

BORROWING FROM THE INSURER: AN EMPIRICAL ANALYSIS OF DEMAND AND IMPACT OF INSURANCE IN CHINA

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ABSTRACT

Farmers in less developed countries face relatively large income risk and have limited access to formal financial products that can help them manage it. We present results from a randomized control trial in rural China designed to understand whether a small change in the timing of the payment of a premium for a swine insurance contract helps overcome an important barrier to insurance demand; and whether the resulting increase in insurance allows farmers to increase investment in activities that expose them to risk being insured against. We find that insurance take-up is three times higher among those who were given the option to pay at the end of the insured period. We use the random variation in insurance take-up thus induced to estimate the impact of insurance on investment. We find a positive impact on investment which suggests that without insurance farmers were not able to fully insure; that the new payment plan helped farmers overcome an important barrier to insurance purchases; and that encouraging insurance purchases in this way can have a positive long run effect on the income and welfare of rural households.

1. INTRODUCTION

Farmers in less developed countries face relatively large income risk and have limited access to formal financial products that can help them manage it. In the presence of risk that cannot be fully insured, farmers engage in risk-avoiding behavior at cost to future expected income (Sandmo 1971, Kurosaki and Fafchamps 2002, Walker and Ryan 1990, Morduch 1991, Dercon and Christiaensen 2011, Hill and Viceisza 2012). This literature suggests that if farmers are offered insurance, they will purchase it, which will in turn allow them to invest in high-return activities that carry risk. However a literature has emerged in recent years to try and understand why risk-averse farmers

who are exposed to uninsured risk do not purchase well-priced insurance instruments (Cai et al 2009, Cole et al 2013, Dercon et al 2012, Hill et al 2013). When insurance is provided for free it has a positive impact on investment behavior (Karlan et al 2013, Gine et al 2012), suggesting that low insurance demand is not the result of a limited need for insurance, and that overcoming the constraints farmers face in purchasing insurance could have substantial welfare effects.

In this paper we present results from a randomized control trial in rural China designed to understand whether a small change in the timing of the payment of a premium for a swine insurance contract would encourage higher demand; and whether the resulting increase in insurance allows farmers to increase investment in activities that expose them to risk being insured against. Just prior to the purchasing window for the next insurance policy period, we randomly selected half of the farmers in our study and provided them with the option of purchasing an insurance contract but delaying payment of the premium until the end of the insured period. If no loss was suffered the premium was to be paid with interest, but if a loss was incurred then the premium and interest payment would be deducted from the indemnity paid by the insurers. We find that insurance take-up is three times higher among those who were given the option to pay at the end of the insured period. The fact that more than 95% of insured households who did not suffer a loss repaid the premium on time suggests that the higher demand is not driven by the illusion of free insurance. We use the random variation in insurance take-up induced by the voucher to estimate the impact of insurance on investment. We find that insurance increases the total investment made by households, particularly higher risk investments.

In many ways the literature explaining low insurance take-up among smallholder farmers is similar to the literature on technology adoption (Feder et al 1985, Munshi 2004, Jack 2011). Insurance, even if subsidized, is a new financial technology for many farmers and as such demand for insurance will likely face the same constraints as demand for new seeds or other agricultural inputs. Farmers who believe it to be unprofitable will eschew it (Clarke 2012), farmers who are uncertain about the new technology may be less likely to invest in it (Bryan 2012), and those who lack liquidity will find it more difficult to make the upfront payments required for purchase (Cole et al 2013).

However, purchasing an insurance contract is different from purchasing agricultural inputs in the level of trust it requires of the purchaser. When insurance is purchased by a farmer, the farmer is putting his or her trust in an insurance company to provide support at a time when support is most needed. Yet often the perceived probability of insurer default is quite high in

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rural areas of less developed countries due to low levels of trust and unfamiliarity with formal financial institutions. In Madhya Pradesh in India, 50% of households surveyed reported that they thought private insurance companies were unlikely to honor an insurance contract (Hill et al 2013), and 15% of households surveyed reported this to be the case in Ethiopia (Berhane et al 2012).

As such a number of studies have shown that demand for insurance is higher when trust in the provider of the product is high. A field experiment undertaken in the same context as our study, that of pig insurance in China, (Cai et al. 2009) provides the first experimental evidence that trust in the insurer is an important determinant of demand. Also in an experimental setting, insurance demand in India was found to be 36% higher when insurance was offered by someone known and trusted by the household (Cole et al, 2013). Similarly changing the background of the insurance flyer to match the religious affiliation of the potential buyer (from a mosque to a Hindu temple) raises insurance take-up.

The role of perceived default risk was also highlighted in Doherty and Schlesinger (1990) who showed that in the presence of default risk many of the standard predictions of demand for insurance do not hold: households may not purchase full insurance, and in the presence of contractual non-performance, demand does not always increase in risk aversion.

The high perceived risk of insurer default can pose a significant constraint to demand for insurance offered by new financial intermediaries. To minimize these concerns the delivery of insurance is often conducted by local organizations with a long history of dealing with farmers. In this paper we test whether delaying the payment of the premium to the end of the insurance period, when it is clear whether or not the insurer will default, may be an alternative way to overcome a trust deficit that may exist. We test this by implementing a randomized control trial built on an operating insurance policy for fattening pigs in Zizhong county of Sichuan province in China.

The delayed payment mechanism that we test in this paper may also increase insurance demand by relaxing liquidity constraints that may make it difficult for farmers to pay the insurance premium at the beginning of the season. Liquidity concerns affect demand for all insurance products, but can be even more of a problem for agriculture when premiums are to be paid at the same time other inputs are bought, and a number of months after the last harvest. Many agricultural insurance products in the U.S. are sold with payment at the end of the insured period. Cole et al. (2013) use a field experiment in India to show that providing farmers with a cash transfer at the same time insurance is offered greatly increases take-up, which is suggestive that liquidity constraints may play a

role in insurance demand. Duflo, Kremer and Robinson (2010) show that asking for payments for agricultural inputs at a time when households are less likely to be liquidity constrained increases the number of household purchasing inputs. Providing farmers with the ability to pay later may provide farmers with the flexibility they need in timing payment for their insurance premium.

Using a simple theoretical model, we show that the type of payment scheme offered to farmers in our study ameliorates constraints to demand caused by liquidity constraints and insurer default risk and thus has the potential to effectively increase insurance demand. In this paper we present results from the first experimental study to analyze the effects of this innovative insurance design on insurance take-up. The context we consider is one marked by high levels of mistrust in insurance contracts (Cai et al 2009) and with few liquidity constraints. As such we may expect that if the new payment scheme increases demand it is as a result of its impact on the perceived risk of insurer default. To explore whether this is the case we look at who the new payment scheme has the largest impact for. We also examine the nature of demand for insurance under the new payment scheme. Doherty and Schlesinger (1990) show that demand does not increase in risk aversion if there is a risk of contractual non-performance. We estimate the relationship between risk aversion and demand for those in the new payment scheme and those not. We find that the Doherty and Schlesinger results hold for purchases with upfront premium payments, but not for those in the new payment scheme. This could indicate that the new payment scheme helps mitigate the risk of insurer default.

Our experimental design also allows us to test whether an information effect may be driving our results. When households were presented with information on the new payment plan that they were being offered, this may have also been a source of information or a reminder regarding the insurance policies provided. As such we split our control into two groups. One group received the same information on swine insurance as was provided in the voucher given to farmers in the treatment group. If part of our treatment effect is driven by increased information or salience of the insurance, we would expect take-up to be higher in the control with information than in the control without information. We do not find this to be the case: take-up is identical in both control groups and insurance demand in the control group with information is significantly lower than insurance demand in our treatment.

In addition to documenting the impact of the new payment plan, we estimate the impact of insurance on investment. If demand for insurance is low because households face barriers to purchasing a well-

subsidized insurance product we would expect that when these barriers are overcome, not only does demand increase but insurance has an impact on behavior consistent with the fact that without the insurance contract households were not able to satisfactorily insure income risk. In particular we would expect investment in activities that the contract insures to increase (Sandmo 1971), with high risk investments benefiting more than low risk investments. We assess this by using the exogenous variation in insurance purchases induced by random allocation of households into the new payment plan, to instrument for insurance purchases. Using this instrumental variables method we assess the impact of insurance on total investment in swine fattening, and in investment in low risk and higher risk breeds of swine. We find insurance to increase the total number of swine purchased for fattening and in particular to increase higher risk breeds. The moral hazard thus induced by the insurance contract is positive, reducing the time it takes to fatten swine by 2 months.

This positive impact suggests that without insurance farmers were not able to fully insure; that the new payment plan helped farmers overcome an important barrier to insurance purchases; and that encouraging insurance purchases in this way can have a positive long run effect on the income and welfare of rural households in China. Low take-up of insurance has resulted in few studies that have shown a positive impact of insurance on investment and household welfare. This paper thus provides an important contribution to the literature on the negative impact of uninsured risk on household welfare. It fits with results of recent (as of yet, unpublished) studies that suggest that insurance has positive investment and welfare effects for farming households in less developed economies (Cai et al. 2009; Gine et al 2012; Karlan et al. 2013).

The remainder of the paper is organized as follows. In Section 2 we provide a simple model to show that the delayed payment mechanism can increase insurance demand. In Section 3 we describe the context and design of the policy experiment. In Section 4 we present the data collected and details of the experimental implementation. In Section 5 we set our empirical strategy. In Section 6 we present our empirical results and in Section 7 we conclude.

2. A SIMPLE MODEL

In this section we introduce a simple model to show that allowing individuals to defer payment of the premium to the end of the insured period will result in higher demand for insurance. The model uses a similar framework to that in Liu and Myers (2012). Consider a risk-averse agent who uses insurance to manage the risk of asset losses. Each period the asset yields fixed

revenue M if the asset survives and zero if it does not. With a known probability q the agent loses her asset and receives no revenue. The insurance policy is defined by a couple (p, M) where p is the premium and M is the indemnity if the asset loss occurs before the end of the period. The agent can choose to insure or not to insure the asset, which is denoted by a dummy variable k ($k = 1$, to insure; $k = 0$, not to insure). The agent perceives some probability of insurer default ξ . That is, when insurance is taken out and the loss occurs, the agent perceives she will get the indemnity with probability $(1 - \xi)$. We also assume r is the one-period interest rate which is fixed.

We consider the two insurance schemes: the traditional scheme with which the premium is paid at the beginning of the period, and the new scheme which allows insureds to enter an insurance contract while delaying premium payment at the cost of an interest charge until the end of the insured period, after income has been realized. In the new scheme, if insureds suffer the insured loss insurers deduct the premium from the indemnity. If not the premium still has to be paid. We assume the both insurance policies are actuarially fair and have no deductible. Thus in the traditional scheme, the premium is given by $p^1 = qM/(1+r)$. While in the new scheme, the premium is $p^2 = qM = p^1(1+r)$.

We use a multi-period setting. The insured is assumed to live forever and maximizes discounted lifetime utility subject to a budget constraint. When the insured does not choose any insurance in period t , her utility is

$$V_0(w_t) = \max_{c_t} \{U(c_t) + \beta E_t V(w_{t+1})\}, \text{ s.t. (1)}$$

$$S_t = w_t - c_t \quad (2)$$

$$w_{t+1} = (1+r)S_t + (1-y_{t+1})M \quad (3)$$

$$S_t \geq s, \quad (4)$$

$$\lim_{t \rightarrow \infty} \beta^t w_t = 0, \quad (5)$$

where $U(\cdot)$ is an increasing and concave utility function; c_t and w_t are consumption and wealth at period t ; β is the rate of time preference; S_t is savings (borrowing if negative) at period t . y_{t+1} is a binary random variable with 1 indicating the event of asset loss, which follows a Bernoulli distribution with

mean q and variance $q(1-q)$. Equation (4) represents a liquidity constraint, where s is the minimum net wealth position allowed by the credit market. If $s = 0$ borrowing is not possible and if $s = -\infty$ there is no liquidity constraint and any amount can be borrowed. Equation (5) is the transversality condition.

If the insured chooses to insure under the traditional insurance scheme, her utility is

$$V_1(w_t) = \max_{c_t} \{U(c_t) + \beta E_t V(w_{t+1})\}, \text{ s.t. (6)}$$

$$S_t = w_t - c_t - p_t^1 \quad (7),$$

$$w_{t+1} = (1+r)S_t + (1-y_{t+1}\Delta_{t+1})M \quad (8)$$

and (4), (5),

where Δ_{t+1} is a binary random variable with 1 indicating the event of insurer default, which follows a Bernoulli distribution with mean ξ and variance $\xi(1-\xi)$.

If the insured chooses to insure under the new insurance scheme, her utility is

$$V_2(w_t) = \max_{c_t} \{U(c_t) + \beta E_t V(w_{t+1})\}, \text{ s.t. (9)}$$

$$S_t = w_t - c_t \quad (10)$$

$$w_{t+1} = (1+r)S_t + (1-y_{t+1}\Delta_{t+1})(M - p^2) \quad (11)$$

and (4), (5).

Under traditional or new insurance scheme, the insured will choose to insure if $V_1(w_t) > V_0(w_t)$ or if $V_2(w_t) > V_0(w_t)$. We denote optimal consumption at period t under no insurance, traditional insurance, and new insurance as c_t^0 , c_t^1 , and c_t^2 , respectively. We next prove $V_2(w_t) > V_1(w_t)$ always holds.

Under the traditional insurance:

$$w_{t+1}^1 | (c_t = c_t^1) = (1+r)(w_t - c_t - p_t^1) \text{ with probability } q\xi$$

$$\text{and } w_{t+1}^1 | (c_t = c_t^1) = (1+r)(w_t - c_t - p_t^1) + M \text{ with probability } (1-q\xi)$$

Under the new insurance:

$$w_{t+1}^2 | (c_t = c_t^1) = (1+r)(w_t - c_t) \text{ with probability } q\xi$$

$$\text{and } w_{t+1}^2 | (c_t = c_t^1) = (1+r)(w_t - c_t) + M - (1+r)p_t^1 \text{ with probability } (1-q\xi)$$

We note that $c_t = c_t^1$ is always feasible in the new insurance scheme because the budget constraint will not be binding in the new scheme if it is not binding in the traditional scheme. It is not difficult to see that $w_{t+1}^2 | (c_t = c_t^1)$ stochastically dominates $w_{t+1}^1 | (c_t = c_t^1)$ in the first degree. Thus $EV_2(w_{t+1}) | (c_t = c_t^1) > EV_1(w_{t+1}) | (c_t = c_t^1)$, which implies $V_2(w_t) | (c_t = c_t^1) > V_1(w_t) | (c_t = c_t^1)$. Intuitively, the first degree stochastic domination is because the insured does not have to pay the premium under the scenario that a loss occurs and the insurer defaults (with probability $q\xi$). Equation (9) implies $V_2(w_t) | (c_t = c_t^2) > V_2(w_t) | (c_t = c_t^1)$. Therefore, we have $V_2(w_t) | (c_t = c_t^2) > V_1(w_t) | (c_t = c_t^1)$. That is, the insured always have higher utility under the new insurance scheme than under the traditional insurance scheme. As a result, the demand for insurance will be higher under the new insurance scheme than that under the traditional scheme.

3. CONTEXT AND EXPERIMENTAL DESIGN

We conducted a field experiment in Zizhong County of Sichuan province, China. Swine production is a major source of economic income for household living in Sichuan province. Livestock (mostly swine) income accounts for 23.34% of the total income for farm households in Sichuan in 2009 (Li et al. 2009). It is also an economic activity characterized by considerable risk. The mortality rate of fattening pigs is as high as 6%-8% in China in past decade and most of the mortality is caused by infectious disease (Jia 2013).

Although there are some large swine producers located in Sichuan, much swine production is done by small and medium income households residing in rural areas with few resources available to help smooth the income shocks associated with swine production. Insurance for swine production is an important means by which households manage this risk. At the time of our experiment, two types of swine insurance were provided: insurance for sows and insurance for fattening pigs, pigs raised for meat use. Our study focuses on insurance for fattening pigs.

Insurance for fattening pigs is provided by the provincial government and a state-owned insurance company, the People's Insurance Company. The government defines the policy conditions and collects payments whilst the insurance company handles contracting and indemnification. Each year, the Government of Sichuan decides whether, when, and what insurance policy to provide. Usually, the window for insurance purchases is open for several months in each year. Before the opening of the window for insurance purchases, farmers have no information on when the window will be open and what kind of policy will be offered. When sales commence, the insurance premiums are collected by village veterinarians or other local government officials and the settlement of claims is handled by the staff in township government and employees of the insurance company. In 2011, during our study period, two insurance policies were provided for fattening pigs. One policy was for a four month fattening period and cost 6 RMB (about one dollar) for one pig. A second policy was for a six month fattening period and cost 7.5 RMB for one pig. In both policies, the guarantee level is RMB 500, the deductible is RMB 100, and the coverage level is 70%. That is, the indemnity is computed following the formula:

$$\text{Indemnity} = \text{Min}[\text{weight} * \text{market price} * 70\% - 100, 500]$$

As the formula indicates, the weight of the pig is the only characteristic of the pig that determines the payout. The breed of the pig is inconsequential.

However, when it comes to raising pigs, not all breeds are equal in the time they take, the risk they represent, and the skill and input level they require (Hu 2007). There are three categories of swine that are purchased for fattening: local hybrids, local cross-breeds and foreign cross-breeds. Local hybrids take longer to fatten, but are the lowest-risk type of investment given their resilience to disease and the low skill level required to fatten them. Local cross-breeds take much less time to fatten, but are not as resilient to disease and require more skill to fatten successfully, as a result they represent a riskier investment for farmers. Foreign cross-breeds take about the same time to fatten as a local cross-bred but are much riskier given their weak disease resistance and high skill requirement. This is summarized in Table 1.

Table 1: Characteristics of investments in swine production

	Local hybrid	Local crossbred	Foreign crossbred
Fattening period	5 months	3-4 months	3 months
Disease resistance	Strong	Medium	Weak
Suitable farm size	Small (<9)	Medium (<50)	Large (>50)
Skill requirement	Low	Medium	High
Feed requirement	Low	Medium	High
Environment requirement	Regular	Clean	Very clean
Reason to raise	Mostly self-consumption	For sale	For sale

Source: Table 6 in Hu (2007)

Given the insurance policy compensates farmers equally for all types; we would expect that the insurance would encourage farmers to purchase the riskier types of cross-breed for fattening. This moral hazard may be considered negative if it changing investment in this way does not result in an increase in return to investment for farmers; however it is positive if the additional risk undertaken allows farmers to realize a higher average return to their investments.

As is typical of a number of microinsurance products, this insurance product has quite low participation rates

among farmers engaged in fattening pigs. This is the case even though it is an insurance product that is heavily subsidized by the government. The low demand of a low-cost insurance product in a setting in which there is an apparent need for insurance products to help insure income risk, provides a unique opportunity for an experiment to look at other, non-price, barriers to insurance purchases.

We designed and implemented an experiment to test whether payment of the premium at the end of the insurance contract would encourage demand, and to

assess the impact of any increase in insurance demand on investment behavior of households.

In this design we randomly selected study households to participate in a new payment scheme. Under the new payment scheme, those wishing to purchase insurance would not pay for the premium at the beginning of the season, but instead would be able to purchase the insurance contract by promising to pay the premium prior to the end of the insurance contract. The cost of delaying the insurance premium payment was added as an additional interest fee that had to be paid by the participant. Thus those that were offered the new payment scheme could choose whether to make a cash payment of the premium (as usual) or to pay the premium plus interest at the end of the insured period.

Specifically, selected farmers were visited at their household and provided with a voucher that gave them the option to enter the insurance contract while delaying premium payment with an interest charge until the end of the insured period. If the farmer's insured pigs do not die during the insured period, the farmer is requested to pay the premium payment with an interest rate of 18% (the prevailing interest rate charged by local microfinance institutions at the time of the policy experiment) after the insured pigs are sold or slaughtered. If the farmer's insured pigs die and the farmer submits valid claim, the premium and interest will be deducted from the indemnity by the insurer.

In addition to the voucher provided to randomly selected households, we randomly selected half of the control households to receive a household visit and all of the same information on the insurance product as the households receiving a voucher, but no voucher or information on delayed payment. This was done in order to control for any information effect that providing the voucher could have had. The remaining farmers in the control group were not visited or provided with information.

The random allocation of participants to the voucher scheme allows us to compare take-up among the treated with take-up among the control group and attribute any significant difference in take-up to the new payment option. The role of the two control groups is to allow us to ascertain whether any of the treatment effect is as a result of farmers being reminded of the insurance scheme. We compare take-up in the treatment group to take-up in both control groups combined, and then separately compare take-up in the treatment group to those receiving information to see what the marginal effect of being provided the voucher was. We also compare take-up between the two control groups to see if there was any marginal effect of being offered information on the insurance scheme.

4. CONTEXT AND BASELINE DATA COLLECTION

In this section we provide information on the data we collected, the implementation of the experiment and the characteristics of our sample population.

4.1. BASELINE DATA COLLECTION

In December 2010, we conducted a baseline household survey of 1684 swine-raising households from 162 teams (clusters of households in a geographically proximate area, "natural" villages) in 18 administrative villages in three towns. In each household, we interviewed the household member who was responsible for swine-raising. In this survey, we collected information on household demographics, income, and assets, swine production, knowledge on swine insurance, and insurance purchases in 2010.

We also asked questions to measure risk preference, trust, time preference, and liquidity constraint.

To measure risk preferences, we followed Binswanger (1980; 1981) to ask households to choose one of the following five lotteries:

- a) RMB1000 for sure
- b) Half chance of RMB900 and half chance of RMB1600
- c) Half chance of RMB800 and half chance of RMB2000
- d) Half chance of RMB400 and half chance of RMB3000
- e) Half chance of 0 and half chance of RMB4000

We then generate a risk aversion index according to the answers following from Binswanger (1980; 1981). To estimate respondents' discount rates we asked respondents to indicate whether they would prefer a gift of a certain amount tomorrow or a larger gift one month from now.

It is difficult to derive an accurate quantitative measure of trust. We asked respondents to self-report using a Likert scale how much they trusted: (i) others in general, (ii) an insurance company to honor payments, (iii) neighbors to take 1000 RMB to a family member, and (iv) neighbors to look after the hogs while away. We generate a trust index using a simple average of the answers to the questions. We also asked for the perceived probability that insurance company would pay the indemnity if insured events occur.

We use a number of indicators to measure the liquidity constraint of households in our sample. We collected data on a variety of incomes sources and on household size in order to generate a measure of per capita income; however this measure is inherently

noisy. In addition to using per capita income, we use responses to a number of questions that were asked regarding a household's borrowing capacity. We asked whether the household felt the need to apply for a loan. We also asked if the household can access 5,000 RMB of cash within a couple of days and if yes, what the sources are. Based on these questions, we generate four dummy variables on liquidity constraint: I have no need to apply for the loan; whether or not the household can access 5,000 RMB within couple of days; whether the household can get this amount from savings; and whether the household can get this amount from savings and loans (i.e., no need to sell assets etc.).

We report the sample means of the explanatory variables generated from the baseline survey in the first column of table 2. We see that baseline demand for insurance is about 11% even though the government subsidizes about three quarters of the commercial premium. However we also see that few households (17%) know that the insurance is subsidized, even though 91% of households are aware of the insurance product (although not the policy details, only 5-9% can correctly provide information on the specifics of the insurance policy).

The baseline characteristics also provide some indications on reasons for low demand. Perhaps most strikingly, we find that only one quarter of respondents thought the insurance company would definitely not default, and another quarter of respondents thought that the probability of the insurer default was higher than 50%. This suggests very low levels of trust in the insurance company and that the perceived risk of insurer default may be a considerable constraint to insurance purchases. Our risk aversion results suggests a highly risk averse population, so perceptions of insurer default will considerably dampen demand. However, the incidence of insurer default in the data is quite low: among those who bought insurance and lost their pigs, only 4% complained that the insurance company refused to repay. The perceived risk associated with pig production was much closer to the actual risk of pig production recorded in our data. Households perceived the probability of losing a pig as 0.13, and our data suggests it ranges from 0.05 to 0.07 in the last three years.

Liquidity constraints do not seem to be too much of a concern for households in our sample. Almost half of the households interviewed (48%) stated that they did not feel they needed to borrow, and almost half (47%) could get RMB5000 (US\$800) within a couple of days if needed. This suggests that if the voucher has an effect it may be as a result of its ability to mitigate the perceived risk of insurer default rather than addressing liquidity constraints that farmers face.

We correlate purchases of insurance at baseline with selected household characteristics using non-parametric Kernel-weighted local polynomial smoothing to estimate and plot the probability of insurance participation conditional on a set of key continuous or categorical variables in Figure 1 in appendix. The plots depict how insurance participation changes with each of the explanatory variables including per capita income, trust index, perceive probability of insurance company to pay indemnity, risk aversion, and knowledge of insurance. The upward sloping curves suggest that insurance demand increased in per capital income, trust, knowledge of insurance and decreases in risk aversion and perceived insurer default. The negative correlation between risk-aversion and insurance purchases is in line with the predictions of Doherty and Schlesinger (1990) in the presence of high perceived insurer default.

4.2. IMPLEMENTATION OF THE EXPERIMENT

The government opened the sales window in June of 2011 for insurance policies for swine-raising households. Prior to the opening of the window we randomly assigned the 162 teams in our baseline sample into three groups: the treatment group (TG) comprising of 81 teams and 842 households; the control group 1 (in which households received information, CG1) comprising 41 teams and 497 households; and the control group 2 (in which households received nothing, CG2) comprising 40 teams and 343 households.

Randomization was conducted at the team level to avoid information spillovers regarding the availability of the voucher. We were concerned that farmers would object to differential treatment if we randomized at the individual level, even if we were able to make the random selection mechanism transparent. We were also concerned that farmers without the voucher may ask other farmers in their team with the voucher to purchase insurance on their behalf. Randomizing at the team level allowed us to mitigate these two risks to the randomization design.

We conducted pair-wise t-tests using the baseline household data to compare the means among groups to test whether our randomization resulted in balance on observed characteristics. The results are shown in Table 2 and indicate that our treatment and control groups are well balanced. Nearly all of the 46 variables presented are balanced across the treatment and control groups. There are two exceptions at 5% significance level and 6 exceptions at a 10% significance level. This is to be expected given 138 pairwise t-tests were performed.

Table 2: Test of balance between treatment and controls

	Total	TG	CG1	CG2	TG-CG1	TG-CG2	CG2-CG3
If buy insurance in 2010	0.108	0.115	0.091	0.117			
Household size	3.77	3.71	3.92	3.69	*		*
Female headed	0.11	0.1	0.1	0.13			
Age of head	53.95	53.57	54.41	54.24			
Head has middle school and above education	0.75	0.76	0.74	0.76			
Anyone has high school and above education	0.29	0.29	0.28	0.32			
Total household income	32155	31245	33213	32855			
Total household asset value	44003	42625	42981	48864			
Per capita income	8234	8270	8299	8054			
Per capita asset	12340	12340	12013	13258			
CRRA coeff. >7.33	0.617	0.632	0.592	0.618			
CRRA coeff. 1.86-7.33	0.187	0.169	0.221	0.181	**		
CRRA coeff. 0.63-1.86	0.127	0.132	0.115	0.134			
CRRA coeff. 0.27-0.63	0.045	0.043	0.058	0.032			
CRRA coeff. <0.27	0.022	0.023	0.014	0.032			
Risk aversion index	5.38	5.43	5.3	5.38			
Number of pigs raised in 2010	10.39	9.75	12.14	9.42			
Number of pigs raised in 2009	8.84	8.77	10.04	7.29			
Number of pigs raised in 2008	6.87	7.8	6.57	5.02			
Percent dead in 2010	5.20%	4.90%	5.60%	5.20%			
Percent dead in 2009	6.40%	6.30%	7.10%	5.60%			
Percent dead in 2008	5.80%	5.90%	6.10%	4.90%			
Perceived percentage death	13.20%	13.60%	13.00%	12.80%			
If insured in 2010	0.11	0.12	0.09	0.12			
Number insured in 2010	1.89	1.45	2.55	2.02			
if know of insurance	0.91	0.93	0.86	0.92	**		*
if mobilized by village officials	0.45	0.43	0.45	0.51			
if know when to buy insurance	0.14	0.14	0.14	0.15			
if know insurance is subsidized	0.17	0.16	0.18	0.18			
if know the guarantee level	0.09	0.09	0.08	0.09			
if know the deductible	0.05	0.04	0.07	0.06	*		
if purchase decision affected by others	0.2	0.19	0.21	0.2			
Index of insurance knowledge	0.27	0.27	0.27	0.28			
If mobilized by village officials	0.45	0.43	0.45	0.51			
Trust index	3.41	3.41	3.44	3.39			
Perceived repayment rate = 100%	0.26	0.26	0.26	0.27			
Perceived repayment rate = 90%	0.09	0.08	0.09	0.1			
Perceived repayment rate = 80%	0.08	0.08	0.07	0.08			
Perceived repayment rate = 70%	0.17	0.17	0.18	0.18			
Perceived repayment rate = 60%	0.14	0.13	0.13	0.16			
Perceived repayment rate < 50%	0.26	0.28	0.27	0.22			
Perceived repayment rate of insurer	0.76	0.77	0.76	0.75			
Time premium	0.143	0.14	0.147	0.146			
If no need to borrow	0.481	0.469	0.473	0.522			
Having high borrowing capacity	0.47	0.469	0.469	0.475			
Having enough savings	0.055	0.064	0.054	0.032			

Source: Baseline survey data. Notes: Significance level: * 10%, ** 5%, *** 1%

Farmers in both TG and CG1 were visited at their household by village veterinarians. The village veterinarians were trained by the research team and

the process of voucher distribution was under supervision of the research team. During this visit, farmers in both TG and CG1 received an information

sheet containing information on the swine insurance policy. Farmers in TG also received the voucher providing them with the option to participate in the swine insurance featured with the new design. The voucher was printed with the farmer's name and national identification number. National identification had to be provided when executing the voucher. This ensured that vouchers were used by those they had been issued to.

4.3. FOLLOW-UP DATA COLLECTION

In December 2011, we collected the insurance sales data from the township governments in charge of premium collection. This was matched with the baseline data using national identification numbers.

At this time we also worked with the village veterinarians to complete a short household survey on all households surveyed in the baseline survey. This survey was designed to collect data on the numbers of pigs that the household had bought and fattened during the season. The attrition rate on this survey was quite high, with only 67.5% of baseline households responding. In Table 3 we present data on the characteristics of those who attrited. We find that it was poorer, less educated households that owned fewer pigs and knew less about insurance, that were not included in the follow up survey. We surmise that this was because the village veterinarians did not invest as much time in interviewing poorer, less-socially connected households. In section 4.2 below we discuss the implications of this attrition for our analysis. This attrition only affects or estimates of the impact of insurance on investment, not our estimates of the impact of the new payment plan on demand. There was no attrition in the collection and matching of administrative data on demand.

5. EMPIRICAL STRATEGY

5.1. ASSESSING THE IMPACT ON DEMAND FOR INSURANCE

Given we have baseline data on insurance purchases we have a choice of three methods for estimating the treatment effects. We can estimate the treatment effect by only considering take-up after the intervention; we can difference post intervention take-up with the baseline data and estimate a double-difference model, or we can estimate an ANCOVA model. The correlation between demand before and after the intervention is quite low, 0.15, which indicates that it is better to estimate treatment effect using only take-up after the intervention than the difference of take-up between the post- and pre-intervention periods.

If we include data on take-up collected at baseline as a regressor in our analysis by estimating the ANCOVA model, we could see further increases in power (McKenzie 2011). Freedman shows that whilst the ANCOVA is consistent, in small samples it may be biased. Although Freedman's simulations suggest that for the size of sample we are considering here we are unlikely to see a meaningful bias, we follow his suggestion and estimate both the treatment effect using only endline data and the treatment effect using ANCOVA. We therefore estimate:

$$Y_{i,1} = \alpha + \gamma_{TG} D_{i,TG} + \varepsilon_{i,1} \quad (1)$$

$$Y_{i,1} = \alpha + \theta Y_{i,0} + \gamma_{TG} D_{i,TG} + \varepsilon_{i,1} \quad (2)$$

where $Y_{i,1}$ is whether or not farmer i bought insurance at t (where t is equal to 0 at baseline and 1 after intervention) and $D_{i,TG}$ indicates whether the farmer was in TG. We first estimate equations (1) and (2) for the full sample, essentially pooling CG1 and CG2. We then estimate equations (1) and (2) for the farmers in TG and CG1. In this estimation estimates the impact of the voucher controlling for any information effect there may have been. Finally we estimate the following equations using the farmers in CG1 and CG2:

$$Y_{i,1} = \alpha + \gamma_{CG1} D_{i,CG1} + \varepsilon_{i,1} \quad (3)$$

$$Y_{i,1} = \alpha + \theta Y_{i,0} + \gamma_{CG1} D_{i,CG1} + \varepsilon_{i,1} \quad (4)$$

where $D_{i,CG1}$ indicates whether the farmer was in CG1. This allows us to test whether there was any information effect (γ_{CG1}). For each regression we estimate two specifications: with and without additional controls from the baseline $X_{i,0}$.

In addition to assessing the impact of our intervention on demand for insurance, we are interested in looking at whether the intervention had a larger effect for those who reported being liquidity constrained during the baseline survey, for those who reported lower levels of trust in the insurance provider, and for those who were more impatient, valuing money more today than tomorrow.

Table 3: Comparing attrited and panel households

	Panel household	Attrited household	Test of difference
Household size	3.83	3.61	***
Female headed	0.11	0.12	
Age of head	54	54	
Head has middle school and above education	0.77	0.71	**
Anyone has high school and above education	0.30	0.29	
Total household income	35293	25033	***
Total household asset value	46175	38637	**
Per capita income	8917	6722	***
Per capita asset	12748	11679	
CRRA coeff. >7.33	0.62	0.62	
CRRA coeff. 1.86-7.33	0.19	0.17	
CRRA coeff. 0.63-1.86	0.12	0.14	
CRRA coeff. 0.27-0.63	0.05	0.04	
CRRA coeff. <0.27	0.02	0.02	
Risk aversion index	5.38	5.40	
Number of pigs in 2010	12.86	4.64	***
Number of pigs in 2009	10.69	4.10	***
Number of pigs in 2008	7.95	3.99	***
Percent dead 2008-2010	0.06	0.05	
Perceived percentage death	0.13	0.14	
if purchased insurance in 2010	0.12	0.08	**
Number insured in 2010	2.59	0.30	***
if know of insurance	0.92	0.87	**
if mobilized by village officials	0.44	0.47	
if know when to buy insurance	0.14	0.12	
if know insurance is subsidized	0.17	0.18	
if know the guarantee level	0.10	0.07	**
if know the deductible	0.06	0.03	*
if purchase decision affected by others	0.19	0.23	**
Index of insurance knowledge	0.28	0.25	*
Trust index	3.36	3.50	***
Percent income from pigraising	0.21	0.15	***
Perceived repayment rate = 100%	0.26	0.27	
Perceived repayment rate = 90%	0.09	0.08	
Perceived repayment rate = 80%	0.07	0.07	
Perceived repayment rate = 70%	0.16	0.19	
Perceived repayment rate = 60%	0.14	0.13	
Perceived repayment rate < 50%	0.27	0.25	
Time premium	0.15	0.14	
If no need to borrow	0.49	0.46	
Having high borrowing capacity	0.49	0.42	**
Having enough savings	0.07	0.03	***

Source: Baseline survey data. Notes: Significance level: * 10%, ** 5%, *** 1%

This allows us to test the predictions of the theoretical model set out in Liu and Myers (2012) and it allows us to explore whether liquidity or low trust is of most importance in constraining demand in this setting. We do this by estimating the following equation:

$$Y_{i,1} = \alpha + \theta Y_{i,0} + \gamma D_{i,TG} + \beta h_i + \delta h_i * D_{i,TG} + \varepsilon_{i,1} \quad (5)$$

where h_i is a dummy variable indicating an initial condition of households including liquidity constraint, trust, risk attitude and perspective, and time preference. When initial conditions are continuous or

categorical variables, h_i takes the value of 1 if the farmer was in the bottom or top half of the income distribution (or trust distribution in the case of trust). The

coefficient on the interaction term δ allows us to test whether the treatment effects estimated in each group are significantly different from each other. However, given our sample size we have limited power to detect differences in the impact of the voucher between groups.

Finally we look at the relationship between risk aversion and insurance demand for households in TG and for households in CG1 and CG2 to identify any differences in determinants of insurance demand under the new scheme. If the voucher addresses liquidity constraints we would expect income to no longer correlate with demand for insurance. The model in Doherty and Schlesinger (1990) would suggest that when insurance purchases are characterized by high perceived default by the insurance company, insurance purchases will decrease as risk aversion increases. If the voucher reduces the risk of default to households, insurance purchases will no longer increase with risk aversion. To test this we run the following regressions separately for treatment and control groups:

$$Y_{i,0} = \alpha + \beta \eta_{i,0} + \varepsilon_{i,1} \quad (6)$$

$$Y_{i,1} = \alpha + \beta \eta_{i,0} + \varepsilon_{i,1} \quad (7)$$

where $\eta_{i,0}$ is risk aversion coefficient assuming constant relative risk aversion.

5.2. ASSESSING THE IMPACT OF INSURANCE ON INVESTMENT BEHAVIOR

The random allocation of households to the new premium payment plan brought about an exogenous variation in the likelihood that a household would purchase insurance, without changing the overall wealth level of the household. This is contrast to insurance premium subsidies which encourage insurance purchases, but also represent a wealth transfer to households (Cole, Gine and Vickrey 2012). We use this exogenous variation in the probability of insurance purchases to identify the impact of insurance on investment by instrumenting insurance take-up with treatment assignment. It is important to note that although allocation to TG did not change the wealth of a household, it did increase liquidity of households prior to the end of the insured period, given households did not have to pay the insurance premium until then. The impact we estimate is this combined effect of insurance and increased liquidity for those in TG.

The correlation between investment in swine production (the number of pigs purchased for fattening) in 2011 and 2010 is 0.554 which means that we have more power to detect an impact when estimating a double difference model. We thus present results for regressions using both an ANCOVA and a double difference model in which insurance is instrumented with allocation to treatment group.

As indicated in the previous discussion, we expect that insurance will result in an increase in household investment in risky but remunerative income earning activities that are covered by the insurance contract. In particular, we expect that overall investment in swine fattening will increase, and that investment in the riskier aspects of this production would increase more than other aspects. We estimate overall investment as the number of piglets purchases subsequent to the purchase of the insurance contract, and the increase in riskier aspects of production by looking at the types of piglets purchased.

First, we have to address concerns regarding the attrition of households between the baseline and follow up survey. We know that wealthier, more educated households differentially attrited between baseline and follow up. This means that our results will not be representative of all households, but are the effect of insurance on poor and middle-income farmers. For these results to be valid, however we need to show that attrition was not correlated with treatment status, and further that the characteristics of those that attrited are not different across treatment categories. In table 4 we show the rate of attrition across treatment categories.

Table 4: Comparing characteristics of attrited households across treatment groups

	TG	CG1	CG2	TG-CG1	TG-CG2	CG1-CG2
Rate of attrition	32.1%	33.4%	33.5%			
Household size	3.49	3.85	3.51	**		*
Female headed	0.12	0.13	0.11			
Age of head	53	54	54			
Head has middle school and above education	0.68	0.77	0.70	**		
Anyone has high school and above education	0.28	0.30	0.28			
Total household income	24454	24252	27458			
Total household asset value	36246	38840	43760			
Per capita income	6896	6137	7161			
Per capita asset	11416	11344	12751			
CRRRA coeff. >7.33	0.63	0.61	0.62			
CRRRA coeff. 1.86-7.33	0.14	0.20	0.21			
CRRRA coeff. 0.63-1.86	0.16	0.13	0.13			
CRRRA coeff. 0.27-0.63	0.04	0.06	0.02			*
CRRRA coeff. <0.27	0.03	0.01	0.02			
Risk aversion index	5.38	5.36	5.48			
Number of pigs in 2010	4.49	4.61	5.01			
Number of pigs in 2009	4.39	3.93	3.68			
Number of pigs in 2008	4.30	3.67	3.74			
Percent dead 2008-2010	0.05	0.07	0.04			
Perceived percentage death	0.15	0.14	0.13			
if purchased insurance in 2010	0.08	0.05	0.09			
Number insured in 2010	0.34	0.18	0.37			
if know of insurance	0.88	0.83	0.91			
if mobilized by village officials	0.40	0.52	0.59		**	
if know when to buy insurance	0.11	0.13	0.14			
if know insurance is subsidized	0.16	0.19	0.19			
if know the guarantee level	0.05	0.06	0.11		*	
if know the deductible	0.03	0.05	0.03			
if purchase decision affected by others	0.20	0.27	0.22			
Index of insurance knowledge	0.25	0.25	0.28			
Trust index	3.55	3.41	3.52			
Percent income from pigraising	0.15	0.17	0.13			*
Perceived repayment rate = 100%	0.26	0.27	0.29			
Perceived repayment rate = 90%	0.07	0.10	0.08			
Perceived repayment rate = 80%	0.07	0.07	0.09			
Perceived repayment rate = 70%	0.20	0.18	0.16			
Perceived repayment rate = 60%	0.13	0.11	0.18			
Perceived repayment rate < 50%	0.26	0.27	0.19			
Time premium	0.13	0.14	0.16			
If no need to borrow	0.43	0.44	0.56		**	*
Having high borrowing capacity	0.39	0.42	0.49			
Having enough savings	0.03	0.03	0.02			
Number of observations	240	151	106			

Source: Baseline survey data. Notes: Significance level: * 10%, ** 5%, *** 1%

We show that there is no significant difference in the rate of attrition between TG and CG1, TG and CG2, and CG1 and CG2. In the rest of the table we test whether the characteristics of those that were not found in the follow up survey are the same across all treatment categories. We find this to be the case. As a result the panel households are also balanced on observed characteristics (see Appendix).

This suggests that although attrition leaves us with a non-representative sample at endline, which has implications for the generalizability of the estimates of impact, the results are internally consistent.

6. RESULTS

6.1. IMPACT OF THE VOUCHER ON DEMAND

In Table 5 we present our main treatment effects using post and ANCOVA estimation. In addition to presenting results for treatment effects estimated with and without controlling for baseline demand, we present results with and without additional controls from the baseline. All standard errors are corrected for clustering within the team; given this was the unit of randomization.

Table 5: Impact of the voucher and information on insurance participation

	(1)	(2)	(3)	(4)
	Post	Post	ANCOVA	ANCOVA
<i>Panel 1: Comparing treatment group with the combination of control groups 1 and 2</i>				
Treatment	0.109*** (4.87)	0.108*** (4.97)	0.107*** (4.99)	0.107*** (4.99)
Insurance participation in 2010			0.146*** (3.84)	0.105*** (2.77)
Baseline characteristics included	No	Yes	No	Yes
Township dummies	No	Yes	No	Yes
Number of observations	1682	1510	1682	1510
<i>Panel 2: Comparing treatment group with control group 1</i>				
Treatment	0.113*** (4.71)	0.112*** (4.68)	0.109*** (4.76)	0.110*** (4.64)
Other explanatory variables	No	Yes	No	Yes
Number of observations	1339	1208	1339	1208
<i>Panel 3: Comparing control group 1 with control group 2</i>				
Information	-0.00821 (-0.45)	-0.0113 (-0.64)	-0.00482 (-0.28)	-0.00862 (-0.50)
Other explanatory variables	No	Yes	No	Yes
Number of observations	840	750	840	750

Source: Administrative data on sales and baseline survey data.

Notes: t-statistics are in parentheses. Significance level: * 10%, ** 5%, *** 1%.

The treatment effects suggest a strong positive increase in take-up as a result of receiving the voucher. Households with the voucher are 10-11 percentage points more likely to purchase insurance

than those without the voucher. We also note from the data that in the treatment group, about 93% household who purchased insurance in 2011 chose to do so using the new payment plan. The treatment

effects presented in panel 1 (comparing TG to CG1 and CG2 combined) and panel 2 (comparing TG to CG1) are almost identical which suggests there was little, if any, effect of providing information on insurance demand. We test this formally in panel 3 and find that indeed, there is no statistical difference between the two control groups: those that received no visit and those that received an informational visit. There was no information effect. Data on farmers' knowledge about insurance that was collected as part

of the follow-up survey shows that knowledge of the deductible was higher among CG1 than among CG2, but knowledge of other aspects of the policy was no different (see Table 6). This was evidently not large enough to result in a different in demand. We also find that there was no difference in knowledge between households in TG to CG1. This suggests that the full 10-11 percentage point effect resulted from receipt of the voucher.

Table 6: Impact of treatments on knowledge of insurance

	TG	CG1	CG2	TG-CG1	TG-CG2	CG1-CG2
Proportion of farmers that know:						
the insurance deductible	0.145105	0.178248	0.311404		**	*
the minimum guarantee level	0.480769	0.362538	0.495614			
that insurance is subsidized	0.263986	0.353474	0.342105			
when to buy insurance	0.433566	0.392749	0.425439			
Number of observations	572	331	228			

Although the insurance take-up in the treatment group is still low (about 15.7%), it is about two times higher than the take-up in the control groups (about 4.7%). The insurance take-up in the control groups dropped considerably from 11% in 2010 to less than 5% in 2011. This is because many of our sampled households did not raise pigs in 2011 because the price of feed and piglets both largely increased in 2011, which makes swine-raising less profitable. We learned that 59% households in the treatment group did not raise pigs at the time of distributing vouchers. Among the 499 households who did not raise pigs then, only 4 purchased insurance later on, in contrast to 128 households who purchased insurance among the 343 households who raised pigs then.² Therefore the participation rate for those who raised pigs at the timing of distributing vouchers is as high as 37%, which is roughly three times of the participation rate in 2010 (11%).

We now turn to exploring heterogeneity in treatment effects. We do this by interacting the treatment dummy with dummies reflecting baseline characteristics. The results are presented in Table 7. It is interesting to see that treatment effect is significant for all sub-groups separated by a variety of criteria: liquidity constraint, trust, risk attitudes, and time preferences. However, the difference in treatment effects between sub-groups is virtually insignificant. This could reflect the fact that a number of these variables, such as income and trust, are likely to be quite noisy, or it could result from lack

of power to detect differences between groups. However, it could also indicate that the treatment effect is the same for households along a number of dimensions.

The only exception is between the subgroups separated based on number of pigs fattened in 2010. The result suggests that swine-raising farmers with larger numbers of swine in 2010 were more responsive to the voucher. It is not clear what this result means for our hypothesis that liquidity constrained farmers would respond more to the voucher. We may expect that those who raise more pigs are in general wealthier and therefore less liquidity constrained. However, we see no relationship between other measures of income or wealth and responsiveness to the voucher. What is more likely is that those who raised a large number of pigs in 2010 were more likely to continue raising pigs in 2011 (given we observe a correlation of 0.54 between the number of pigs purchased for fattening in 2010 and 2011). And thus it was for these farmers that the insurance voucher had more relevance.

As a further test (and one with potentially more power) of the role of liquidity constraints and perceived default risk in explaining our results we examine the correlation between baseline measures of income and risk aversion and insurance purchases with and without the treatment. We use the finding from Doherty and Schlesinger (1990) that in the presence of contractual non-performance demand does not always increase in risk aversion. We examine the relationship between risk aversion and demand for

² Unfortunately, we do not know how many households raised pigs at the time of distributing the voucher in the control groups.

insurance for the treatment and control group before and after the intervention. If perceived default risk is important in constraining demand and if perceived default risk is mitigated by the presence of the new payment plan, we would expect to observe a different relationship between risk aversion and demand for the treatment group after the intervention. Similarly, if liquidity constraints are overcome by the new payment plan we would expect the positive relationship between wealth and demand to be weakened after the intervention. Results are presented in Table 8, and show that for both the treatment and control group

prior to the intervention, increased risk aversion was associated with reduced insurance demand. This relationship also held true for the control group after the intervention. However this negative relationship was no longer observed among the treatment group after the intervention. There is no significant relationship between risk aversion and demand among the treatment group after the intervention. In summary, these results are consistent with a hypothesis that part of the voucher's effectiveness was as a result of allaying fears of default risk, but that measuring default risk is difficult.

Table 7: Heterogeneity in treatment effects

	TG versus CG1 & CG2				
	Yes		No		Diff
<i>Indicators for liquidity constraint</i>					
Having higher per capita income	0.127	***	0.088	***	0.039
If no need to borrow	0.111	***	0.103	***	0.008
If can get cash immediately	0.127	***	0.089	***	0.038
If can get cash immediately from savings	0.140	*	0.105	***	0.035
If can get cash immediately from savings or loans	0.114	***	0.101	***	0.014
<i>Indicators for Trust</i>					
Higher trust index	0.108	***	0.107	***	0.001
If trust insurance company will repay	0.119	***	0.098	***	0.021
If trust often in general	0.103	***	0.109	***	-0.005
If trust seldom in general	0.109	***	0.104	***	0.005
<i>Indicators for risk attitude and perspectives</i>					
If more risk-averse	0.106	***	0.111	***	-0.005
Higher death ratio of fattening pigs	0.126	***	0.097	***	0.029
Raising more fattening pigs	0.151	***	0.072	***	0.079
Higher percentage of income from fattening pigs	0.114	***	0.102	***	0.011
<i>Time preference</i>					
If being patient	0.113	***	0.096	**	0.017

Source: Administrative data on sales and baseline survey data.

Notes: Significance level: * 10%, ** 5%, *** 1%.

Table 8: Relationship between risk preferences and insurance demand

	Demand for insurance in among CG1+CG2 in 2010	Demand for insurance in among TG in 2010	Demand for insurance among CG1+CG2 in 2011	Demand for insurance among TG in 2011
Risk aversion	0.060 (0.010)***	0.035 (0.011)***	0.019 (0.007)**	0.012 (0.012)
Constant	0.001 (0.020)	0.058 (0.021)***	0.016 (0.014)	0.136 (0.024)***

Notes: Robust standard errors are in parentheses. Significance level: * 10%, ** 5%, *** 1%.

6.2. IMPACT OF INSURANCE ON PRODUCTIVE INVESTMENTS

The large and significant impact of the voucher on insurance demand allows us to estimate the impact of insurance on production choices by using the random allocation of the voucher as an instrument for insurance purchases. Table 9 presents regression results from an instrumental variable estimation of the impact of insurance on productive investments undertaken by households, instrumenting insurance with dummies indicating a household's allocation to group TG and to group CG1. The coefficient estimates on insurance provide an estimate of the local average treatment effect of insurance for those induced into taking insurance by the new payment plan. Given these households did not have to pay the premium until the end of the insured period, the new payment plan also increased the liquidity of these households relative to those who purchased insurance in the control groups. The low premium rates and the limited evidence of liquidity constraints suggest this will not be a primary driver of any results we observe, but we cannot rule out that this potential impact pathway. The previous section suggests that the first stage of these regressions will allow us to predict well insurance purchases, and indeed this is what we find (see appendix for results from the first stage regression).

We first examine the impact of insurance on the total number of piglets purchased during the insurance window (columns 1 to 3), and then on the different types of piglets purchased (columns 4 to 12). We find that households who were induced to purchase insurance by provision of the delayed payment voucher invested more in pig production, measured by the number of piglets purchased for fattening, than those who without insurance. This is as Sandmo predicts: without insurance households underinvest in remunerative but risky activities.

The results presented in the remaining columns of table 8 suggest that the provision of insurance also has portfolio effects by altering the type of investment. We disaggregate investment into the three categories described above: low risk and low return investment (purchases of local breeds), medium risk and medium return investment (purchases of cross-breeds) and high risk and high return investment (purchases of foreign breeds). When we disaggregate the types of investments undertaken in this way, we find that households with insurance are no more likely to invest in low-risk breeds, but are significantly more likely to undertake medium-risk investments by purchasing cross-breeds. Interestingly, we find no effect of insurance on the most risky type of investment, ownership of foreign pigs, however we also find very few households owning pigs of this type, perhaps because the production technologies available to

these households are not well suited to taking on this type of investment.

Local cross-breeds take a shorter time until the desired weight for slaughter is reached, and as a result provide households with a more remunerative investment option. Increased investment in these breeds suggests that insurance has a positive welfare effect on households.

7. CONCLUSION

Farmer participation in insurance markets in less developed economies is constrained by many of the same barriers that limit participation in other markets. However, the role of trust in determining demand has been documented particularly in Cai et al (2009) and also in other studies on demand for insurance products (for example, Cole et al 2009). When insurance is purchased by a farmer a farmer is putting his or her trust in an insurance company to provide support at a time when support is most needed.

In this study we examine the impact of a small change in the premium payment schedule that might help mitigate this trust deficit that constrains demand. Delaying the payment of the insurance premium to the end of the insured period allows farmers to observe whether or not the insurer defaults before paying the insurer. We find that this change in the payment schedule results in a large increase in demand for insurance. This effect could be driven by ameliorating the cost of the perceived risk of insurer default, or by the fact that it allows farmers to postpone payment of the premium to a season in which they are likely to have more money.

This change in the premium payment schedule has a positive effect on investment by increasing the total investment in swine production and also by encouraging riskier, higher-return investments. This positive impact suggests that without insurance farmers were not able to fully insure; that the new payment plan helped farmers overcome an important barrier to insurance purchases; and that encouraging insurance purchases in this way can have a positive long run effect on the income and welfare of rural households in China.

Table 9: Impact of insurance on investment

	Total investment (number of pigs)			Low risk investment (local hybrid pigs)			Medium risk investment (local cross- bred pigs)		High risk investment (foreign cross-bred pigs)			
Insured in 2011	8.574** (2.00)	7.691** (1.96)		1.176 (0.84)	0.114 (0.10)		4.322 (1.37)	5.933** (2.05)		0.798 (0.46)	-0.0161 (-0.01)	
Change in insurance between 2011 and 2010			11.63** (2.02)			-1.329 (-0.63)			5.936* (1.65)			5.905 (1.16)
Lag of dependent variable	0.574*** (3.00)	0.271 (1.12)		0.0190 (0.60)	-0.00228 (-0.06)		0.0741 (0.97)	-0.0801 (-0.87)		0.208* (1.91)	0.236* (1.86)	
Constant	-0.562 (-0.86)	0.343 (0.07)	-0.898** (-2.33)	0.236* (1.75)	-3.346 (-1.31)	-0.587*** (-4.50)	0.238 (0.91)	4.271 (0.73)	0.0659 (0.31)	0.0570 (0.25)	2.654 (1.03)	-0.988** (-2.48)
Estimation method	ANCOVA	ANCOVA	DD	ANCOVA	ANCOVA	DD	ANCOVA	ANCOVA	DD	ANCOVA	ANCOVA	DD
Other characteristics	No	Yes	No	No	Yes	No	No	Yes	No	No	Yes	No
Observations	1131	1024	1131	1131	1024	1131	1131	1024	1131	1131	1024	1131

Source: Administrative data on sales and baseline and follow-up survey data.

Notes: t-statistics are in parentheses. Significance level: * 10%, ** 5%, *** 1%.

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APPENDIX

Figure 1 Insurance participation of 2010 (pre-intervention year) conditional on some key factors

Figure 1a Insurance participation of 2010 conditional on income

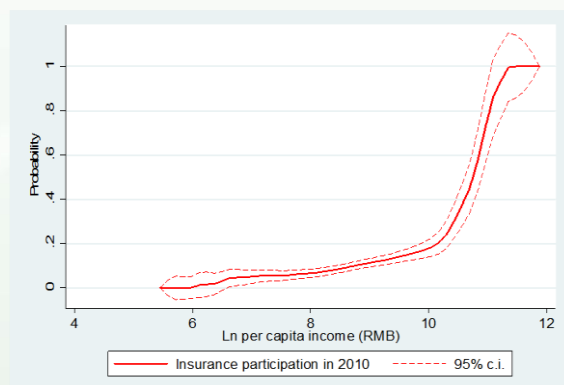


Figure 1b Insurance participation of 2010 conditional on measure of trust

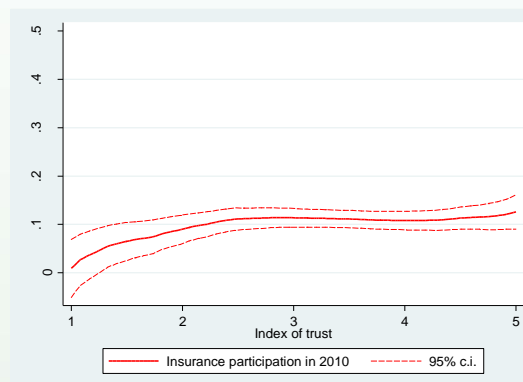


Figure 1c: Insurance participation of 2010 conditional on perceived probability of insurer to pay indemnity

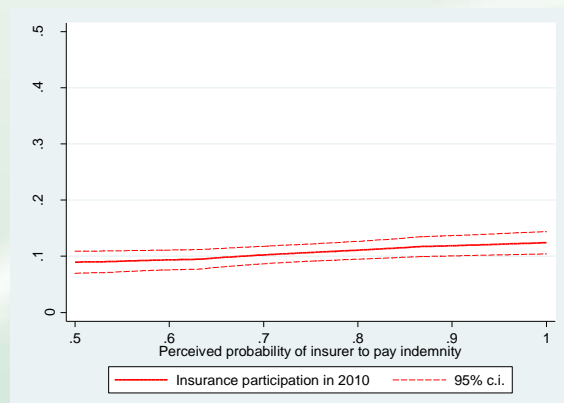


Figure 1d: Insurance participation of 2010 conditional on measure of risk aversion

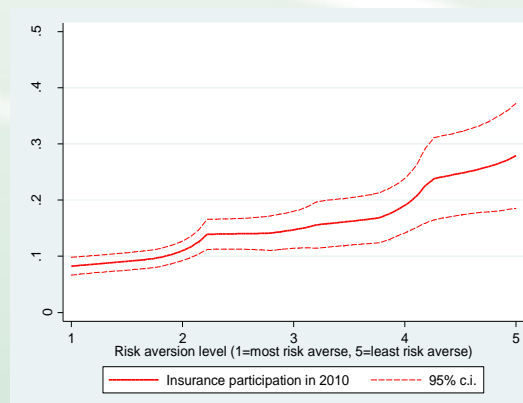


Figure 1e Insurance participation of 2010 conditional on insurance knowledge

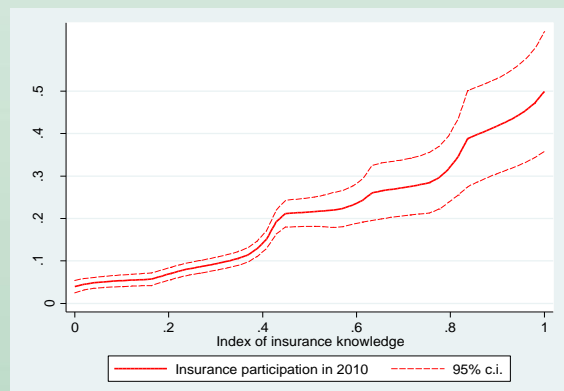


Table A1: Balance in panel

	TG	CG1	CG2	TG CG1	TG CG2	CG1 CG2
Household size	3.80	3.93	3.75			
Female headed	0.09	0.09	0.15		**	*
Age of head	54	55	54			
Head has middle school and above education	0.79	0.72	0.79	**		
Anyone has high school and above education	0.30	0.27	0.33			
Total household income	33937	37324	35745			
Total household asset value	44811	44485	52049			
Per capita income	8827	9323	8554			
Per capita asset	12591	12300	13791			
CRRA coeff. >7.33	0.63	0.59	0.61			
CRRA coeff. 1.86-7.33	0.18	0.23	0.17	*		*
CRRA coeff. 0.63-1.86	0.12	0.10	0.14			
CRRA coeff. 0.27-0.63	0.05	0.06	0.04			
CRRA coeff. <0.27	0.02	0.02	0.04			
Risk aversion index	5.45	5.33	5.31			
Number of pigs in 2010	11.88	15.40	11.66			
Number of pigs in 2009	10.32	12.51	8.95			
Number of pigs in 2008	8.94	7.87	5.59			
Percent dead 2008-2010	0.06	0.06	0.06			
Perceived percentage death	0.13	0.12	0.13			
if purchased insurance in 2010	0.12	0.11	0.13			
Number insured in 2010	1.91	3.59	2.86			
if know of insurance	0.95	0.88	0.93	**		
if mobilized by village officials	0.44	0.41	0.47			
if know when to buy insurance	0.15	0.13	0.15			
if know insurance is subsidized	0.16	0.16	0.18			
if know the guarantee level	0.10	0.09	0.09			
if know the deductible	0.04	0.08	0.07			
if purchase decision affected by others	0.19	0.18	0.19			
Index of insurance knowledge	0.28	0.27	0.28			
Trust index	3.34	3.43	3.33			
Percent income from pigraising	0.21	0.22	0.19			
Perceived repayment rate = 100%	0.26	0.26	0.26			
Perceived repayment rate = 90%	0.09	0.09	0.10			
Perceived repayment rate = 80%	0.07	0.08	0.08			
Perceived repayment rate = 70%	0.15	0.18	0.17			
Perceived repayment rate = 60%	0.14	0.13	0.15			
Perceived repayment rate < 50%	0.29	0.26	0.24			
Time premium	0.15	0.15	0.14			
If no need to borrow	0.48	0.48	0.50			
Having high borrowing capacity	0.50	0.48	0.47			
Having enough savings	0.08	0.07	0.04		**	
Number of observations	572	331	228			

Table A2: First stage results

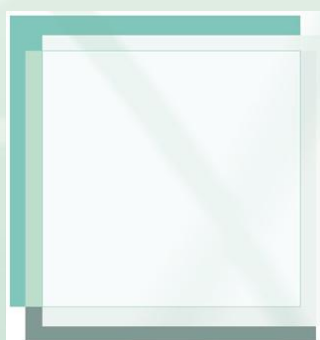
	(1)	(2)	(3)	(4)
	if insured in 2011	if insured in 2011	if insured in 2011	
	(admin)	(admin)	(admin)	ddins
treatment	0.152*** (4.85)	0.154*** (4.95)	0.154*** (4.95)	0.134*** (3.07)
Info	-0.0158 (-0.67)	-0.0170 (-0.72)	-0.0170 (-0.72)	0.00566 (0.15)
total number of eligible pigs bought in 2010		0.00186 (1.50)	0.00186 (1.50)	
Constant	0.0702*** (3.84)	0.0645*** (3.49)	0.0645*** (3.49)	-0.0570** (-2.56)
Observations	1131	1131	1131	1131
R-squared	0.046	0.050	0.050	0.025

t statistics in parentheses

= "*" p<0.10

** p<0.05

*** p<0.01"



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