

# **THE ECONOMIC THEORY OF RISK AND INSURANCE**

Published @ 2017 Trieste Publishing Pty Ltd

ISBN 9780649539208

The Economic Theory of Risk and Insurance by Allan H. Willett

Except for use in any review, the reproduction or utilisation of this work in whole or in part in any form by any electronic, mechanical or other means, now known or hereafter invented, including xerography, photocopying and recording, or in any information storage or retrieval system, is forbidden without the permission of the publisher, Trieste Publishing Pty Ltd, PO Box 1576 Collingwood, Victoria 3066 Australia.

All rights reserved.

Edited by Trieste Publishing Pty Ltd.  
Cover @ 2017

This book is sold subject to the condition that it shall not, by way of trade or otherwise, be lent, re-sold, hired out, or otherwise circulated without the publisher's prior consent in any form or binding or cover other than that in which it is published and without a similar condition including this condition being imposed on the subsequent purchaser.

[www.triestepublishing.com](http://www.triestepublishing.com)

**ALLAN H. WILLET**

**THE ECONOMIC  
THEORY OF RISK  
AND INSURANCE**



THE  
ECONOMIC THEORY OF RISK AND  
INSURANCE 113716

BY  
ALLAN H. WILLETT, A.M.

SUBMITTED IN PARTIAL FULFILMENT OF THE REQUIREMENTS  
FOR THE DEGREE OF DOCTOR OF PHILOSOPHY  
IN THE  
FACULTY OF POLITICAL SCIENCE  
OF  
COLUMBIA UNIVERSITY

New York  
1901



## PREFACE

---

THE following study deals almost exclusively with the idealized conditions of the static state. It only incidentally attempts to show the bearing of the static laws on the phenomena of the real world or the practices of existing insurance companies. It must consequently wear something of the air of unreality which attaches to all discussions that deal largely with abstractions. Its only purpose is to shed a little light on a rather neglected portion of pure economic theory.

A word of explanation may be in order with regard to my failure to give credit to others in all cases for ideas which have been published before. This has sometimes been due to the fact that the ideas were so much common property that it was impossible to assign them to any particular writer. In other instances the omission is to be explained on the ground that in the course of a considerable amount of reading on the subject of insurance, the significance of many statements was overlooked at the time when they were read. After their importance had come to be appreciated, it was not always possible to trace them to their sources.

It gives me pleasure to acknowledge my indebtedness to my friend, Professor James P. Kelley, for the valuable assistance which he has given me in preparing this book for the press. He kindly undertook to read it all in the proof, and I have been indebted to his suggestions for many improvements, both in substance and in form.

ALLAN H. WILLETT.

COLUMBIA UNIVERSITY, *May 20, 1901.*

287]

5





## CONTENTS

### INTRODUCTION

	PAGE
General Theory of Distribution . . . . .	11
I. THE STATIC STATE . . . . .	12
Conception reached by a process of abstraction . . . . .	13
Risk as a disturbing factor . . . . .	14
Distinction between the ideal Static State and the approx- imate Static State . . . . .	16
II. PROFIT AND THE ENTREPRENEUR . . . . .	16
Economic character of the captain of industry . . . . .	18
Nature of profit . . . . .	18
Distinction between profit and other monopoly gains . . . . .	19
The entrepreneur as the recipient of profit . . . . .	20
The capitalist-entrepreneur . . . . .	23

### CHAPTER I

#### THE NATURE OF RISK

Appearance of accident due to limitations of man's knowledge . . . . .	25
Distinction between chance and uncertainty . . . . .	27
Risk related to uncertainty . . . . .	28
How degree of risk may be estimated . . . . .	29
Effect of increasing the number of risks . . . . .	31
Area of uncertainty . . . . .	32

### CHAPTER II

#### CLASSES OF RISKS

Economic and extra-economic risks . . . . .	35
Personal risk . . . . .	36
Risks to capital and risks to labor . . . . .	37

	PAGE
Positive and negative loss . . . . .	38
Static and dynamic risks . . . . .	38
Developmental risks . . . . .	41
Comparison of static and dynamic losses . . . . .	43
Other classes of risks . . . . .	45

## CHAPTER III

## THE COST OF RISK

Repellent influence of uncertainty . . . . .	50
Disturbing factors . . . . .	50
Effect of inequalities of risk upon the apportionment of capital . . . . .	53
Effect of the law of diminishing utility . . . . .	54
How cost of risk may be estimated . . . . .	55
Burden rests upon consumers . . . . .	56

## CHAPTER IV

## THE ASSUMPTION OF RISK

In what sense risk-taking is productive . . . . .	60
Social gain from the assumption of risk . . . . .	62
How the amount of the reward for risk-taking is determined . . . . .	64
Distinction between reward for risk-taking and accidental gains and losses . . . . .	66
Reward obtained through the insurance fund . . . . .	67
Insurance fund includes only accumulations for uncertain losses . . . . .	69

## CHAPTER V

## THE REWARD FOR RISK-TAKING

Capitalists assume risks and receive the reward . . . . .	72
Pure interest and the reward for risk-taking . . . . .	74
Interest and the insurance fund . . . . .	75
Profit and the reward for risk-taking . . . . .	77
Relation of the entrepreneur to risk . . . . .	79
Advisability of making the reward for risk-taking a separate category of distribution . . . . .	83

## CHAPTER VI

PAGE

## WAYS OF MEETING RISK

Avoidance, prevention and assumption . . . . .	86
On what principles the choice is made by a man in isolation; by a man in society . . . . .	88
Effect of society on risk and on prevention . . . . .	90
How far preventive measures will be adopted . . . . .	93
Social methods of meeting risk; distribution of losses . . . . .	95
Corporations . . . . .	95
Mutual guarantee against loss . . . . .	96
Transfer of risk . . . . .	97
The capitalist-entrepreneur as insurer . . . . .	99

## CHAPTER VII

## INSURANCE

Definition of insurance . . . . .	105
Gain from combination of risks . . . . .	107
Other economic benefits of insurance . . . . .	111
Cost of insurance . . . . .	112
Insurance as a method of distributing losses . . . . .	114
Insurance not gambling . . . . .	115
How entrepreneurs choose between prevention and insurance	117
Accumulations by insurance companies . . . . .	119
Productivity of the insuring capital . . . . .	122
In what sense all insurance is mutual . . . . .	123

## CHAPTER VIII

## CONCLUSION

Influence of risk on the accumulation of capital . . . . .	128
Relation of the entrepreneur to developmental risks . . . . .	132
Speculation as a method of creating security . . . . .	134
General summary of the static theory of risk and insurance . . . . .	139