Barefoot Hedge-Fund Managers

The hazard of being poor

After gaining a thorough grasp of the subject, I divided the risk of poverty into three primary categories: job insecurity affects income, accustomed to poverty: the global economic crisis, and the consistent bad breaks are likely to injure them more.

First, job instability has an impact on income; as one aspect of poverty is a lack of financial resources to meet basic necessities, laboring for money is one of the variables influencing the risk of being poor, particularly for employment that is uncertain. According to the eighteen-country data set in the article, there are three majority jobs of the poor: small business, casual labor, and farm. The small businesses have an average of 50% of the urban poor have a non-agricultural business. Then, the casual labor that in rural regions almost half of those employed among the severely poor are casual laborers, while in metropolitan areas, it is around 40%. These occupations are risky since they are short-term jobs where employees cannot predict when they will be recruited because if a business fails, they will be among the first to be laid off, hence their income is highly uncertain. Lastly, farmers that the fraction of the rural poor who report running a farm business ranges between 25 percent and 98 percent (except for South Africa). Unfortunately, the vast majority of land farmed by the poor is unirrigated causing agricultural earnings extremely weather-dependent ,for instance, varying agricultural income and increasing in agricultural prices which most of the impacts will occur in developing countries or poor country because of the lack of support from the standard social insurance programs by the government.

Second, accustomed to poverty: the global economic crisis, despite a warning from Robert Zoellick, World Bank President, that the global economic crisis could affect global demand, resulting in the poor losing jobs and welfare from the government due to budget cuts, but in reality although the global economic crisis increased the risk of the poor, it just added little to the overall risk they face on a daily basis. For instance, the interview of the Indian Muslims migrant about migrant experiences during the Mumbai crisis mentioned that even though there were some tragedies, there were lots of jobs to do so they were happy and no worry to find the jobs.

Third, the consistent bad breaks are likely to injure more, this topic is divided into two parts. Firstly, cut in consumption or reduction in consumption is more painful for someone who consumes little to begin with,since for the poor, a large reduction in income may mean cutting essential expenditures, whereas the not-so-poor household may be able to reduce consumption in trivial ways such as fewer phone bills or unnecessary purchases. Secondly, the topic is when the relationship between income today and future income is S-shaped. According to the case of Ibu Tina, the Indonesian businesswoman, her relationship between income tomorrow and income today has a S-shaped since to be profitable, her company needed to operate on a small scale. At the beginning, the Garment business of Tina's husband that she joined and consists of 4 employees was doing well. However, when the the bounced check situation, they became insolvent and in debt causing Tina and her husband moving them to the poverty-trap zone และbeing permanently poor at the end. Furthermore, this process is often reinforced by a psychological process. Because, aside from the desolation, what Tina was endured could have caused her to have these situation: 1)Loss of hope and the realization that there is no easy way out can make it much more difficult to maintain the self-control required to go back on track, and Facing risk that cause worry and 2) Facing Risk that leads to worry causing stress and depress. In terms of stress and depression, this is a symptom that often occurs in poor people because stress causes people to focus less on something and therefore less in productivity respectively. To indicate the stress, the cortisol is a measure of a person's stress level and their stress level can be reduced when someone reaches out to help. According to the article, this shows that stress is one of the major factors affecting the livelihoods of the poor

The Hedge

To cope with the risk among poor people, they sometimes face the situation of self-defeating because there is more work when the bad time occurs which drives wages down. In the place that is isolated, in India, working more is not the effective way to solve getting paid less.

From this problem, the best way to solve these risks is to try to limit exposure of buildings like a hedge-fund management and a diversification of risk. Moreover, having diversification activities is a way to reduce risk as well since when one in the family is in an unstable situation, another can keep going. This is one of the risk diversification. For example, when some areas in the village lack rainfall, the crops on the other section which can access the underground water can survive and continue growing since different parts of the village may have different conditions of the microclimates: exposition, slope, elevation and moisture. In addition, poor people will limit risk by using the conservative way for their agriculture business and do not invest new seeds because there is always a small chance that the crop will fail, and the farmer will lose the extra investment with new seed. Another way to cope with the risks is the farming family, in India, spreads the risk by creating a risk portfolio from marriage. However, all these solutions managing the risk tend to be very costly. The problem is poor farmers have inefficient ways to cope with the risk when they input conservative farming while living in the wavering rainfall. Another way is poor farmers try to become someone's tenant, but this way makes farmers farm less intensively and less efficiently. Lastly, these groups of people have multiple occupations which is also inefficient.

Another way dealing with risk is helping each other out in neighborhoods where most people can extend their network of people that they know by extended family, communities based on religion. On the other hand, helping each other is not a charity, people have to return in the similar way that they are given to create the better off for everyone. Using informal insurance, when the shocks happen, the households should be able to consume more or less at the same amount if the risks are well insured. However, health shocks are terribly insured since the families have to deal with this shock by themselves and there is no helping each other out of the risk like the individual level. The 'moral hazard' is the reason behind why people do not want to offer unconditional help to each other since they need the guarantee that they will get a similar return if they need some help in the future. Nonetheless, even though people will not directly offer help to each other when they see someone in a terrible situation, they will take an action or offer for other good things to substitute the help that is obligated with the expensive condition – the hospitalization in this case.

Where are the insurance companies for the poor?

The insurance company typically supplies formal insurance, which is quite irregular among the poor. Moreover, it is commonly used among farmers in developed countries but is less likely to be seen in developing countries. Due to the fact that the poor need to endure a tremendous amount of risk, if the insurer offers a reasonable insurance premium, there are billions of poor waiting to be insured. With a tiny profit per policy, the company could make a massive return in terms of both money and the poor's benefits. However, this market still lacks organizers, so international organizations and large foundations are in demand to invest, aiming to stimulate the insurance options for the poor.

On the other hand, providing insurance also causes some complications, which could happen in all countries while intensified in developing countries. First, the moral hazard problem is when people change their behavior once they realize that they will not take full consequences. To demonstrate, the poor generally visit the health providers even without health insurance. If it becomes free, the patients have more demand to see the doctor, and the doctors will gain more money from the reimbursement. Furthermore, in developing countries where health care is inefficiently regulated, the possibility that bankruptcy will occur increases significantly.

The next issue is adverse selection. In reality, the company cannot specify those who will have problem; therefore, the company decided to raise the premium for everyone to prevent adverse selection, which exacerbates the original problem. Consequently, affordable health insurance should be mandatory.

The last problem is outright fraud. The example case will be cattle insurance provided for the farmer under the condition that the farmer needs to show the dead cow's ear. As a result, the cow's ear market became boom since the farmer tried to claim the insurance from another dead cow’s ear and keep their cow.

Nevertheless, some types of insurance are easier to manage without moral hazard and fraud, such as weather insurance and catastrophic health insurance, which can limit the pay of each treatment for a significant illness or accident. However, the adverse selection remains. Therefore, the company needs to ensure many clients. This is why microfinance institutions (MFIs) offer their borrowers health insurance, as it secures both clients and MFI if the health problem forces clients to default.

An example of MFI is SKS microfinance, a pilot health insurance. They provide mandatory capped benefits for the first renewal to avoid adverse selection but end up losing their clients. Clients who continue borrowing from SKS try to use the loophole to avoid paying the new premium, showing that clients are resistant to the mandatory insurance.

The main reason the poor do not want insurance is that the government is spoiling the market. To illustrate, when a disaster occurs, the government kindly helps them, so it might influence the poor to think that insurance is unnecessary. Another interesting finding is that the farmer understands the concept of insurance, but they are not interested in buying it. Regardless, their decision is swayed by small things like answering many questions about a particular topic.

The poor are not enthusiastic about insurance benefits because the insurance covers just catastrophic scenarios. Moreover, the insurance is required to pay in advance, so trust is another issue. Unfortunately, the lack of creditability might be endemic. In detail, the SKS's two unsatisfied clients in the community affect a whole group's decision. The weather insurance also faced similar issues when crops dried up, but the rainfall was still above the cutoff resulting that no one getting paid. Therefore, it is hard for the farmer to accept the judgment, specifically in an unreliable organization.

For Government action, private insurance should continue selling the product, but the government should support the insurance premium for the poor. According to the Ghana case, this method could work where their government offers a subsidy on weather insurance premiums resulting in almost farmers buying insurance. Furthermore, the farmer who obtained cheap insurance is more likely to use fertilizer and get better off. Lastly, the subsidy may be reduced over time as individuals better understand how insurance works and the market expands. If the poor did not have to be hedge-fund managers of their own lives. This appears to be an excellent area to utilize public funds to promote the common good.

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