given way considerably in the social sphere. Laws that used to govern private conduct in the workplace, the public square, and the bedroom have been decreed by the Supreme Court to have unconstitutionally interfered with the way people seek to live their lives. Thus laws requiring school prayer and saluting the flag and prohibitions on abortion, birth control, homosexuality, and other "private" behaviors have been gradually erased or eased over the years. The tension over government's role "points to one of the great questions of political philosophy," Sandel wrote. "Does a just society seek to promote the virtue of its citizens? Or should law be neutral toward competing conceptions of virtue, so that citizens can be free to choose for themselves the best way to live?"[38] Sandel labels the efforts by conservatives to use government to support religion, sexual propriety, family coherence, and gun rights "the recrudescence of virtue," with obvious disapproval.[39] The advocates of government supporting such steps include conservative intellectuals such as the columnist George Will, the former education secretary William Bennett, and the columnist and editor William Kristol, son of the author and columnist Irving Kristol, one of the godfathers of the so-called neoconservative movement. Many of these conservatives, including most Republican candidates for the presidential nomination in 2016, have extended their battle to enacting laws that would permit American businesses to discriminate against gay married couples.

In the economic sphere, however, the desire for government to promote virtuous behavior is alive and well and widespread. It is part of a long tradition going back to the vision of the Founders. To understand the wellsprings of moral hazard, it is also thus important to trace the origins of these sentiments because they parallel the growth of the United States as a global player economically. That discussion is picked up in the next chapter.