Is there a role for insurance in reducing income inequality?

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Meeting report[1]

Lower income households tend to be disproportionally affected by unexpected life events and economic shocks. Unlike higher income households, they often have fewer financial buffers at their disposal and lack comprehensive insurance coverage.

Enhanced access to financial services for low income households and small businesses can help to reduce their vulnerability and increase their resilience. For example, some insurance solutions can provide compensation to households affected by financial shocks (such as a fire, sudden unemployment or a personal injury). In many cases, such risks are not at all or only partially covered by social security systems.

The various insurance solutions that can increase both individual and collective financial resilience in the EU were discussed during a CEPS roundtable on 14 September 2022. This report summarises these discussions with decision makers, academics, business representatives and other key stakeholders.

Why is there a need for insurance to reduce income inequality?

In recent decades, income and wealth inequality has increased in many European countries. A certain level of inequality allows for economic prosperity, while excessive inequality reduces economic prosperity and the broader welfare of citizens.

Traditionally, inequality is primarily reduced by government policies. Governments typically use a combination of benefits and progressive personal income and wealth taxes. In essence, these policies primarily aim to guarantee minimum living conditions to all and soften the impact of a large sudden drop in income. Existing insurance products usually 'top-up' the government schemes or provide broader coverage against a risk-based premium.

The government's ability to reduce income inequality has been challenged by various crises. For example, the global financial crisis, the eurozone debt crisis, Covid-19, and the current inflation/energy

[1] This meeting report is the authors' interpretation of the discussion held during the High-level roundtable 'Is there a role for insurance in reducing income inequality in the EU?' on 14 September 2022. The discussion was led by Cinzia Alcidi, Director of Research at CEPS and Charlotte Müller, Chief Economist Europe at Swiss Re Institute, and moderated by Willem Pieter de Groen Senior Research Fellow at CEPS. A selected group of decision makers, academics, business representatives and other key stakeholders also participated in the discussions.

crisis have all put pressure on government finances, reducing government income and increasing their expenses under unmodified policies.

Similarly, megatrends such as the ongoing digitalisation process, climate change and an ageing population are likely to further fuel inequality and weaken government finances. For example, automation and skills adaptation create additional hurdles for current employees who find themselves more exposed to more atypical forms of employment relations or they lose their jobs due to automation or a lack of necessary skills.

The increased inequality and uncertainty about household finances as well as weakened government finances compel policymakers to explore alternative solutions.

What is the potential for insurance products in reducing income inequality?

Insurance can contribute to reducing income inequality. It can primarily contribute towards avoiding sudden large drops in income, increasing expenses and wealth generation.

More specifically, insurance products can support households, society and governments when unexpected events occur by pooling risk. This is especially relevant for those households most sensitive to financial losses caused by unexpected events, i.e. low probability but high impact events. However, under current circumstances, insurance products do not always reach these most vulnerable households, causing an insurance gap and thus amplifying income inequality.

This gap can be tightened by making some of the insurance products mandatory, providing financial incentives (e.g. discounts), and collective insurance product distribution.

There is a broad range of insurance products that have the potential to reduce income inequality. These include home insurance, disability insurance, health insurance and other insurance products that avoid sudden drops in personal incomes or large increases in expenses.

More work is required to specify the insurance products that can contribute most to reducing income inequality.

What role for governments to unlock the potential for insurance products?

The insurance sector can take various measures to make vulnerable households more aware about the benefits of specific insurance products, ease access to insurance products and to keep the prices of the insurance products low. However, there are limits to what the insurance sector can do without government interventions.

Public-Private Partnerships (PPPs) can contribute to raising insurance penetration among households. These PPPs could take various forms, such as insurance sector distributing the insurance products as well as the insurance coverage, while governments contribute either by subsidising the insurance products, thus guaranteeing extraordinary losses and/or making insurance mandatory.

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