Insurance for Financial Crisis?

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1. Background

- After the financial crisis: bail-out of financial institutions and industries
- Debated by economists because of perverse incentives (-> e.g. EU state aid control)
- Financial intervention by government not new (Natcats, Techcats, export insurance)
- Can we learn from the economics of natural catastrophes? (Michel-Kerjan, JEP 2010; Schich/Kim, FMT 2010)

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2. The basic idea

- Why not insurance for financial crisis? Similar to the insurance of natcats
- Counterarguments? Many! (predictability of risk, business failure due to crisis?, moral hazard, lacking capacity,…)
- Problems serious, but not incurable
- Innovations of the insurance industry; e.g. insurance of enterprise risk

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The product is suitable for individuals as well as for small or large companies, irrespective of the business they perform. It is available in three versions and adjusted to the size and value of your company or property (see table).

Annum Payout (USD)	Amount insured (USD)
700	30.000
1.300	50.000
2.500	100.000
30.000	1.000.000

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3. Lessons learned from the economics of natcats – in a nutshell

- Structural (ex ante) solutions superior to *ad hoc* (ex post) solutions
- Insurance solutions favored (Kunreuther 1968) -> market solutions as far as possible
- Reinsurance by state necessary to support development of insurance coverage (Schwarze/Wagner 2004)
- Government capacity to diversify risks over population and over generations (Kunreuther/Michel-Kerjan 2004)

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4. Proposal: Multi-layered insurance approach

- Self-insurance by victims (1st layer)
  -> moral hazard, adverse selection
- Private insurance and reinsurance (2nd layer)
  -> permanent monitoring, pre-emptive effect
- Public as reinsurer of last resort (3rd layer)
  -> capacity problem, cross-time diversification

5. Problems – to be discussed

- When is it a financial crisis? (public choice problem)
- State subsidies of the third layer may trigger severe inefficiencies (incentive problem)
- Should the private insurance at the second layer be mandatory or voluntary? (problem of separating equilibrium)

Thank You!