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Dull Disasters

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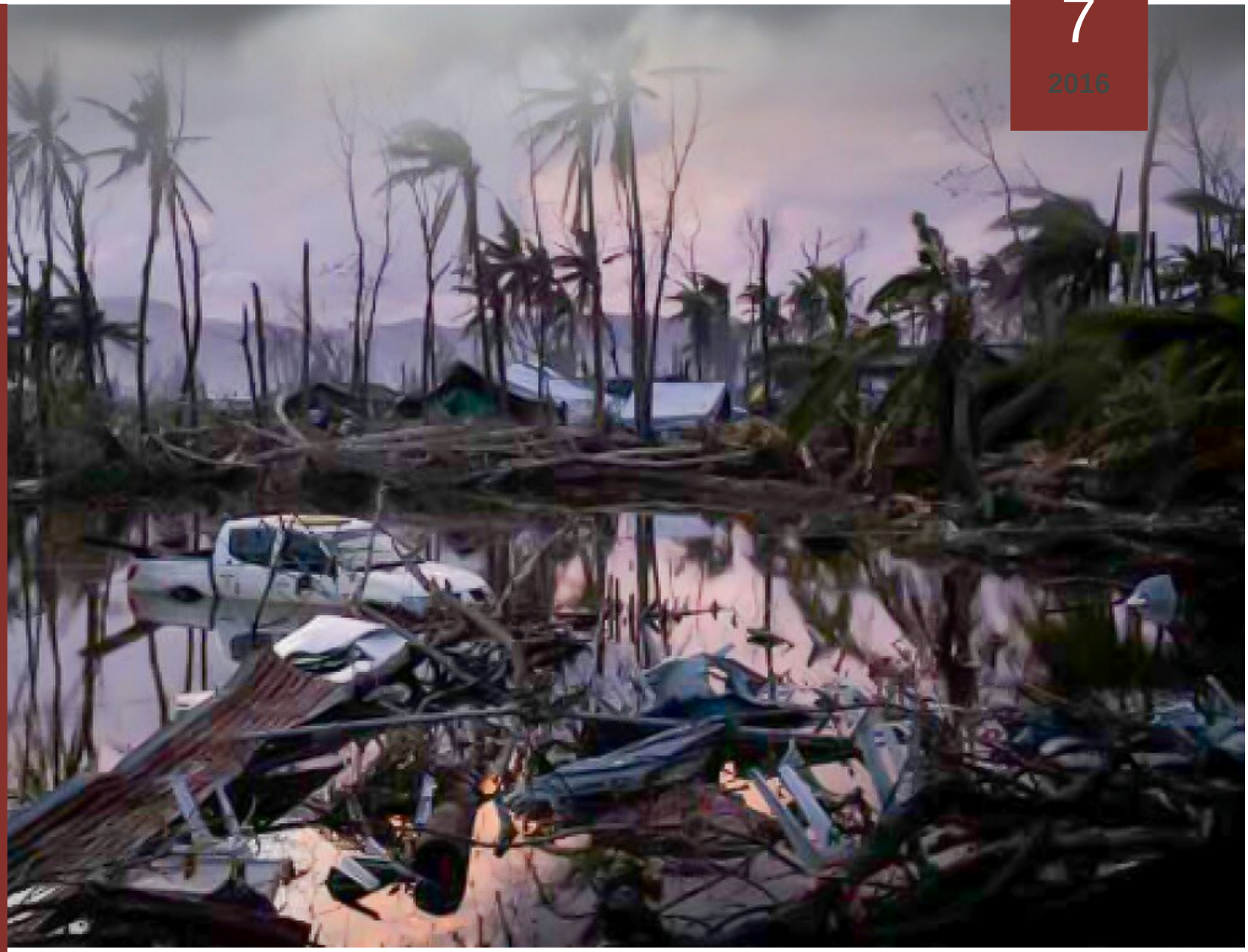

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Overview


1. The promise of microinsurance
2. Disasters and responses
3. Insurance-like systems
4. Whatôs next?

The cost of risk

- Poor people tell us: much hardship from shocks
  - Ethiopian families: 95% affected in five year period; most common drought, illness and death (Dercon et al. 2005)

The cost of risk: risk matters

adverse shocks cause poverty:

1/3 of poverty can be associated with adverse event (Dercon et al. 2005)

Loss of assets, leading to long-term poverty (Barrett and Carter2013, Dercon, 2004)

Loss of health and human capital via stunting (Dercon and Porter, 2014)

Caution in investment decisions such as using less fertilizer (Dercon and Christiaensen, 2011)

1. The promise of insurance

A transparent market-based contractual solution….

- Health indemnity insurance
- Climate risk: óndex insuranceô

- Large number of schemes piloted and scaled across developing world…

The evidence: health insurance impact and uptake

Growing literature on SHI and CBHI …. Few high quality....systematic reviews...

Achraya et al. 2013 (WBRO), Spaan et al 2012 (WHO Bull.), ...

- In most cases, little impact on utilisation of health services, with exceptions
- Some ófinancial protectionôagainst large out-of-pocket expenditure, but not for the poorest
- No systematic evidence of improvement in health status or of quality of care
- But also: uptake low ï e.g. 1/5 when offered in Kenya, with ñtrustò big factor

The evidence:
weather index insurance impact and uptake

Attractive product ï

Some systematic reviews...

Impact?

If insured, evidence of apparent sense of ópotectionô with increase in farm investment
(Karlan and Udry on Ghana; Carter/Elabed on Mali/)

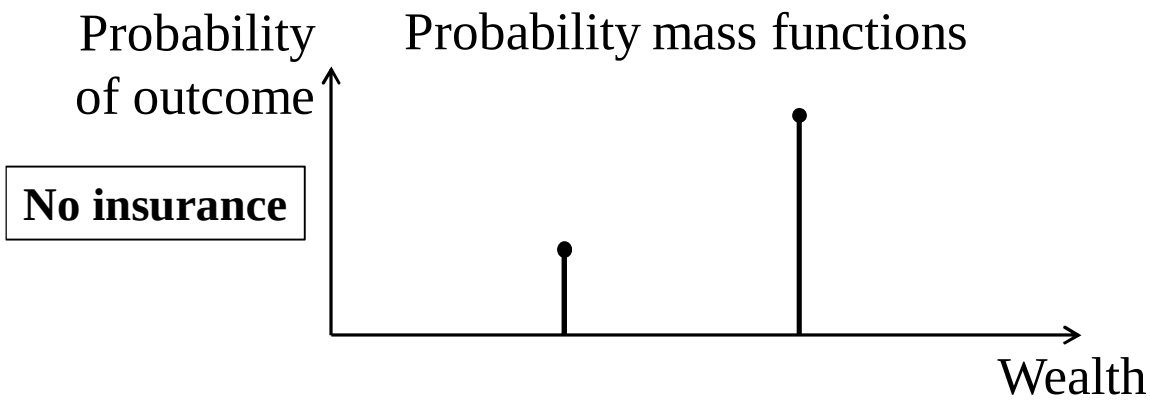
Uptake? (Cole et al. 2012, systematic review)

Low! 5-10% in AP/Gujarat in India; Malawi/Ethiopia

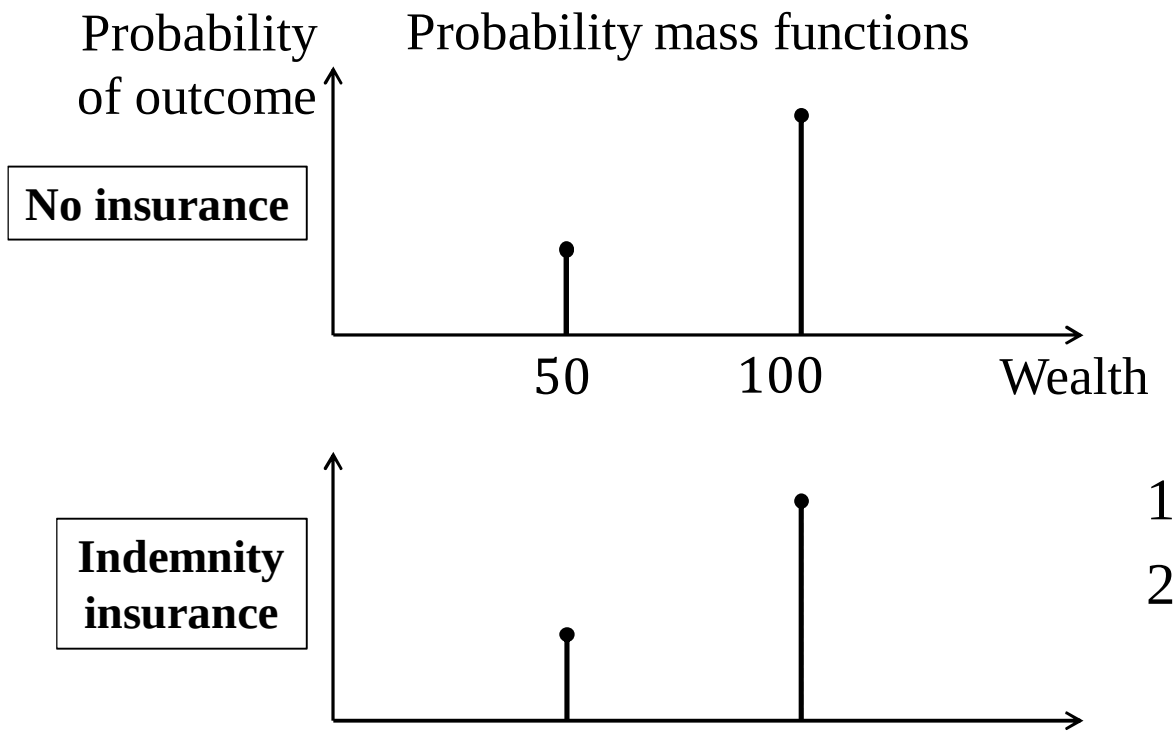
Reasons?

- Cost
- Financial literacy
- Trust
- Risk aversion (!)

The problem with index insurance….

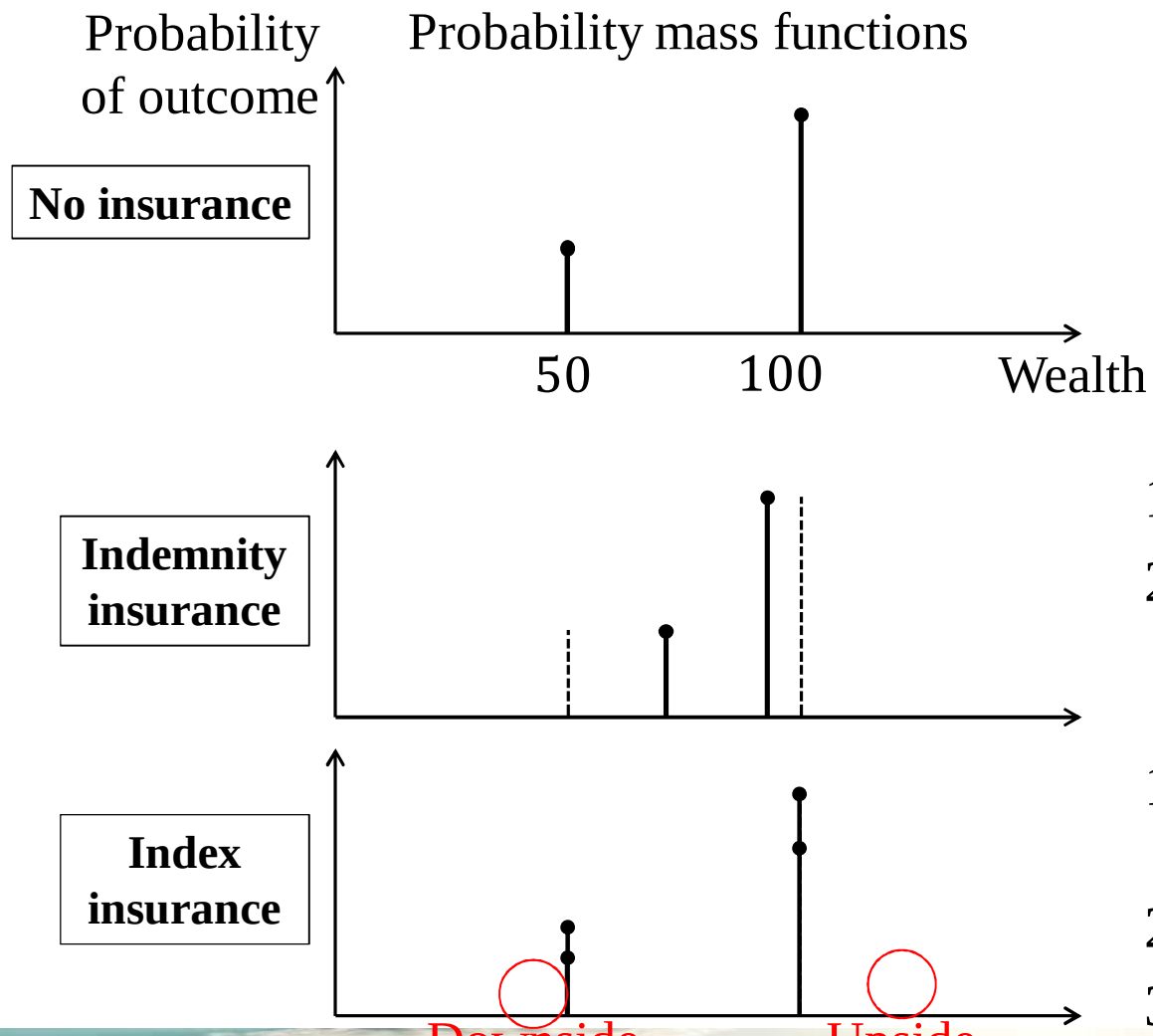


Understanding basis risk/reliability is critical



1. Reduces risk
2. Reduces average outcome

Understanding basis risk/reliability is critical



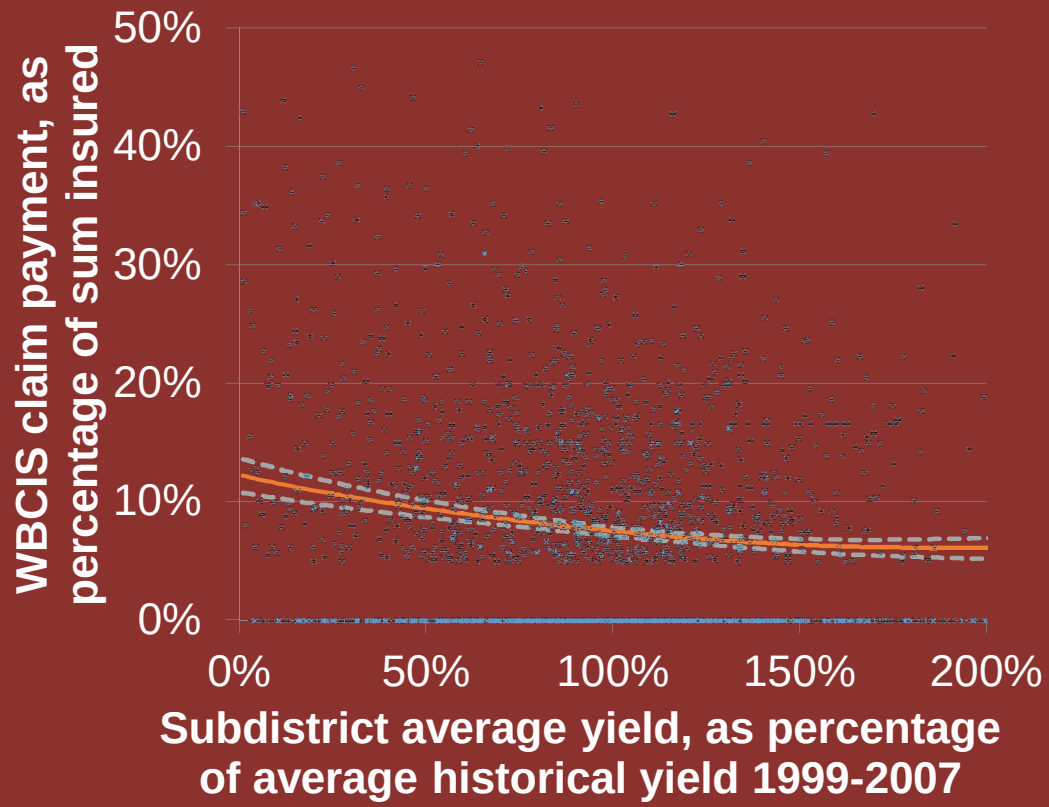
1. Reduces risk
2. Reduces average outcome

1. Reduces risk when the hedge works
2. Increases risk when it doesnôt
3. Reduces average outcome

The evidence:
weather index insurance quality?

An empirical issue!

- Large Indian micro-insurance weather index scheme (318 products)
  - When "catastrophic" (-30%) yield outcome, only 51% payout
  - For very $1 in premiums, average payout in catastrophic (-30%) year only $1.1!
- Largest scheme in Africa had to switch to area index as performance of weather index product caused lots of "ex-gratia payments"
- More a risky parametric derivative than an insurance… and may help to explain why less risk averse buy more (Dercon et al. 2014)



The assessment: micro-insurance and the SDGs?

- Insurance markets development - of course important ï but as tool to reach poorest?
  - Uptake low: ñtake money now with promise of something laterò
  - Impact? But impact on poorest?
  - Poor products? Consumers, at times unprotected.

- **Is a product with low uptake and risk of poor products right way to protect progress in Global Goals that Leaves No-one Behind**?

The assessment: micro-insurance and the SDGs?

Insurance-like **systems** development:

- System of **guaranteed inclusion** of the poorest;
- Based on **insurance principles**;
- Understand **informal** systems and build on them;
- Potentially using **insurance products** to support it;
- With improving consumer **protection,** product **quality** and **risk reduction** incentives

Insurance as a **Public Policy** not **Market Development** issue…

The assessment: micro-insurance and the SDGs?

Example: HSNP

- Basis: cash transfer scheme for the poorest in Turkana, Kenya
- Scalable during crisis
  - E.g. 100,000 people received transfer within 2 weeks when drought became likely in 2015
- Clear information on who are poorest and are on scheme; others are offered index insurance products
- Underwritten by index insurance policy with ARC Ltd., and DFID underwrites basis risk of scaling.

HSNP

Hunger Safety Net Programme

2. Disasters and Responses

Example: Ebola (West Africa)

Example: Earthquake (Nepal)

Example: Hurricane Katrina (United States)

The experience and its causes

The experience

Cry for help and quarrels over responsibilities

Improvised politicized and fragmented response

Underfunded response

The causes

Ambiguity and failures of decision-making

Inadequate preparedness

Weak ex-post finance model

The *Dull Disasters* diagnosis: medieval financing

Strategic delays if multiple donors (Clarke and Wren-Lewis, 2016)

Crying Wolf

Poor Coordination

Poor information sharing (Bharosa et al., 2010; Stephenson, 2005)

Political incentives: benefactors

United States: presidential disaster declaration adds 1 percent to state-wide vote (Reeves, 2011)

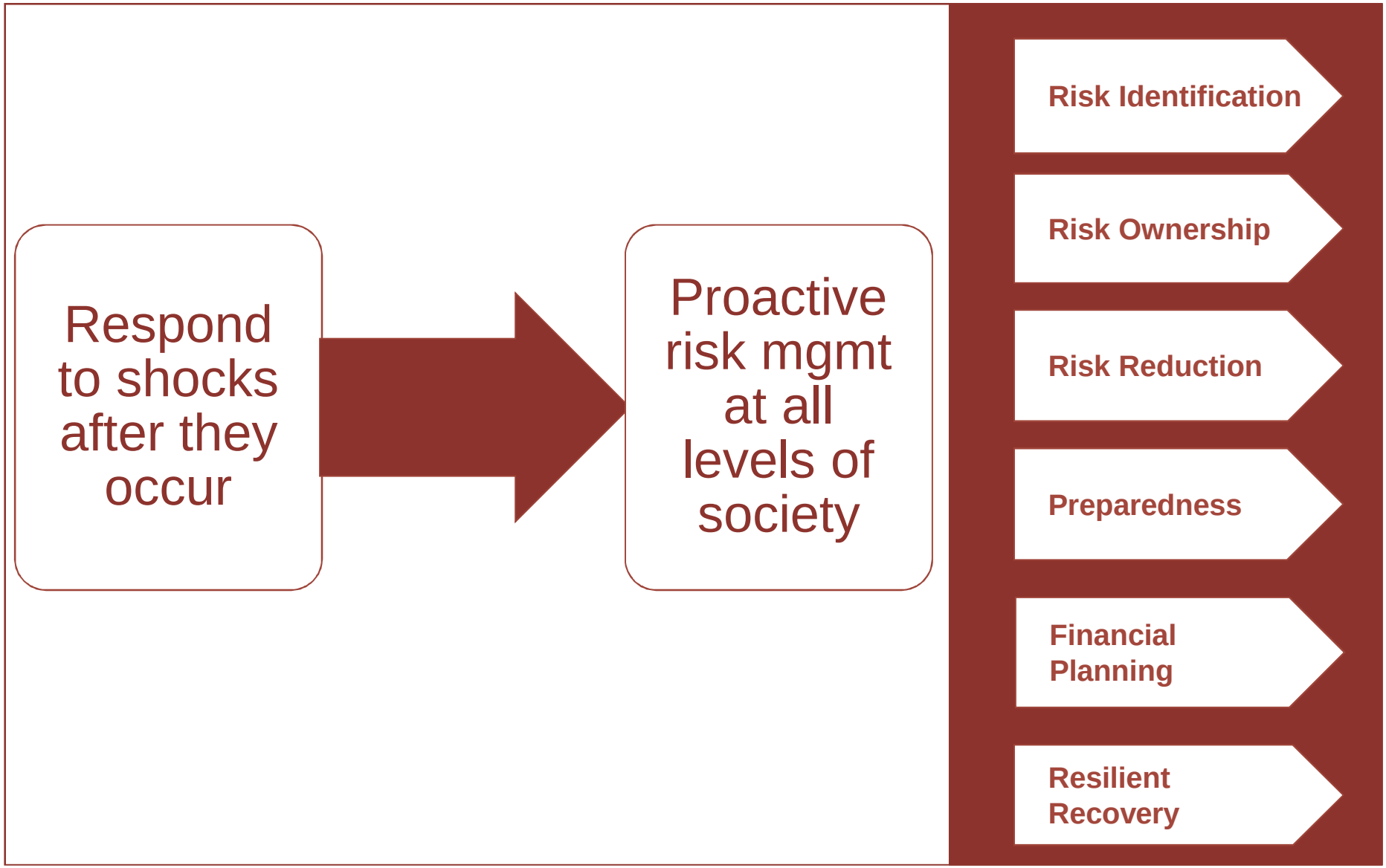
But no impact on elections from disaster preparedness spending (Healy and Malhotra, 2000)

Mexico: disaster payouts pre-election plus 8 percent (Fuchs and Rodriguez-Chamussy, 2014)

India: politicians punished for extreme events, but less if response near election (Cole et al.,2012)

poor incentives for investing in risk reduction

Cultural shift in managing risks and crisis



3. An insurance-like system…

Clear risk ownership and a fast, evidence-based **decision-making process**

…..be clear what/whose risk is covered: e.g. targeting rules, infrastructure priority lists, … and be clear what is not covered ï what ôsovereignsô will do, what ôprivate agentsô will need to do

….and how action is triggered

A coordinated, credible **plan** for post-disaster action agreed in advance

…. How will people be reached? e.g. a social protection scheme; a housing rebuilding scheme

… Who will manage recovery? E.g. Fonden

Financing on standby to ensure that the plan can be implemented

… credible financing arrangements

Example: FONDEN (Mexico)

Impact Evaluation

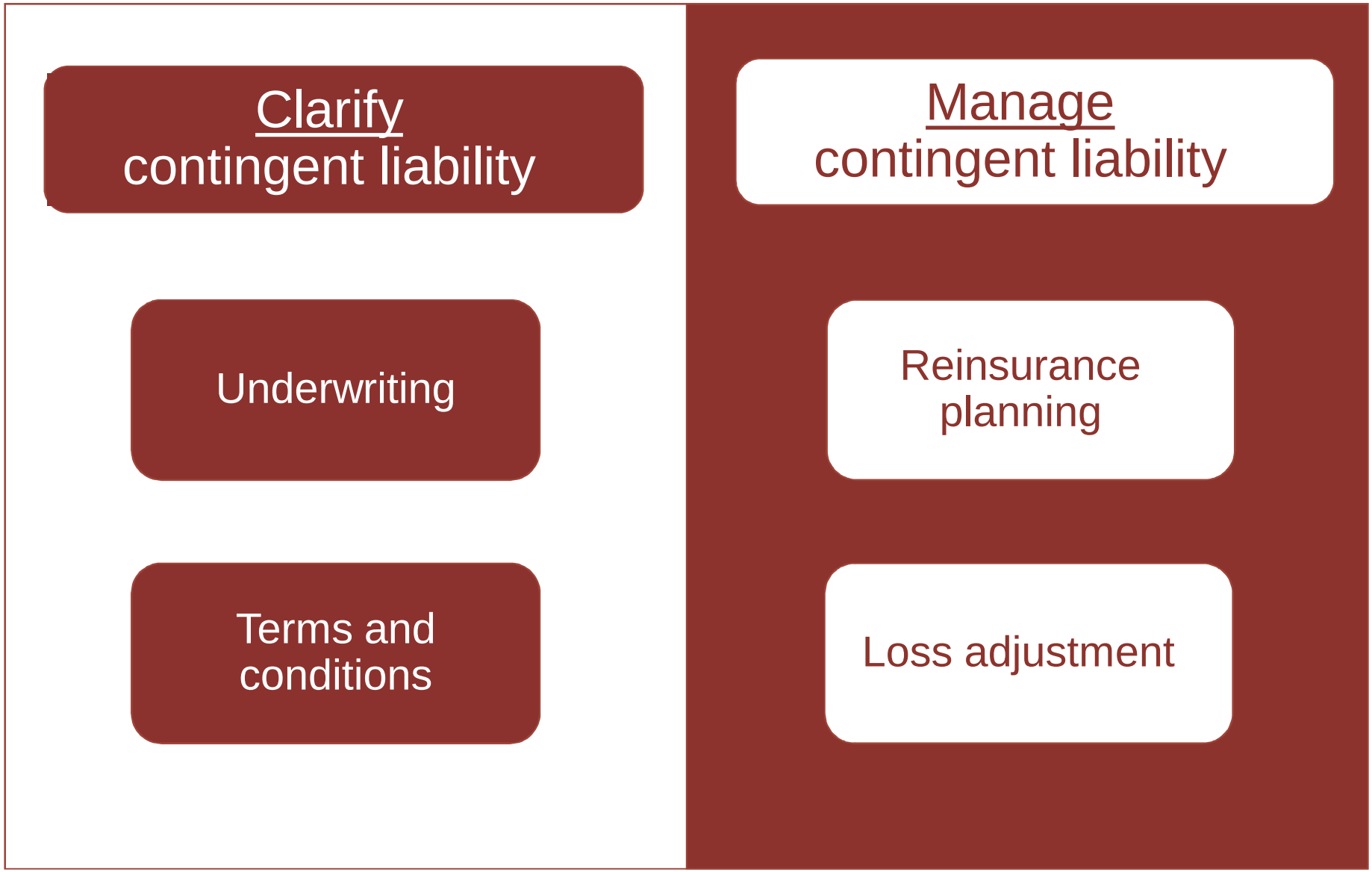
de Janvry, del Valle, and Sadoulet, 2016

2 ï 4 percent increase in post-disaster local economic activity

Example: HSNP (Kenya)

Hunger Safety Net Programme

Principles for an insurance-like financing system



Financial architecture can solve commitment problems

The instrument set for financial planning

Goal	Ex ante instrument (arranged before disaster)	Ex post instrument (arranged after disaster)
Risk Retention (changing when/how one pays)	Contingency fund or budget allocation Line of contingent credit	Budget reallocation Tax increase Post-disaster Credit
Risk transfer (removing risk from the balance sheet)	Trad. insurance/reinsurance Index insurance, reinsurance, or derivatives Capital market instruments	Discretionary post-disaster relief (begging bowl financing)

How credible is the commitment?

Goal	Ex ante instrument (arranged before disaster)	Ex post instrument (arranged after disaster)
Risk Retention (changing when/how one pays)	Requires discipline	Undermines discipline
Risk transfer (removing risk from the balance sheet)	Supports discipline	

Clarke and Wren-Lewis (2016)

But: details matter for impact!

1. How credible is the commitment?
2. How cost-effective is the financing?
3. How reliable is our data and the product?
4. How fast is the decision process?
5. What is being protected? What is the plan?

How costly is the financing? Example: Jamaica

Reallocating budget expenditure on operations and maintenance to finance more timely reconstruction was three times more expensive than insurance, which was in turn slightly more expensive than raising taxes

(Bevan and Adam, 2016)

The Opportunity for disaster responses

The Past

Slow, politicized, tactical decision-making process

Poor preparedness planning

Begging Bowl Finance

The Future

A fast, trigger-based decision-making process

A coordinated, credible **plan** agreed in advance

Financing on standby

4. What Next?

The Principles

Risk ownership: clarity of what the state will cover

Invest in preparedness and response

Financing on standby for contingent liabilities

The Actions

Risk assessment and dialogue with population

Investment in risk reduction, response and private insurance market development

Pre-agree financing plan

And this wonôt be plain sailing….

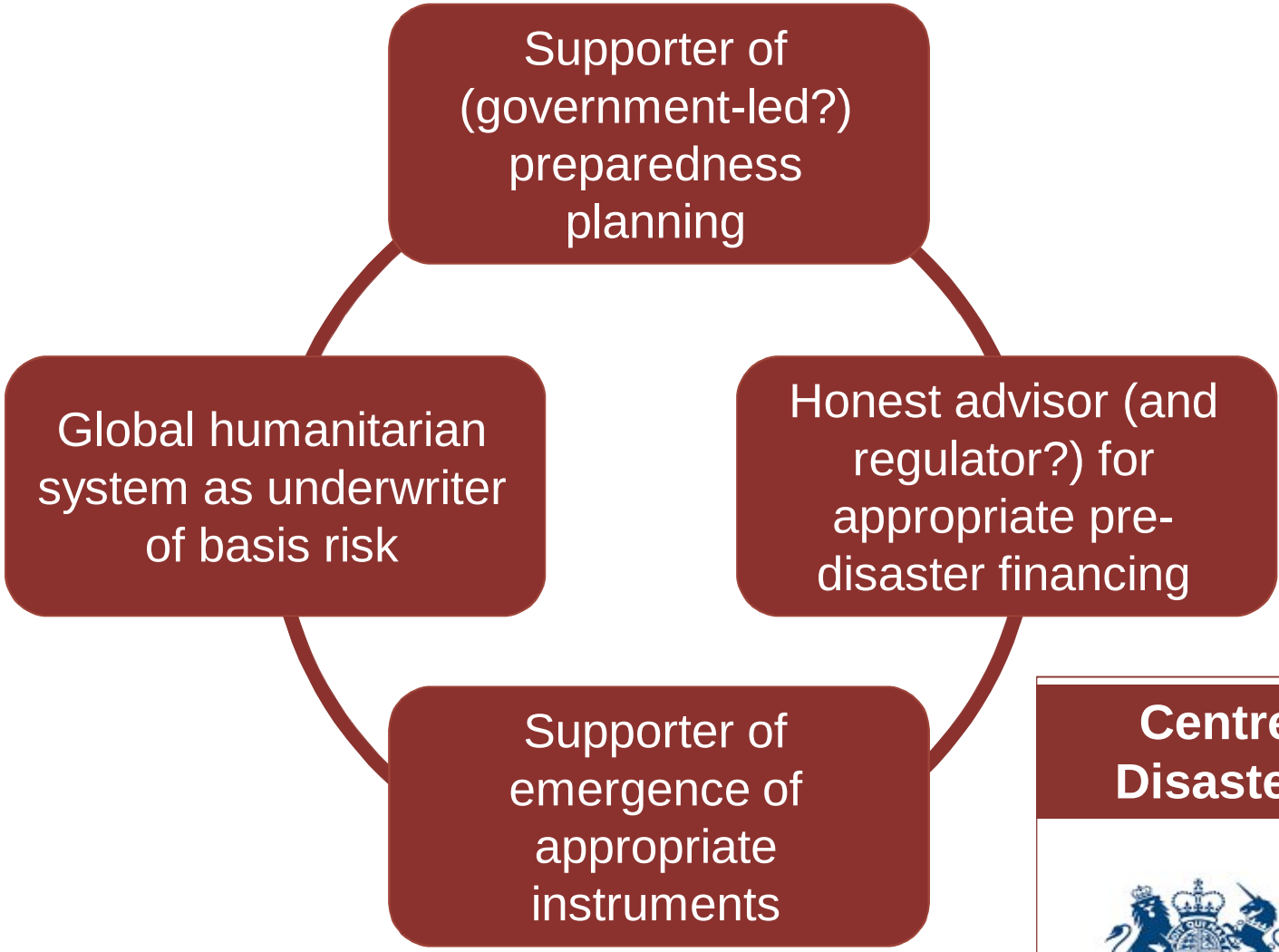
Africa Risk Capacity (ARC) ï risk pool in Africa for weather risk

ÓARCôs covenant: A worthy insurance scheme goes awry

[…] A joint assessment by the government [of Malawi] and international agencies reckons that 6.5m people will need aid by January. Yet ARCôs software, bizarrely, concluded that only 21,000 people were at risk. According to the model, there was hardly a drought at all.ô

The Economist Magazine (August 27, 2016)

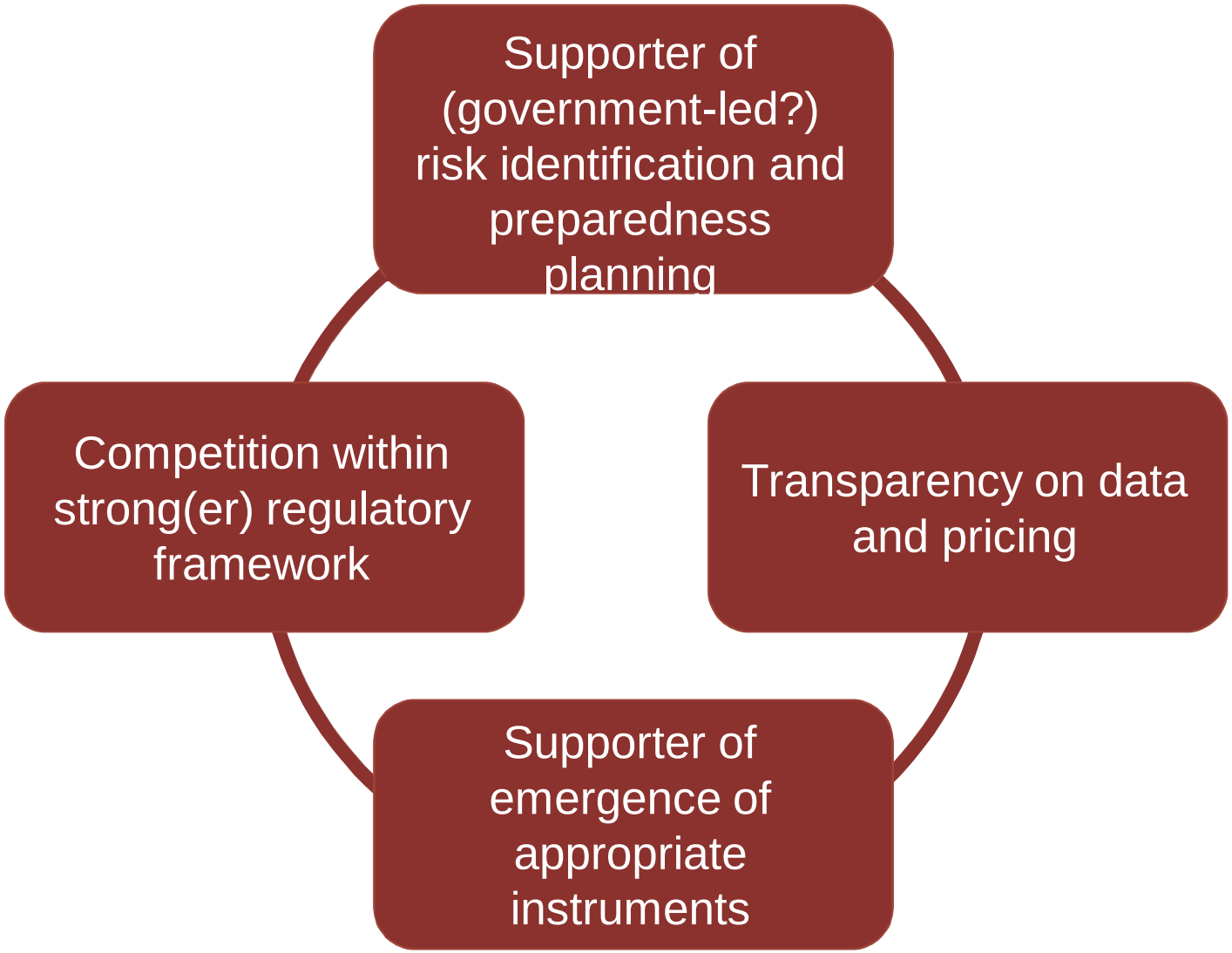
What can the international community do?



Centre for Global Disaster Protection

UKaid from the Department for International Development

What can the insurance industry do?



Concessional Insurance?.

Donors are supporting insurance

ï e.g. risk capital in risk pools like CCRIF or ARC (a bit like IBRD)

Should they make insurance ócconcessionalô?

ï subsidies for products as so much underinsurance (a bit like IDA)

- e.g. V20 $60bn assets lost in last 15 years, but only $2.2bn insured

- Some countries may be too poor to pay, but also keep in mind massive opportunity costs ($3bn humanitarian spent in natural disaster setting per year?)

Conclusion: Insurance and the Poor

- **Not** about a **Market-Based Solution** to SDGs or Poverty
- But a **Public Policy** issue: use **insurance principles** for a system that ensures poor people are protected
  - Systems that provide protection of the poor against health and climate risk, ensuring maximum inclusion
  - Use sovereign insurance as part of pre-arranged financing for large relative to local economy
  - Use micro-insurance to reach more people
- Role of **private providers**?
  - Don't just go an sell just insurance products to families
  - But use the power of **insurance principles and risk transfer** to develop systems to protect people

Dull Disasters

Risk, extreme events and slow onset hazards will remain but we can dull the disasters around us!

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