The Human Dynamics of the Insurance Cycle and Implications for Insurers: An Introduction to the Theory of Plural Rationalities

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Abstract

There has been a diversity of explanations for the insurance cycle. Almost all of these assume that market participants share a common risk perspective and a common goal of profit maximization. But if we relax this assumption and allow for the plural rationalities suggested by Cultural Theory, as well as the idea from Cultural Theory that there is a reflexive relationship between the marketplace and market participants, a significantly different explanation arises.

Observers of the insurance cycle often wonder why the sector continues to inflict upon itself a series of near-fatal wounds. Proposed causes include factors as diverse as the weather, stock market volatility and faulty memories. Neo-Classical economics and Game Theory both place strong emphasis upon the idea of equilibrium, and yet the insurance cycle never seems to reach equilibrium.

A new reason for the inherent instability of the insurance business can be found in the literature of anthropology. The theory of plural rationalities, also known as Cultural Theory of Risk or simply Cultural Theory, posits that the world is populated by people with four fundamentally different attitudes toward risk.