Insurance, risk aversion, and loss manipulation: An experiment

Adriaan R. Soetevent (University of Groningen)

Martedì 4 novembre, ore 12.00, Aula della Scuola di Dottorato, Palazzo Cà Borin, Via del Santo 22, Padova

Abstract

We challenge the view that consumers and insurers in insurance markets have a common interest to minimize the value of potential losses. We do this in two ways. First we derive the theoretical result that when consumers are risk-averse, an insurer's profits increase with potential loss size. This prediction is subsequently tested in an experimental market insurance game. Our findings show that insurer-subjects do indeed set high losses to induce consumer-subjects to buy insurance and to exploit their risk-aversion. In case of competing insurer-subjects the loss size is reduced but not eliminated. The policy implication is that one should not grant insurance companies buyer-power on grounds that they are an e ffective countervailing power to off set provider market power.