Hazard and Commitment in the Morality of Governance.
Chapter 22 in Responsibility and its Avoidance.
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22. Hazard and Commitment in the Morality of Governance

The idea of 'moral hazard' is here expanded from its restricted economic usage to describe hazards in the moral foundations of many relationships between parties in society. The first part of the paper defines the issue and argues that many well established semi-contractual relationships such as kinship obligations or the rights and duties of citizenship also demonstrate moral hazards. An early draft led to an elegant rejoinder from a friend who said, in effect: 'Come on now; rules are not invented unless people benefit in some way, so they have an interest in enforcement that may be just as powerful as their interest in displacement of risks or in taking personal advantage when they can get away with it'. The second part of the paper therefore shows how propensity to take risks and to evade in society is held in tension with an urge to commit and to enforce. Until recent times in the UK the state has been a credible rule maker and enforcer and we citizens have been comfortable evaders of responsibility. As the state 'fails' citizens begin to look for surety in the expression and enforcement of their values elsewhere; hence the re-emergence of sects and fundamentalisms – whether religious or economic.

'A rule is an incentive to rule avoidance'. Let this statement stand for the moment as if it is ancient wisdom, something Ozymandian, inscribed in stone. It isn't; but the idea serves to concentrate the mind. [1]

From London's cyclists jumping the traffic lights to city bankers dealing in ill-conceived derivatives to American presidential candidates escalating their rhetoric on Iran, the idea that people sometimes behave unguardedly in response to risk seems to resonate with everyday experience. These are all rather different. So will one kind of behavioural explanation fit all?

Moral hazard is a concept developed by economists to explain perverse behaviour in matters of insurance - namely when a person persuades an agent to insure him or herself against a risk he/she is prone to become careless in risk avoidance. It has had much wider application, particularly recently in relation to banks. This note explores the idea that moral hazard is also useful in explaining behavioural dilemmas within a range of public institutions and mutuals as well as in many other private contractual relations.

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1 'My name is Ozymandias, King of Kings /look on my works ye mighty and despair'. Percy Bysshe Shelly. Quoted in full in Chapter 7 above.

Moral hazard definitions seek to explain responses to a risk when that risk is contractually shared by other parties. If 'A' accepts, or appears to accept, responsibility for an action, 'B' will be inclined to take the view that it is less responsible and will act with less regard to possible negative outcomes, on the grounds that ' A' will pay when things go wrong. In the much cited hypothetical case, if a motorist (B) takes out car insurance with a company (A), s/he may be more inclined to take risks than if, without risk mitigation and fully exposed to the dangers of the road, s/he drives more cautiously. The concept has been applied to the banking crisis. If bankers, as rational actors within the economy, had not been convinced that governments would bail them out when things went wrong, they would have curtailed the more risky of their activities and/or held more adequate reserves.

Might the concept stretch to other risky situations, such as other means of regulation of the roads? [2] Our London cyclist, or for that matter the motorist approaching the same junction from another direction, are a potential hazard to each other of a literal kind. Without due caution and some agreement on priority serious damage to nerves as well a skin and bones, paint and metal can result. The traffic light is the publically imposed administrator of a rule of priority. Both parties paying adequate attention to the traffic lights should prevent an accident. However, frustration with the progression of the lights from green [go], to amber [caution] to red [stop] or the other way around can lead to behaviour that tests the boundaries of these instructions. The discourse that surrounds the resulting crunch will be all about who misread the signals. The moral hazard question is whether paying attention to traffic lights is a better guarantee of risk avoidance than paying direct attention to the physical hazard; which is the other user of the road.

Consider the case of the 30mph speed limit. A speed limit is a rule imposed by government in built up areas with the aim of making the highway safer for pedestrians and other road users. The aim is clear. Recent public and parliamentary debate has led to new categories of speed limit, such as the 20mph limit that now appears in the vicinity of schools or hospitals. The intention is that this is a speed at which different road users can register each other's intentions. The aims are worthy but the behavioural outcomes are sometimes not so. Drivers are prone to monitor their speed in relation to the signs, or more often, the speed monitoring cameras. Doing so, their attention is focused upon speedometer or road sign rather than the actual hazard; an unexpected movement of a child, the stumble of an old lady, the semi-

2 There is theoretical support: Pal Andreas Pedersen 'Moral Hazard in Traffic Games' Journal of Transport Economics and Policy Vol 37 Part 1 Jan 2003 pp47-63.

comatose mobile phone user, or an erratic action by another motorist. Some local authorities, aware of the issue, have experimented with the removal of traffic regulating restrictions and behaviour modifying street furniture so that road users re-engage with other road users and pay attention to the risks of harm that they represent to each other. [3]

Stepping from the road itself to the car another well documented instance concerns compulsory seat belt legislation. An article by John Adams entitled 'The Failure of Seat Belts Legislation' illustrates the way in which the law requiring car occupants to wear seat belts, that was enacted in the belief that large numbers of lives would be saved and even more injuries prevented, made no apparent difference to the figures but did transfer some fatalities from car occupants to pedestrians. [4] Perceiving car driving now to be safer 'belted up' drivers are prepared to take greater risks – a matter of 'risk compensation'.

For economists, such as Hulsmann, [5] private property rights are the moral element that is subverted when risks are not faced by the holder of the property and incentives become skewed. But, he argues, the market does tend to correct itself, removing the hazard.Car insurance agents in practice adjust incentives by insisting on a range of deductibles and premiums designed to curb a motorist's foolhardiness. To Hulsmann it is a government intervention that causes the ultimate moral hazard, because property owners thereby have their rights curtailed and loose proper incentives. For economists of this metal, morality – if the term is needed at all - is most evident in the exercise of rational self interest. This line of reasoning will always conclude that only a free market allows for this outcome.

For a non-economist, this concentration on private rights ignores a range of other rights: entitlements and obligations that ordinary people [not necessarily economist minded] in all known societies – subscribe to in order to meet wider

3 From memory [my wife's]; The Royal Borough of Kensington and Chelsea pioneered this approach. Local authorities are not allowed to remove actual traffic lights but seek to minimise distracting street clutter. The present policy of the Royal Borough states that it "is committed to encouraging road user autonomy and responsibility by removing barriers and restrictions in the allocation of road space and has found that this can be done without compromising road safety'" [p40] http://www.rbkc.gov.uk/pdf/Transport%20and%20streetscape%20policy.pdf

4 Chapter 6 in Verweij, M. and Thompson, P. (2006). Clumsy Solutions for a Complex World Palgrave Macmillan.

5 Jorg Guido Hulsmann 'The political Economy of Moral Hazard' http://mises.org/daily/2935 [originally published in the Czech journal Politická ekonomie (February 2006): 35–47 pdf.

social needs. The social benefits of kinship, or of mutual association, or of citizenship, entail other rights and obligations and are supported by other moral codes. Such institutional arrangements can also be viewed as rational responses to social, common or public goods; conditions that are not responsive to competitive individualist choice. However, the rights or rules that evolve to govern such goods are not utopian. Once established, through processes of logical, self-interested negotiation within society, they are also in practice subject to moral hazards.

The moral hazards of kinship are the stuff of Hollywood or Bollywood dramas; the playboy son who free rides on hard earned family wealth, the 'treasure hunter' who marries for money. Perhaps more common in contemporary Western societies is the child that takes parental nurture for granted and, come adulthood, is somehow not available when the parent needs support in old age.

Likewise, in all societies rational individuals will often find advantage in associating with others to achieve a common benefit. For clubs, associations and common property regimes would-be free riders are a well-documented problem; though this is not always referred to as a moral hazard issue. [6] The problem is well-rehearsed by games theoreticians. Institutional solutions in the form of checks and balances and mutual monitoring are to be found. But in daily life free riding is the social phenomenon that members of clubs and associations seek to control through gossip and ostracism when rules of participation fail.

The moral code of citizenship is a social contract that requires compliance with the law and the instruments of the state, such as tax, in return for the protections, privileges and services that come with citizen status. Moral hazard is seen in the many ways in which citizens seek to take the benefits while avoiding, if not evading the costs; including their tax obligations. The politics of the liberal Western democracies at the present time is dominated by tax-averse middle classes who take the services and protections of the state for granted [including, notably, and at some cost, the protection of their bank deposits] and resent the state's attempts to support the poor or disabled.

It would seem that moral hazard is built into the social fabric of society. Two additional points need to be made however.

One is that, in any of these contexts, there are rather unpredictable differences in degree. Some people seem much more inclined to honour the spirit of social

6 Bengt Holmstrom 'Moral hazard in teams' http://www.jstor.org/stable3003457

contracts than others. Returning for a moment to motorist behaviour, one may note that some respond to 30mph limits by driving as close as possible to the limit while others drive as they feel inclined, wary only of speed check cameras and the blue lights of police cars. In other words, extremists [and many persons under 40] often try to get away with what they can; conformists [and most persons over 40] will conform to the norm but may still be inclined to free ride a bit. In either case the risk to others in society is that they are responding to is a speeding penalty rather than the damage they can do to themselves or other users of the highway.

The second is perhaps equally serious. Most, perhaps all, contractual arrangements that allocate responsibilities between parties will be subject to moral hazard risks. The following public policy and governance issues may illustrate the point:

- Citizens elect politicians to represent their interests. Having done their bit at the ballot box they are careless of their citizenship responsibilities for keeping the politician on 'message'. But when things go wrong are ready to blame.
- A party in power, may recognise the need for statesmanship in international affairs, while the party out of power feels free to indulge in warlike posturing. [7]
- A bureaucrat head of office may realise the need to act responsibly in fulfilling the purpose of the office while subordinates are more inclined to 'work to rule'.
- A team leader will often find that team members forget to 'pull their weight' and are inclined to shirk responsibilities, to the neglect of their common purpose.
- Workers, struggling to keep their jobs alive and 'their' company afloat are aghast when managers award themselves big bonuses or owners sell out to asset strippers.

Getting the business of government done or achieving outcomes in the private sector entails such relationships and requires solutions to such inherent dilemmas. In these and other instances there are two or more parties to a public or corporate activity each engaged through some form of contract. Hulsmann makes much of the separation of ownership and control that happens when risk is shared between private parties through a contract. Separation of roles does

7 At the time of initial drafting – May 2012, an American presidential election campaign dominating airwaves – commentators have expressed the hope that a Republican party in power would be less bellicose than Mick Romney, its candidate appears at the hustings.

indeed allow wriggle-room for one party or the other – perhaps even both, to shift the burden of responsibility one way or the other and enjoy a relatively 'free ride'. [8] But the institutions in question, if they are to function effectively, require sharing of responsibility. [9] Does this mean that we should abandon the purposes for which they evolved?

Today in America it seems that the concept of moral hazard is most often used to explain the reaction those who resent any moves by the government to provide anything that might be deemed to be welfare. [10] An article by Shaila Dewan in the New York Times Review suggests that The Tea Party movement is based on an aversion to supporting 'scroungers'. To bail out mortgage companies, to support people whose homes are being repossessed, or to introduce compulsory health insurance; such moves would only encourage improvidence and are unfair to the prudent and conscientious citizens who have been paying their way. Such is their argument. The American Right, religious though it mostly claims to be, seems to have forgotten the old saying; "There, but for the grace of God, go I". To the Biblical question "Am I my brother's keeper" their answer would seem to be a resounding 'No'. But, to be fair, if their complaint is simply about the state as agent and that they want to express their Christian values by other means, then the challenge to them is to find those other means. Is charity a sufficient way to exercise civic responsibility for the wellbeing of their neighbours in need? Do church organised 'spaghetti dinners' equate with private welfare?

Whether such a political position would remain sustainable if its proponents come to power remains to be seen. Perhaps, after all, what we see here is itself a product of moral hazard – the party out of power being free to avoid expressions of responsibility.

British politics is not without responsibility avoidance. While current British governments are busy backtracking on the social contract that was the Welfare State, perhaps party leaders out of power will eventually find grounds for

8 See Christopher Hood (2002). 'The risk game and the blame game' Government and Opposition, Vol. 37 June 15-37.

9 Management consultants spend much time attempting to overcome these moral hazard problems; convincing teams be teams, workers to feel 'ownership', leaders to be inclusive, etc.

10 Shaila Dewan, 'Moral Hazard; a Tempest Tossed Idea.' New York Times Feb 25 2012. I am indebted to my cousin Tamara and her husband Skip for supplying this and the Lemann article as cut outs from the American press as contributions to the our discussions of the issues addressed in this paper.

identifying with their neighbours in misfortune. But these are curious times. Institutions of high finance fail. They [perversely perhaps] are propped up by governments of all stripes. These governments already flounder under mountains of debt. Social inequality grows apace nearly everywhere. But so far there has been little noticeable political response. [11]

Shaila Dewan argues that Tea Party logic leads to the abandonment of any role for government in addressing market outcomes that leave many people homeless, insurance-less and without jobs. The potential morality that is in mutuality or that sees virtue in a supportive state is not countenanced but avoided in any such philosophy. But in casting aside one kind of institution – the state - it is worth remembering that the private sector, civil society institutions, even family and kin, are equally prone to responsibility shirking. [12] None of these institutions 'work' unless people make them work. To make them work the hazards in them have to be overcome, not avoided.

So is a rule indeed an incentive to rule avoidance? Will heroic efforts in governance always end up shattered on the sands? [13] Moral hazard would say yes. But, this is no anarchist's charter. While many social rules deserve to be broken, society cannot do without rules. The hazard lies not in evasion, avoidance, token compliance [or even unthinking compliance] but in focusing upon the rule rather than the spirit or purpose of the rule.

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On reading the above my friend A.C., who has long experience of working within UK local government as a planner, sent a rejoinder. He felt that there was a missing dimension to the argument. Part of the dynamic was missing. Besides the rule and a person's response to that rule is the question of enforcement. Enforcement can obviously counteract the risk of defection that is inherent in the moral hazard. In A.C.'s model therefore there are national laws and codes of practice that he refers to as 'institutional interventions'. There are community pressures of various kinds that constitute social controls and there is

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11 Nicholas Lemann, 'Evening the Odds; is there a politics of inequality', New Yorker April 23, 2012.

12 I have obviously expanded the idea of moral hazard considerably. A continuum might be described as follows; 'risk displacement' … normal neglect … responsibility avoidance … shirking … fraud'.

13 Back to Osymandias: one of Britain's favourite poems goes on to dismiss the arrogance of power ….. 'Nothing beside remain/Round the decay/of that colossal wreck, boundless and bare/the lone and level sands stretch far away'.

enforcement, which, I suppose is the propensity of state or citizen to put pressure upon potential deviants to prevent their deviating. Let me set out a bit of his argument in his own words:

As you can see, I'm thinking 'inside the box'...... The box at any one time, frames the interactions of .... 'community pressures' that range from the basic values to 'ethical norms' embodied in religious faith and secular principles to the cultural, tribal and other traditional customs I call 'social control'. These pressures I see as being reflected to a greater or lesser extent in the rules adopted by society – what I call 'institutional interventions' – in terms of laws and codes of practice imposed by governments and non-governmental organisations to influence individual and corporate behaviour.

*...... my box is also three dimensional at any one time because the weight that can be attached to institutional interventions and the effectiveness of community pressures depends entirely on the degree to which they are enforced. By 'enforcement' I mean everything from police clear-up rates and court sentencing to householders refraining from mowing their lawns on a Sunday afternoon. Without 'enforcement', ethical norms, social control, laws and codes of practice are just empty vessels (**to paraphrase Paul to the Corinthians, 13**). There is nothing to deter anti-social behaviour and so even those initially desisting on moral grounds are soon faced with the predictable choice of being victims or adopting their own form or anti-social behaviour in order to survive (e.g. vigilantism).*

By hitting upon the significance of enforcement, which he – rightly I think – assumes to be usually a state responsibility [in the modern era] A.C.'s script turns our attention to the outcomes of responsibility avoidance for societies. Moral hazard implies that when the state assumes responsibility many individuals are happy to say 'so be it', we are not responsible. 'Nothing to do with me gov' is the average citizen's response to litter on the streets, louts brawling outside pubs, or drivers speeding down narrow country lanes. But A.C. extends his analysis to note the social consequences when the state is unable or unwilling to be the hierarchical enforcer, interestingly inverting the equation.

If I am correct in my understanding, then I can proceed to address the question of where does moral hazard fit. ... It fits as a pressure based on maintaining ethical norms .... reducing the numbers and extent of laws by relying on the maintenance of social controls and implying an increase in the scope of (voluntary) codes of practice. The countervailing pressure that moral hazard comes up against is enforcement. Greater reliance on individual responsibility in the face of anti-social behaviour puts the onus on the less formal social control and voluntary codes of practice to effect enforcement. Historically, this has encouraged falling back on *previous tribal or sect loyalties or falling for extreme ideological movements of a political and/or religious nature to bridge the gap between basic principles and the reality of human activities (e.g. the 'strong church/ weak state syndrome).*

It has taken me a little while to digest this argument about the flipside of centralisation. Yet, when the state is failing, as my Chapter 17 argues, it is logical to assume that people in UK towns, neighbourhoods [constituent nations even] will seek other means of maintaining aspects of the common good that they value. And to maintain they must enforce. So should we be surprised at the revitalisation of religious sects and ethnic communities? [14] The emergence of fundamentalist movements as well as extremist political parties is another manifestation. They may be long on enforcement as well as short on compassion and quite unable to create the kind of good in society that they proclaim but they are the inevitable outcome of the falling off of the Western state from its secular, democratic, welfare ideals.

A final point about the relationship between values, instruments, avoidance and enforcement can be made. It is about moral inconsistency. As a planner in UK local government my friend A.C. knows from first hand experience that the law of the land concerning, say, the protection of 'green belt' land around cities, is an expression of nationally determined values to which many citizens subscribe but to which the same citizens are prepared to countenance exceptions – particularly if they own a field within the green belt that could be sold to advantage or if they seek a profitable site close to the city upon which to build houses. Curiously this kind of inconsistency brings behaviour out into a political/administrative/legal field within which argument is possible and values can be contested [**Chapter 12**]. For something to be in a field of political disputation may be messy but it is healthier than the kind of responsibility evasion which we UK citizens normally display.

14 The converse also holds. Where the state is weak or has never been able to enforce what it deems to be the public good – I suggest countries such as Afghanistan - it is surely to be expected that non-state agents such as tribes or extended families will be looked towards by the citizens as providing the basis of social order, higher order emerging, if at all, through negotiation between such entities.