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PRELIMINARY REPORT

Moral Capital as an Element of Successful Transitions

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ABSTRACT
Moral capital is of great importance for both the economic and non-economic well-being of a society. However, moral capital is likely to erode during transitions, especially economic ones. The aim of the work is to determine the mechanisms through which the economic and political transition contributes to the erosion of moral capital, but also which measures can affect the rebuilding of moral capital. Analyzing individual cases, especially in Serbia, we draw general conclusions about the impact of economic and political transition on the decline of moral capital in transition countries. In this paper, we argue that the processes put in motion during economic and political transitions that lead to loss of moral capital are likely to result in a new equilibrium state. This state is characterized by the migration of the bearers of moral capital both to the margins of society and out of society and is highly unlikely to be reversed without a focused intervention by the state and society. We further argue that economic theory could both offer a justification for such an intervention and inform on the most effective way to conduct it. This is because the loss of moral capital can be seen as an instance of market failure in transition, one in which parts of the transitional elite are imposing a negative externality on the rest of society. Internalizing this externality -by making the culprits responsible could make the transition more successful; it would benefit justice and prosperity not only in the current economic transition but also in the future restructuring of the national economy and society. We argue that measures to restore moral capital ought to combine monetary transfers, improvement of institutional framework, and immaterial incentives with the aim of initiating processes that could benefit the whole society. Legally required monetary transfers should repair direct damage caused by corrupt actions, but should not benefit any particular individual, while immaterial incentives should be initiated both by the state and the wider society. We found out that activities of transition elites contribute to negative externalities, such as deterioration of moral capital, which results in less social and economic well-being. Additionally, we propose measures which can contribute to the internalization of these externalities.

Keywords: *moral capital, social capital, transition, transitional justice, market failure, negative externality, business ethics, corruption*

JEL Classification: B55, N34, O15, P20, P30, Z13

INTRODUCTION

Transitions, such as those from a centrally planned to a market economy, are complex processes. They are accompanied by political and economic shocks which bear social, economic, and business risks (Hoskisson et al., 2000). Among other effects, these shocks can also affect many aspects of intangible assets, both at the level of the economy and at the level of individual

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companies. For instance, transition can frequently result in the loss of moral capital. The definition of moral capital is not unique in all disciplines, but it is most often associated with intangible assets that refer to trust, credibility and the positive reputation that an individual or institution enjoys in society (Kang and Glassman, 2010). Moral capital arises as a result of the actions of individuals or institutions in accordance with the dominant moral principles in society, which is why they are associated with a long-term period of construction. The existence of moral capital guarantees personal security and security of property, but also the security of contract implementation, which contributes to the creation of new business opportunities and lower transaction costs (Ratnapala, 2003).

Economic and political transition, in addition to other changes, lead to changes in the value system, that is, to changes in moral norms. Due to the high degree of uncertainty during the transition period, many institutions and individuals begin to make moral compromises. In this way, the value of moral capital decreases. This occurs both through marginalizing the influence of individuals with higher moral norms who remain in the transitional society, and through being a reason for many of them, unwilling to accept elements of immoral behavior in everyday life and business practices, to leave the society. The lack of moral capital is problematic in various ways. It is an injustice towards those who left after their opportunities for achieving an economically prosperous future and immaterial well-being were reduced because of a decline in moral capital in their homeland. After all, their ancestors too have won freedom and built the country which they left, to benefit them as well as others. Moreover, it is an injustice towards the rest of the society that could also benefit from their presence, their knowledge and moral capital (Horvat, 2004).

In this paper, we argue that an approach towards initiating the recovery of moral capital could be informed by recognizing its loss as a negative externality characteristic of societies in transition. The loss of moral capital ensues because the individuals that cause it do not pay for the damage they cause and, therefore, do not consider the consequences that their actions have on the rest of society. Transitional justice could be satisfied, and a greater social well-being could be achieved if they are forced to account for the damage they impose on others in addition to accounting for the private benefit they derive from their actions. To encourage individuals and companies to compensate for the damage caused to society by their actions, it is necessary to have strong and efficient institutions that will identify such behavior, evaluate its effects, and have enough power to exert pressure on those causing the damage. Depending on the social, economic, and political arrangements, these can be both formal and informal institutions (Peng et al., 2008). However, with the collapse of the system of regulation of an interventionist state, and the erosion of social norms of conduct which can accompany transitions, many formal and informal institutions – affected by national culture and level of economic development – lost their importance. This opened space for unethical behavior, which can still formally remain within legal bounds. The newly created business environment designed by transitional formal and informal institutions puts constraints on crafting a new business model (Peng and Lin, 2009). Such a business model can be characterized by unethical behavior with costly consequences on economic justice and efficiency (Otusanya, 2011).

Several factors present great difficulty in designing the legal mechanisms and incentives that could satisfy transitional justice and restore well-being. They include the breath of the consequences of the loss of moral capital, the complexity of the processes by which it affects output and well-being, the multitude of the social groups involved and affected, as well as the interactions of material and immaterial elements in both the source of the problem and its potential solutions.

This is a theoretical, not an empirical paper. In the following section, we first clarify the terms which we are using and present a theoretical framework. In the two sections that follow, we motivate our study by explaining why moral capital is important. We first explain the importance of moral capital for economic prosperity and well-being and then consider the importance of business ethics and the impact of corruption - as the most visible form of the decline in moral capital - on economic performance. In the subsequent chapter, we outline the processes by which we expect moral capital to be lost during transitions, and support this with some stylized facts from historical transitions. We then postulate that the loss of moral capital can be considered as a type of market failure in the category of negative externalities. Building on the theorized idea of loss of moral capital as a negative externality, we then proceed to derive policy recommendations that could potentially be used to internalize this externality and initiate the recovery of moral capital. In the penultimate chapter, we speculate on the likely reach and limitations of such measures, while the final chapter concludes.

THEORETICAL FRAMEWORK - THE IMPORTANCE OF MORAL CAPITAL FOR WELL-BEING AND ECONOMIC PROSPERITY

We treat the concept of moral capital as economists: we consider it as a factor that can firstly raise output given a fixed set of other factors of production, and secondly increase an individual's utility. In economics, capital denotes a factor of production: the more capital is allocated to a fixed number of workers, the more goods or services can be produced. Under capital, we traditionally understand physical capital, for instance, a machine used for production. When we speak of social capital, we thus have in mind some characteristics of a society that also enable us to produce a greater number of goods or services, given a fixed amount of all other factors of production (such as physical capital -K, land - T, labor -L, knowledge (N), etc.), as illustrated in Figure 1. Note that for the arguments presented in this paper, we need not assume a specific form of the production function as long as a higher amount of social capital S will result in a higher amount of output Y.

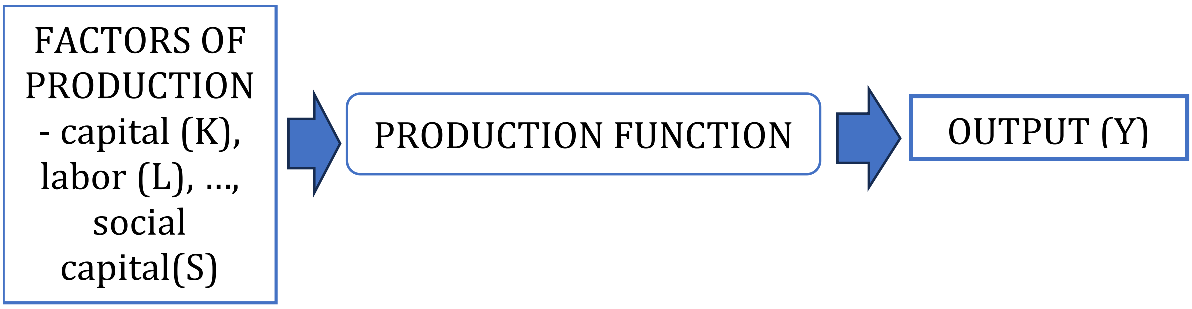

Figure 1. Social Capital as a Factor of Production

Several existing concepts of social capital agree with our theoretical framework. While different authors emphasize different aspects of social capital, all are concerned with various features of the networks of human interaction: how many people one knows, how much trust and ease of cooperation there is between equal members of a society and between social groups (Paldam, 2008), etc. Trust and cooperation as two concepts of social capital are closely related. Trust can be defined as trust in an individual and trust in institutions, on the basis of which it can be expected that individuals will act morally if they believe that other members of society and institutions will respect moral norms. In contrast, Uslaner (1999) found that the moral codes of individuals lead to moral behavior rather than the expectations of others to behave morally. In contrast, the network concept of social capital refers to the strength of ties that exist in society, but also the number of ties that an individual has achieved. All this will affect the efficiency and productivity of the business. Thus, in a team where members are connected by numerous and strong ties and there is a high degree of trust, it is much easier to cooperate and transfer knowledge, which therefore contributes to better performance.

Under moral capital, we, therefore, have in mind a special subtype of social capital that can lead to greater output through adherence to moral norms. The concept is intuitive since one can imagine that a corporate culture that excludes lying is likely to make doing business less risky, easier, and more important in mitigating moral hazard in doing business (Lin and Pursiainen, 2022). However, moral capital also represents a broader concept that includes tolerance, mutual respect, reciprocity, and trust. Among them, trust plays an important role in maximizing the efficiency of economic and many other transactions (Mladjan and Fatić, 2018). Uslaner (2002) argues that trust arises from institutional assurances or a moralistic belief in people who never betrayed such trust. Seligman (1997) moreover argues that trust, once accumulated, generates a whole range of other components of social capital, such as civility, that facilitate the efficiency of "general exchange". In societies with greater moral capital, employees and managers can quickly and more completely unify their efforts towards jointly defined goals, which results in synergistic effects (Casey and Delaney, 2022). Moral capital can, therefore, be understood as a connective tissue that contributes to better understanding between individuals, growth of motivation, and better business performance as a result. Moral capital contributes to the build-up of reputation and trust, which can also be reflected in encouraging the moral behavior of other players in a market. Respecting the company's moral norms will motivate suppliers and customers to form strategic partnerships with the company, reduce transaction costs, and facilitate the exchange of knowledge, resulting in the creation of new and improved capabilities (Al-Ali, 2003).

If we instead speak of moral capital in a context which surpasses the economic sphere, we consider it as a factor that raises not only the output of goods and services but also the immaterial well-being, as measured by individual's utility and used in Mladjan and Fatić (2018). This is illustrated in Figure 2. Two remarks are in place here. Firstly, income is not the only factor that affects one's well-being as measured by one's utility. Factors such as lifestyle, location of life and work, tone of interactions with other humans, the health of oneself and family members, etc., could all matter. Secondly, which factors exactly matter, to what extent, and how their interactions matter for the overall well-being of an individual depend on the individual's preferences which are at least in part based on one's system of values. For instance, one may prefer to take a job with a lower salary if it leaves more leisure time and creates less stress. Also, because of immaterial factors, one may prefer to live in one's ancestral homeland rather than in a foreign country where income may be higher. At the same time, when we speak about the well-being of a society, we mean the sum of the utilities of society's members. A society could, for instance, maximize its income through free trade if it were to specialize in the provision of services for export, minimizing the number of people working in the military and the defense industry. However, this may not be the preferred choice in case members of this society value freedom and sovereignty as guarantees for the free development of national culture and in case these could become jeopardized through the foreign occupation of an ill-defended nation. In a similar vein, societies could produce more products and services, and both individuals and societies could experience a higher level of utility in case there is more social and moral capital.

We acknowledge that high trust, ease of cooperation, and strong network – as features of social capital – could also help achieve high output even in a mafia-like environment. In particular, mafia members could trust each other, have strong networks, and ease of mutual understanding which allows them to engage in profitable undertakings in the short run. In our analysis in this paper, however, we assume that, when taking a longer-term horizon, the Serbian folk wisdom that "Justice upholds lands and cities, and injustice ruins and puts them down" holds true. This view also has empirical support. Previous studies have found that the low quality of institutional framework in Western Balkans transitional countries negatively affects the prosperity of these countries (Jovanović Gavrilović and Gligorić, 2018). Not in the least because of this reason, we are interested in exploring the fragility of the type of moral capital that corresponds to morally elevated interactions, such as judged based on a Christian set of values.

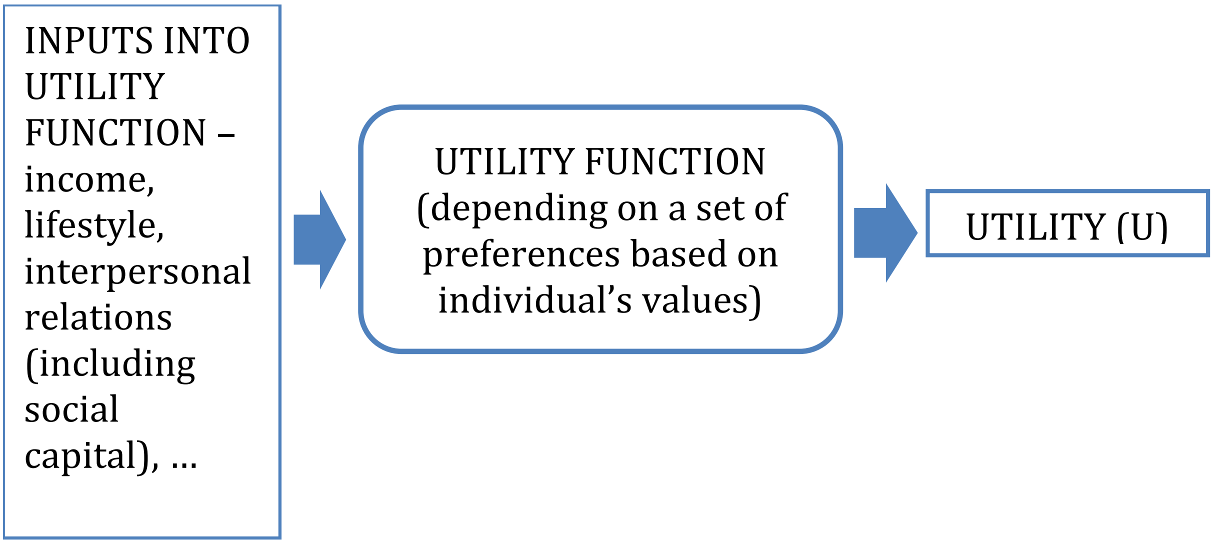

Figure 2. Social capital as a factor which raises an individual's well-being

Here, we theorize that the bearers of moral capital, and any other type of social capital, are individuals. They increase the well-being of the rest of society by making the social interactions morally more elevated, and by creating moral improvements in the norms of interactions, judging based on the aforementioned set of values. While the moral norms held by different social and economic strata are all relevant to the moral capital of a society, a higher importance can arguably be given to the morality of the elite. Decisions of the members of the elite shape the economic, political, and social system in general; they both hold positions endowed with greater decision-making power and, for the same reason, they are likely to serve as role models for the rest of society, which is an important mechanism studied by virtue ethics (Mladjan and Fatić, 2018; Fatić, 2016). An individual's well-being is affected by both material and immaterial factors. One can be expected to care both about one's own purchasing power and about the safety, respect, and care provided by one's neighbors, the state, and the rest of society. Morality and ethics define the preferences of consumers, for instance, their willingness to sacrifice a part of their material benefits to achieve some of the broader social interests, or their willingness to choose products or services that will positively affect the well-being of future generations (Mladjan and Marković, 2021). The salary one earns is important, but so is the friendliness of one's colleagues. These immaterial factors can also result in higher productivity and output (Sunanda, 2018).

The connection between the effect of moral capital on general well-being and economic prosperity is reinforced by the variety of talents possessed by the individuals who bear a society's moral capital. We expect the share of moral capital carried by the individuals who possess knowledge valuable for the economy to be disproportionally larger than their number in society. This occurs not because the less knowledgeable members of society necessarily have lower moral norms of conduct, but because the moral norms of the more knowledgeable ones could be socially more influential. The moral norms of more knowledgeable individuals have high importance because they direct processes and outcomes in the economic, political, and other spheres of society, and present a role model role for the rest of the society (Fatić, 2016). Moreover, Muratza et al. (2016) find that individuals with higher moral standards are more willing to share their knowledge with others and to devote themselves to the welfare of the organization they belong to, or to other individuals beyond what is formally expected of them.

Because knowledge and moral capital are important for economic growth (Whiteley, 2000), and because the bearers of one are frequently also the bearers of the other, changes in the participation in the life of a nation of the bearers of knowledge and moral capital can greatly influence economic prosperity. Changes in the moral environment within a society – that would alter the participation of the bearers of moral capital— could thus have a large impact on the economic well-being of everyone in the society. The existence of moral capital in society contributes to the growth of social trust, which encourages economic activity, not in the least through the creation of innovations (Foss, 2012). In this way, even those who do not respect ethical norms benefit from moral capital. If a deterioration of the moral norms of social interactions induces the bearers of moral capital to change their moral environment, society may become impoverished. This could happen if they withdraw to the margins of the social and economic life of their nation, or if they migrate out of their country, in both cases being driven by a desire to avoid compromising their moral norms. In a reverse process, a moral recovery could lead to an economic recovery as the bearers of moral capital move back from the margins of the society and from abroad to the center of cultural and economic life of a society which, in the process of moral recovery, is less likely to exert pressure on them to breach their moral norms.

This theoretical work builds on our own observations and findings of related studies of the economic and post-communist transition process in Serbia and Eastern Europe to establish a theoretical framework (Mladjan and Marković, 2016). We then argue that processes which we postulated can be described as market failures, which in neoclassical economics can provide the grounds for governmental and non-governmental intervention to correct this failure (Pyndick and Rubinfeld, 2001). Proceeding in two ways, we predict several measures that could plausibly reverse the process of market failure associated with the loss of moral capital, and we give suggestions for further research that could subject our theoretical framework to the tests of the rigor of the scientific method (Popper, 2002). Our approach is transformative in the policy implications which it recommends (Cresswell, 2014). Given the complexity of the mechanisms described and the difficulty of examining each of them empirically, our approach is also pragmatic in that it gives actionable suggestions – in our view morally nonproblematic - based on what appears plausible even if it is not verified.

THE IMPACT OF BUSINESS ETHICS AND CORRUPTION ON ECONOMIC PERFORMANCE

While acknowledging that induction cannot prove a theory right, we nevertheless proceed to present stylized empirical facts from related literature that can help demonstrate the importance of moral capital and the plausibility of our theoretical framework. Ethical business practice is one of the focus points of research in the field of business. The issue of ethics in business is a question that has been studied for the last few decades, ever since the prevailing view became that companies ought to fulfill the goals of not just the owners but also other stakeholders (Lindgreen and Swaen, 2010). Although most companies have adopted this narrative, today we are witnessing an increasing number of ethical scandals in which companies from transition, emerging, and developed markets are involved. For instance, in 2016, the US authorities discovered an emission-cheating device installed in Audi cars. These devices helped Audi to meet gas emission standards in the USA. Volkswagen, the owner of Audi, pleaded guilty and agreed to pay a large fine. Contemporaneously and in a similar vein, the largest company in Croatia, Agrokor, went into bankruptcy due to the discovery of corrupt activities of the company's owner. Many large foreign companies, as well as small domestic firms, Agrokor's suppliers and creditors, faced huge financial losses during its restructuring.

The new concept called shared value argues that the future of business practice lies in the close coordination of management and the wider community, as well as a mutual understanding of their goals (Dembek, Singh and Bhakoo, 2016). For the concept to be widely accepted, it is necessary to evaluate both the goals of the companies and the goals of the wider community. While valuing business goals is possible based on realized profits, valuing social goals is much more difficult (Porter and Kramer, 2011). Namely, many social goals are by their nature intangible, while the achievement of certain social goals – such as, for instance, clean air – creates benefits for future generations as well. Although the concept of shared value attracted a lot of attention and was accepted by certain large multinational companies, critics also appeared. One line of criticism was that the concept does not actually offer practical tools that will facilitate its application in practice (Beschorner, 2014). Another line of criticism was that the concept must be upgraded so that the ethical framework gives clear guidelines to managers when, instead of "win-win", they encounter "lose-win" or "win-lose" situations. This also brings us to the question of the ethical framework within which managers move as individuals (de los Reyes Jr, Scholz, and Smith, 2017).

Many managers view business value creation through short-term financial goals and view social goals as opposed to economic goals. For this reason, managers frequently neglect activities which can both positively affect the realization of social goals and contribute to business performance in the long run (Kramer and Porter, 2006). The long-term orientation of business managers engenders a higher level of ethical values, which positively affects the inclination of managers to include social goals in their decision-making framework (Nevins, Bearden and Money, 2007).

Social, political, and economic shocks in countries in transition from centrally planned to market economies have led to a change in the ethical framework of the newly created social class of owners (Fülöp, Hisrich and Szegedi, 2000). The former informal social institutions, which existed both in the era of socialism and before that, have acquired a new business role. Networks of social contacts, which in the past were a substitute for institutional support for an individual, have become an instrument that defines the business context in transition countries. These networks – known in Russia as blat and in China as guanxi (Michailova and Worm, 2003) – largely defined what is moral and acceptable when doing business in these countries. However, these networks were often accused of being associated with corruption in business.

A widely accepted definition of corruption is an arrangement consisting of the exchange of two or more parties which 1. has an influence on the allocation of resources either immediately or in the future; and 2. involves the use or abuse of public or collective responsibility for private ends (Kwok and Tadese, 2006). These social networks challenge the market principle in that individuals and companies that are not part of these networks face additional transaction costs. Moreover, they cannot count on the services provided by state institutions to network members. In this way, the possibility of new competitors entering the industry is hindered, which can lead to higher prices of products and services and their lower quality.

The existence of these networks is also connected with the moral values of individuals. In order to become a member of this network, an individual must accept the value system that governs within the network. Namely, since networks function on the basis of reciprocity in providing services, there must be a high degree of trust among network members (Karhunen et al., 2018). To gain trust, an individual must prove himself within the network as trustworthy by keeping his promise and creating business benefits for other members, frequently in violation of legal regulations, although relations in these networks evolve over time and follow economic development (Michailova and Worm, 2003). Companies that are not part of these informal networks do not have access to local information and knowledge, so for this reason, many multinational corporations directly or indirectly encourage their managers to be members of these networks in transition countries. This is particularly visible because in some transition countries, we see a high degree of inflow of foreign direct investment, even though these countries are characterized by a high degree of perceived corruption (Rakita, Azdejković and Marković, 2012).

The decision to connect to these networks is not an easy one for management because involvement in this corrupt relationship can be fraught with high risks. If, despite the payment or the provided support, the service is not performed, there is no possibility of relying on formal institutions to convince a network member to perform the promised service. In addition, the disclosure of participation in corrupt relationships can expose the company to legal consequences in the home market. An additionally damaged reputation in the transition market can negatively affect business cooperation with companies in other markets, as the company's reputation spills over to its strategic partners (Jiang, Li and Gao, 2008). The imperative of corrupt practice leads to the growth of transaction costs of business and a lack of trust in the market. Because of the above, previous studies have shown that the growth of corruption leads to lower premiums for local targets in international acquisitions (Weitzel and Berns, 2006).

Wide acceptance of corruptive practices may have additional indirect costs for companies. Individuals who refuse to adopt this value system may become passive due to disappointment because they cannot create benefits for themselves that would correspond to their capabilities in a less corrupt environment. Previous studies have shown that employee productivity largely depends on the ethics of managers and whether employees perceive that the company they work for respects business ethics (Ouakoua, Zaitouni and Arya, 2020). In addition, a number of individuals may decide to emigrate to countries that they consider to be characterized by a lower level of corruption (Dimant, Krieger and Meierrieks, 2013). As a result, companies in transition markets may face a labor shortage and a shortage of personnel with specific competencies. Finally, recent research has shown that a higher degree of perceived corruption is associated with a lack of trust in the national government, which negatively affected the effectiveness of the state's response to the emergencies of the Covid-19 pandemic (Škrinjarić, Budak and Carragher, 2023). A more effective response by the state would have resulted in the preservation of lives and a smaller number of patients, that is both lower economic costs for the national economy, companies, and individuals and higher non-material well-being. In the end, we can conclude that in societies and corporate cultures that are tolerant of corrupt practices, there will be lower business and economic performance, which will have a negative impact on the economic and intangible well-being of the entire society.

DYNAMICS OF THE LOSS OF MORAL CAPITAL IN TRANSITIONS

The process of changes in the political or economic system is typically associated with a change in elites. Prior to the transition, the members of the upcoming elite do not have the resources of the incumbent system on their side. To initiate a non-reversible transition that would allow them to replace the incumbents, they thus initiate struggles only in those spheres of society's life in which they have the greatest chance for victory. For instance, they focus on winning the elections or performing a successful military coup. If they manage to start a transition, many spheres of life would initially still be dominated by the incumbents. In all these spheres, the upcoming elite would want to ensure that the prominent executive posts are held by individuals loyal to them. To ensure this, they could try to win the loyalty of the same people who held these positions during the previous regime or to replace them with the existing or newly recruited members of their ideological or interest group. In either case, an elite strengthening its hold on power may find it effective to use material means to win and maintain the loyalty of holders of the commanding posts in society. Huyse (1995) provides evidence that the incorporation of large parts of previous elites, in particular the specialists, was a pragmatic decision taken all over Eastern Europe during the post-communist transition, while Mladjan (2018) describes the aforementioned tipping point in the process of elite change. Contemporary Montenegrin Politician Nebojša Medojević argues that, following the recent political change in Montenegro, key commanding posts have been kept by people loyal to the previous regime and that such an outcome is something on which the previous regime had been working for years before the Democratic Party of Socialists stopped being able to form the government in 2020 after 30 years in power (Apostolović, 2023).

The process of transition is, therefore, likely to be associated with corruption and a deterioration of moral capital (World Bank, 2000; Peña Miguel and Cuadrado-Ballesteros, 2019). The members of the previous regime that accepted material compensation to change their loyalty are compromising their ideas. Representatives of the former regime bring their own system of values and norms of behavior into the new system. In the case of the transition to a market economy, some have argued that this may refer to the acceptability of corruption (Sandholtz and Taagepera, 2005). This could lead them to become more prone to moral compromise in other spheres of their life, too. The newly recruited members of the upcoming elite are, from the start, paid for their work, which may have nothing to do with what they believe. In a similar vein, the experts of various disciplines who are open about having no ideological preference but need for the upcoming elite to strengthen its hold on power will require material compensation so as not to ally with the incumbents, such as in the post-communist transitions in Eastern Europe in the 1990s. The proven followers of the upcoming ideology may expect material compensation for any hardship they could have incurred during the unpaid struggles in the previous years. But even they may over time become accustomed to receiving material compensation for anything they earlier used to be willing to do solely out of principle and may finally start to consider material compensation more important than their principles. Also, the representatives of the old regime who may be corrupt and have accepted the new system can use their newly acquired positions to continue using corrupt activities in order to obtain additional benefits for themselves. In the case of economic transition, some have argued that the development of market institutions and their efficiency can contribute to reducing the spread of corruption (Broadman and Recanatini, 2001). In addition, weak results in anti-corruptive activities may lead to a decline in support for the transition to the market economy, endangering a process that, in the medium term, can create economic and intangible benefits for society.

The loss of moral capital could, for two reasons, be more severe in economic transitions. Firstly, valuable property that changes ownership would provide greater means to the upcoming elite to gain allies by corruption. Peña Miguel and Cuadrado-Ballesteros (2019) demonstrate that corruption is larger in case of larger privatizations, and there is ample anecdotal evidence from East European transitions that the privileged buyers of previously state-owned companies were either members of communist secret services or their offspring. Secondly, confiscating or privatizing this valuable property would make the attraction to the upcoming elite particularly large for individuals with a passion for becoming rich rather than with morally elevated principles.

The wish of the transitional elite to ensure the completion of the transition and lower the risk of its reversion could, therefore, lead to a top-down process of loss of moral capital – the lowering of ethical standards of professional and private conduct – driven by the opportunities to achieve a material benefit by connecting to the upcoming elite. Note that this could proceed even if the transition itself is inspired by a nobler set of ideas than those upheld by the incumbent system and even if the transitional elite is, in the beginning, morally more elevated than the incumbent one. Moral compromises could be made to strengthen their hold on power. An additional reason why moral capital is lost in such a top-down process is the displacement of individuals with high moral norms who are unwilling to accept a change towards morally problematic codes of conduct. Dimant, Krieger and Meierrieks (2013) provide evidence of corruption as a push factor for migration. While they may be fired, they may also withdraw themselves, either to the margins of society or from the country itself. Given that these processes result in a corrupt elite, the top-down loss of moral capital also corrupts the people outside of the ruling circles as they look up to the new elite, emulating their lifestyle in an effort to join them. Fatić (2016), for instance, in his work on virtue ethics, describes how elites serving as role models could have positive or negative effects on the morality of the rest of the society. Because of the above, corruption is considered one of the main obstacles to the development of developing countries, especially because it leads to a decline in interpersonal trust and trust in public institutions (Rose-Ackerman, 2001). A lack of trust leads to individuals and businesses focusing on short-term financial goals and neglecting the goals of the wider community.

The fact that the bearers of a society's moral capital are, to a large extent, also the bearers of its knowledge importantly shapes the processes of changes in moral capital in transitional societies. Dimant, Krieger and Meierrieks (2013) find that corruption pushes especially the migration of highly qualified workers, while Li and Zhang (2023) provide evidence of corruption as a driver of brain drain. In particular, when individuals who hold high moral norms change their moral environment – by migration or withdrawal to decision-making margins of the society – the productive and growth capacity of the economy is reduced not only by the loss of their moral capital but also by the loss of their knowledge (Li and Zhang, 2023; Marković and Mlađan, 2017). The economic decline triggered by this, and potentially in other ways, creates fertile ground for the development of another channel by which moral capital is lost. Within such a bottom-up process, in an environment of economic decline, the poor would see themselves as existentially endangered. In order to survive, they may thus be tempted to breach their pre-crisis moral norms in various ways, for instance, by lying, stealing, or smuggling. Gradually stretching the criteria for acceptability of owns' actions from moral to legal, from legal to legitimate, and from legitimate to personally beneficial, large parts of an impoverished society may over time, become accustomed to a lower level of morality. With the loss of morality among the poor, even the well from which a future moral elite could arise would be poisoned. Such a state may, misfortunately, be a stable post-crisis equilibrium. Just like in a moral society, a person who transgresses would be ostracized and thus given an incentive to improve their behavior; a person who would act in a morally sound way within an immoral society would potentially suffer and be excluded, creating an incentive for all others to accept low morality. The new equilibrium could thus be self-perpetuating both because people got accustomed to different morals, in that it became emotionally "cheap" to maintain it, and because it became costly for any individual to deviate from it.

The afore-described dynamics, especially the expected stability of the negative equilibrium that would be reached, imply that some sort of intervention, some of which we will elaborate on in the remaining part of this text, may be necessary to initiate the recovery of moral capital. This is not to say that society's self-regulating mechanisms could not lead to the recovery of its moral capital. However, a strong state intervention could be necessary in order to significantly shorten the time needed to establish a new fairer balance, which would also stimulate economic growth.

LOSS OF MORAL CAPITAL AS AN EXTERNALITY ASSOCIATED WITH TRANSITIONS

Would it be justified to act against the loss of moral capital in transitions? If so, are there ways to prevent the processes that result in the loss of moral capital, or even to reverse them? We argue that both of these questions could better be addressed by recognizing the problem of loss of moral capital as an instance of a negative externality (Pindyck and Rubinfeld, 2001: 591). Many such negative externalities are characteristic of societies in transition (Mladjan and Markovic, 2016). An externality is a type of market failure in which an agent acts to maximize his own well-being without considering the effect his decisions have on the rest of society. The agent measures his well-being using a set of preferences, which are ultimately driven by his values (Mladjan and Fatić, 2018), where these need not include any care for others. The effect on others can be ignored as long as there is no response from society, neither reward nor punishment. Recognizing the process of loss of moral capital as a negative externality is powerful in at least two ways. Firstly, it provides a justification to act against it, and secondly, it offers the logical toolkit of neoclassical economics to help us do this.

Thus, because the loss of moral capital affects justice (Mladjan, 2018), economic prosperity, and immaterial well-being, internalizing this externality should simultaneously contribute to justice and social well-being. Firstly, it appears that each agent is obliged to consider the full consequences of his actions. An administrative ban, fine, redistributive tax, or another similar measure may force the agent to act differently in the first place. But these could also give one a reason to objectively reflect upon and reconsider one's own deeds and perhaps even willingly decide to correct one's behavior. Secondly, the intervention would lead to an improvement in economic efficiency and social well-being compared to the original state which is characterized by a pronounced negative externality (Mladjan, 2018).

Could the loss of moral capital in transition – the lowering of ethical standards of professional and private conduct – be recognized as a negative externality? Are we able to distinguish between the culprits and the victims? Directly responsible are those who engage in any form of corruption to achieve material gains, such as the appropriation of resources during privatization (Peña Miguel and Cuadrado-Ballesteros, 2019). Moreover, those whose lifestyle adheres to low moral norms, but who have risen to prominence as role models for the rest of society by means of an external perception of their personal and business success are also responsible. In a similar vein, the members of the upcoming elite hurt the rest of society by allowing the afore-described top-down changes in moral norms in order to derive a benefit for their interest group. Parts of the upcoming elite can also be responsible for a bottom-up loss of moral capital. If they do not take sufficient care to ensure that the living standards of the vulnerable groups in society remain above the level at which temptations to break moral norms in order to ensure material existence for their families overwhelm the existing morality of the poorer, the upcoming elite is responsible for yet another negative externality.

A single corrupt action could simultaneously inflict several types of externalities, those related to moral capital as well as others. For instance, not only would several potential buyers be cheated in a corrupt privatization, but the economy's productive potential would also be hurt if the factory is not sold to the most competent. In the same case, bad role models could be created and moral capital reduced, leading to a further decline in economic prosperity and immaterial welfare. Transitions are indeed abundant with such negative externalities (Mladjan and Marković, 2016), and internalizing them contributes to transitional justice, improved economic performance, and to collective well-being. Fortunately, just as a single corrupt action can result in several types of negative externalities, we argue that steps taken to restore transitional justice can correct both material and immaterial externalities: those related to the loss of moral capital as well as others.

Moreover, many transitional societies are not such for the first time, as the European twentieth century transitions to communism and away from communism illustrate. Forcing all responsible to offer compensation for the damage they inflict today would incentivize the potential culprits to act differently in the future, reducing the likelihood of problems in any subsequent transitions. In this way, negative examples would not be affirmed and incentivized, setting obstructive moral norms for the education and upbringing of the current and future generations by showing that corrupt actions during recurring transitions – actions that are illegal or otherwise morally problematic – would remain unpunished. Note that what is corrupt could be but need not be illegal. For instance, if a committee that has full freedom in choosing whom to hire decides to employ a person on the basis of being a cousin of an influential person, it is not acting illegally but is acting corruptly.

HOW TO RESTORE THE MORAL CAPITAL LOST IN TRANSITION?

Having identified the loss of moral capital as a negative externality imposed by parts of the transitional elite and its allies, the challenge that remains is accounting for how to rectify the injustice and repair the damage it has caused. While we do not have evidence of the expected success of each of the actions which we propose, we rely on our understanding of the context in which the loss of moral capital takes place – based on the literature presented in this paper and our experience of life in a transition environment in Serbia since the 1990s – to propose measures which we expect to be plausibly effective. A legal reaction sends a message about the rule of law, providing an incentive for activities in accordance with the legal framework that limits the loss of moral capital. However, the complexity of the processes by which moral capital is lost makes it hard to design sanctions for the perpetrators and incentives for the whole society that could stop and reverse the process. While we know from economics how to internalize externalities that relate to material goods, the loss of moral capital is an immaterial externality. One could, of course, allow for the possibility of material compensation for immaterial damage, a solution proposed by some of the restorative theories of justice: the victim may feel better when offered a material compensation, and it would be up to her to decide whether to accept it. However, such compensation may not restore the moral capital itself which is an immaterial category with effects on both material and general well-being.

To satisfy transitional justice and restore moral capital, we propose the following steps (Posner and Vermeule, 2004). Firstly, the acts that lead to the destruction of moral capital typically have a purely material side, such as an illegal appropriation of some resource. The culprit should here be required to return the corruptly acquired good or pay its value back if a return is no longer possible. In addition, they should be required to compensate the rightful owner of the goods, be it the state or a private person, for any lost gain during the period of illegitimate possession. Such material compensation could, in part, also recover moral capital: if misdeeds are normally punished, fewer would develop the habit of achieving illegitimate gains, lowering their moral norms. But such measures could also lead to the respect of the law solely out of fear of punishment. The law would be respected, but high moral capital – a guarantee for reliable business and social relationships that surpass legal guarantees – would be missing. Such a social equilibrium of lawful behavior, inspired by fear and self-interest rather than belief, would moreover be prone to collapse whenever law-enforcement institutions were weakened.

We, therefore, argue that the stimulation of moral values would require moral characteristics and be a non-material category. The culprits for the loss of moral capital should, therefore, also pay for programs that affirm morality in society; education through schools and media could set good examples and emphasize the importance of demanding moral values. Respect for those who uphold especially high standards of integrity should be prominent in society. Such respect would also strengthen public integrity, even more so when those honored have demonstrated their integrity by resisting temptations. Honoring them may even inspire them to raise their integrity to an even higher level and in doing so set higher standards of moral conduct for the rest of society. However, we caution against using payments to individuals, unless a person had suffered material damage due to refusing to act improperly. If morality is instead made to be profitable, it could lead to some pretending to uphold demanding moral values. Similarly, those who originally do hold such values could move from acting out of principle to acting for profit, losing a part of their moral capital.

In addition to a set of governmental interventions, the participation of the wider society in strengthening morality would allow for more complete compensation of the bearers of moral capital and allow for a further reach of measures to internalize the externalities that lead to loss of moral capital, especially in more collectivist societies (Abraham and Pane, 2014; Cohen and Avrahami, 2006). By combining the fine judgment of a multitude of individuals, society ought to be better than the state in identifying those whose morality is truthful. The temptations they resisted to uphold it through severe hardship can be well observed by their neighbors and colleagues, while any administrative rules of the state could be cheated. Such individuals could subsequently be honored by their fellow citizens by offering them respect and promotion to role models. In addition, a decentralized way of identifying and awarding the bearers of moral capital could even include material compensation, such as in the form of better job opportunities or aid offered by fellow citizens, with less risk of moral hazard. Society's system of decentralized judgment should also better be able to measure and deliver the appropriate size of the compensation, while the estimates of the state's administration could, for political reasons, be biased in one way or another.

THE REACH OF THE MEASURES TO IMPROVE MORAL CAPITAL

The measures we proposed to restore the moral capital lost in transition may appear imperfect and incomplete. It is hard to legally regulate and sanction many important ways in which moral capital is lost, since many corrupt practices may not be illegal. It may also be impossible to directly compensate many who have suffered from a loss of moral capital in their environment because it is hard to prove the immaterial suffering and its extent as well as the fraction of economic decline that can be ascribed to moral decadence. Fortunately, just as a single corrupt action can open several aforementioned channels by which moral capital is lost, we expect that even the proposed incomplete measures to rectify transitional injustices and moral losses inherent in such injustices ought to be able to initiate a series of events that are capable of raising moral capital.

In particular, requiring the culprits to invest their money, time, and effort in programs that stimulate a high level of public integrity could potentially lead to their own change in values, just as a child forced by its parent to act in a certain way gradually realizes the reasons and benefits of such conduct. Moreover, they may inspire more people, especially from their circle of friends, to follow them. Those who persistently upheld the moral norms could add to this virtuous process by accepting the former transgressors into their midst, helping them refine their morality even further.

The measures by the upcoming transitional elite to affirm morality would be noticed. Their compatriots – who, to avoid compromising their moral principles, previously chose to leave the decision-making circles or the country itself – would be attracted to rejoin society for at least two reasons. Firstly, they would rejoin because of improvements in the moral environment and, secondly, because of the noble desire to help with further moral recovery (Cingolani and Vietti, 2019; Nicholson, 2004). The returnees from abroad, in the absence of sufficient savings, may in some cases, need to accept a cut in material well-being when returning to their home country. However, the economic recovery associated with the steps taken to recover the moral capital would be yet another factor for them to rejoin society. Note that the re-inclusion of the members of society that uphold high moral principles would speed up the build-up of moral capital. It would attract people with a lower level of tolerance for immorality that refrained from returning in the initial phases of recovery. An important positive side effect of the re-inclusion of a number of bearers of moral capital would be a rise in material well-being. It would result both from a rise in moral capital and the stock of knowledge in the economy which they bring.

The individuals belonging to the moral elite who personally suffered during the period of exclusion should not object that they would not be directly compensated, recognizing the moral hazard this could cause. Instead, holding morally elevated values, they should accept this. They should rejoice in the processes that would benefit themselves, their descendants, and the whole society for which they care. After all, the exile allowed them to test and refine their morality in practice and, in the case of returnees, in comparison to that of other nations. Upon return, the respect from the rest of society for their perseverance would help them further raise their moral standards. Serving as role models, they would, in this way, also raise the moral standards of society.

Even if not all the damaged ones could be directly compensated, the processes of recovery could also break the social equilibrium in which one dedicates effort to appropriating as much as possible for oneself and to measuring who owes how much to whom. Instead, in our view, they could lead to a culture of generous mutual giving that adds value which can later be shared by all, and a society that is seen by all as their community of shared destiny, to which all social, educational, and moral groups belong.

LIMITATIONS AND SUGGESTIONS FOR FUTURE RESEARCH

A limitation of this work stems from the fact that the conclusions are mainly based on the experiences of the transition process in the former socialist countries, especially those in the Balkans. Somewhat different, more gradual models of transition have been taking place in certain Asian countries, so the impact of transition on moral capital could also be different there. Another limitation of our work is in the lack of our own analysis of either qualitative or quantitative data, but in relying on the findings of the existing literature, our own experience of life in a transition environment, and our own reasoning. Nevertheless, we clearly state that this is a theoretical rather than an empirical paper. We rely on stylized facts to argue that loss of moral capital is a market failure, which in turn provides both a justification to act against it and guidance on how to do this. We do not provide empirical evidence that would help us estimate the likelihood of success of the interventions we propose to restore morality but approach the problem pragmatically by finding the measures themselves morally non-problematic and plausibly effective.

Our study opens at least two directions for future research. Firstly, testing whether our theory is correct would entail testing whether the loss of moral capital can indeed be considered a negative externality. Qualitative research could use interviews to obtain further evidence on how important loss of morality was for individuals to immigrate or move to the margins of society. Interviews could also examine how destructive bad role models and poverty generated through corrupt privatizations were for the moral norms of the poorer ranks of society. Quantitative research based on surveys of actions and values could give us a clearer picture of how widespread and deep such changes were. Secondly, both qualitative and quantitative research could help us better evaluate the expected effectiveness of the proposed interventions and better design them. For instance, further research on the effectiveness of potential precedents of the policies which we propose, the conduct of questionnaires that would attempt to estimate the expected effects of specific measures, and tests of the effectiveness of early phases of their implementation before a next phase is initiated, would all serve this purpose. In the future, it would also be relevant to examine how moral capital changed in transition countries where the process of transition to a market economy is considered successful, and in those countries where the transition is considered unsuccessful, and how political transitions compare to economic ones.

CONCLUSION

Moral capital is likely to be eroded during transitions: even well-intentioned transitional elites would be tempted to use material means to win support and ensure the irreversibility of transition. When transitions are economic, the wealth available for redistribution is increased. Increased are also the means for and temptations of corruption and illegitimate cooption into the decision-making elites. All of this can be expected to cause a decline in moral capital. The loss of moral capital originating in the elites would spread down to the rest of society as long as their apparent success makes them serve as role models. The economy would decline because of the loss of both the moral capital and the knowledge of the bearers of moral capital who would be marginalized or would leave their society. In addition, the lack of moral capital results in a lack of trust and security, which significantly complicates doing business. The lack of trust and security increases transaction costs and reduces the willingness of companies to invest in long-term projects. This leads to worse business performance. Companies which do not accept corrupt practices face a competitive disadvantage in transition markets. On the other hand, poorer people would have other reasons to lose their morality, compromising it in their daily lives to ensure subsistence for their families in an impoverished economy.

Once lost, the moral capital would be hard to recover spontaneously because individual moral acts may not have the immediate power to change an immoral society. State intervention and strong and efficient institutions may be necessary to change the direction of changes.

To sum up, we have argued that the loss of moral capital can be seen as a negative externality imposed on the rest of society by parts of the transitional elite and their allies. Fortunately, by internalizing this externality, by making the culprits responsible and awarding the victims, we expect we could both satisfy transitional justice and start a number of processes that would result in a recovery of moral capital, knowledge, and, as a result, economic prosperity and higher general well-being. We argue that encouraging a high degree of public integrity must be a deliberate public policy and that the state's measures to restore moral capital should primarily aim to affirm morality and inspire respect for individuals of high integrity.

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