The Moral Economy of Speculation: Gambling, Finance, and the Common Good

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I recently participated in a panel discussion in Jaipur, India, about whether capitalism has lost its way. After the session, an Indian university student came up to me with a question that had not been discussed during the panel. It was a question about America. "How will it be possible," he asked, "for a great nation like the United States to continue to exercise power and influence in the world if it no longer makes things?"

I wasn't sure how to reply. I assumed he was referring to the massive loss of US manufacturing jobs in recent years. I quickly thought of the arguments economists make about the efficiencies of outsourcing, productivity gains, and the mutual benefits of global trade. But I doubt this would have gotten to the heart of his question, which seemed to be about more than economics. I replied that I shared his worry but didn't have a good answer and would have to think more about it.

This lecture is an attempt to make sense of the concern, widespread but inchoate, that the nature of economic activity in the United States has shifted in recent years, in ways that bode ill for civic life. Increasingly, people make money, not by producing goods and providing services but by managing risk. You might say we have been moving from an economy of production to an economy of speculation.

This is a troubling development that should prompt us to reconsider the way we organize our economic life. The reason it is troubling is not primarily an economic one. I do not claim that an economy of speculation necessarily makes for a less prosperous society. But it does make for a less just society. And it promotes an ethic of speculation corrosive of moral and civic norms worth caring about.

Investing and Gambling

To explore the moral and civic implications of an economy of speculation, consider the following question: is there a difference—a morally important difference—between investing and gambling? Most people would say yes. Societies generally encourage investing and discourage gambling, though it is not easy to explain why.

In practice, the difference between investing and gambling can be elusive. Both activities involve taking a risk in the hope of realizing a gain. Both are, in this sense, speculative. When a farmer plants a crop, he takes a chance on favorable weather and on the price of wheat when the harvest comes in. When an investor buys a stock, she hopes the price will go up but knows it might go down. When a bank makes a loan to a business or a home owner, it takes on a certain risk in the hope that the business or the home owner will be able to repay the loan with interest. What, then, is the difference between these activities and placing a bet in a Las Vegas casino? If all involve speculation, why should we praise investing but disparage gambling?

The most obvious answer is that investment promotes the production of useful goods and services, whereas gambling is either a form of entertainment or a way of making money without producing anything useful. But if this is the basis for distinguishing investing from gambling, it raises a difficult question: how can we decide what goods and services are useful or valuable? Since people are likely to disagree about what is useful or valuable, shouldn't we let people decide for themselves what deals to make and what risks to take? Shouldn't we treat both forms of risk taking—investing and gambling—in the same way?

In recent decades, we have increasingly come to adopt this stance. We have lost hold of the distinction between investing and gambling. Or, to describe the development more sympathetically, we have become less judgmental about the distinction, and in particular less censorious about gambling. By "we," I mean our society collectively, as expressed through public attitudes, laws, and economic practices. We have made our peace, so to speak, with a moral economy of speculation.

I think this has been a mistake. We should not embrace a moral economy of speculation uncritically. The most obvious reason is practical: as the financial crisis of 2008 showed, an economy in which some people make a lot of money managing (and manipulating) risk is actually very risky. When the bets go wrong, a lot of people suffer, including those who are not speculators, people who make their living by producing useful things and performing valuable services in what is sometimes called the "real economy."

But there is a further reason to worry. Beyond the systemic risk and economic damage that reckless, rampant speculation can bring, it also carries a moral cost: heaping rewards on speculative pursuits that are untethered from socially useful purposes is corrosive of character. It is corrosive not only of individual character but also of the virtues and attitudes that make for a just society. This is the element of truth in the traditional—some would say puritanical—hostility to gambling.

The financial crisis prompted much discussion about the systemic risk associated with casino capitalism, especially when major banks and financial institutions are "too big to fail." But we have paid less attention to the moral implications of an economy increasingly dominated by speculative rather than productive activities. This is the topic I would like to explore in this lecture.

What happens when the morally corrosive aspects of gambling are writ large and come to predominate in the economy as a whole? When the ethic of speculation becomes widespread, it threatens to sever the link, always fragile, between contribution and compensation, between the work people do and the rewards society bestows.

EARNINGS VERSUS WINNINGS

Admittedly, even the most meritocratic societies fail to align virtue with success. We need only remind ourselves of the gaping pay differentials associated with different kinds of work. Few people believe that the social contribution of a lavishly paid NBA star is really a thousand times more valuable than that of a nurse or a kindergarten teacher. Since this feature of market societies is easy to forget, we need constantly to remind ourselves that what people earn does not necessarily reflect what they morally deserve.

Still, it is hard to imagine a society that gave up altogether on trying to align compensation, broadly conceived, with the social value of the work people do. It is worth asking how our social, economic, and moral life would change if we came to regard all earnings as morally arbitrary winnings and gave up the aspiration to link contribution and reward. A pure economy of speculation, universally regarded as such, would have a certain advantage over ours. It would liberate us from the burden (and for some the hubris) of assuming that worldly success reflects superior virtue or moral desert. Everyone knows that people who win big in casinos are lucky, not meritorious.

But this pure case is hypothetical. It does not describe the way we actually regard success and striving. Although we speak colloquially of "casino capitalism," we don't really believe that all earnings are mere winnings. Even as speculative activities loom larger in our economic life, we continue to assume that success tracks merit, at least to some degree. This assumption is hard to give up altogether. But as the speculative aspect of economic life increases, the meritocratic way of thinking about success becomes less plausible.

This tension, between the way we regard striving and success and the way the economy actually allocates rewards, is a growing source of dissonance and frustration. We sense that working hard and playing by the rules yields less and less, especially for those who do not inhabit the uppermost reaches of the income scale. Reflexive invocations of the work ethic by politicians and editorial writers ring increasingly hollow.

THE ETHIC OF SPECULATION

One expression of this hollowness, and a possible source of it, is the growing legitimacy of speculation. In recent decades, the prejudice against gambling has faded. Here are some illustrations of the trend.

Casino Gambling

For years Nevada was the lone outpost of casino gambling in the United States. In 1976 New Jersey became only the second state to legalize casinos. Today, twenty-three states have commercial casinos. And they are popular. In the past two decades, casino revenues have quadrupled, to about thirty-seven billion dollars per year.[1]

How much is the thirty-seven billion dollars Americans spend playing slot machines and roulette tables? More than three times what we spend going to the movies. In fact, it is more than we spend on movies, music, and outdoor equipment combined.[2]

And there is more to come. In 2013 Nevada and New Jersey approved online gambling.[3] Until recently, the federal government considered online gambling illegal and prosecuted companies offering online poker, lotteries, and other games. But in 2011 the Justice Department reversed course, opening the way for states to legalize online gambling.[4]

State Lotteries

Meanwhile, the states have begun running numbers rackets of their own, with the proliferation of state lotteries. In the early American republic, lotteries were a popular way of raising funds for public projects, including schools and universities. But by the late nineteenth century, and through most of the twentieth, lotteries were illegal.[5]

The past few decades have brought the most fateful change in public finance since the income tax. In 1970 only two states had lotteries. Today, forty-three states and the District of Columbia run lotteries, with total sales of sixty-eight billion dollars. State lottery sales are so robust they exceed the amount spent in casinos.[6]

As states have become hooked on the revenue, they need to fuel the demand. And so, in addition to running the games, state lotteries have become one of the biggest advertisers in the country. Not surprisingly, lotteries direct their most aggressive advertising at their best customers—the working class and the poor. A billboard touting the Illinois lottery in a Chicago ghetto declared, "This could be your ticket out."[7]

In sharp contrast to most government amenities (such as police protection and good public schools), lottery ticket outlets saturate poor and blue-collar neighborhoods and have less presence in affluent ones.[8]

Although state lotteries are sometimes defended as a voluntary alternative to taxation, they are a regressive form of public finance. In eleven states, revenues from lotteries are greater than revenues from corporate income taxes. Counting casinos, racetrack betting, and lotteries, only two states have not legalized gambling of one kind or another: Hawaii and Utah.[9]

Financialization

The most consequential expression of the speculative impulse in recent years is not the gambling that takes place at racetracks or slot machines or even online. It involves the growing role and changing character of financial activity in the economy as a whole. The same decades that brought the spread of casinos and state lotteries also witnessed the financialization of the US economy.

As sociologist Greta Krippner and others have pointed out, the financial industry has become a dominant presence in the American economy. In the 1950s and '60s, the financial sector accounted for 10–15 percent of total profits in the US economy. By the mid-1980s, it accounted for 30 percent. And by 2001 more than 40 percent of total profits came from financial activity.[10]

And that only begins to measure the turn to finance. Within traditional manufacturing companies, financial transactions now contribute as much to the bottom line as producing and selling goods. Take the Ford Motor Company, an icon of American manufacturing. Ford now makes more money selling car loans than it makes selling cars. General Electric makes more money selling credit cards and financing takeovers than it makes selling refrigerators.[11] Taken together, these trends illustrate the shift from an economy of production to an economy of speculation.

I do not mean to suggest that finance is a bad thing. Healthy financial markets are essential to a flourishing modern economy. But it is important to be clear about the function of finance: to allocate capital to socially useful purposes by connecting people who have money to invest with people who need capital to build factories, homes, farms, businesses, or—in the case of government—to build bridges, schools, hospitals, transit systems, and the like.

Unfortunately, relatively little of the money being made in finance these days has much to do with these productive purposes. Much of the money being made is the result of outright speculation that is hard to distinguish from gambling.

Derivatives and Naked Swaps

Consider the derivatives that played a prominent role in the financial crisis. Most derivatives are not investments in productive activity. They are side bets on whether the price of something owned by other people will go up or down.

Sometimes, it makes good economic sense for people to place a bet on future prices. For example, a farmer planting wheat may want to sell his future crop for today's price. To avoid the risk that the price of wheat will collapse by harvest time, he is willing to forego the possibility that the price of wheat will be higher then. When he sells his future crop to a broker at today's price, he buys an insurance policy, in effect, against a devastating drop in prices. An airline concerned about the price of jet fuel might reasonably seek a similar arrangement. To protect itself against the risk that the price of jet fuel will spike next month or next year, it might enter into a long-term contract for fuel at a fixed price.

Hedging contracts such as these do involve a kind of bet on future prices. But they are not idle wagers. They trade away potential windfalls in exchange for a stable price. Futures contracts such as these serve a socially useful purpose. They are a form of insurance that enables the farmer and the airline to operate their businesses unhampered by excessive risk.

But now imagine two people who have no wheat to sell, and who do not want to buy any, but who simply have a hunch about the future price of wheat and want to wager. If they disagree about what the price of wheat will be a year from now, they might make a bet with one another about whose prediction will come true.

Such a wager bears a certain resemblance to the farmer's hedging contract, but with an important difference: the wager does nothing to finance the planting of the wheat crop or to ensure the farmer a stable price. It is not an insurance policy, because neither party to the deal has any wheat crop to insure. It is simply a bet on what will happen in the future, like a bet on who will win the Super Bowl. Someone will win the bet, and someone else will lose.

Conceived as isolated acts, such wagers seem harmless enough. So why worry about them? For several reasons: First, as we have seen, speculation by big institutions on a vast scale can create systemic risk. Second, such wagers do not improve the general welfare and in most cases diminish it. Unlike the exchange of goods and services, an outright bet does not give rise to mutual gain. Wagers are zero-sum games. The winner's gain is entirely offset by the loser's loss. And since such bets typically incur transaction costs, they represent a net social loss.[12] Third, according outsize rewards to speculative activity that provides no insurance and serves no other productive purpose may be morally corrosive.

The similarity between gambling and commodity futures trading by parties with no underlying interest in the commodities themselves is stated with comic clarity by Eddie Murphy's character Billy Ray Valentine in the movie *Trading Places*. The blue-blood partners of a Philadelphia investment firm are trying, as a sociological experiment, to convert Valentine, an inner-city con artist, into a successful commodities trader. In patronizing terms, they explain to Valentine how they broker speculative contracts on gold and orange juice futures.

> RANDOLPH DUKE: Now, some of our clients are speculating that the price of gold will rise in the future. And we have other clients who are speculating that the price of gold will fall. They place their orders with us, and we buy or sell their gold for them.
>
> MORTIMER DUKE: Tell him the good part.
>
> RANDOLPH DUKE: The good part, William, is that, no matter whether our clients make money or lose money, Duke & Duke get the commissions.
>
> MORTIMER DUKE: Well? What do you think, Valentine?
>
> BILLY RAY: Sounds to me like you guys [are] a couple of bookies.
>
> RANDOLPH DUKE: [chuckling, patting Billy Ray on the back] I told you he'd understand.[13]

Rewarding speculators (and bookies) with vast sums is corrosive of the work ethic because it mocks the belief that productive labor is the key to success. But it can also be corrosive in another way. Sometimes, gamblers find themselves with a rooting interest in the misfortune of others. Recall the bets that were won and lost, on a spectacular scale, during the subprime mortgage crisis.

In 2005 and 2006 a hedge fund manager named John Paulson thought the housing market was overvalued. He believed that many people holding subprime mortgages would be unable to make their payments and would lose their homes. So he placed a bet. Since Las Vegas bookmakers do not take wagers on the collapse of subprime mortgages, Paulson had to find another way to place his bet. With the help of Goldman Sachs, he took advantage of some complex financial instruments that enabled him to bet against the housing market. When the housing market crashed, one of Paulson's funds shot up by 590 percent. Paulson himself made an estimated three to four billion dollars in one year. According to the *Wall Street Journal*, it was the biggest one-year payday in Wall Street history.[14]

Put aside the question whether anyone should make that much money for placing and winning a complex series of bets. Paulson's bounty raises a further question: is it tainted by the fact that it depended on the misfortune of others—not only the misfortune of the investors who took his bet and lost their shirts, but also the misfortune of the millions who lost their homes? To be fair, Paulson did not create their predicament. He didn't sell anybody a subprime mortgage. He took no joy in their loss. Yet his winnings did depend on the housing market crash.

Similar questions can be asked about bets that a country, say, Greece, will default on its bonds. If I hold Greek bonds and fear a default, I might want to hedge my position by buying a credit default swap. Such swaps pay out if the default comes to pass. They are a kind of insurance policy for bondholders.

Now suppose I hold no Greek bonds, but believe the country will default. You disagree. Should you and I be able to wager on Greek's financial fate, even though neither of us has a stake in the matter (apart from the bet we are contemplating)?

Financial instruments that enable wagers on whether the housing market will crash or whether Greece will go bankrupt raise one of the unresolved questions of the financial crisis: should we allow "naked" credit default swaps—bets on future events that, unlike the wheat farmer's hedge, don't insure anything or protect any interest independent of the wager itself?[15] If the answer is yes, then gambling and finance are not so different after all.

Speculating on Life and Death

One way of exploring the ethics of naked credit default swaps is to consider the evolution of life insurance. Traditional life insurance policies involve a kind of bet. When I take out a policy on my life, I wager, in effect, that my beneficiaries will receive a payout worth more than the premiums I pay in. But it is a bet I hope to lose. I "win" only if I die before my time.

If I live to a ripe old age, I will pay more in premiums than my family will ultimately collect.

By enabling me to buy protection against risk, a traditional life insurance policy serves a useful purpose—providing financial security for one's family in the event of an early death. In this respect, it is analogous to the wheat farmer's price hedge, which serves the legitimate purpose of reducing his risk and enabling him to plant, tend, and harvest his crop.

But should people be able to take out life insurance policies on strangers, simply as a bet? Suppose you and I see an elderly passerby who is coughing and wheezing, and predict he will die within a month. Should we be able to buy an insurance policy on his life and collect a windfall if our prediction proves correct? Or suppose we disagree in our predictions. You think the ailing stranger will die within a month, but I say he will rally and live for years. Is there anything wrong with betting with one another on how long he will live? (Put aside the awkward question of how we will keep track of his longevity.)

A wager such as this would not reduce anyone's risk or protect any interest. It would simply be a bet. In this respect, it is like a naked credit default swap. Should such wagers be permitted? The question is not merely hypothetical. In recent decades, life insurance has come to exemplify the moral economy of speculation.[16]

Janitors Insurance

Protecting one's family against the loss of a breadwinner is not the only purpose of traditional life insurance. It has long been common practice for companies to take out insurance on the lives of their chief executive officers and top executives, to offset the significant cost of replacing them should they die. In the parlance of the insurance business, companies have an "insurable interest" in their CEOs that is recognized in law. In recent decades, however, companies have begun buying insurance on the lives of their rank-and-file workers.

For example, when Michael Rice, a forty-eight-year-old assistant manager at Walmart, was helping a customer carry a television to her car, he had a heart attack and later died. An insurance policy on his life paid out about three hundred thousand dollars. But the money did not go to his wife and two children. It went to Walmart, which had purchased the policy on Rice's life and named itself as the beneficiary. A Walmart spokesman acknowledged that the company held life insurance policies on hundreds of thousands of its employees—not only on assistant managers but even on maintenance workers.[17]

Such insurance is known in the business as "janitors insurance," or "dead peasants insurance." Until recently, it was illegal in most states; companies were not considered to have an insurable interest in the lives of their ordinary workers. But during the 1980s, the insurance industry successfully lobbied most state legislatures to relax insurance laws, allowing companies to buy life insurance on the lives of all employees, from the CEO to the mailroom clerk.[18]

By the 1990s major companies were investing millions in corporate-owed life insurance (COLI) policies, creating what amounted to a multibillion-dollar death-futures industry. Among the companies who bought policies on their workers were AT&T, Dow Chemical, Nestle USA, Pitney Bowes, Procter & Gamble, Walmart, Walt Disney, and the Winn-Dixie supermarket chain. Companies were drawn to this morbid form of investment by favorable tax treatment.[19]

Few workers were aware that their companies had put a price on their heads. And most COLI policies remained in effect even after a worker quit, retired, or was fired. So corporations were able to collect death benefits on employees who died years after leaving the company. In some states, companies could even take out life insurance and collect death benefits on the children and spouses of their employees.[20]

Janitors insurance was especially popular among big banks, including Bank of America and J. P. Morgan Chase. In the late 1990s, some banks explored the idea of going beyond their employees and taking out insurance on the lives of their depositors and credit-card holders.[21]

By the early 2000s, COLI policies covered the lives of millions of workers and accounted for 25 percent to 30 percent of all life insurance sales. In 2006 Congress sought to limit janitors insurance by enacting a law that required employee consent and restricted company-owned insurance to the highest-paid one-third of a firm's workforce. But the practice continued. By 2008 US banks alone held $122 billion in life insurance on their employees. The spread of janitors insurance throughout corporate America had begun to transform the meaning and purpose of life insurance. "It adds up," the *Wall Street Journal* wrote, "to a little-known story of how life insurance morphed from a safety net for the bereaved into a strategy of corporate finance."[22]

What, if anything, is wrong with this practice? The most obvious objection is a practical one: allowing companies a financial stake in the demise of their employees is hardly conducive to workplace safety. A cash-strapped company with millions of dollars due upon the death of its workers has a perverse incentive to skimp on health and safety measures.

There is also the matter of consent. Some states now require companies to secure the consent of employees before taking out insurance on them.[23] But even where workers agree to such schemes, something morally distasteful remains. Partly it's the attitude toward workers embodied in such policies. Creating conditions where workers are worth more dead than alive objectifies them; it treats them as commodity futures rather than employees whose value to the company lies in the work they do.

A further objection is that COLI policies distort the purpose of life insurance; what was once a source of security for families now becomes a tax break for corporations.[24] That companies now invest billions betting on the life expectancy of their workers rather than producing goods and services is a powerful instance of the shift from an economy of production to an economy of speculation.

Viaticals

Another novel use of life insurance arose in the 1980s and '90s, prompted by the AIDS epidemic. It was called the viatical industry. It consisted of a market in the life insurance policies of people with AIDS and others who had been diagnosed with a terminal illness. Here is how it worked: Suppose someone with a $100,000 life insurance policy is told by his doctor that he has only a year to live. And suppose he needs money now for medical care, or perhaps simply to live well in the short time he has remaining. An investor offers to buy the policy from the ailing person at a discount, say $50,000, and takes over payment of the annual premiums. When the original policyholder dies, the investor collects the $100,000.[25]

It seems like a good deal all around. The dying policyholder gains access to the cash he needs, and the investor turns a handsome profit—provided the person dies on time. But there's a risk. While the viatical investment guarantees a certain payoff at death ($100,000 in this example), the rate of return depends on how long the patient lives. If the person dies, as predicted, in one year, the investor who paid $50,000 for a $100,000 policy makes a killing, so to speak—a 100 percent annual return (minus the premiums he paid and fees to the broker who arranged the deal). If the patient lives for two years, the investor must wait twice as long for the same payout, so his annual rate of return is cut in half (not counting additional premium payments, which reduce the return even further). If the patient makes a miraculous recovery and lives for many years, the investor may make nothing.

Of course, all investments carry risk. But with viaticals, the financial risk creates a moral complication not present in most other investments: the investor must hope for the early demise of the person whose life insurance he buys. The longer the person hangs on, the lower the rate of return.

Needless to say, the viatical industry took pains to de-emphasize this ghoulish aspect of its business. Viatical brokers described their mission as providing those with terminal illnesses the resources to live out their last days in relative comfort and dignity. (The term "viatical" comes from the Latin term for money and provisions supplied Roman officials setting out on a journey.) But there was no denying that the investor had a financial interest in the prompt death of the insured. "There have been some phenomenal returns, and there have been some horror stories where people live longer," said William Scott, president of a Fort Lauderdale viatical company.[26]

Some of these "horror stories" led to lawsuits, in which disgruntled investors sued brokers for selling them life insurance policies that failed to "mature" as quickly as expected. The discovery, in the mid-1990s, of anti-HIV drugs extended the lives of tens of thousands of people with AIDS and scrambled the calculations of the viatical industry. An executive of a viatical firm explained the downside of life-extending medication: "A 12-month expectancy turning into 24 months does play havoc with your returns."[27]

Once an AIDS diagnosis ceased to be a death sentence, viatical companies sought to diversify their business to cancer and other terminal illnesses. Undaunted by the downturn in the AIDS market, William Kelley, executive director of the Viatical Association of America, the industry's trade association, offered an upbeat assessment of the death-futures business: "Compared to the number of people with AIDS, the number of people with cancer, severe cardiovascular diseases, and other terminal illnesses is huge."[28]

Unlike janitors insurance, the viatical business serves a clear social good—financing the final days of people with terminal illnesses. Moreover, the consent of the insured is built in from the start. So the moral problem with viaticals is not that they lack consent. It's that they are wagers on death that give investors a rooting interest in the prompt passing of the people whose policies they buy.

In this respect, the ethical issue posed by viaticals is similar to the one posed by speculating on a housing market crash or on Greece defaulting on its debt: is it morally dubious to make money by betting on the misfortune of others, even if the speculator does nothing to hasten the death, foreclosure, or bankruptcy on which his profit depends? These practices seem troubling, yet it is not obvious what is morally objectionable about them.

Why should I care if, somewhere, an investor is hoping I die? Perhaps I shouldn't care, provided he doesn't act on his hope or call too often to ask of my condition. Perhaps the moral problem lies not in any tangible harm to me but in the corrosive effect on the character of the investor, and on the moral sensibilities of a society where such speculation becomes widespread.

Notwithstanding the morally corrosive aspect of viaticals, they are not death bets pure and simple. By providing ready cash for those who need it, they do perform a social good. Whether they should be permitted therefore depends on evaluating the good they serve against their morally corrosive effects.

Death Pools

A clearer case of a pure wager on death is offered by "death pools," a macabre gambling game that became popular on the Internet in the 1990s, about the same time the viatical industry took off. Death pools are the cyberspace equivalent of traditional office pools except that, instead of picking the winner of a football game, players compete to predict which celebrities will die in a given year.[29]

Many websites offer versions of this morbid game, with names such as "Ghoul Pool," "Dead Pool," and "Celebrity Death Pool." One of the most popular is Stiffs.com, which held its first game in 1993 and went online in 1996. For a fifteen-dollar entry fee, contestants submit a list of celebrities they think are likely to die by year's end. Whoever makes the most correct calls wins the jackpot of three thousand dollars. Second place is five hundred dollars. Stiffs.com attracts more than a thousand participants a year.[30]

Serious players do not make their picks lightly, but scour entertainment magazines and tabloids for news of ailing stars. Current betting favors Zsa Zsa Gabor, Billy Graham, and Fidel Castro. Other popular death-pool choices are Kirk Douglas, Nancy Reagan, Muhammad Ali, Ruth Bader Ginsburg, Stephen Hawking, Aretha Franklin, and Ariel Sharon. Since aged and ailing figures dominate the lists, some games award extra points to those who successfully predict long shots like Princess Diana, John Denver, or others who meet untimely deaths.[31]

Betting on when celebrities will die is a recreational activity. No one makes a living at it. But death pools raise some of the same moral questions posed by viaticals and janitors insurance. The moral tawdriness of the game lies mainly, I think, in the attitude toward death it expresses and promotes.

Like viaticals, death pools are morally disquieting because they speculate on morbidity. But unlike viaticals, they serve no socially useful purpose. They are strictly a form of gambling, a source of profit and amusement. Distasteful through they are, death pools are hardly the most grievous moral problem of our time. In the hierarchy of sin, they are boutique vices. But they are interesting for what they reveal, as a limiting case, about the moral fate of insurance in an age of speculation.

Life insurance has always been two things in one: a pooling of risk for mutual security and a grim wager, a hedge against death. These two aspects of life insurance coexist in uneasy combination. In the absence of moral norms and legal restraints, the wagering aspect threatens to swamp the social purpose that justifies life insurance in the first place.

When the social purpose is lost or obscured, the fragile lines separating insurance, investment, and gambling come undone. Life insurance devolves from an institution to provide security for one's survivors into just another financial product and, finally, into a gamble on death that serves no good beyond the fun and profit of those who play the game. The death pool, frivolous and marginal though it seems, is actually the dark twin of life insurance—the wager without the redeeming social good.

The advent in the 1980s and '90s of janitors insurance, viaticals, and death pools augured the rise of an economy of speculation. The first decade of the twenty-first century carried this tendency further. But before bringing the story into the present, it is worth looking back to recall the moral unease that life insurance has provoked from the start.

A BRIEF MORAL HISTORY OF LIFE INSURANCE

We commonly think of insurance and gambling as different responses to risk. Insurance is a way of mitigating risk, while gambling is a way of courting it. Insurance is about prudence; gambling is about speculation. But the line between these activities has always been unstable.[32]

Historically, the close connection between insuring lives and betting on them led many to regard life insurance as morally repugnant. For centuries, life insurance was prohibited in most European countries. Lacking moral legitimacy, "life insurance did not develop in most countries until the mid- or late nineteenth century."[33]

England was an exception. Beginning in the late seventeenth century, shipowners, brokers, and insurance underwriters gathered at Lloyd's coffeehouse in London, a center of marine insurance. Some came to insure the safe return of their ships and cargo. Others came to bet on lives and events in which they had no stake apart from the wager itself. For example, many people took out "insurance" on ships they did not own, hoping to profit if a ship was lost at sea. The insurance business commingled with gambling, with the underwriters acting as bookmakers.[34]

English law placed no restrictions on insurance or gambling, which were more or less indistinguishable. In the eighteenth century, insurance "policyholders" placed bets on the outcome of elections, the dissolution of Parliament, the chance that two English peers would be killed, the death or capture of Napoleon, and the life of the queen in the months preceding the Queen's Jubilee.[35]

Other popular subjects of speculative gambling, the so-called sporting part of insurance, included the outcome of sieges and military campaigns, the "much insured life" of Robert Walpole, and whether King George II would return alive from battle. When Louis XIV, the king of France, fell ill in August 1715, the English ambassador to France wagered that the Sun King would not live beyond September. (The ambassador won his bet.) "Men and women in the public eye usually supplied the subjects for these gaming policies," which amounted to an early version of today's Internet death pools.[36]

One especially grim life insurance wager involved eight hundred German refugees who, in 1765, were brought to England and then abandoned without food or shelter on the outskirts of London. Speculators and underwriters at Lloyd's placed bets on how many of the refugees would die within a week.[37]

Most people would regard such a wager as morally appalling. But from the standpoint of market reasoning, it's not clear what is objectionable about it. Provided the gamblers were not responsible for bringing about the refugees' plight, what's wrong with betting on how soon they will die? Both parties to the bet are made better off by the wager; otherwise, economic reasoning assures us, they wouldn't have made it. The refugees, presumably unaware of the bet, are no worse off as a result of it. This, at least, is the economic logic for an unfettered market in life insurance.

If death bets are objectionable, it must be for reasons that lie beyond market logic, in the dehumanizing attitudes such wagers express. For the gamblers themselves, a cavalier indifference to death and suffering is a mark of bad character. For society as whole, such attitudes, and the institutions that encourage them, are coarsening and corrupting.

The rampant wagering on death in Britain prompted a growing public revulsion against the unsavory practice. And there was a further reason to limit it. Life insurance, increasingly seen as a prudent way for breadwinners to protect their families from destitution, had been morally tainted by its association with gambling. For life insurance to become a morally legitimate business, it had to be disentangled from financial speculation.

This was finally achieved with the enactment of the Gambling Act of 1774. The law banned gambling on the lives of strangers and restricted life insurance to those who had an "insurable interest" in the person whose life they were insuring. Since an unfettered life insurance market had led to "a mischievous kind of gaming," Parliament now prohibited all insurance on lives "except in cases where the persons insuring shall have an interest in the life or death of the persons insured."[38]

In the United States, the moral legitimacy of life insurance was slow to develop. It was not firmly established until the late nineteenth century. Although a number of insurance companies were formed in the eighteenth century, they sold mostly fire and marine insurance. Life insurance faced "powerful cultural resistance." As Viviana Zelizer writes, "Putting death on the market offended a system of values that upheld the sanctity of life and its incommensurability."[39]

By the 1850s, the life insurance business began to grow, but only by emphasizing its protective purpose and downplaying its commercial aspect. As the industry grew, the meaning and purpose of life insurance changed. Once gingerly marketed as a beneficent institution for the protection of widows and children, life insurance became an instrument of saving and investment and a routine part of business. The definition of "insurable interest" expanded from family members and dependents to include business partners and key employees. Corporations could insure their executives (though not their janitors or rank-and-file employees).[40]

The insurable-interest requirement limited life insurance to those with a prior stake, whether familial or financial, in the life they were insuring. This helped distinguish life insurance from gambling—no more bets on the lives of strangers simply to make money. But this distinction was not as sturdy as it seemed. The reason: the courts decided that, once you had a life insurance policy (backed by an insurable interest), you could do with it what you pleased, including selling it to someone else. This doctrine of "assignment," as it was called, meant that life insurance was property like any other.[41]

In 1911 the US Supreme Court upheld the right to sell, or "assign," one's life insurance policy. Justice Oliver Wendell Holmes, writing for the Court, acknowledged the problem: giving people the right to sell their life insurance policies to third parties undermined the insurable-interest requirement. It meant that speculators could reenter the market: "A contract of insurance upon a life in which the insured has no interest is a pure wager that gives the insured a sinister counter interest in having the life come to an end."[42]

Holmes conceded that the whole point of requiring an "insurable interest" was to prevent life insurance from devolving into a death bet, "a mischievous kind of gaming." But this was not reason enough, he thought, to prevent a secondary market in life insurance that would bring the speculators back in. "Life insurance has become in our days one of the best recognized forms of investment and self-compelled saving," he concluded. "So far as reasonable safety permits, it is desirable to give to life policies the ordinary characteristics of property."[43]

A century later, the dilemma that confronted Holmes has deepened. The lines separating insurance, investment, and gambling have all but vanished. The janitors insurance, viaticals, and death pools of the 1990s were only the beginning. Today, markets in life and death have outrun the social purposes and moral norms that once constrained them.

THE LIVES OF STRANGERS

Life-extending AIDS drugs were a blessing for health, but a curse for the viatical industry. Investors found themselves stuck paying premiums on life insurance policies that failed to "mature" as promptly as expected. If the business was to survive, viatical brokers needed to find more reliable deaths to invest in. After looking to cancer patients and others with terminal illnesses, they came up with a bolder idea: Why limit the business to people with diseases? Why not buy life insurance policies from healthy senior citizens willing to cash them in?

Alan Buerger was a pioneer of the new industry. In the early 1990s, he had sold janitors insurance to corporations. When Congress cut back the tax advantages of janitors insurance, Buerger considered moving into viaticals. But then it occurred to him that healthy, wealthy seniors offered a bigger, more promising market. "I felt like I was struck by lightning," Buerger told the *Wall Street Journal*.[44]

In 2000 he began buying life insurance policies from people age sixty-five and older and selling them to investors. The business works like the viatical business, except that the life expectancies are longer and the value of the policy is typically higher, usually a million dollars or more. Investors buy the policies from people who no longer want them, pay the premiums, and collect the death benefit when the people die. To avoid the taint that came to be associated with viaticals, this new business calls itself the "life settlement" industry. Buerger's company, Coventry First, is one of the most successful in the business.[45]

The life-settlement industry presents itself as "a free market for life insurance." Previously, people who no longer wanted or needed their life insurance policies had no choice but to let them lapse or in some cases to cash them in with the insurance company for a small surrender amount. Now, they can get more for their unwanted policies by selling them off to investors.[46]

It sounds like a good deal all around. Seniors get a good price for their unwanted life insurance policies, and investors reap the benefits when the policies come due. But the secondary market in life insurance has bred a number of controversies and a spate of lawsuits.

One controversy arises from the economics of the insurance industry. Insurance companies don't like life settlements. In setting premiums, they have long assumed that a certain number of people will drop their policies before they die. Once the children are grown and one's spouse is provided for, policyholders often stop paying premiums and let their policies lapse. In fact, almost 40 percent of life insurance policies result in no death benefit payout. But as more policyholders sell their policies to investors, fewer policies will lapse, and the insurance companies will have to pay out more death benefits (that is, to investors who keep paying the premiums and eventually collect).[47]

Another controversy involves the moral awkwardness of betting against life. With life settlements as with viaticals, the profitability of the investment depends on when the person dies. In 2010 the *Wall Street Journal* reported that Life Partners Holdings, a life-settlement company in Texas, had systematically underestimated the life expectancy of the people whose policies they sold to investors. For example, the company sold investors a two-million-dollar insurance policy on the life of a seventy-nine-year-old Idaho rancher, claiming he had only two to four years to live. More than five years later, the rancher, eighty-four, was still going strong, running on a treadmill, lifting weights, and chopping wood. "I'm healthy as a horse," he said. "There's going to be a lot of disappointed investors."[48]

Another controversial feature of the business involved its inventive ways of finding policies to sell. By the mid-2000s, the secondary market in life insurance had become big business. Hedge funds and financial institutions like Credit Suisse and Deutsche Bank were spending billions buying the life insurance policies of wealthy seniors. As the demand for such policies increased, some brokers began paying elderly people who held no insurance to take out large policies on their lives and then flip the policies to speculators for resale. These policies were called speculator-initiated, or "spin-life," policies.[49]

In 2006 the *New York Times* estimated that the market in spin-life policies was approaching thirteen billion dollars a year. It described the frenzy to recruit new business: "The deals are so lucrative that older people are being wooed in every fathomable way. In Florida, investors have sponsored free cruises for seniors willing to undergo physical exams and apply for life insurance while on board."[50]

The battle between insurance companies and the life-settlement industry played out in state legislatures across the country. In 2007 Goldman Sachs, Credit Suisse, UBS, Bear Stearns, and other banks formed the Institutional Life Markets Association to promote the life-settlement industry and to lobby against efforts to restrict it. The association's mission: to create "innovative capital market solutions" for the "longevity and mortality-related marketplace."[51] This was a polite term for the market in death bets.

By 2009 most states had enacted laws banning spin-life, or "stranger-originated life insurance" (STOLI), as it came to be called. But they permitted brokers to continue trading in life insurance policies from ill or elderly people who had bought them on their own, unprompted by speculators. Seeking to fend off further regulation, the life-settlement industry sought to draw a principled distinction between "stranger-owned life insurance" (which it supported) and "stranger-originated life insurance" (which it now opposed).[52]

Morally speaking, there's not much difference. For speculators to induce senior citizens to buy and flip life insurance for a quick profit does seem especially tacky. It is certainly at odds with the purpose that justifies life insurance—to protect families and businesses from being financially devastated by the death of a breadwinner or key executive. But all life settlements share this tackiness. Speculating on other peoples' lives is morally questionable regardless of who originates the policy.

DEATH BONDS

Only one step remained for the growing market in death bets to come of age—securitization by Wall Street. In 2009 the *New York Times* reported that Wall Street investment banks planned to buy life settlements, package them into bonds, and resell the bonds to pension funds and other big investors. The bonds would generate an income stream from the insurance payouts that came due as the original policyholders died. Wall Street would do for death what, over the past few decades, it did for home mortgages.[53]

According to the *Times*, "Goldman Sachs has developed a tradable index of life settlements, enabling investors to bet on whether people will live longer than expected or die sooner than planned." And Credit Suisse is creating "a financial assembly line to buy large numbers of life insurance policies, package and resell them—just as Wall Street firms did with subprime securities." With twenty-six trillion dollars of life insurance policies in existence in the United States, and a growing trade in life settlements, the death market offers hope for a new financial product to offset the lost revenue from the collapse of the mortgage securities market.[54]

Although some rating agencies remain to be convinced, at least one believes it is possible to create a bond based on life settlements that minimizes risk. Just as mortgage securities bundled loans from different regions of the country, a bond backed by life settlements could bundle policies on people "with a range of diseases—leukemia, lung cancer, heart disease, breast cancer, diabetes, Alzheimer's." A bond backed by this diversified portfolio of ailments would enable investors to rest easy, because the discovery of a cure for any one disease would not cause the bond price to tank.[55]

AIG (American International Group), the insurance giant whose complex financial dealings helped bring on the 2008 financial crisis, has also expressed interest. As an insurance company, it has opposed the life-settlement industry and fought it in court. But it has quietly bought up eighteen billion of the forty-five billion dollars in life-settlement policies currently on the market and now hopes to package them into securities and sell them as bonds.[56]

What, then, is the moral status of death bonds? In some ways, it is comparable to the death bets that underlie them. If it is morally objectionable to wager on the lives of human beings and to profit from their deaths, then death bonds share this defect with the various practices we've considered—janitors insurance, viaticals, death pools, and all purely speculative trade in life insurance.

It might be argued that the anonymity and abstractness of death bonds reduce the corrosive effect on our moral sensibilities to some degree. Once life insurance policies are bundled in vast packages and then sliced and diced and sold off to pension funds and college endowments, no investor retains a rooting interest in the death of any particular person. Admittedly, death-bond prices would fall if national health policy, environmental standards, or improved eating and exercise habits led to better health and longer lives. But betting against this possibility seems somehow less troubling than counting the days for the New Yorker with AIDS or the Idaho rancher to die. Or is it?

Sometimes we decide to live with a morally corrosive market practice for the sake of the social good it provides. Life insurance began as a compromise of this kind. To protect families and businesses against the financial risks of an untimely death, societies came reluctantly to the conclusion, over the past two centuries, that those with an insurable interest in a person's life should be permitted to make a wager with death. But the speculative temptation proved difficult to contain.

As today's massive market in life and death attests, the hard-fought effort to disentangle insurance from gambling has come undone. As Wall Street gears up for the death-bond trade, we are back to the freewheeling moral universe of Lloyd's coffeehouse in London, only now on a scale that makes their wagers on the death and misfortune of strangers seem quaint by comparison.

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I've tried in this lecture to make sense of a growing unease with the kind of economic activity our society has come to honor and reward. Increasingly, people are rewarded less for making things than for managing and manipulating risk, less for producing useful goods and services than for speculating on future prices and events. As state governments rely increasingly on revenue from lotteries and casino gambling, as financial activity accounts for a growing share of the gross domestic product, as life insurance becomes hard to distinguish from betting on the lives of strangers, as derivatives and naked credit default swaps turn finance into a form of high-stakes gambling, the speculative impulse that defines our economy strays ever further from the social purpose of finance, which is to allocate capital to productive purposes.

I have tried to show how these attitudes and practices have deepened their hold in recent decades. And I have tried to suggest why those who find them troubling are right to be worried. A moral economy of speculation not only heightens inequality; it also dishonors productive labor and rewards economic activity that bears little relation to the common good. I realize I have not offered a way out of this predicament. But I hope that shedding light on these attitudes and practices may prompt us to seek an economy less friendly to speculation and more hospitable to the sturdier things a just society requires.

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