BOOK REVIEWS

Liability: Perspectives and Policy, Robert E. Litan and Clifford Winston, Editors, (The Brookings Institution, 1988), 248 pages.

Reviewer: Robert E. Hoyt, Ph.D., Assistant Professor of Risk Management and Insurance, The University of Georgia.

In recent years concern over growth in the number of liability lawsuits and increases in the amount of jury awards and out-of-court settlements has led to a rather active debate over the merits of the U.S. civil litigation system. At the same time, escalating premiums and reductions in coverage for many types of liability insurance have led some to question the efficiency of the insurance market. Unfortunately, much of the debate over the functioning of the current liability system has been based more on emotion and personal interest than on economic theory and empirical analysis.

Liability: Perspectives and Policy seeks to supply a solid theoretical framework for analysis of the divergent views surrounding the liability debate. The book, edited by Robert Litan and Clifford Winston, brings together analyses of the major issues by several economists and experts on liability law and the insurance industry.

The presentation in the book begins with an overview of background and trends in the American civil litigation system. In the following chapter, Winston and John Calfee start their discussion of economic aspects of liability rules and liability insurance with the proposition that the U.S. liability system can be characterized as an attempt in one mechanism to achieve two goals: providing an incentive to prevent injury and compensating for injury. They then proceed to analyze, based on economic theory, the efficiency of three different liability standards in achieving these two goals. The three liability standards that they consider are first party liability, negligence and strict liability. A major conclusion of the theoretical analysis is that it appears unlikely that the goals of deterrence and compensation could be achieved efficiently under only one liability standard. This finding is supported by the other contributors in the subsequent chapters.

In the third chapter, a comprehensive discussion and empirical analysis of prices and profitability in the liability insurance market is presented by Scott Harrington. His findings suggest that the recent increase in general liability premiums reflected increases in reported losses and that a central problem for insurers seems to be the difficulty in forecasting future claims. Harrington concludes that if the problem in insurance markets stems from unanticipated changes in claim costs rather than a tendency to underprice, then there is little support for rate regulation.

Chapter four contains an analysis of medical malpractice liability contributed by Patricia Danzon. In her discussion she considers the efficiency of the current medical malpractice liability system in terms of its ability to achieve the goals of optimal compensation and deterrence. She concludes that the current system, by attempting to provide full compensation for all economic and noneconomic damages, is inefficient. Her recommendations for reform, however, do not call for a dismantling of the tort system. Instead, she suggests retention of a fault-based rule of liability with modifications directed at reducing uncertainty and inappropriate levels of compensation.

In the fifth chapter Peter Huber provides an overview of the current status in the area of environmental hazards and liability law. He observes that courts have continued to broaden the exposure of insurers in this area through "creative reading" of policy coverages. The result has been a significant decrease in the availability of environmental liability insurance. Although Huber presents a comprehensive discussion of legal and regulatory developments, his chapter lacks much of the linkage to economic theory that is so effectively developed in the preceding chapters.

Chapter six, contributed by W. Kip Viscusi, deals with liability for occupational accidents and illness. He describes the current reliance on two mechanisms for achieving the goals of compensation and deterrence. The first, workers' compensation, serves mainly to provide income and medical insurance. While the second, government regulation, such as that provided by OSHA, focuses on the control of occupational risk. He contends, however, that market forces, such as workers' preferences, are still very significant in providing strong incentives for job safety.

The seventh chapter tests the impact of expanded product liability litigation and increased damage awards on product-related injuries. In this chapter, George Priest finds little evidence of a reduction in injury rates, in spite of the increased frequency and severity of product liability litigation and awards. As Priest observes, for a liability rule to be efficient it must place liability on the party for who marginal prevention costs are lower. He suggests that the failure of the system to reduce accident rates appears to stem from the fact that courts devote little attention to the marginal costs and benefits of accident prevention.

The final chapter, written by the editors, serves to review and summarize the major policy implications of the various chapters.

Liability: Perspectives and Policy as a whole does a commendable job of providing the theoretical groundwork for continuing research in liability and liability insurance. In addition to the theoretical discussion, the authors of each of the chapters suggest necessary focus for future work. It should, therefore, serve as a valuable introduction to individuals considering research in this area. One unfortunate result of the books academic rigor, however, is that many of the participants in the ongoing debate over the functioning of the liability system will likely be unwilling or unable to digest the information that it contains.

Economics of Insurance by Karl H. Borch (North-Holland 1990), 402 pp.

Reviewer: Dr. Tapen Sinha, School of Business, Bond University, Australia.

The writing of this advanced textbook was undertaken by one of the outstanding theorists of the economics of insurance: Karl H. Borch. He was one of the few researchers who contributed in economic theory as well as in insurance. (A summary of Borch's contribution to insurance was presented by Phelm P. Boyle in *The Journal of Risk Insurance*, June 1990.) Unfortunately, he died before he was able to complete the book, so this task was undertaken by two of his colleagues at the Norwegian School of Economics and Business Administration: Knut K. Aase and Agnar Sandmo.

From the overall structure of the book it is clear that this monograph was to be the magnum opus encompassing all the research interests of the author. The topics covered are (1) insurance and economics, (2) insurance and utility theory, (3) insurance and competitive equilibrium, (4) life insurance, (5) business insurance, (6) household insurance, (7) uninsurable risks, and (8) risk theory and government supervision. Each topic is discussed from the point of view of (neo-classical) economic theory. This approach stands in stark contrast with the literature on general insurance theory in which concepts like Pareto Optimality is never even mentioned. Borch weaves in concepts such as the capital asset pricing model (CAPM), Bellman's equation, and asymmetric information effortlessly into standard literature.

This book could aid a person familiar with the mathematics of insurance (e.g., an actuary) as to what economics/finance has to offer. For example, one can learn that there are only two basic types of insurance: term life and contingent annuities. Other complicated policies are merely different combinations of these basic policies. One can learn how the basic life cycle model of economics can accommodate various concepts of insurance. The concepts and limitations of optimal insurance structures using utility theory are demonstrated beautifully. Historical notes are presented also in an interesting fashion.

There is one important shortcoming of the monograph as a textbook. It was originally meant to be a self contained integrated textbook. But Borch's sudden death forced Aase and Sandmo to simply insert many of the published articles of Borch "as is" in the relevant chapters. This process has resulted in a book with uneven levels of difficulty for the uninitiated. After all, *Economics Letters, Geneva Papers of Risk and Insurance, Journal of Risk and Insurance* and *Econometrica* (some of the journals from which the articles are taken) do not call for the same writing style.

There are some minor (but still disturbing) errors in the book. For example, in chapter 1, Jensen's inequality is claimed to state $E\ u(x) < E(x)$ (p. 5) whereas later (p. 31) we get the (correct) version of the inequality $E\ u(x) < u(E(x))$ if