

## Some thoughts on micro-insurance

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- There is often a high correlation between the index and the individual basis risk.
- Problems of credibility may undermine well-designed programmes. In a micro-insurance program carried out in India (Maharashtra state) under the aegis of an NGO (SSP), the very low uptake (less than 3%) and the even lower re-contracting rate after one year are mainly caused by the lack of information and trust on the part of the villagers. Lack of trust is reinforced by the fact that subscribers sometimes go to clinics that do not offer the agreed-upon discount (on the purchase of medical services and medicines) simply because they are not part of the programme. In other words, villagers are not well-informed about which medical institution is offering the subsidized services.
- Financial illiteracy is pervasive.
- There exists the possibility of the worst outcome occurring (the insurance premium has been paid and the insured obtains an outcome that lies just below the threshold, so that he or she does not get any indemnity), and this possibility may well be over weighted by potential insured.
- If agents behave according to prospect theory, there may exist a large domain where they are risk-seekers so that they would actually prefer a lumpsum contract. The choice is thus more complex than simply accepting or rejecting indexed insurance.

### 2. Role of informal groups.

The question of local groups and organizations is often treated too simplistically. Groups may indeed differ significantly along several dimen-

sions, such as whether they belong to horizontally- or vertically-structured societies. Patronage systems obtain in the latter and may sometimes provide effective insurance to poor villagers. In maritime artisanal fishing villages, for example, the labour remuneration contract includes both a fixed and a variable component (it is neither a pure share contract nor a fixed wage contract). Since net income accounts are settled at the end of the week or the month, the crew workers are always insured that they get a minimum income on days where the catch is poor or even nil (or its value exceeds the cost). Moreover, the workers do not perceive that the implicit insurance contract entails a cost to them.

Informal groups are often characterized by highly personalized relations. Therefore, the risk exists that someone who has not paid his (her) part of the insurance premium paid by the group to an insurance agent, and has been quite unlucky, asks for a share of the insurance payout. He (she) would swear that he would pay the premium next time and complains that he (she) really needs immediate relief. Group membership may thus be a too flexible concept in some communities.

### 3. Uniform shares.

Why shares are typically set at a uniform level, so that the solution proposed by Stefan Dercon (refund the premium to those who face the worst insurance outcome –see above) proves infeasible? There are several possible answers to that question:

- Uniform treatment allows to resist elite capture.
- Uniform treatment allows to avoid endless discussions and conflicts. The problem of differentiating shares is especially hard to solve when the group is heterogeneous or, even though the group is homogenous, people claim to work harder than others or be more skilled.

#### **4. Insurance-efficiency tradeoff in production cooperatives.**

Interesting insurance mechanisms may be provided by agricultural production cooperatives or traditional farms. This happens when collective fields or production enables the members to share risks at least to some extent. Due to the moral-hazard-in-team problem, this solution involves an efficiency cost. Yet, an acceptable insurance-efficiency trade-off (second-best efficient) may obtain if collective production, the output of which is equally shared amongst members, coexists with individualized production on private plots whose output entirely accrues to the worker (hence first-best efficiency obtains on those plots). This solution was implemented in Hungarian agricultural cooperatives during the communist era, or within the extended family farms sometimes found in West Africa (in Mali, in particular).



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