Can there be Recession Insurance?

There's a great opportunity for creative entrepreneurs to invent and offer insurance so that business will not have to shut down because of a recession

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Many companies are going bankrupt. Restaurants, shops, and manufacturers are shutting down. There is little a business can do when the demand for its products falls, and it does not have the privilege of bailout money from the government, like the financial industry. If you are a big bank, you get money from the state. If you are a grocer, you are out of luck. The state will not buy unsold bananas like it buys non-performing loans.

Since markets provide insurance for many calamities, why not also insurance against recessions? In fact, there is indirect recession insurance. The company Intrade organizes a predictions market. Participants make bets with real money on outcomes such as recessions and unemployment. Someone who seeks to protect himself from a recession could buy contracts on the economy being in a recession during some particular year. If there is a recession, then the payoff will offset losses from the recession.

The financial markets also have bear-market mutual funds, including exchange-traded funds (ETFs) that rise as market averages fall. One can buy bear funds for sectors such as real estate and the financial industry, and also for broad market averages. These funds can be used to hedge against a portfolio of stocks, bonds, and real estate, but could also hedge one’s business.

However, such vehicles require some financial savvy. It may be difficult to apply such instruments to protect one’s business. An insurance company could provide a useful service to enterprises by providing recession insurance.

Recession insurance would need to have the funds available to cover the losses of a business due to the recession. The insurance premiums would be used to buy shares in bear market mutual funds as well as put options on stocks and commodities. A put option is a contract to sell a number of stocks or amount of a commodity during some time interval at some set price. Suppose a stock has a current market value of $100, and the put option is set to sell the stock at $100. If the price of the stock falls to $40, one can buy the shares at $40 and exercise the option and sell the shares at the $100 contract price, for a profit of $60 per share. On the other hand, if the share prices rises above $100, the option expires worthless.

There are bear market hedge funds that hold put options. Many who put money in “hedge funds” were not really hedging, but speculating, which is why they lost money. Insurance companies could offer a variety of recession insurance for various industries. Firms can self insure with such financial instruments, but few do. An insurance firm would have the expertise to know how much insurance is warranted, and what types of hedges are appropriate.

The best insurance is prevention. National governments can prevent recessions by eliminating their real estate boom-bust cycles and by avoiding the manipulation of their money and interest rates. The boom-bust sequence is caused by the large subsidy the states gives to landed interests and their financial backers. Much of the gain from economic expansion is capitalized in higher rents and land values. Governmental public works and services provide a subsidy to landowners by lifting their rents while the expense is paid by others, by workers and enterprises. The land subsidy is eliminated by untaxing wages, goods, interest, and dividends, and instead getting public revenue from land rent and land values. The gains from public services and economic expansion would no longer fuel the land speculation that creates the real estate bubble.

The price of land would fall to near zero, so mortgages would be only for buildings, not land. The value of buildings comes from the cost of construction, so real estate mortgages would be stable, and there would be no more speculative derivatives based on mortgages. Also, the secondary mortgage market would have to be entirely private, with no government backing.

To completely eliminate the boom-bust cycle, the central bank would have to stop controlling the money supply. Money would become private, issued by banks, credit unions, and other private companies, according to how much folks want to hold. The interest rate would then also be set by the supply and demand for funds, and no longer pushed down to stimulate real estate.

So long as government policy generates a boom-bust sequence, investors and enterprises need to protect themselves, so this provides a great opportunity for creative entrepreneurs to invent and offer insurance so that next time, business will not have to shut down because of a recession.

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FRED E. FOLDVARY, Ph.D., (May 11, 1946 — June 5, 2021) was an economist who wrote weekly editorials for Progress.org since 1997. Foldvary's commentaries are well respected for their currency, sound logic, wit, and consistent devotion to human freedom. He received his B.A. in economics from the University of California at Berkeley, and his M.A. and Ph.D. in economics from George Mason University. He taught economics at Virginia Tech, John F. Kennedy University, Santa Clara University, and San Jose State University.

Foldvary is the author of *The Soul of Liberty*, *Public Goods and Private Communities*, and *Dictionary of Free Market Economics*. He edited and contributed to *Beyond Neoclassical Economics* and, with Dan Klein, *The Half-Life of Policy Rationales*. Foldvary's areas of research included public finance, governance, ethical philosophy, and land economics.

Foldvary is notably known for going on record in the *American Journal of Economics and Sociology* in 1997 to predict the exact timing of the 2008 economic depression—eleven years before the event occurred. He was able to do so due to his extensive knowledge of the real-estate cycle.