

Governing kidnap for ransom: Lloyd's as a “private regime”

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Abstract

Kidnap for ransom raises significant governance challenges. In the absence of formal regulation and enforcement, insurers have created an effective private governance regime to facilitate smooth commercial resolutions. Controlling ransoms is paramount: “supernormal” profits for kidnappers create kidnapping booms and undermine the market for insurance. Ransom control requires cooperation, but there are high transactions costs in enforcing a collusive agreement. The Coasean prediction is that a single firm will form to internalize the externalities arising from lax insurance and mismanaged ransom negotiations—or a government must order the market. There is indeed a single source of kidnap insurance: Lloyd's of London. Yet, within the Lloyd's market several insurers compete for business. Lloyd's is a club providing private governance: Its members issue standard contracts, follow the same regime for kidnap resolution, and exchange information to stabilize ransoms. Lloyd's, therefore, combines aspects of Coase's “single firm” and “government” solution to the externalities problem.

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