Course Outline: Mini-Lecture on Behavioral Insurance

Instructor: Markus Fels (TU Dortmund), markus.fels@udo.edu

Date: December 2018/January 2019 (Mo and Thu, 14:00-16:00)

Location: TU Dortmund campus

Date	**Room**
Mo, Dec 17th	SRG 2.028
Thu, Dec 20th	SRG 3.031
Thu, Jan 10th	SRG 3.031
Mo, Jan 14th	SRG 2.028
Thu, Jan 17th	C1-06-777
Mo, Jan 21st	SRG 2.028
Thu, Jan 24th	SRG 3.031
Mo, Jan 28th	SRG 2.028
Thu, Jan 31st	SRG 3.031

Description:

Insurance is an important topic in Economics as risk is an integral part in almost any economic activity. People's attitude towards risk and their desire to insure against at least some of it have thus claimed a prominent spot in economic analysis. As more and more deviations from standard theoretic predictions have been documented in insurance markets, there is now a steady growth in the literature on behavioral models of insurance that seek to explain such "anomalies".

The course seeks to give a first impression as to how the "toolbox" of behavioral economics can be applied to understand insurance choices. The focus of the lecture is on insurance theory although frequent reference is made to empirical regularities that motivate the further development of the theory. After a short introduction to the standard economic theory of insurance and the summary of some empirical regularities that seem to be at odds with it, behavioral approaches to decision-making are introduced that have relevance for decisions under risk in general and insurance decisions in particular. Finally, the lecture offers an introduction to an alternative insurance motive that differs from the standard assumption of risk aversion being the main driver of insurance demand.

Tentative Outline:

I. **"Standard" Insurance Theory: Expected Utility, Risk Aversion, and Insurance Demand**

- Risk Aversion and Insurance
- Some Comparative Statics
- Asymmetric Information and the Need for Cost-Sharing
- A Collection of Empirical "Puzzles"

Suggested Reading:

L. Eeckhoudt, C. Gollier, H. Schlesinger. "Economic and Financial Decisions under Risk". Princeton University Press.

P. Zweifel, R. Eisen. "Insurance Economics". Springer.

II. **Behavioral Economics and Its Application to Insurance**

- Prospect Theory (Value Function, Probability Weighting, Mental Accounting)
- Heuristics (Availability, Recency)
- Implications for Insurance

Suggested Reading:

H. Kunreuther, M. Pauly, S. McMorrow. "Insurance and Behavioral Economics: Improving Decisions in the Most Misunderstood Industry". Cambridge University Press

M. Rabin, R. Thaler (2001). Anomalies: Risk Aversion. Journal of Economic Perspectives 15, 219-232.

D. Kahneman, A. Tversky (1979). Prospect Theory: An analysis of decision under risk. Econometrica 47, 263-291.

E. Johnson, J. Hershey, J. Meszaros and H. Kunreuther (1993). Framing, probability distortions and insurance decisions. Journal of Risk and Uncertainty 7, 35-51.

III. **Alternative Motives for Insurance: The Access Motive**

- Contrast to RA: Insurance and gambling with indivisibilities in consumption
- Cost-Sharing and Access
- Another Contrast to RA: The Role of Public Insurance
- Complementarity to Behavioral Approaches

Suggested Reading

J. Nyman (1999). The Value of Health Insurance: The Access Motive. Journal of Health Economics 18, 141-152.

Vasquez (2017).Utility of wealth with many indivisibilities. Journal of Mathematical Economics71, 20-27.

M. Fels (2018). Mental Accounting, Access Motives, and Overinsurance. Scandinavian Journal of Economics, forthcoming.

Prerequisites: Knowledge of Microeconomics (Master level), Statistics