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# The political use of the term “moral hazard”: evidence from policymakers of the Eurozone

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DEPARTMENT OF EUROPEAN POLITICAL  
AND GOVERNANCE STUDIES

Bruges Political Research Papers

78 / 2019





College of Europe  
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European Political and Governance Studies /

Etudes politiques et de gouvernance européennes

Bruges Political Research Papers / Cahiers de recherche politique de Bruges

No 78 / November 2019

The political use of the term “moral hazard”: evidence from policymakers of the Eurozone

by

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This paper is a revised version of the Master's thesis supervised by Dermot Hodson. I would like to thank him for his guidance throughout the research process, as well as Michele Chang for the teaching in European Political Economy and her useful comments on the publication of this work.

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## **Abstract**

Since the global financial crisis of 2007-8, the need for increased risk sharing between the members of the euro area has been acknowledged. However, the evolution towards an “insurance union” has been hampered by the political division between risk sharing and risk reduction. This paper intends to contribute to the explanation of this political deadlock by exploring the main explicit argument underpinning this division, that is to say moral hazard. Unlike most of the academic research on moral hazard, which takes the concept for granted, this paper explores moral hazard from an ideational point of view. The purpose of this research is to question the neutrality of the argument of moral hazard. Using discourse analysis techniques, the empirical study provides information on how and why policymakers of the Eurozone use the term “moral hazard”. This study argues that contrary to appearances, moral hazard is not a de-politicised concept. The author found evidence that the conception of moral hazard is shaped by strategic interests and/or prevailing set of ideas that explain divergent preferences towards risk sharing.





## 1. Introduction

When the global financial crisis (GFC) of 2007-8 spread to Europe, the members of the Eurozone seemed relatively powerless. The international financial crisis fiercely exposed the flaws in the foundations of the Economic and Monetary Union (EMU). In particular, the events have highlighted the scarce ability of the Eurozone to absorb asymmetric shocks. In response, the need for increased risk sharing between the members of the currency union has been acknowledged.<sup>1</sup>

However, the political debate on the future of the Eurozone resulted in a theoretically doubtful division between risk sharing and risk reduction.<sup>2</sup> This political dissociation has led to a paralysis, preventing substantial progress in the reform of the EMU. This paper intends to contribute to the explanation of this political deadlock by exploring the main explicit argument underpinning the division between risk sharing and risk reduction, that is to say moral hazard. Moral hazard, defined in the economic literature as “the impact of insurance on the incentives to reduce risk”,<sup>3</sup> has become the main objection against risk sharing – notably in Germany,<sup>4</sup> hence a key feature of the political debate on the future of the euro area.

Unlike most of the academic research on moral hazard, which takes the concept for granted and tests its empirical relevance, this paper explores moral hazard from an ideational point of view. This original perspective is driven by the observation of differences in perception of the risk of moral hazard, which suggests that “there is less hard empirical science in this domain than one might

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<sup>1</sup> See for example, European Commission, *Reflection paper on the deepening of the economic and monetary union*, Brussels, European Commission, 2017.

<sup>2</sup> “The expectation that a shock absorber will do its job when an economy is threatened by a significant shock contributes to the prevention of severe shocks. With a view to resilience, risk reduction and risk sharing reinforce each other”, Frank Vandenbroucke, “Risk reduction, risk sharing and moral hazard: a vaccination metaphor”, *Intereconomics*, vol.52, no.3, 2017, p. 157.

<sup>3</sup> Ralph A. Winter, “Optimal insurance under moral hazard”, in Georges Dionne (eds.), *Handbook of insurance*, Boston, Springer, 2000, p. 155, cited in David Rowell, and Luke B. Connelly, “A history of the term “moral hazard””, *The Journal of Risk and Insurance Association*, vol. 79, no. 4, 2012, p. 1051.

<sup>4</sup> “The main objection in Germany remained that of ‘moral hazard’”, Matthias Matthijs and Kathleen McNamara, “The euro crisis’ theory effect: northern saints, southern sinners, and the demise of the Eurobond”, *Journal of European Integration*, vol. 37, no. 2, 2015, p.238.

wish”.<sup>5</sup> In other words, the purpose of this research is to question the neutrality of the argument of moral hazard. This paper focuses on the following research question: to what extent the conception of moral hazard can explain the divergent preferences towards risk sharing in the Eurozone?

Using discourse analysis techniques, the empirical study provides information on how and why policymakers of the Eurozone use the term “moral hazard”. This paper argues that contrary to appearances, moral hazard is a politicised concept shaped by strategic interests and/or prevailing set of ideas that explain divergent preferences towards risk sharing.

The paper is structured as follows. Section 2 reviews the literature on the history of moral hazard. Section 3 presents the theoretical and methodological framework of the study. The identification of conception(s) of moral hazard in the policy discourse is carried out in section 4. Section 5 is dedicated to the explanation of the identified conception(s) of moral hazard. Finally, the concluding section summarizes the main findings and their limits and suggests possibilities for further research on the topic.

## **2. Moral hazard: an ambiguous concept**

This section highlights the origin of the term “moral hazard” and the evolution of its use. Contrary to appearances, “moral hazard has never been a straight-forward, purely logical or scientific concept”.<sup>6</sup> The first thing to note in this regard is the linguistic nature of the term: moral hazard is an idiom. The non-explicit meaning of moral hazard makes its use easily prone to political manipulation. This risk is even greater given the strong normative and negative connotations associated with the modern definitions of the two composing words. However, the normative meaning of “moral” and perilous meaning of “hazard” are not the exclusive ones.

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<sup>5</sup>Frank Vandenbroucke, and al., “Institutional moral hazard in the multi-tiered regulation of unemployment and social assistance benefits and activation: a summary of eight country case studies”, *CEPS Special Report*, no.137, 2016, p.32.

<sup>6</sup> Tom Baker, “On the genealogy of moral hazard”, *Texas Law Review*, vol. 75, no. 2, 1996, p. 239.

For instance, in the 18<sup>th</sup> century, “hazard” meant “chance, accident, fortuitous happening”.<sup>7</sup> Similarly, in the 17<sup>th</sup> and 18<sup>th</sup> centuries, it was possible to find a non-normative use of “moral” within the probability literature. Classical mathematicians established a distinction between two types of expectation: mathematical and moral.<sup>8</sup> Moral expectation was synonymous to utility. Between danger and chance, charged with moralistic overtones or not, the terminology of moral hazard is ambiguous. It is now interesting to see how the term was actually used in the literature in light of this genealogy.

### **Moral hazard and the insurance business literature**

The first recorded use of the idiom dates back to 1865, in the fire insurance literature.<sup>9</sup> Soon, 19<sup>th</sup> century fire insurers developed a dual conception of moral hazard, where it could be due both to character and to temptation.<sup>10</sup> By character, fire insurers refer to individual predisposition (i.e. personal characteristics) of the applicant likely to increase moral hazard, regardless of the insurance contract. In addition to the “character component” of moral hazard, insurers also acknowledged the risk associated with the insurance contract itself: “heavy insurance also increases the moral hazard, by developing a motive for crime, where otherwise no temptation existed, and wrong was in no way contemplated”.<sup>11</sup> Here, the risk of moral hazard is independent from individual predisposition and inherent in certain types of insurance contract. The role of the insurer is therefore to minimise the temptation created by the insurance. By using the word “temptation” to describe potential behavioural changes due to insurance, fire insurers understood the “incentive” aspect of moral hazard in moralistic

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<sup>7</sup> Samuel Johnson, *A Dictionary of the English Language*, London, Consortium, 1755, cited in Baker, *Ibid.*, p. 246.

<sup>8</sup> Rowell and Connelly, *op.cit.*, p. 1057.

<sup>9</sup> Where moral hazard was defined as “the danger proceeding from motives to destroy property by fire, or permit its destruction”, Arthur C. Ducat, *The practice of fire underwriting*, New York, Insurance Monitor Office, 1865, 4<sup>th</sup> edn., p. 164, cited in Baker, *op.cit.*, pp. 248-249.

<sup>10</sup> Rowell and Connelly, *op.cit.*, p. 1061.

<sup>11</sup> Aetna Insurance Company, *Aetna guide to fire insurance for the representatives of the Aetna insurance Co*, Hartford, Aetna, 1867, cited in Baker, *op.cit.*, p.251.

terms”.<sup>12</sup> In summary, according to the insurance business literature, moral hazard could manifest from both bad character (i.e. immoral people who will deliberately fraud) and wrong incentives (i.e. insurance contract design which could tempt good people to act carelessly).<sup>13</sup> In order to cope with the moral hazard problem, business insurers developed communicative strategies, such as using the idiom normatively in public discourses.<sup>14</sup> The emphasis on morality was used to moderate temptations.

### **Moral hazard and the economic literature**

As seen in the previous paragraph, moral hazard did not originate in the economic literature, but in the business insurance one. However, since the work of Kenneth Arrow,<sup>15</sup> the idiom became extensively used in economics and, at the same time, entered the policy debate.<sup>16</sup> Yet, the concept of moral hazard is different from the one seen before. In economics, moral hazard has a single and value-neutral definition: “the effect of insurance on incentives”.<sup>17</sup> While the business insurance morally-charged notion of temptation has been replaced by incentives, character has disappeared from the equation.<sup>18</sup> Instead, economists have coined a new term referring to the problem of individual predisposition and insurance: adverse selection.<sup>19</sup> In general, economists consider that “moral hazard problems arise when there is imperfect information concerning the actions of those who purchase insurance, because those actions cannot be perfectly monitored”.<sup>20</sup> Thus, the problem of moral hazard,

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<sup>12</sup> Baker, *loc.cit.*

<sup>13</sup> Rowell and Connelly, *op.cit.*, p. 1061.

<sup>14</sup> *Ibid.* p. 1064.

<sup>15</sup> Kenneth J. Arrow, “Uncertainty and the welfare economics of medical care”, *American Economic Review*, 1963, vol. 53, no. 5, pp. 941-973, cited in Baker, *op.cit.*, p. 267.

<sup>16</sup> Baker, *op.cit.*, p. 267.

<sup>17</sup> Arrow, *op.cit.*, p. 961.

<sup>18</sup> Although the morality of moral hazard has been initially discussed (e.g. the so-called “Arrow versus Pauly” debate), the “observation that moral hazard has little to do with morality has become the conventional wisdom”, Baker, *op.cit.*, p. 269. The neoclassical assumption of rational expectations may have an important role in this evolution.

<sup>19</sup> Namely, the fact that “high-risk individuals are more likely to buy insurance and/or to buy more insurance”, Rowell and Connelly, *op.cit.*, p. 1071. The problem of “adverse selection” is therefore linked to personal attributes.

<sup>20</sup> Joseph E. Stiglitz, “Risk, incentives and insurance: the pure theory of moral hazard”, *The Geneva Papers on Risk and Insurance*, 1983, vol.8, no. 26, p.5.

in economic terms, is not based on moral weakness but on asymmetry of information. The risk of moral hazard can therefore be mitigated by setting the right incentives and by reducing the asymmetry of information.<sup>21</sup> A number of economists working on EMU reforms have engaged in the theoretical effort of minimising the risk of moral hazard.<sup>22</sup> However, the recommendations of experts to reduce the risk of moral hazard have not reached the necessary political credibility to materialize themselves. One of the purposes of this paper is to provide an explanation for this situation.

In conclusion, this section revealed the ambiguity of the term. The literature review on the idiom has shown different conceptions of moral hazard (see Table 1), which echoes the change of meanings of “moral” and “hazard” over time. Before entering the economic literature, moral hazard was a business insurance concept, where personal characteristics and morality had an important role to play in the occurrence of the phenomenon. In contrast, the economics of moral hazard are exclusively focused on incentives, free of value judgments and character. Based on all this information, the next section will introduce the theoretical and methodological framework used to explore and explain the conception(s) of moral hazard.

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<sup>21</sup> However, the message sent in the policy debate by the economics of moral hazard is not always in line with this acknowledged theoretical possibility to reduce the risk: “by providing a “scientific” basis, the economics of moral hazard legitimize the abandonment of socio policies as the result of search for truth, not an exercise of power”, in Baker, *op.cit.*, p. 240.

<sup>22</sup> See for example the joint proposals of German and French economists in Agnès Bénassy-Quéré and al., “Reconciling risk sharing with market discipline: a constructive approach to euro area reform”, *Centre for Economic Policy Research*, no. 91, 2018 or Sebastian Dullien and al., “Fit for purpose: a German-Spanish proposal for a robust European unemployment insurance”, *Friedrich Ebert Stiftung*, 2018.

**Table 1.** Review of conceptions of moral hazard in the literature, by dimension

	<b>Insurance business</b>	<b>Economics</b>
<b>Definition</b>	In the framework of an insurance contract, the insured person may gain through loss due to character and temptation	The impact of insurance on the incentives to reduce risk
<b>Context</b>	Highly moralistic	Value-neutral (based on rationality)
<b>Management of the risk</b>	Exclude bad applicants; contract design; “naming and shaming” communicative strategy	Provide right incentives; reduce asymmetry of information

Source: author.

### **3. Theoretical and methodological framework**

This section presents relevant theories and concepts allowing the analysis of moral hazard from an ideational point of view, and the methodological approach used to carry out this research. This study assumes that depending on the conception of moral hazard, risk sharing preferences may differ. This is a constructivist argument: ideas matter in policymaking and therefore deserve a particular attention when formulating explanatory hypotheses. Indeed, while rationalists approximate humans to calculating machines, constructivists consider that the social environment plays an important role in explaining humans' actions.<sup>23</sup> In addition, by assuming that conceptions of moral hazard have a potential impact on players' views towards the desirability of an “insurance union”, we are problematizing agents' preferences. Therefore, constructivist perspectives allow us to study moral hazard from an ideational point of view by endogenizing the concept. This process will permit the identification of potential

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<sup>23</sup> James Fearon, and Alexander Wendt, “Rationalism v. Constructivism: a skeptical view”, in Walter Carlsnaes, Thomas Risse and Beth Simmons (eds.), *Handbook of international relations*, London, SAGE Publications, 1992, p.60.

different conceptions of moral hazard amongst Eurozone policymakers. The next paragraph will present two contrasting theories of ideas that could explain the potential differences in the conceptions of moral hazard.

### **Theories of ideas: discursive institutionalism versus policy paradigms**

Discursive institutionalism (DI), a theory developed by Vivien Schmidt, offers valuable insights in this regard. DI explains change and continuity in policymaking by analysing “the substantive content of ideas and the interactive processes of discourse”.<sup>24</sup> Political discourses are not treated as neutral documents, but rather as following a “logic of communication”.<sup>25</sup> Beyond tracing inconsistencies in the use of ideas, this logic highlights the instrumentalization of ideas by political speakers. The argument being that policymakers may, strategically, use and frame “interest-based ideas”.<sup>26</sup> With this in mind, DI offers an explanation to the potential “puzzle of moral hazard”:<sup>27</sup> the different conceptions of moral hazard are due to strategic purposes (hypothesis 1).

Policy paradigms present an alternative explanation to our puzzle. In contrast to DI, which focuses on the instrumentalization of ideas by policymakers, the work of Peter Hall on policy paradigms<sup>28</sup> tends to analyse “the way in which ideas condition policymaking”.<sup>29</sup> Here, the answer to our puzzle would be the following: the different conceptions of moral hazard reflect a prevailing set of ideas in a given institutional or sociological framework (hypothesis 2).

In summary, both DI and policy paradigms provide a plausible answer to why could there be different conceptions of moral hazard. On the one hand, the different conceptions could be

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<sup>24</sup> Vivien A. Schmidt, “Speaking to the markets or to the people? A discursive institutionalist analysis of the EU’s sovereign debt crisis”, *The British Journal of Politics and International Relations*, vol.16, no.1, 2014, p. 190.

<sup>25</sup> Vivien A. Schmidt, “Discursive institutionalism: the explanatory power of ideas and discourse”, *Annual Review of Political Science*, vol.11, 2008, p. 304.

<sup>26</sup> Schmidt, “Speaking to the markets or to the people?”, *op.cit.*, p. 199.

<sup>27</sup> Namely, why are there different conceptions of moral hazard?

<sup>28</sup> Peter A. Hall, “Policy paradigms, social learning, and the State: the case of economic policymaking in Britain”, *Comparative Politics*, vol. 25, no. 3, 1993, pp. 275-296.

<sup>29</sup> *Ibid.*, p. 290.

the result of strategic games. On the other hand, the differences could mirror stable prevailing set of ideas, making the political use of moral hazard rather sincere.

### **Research methodology**

The research design is based on a two-level analysis: First, the identification of conception(s) of moral hazard of euro area policymakers; and second, the explanation of these potential differences. Based on the information provided by the precedent paragraphs, we can claim that the conception of moral hazard (dependent variable) is a function of interests and ideas (independent variables).

The methodology to identify and explain the conception(s) of moral hazard of Eurozone policymakers is based on a discourse analysis (with the software AntConc). We used as empirical data speeches where the term “moral hazard” appears. More specifically, we carried out a comparative study of cases of Germany (Axel Weber, Jens Weidmann and Wolfgang Schäuble), the ECB (Jean-Claude Trichet and Mario Draghi) and France (Christian Noyer, François Villeroy de Galhau and Pierre Moscovici). In total, the corpus counts seventy speeches.<sup>30</sup> These case studies are not random choices. On the one hand, Germany and France are key Member States in European political negotiations, leaders of often opposed coalitions. Therefore, the information on their conception of moral hazard is crucial for the purpose of this paper. On the other hand, the ECB has played a key role in the management of the euro crisis and has been very active in the EMU reform debate. In addition, “the increasing politicization of the ECB’s decisions and policies”<sup>31</sup> since the euro crisis contributes to the value of this case study. The identification of moral hazard conception(s) of euro area policymakers follows a multidimensional pattern (see Table 1), with the aim to determine how the conception(s) range vis-à-vis the insurance business literature and economic ones.

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<sup>30</sup> For an overview of the entire corpus, refer to the original master’s thesis.

<sup>31</sup> Anna-Lena Högenauer, and David Howarth, “Unconventional monetary policies and the European Central Bank’s problematic democratic legitimacy”, *Journal of Public Law*, vol. 17, no. 2, p. 2.



Therefore, the analysis focuses on key differentiation parameters identified (see Table 2). Collocations and concordances are of particular interest throughout this analysis. Finally, after this phase of identification, we proceed to the explanation. Our first hypothesis, namely that the different conceptions of moral hazard in the policy discourse are due to strategic purposes, is tested as follows: we have searched for particular frames of moral hazard, potential political strategies, changes and inconsistencies in line with specific interests. The explanatory power of the second hypothesis (i.e. the different conceptions of moral hazard reflect a prevailing set of ideas) is assessed according to references or allusions to policy paradigms, such as neoclassical principles and ordoliberalism.

This section has clarified the theoretical and methodological framework. Based on constructivist perspectives, this study endogenizes the conception of moral hazard. The explanatory variables are drawn from two different theories on the role of ideas in policymaking: interests (DI) and prevailing sets of ideas (theory of policy paradigms). To test our hypotheses, we carried out a discourse analysis of the selected cases. The next sections are dedicated to the analysis of the collected data.

**Table 2.** Review of key differentiation parameters between conceptions of moral hazard in the literature, by dimension

<b>Definition</b>	Terminology (e.g. temptation v. incentives) Role of character v. role of insurance
<b>Context</b>	Moralistic
<b>Management of the risk</b>	Perception on the ability to minimize the risk of moral hazard

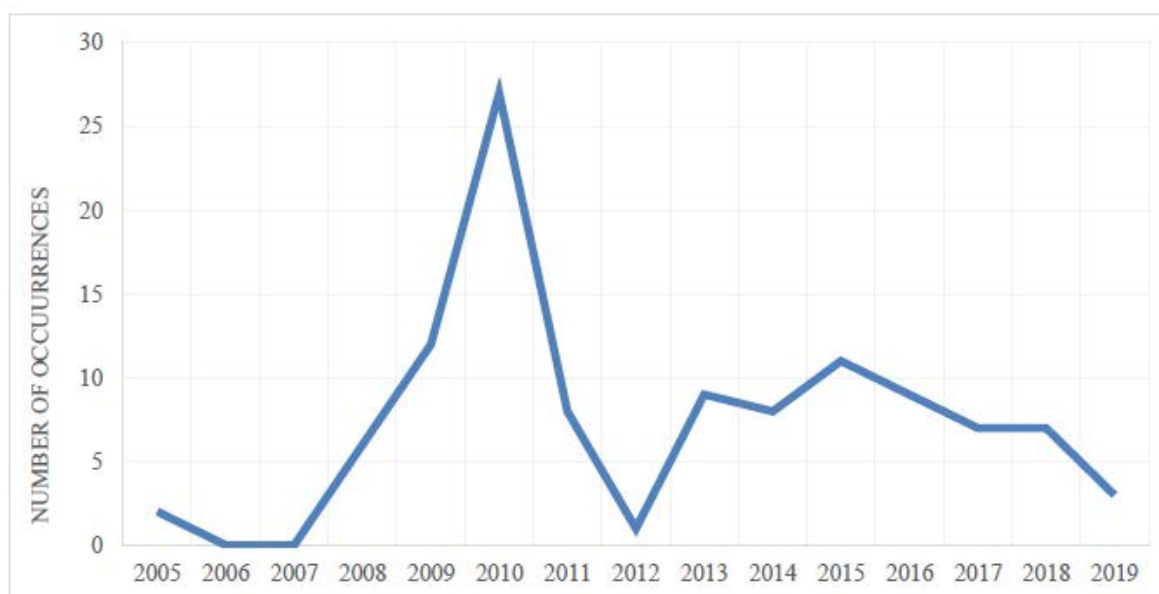
Source: author.

**4. Moral hazard and euro area policymakers**

This section identifies the conception(s) of moral hazard conveyed by policymakers of the Eurozone, thus testing the preliminary hypothesis of the research: the co-existence of different conceptions of moral hazard contributes to the political division over risk sharing mechanisms.

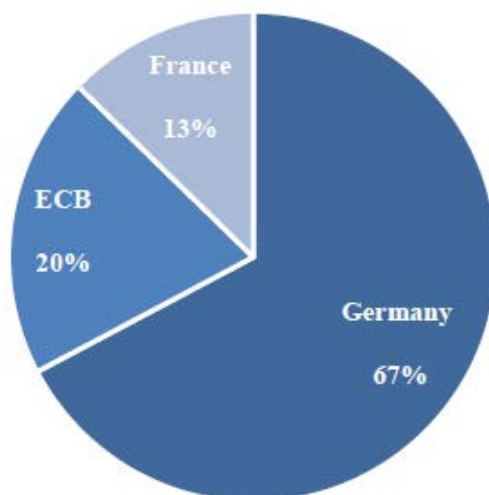
The conception(s) of moral hazard are assessed according to the dimensions identified (see Table 2). For each dimension, we compare the empirical evidence from Germany, the ECB and France. But before, let us briefly present the preliminary findings of the aggregate data: since the GFC, the use of the term has increased significantly (see Graph 1), mainly due to German policymakers (see Graph 2).

**Graph 1.** Number of occurrences of the term “moral hazard”, over time



Source: author.

**Graph 2.** Occurrences of the term “moral hazard”, by case study (% of the total)



Source: author.

## Definition(s) of moral hazard

To determine the conception(s) of moral hazard of Eurozone policymakers, we first browse through the definitions they provide. In doing so, we established an interesting fact: moral hazard appears as a “taken for granted idea”.<sup>32</sup> This statement is reinforced by some expressions used to describe moral hazard, such as: “the classical phenomenon of moral hazard”,<sup>33</sup> or “the well-known problem of moral hazard”.<sup>34</sup> By referring to moral hazard as a classical and well-known concept, policymakers assume the existence of a unique and non-ambiguous shared conception. The purpose of this paragraph is to challenge this assumption.

The case study of Germany offers a wide range of definitions of moral hazard. We find definitions in line with the economic literature, ambiguous definitions (somewhere in between insurance and economics), and even new definitions. As definitions consistent with the economics of moral hazard, we can quote the following examples: “incentive to engage in risk-prone behaviour”<sup>35</sup>, “an incentive to take particular risks”<sup>36</sup> (author’s translation) and “the increase in risk through misguided incentives” (author’s translation).<sup>37</sup> In these cases, the insurance changes the agent’s incentives towards riskier actions. Regarding ambiguous definitions, we have, for instance: “the seduction by false incentive systems when risk and

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<sup>32</sup> In more than half of the speeches, moral hazard is not defined.

<sup>33</sup> Axel Weber, Dinner Speech at the Joint Bundesbank-CEPR-CFS conference, “Risk Transfer: Challenges for Financial Institutions and Markets”, *Deutsche Bundesbank*, 11 December 2008, retrieved 18 April 2019, <https://www.bundesbank.de/resource/blob/702734/53e83cd15a434c858a525a4b88a6bcd2/mL/2008-12-11-weber-dinner-speech-at-joint-bundesbank-cepr-cfs-conference-download.pdf>.

<sup>34</sup> Jens Weidmann, Speech delivered at the German Embassy in Rome, “Solidity and solidarity in the euro area”, *Deutsche Bundesbank*, 27 April 2016, retrieved 18 April 2019, <https://www.bundesbank.de/en/press/speeches/solidity-and-solidarity-in-the-euro-area-667150>.

<sup>35</sup> Axel Weber, Dinner Speech at the International Conference on Financial Market Regulation in Berlin, “The G20 Agenda on Financial Regulation”, *Deutsche Bundesbank*, 19 May 2010, retrieved 18 April 2019, <https://www.bundesbank.de/resource/blob/702762/a5b31ad4e0eb9b98d1f2ee10d3abc56d/mL/2010-05-19-weber-g20-agenda-on-financial-regulation-download.pdf>.

<sup>36</sup> Axel Weber, Rede an der Ruhr Universität Bochum in Bochum, “Zur Rolle der Wirtschaftspolitik nach der Krise”, *Deutsche Bundesbank*, 11 April 2011, retrieved 18 April 2019, <https://www.bundesbank.de/resource/blob/689068/7cbc8c1d41f825a9058f8a44f1e4f989/mL/2011-04-11-weber-rolle-der-wirtschaftspolitik-nach-der-krise-download.pdf>.

<sup>37</sup> Wolfgang Schäuble, Rede beim Wirtschaftstag des Wirtschaftsrats der CDU in Berlin, “Europa 2016: mehr oder weniger integration?”, *Dr. Wolfgang Schäuble MdB*, 21 June 2016, retrieved 23 April 2019, <http://www.wolfgang-schaeuble.de/klug-handeln-mit-dem-mammon/>.

liability fall apart” (author’s translation)<sup>38</sup> and “who knows that others will catch him if necessary, will all too easily give in to temptation to take risks that are too great” (author’s translation).<sup>39</sup> Both definitions are mixing elements from the insurance and the economic definitions (i.e. seduction/temptation and incentives). By using the words “seduction” and “temptation”, Schäuble brings the problem of moral hazard closer to the field of morality and away from that of rationality. Finally, Schäuble coined a new definition of moral hazard, namely “political moral hazard”.<sup>40</sup>

[...] this problem of political moral 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.<sup>41</sup>

Solidarity and responsibility are at the heart of the definition of “political moral hazard”: because of European solidarity (i.e. the insurance), agents (i.e. governments) will become less responsible. Here again, the terms “solidarity” and “responsibility” relate to moral principles rather than rationality. Thus, “political moral hazard” appears closer to the definition found in the insurance business literature. All in all, the diversity of definitions of moral hazard in the German corpus already suggests that the concept is far from being unique and unambiguous. While Schäuble himself refers to moral hazard as “an economic problem”,<sup>42</sup> “[...] for which economists coined the term”,<sup>43</sup> the idiom is not always used in line with the economic

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<sup>38</sup> Wolfgang Schäuble, Bibelarbeit zum Evangelischen Kirchentag 2015 in Stuttgart, “Klug handeln – mit dem mammon?”, *Dr. Wolfgang Schäuble MdB*, 4 June 2015, retrieved 18 April 2019, <http://www.wolfgangschaeuble.de/klug-handeln-mit-dem-mammon/>.

<sup>39</sup> Wolfgang Schäuble, Bundesminister Dr. Wolfgang Schäuble im Interview mit der Frankfurter Allgemeinen Zeitung, “Die rettungsschirme laufen aus – das haben wir klar vereinbart“, *Dr. Wolfgang Schäuble MdB*, 24 July 2010, retrieved 18 April 2019, <http://www.wolfgang-schaeuble.de/die-rettungsschirme-laufen-aus-dashaben-wir-klar-vereinbart/>.

<sup>40</sup> Wolfgang Schäuble, Speech to open the Brookings Institution discussion in Washington, “Eurozone at a crossroads (again)”, *Federal Ministry of Finance*, 16 April 2015, retrieved 18 April 2019, <https://www.bundesfinanzministerium.de/Content/EN/Reden/2015/2015-04-17-brookings-washington.html>.

<sup>41</sup> *Ibid.*

<sup>42</sup> Wolfgang Schäuble, Rede von Bundesminister an der London School of Economics, *Dr. Wolfgang Schäuble MdB*, 18 February 2009, retrieved 19 April 2019, <http://www.wolfgang-schaeuble.de/rede-vonbundesminister-dr-wolfgang-schaeuble-an-der-london-school-of-economics-am-18-februar-2009-in-london/>.

<sup>43</sup> As seen in the first section, this is actually a false statement. Schäuble, Bundesminister Dr. Wolfgang Schäuble im Interview mit der Frankfurter Allgemeinen Zeitung, *loc.cit.*

definition.

The case study of the ECB is very different from that of Germany. The definitions of moral hazard by Presidents of the ECB are consistent with the economic definition. Although rarely defined, moral hazard is described as “a situation in which asymmetric information can lead borrowers to take action that erodes the value of the loan”<sup>44</sup> and “weaken incentives for pre-emptive fiscal and macroeconomic adjustment by countries concerned”.<sup>45</sup> The first definition refers to the relationship between a bank and its clients, where moral hazard would be due to asymmetric information, a factor underlined by the economics of moral hazard. The consistency of use of the term with the economic literature is reinforced by the fact that Trichet distinguishes moral hazard from adverse selection. The second definition is related to the European framework, where a permanent crisis management mechanism – the insurance – could, depending on the design, “weaken incentives for sound fiscal and macroeconomic policies”.<sup>46</sup> In both definitions, moral hazard is a matter of information and insurance design.

The (rare) definitions of moral hazard identified in the case study of France are also in line with the economic definition. For instance, according to Moscovici, “any insurance scheme produced some moral hazard. Insurance can induce more risky behaviour”.<sup>47</sup> This definition of moral hazard clearly links the problem of moral hazard to the essence of insurance. The role of individual characteristics, such as moral weakness, is absent of the definition. In summary, following the analysis of the definitions of moral hazard in the corpus, we can assert that policymakers have different views on what the idiom means. We find

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<sup>44</sup> Jean-Claude Trichet, University lecture at the Universidade Nova de Lisboa, “What role for finance”, *European Central Bank*, 6 May 2010, retrieved 19 April 2019, <https://www.ecb.europa.eu/press/key/date/2010/html/sp100506.en.html>.

<sup>45</sup> Jean-Claude Trichet, Hearing at the Committee on Economic and Monetary Affairs of the European Parliament, “Introductory statement”, *European Central Bank*, 21 March 2011, retrieved 19 April 2019, [https://www.ecb.europa.eu/press/key/date/2011/html/sp110321\\_1.en.html](https://www.ecb.europa.eu/press/key/date/2011/html/sp110321_1.en.html).

<sup>46</sup> *Ibid.*

<sup>47</sup> Pierre Moscovici, Discours à la conférence “Les 20 ans du noyau dur européen” in Berlin, *Le blog de Pierre Moscovici*, 1 September 2014, retrieved 19 April 2019, <http://www.pierremoscovici.fr/2014/09/02/mondiscours-a-la-conference-les-20-ans-du-noyau-dur-europeen-a-berlin/>.

various definitions within and between case studies. While policymakers from the ECB and France use a pure economic definition of moral hazard, Germans sometimes use mix definitions.

### **Contextual use(s) of moral hazard**

The methodology to assess the contextual use of moral hazard is based on the analysis of collocations and concordances with the term. The broader context of the speeches is also of interest. Beyond the narrow definitions, we tried to find whether personal characteristics and morality play a role in the notion of moral hazard of euro area policymakers. The contextual analysis of the term “moral hazard” in the case study of Germany confirms the ambiguity found in the previous paragraph. Moral hazard is used in a context where the role of insurance and rationality and the role of character and morality are confused. Indeed, when looking at collocations with moral hazard – words that are usually used next to the idiom – we discover a list of words<sup>48</sup> whose meaning can be divided into different registers (morality and rationality) and associated with the role of character or insurance. For example, among moralistic collocations, we have the following words<sup>49</sup>: unfaithfulness (10.64); norms (10.64); luxury (10.63); ethically (10.64); temptation (9.64); ill (9.31); fairness (9.31); evil (9.05); morally (8.64); Jesus (8.64); moderation (8.52) etc. The list of collocations referring to individual characteristics is also significant. We can cite the following examples: honesty (10.64); greedy (10.64); Christians (10.64); chivalry (10.64); arrogance (8.64); willingness (7.94); indebted (7.83); Greeks (7.47) etc. To be more specific, we can also look at concordances in the context of the term “moral hazard”. Let us take for example the word “those”, used to characterize a certain group of people:

It also becomes an economic problem under the heading of moral hazard. Those who take risky but also profit-promising actions will be even more willing to take risks if the risk is assumed by a third party. It must not be allowed to happen that we do not

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<sup>48</sup> See Annex 1 (in master’s thesis) for the complete list of collocations.

<sup>49</sup> Collocations are ranged by decreasing probability, indicated in parentheses.

only continue to operate in the spirit of a "further way", but that even those who have managed solidly and modestly have to use their tax money to finance the bail-out of those who drive at risk.<sup>50</sup>

This paragraph is structured around the division of “those who have managed solidly and modestly” and “those who drive at risk”. Obviously, the problem here lies in individual characteristics and not in the insurance *per se*. The problem of moral hazard is due to irresponsible people. Besides collocations and concordances which indicate that the term is used in a moralistic framework, we can also find references to the economics of moral hazard. For example, these words are usually near to the term “moral hazard” in the speeches: maximisation (9.64); schemes (9.42); incentives (8.56); agents (8.05); economists (7.31); insurance (7.17); efficiency (7.18); decision (7.10) etc. These collocations recall the role of the insurance and rationality in the moral hazard problem. In addition, it should be noted that the term “decision” implies control and awareness over the phenomenon and its consequences. When looking at concordances of “decision” in the context of moral hazard, we find, for example, the following paragraph:

In Anglo-Saxon terms, this means avoiding the "moral hazard" problem. [...] Those who have decision-making responsibility must also be responsible for the consequences of their decisions and must not be able to pass them on to others.<sup>51</sup> (author's translation).

According to this formulation of the problem, moral hazard seems to be the result of a deliberate and informed action (based on a rational calculation), and not careless (as mentioned in the insurance literature). All in all, we can conclude that the contextual use of the term “moral hazard” in the German corpus is ambiguous. This claim is confirmed by the analysis of the broader context of the corpus, where words like “values” (30), “Jesus” (4), “God” (4),

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<sup>50</sup> Schäuble, Rede von Bundesminister an der London School of Economics, *loc.cit.*

<sup>51</sup> Wolfgang Schäuble, Rede bei der Stiftung Ordnungspolitik in Freiburg im Breisgau, “Noch nicht über den berg – zur krise in der Eurozone”, *Dr. Wolfgang Schäuble MdB*, 12 July 2014, retrieved 20 April 2019, <http://www.wolfgang-schaeuble.de/noch-nicht-ueber-den-berg-zur-krise-in-der-eurozone/>.

“religion” (3), “sin” (3) and “protestant” (2) are used.

The contextual analysis of the term “moral hazard” in the case study of the ECB also confirms the findings of the previous paragraph: moral hazard is used in accordance with the economic literature. The list of collocations with “moral hazard”<sup>52</sup> does not include any notable references to morality or character. Instead, words like “designed” (7.55), “regulatory” (7.30), “arbitrage” (7.08), or “incentives” (6.25) are usually close to “moral hazard” in the corpus of the ECB. The analysis of the broader context of the corpus does not provide additional information.

On the contrary, the contextual analysis of the term “moral hazard” in the case study of France challenges the findings of the previous paragraph. While the definitions of the idiom were similar to that of economics, the context indicates that morality has a key role to play in the phenomenon. On the one hand, French policymakers usually associate words<sup>53</sup> like “scheme” (10.43), “insurance” (8.84) or “incentives” (8.10) with the term “moral hazard” (in line with the economic conception). On the other hand, the statistical analysis of the corpus also provides evidence of significant references to the insurance conception, with words such as “legitimate” (10.43), “perverse” (9.43) or “amoral” (9.43) likely to be used near the term “moral hazard”. In order to get a more precise view of the conception of moral hazard conveyed by the French policymakers, we looked at concordances of “amoral” in the context of moral hazard. By doing so, we find the two following paragraphs:

It is essential to defuse this mechanism, not only, and obviously, amoral - hence the expression "moral hazard" - but which even leads to maximizing risk taking, precisely because speculators know that in the end they will not be the payers. I will therefore summarize the "resolution" section of the draft law a little summarily by using the formula "who is at fault, pays", adding that the person who is at fault must no longer be able to decide: he must be punished.<sup>54</sup> (author's translation)

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<sup>52</sup> See Annex 2 (in master's thesis) for the complete list of collocations.

<sup>53</sup> See Annex 3 (in master's thesis) for the complete list of collocations.

<sup>54</sup> Pierre Moscovici, Déclaration à l'Assemblée nationale, “Les axes du projet de loi de séparation et de régulation des activités bancaires”, *Vie Publique*, 12 February 2013, retrieved 18 April 2019, <http://discours.vie-publique.fr/notices/133000375.html>.



In 2008, governments were forced to help banks. They had taken excessive risks, anticipating that in the event of bankruptcy, the State would come to the rescue. It is essential to defuse an amoral mechanism that leads to maximizing risk-taking, "Who fault pays", this is the principle.<sup>55</sup> (author's translation)

These two paragraphs illustrate Moscovici's conception of moral hazard. The former Finance Minister of France clearly states that moral hazard is immoral, giving meaning to the idiom. The moral hazard problem is framed as a "morality tale", where the sinners (those who have fault) should be punished. However, if the morality of moral hazard is claimed without any ambiguity, it is not clear that this refers to individual moral weakness. Indeed, the expression "amoral mechanism" is an oxymoron, since morality is supposed to be a matter of people and not of tools, or mechanisms. This merger seems to reflect a certain will to mitigate the role of character in the moral hazard problem. The broader context of the corpus is less indicative of moralistic references.

In summary, while the contextual analysis confirmed the findings of the previous paragraph for the cases of Germany and the ECB, it brought new evidence in the case of France. Unlike definitions of moral hazard, which are consistent with the economics literature, the contextual use of the idiom reveals the role of morality in the French conception of the phenomenon.

### **View(s) on the management of the risk of moral hazard**

The final dimension that we consider of interest to draw a comprehensive picture of conceptions of moral hazard is the perception on the management of its risk. Indeed, the political arena seems divided between those who believe that any risk of moral hazard should be avoided (i.e. no insurance mechanism) and those who believe that the benefits of insurance are superior to its costs and that the risk can be minimised. This paragraph tries to determine

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<sup>55</sup> Pierre Moscovici, Déclaration à l'Assemblée nationale, "Les grandes lignes de la réforme bancaire", *Vie Publique*, 20 March 2013, retrieved 22 April 2019, <http://discours.vie-publique.fr/notices/133000717.html>.

in which group our policymakers stand. The corpus of German policymakers' speeches depicts moral hazard as an underestimated problem in the euro area. According to Schäuble, "a lot of people underestimate the problem of moral hazard",<sup>56</sup> even though "European monetary union is also a story of moral hazard".<sup>57</sup> With these words, Schäuble implies that moral hazard has materialised throughout the history of the EMU and that political leaders ignored the problem. Thus, moral hazard is not perceived as a potential problem, but as an actual one. By reducing the EMU to a "moral hazard story", Schäuble also points out how important the problem of moral hazard is to him. The words of Schäuble convey the idea that euro area policymakers should first think about the moral hazard problem inherent in the EMU before thinking about introducing any other kind of insurance scheme. In order to deal with the moral hazard problem, he seems to recommend avoiding any other possibility for moral hazard: "we need to avoid any wrong incentives to avoid moral hazard",<sup>58</sup> that is to say, any insurance. However, Weber and Weidmann seem to believe that minimising the risk of moral hazard is, in some cases, possible through "transfers [that] are not permanent, [...] and tied to strict conditionality",<sup>59</sup> and by "imposing far-reaching consequences for violations of this conditionality on the member state in question".<sup>60</sup> However, the vision that no additional possibility for moral hazard should be added in the euro area (Schäuble's perception) seems to be dominant in the corpus.

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<sup>56</sup> Schäuble, "Eurozone at a crossroads (again)", *loc. cit.*

<sup>57</sup> *Ibid.*

<sup>58</sup> Wolfgang Schäuble, Keynote speech at the Symposium on Financial Stability and the Role of Central Banks of the Deutsche Bundesbank, "Bundesbank symposium on financial stability", *Federal Ministry of Finance*, 28 February 2014, retrieved 24 April 2019, <https://www.bundesfinanzministerium.de/Content/EN/Reden/2014/2014-02-28-bundesbank.html>.

<sup>59</sup> Jens Weidmann, Speech delivered at the German Embassy in Paris, "Safeguarding the future of monetary union", *Deutsche Bundesbank*, 27 October 2017, retrieved 23 April 2019, <https://www.bundesbank.de/en/press/speeches/safeguarding-the-future-of-monetary-union-618648>.

<sup>60</sup> Axel Weber, Opinion expressed at the public hearing of the Budget Committee of the German Bundestag, "The Draft Act Assuming Guarantees in connection with the European Stabilisation Mechanism", *Deutsche Bundesbank*, 21 May 2010, retrieved 23 April 2019, <https://www.bundesbank.de/en/press/pressreleases/opinion-expressed-by-professor-axel-a-weber-president-of-the-deutsche-bundesbank-670296>.

In the case of the ECB, the analysis of the corpus gives an unambiguous idea of how Presidents of the ECB perceive the risk of moral hazard. The shared view that denotes from the speeches is that moral hazard is not a necessity, and that the risk of materialisation can be minimised. The moral hazard problem is not perceived as an inevitable consequence of the law of nature. To illustrate this statement, we can cite the following sentence: “[...] the moral hazard that can – but need not – be created by intervention in a crisis”.<sup>61</sup> With these words, Trichet refutes the idea that moral hazard is inherent in public intervention. The possibility to reduce the risk of moral hazard is highlighted in many passages of the corpus. For instance, Draghi said: “[a European Deposit Insurance Scheme] is realistic in its design and provides a number of safeguards against moral hazard, so that risk-sharing does not become risk-shedding”,<sup>62</sup> and “work needs to continue on designing a fiscal capacity that provides adequate macroeconomic stabilisation while containing moral hazard”.<sup>63</sup> With these words, the President of the ECB argues that moral hazard can – and should – be contained. According to Draghi, trust is the key element to dismiss the “fear of moral hazard”.<sup>64</sup> By using the word “fear”, he clearly implies that some concerns for moral hazard in the euro area might be excessive and irrational.

The case study of France also suggests that policymakers believe in the possibility to reduce the risk of moral hazard. For example, according to Moscovici, “we will need to move towards better adjustment mechanisms in the eurozone, potentially in the form of a euro area

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<sup>61</sup> Jean-Claude Trichet, Lunch remarks at the SIEPR Economic Summit in Stanford, “Risk and monetary policy”, *European Central Bank*, 12 March 2010, retrieved 23 April 2019, <https://www.ecb.europa.eu/press/key/date/2010/html/sp100312.en.html>.

<sup>62</sup> Mario Draghi, Marjolin lecture delivered at the SUERF conference organized by the Deutsche Bundesbank in Frankfurt, “How central banks meet the challenge of low inflation”, *European Central Bank*, 4 February 2016, retrieved 23 April 2019, <https://www.ecb.europa.eu/press/key/date/2016/html/sp160204.en.html>.

<sup>63</sup> Mario Draghi, Statement at the thirty-eighth meeting of the International Monetary and Financial Committee in Bali, *European Central Bank*, 12 October 2018, retrieved 23 April 2019, <https://www.ecb.europa.eu/press/key/date/2018/html/ecb.sp181012.en.html>.

<sup>64</sup> Mario Draghi, Speech in honor of Dr. Theodor Waigel at SignsAwards in Munich, “Laudatio for Theo Waigel” *European Central Bank*, 17 June 2016, retrieved 23 April 2019, [https://www.ecb.europa.eu/press/key/date/2016/html/sp160617\\_1.en.html](https://www.ecb.europa.eu/press/key/date/2016/html/sp160617_1.en.html).

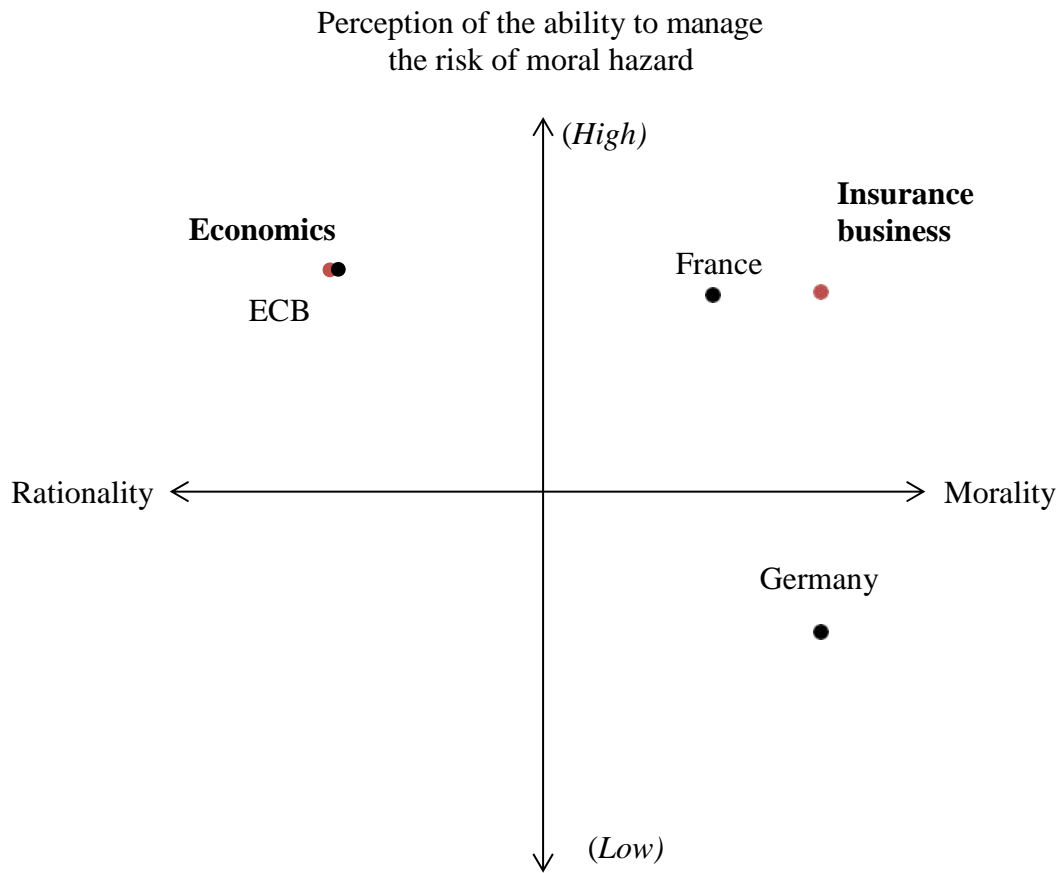
fiscal capacity, while avoiding moral hazard”.<sup>65</sup> This statement makes stabilisation mechanisms for the Eurozone a necessity for the sustainability of the EMU, and at the same time, refutes the mandatory nature of moral hazard.

In conclusion, the analysis of the different case studies provides strong evidence of co-existing divergent conceptions of moral hazard among policymakers of the euro area (see Figure 1). While moral hazard is often depicted as a classical economic concept, only the conception identified in the ECB’s case is fully consistent with the economics literature. The conception of moral hazard identified in the case of France is a bit different. Although narrow definitions and the perception of management of the risk are similar to that of the ECB’s, the contextual analysis disclosed the moral dimension of moral hazard in the French conception (moving the conception closer to the insurance business literature). Finally, the case study of Germany unveiled an original conception of moral hazard. The German conception is characterised by a combination of rationality, morality and character that leads to relatively excessive concerns for moral hazard (see Graph 2) and the belief that any possibility for such a phenomenon should be avoided.

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<sup>65</sup> Pierre Moscovici, Speech at “Forum Constitutionis Europae” at the Humboldt University in Berlin, “Economic and political challenges for Europe”, *Le blog de Pierre Moscovici*, 16 March 2015, retrieved 24 April 2019, [http://www.whi-berlin.eu/tl\\_files/FCE/15-03-16%20speech\\_Humboldt.pdf](http://www.whi-berlin.eu/tl_files/FCE/15-03-16%20speech_Humboldt.pdf).

**Figure 1.** Mapping the conceptions of moral hazard



Source: author.

## 5. Explaining the puzzle of moral hazard

The empirical analysis revealed a specific conception to each case study. Policymakers from Germany, France and the ECB have different views on what is moral hazard. The purpose of this section is to explain this puzzle. For each conception identified, we tested the explanatory power of DI and of policy paradigms.

### The explanatory power of theories in the German conception

The conception of moral hazard in the case study of Germany is characterised by a relatively high degree of morality and an ability to manage the risk relatively low. One potential explanation of these features could be the strategic tailoring of moral hazard by policymakers to specific concerns of the German public opinion (DI). In particular, the fear of debt and of a European “transfer union” have been identified as key concerns of the German population by the experts interviewed.<sup>66</sup> The perceived relatively low ability to manage the risk of moral hazard could be link to a specific framing of risk sharing in line with these concerns. More specifically, Dominic Ponattu pointed out the frequent assimilation of risk sharing to the “transfer union” in the German public debate.<sup>67</sup> If risk sharing is assimilated to a “transfer union” – strongly rejected by the public opinion – and that the risk of moral hazard is attached to risk sharing; by syllogism, the probability to see German policymakers defend the possibility to minimise the risk of moral hazard is slight. The analysis of the German corpus presents evidence of this specific framing of risk sharing. On several occasions, Schäuble uses the triptych “risk sharing – transfers – weaken incentives/moral hazard”:

[...] we do not need to talk about new approaches to the further communitisation of risks or about new European transfers. European transfers do not solve any structural

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<sup>66</sup> Interview with Dr. René Repasi, Assistant Professor at Erasmus School of Law and Scientific Coordinator of the European Research Centre for Economic and Financial Governance (EURO-CEFG) of the Universities of Leiden, Delft and Rotterdam, Bruges (skype interview), 24 April 2019.

Interview with Dr. Dominic Ponattu, Economist and Project Manager at Bertelsmann Stiftung, Bruges (phone interview), 4 April 2019.

<sup>67</sup> *Ibid.*

problem. And the incentives for reform would be reduced”.<sup>68</sup> (author’s translation)

“Providing debt relief and permanent transfers over and over again won’t help a society to improve the long-term performance of its economy [...]. Debt relief and permanent transfers wouldn’t solve a single structural problem. They would weaken the incentives to carry out reforms. And they would create a problem of moral hazard in political terms.”<sup>69</sup>

These two excerpts are indicative of a certain rhetorical manipulation. Indeed, in the first sentence of the first paragraph, Schäuble clearly assimilates risk sharing to European transfers. By using the coordination conjunction “or”, he implies that the two concepts are interchangeable. The second paragraph also shows a certain logic of communication. Schäuble draws a caricatured portrait of some EMU reform proposals (such as Eurobonds and a euro area budget with a stabilisation function) in order to undermine their credibility. The association of risk sharing and moral hazard with permanent transfers seems to be intended to fuel public resistance to any risk sharing proposals. The framing of risk sharing by German policymakers suggests that they are not only reacting to public opinion constraints, but also participating in strengthening them. The fear and rejection of an “insurance union” by the German public opinion could have been influenced by a certain public discourse. Because “insurance is a social institution, which defines norms and values in political culture and ultimately shapes the way citizens think about issues of membership, community, responsibility, and moral obligations”<sup>70</sup>, politicians have the power to affect social attitudes towards an “insurance union”. Therefore, a specific discourse, such as the initial framing of

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<sup>68</sup> Wolfgang Schäuble, Rede beim Deutschen Logistik Kongress in Berlin, “Eine welt in bewegung – aktuelle politische herausforderungen”, *Dr. Wolfgang Schäuble MdB*, 29 October 2015, retrieved 27 April 2019, <http://www.wolfgang-schaeuble.de/eine-welt-in-bewegung-aktuelle-politische-herausforderungen/>.

<sup>69</sup> Schäuble, “Eurozone at a crossroads (again)”, *loc.cit.*

<sup>70</sup> Rowell and Connelly, *op.cit.*, p.1063.

the euro crisis or the conveyed impression that the “veil of ignorance”<sup>71</sup> has disappeared, could contribute to explaining the vivid rejection of an “insurance union” by Germans and the preference for avoiding any possibility of moral hazard. Indeed, the initial framing of the euro crisis as a story of “Northern Saints and Southern Sinners”<sup>72</sup> could have hysteresis effects. According to Repasi, this initial framing has become a point of reference for German public opinion, from where any EMU reform proposals are judged.<sup>73</sup> In addition, interviewees also mentioned the role of the current relatively good economic conditions in Germany<sup>74</sup> and the myth of a “self-made-success”<sup>75</sup> in social attitudes towards an “insurance union”. The artificial withdrawal of the “veil of ignorance” distorts preferences in favour of a constructed national interests. The defence of national interests seems to be hidden behind the fact that German policymakers present (public) risk sharing as a counter-productive solution for the Eurozone – because of moral hazard. This claim is reinforced by Schäuble’s words, when he said that “the monetary and social costs [of solidarity] wouldn’t be acceptable to the creditor countries anyway”.<sup>76</sup> We interpret this “anyway” as “even if the risk of moral hazard could be minimised”. Finally, the claim that the German conception of moral hazard could be shaped to defend national interests is sustained by the fact that the focus on moral hazard seems to change depending on whether domestic or European issues are discussed.<sup>77</sup> The emphasis on the moral hazard problem by German policymakers appears to be largely link to European

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<sup>71</sup> “The idea of the original position is to set up a fair procedure so that any principles agreed to will be just. The aim is to use the notion of pure procedural justice as a basis of theory. Somehow we must nullify the effects of specific contingencies which put men at odds and tempt them to exploit social and natural circumstances to their own advantage. Now in order to do this I assume that the parties are situated behind a veil of ignorance. They do not know how the various alternatives will affect their own particular case and they are obliged to evaluate principles solely on the basis of general considerations”, in John Rawls, *A theory of justice*, Cambridge, The Belknap Press of Harvard University Press, 1971, revised edition (1999), p. 118.

<sup>72</sup> Matthijs and McNamara, *loc.cit.*

<sup>73</sup> Repasi, *loc.cit.*

<sup>74</sup> Ponattu, *loc.cit.*

<sup>75</sup> Repasi, *loc.cit.*

<sup>76</sup> Schäuble, “Eurozone at a crossroads (again)”, *loc.cit.*

<sup>77</sup> Ponattu, *loc.cit.* The interviewee stressed that unlike for the European level, moral hazard is not perceived by the public opinion as a factor that should prevent risk sharing at the domestic level. According to him, the unity of the country explains this difference.



matters.<sup>78</sup> All in all, DI seems to be able to explain both dimensions of the German conception of moral hazard: the relatively perceived low ability to manage the risk and the morality of moral hazard can be linked to the response to public opinion concerns and to the defence of (constructed) national interests.

The attempt to explain the German conception of moral hazard does not end with DI. The alternative hypothesis could also play a role. The conception of moral hazard of German policymakers could be influenced by a prevailing set of ideas – a policy paradigm – that shape their perception. More explicitly, the analysis of the corpus highlighted the salience of references to ordoliberalism. We find several direct concordances of ordoliberalism, notably in the speeches of Schäuble, as for example:

I have my intellectual roots in the Freiburg school of ordoliberalism. The intellectual godfather of the Freiburg School is Walter Eucken, whose German brand of institutional economics is perhaps not well known internationally but has been very influential in Germany.<sup>79</sup>

With these words, Schäuble clearly states that, just as for many Germans, ordoliberalism is part of his intellectual influences. The question is whether this influence have a role in his conception of moral hazard. According to Josef Hien, ordoliberalism is not (only) an economic theory, but also an ethical theory “with strong roots in Protestant social thought”.<sup>80</sup> This feature may be of great importance for the explanation of the German conception of moral hazard. Indeed, the religious foundations of ordoliberalism can easily explain the moral dimension of moral hazard. In addition, the Protestant view of human nature (characterised by

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<sup>78</sup> This statement is notably based on the fact that among the 42 speeches of the German corpus, only 2 have no reference to European affairs (AntConc results – concordances of “euro\*”, which refers to every word starting with “euro”).

<sup>79</sup> Wolfgang Schäuble, Speech at the 4th Lindau Meeting in Economics in St. Gallen, “From financial to debt crisis – financial markets, fiscal policy and public debt in Europe’s Monetary Union”, *Federal Ministry of Finance*, 27 August 2011, retrieved 28 April 2019, <https://www.bundesfinanzministerium.de/Content/EN/Reden/2011/2011-08-27-nobelpreis-lindau.html>.

<sup>80</sup> Josef Hien, “The religious foundations of the European crisis”, *Journal of Common Market Studies*, 2017, p.1.

a mistrust of individual freedom), and its related notion of solidarity,<sup>81</sup> could also explain the emphasis on the moral hazard problem<sup>82</sup> and the disregard for risk sharing proposals. According to Schäuble (and ordoliberalism), “morality is a scarce commodity”,<sup>83</sup> an uncommon quality among individuals. Thus, under this assumption, and if moral hazard is a question of moral weakness, the problem of moral hazard is likely to happen. This set of ideas explain the perceived relatively low ability to manage the risk of moral hazard.

In conclusion, DI and policy paradigms contribute to explain the German conception of moral hazard. The morality of moral hazard and the perceived relatively low ability to manage its risk result from strategic rhetorical manipulation aimed at influence public opinion against risk sharing proposals and defend material interests. However, the explanatory power of ordoliberalism is also important. The Protestant roots of this policy paradigm also explain the characteristics of the German conception of moral hazard. In the case study of Germany, it is difficult to know which of the explanatory variables is dominant with the available data.

### **The explanatory power of theories in the ECB’s conception**

The conception of moral hazard in the case study of the ECB is characterised by the absence of morality and a perceived ability to manage the risk relatively high. These characteristics are not surprising given the nature of the institution. The (supposed) technocratic nature of monetary policy may explain the ECB’s non-moral conception of moral hazard. The theory of policy paradigms suits the case of the ECB. Because of prevailing set of ideas about how the economy works, embodied in the status of the institution (independence), moral hazard is not perceived as a moral phenomenon, but as an economic one. By “prevailing

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<sup>81</sup> *Ibid.* “Ordoliberals rejected the transfer solidarity embedded in the Weimar Welfare State institutions because it created moral hazard, set wrong incentives and undermined personal responsibility”, in Hien, *op.cit.* p.6.

<sup>82</sup> Ordoliberalism pays particular attention to the moral hazard problem (see *Ibid.*).

<sup>83</sup> Wolfgang Schäuble, Aufsatz erschienen in der Frankfurter Allgemeinen Zeitung, “Die balance halten. Leidenschaft, verantwortungsgefühl, augenmass – was uns Max Weber noch immer zu sagen hat”, *Dr. Wolfgang Schäuble MdB*, 1 February 2019, retrieved 28 April 2019, <http://www.wolfgang-schaeuble.de/diebalance-halten-leidenschaft-verantwortungsgefuehl-augenmass-was-uns-max-weber-noch-immer-zu-sagenhat/>.

set of ideas”, we refer notably to neoclassical assumptions (e.g. rationality of agents) underpinning the economic conception of moral hazard. In the corpus, Trichet refers directly to this policy paradigm: “the role of distortions in economic incentives is probably better known as it had traditionally been widely appreciated even within neo-classical modelling”.<sup>84</sup>

However, from a public policy perspective, the ECB’s use of the idiom differs slightly from a pure neoclassical application. While some neoclassicals have disregarded the ability to manage the risk of moral hazard and used the idiom to justify “the abandonment of redistributive policies”,<sup>85</sup> the ECB emphasises on the possibility to reduce the risk and argues in favour of risk sharing proposals in the name of the general interest.<sup>86</sup> This position of the ECB can be interpreted from a DI point of view. Indeed, the promotion of risk sharing mechanisms could be strategic from the part of the ECB as it would enhance its “policy effectiveness and performance”<sup>87</sup> (i.e. increase its output legitimacy).<sup>88</sup>

To conclude, policy paradigms and DI contribute to explain the ECB’s conception of moral hazard. The technocratic approach towards monetary policy is transposed to moral hazard and explains the non-moral conception of the phenomenon. However, while the ability to minimise the risk of moral hazard is acknowledged in the economic literature, the explicit argumentation on the general interest of the Eurozone seems rather strategic than derived from a prevailing policy paradigm.

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<sup>84</sup> Trichet, “Risk and monetary policy”, *loc.cit.*

<sup>85</sup> Baker, *op.cit.* p. 290.

<sup>86</sup> “what is clear is that while the end result - herd behaviour – seems to be individually rational, it is socially wasteful”. In Trichet, “Risk and monetary policy”, *loc.cit.*

<sup>87</sup> Vivien Schmidt, European Commission, Discussion Paper, *The Eurozone’s crisis of democratic legitimacy: can the EU Rebuild public trust and support for European economic integration?*, Brussels, European Commission, 2015.

<sup>88</sup> For instance, the introduction of a safe asset would greatly facilitate the quantitative easing.

## The explanatory power of theories in the French conception

The conception of moral hazard in the case study of France is characterised by an intermediate degree of morality and a perceived ability to manage the risk relatively high.<sup>89</sup> The analysis of the corpus did not disclose references to a particular policy paradigm. While French and German economists are known for their different philosophies of governance derived from different schools of thought (i.e. Keynesianism versus ordoliberalism),<sup>90</sup> the collected data do not allow us to argue that this contrast could explain the variations in conceptions of moral hazard.

Therefore, given our theoretical framework, the explanation of the French conception of moral hazard should be the strategic tailoring of the idiom by policymakers to specific interests (DI). In this regard, the detailed analysis of Moscovici's speeches is revealing. Indeed, the examination of Moscovici's corpus indicates changes in the use of moral hazard between the time he was Finance Minister and the time he became Commissioner. First thing to note, in 2013 (the year before his nomination as European Commissioner), Moscovici used (relatively) intensively the term "moral hazard".<sup>91</sup> It was also this same year that he emphasised the morality of moral hazard and its role in the crisis.<sup>92</sup> These two developments can be interpreted as a communication strategy for his "campaign" to become a European Commissioner.<sup>93</sup> By echoing German's views, Moscovici could broaden and strengthen support for his nomination. The use of the term "moral hazard" by Moscovici as a European Commissioner is slightly different. As a Commissioner with the objective of defending the

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<sup>89</sup> Unlike German policymakers, the French do not perceive the moral dimension of moral hazard as an impediment to minimise the risk and promote risk-sharing proposals. This observation could be explained by the fact that the moral dimension in the French conception applies to the system in general and not to the intrinsic nature of individuals (German conception).

<sup>90</sup> Peter A. Hall, "The economics and politics of the euro crisis", *German Politics*, vol. 21, no. 4, 2012, p. 367.

<sup>91</sup> 78% of occurrences of the term "moral hazard" in 2013 are of Moscovici.

<sup>92</sup> "It is essential to defuse this mechanism, not only, and obviously, amoral - hence the expression "moral hazard" [...]". (author's translation) in Moscovici, "Les axes du projet de loi de separation et de regulation des activités bancaires", *loc.cit.*

<sup>93</sup> An alternative explanation of these developments is also the aftermath of the presidential campaign of 2012 won by François Hollande (where the expression "finance is my enemy" became famous).

general interest of the EU, he emphasises on the necessity to deepen the EMU (notably by introducing further risk sharing) and on the ability to minimise the risk of moral hazard.

“We will need to move towards better adjustment mechanisms in the eurozone, potentially in the form of a euro area fiscal capacity, while avoiding moral hazard and acknowledging the importance of fiscal subsidiarity”.<sup>94</sup>

After 2014, the moral dimension of moral hazard is no longer highlighted by Moscovici in the corpus. Instead, the evolution of its use of the term suggests that once a Commissioner, he started to challenge the German conception of moral hazard. This assertion is reinforced by the fact that all collected speeches where Moscovici used the term “moral hazard” after 2013 are made in Berlin.<sup>95</sup>

In conclusion, the solution to the “puzzle of moral hazard” is nuanced. There is not a clear answer on whether DI or policy paradigms has the greater power of explanation. Except for the case of the French conception, where the hypothesis of a strategic use is unequivocally confirmed, both DI and policy paradigms contribute to the explanation of the conception of moral hazard. However, one pattern seems to emerge from the analysis of the German and the ECB’s cases: generally speaking, DI explains largely the perception of the ability to manage the risk, and policy paradigms the (non-) moral dimension of moral hazard.

## 6. Conclusion

Moral hazard is used in the political arena as an economic concept to justify the reluctance towards further risk sharing mechanisms. However, given the differences in perception of the risk of moral hazard, one could wonder if it is a de-politicised concept as it is claimed. By investigating how and why policymakers of the Eurozone use the term, this paper was aimed

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<sup>94</sup> Moscovici, “Economic and political challenges for Europe”, *loc.cit.*

<sup>95</sup> Moscovici, “Les 20 ans du noyau dur européen”, *loc.cit.* and Moscovici, “Economic and political challenges for Europe”, *loc.cit.*

at answering the following research question: to what extent the conception of moral hazard can explain the divergent preferences towards risk sharing?

The research question presupposes the existence of different conceptions of moral hazard. The analysis confirmed this primary hypothesis. First, the literature review on the history of moral hazard has disclosed the ambiguity of the concept: before entering the economic literature as a concept exclusively based on rationality, moral hazard was a morally charged concept in the insurance business literature. Second, the empirical analysis revealed idiosyncratic conceptions of moral hazard. The conception of the ECB is coherent with the economic view of moral hazard, where the phenomenon is due to the exclusive impact of insurance and lies in the rationality of agents. The problem of moral hazard is perceived as manageable by setting the right incentives. In contrast, the French conception is closer to the insurance business literature, where the morality of moral hazard is not perceived as an impediment for reducing its risk. Finally, the German conception of moral hazard is characterised by the significance of morality and personal characteristics and by a low perception of the ability to minimise its risk. All in all, the different conceptions of moral hazard identified already provide an answer to the research question: divergent preferences towards risk sharing are due to different conceptions of moral hazard.

However, this paper also aims to investigate how and why ideas matter. To this end, we analysed the drivers behind the differences identified. The first hypothesis tested to explain the so-called “puzzle of moral hazard” has been confirmed by the empirical analysis. Indeed, we found evidence that differences in the conception of moral hazard are due to strategic purposes. The case that best illustrates this statement is the case of the French conception, and more specifically of Moscovici. Indeed, through a chronological analysis of the uses of the term by Moscovici, we were able to establish changes in the conception in line with changes of interest. The case of Germany is also revealing of strategic tailoring of moral hazard. In response to

public opinion concerns, German policymakers seems to emphasise the moral hazard problem at the European level. In addition, their particular framing of the term can be interpreted as a communication strategy to defend a (constructed) national interest. Finally, we found one specific interest that could explain why the successive Presidents of the ECB have highlighted the possibility to reduce the risk of moral hazard and have promoted risk sharing: the increase of the ECB's output legitimacy. The second hypothesis tested has been partially confirmed. Indeed, we found evidence of the role of policy paradigms in the conception of moral hazard in the cases of Germany and the ECB, but not in the case of France. In the case of Germany, and more specifically of Schäuble, the frequent references to ordoliberalism are indicative of the influence of such a set of ideas in the conception of moral hazard. In the case of the ECB, the technocratic nature of the institution and the influence of neoclassical ideas explain the non-moralistic conception of moral hazard.

Based on the findings of this research, we can state that moral hazard is a politicised concept. More than the result of scientific evidence that could justify risk sharing preferences, the conception of moral hazard is actually the result of an implicit battle of ideas and interests. These conclusions call into question the value of moral hazard as a (neutral) argument to prevent further risk sharing. Rather than the genuine reason behind divergent risk sharing preferences, moral hazard seems to be the excuse.

However, this research has several limits that reduce the scope of its findings. In terms of theory, the available data were not sufficient to precisely assess the explanatory power of DI and policy paradigms in the case study of Germany. In addition, given the limited number of policymakers considered, the generalisation of the conception of moral by case study poses some problems. This is all the more problematic in the case of Germany and France, where the identified conception of moral hazard is fully representative of one of the policymakers. Finally, including the other French Finance Ministers of the studied period in the French

corpus would have given a more comprehensive view of the use of the term over the time period.

This paper represents a first attempt of investigation of moral hazard from an ideational point of view and of its implications at the European level. Beyond the scope of this study, the research on the topic could be deepened from different perspectives. For instance, one could look not only at the conception of policymakers, but also at the one of the public opinions. Another interesting direction to further investigate the topic is the potential differences in the conception of moral hazard between northern and southern countries, and between left- and right-wing parties.



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