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Companies People Ideas

Make Car Insurance Fairer
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Smorgasbord of Your Ideas

- Season tickets to cinemas: Now available in the U.K. and France.
- Screen savers for television: Have a rotating collection of family pictures or artwork stored on a TiVo-like device.
- TV closed captions: Simply shipping televisions with this feature turned on would improve literacy among TV-addicted kids.
- Video eyeglasses for dental patients: Watch a movie while your cavity is being filled.

Make Car Insurance Fairer

Wouldn't it be a great idea if the oil companies offered all-you-can-drive gasoline? For one fixed price, you could drive as much as you wanted. Of course, this is ludicrous. It would be massively unfair. It would create terrible incentives. Yet this is how auto insurance is sold. Some insurers offer a 15% discount if you drive less than 7,500 miles a year. But beyond this distance the price is fixed. People who drive 10,000 or 100,000 miles pay exactly the same premium.

Econ 101 says that when something is free, people consume too much. In this case, all-you-can-drive insurance encourages people to drive more than they otherwise would if they had to pay the full cost of each mile. The heavy drivers don't bear the total costs related to their actions--hospital bills, body shop bills, highway congestion.

Low-mileage drivers (e.g., women, who drive half as much as men) get a raw deal. Fixed-price insurance hurts Detroit, too. More people would choose to have second and third cars--maybe a ragtop for weekends?--if the extra insurance weren't so expensive.

So what should be done? Simple. Charge drivers for insurance on a per-mile basis. That does not mean higher average insurance rates. It does mean that the low-mileage drivers would stop subsidizing the high-mileage drivers. If the per-mile fee reflected the incremental risk, Berkeley professor Aaron Edlin calculates that driving would be cut back by 9%, with an insurance savings of \$8 billion a year and an additional \$9 billion savings in reduced congestion. Not to mention the environmental benefits of reduced fuel consumption.

Proposals for implementing usage-sensitive rates go way back. In 1963 Nobel Prize-winning economist William Vickrey suggested that insurance be included in the purchase of tires. Anticipating the objection that this might lead people to drive on bald tires, Vickrey said drivers should get credit for the remaining tread when they turn in a tire.

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Andrew Tobias proposed a variation on this scheme in which insurance would be included in the price of gasoline. That would have the added benefit of solving the problem of uninsured motorists (roughly 28% of California drivers). As Tobias points out, you can drive a car without insurance, but you can't drive it without gasoline.

In Vickrey's time, turning back odometers was, perhaps, too easy. With digital electronics, rolling back the odometer is much harder. It is also illegal. Odometer readings are good enough for car leasing--why not for car insurance?

Alternatively, an insurer could monitor distances driven using the Global Positioning System. As this magazine noted earlier (Nov. 27, 2000), Progressive Corp.

had a pilot insurance program using this technology.

GPS could slice the risk equation more finely. Highway mileage could be given a discount, and nighttime driving could be charged a premium. Speeding could also lead to higher premiums. To put a positive spin on it: You safe drivers would get the discounts you deserve.

Why has the insurance industry been so cool to mileage-based pricing? An established insurer might be reluctant to adopt it because it would lead to higher rates for half of its customers, and that half would be angrier than the other half would be pleased. Pay-per-mile insurance makes the most sense to a company that is trying to grow and to attract more women customers.

Another stumbling block is that some states make it very difficult for insurers to provide this product. Patrick Butler has been working for some 20 years to get the law changed to bring per-mile insurance to the marketplace. With the support of the National Organization for Women, he has drafted model legislation to allow firms to offer per-mile insurance.

In January 2002 Texas became the first state to explicitly permit per-mile insurance. There is mileage-based insurance legislation pending in both Oregon and Georgia.

In the U.K., Norwich Union, a major auto insurer, has already rolled out a similar plan. Early indications suggest that customers who drive less than the norm are saving, on average, 25%.

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---- INDEX REFERENCES ----

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3/17/03 FORBES 154

Page 3

3/17/03 Forbes 154

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(Publication page references are not available for this document.)

3/17/03 FORBES 154

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