

Comments on: « Adverse Selection and
Institutional Change in Eighteenth
Century Marine Insurance » by
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« The Emergence of Institutions »

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Motivation

- Beginning of the 18th century, Britain, America, France and Holland had similar marine insurance institutions:
 - Underwriting by private individuals

- Over time:
 - America, France, Holland → dominated by joint-stock corporations.
 - Britain → dominated by private underwriting.

- **Research question:** How to explain the institutional changes which occurred in the marine insurance industry? Why did the institutions develop in different directions?

Marine Insurance

- Transactions were complicated: agency problem on both sides of the market.
- Key problems:
 - For underwriters → knowing the premium to charge.
 - For merchants → the reliability of the insurance policy.
- Response of underwriters: try to improve the security of the policy by forming companies (from syndicates to corporations).
- Assumption: corporations have inferior access to information than private underwriters (network effects).

Model

- Many merchants, many private underwriters, two insurance corporations.
- Merchants (with θ_i =merchant i 's type) can choose both kinds of underwriters:
 - private underwriters (+: set appropriate premium because they have an idea of θ_i , -: less financially secure).
 - corporations (+: more financially secure, -: set the same premium for all merchants because unable to learn θ_i).
- The game (1 shot):
 - First: corporations announce their premium.
 - Second: merchants learn θ_i and choose between private underwriters or corporations.

Results

➤ 18th century marine insurance industry may have been characterized by multiple equilibria:

- (i) All types of merchants insure with corporations (if expect that no merchants insure with private underwriters (PU) → no network effects → no informational advantage but insecurity).
- (ii) With a small probability that PU fail, *good risks* merchants insure with PU (to benefit from lower premia), *bad risks* merchants insure with corporations.

➤ Wars can explain institutional changes:

- Wartime: Corporations have the informational advantage (information about political and military development= high fixed costs).

➤ Wars can also explain institutional stability:

- Formalize and strengthen Britain's marine insurance institutions.

Questions

- Isn't it a strong assumption to assume that corporations have inferior access to information? Can this assumption persist with repeated games (if corporations build up a connection with merchants they would become able to learn θ_i)?
- In the model bad risks merchants pay higher premia to corporations which never fail. How can that be justified knowing that it was common in the 18th century to insure with several underwriters depending on the risk?
- Knowing that merchants also purchased insurance in other ports in other countries (if they find better premia), is it pertinent to explain the changes (or stability) in institutions in the four countries separately?
- For Britain, it is explained that corporations charge higher premia than PU (as predicted by the model) and that they confine themselves to the best risk merchants. Isn't it in contradiction with the model predictions?