HUEBNER COLUMN

Micro Insurance for Primary Risks Getting Collective Development through Individual Resilience

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Abstract

Poverty is a consequence but a cause of underdevelopment too because it also means vulnerability. If we admit that human development means that one can remain or become an owner of oneself and of one's capacities, then the insurance of primary risks (those that directly threaten the economic capacity of the productive individuals) has three irreplaceable advantages: to reduce the paralyzing effects of the risk and to reinforce people's autonomy; to protect what is earned thanks to previous efforts and to facilitate the restoration of the victims' economic capacities; to reinforce individuals' responsibility as they are considered as the actors of their own development. The goal of development is a contradiction between the necessity to take risks to improve one's life and the impossibility to assume them because of poverty. This is why we naturally lean towards insurance mechanisms as a determining and major factor of a stable and serious economic development for emerging countries. Through this means and especially through adapted forms of Micro Insurance, individual resilience also becomes a factor of global development.

On the individual and the collective scale, the historical experience of the poor countries did not give them the means to rapidly recover after an incident, whether it be a

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personal accident or a natural disaster. In this regard, the comparison with rich countries is edifying so important is the difference in resilience that makes some countries powerful and some others weak. More than the intrinsic gravity of a disaster, the problem is that its impact remains *concentrated* on the victims' productive capacity (individual, group, community) and these victims do not have the possibility to spread out the damages in order to soften their impact on each person. It gives a particular interest to the coverage of the *primary* risks that is those which directly threaten the economic capacity of productive individuals. To this regard, the deficiency of the poor countries can take different forms:

- Persistence of a gap between the cost of the risks coverage and the price that the population can afford to pay;
- Even if insurance is not considered as a luxury anymore, concerning the pure premium, it is becoming one concerning the commercial premium which includes a safety loading in order to insure extreme losses;
- Inexperience of financial mechanisms;
- Insufficiency of legal structures and financial systems, etc.

In this context, which often strays from the theoretical hypotheses of the theory of insurance, the emergence of the concept of Micro Insurance is particularly interesting. Within twenty years we moved from informal local practices to techniques that are the subject of books of synthesis (Nabeth, M., 2006) and practical textbooks edited by international organizations. Neither micro-credit nor Micro Insurance can pretend to be the cure-all for world misery. But they reduced great poverty and greatly prevented the return of misery where they have been used. Above all, they can be the basis of a complete insurance system (from local conditions scrupulously respected to international capabilities of reinsurance) that could provide the poor countries with the economic resilience that widely contributed to the development of rich countries.

Vicious Circles of Poverty

Vulnerability as well as poverty is a personal reality before being a statistical category. Poverty is a state; vulnerability measures the probable extent of future poverty. Vulnerability has to be at the centre of the reflection on development: first because it characterizes people's *future* as well as their organizations' *future* and then because it is, for the same reason, a major barrier to development. Being poor means being powerless in front of *all* the risks. The problem is apparently simple to describe but also complex in practice and the theory of vulnerability still has to be written. Economic insecurity is a vicious circle. We do not know which one is the cause of the other: vulnerability or poverty. What is certain is that as long as we do not solve the problem of vulnerability everything that can be done against poverty today will have to be done again tomorrow because there is not one single vicious circle but two of them which mutually reinforce each other.

On one side, the individual's lack of capacity is a consequence of poverty. Amartya Sen would talk about "capability", a richer term which expresses the various combinations of functioning that the person can achieve, reflecting thus "the person's freedom to lead one type of life or another...to choose from possible livings (Sen, 1992). Because they do not have the capacity to buy insurance or to create their own activity, poor individuals are at the origin of a first loop that maintains their vulnerability, their weak capability and their state of poverty. On another side, the same people cannot produce surplus that would enable them to buy insurance and to contribute to a protection system under normal conditions. Thereby, they do not contribute to provide the solvency *capacity* that insurance needs. There is no possibility to locally reinsure them and insurance companies cannot be solvent except if they dramatically increase the premiums. Individuals still face all these risks and it reinforces their state of poverty: the circle is now complete. When a poor person finishes one of these circles, she/he starts the second one. As long as we content ourselves with targeting the central term – poverty – applying exterior bandages that take the form of exogenous reductions of poverty, there is no reason that this infernal process will stop by itself. Breaking one of the circles is not enough as long as the other one still exits. We cannot stop the spiral of poverty without breaking the double dynamic of vulnerability.

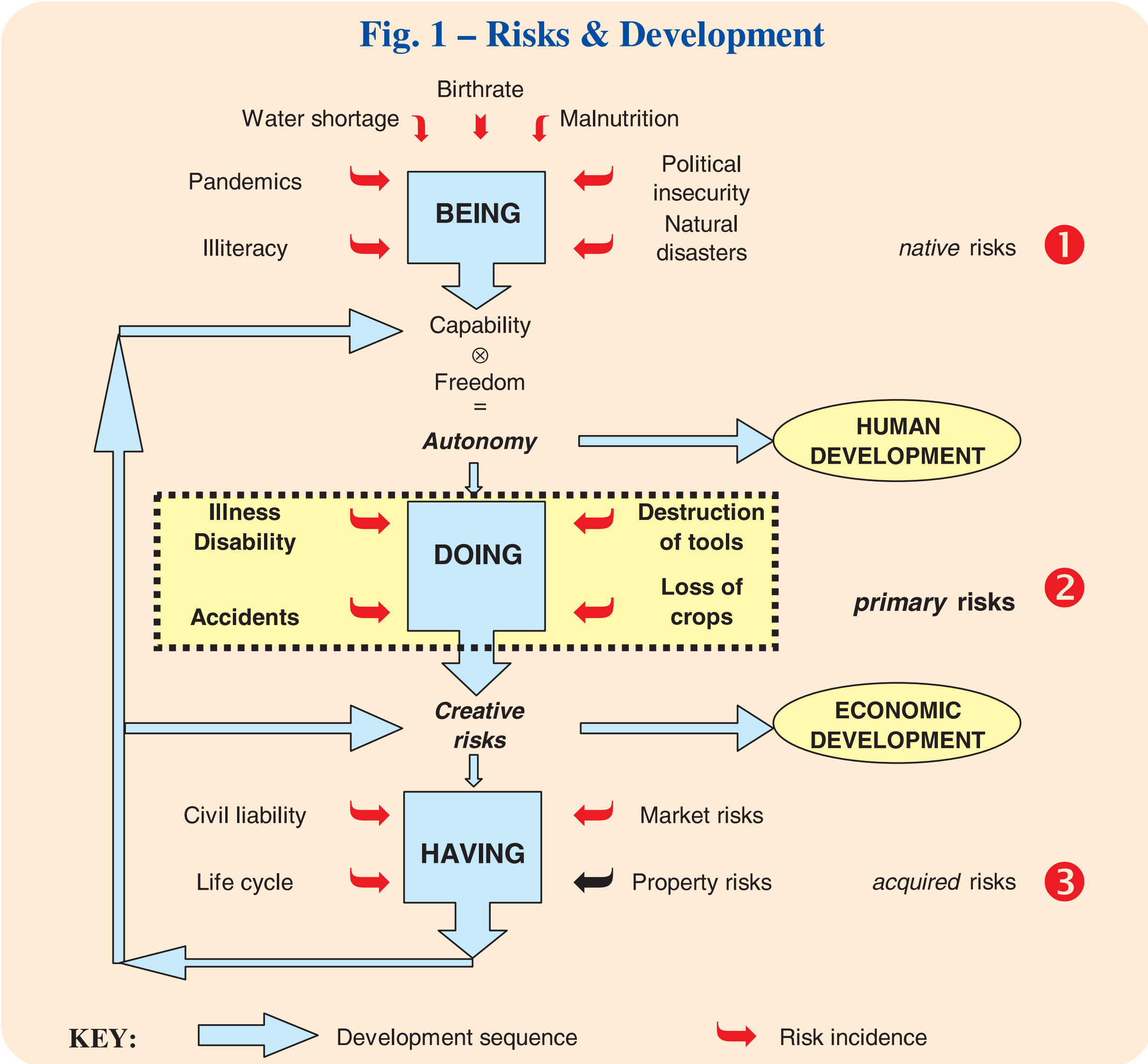
The preceding comments do not apply to assistance operations that are mobilised after natural disasters. The goal of these restoring interventions, often irreplaceable, is to cope with the emergency and they cannot, on top of that and in the same time, anticipate the problems that we might face during future catastrophes. The restoring logic is not the one of reconstruction but one can feel that it will be more efficient in the future if we undertake to reduce the person's vulnerability as of today. We also have to consider numerous common hazards that can have the same impact as a natural disaster due to their exceptional repetition and their cumulative damages. We can give the example of food insecurity or problems linked to health insurance.

It is clear that it is not enough to protect people, even if it is often essential, but it is necessary to create favourable conditions that will allow them to be the creators of their own development. As he was about to conclude his Nobel Peace Prize acceptance speech, Muhammad Yunus, who dreams of putting poverty "into a museum", used a nice expression to compare poor people to bonsai. According to him, they would have everything they need to become big trees if their roots were not atrophied. "To me poor people are like bonsai trees. When you plant the best seed of the tallest tree in a flower-pot, you get a replica of the tallest tree, only inches tall. There is nothing wrong with the seed you planted; only the soil-base that is too inadequate. Poor people are bonsai people. There is nothing wrong in their seeds. Simply, society never gave them the base to grow on. All it needs to get the poor people out of poverty for us to create an enabling environment for them. Once the poor can unleash their energy and creativity, poverty will disappear very quickly (Yunus, 2006)."

Those sentences pronounced by the "banker to the poor" raise the problem. We have to determine if what is done in terms of development aid creates favourable conditions to get out of poverty. Compared to the common arguments about development, it is just another way of talking about the same thing but it changes everything. If we only focus on reducing poverty, the problem remains whole. When economists build development models it is more the reinforcement of the capability of actor-individuals'– indicating by this manner that individuals are viewed, as Amartya Sen says, "as active agents of change, rather than passive recipients of dispensed benefits (Sen, 1999)" – than the reduction of a "poverty index" that they should target.

Dealing First with Initial Risks

If it is legitimate to match terms that seem distant such as Micro Insurance, resilience and development, it is because development and risks are closely linked in real life. Figure 1 shows how complex this overlapping can be.



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This figure is complicated because its aim is complicated in itself. The point is to gather multiple connections within a single image between: 1° people's capacity and vulnerability, 2° the economic *and* human development process, and 3° a classification (in a certain order) of the risks that might jeopardize this process should they occur. The sequence described in figure 1 is essential to understand the uncertainties linked to development. Each term could be the subject of a comment. Let us focus on two major elements.

First, we have to outline the practical and theoretical interest of the risks classification that structures the diagram. *Native* risks are put in the highest part of the diagram because they are specific to the environment in which the individual is born. Whatever she/he does, the individual has no influence on these risks.

In the lowest part of the scheme are the *acquired* risks which affect more the well-being of an individual than the bases of its capacity to act. These risks are only those that people face once they solved primary problems of life that is to say finding something to eat, clothes, accommodation…and once they overcame risks linked to the actor-individual's "capability" (represented at the centre of the scheme). It is clear that the third category of risks, suspended between the first two categories, has a determining role at the heart of the development process and that is why it is essential that it becomes a major concern. We will call them *primary* risks because they act at the root of the wealth production process which is important for the individual's prosperity as well as for the development of the community. This central category of risks is articulated with two other categories, respectively going from the concept of *autonomy* of the person upstream to the acceptation of *creative risks* downstream.

Secondly, the figure can be indifferently read on the individual scale or on the scale of a local community or a national group. If an accident strikes a person or a natural disaster strikes a community and there is no insurance of any kind against those incidents it is as if we were cutting off the central part of the scheme following the dotted line. Then, what do we see? We can see two things that should never be separated, whether from a theoretical or political point of view. On the one hand, the development process becomes incomprehensible. On the other hand, the poor individual is sent back to the fatality of circumstances which make it difficult to live where she/he is. Most of the time, it is a place that she/he did not choose. In these conditions, how can we still talk about individual autonomy and creativity? We then proved that we need to give the priority to everything that enables to cover what we called *primary risks*.

Economic Insecurity and Risk of Destitution

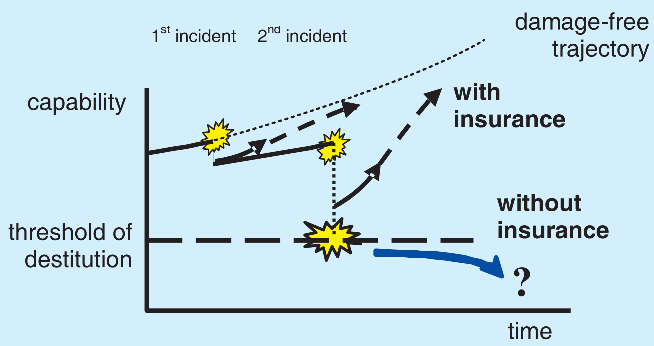
In relation to a normal reference situation we can imagine three types of elementary incidents: illness or accident which affect the resource "work", the destruction of the work tool and the partial loss of the product. In the third case we notice an a posteriori waste: the available product is equivalent to the one that would have been obtained with fewer resources but factors remain available for the next period. In the first two cases, the undamaged factor becomes overabundant: in case of an illness, for example, the available capital is superior to the one that the individual can actually develop with less work. In each case, effective production that can generate income is inferior to potential production: resources, though rare, have been wasted since they were not used to increase production, wealth and well-being as much as they could have normally done. Given the fact that there is no compensation mechanism for the different hazards on a community scale, the sum of these gaps becomes a collective waste.

That is why putting the problematic of risks at the very centre of the reflection on development is interesting. The risk does not only lie within the producer's environment but also *at the heart* of the combination of the factors of production: one cannot make goods and services just with primary resources, work and capital; a certain *safety* is also needed. If we remove this term, the result becomes completely unpredictable and without risks coverage it will be more often negative than positive: damages are unpredictable variables but it is always disadvantageous.

Any event that impacts on conditions of production results in very serious damages. More importantly, they are very difficult to overcome. Any incident (illness, accident, loss of a work tool, destruction of a harvest, etc.) successively has three negative impacts for the producer, the victim. First there is a *direct cost*. It can be immediately measured in monetary terms by a decrease of the individual's funds or by a revalorization of her/his assets. Secondly, there is a deterioration of *her/his economic capacities* either by a direct effect on the human capital or the productive capital or by impoverishment as a consequence of the first effect. Finally, there is the cost of the *increased effort* that she/he will have to make to repair the consequence of the incident but also to catch up, if possible, with the former trajectory on which she/he was progressing before the incident.

There are other concerns too. If we do not take measures to work in that direction, poor populations will keep facing an infernal dynamic that depends on intervals between each successive incident. Life would be easier if we could be sure to be completely cured before watching our hangar going up in smoke! Chance, "the greatest romancer in the world" (H. de Balzac) does not always leave time for its victim to recover. If populations of rich countries can bounce back so rapidly after an incident it is because tools for restoration come very soon after the incident happened and not months or years later after long efforts of recovery while there is plenty of time for another accident to happen.

Fig. 2 – Incidents and Probability of Destitution



The question of the accumulation of incidents is essential. More than the gravity of the damages it is the accumulation of incidents that can have irreversible consequences. We represent here (Figure 2) the possibility of two incidents of any kind. They can strike the same family in a short period of time *i.e.* before the victim can rebuild its capacity to bounce back and to produce again. If this family does not have any protection (insurance) that could intervene quickly for restoration or assistance the threshold of destitution is basically going to be crossed. From this moment on, the context becomes very different and everything that has been said becomes irrelevant: talking about production, income or economic relations do not make sense anymore since the individual crossed the threshold beneath which the implementation of her/his own resources cannot enable him to ensure her/his own future. Her/his economic survival and sometimes simply her/his survival have become a matter of assistance and solidarity that requires external measures.

As a consequence, the important thing is to avoid that the delay in the repairs of the first damage brings the individual in a disastrous or worse, irreversible, situation. The capacity to rebuild is needed very quickly as well as the possibility to earn her/his living and to support her/his family. It is enough to set a priority for action. If we deal with poverty in priority, we will diminish the poverty of people who benefit from the aid system but we will not take in charge their vulnerability. Consequently, they are at risk of being poorer tomorrow. On the contrary, if we begin with tackling vulnerability they might get out from poverty more slowly but they will be out of it once and for all.

Poverty, Vulnerability and Development: The Answer of Insurance

A few reflections should be enough to demonstrate why insurance tools meet the objective of fighting poverty through the fight against vulnerability. In reality, what are the alternatives? First, let us try to imagine what exit strategy exists for a person or a community who know that they face an important risk for their economic capacity. Since there is no possibility to use instruments such as insurance, there are six possibilities:

1. *Solidarity* can be analyzed as a spontaneous sharing of the risks but it does not offer remedy to situations of vulnerability; it is a temporary remedy that will not rebuild the future potential;
2. *Prior savings* are often considered as a goal to achieve. Such a recommendation is coherent with the models of some economists. But from westerner economists there would be a certain cynicism to "advice" the poorest to accumulate prior savings while they have difficulties to reach a living wage. Let us add that the building up of a precaution reserve that remains idle is done to the detriment of the investment capacity. This inconvenience could be reduced thanks to the development of micro-finance (in the field of savings);
3. The acquisition of *negotiable assets*: it is more serious because this asset can participate in the accumulation of capital for the future when there is no incident. This is not a bad solution except that when you need it and if there is a systemic risk which goes beyond the individual everybody will want to sell in an emergency. These assets will be sold in the worst possible conditions;
4. *A posteriori debt*: facing an event that has just happened, one can use debt. The service of the debt can rapidly become unbearable for an individual weakened by an incident. It jeopardizes the possibility of going further except if we admit that when one has problems the only thing to do is to go into debt leaving the service of the debt to future generations (here is an example about which the wealthiest nations do not practice what they preach!);
5. *External assistance*: it is necessary when the threshold of destitution is crossed and when the scale of the incident goes beyond local reaction capacities; it does not restore the damaged capacities since it is dedicated to the repairing of the most urgent damages;
6. or… *destitution*.

Beyond the reservations that have been expressed about each of these issues, the temptation to use insurance comes from the fact that, by construction, it makes us think of the safety provided by the *ratchet-wheel* effect. When one succeeds in getting some potential thanks to one's own effort it may be useful to protect it against an unpredictable damage. It avoids falling back and doing again all that has already been done. On the contrary, facilitating the movement forward can only benefit the development process.

Insurance also draws the attention for another reason: the beneficiary is well targeted and the intervention is quick. In this field, the comparison is eloquent compared to vertical modes of aid distribution which go through public or private organization more or less bureaucratic and slow to mobilise. From the funding to the giving of the funds, very heavy costs, which can be compared to transaction costs, have to be assumed. This is contradictory with the rapidity that urgent situation require. Inversely, when it is about insurance, the system works from bottom to top by engaging a contractual engagement chain and this chain is already in place at the moment when the availability of the funds is the most needed that is to say when there is an incident.

Considering the ultimate goal, which is to reduce poverty, insurance tools show indisputable advantages: rapidity and targeting of the beneficiary; reduction of the paralyzing effects of the risk; protection of what is earned thanks to previous efforts (ratchet-wheel effect) and easier restoration of the victim's economic capacity; contribution to the efficiency of external aids because everything that is covered by an insurance becomes less vulnerable, it then consolidates the system on which development aid is trying to have an impact (not only can this aid be reduced and redeployed somewhere else but it also becomes more efficient); reinforcing individuals' responsibility; reduction of the credit risk (the insured is a "better risk" for the loaner than an non-insured borrower), etc.

These are solid reasons to take an interest in insurance if we pretend to take an interest in development. However, let us not forget that it needs to be done by the rules if one does not want to create frustrations, deceptions or even disasters. Experts in Micro Insurance keep repeating it (and they know why they have to repeat it so many times!): Micro Insurance is above all the insurance. In other words, it is imperious to deal with technical problems with the same "prudential" rigour as a traditional insurer. The interest of the insured person is that the insurer be able to honour its commitment at the very moment when the insured needs it the most that is when the incident happens. It is at this point that "the tyranny of the safety coefficient" is involved. It is a principle according to which each insurer that offers coverage has to make sure that he has the possibility to face exceptional situation if he does not want to betray his customer. In practice, it means that an insurance system remains fragile if it does not include any reinsurance scheme which enables to deal with extreme situations (Vate, 2006).

In this perspective, we can use the whole range of risk-sharing or risk-transferring tools which are available today including for example traditional reinsurance but also more recent form of *cat bonds*, indexed insurance or weather derivatives. Thanks to their extreme diversity these tools can fit all kinds of situation, including the particular conditions that characterize low income countries[1] .

Conclusion

Under the specific condition of scrupulously respecting the condition of seriousness and solvency that have been pointed out, insurance can fully play its role of an instrument of development: it begins with protecting the actor-individuals against the risks that they *undergo*, which are *destructive* risks, then it enables them to preserve the risks that they choose because this is by assuming those risks that they will become *creators*. We know that we cannot be creative without taking some risks but we also know that we cannot

1 Since the summer of 2007, the "Subprimes" provoked a wave of critics that blamed any kind of securitization without distinction. Let us be careful not to throw out securitization with the subprimes bath water! Actually, they are fragile debts—not to say doubtful—on which the insolvency risk is not due to exogenous and independent hazards but to systemic effects of economic fluctuations such as the increase of the interest rates or the decrease of real estate prices together with a frequent violation of ordinary criteria of solvency. This has nothing to do with the securitization of insurable risks as long as one scrupulously respects criteria of insurability which are the foundations of the insurance industry.

take these risks if we are too vulnerable. Thanks to Micro Insurance, and to complementary reinsurance tools, the reinforcement of individual resilience is a factor of global development.

At the time when a new financial system, which has been violently shaken by an unprecedented crisis, is being redefined, it is urgent to remind ourselves that the monetary loss of the worst disasters which can ruin a low income country can be compared, in billion dollars, to the daily volatility of world financial markets; to remind ourselves also that financial innovation, of which we abused in a speculative framework, has to serve the real economy beginning with the one of the poorest countries that sharply lags behind the rest of the world. Insurance, capability, human development, empowerment…the virtuous circle is initiated.

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