ECON 4915 – Development Economics
Spring 2011

Seminar 3

Question 1

Our discussion on mutual insurance suggests that if there is perfect insurance among members of a group, individual consumption should track group consumption more closely than it tracks individual income.

Based on Townsend's 1993 article, discuss how we can possibly test (empirically) the existence of perfect insurance in a community. Discuss his main findings.

Question 2

Consider a perfect mutual insurance scheme. Even if everybody may prefer to participate in such a scheme *ex ante*, the *ex post* preference can be different – individuals with low output gain and individuals with high output lose. Can perfect insurance then be enforceable?

Discuss properties of imperfect insurance schemes when perfect insurance is no longer enforceable.

Consider two different groups, one with (relatively) rich members and the other with (relatively) poor members. In which of these groups can perfect insurance more likely to be enforced? On a related note, suppose the government decides to introduce agricultural banks in villages. Discuss its potential effect on the enforcement constraints of mutual insurance (for the last part, ignore information effect completely, and just consider the enforcement constraints).

Tuesday's seminar: **A3** will review Question 1, and **A4** will review Question 2.

Wednesday's seminar: **B5** will review Question 1, and **B6** will review Question 2.