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Presidential Address: Cycles, Context, and Change

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Over the years, I have come to think of the presidential address as an opportunity for the association members to become acquainted with the incoming president. In that spirit, I have prepared a presentation that is focused on a topic that has been of interest to me for a long while, the cyclicality of social concerns, including those related to risk management and insurance. I have titled it "Cycles, Context, and Change," and my purpose is to suggest a somewhat broader view of our work than we typically are encouraged to take.

The idea came to me shortly after realizing that I would become president and asked to speak here. To prepare, I read the published speeches of my predecessors. Two interesting patterns emerged in the reading: first was that the issues in the minds of the presidents seem to change very little year to year. There was concern over membership, the need for a second journal, the question of what we should call ourselves, where we should be housed within a university, how we could become better recognized among our academic and industry peers, etc. The second pattern was that, like our presidents, the *Journal of Risk and Insurance* authors seemed interested in many of the same questions year to year. Consider these titles:

"Rates of Return in the Property and Liability Insurance Industry," Irving H. Plotkin (1969)

"The Efficiency of Alternative Models for Solvency Surveillance in the Insurance Industry," George E. Pinches and James S. Trieschmann (1974)

"An Economic Appraisal of Territorial Pricing Issues in Automobile Insurance," Robert C. Witt (1979)

"Bodily Injury Claim Payments as a Function of Automobile Liability Insurance Limits," Stuart A. Klugman and Michael L. Murray (1984)

"On the Surprisingly Low Cost of State Catastrophic Health Insurance Programs," Bernard Friedman, Caroline Ross, and Glen Misek (1984)

"The Problem of Overutlization in Health Insurance," O. D. Dickerson (1959)

"Some Life Insurance Investment Problems," Frank J. Traverse (1939)

Reading paper titles from ten to sixty years ago that sound similar to topics of interest today, I am reminded of the numerous meetings where Yehuda Kahane graciously mentions an article addressing an issue currently being discussed which Yehuda published a good number of years prior. When that occurs, I wonder if we ever study anything new.

These two patterns of recurring issues also remind me of an argument I've been involved in with friends and colleagues for quite some time. That argument has to do with the "state of the world." It goes something like this: Someone will lament the state of the world. Violence is rampant, children are disrespectful, educational opportunities have lessened in quality or students are less enthused, business and politics are corrupt, etc. In essence, the speaker wishes for the good old days. Each new generation seems to think that social interaction was better in the past than the present.

For example, consider how we respond to people in government as though our elected officials were more trustworthy in years prior. I look at the furors over Dan Rostenkowski, Spiro Agnew, and Burt Lance. And yet, more than 100 years ago in 1876, Rutherford B. Hayes was elected president through his party's ability to buy votes in the electoral college. And the Grant administration that preceded him was even more corrupt. Or consider the public displeasure with Bill Clinton's supposed womanizing in contrast with what we now know about John Kennedy, or even the likely romantic involvement of Franklin Delano Roosevelt with a woman other than Eleanor. Jefferson Davis and George Washington give additional examples.

Let me pursue this idea of constancy of problems by considering our concerns about family, homosexuality, and juvenile delinquencies. Each deserves the attention of the entire speech, but I will just mention them here. Today we hear much discourse on the breakdown of the American family and the havoc caused by high divorce rates. Yet, as far back as 1816, when general divorce laws first became prominent, commentators warned that "[allowance of divorce in the United States was dreadful, beyond conception, and that the] whole community would be thrown into general prostitution" with its expansion (Friedman, 1985, p. 206). Our current heated concern over divorce, therefore, sounds like old stories.

Likewise, the question of homosexuality is one not new to recent generations. Plato and his followers discussed homosexuality in some detail, actually encouraging its practice as a more full life experience for those who ultimately would be the leaders of Plato's Republic. Plato's Republic has returned in the form of debate concerning Colorado's legislation intended to prohibit municipal ordinances designed to afford homosexuals status as protected minorities (Nussbaum, 1994).

Juvenile delinquency has similarly been an issue for ages. An example comes from analysis of life during the 1950s, an era many of us have considered idyllic. Recent research suggests that the 1950s was a time of greater juvenile delinquencies than we see today and an era of general disequilibrium for American youth (Gilbert, 1986).

In response to this kind of rhetoric about the downturn in our social condition, I often present my belief that the state of the world has not worsened, but rather that we are involved in cycles, that we experience periods of liberalism and conservatism, periods of boom and bust, periods of logic and emotion, and so on. Others have provided more scientific evidence of cycles (see Strauss and Howe, 1991). Let me give you some examples of observed cycles that support this notion.

Marc Galanter (1986) cites evidence that per capita civil case filings increased substantially during the late nineteenth century and early twentieth century before declining, and then rose again later in the twentieth century. He cites this evidence as a possible indication that the litigation increase observed in the 1970s and 1980s was part of a cycle rather than an overall absolute increase. He further points to more recent evidence that litigation patterns are again showing a decline in frequency. You might have read recently of the Jury Verdict Research findings that indicate plaintiff win rates in personal injury cases have declined by more than ten points, while awards are also declining in value. While limited, the results do support the possibility of a cyclical pattern.

On a different front, Dave Cummins (1987) discussed the cyclicality of business education in his 1986 presidential speech. He quoted a *Harvard Business Review* piece, which summarized the results of two 1959 studies criticizing the vocational nature of business education and the lack of mathematically-oriented "rigorous" research. By 1980, as Cummins notes, the criticism reversed its course, blaming business schools for the downturn in U.S. business competitiveness. The claim was that business schools ignored common sense, insight, and communication skills in favor of "analytic detachment," among other things. Today we observe emphasis on teamwork, internships, cultural understanding, and verbal skills (O'Reilly, 1994). I fully expect analytic, especially mathematical, skills to see a renewed demand in twenty to thirty years.

Similarly, the existence of a cyclical pattern of acceptable and preferred management styles is posited in a recent article in *Administrative Science Quarterly* (Barley and Kunda, 1992). The authors demonstrate a consistent pattern of movement between normative control and rational control rhetorics. There seems to be approximately a thirty-year turnover between motivational techniques that alternatively suggest scientific, physical, or individualistic approaches and social, emotional, or communal approaches to workplace motivation. While reading the article, I considered the complexity of human behavior and the possibility that motivational techniques are aimed at finding a "holy grail" of sorts; that is, aimed at finding something that may not exist. If it is nonexistent, efforts to find the "right" motivational technique may inherently involve a cyclical pattern, moving from one option to another and back again in vain.

Perhaps any effort to identify a universal answer where none exists will demonstrate cyclicality. Consider insurance ratemaking, for example. My personal observation has been that, because insurance rates always appear too high to consumers (and their elected officials by association), the public in a jurisdiction with high insurance costs that uses prior approval regulation ultimately believes that only a more flexible system will work to alleviate rates, while citizens of a state where file and use (or some more competitive variant) is used likely look toward prior approval to reduce their insurance costs. If the best rate regulation is indeed a "holy grail," then we are likely to observe movement from one to another and back again over time.

Some of the U.S. cyclical patterns seem rooted in our societal mission of "equality and liberty." Equality implies sameness while liberty implies individuality. We yearn for all peoples to have equal opportunities, and yet we also celebrate the individual successes of some fortunate few. Struggles over health care seem mired in this tension. Consider the Siamese twins who were born about a year ago. As a community, we argued whether or not hundreds of thousands of dollars should be spent to separate the twins and try to save their lives despite a quite remote chance that either would survive and an even smaller likelihood that either would live a so-called "productive" life. We seem to believe that every individual ought to have available life-saving medical care, and, yet, as a community we believe that our expenditures on medical care are not affordable. Who will receive care and who will not currently rests primarily on wealth; other methods of resource distribution may be too societally difficult to implement. The push and pull of equality and liberty seem to swing us back and forth between universality of health care and individuality of choice/success/merit.

Why do I consider it sufficiently important to think about cycles that I focus on it here in what may be my most important professional presentation to date? As I tried to present initially, the concept of cycles and repetition of problems have been of interest to me for most of my adult life. Furthermore, I am increasingly convinced that, as leaders in business and teachers of future leaders, we are obligated to be familiar with and understand the lessons learned from history. Many challenges (business and otherwise) already have been faced by others who have had differing degrees of success in trying a variety of responses. Appreciation of those past experiences may make future breakthroughs more common. We are likely to find that some cycles are inherent and desirable. Other cycles may be better if broken, which may be made more likely with a recognition and understanding of the cycle itself.

Recently I shared some of my thoughts with an incredible man I am fortunate to call my friend. Merle Curti is considered by many to be the founder of the field of American intellectual history and at the age of 97 continues to write, read dissertations, and offer intellectual challenges. Curti coauthored the history book used by most high schoolers in the U.S. from 1950–1986, won a Pulitzer prize, studied under Frederick Jackson Turner and Arthur Schlesinger, and treats each person he meets with complete dignity. I posed this question to Curti, whether or not most societal problems seem simply cycled through our collective psyche, with only context changing. Curti responded:

> I can understand your feeling that problems remain pretty much the same but the context changes. Since the context becomes part of the problem, does it not follow that traditional methods may not be well geared to the new entity problem-plus-context? In

> other words, should we not only test older methods but look to the implications of what has happened in other but related disciplines or fields for different ways of analyzing and "solving"? It seems to me that until the late fifties and more particularly the sixties the same problems in trying to teach, research, and write history kept recurring and we kept on with traditional methods increasingly less satisfactory. Then as historians really sensed the implications for their field of quantum theory, relativity and later chaos theory, as the limited number of actors or agents in history (limited by gender, ethnicity, race, geography) and the kinds of behavior related to them expanded, the problems had become new and did need trying different ways of organizing as well as expanding material, different conceptualizations, different methods (cultural anthropology, quantification, oral history, etc).

Thus, Curti seems to believe that appreciation for context and willingness to incorporate a broad definition of context will promote greater innovation and ultimate success in meeting challenges. Think about some of the most influential recent "discoveries." The options pricing model in finance required use of the heat transfer equation from physics (Black and Scholes, 1973). Ronald Coase, an economist, revolutionized legal thought and research with his seminal work in 1960. Chaos theory demanded simultaneous understanding from both mathematics and physics (Gleick, 1987). Risk perception research took a leap forward with the joint effort of a psychologist and mathematician (Kahneman and Tversky, 1979).

We might benefit in risk management and insurance by looking to other disciplines for similar kinds of synergy. An interesting example comes from system dynamics, where researchers have postulated that endogenous as well as exogenous factors affect the magnitude of the underwriting cycle (Senge and Sterman, 1990). According to a system dynamicist, cycles are produced when two "accumulations" (or inventories) exist, each affecting a "flow" into or out of the other. In the underwriting cycle, two accumulations are the amount of surplus and the number of policies in force. Surplus affects the number of policies written, a flow into policies in force. In turn, the number of policies in force affects revenues, a flow into surplus. The linking of these two accumulations with the two flows places inherent caps on the accumulations, generating an up and down swing in values.

This explanation provides the traditional view of the typical underwriting cycle. The swings, however, may well be heightened by additional forces, such as the impact of increasing claims (due to increased numbers of policies in force) on the behavior of claims adjusters. As claims rise in number, the adjuster may become overburdened with responsibilities. He or she then has an incentive to settle quickly, offering larger settlements in order to be successful in closing the case, and thus exacerbating the loss ratio. New claims adjusters are hired, but by the time they are sufficiently trained to perform their job, the worsening loss ratio has reduced surplus, thus hardening the market and shrinking the number of policies in force, which in turn reduces claims so that the new claims adjusters are not needed.

Our intrigue with the underwriting cycle seems at least in part to generate from a preference to get out of it. In general, I think, repetitions are considered undesirable, and so we seek change. And yet change is such an oddity. We yearn for it, as evidenced by our preference for politicians who promise change; and we also fear it. I suggested to Curti that perhaps change arrives primarily through technological innovation, and he somewhat agreed, if I included in my definition the basic sciences. Curti further proposed that perhaps the revolution in linguistics has had the greatest impact on all specialized fields in recent years. The revolution is to suggest that words are more than just sounds, that, for example, a rose by any other name would *not* smell as sweet. The words we use to denote various conditions, events, etc. seem to have incredible import on context and therefore on cycles.

I wonder about the linguistics of insurance. What is insurance? A variety of similar definitions can be found in the various books published by members of ARIA, and yet most of those definitions describe its qualities (spreading losses, sharing risk, calculating premiums) rather than stating what it is. To an individual consumer it may be "peace of mind." To a business organization it may be a financing tool. Regulators might consider insurance as a promise that requires oversight for proper enforcement. Insurers may view their product as a service.

Whatever are our individual definitions of insurance, a major change in the industry appears to be developing. On the one hand, personal insurance appears destined to become increasingly controlled by government, either through legislation or the courts. Pricing, coverage, and industry practices all face significant regulatory oversight. As a result, personal insurance today appears more of an intermediary business (insurers providing government mandates) than a primary business. On the other hand, commercial insurance experiences far less government involvement. Yet it too shows signs of significant change. Competition from innovative retention programs is forcing commercial insurers to reorient their business strategies. Profits for commercial insurers in the future appear dependent upon their ability to offer a wide variety of services: claims administration, loss control expertise, underwriting and reserve analysis, legal advice, and possibly a realm of services not currently considered a part of insurance.

What I am suggesting is that a widening gap appears to be emerging between personal and commercial insurance far more than we have observed previously. I am also suggesting that the product "insurance" is being transformed into something far different from what we have generally known to date. And yet as I contemplate these ideas, I recognize the cyclicality of my thoughts. Friedman (1985, pp. 546-547) shows that, more than 120 years ago, "courts and juries often found ways to stretch the language of insurance policies to allow a widow to collect life insurance, or to help a man whose house or store burned down, despite some flaw or doubt." Further, "states passed a torrent of statutes.... On balance, regulation was unfriendly to companies."

And so, when we talk about the unpredictability of the courts and regulators, the burdens each places on insurers' ability to provide their product, are we reflecting a new condition or a recycled situation? The distinction is important because our research of and responses to these conditions may differ depending on the answer. If the problem is recycled, what can we learn from earlier experiences? What can we learn from the context as other disciplines may have considered the problem? What has changed since the preceding experience of the problem? A personal example comes from an early paper I published in the *Journal of Insurance Regulation* (Schmit, 1986) in which I posited that U.S. courts were becoming increasingly regulatory of insurance contracts. My piece was quite negative about the courts, and I sounded an alarm for insurers. With additional knowledge of the longstanding nature of court interpretation of insurance contracts, I see that my earlier analysis was incomplete and therefore not very helpful. An interesting proposition today would be a study in variations of underlying context between the late nineteenth century and our current experiences.

I have focused on insurance here, yet I believe that risk management, all business, and, in fact, all human interactions are affected by similar cycles, contexts, and changes. I choose to talk about them in this address because I personally have been surprised by the consistency of problems across time. As I sought out information for this presentation, I became more aware of cyclical conditions and became increasingly impressed with the importance of paying attention to them in my teaching, research, and consulting activities. I am appreciative of the opportunity to share these thoughts with a group of people interested in patterns, predictability, innovation, and advancement, especially amidst a group of people who shared their own knowledge and curiosity so that I could participate in our own cycle of education and training, each of us connected to the "generations" before and after us through our shared understanding of risk management and insurance.

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