RESEARCH BRIEF

The role of insurance in mitigating social inequality

THE GENEVA ASSOCIATION

INSURANCE FOR A BETTER WORLD

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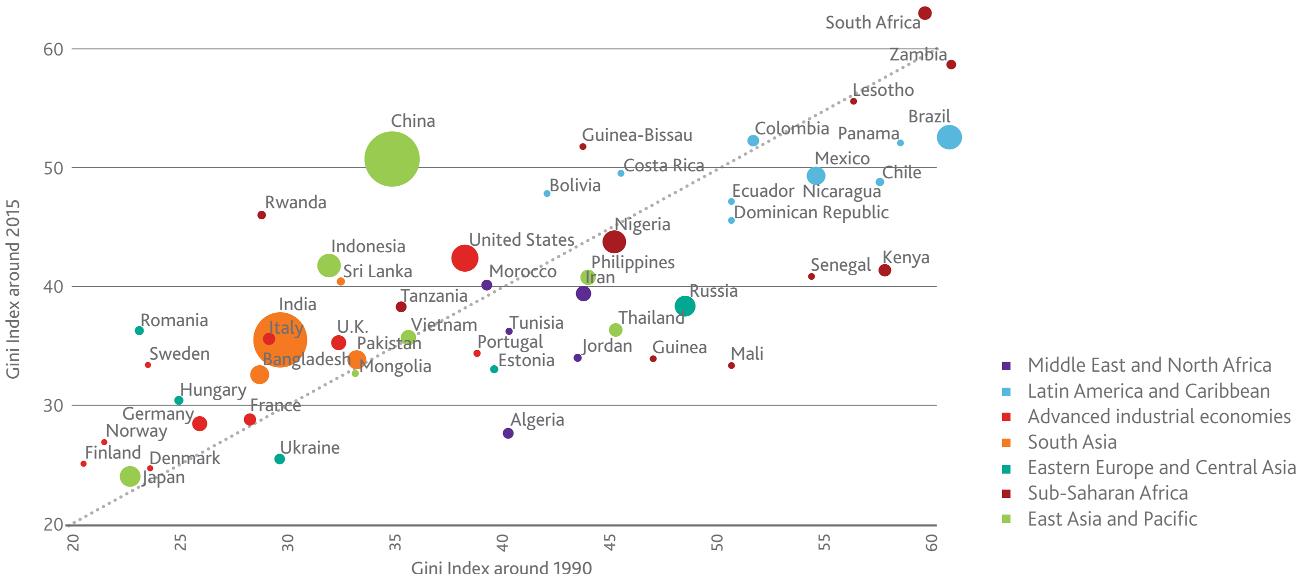
Rising levels of social inequality, in terms of income and wealth, have developed into a "defining issue of our time" (Barack Obama). The COVID-19 pandemic is adding to the challenge as it is likely to have long-lasting economic and social impacts on a global scale, including much-reduced fiscal leeway for governments to address social inequality and poverty going forward.

Global patterns of wealth inequality

Catalysed by Thomas Piketty's best-selling book *Capital in the Twenty-First Century*, the notion of inequality has staged a spectacular march from the world of academia to the frontlines of politics. Having said this, a closer inspection of the relevant data reveals that rising income and wealth inequality is not a universal and ubiquitous trend but needs to be examined at the country level, with domestic policies arguably able to make a difference. The 1980s were a turning point for inequality, with major policy changes such as the Reagan-Thatcher reforms in the Western world and the beginning of liberalisation and deregulation in China and India. As a consequence, aggregate national wealth and income have grown significantly and inequality between countries has reduced. On the other hand, these reforms translated into a more unequal distribution within these countries.

One of the most established measures of inequality is the Gini coefficient.[1] Figure 1 compares recent levels of income inequality with those recorded one generation ago for a number of countries. Countries above the 45-degree line saw a rise in inequality as measured by the Gini coefficient; countries below experienced falling inequality.[2]

Figure 1: Income inequality 1990 versus 2015 (based on disposable income or household consumption)



Source: Atkinson et al. 2017 and http://iresearch.worldbank.org/Povcalnet/home.aspx.

1 The Gini index, or Gini coefficient, is a statistical measure of distribution developed by the Italian statistician Corrado Gini in 1912. It ranges from 0 to 1, with 0 representing perfect equality and 1 indicating perfect inequality. The Gini index can be represented graphically through the Lorenz curve, which describes income or wealth distribution by plotting the population percentile by income on the horizontal axis and cumulative income on the vertical axis. The Gini coefficient is equal to the area below the line of perfect equality, i.e. 0.5 minus the area below the Lorenz curve, divided by the area below the line of perfect equality.

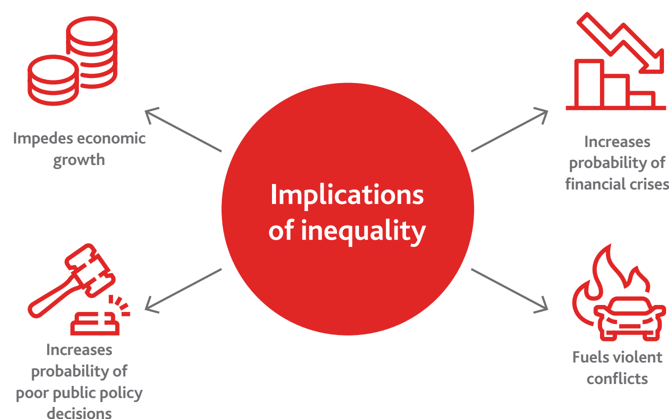
2 The Gini coefficients indicated are based on household survey data and, depending on data availability, capture either consumption, disposable income or a mix of the two.

A risk and resilience perspective

For insurers, one of the most relevant aspects of social inequality is its impact on the stability and resilience of economies and societies (Figure 2). From a macro-level perspective, inequality affects an economy's capacity to develop smoothly across its path of potential growth and to minimise income and asset losses resulting from shock events.

These effects are transmitted through less stable and dynamic economic growth, a higher vulnerability to financial crises and the risk of social unrest and political violence. Hence, it is in the insurance industry's enlightened self-interest to consider products and solutions which contribute to mitigating widening income and wealth parities.

Figure 2: Socio-economic implications of inequality



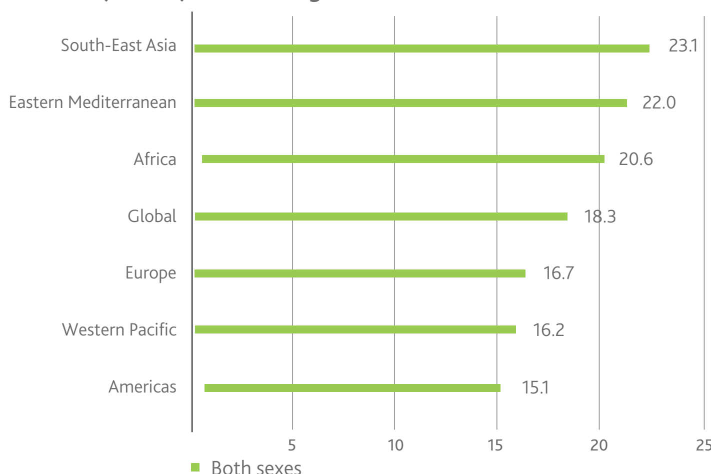
Source: Adapted from Dabla-Norris 2015

From a 'micro' resilience angle, inequality influences the ability of individuals, households and businesses to withstand shock events, based on unequal access to (insurance) protection or an insufficient awareness of it (e.g. as a result of financial illiteracy). A prominent example is 'health inequality', with implications for life expectancies and health outcomes. Another example is unequal access to disaster risk protection: in the world's poorest countries virtually all natural catastrophe losses remain uninsured whereas in high-income countries this share (the 'protection gap') is below 50%. Climate change is expected to significantly exacerbate social inequality in low-income countries over the coming years and decades. In this context, climate risk insurance is an emerging area where innovative solutions are being designed to mitigate these effects.

Insurance solutions

Social insurance is widely used to redistribute wealth and income from the rich to the poor. While private insurance is not designed to address social inequality, its relevance for income and wealth distribution is obvious: when calamities like premature death or disability of the main breadwinner or job displacement strike, households lose income or the ability to earn income. Such shocks hit the poorest the hardest (as shown by Figure 3 and the regional split of the probability of dying prematurely from non-communicable diseases). Insurance benefits offer at least partial financial relief, the relative value of which is likely to be highest for less wealthy people. As such, from a public policy perspective, private insurance can be considered an effective tool to dampen social inequality.

Figure 3: Probability (%) of dying between age 30 and exact age 70 from any of cardiovascular disease, cancer, diabetes or chronic respiratory disease; data as of 2016 for WHO regions



Source: Global Health Observatory data (World Health Organization)

Private-sector solutions also effectively complement redistributive social insurance programmes by providing personalised insurance packages and generally competitive premiums to customers. In addition, especially in developing countries, collecting premiums and submitting and settling claims through innovative ways (e.g. via mobile phones) can expand coverage beyond formal sector employees and include people who would otherwise be left out of social insurance programmes. More generally, in developing countries, standalone public schemes may not be the most effective way of covering individual risks because of weak fiscal and taxation capacities and a lack of trust in government-run programmes.

While it is intuitively plausible that private insurance can complement public programmes in alleviating the risk of impoverishment and widening income and wealth disparities, there is little research substantiating this hypothesis. Lee et al. (2017) have attempted a quantification of the link between private insurance market development and inequality, based on cross-country data. This research found that **life insurance** (which covers existential threats such as premature death and permanent disability) plays a more important role in the mitigation of social inequality than non-life insurance which, however, has been identified as more relevant for promoting economic growth.

Country-specific research shows that surviving secondary earners without insurance are at a significantly higher risk of impoverishment than those with life insurance. Other research demonstrates the wealth- and income-stabilising role of retirement **annuities**. Households can achieve an increase in wealth by investing in annuities, reflecting the fact that without private annuities to insure against longevity risk, beyond what is covered by first-pillar pension benefits, individuals would have to consume less before retirement and increase their savings and investments in liquid assets.

Another major and more recent risk facing an increasing number of households is job displacement. In principle, it could be tackled through (primarily) public-sector solutions, such as wage insurance, which would offer a temporary earnings supplement for workers facing a reduction in wages after re-employment. It is generally targeted at workers with low to medium earnings, and thus narrows the income gap between these workers and high-wage workers. Even though **wage insurance** has made it to the mainstream political debate (in the U.S., for example) its practical relevance remains limited, including for the challenges summarised in Figure 4. On the other hand, there are – still largely untested – private-sector concepts and ideas, such as **livelihood insurance**, aimed at covering long-term economic risks to individuals' paychecks for every major career and job category. In order to prevent the risk of moral hazard, livelihood insurance policies would have to be designed to insure individuals against an index of aggregate risks, such as an erosion of income of people in one's occupation.

Especially in light of the fiscal dislocation brought about by COVID-19, private insurance solutions can potentially play a bigger role in complementing public-sector schemes going forward, for example through Public-Private Partnerships (PPPs), which have a proven track record of kick-starting commercially viable insurance schemes with private-sector participation. This prospect not only provides commercial opportunities for insurers but also underlines the insurance industry's role in stabilising economic growth and preventing social unrest and political violence.

Figure 4: Opportunities and challenges presented by wage insurance

Source: The Geneva Association, based on Almeira 2017

Recommendations

In order to capture this potential, insurers are recommended to consider the following courses of action:

- **Proactively engage with the public sector to examine complementary approaches to protection:** The post-COVID-19 environment of severe fiscal constraints and citizens' heightened awareness of the value of life, health and income protection offer a fertile ground for insurers to suggest new forms of involvement and partnerships with the public sector.

- **Accelerate efforts towards product innovation:** In order to better serve customer segments, which are particularly vulnerable to adverse economic shocks, far-sighted insurers do more than simply downscaling traditional products. Innovative responses include parametric policies which are triggered by movements of an index and provide the insured with utmost clarity on payouts.

- **Harness technology for inclusive insurance propositions, including informal sector workers:** Technology can go a long way in promoting the appeal, affordability and accessibility of insurance products.

- **Promote financial and insurance literacy with a view to alleviating inequality:** The results of various empirical studies demonstrate the role of financial literacy in helping poor people improve their economic well-being, strengthen resilience and reduce poverty.

Policymakers and regulators may want to consider the following recommendations:

- **Advanced economies – Harness private risk-pooling and transfer mechanisms to ease the growing pressure on public social security schemes:** Here, in light of COVID-19, governments should proactively approach insurers and their associations to further explore concerted efforts towards promoting the sustainability of protection schemes. Such efforts should be based on mutual trust and the rule of law (contractual certainty).

- **Developing economies – Narrowing gaps in social security through private insurance:** The high degree of labour market informality and fiscal constraints in many low-income countries pose structural limits to funding and implementing government schemes. Introducing private-sector-driven risk transfer could help expand the reach of protection schemes.

- **Policies and regulations conducive to financial inclusion:** A number of supervisory authorities have committed to the objective of financial inclusion, i.e. promoting the availability, affordability and equality of opportunities to access financial services such as insurance. For such commitments to be meaningful, regulatory incentives to foster the growth of inclusive insurance are indispensable.