BY JOHN ADAMS (reviewer)

DANGEROUS COMMERCE: INSURANCE AND THE MANAGEMENT OF INTERNATIONAL RISKS

BY VIRGINIA HAUFLER

Cornell University Press, Ithica and London, 205pp. £23.50, (cloth)

ISBN 0-8014-3231-6

Published 30 June 1997.

Risk management is a balancing act in which the potential rewards of a course of action are weighed against possible losses. There is a view, widely found throughout the insurance industry, that this act ought not to be influenced by insurance. An introductory insurance textbook insists that "the insured should never be influenced in any way by the existence of his insurance policy ... he should always act as if uninsured." The possibility that behaviour will be influenced by insurance - such as being less careful about locking up if you have burglary insurance - is referred to in the industry as "moral hazard". There is a lot of it about and, as this book demonstrates, the belief that it ought not to exist is naive. The acquisition of insurance alters the potential consequences of a course of action, and thereby alters behaviour.

Virginia Haufler charts the role of insurance, in a great variety of forms, in promoting the growth of international trade. She traces the growing involvement of governments in insuring international commerce, to the point where today government insurance for trade, credit and foreign investment exceeds that provided by the private sector by a factor of more than 1000. In addition to providing direct insurance, governments insure their nations' commerce in many other ways, ranging from naval protection and the negotiation of treaties, to a readiness to adjust interest rates and intervene in exchange rates. Haufler observes

> "We cannot understand the institutions of production and exchange apart from the institutions we have designed to protect them. In turn, the character of protection affects the institutions of production and exchange. It is doubtful whether the globalization of trade and production could have progressed so far without the availability of protection, both by the state and, when that fails, by private sector services."

She contrasts the present circumstances of global commerce with those of previous centuries, citing Karl Polanyi:

> "In the past the organization of trade had been military and warlike, it was an adjunct of the pirate, the rover, the armed caravan, … the sword-bearing merchant, the armed burgesses of the towns, the adventurers and explorers, the planters and conquistadores …"

She concludes that insurance is a benign force for progress and prosperity: "the private networks of international insurance may tie trade with peace more closely than ever before as the socialization of risk moves forward."

All this she argues very convincingly. Yet the more she piled up evidence in support of her thesis, the more preoccupied I became with a significant exception - possibly the most dangerous and rapidly growing element of international commerce today - the drugs trade. It is a trade conducted by planters, pirates and sword bearing-merchants, and a trade that governments around the world are seeking to obstruct with *anti-insurance*. The institutions of production and exchange of drugs encounter, not institutions designed to protect them, but to eliminate them. Does the drugs trade thrive in spite of the institutions designed to eliminate it, or because of them? It appears to be a trade that thrives on risk; the greater the risks associated with production and distribution, the greater the potential profits and, so long as enough drugs get through, the actual profits. The total volume of trade may be diminished by all the efforts to obstruct it, but the substantial profits, for some, have created vast criminal empires.

The book also provides examples of business, encouraged by insurance, which ought to have been left undone. Haufler observes that "when a firm believes there is an unacceptable risk on a prospective transaction, it has a number of options other than buying insurance, including abandoning the project - an alternative chosen by many commercial banks with regard to Latin American debtor states." But she glosses over the extent to which the debt crisis itself was a product of excessive faith, on the part of the lenders, in insurance - in the form of their governments' ability, and willingness, to intervene to prop up the defaulting debtors or cushion the losses.

Insurance alters the terms of trade. In attempting to anticipate its consequences one must look for its probable impacts on both the rewards and the costs of a particular course of action. Its consequences are not always benign. It can encourage carelessness. Its absence can encourage vigilance; Haufler offers an example: "the lack of insurance or its high cost may also prompt more effective environmental protection to prevent losses from occurring."

This is an informative book and tells an interesting story, but the evidence it presents demands a more ambivalent conclusion. Insurance is a two edged sword.

771 words

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> *Risk*, UCL Press (1995)
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> Virtual Risk and the Management of Uncertainty, *What Risk?* Roger Bate (ed), Butterworth Heinenman (1997)

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