Key Findings from the Working Paper
Information, Networks and Informal Insurance: Evidence from a Lab Experiment in the Field

In developing countries a generation ago, it was common for people in rural settings to have a good sense of how their neighbor was doing financially. They usually shared the same occupation, often farming, so they experienced the same weather patterns, could view the well-being of the crops in one another’s fields, and likely sold their crops in a common market at a similar price.

This allowed them to have a sense for their neighbor’s income and understand what financial help might be needed or available when times got tough, an important point when lacking a formal banking methods.

Now, as the occupations in developing countries diversify rapidly, and farmers may be more likely to become or have shopkeepers or phone card salespeople as their neighbors, the understanding of one another’s financial well-being has become more hidden and harder to discern.

This new working paper examines the role hidden income and hidden savings play within the financial life of a community; it provides some of the first empirical evidence on the interaction of hidden income, hidden savings and social networks. While these insights have important theoretical implications for economists, the work also suggests highly practical considerations for policymakers as well.

The findings are based on laboratory experiment results from India where rural villagers participated in a series of simple games. Players could share money and risk with partners who they chose for half of the experiment and with partners who were randomly assigned to them for the other half. In these games, participants also have varying levels of understanding of their partners’ assets.

The paper identifies the following implications for researchers and policymakers:

• When risk-sharing partners in a community do not have equal information about their partners’ income, risk sharing is significantly reduced.

• When the participants in the experiment could misreport their income, they often did. Sharing between partners fell by about 40% on average.

• The effects of hidden income is reduced among partners who are socially closer than among those who are less-connected socially.
• These findings suggest the need for more research on who optimal risk partners might be.

• The findings also suggest that microfinance institutions who foster the formation of joint-liability groups (e.g., ROSCAs) may find benefits for forming groups with close ties and a need for new solutions or safety nets for those who may be more socially isolated.

ABOUT THE CONSORTIUM ON FINANCIAL SYSTEMS & POVERTY The Consortium on Financial Systems and Poverty (CFSP) is a research organization of leading and emerging economists. Our goal is to improve the lives of the world’s poor and to reduce poverty through helping to identify, define and develop efficient financial systems. We strive to generate tangible and objective results that have meaningful lessons for policymakers, researchers, and stakeholders. We are based at the University of Chicago and led by Professor Robert M. Townsend of Massachusetts Institute of Technology.

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