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Book Review

Deregulating Property—Liability Insurance, edited by J. David Cummins, 2002, Brookings Institution Press, 408 pages. Reviewer: David L. Eckles, Assistant Professor of Risk Management and Insurance, University of Georgia, Athens, GA.

Deregulating Property-Liability Insurance is a collection of papers presented at a conference regarding insurance regulation sponsored by the American Enterprise Institute-Brookings Institution Joint Center for Regulatory Studies in January 2001. Specifically, the conference and the papers primarily focus on the private passenger automobile insurance market, and the regulation thereof. The conference examined five states, three of which are known for their strict regulation within the private passenger automobile market. Massachusetts, New Jersey, and California were the states studied by Sharon Tennyson, Mary A. Weiss, and Laureen Regan; John D. Worrall; and Dwight M. Jaffee and Thomas Russell, respectively. The remaining states studied included Illinois (by Stephen P. D'Arcy) and South Carolina (by Martin F. Grace, Robert W. Klein, and Richard D. Phillips), both of which have deregulated their private passenger automobile insurance markets (South Carolina has only recently deregulated, while Illinois had done so many years ago). In addition to the studies of these specific states, Scott E. Harrington examined data from all of the states in an effort to determine the effects of prior approval rate regulation on a variety of industry/consumer concerns (including loss ratios and increases in the average cost of private passenger automobile insurance). In addition to a fairly comprehensive examination of regulation within the private passenger automobile market in the United States, Georges Dionne and Richard Butler provide studies of insurance regulation in other countries (Dionne) and within other insurance markets in the United States (Butler).

In *Deregulating Property-Liability Insurance*, J. David Cummins (Editor) synthesizes these papers into one text that outlines the arguments for and against insurance rate regulation. The general theme of the book is that while regulation may serve a useful purpose in some insurance markets, the marketplace for private passenger automobile insurance is sufficiently competitive to make insurance regulation not only unnecessary, but also detrimental. This conclusion is borne from (most of) the aforementioned studies, as well as Cummins's own introductory chapter. Sprinkled between the individual papers are comments on the papers from other experts and authors well known to *JRI* readers (including Richard A. Derrig, David Appel, and Georges Dionne). A brief synopsis of each chapter follows.

Chapter one is an introductory chapter written by the editor, J. David Cummins. In a book comprising numerous independent studies by different authors, Cummins's chapter nicely brings everything together. Cummins provides a brief history of insurance regulation as well as the various theories for why insurance regulation exists. Cummins points out that the evidence from the subsequent chapters suggests that ongoing insurance regulation is not a result of insurers engaging in unfair practices (cartels, monopolistic pricing, etc.), but rather is a result of consumers desiring lower premiums (primarily resulting from subsidies from lower risks to higher risks). In this chapter, Cummins also outlines the arguments and evidence presented in the remaining chapters, both for and against deregulation.

Chapter two is an essay entitled "Automobile Insurance Regulation: The Massachusetts Experience" written by Tennyson, Weiss, and Regan. The essay gives an overview of the Massachusetts regulatory system and considers the impact of the regulation on various aspects of the automobile insurance industry in Massachusetts. The authors consider regulatory impact on individual rates (and the subsidies present), regulatory impact on firm performance, regulatory impact on insurance costs for all drivers, regulatory impact on the market structure, as well as regulatory impact on competition. The authors find that the regulation is related to relatively poorer performance of Massachusetts insurers, creates subsidies from low-risk drivers to high-risk drivers, and creates a market characterized by smaller insurers and a larger residual market.

Chapter three is Worrall's study "Private Passenger Auto Insurance in New Jersey: A Three-Decade Advertisement for Reform." Worrall provides an in-depth look at New Jerseys' current regulation, as well as a history of various laws and regulations enacted in New Jersey beginning in the early 1970s. Worrall also studies the New Jersey market with respect to fraud, market concentration, distribution systems, barriers to entry and exit, the residual market, and total claims costs. Worrall's chapter is followed by a brief discussion by Derrig comparing the different regimes and effects of the Massachusetts and New Jersey regulatory systems.

Grace, Klein, and Phillips's "Auto Insurance Reform: Salvation in South Carolina" is the fourth chapter. Similar to the prior studies, Grace, Klein, and Phillips provide a description of the insurance regulation in South Carolina (prior to 1999 reforms). The authors also examine the impact on the industry (market concentration, entry and exit barriers); insurance prices, availability, and demand; and insurer performance and costs. They also consider the early effects of the regulation reform that occurred in 1999 (although when the paper was written, there were not sufficient data available for a complete study).

Jaffee and Russell's "Regulation of Automobile Insurance in California" provides a counterexample of the ill-effects of regulation in the automobile market. Studying Proposition 103, a piece of legislation moving California from being one of the least regulated to most regulated states, Jaffee and Russell ultimately find that the more stringent regulation imposed by Proposition 103 has not had the negative effects found in the other studies. Particularly, Proposition 103 was found to have not caused an irregular change in entry/exit patterns, to have had no effect on the size of the assigned risk pool, and to have caused no decline in the rate of return of insurers. Jaffee and Russell do find a relative decrease in insurance premiums in California after the introduction of Proposition 103, but they attribute this change to decreases in underwriting expenses and losses (a result of an increase in relative driver safety), antifraud activity, a court ruling denying third parties the ability to sue for bad faith claims, a possible increase in profit margins, and potentially lower quality insurance. Following the chapter, Appel provides additional analysis and suggests Jaffee and Russell further consider cost components in their analysis.

In chapter six D'Arcy examines the effects of insurance price deregulation in Illinois ("Insurance Price Deregulation: The Illinois Experience"). In addition to providing evidence relating to regulation in Illinois, D'Arcy also provides a very interesting history on insurance regulation in the United States. With respect to Illinois, D'Arcy shows that loss ratios exhibited in Illinois were not significantly different from loss ratios from other (more regulated) states, suggesting no support for the notion that a competitive market will lead to excessive premiums. D'Arcy also suggests that the lack of regulation in Illinois reduces the variability of premiums (and loss ratios), consistent with the idea that the absence of regulation does not disrupt the market from normal (competitive) rate changes. In further support of this "market disruption" hypothesis, D'Arcy also finds a significantly larger residual market pool in states with more restrictive regulation than Illinois. Uninsured motorists were found to be more prevalent when loss ratios were declining and less prevalent when loss ratios were rising for highly regulated states, evidence of the "maximization of political support" theory. Finally, D'Arcy finds slightly higher rates of insolvencies for regulated states.

Harrington's essay "Effects of Prior Approval Rate Regulation of Auto Insurance" considers the effect of rate regulation (prior approval) on the automobile market's loss ratios, residual market population, loss ratio volatility, and growth rates in average insurance expenditures. Harrington finds a significantly "positive but economically negligible" (p. 299) effect of regulated states on loss ratios. He also finds a significantly higher proportion of residual market participants in regulated states. Harrington further finds higher loss ratio volatility and higher volatility of expenditure growth for states using prior approval regulation. The evidence provided by Harrington that regulation does not materially affect prices, but can reduce insurance availability, echoes results from prior studies (including D'Arcy). Harrington's paper is followed by some brief comments from Dionne discussing the methodology used by Harrington.

In "Form Regulation in Commercial Insurance," Butler argues that regulation requiring insurers to receive approval before changing language in an insurance contract imposes a time-related tax on commercial purchasers of insurance and has resulted in a shift away from insurance to alternative risk transfer mechanisms. Butler first provides a model and simulation showing reduced consumer welfare when regulation delays new forms from being brought to market. Butler then shows that states with more stringent regulation have longer delays in allowing new insurance forms to be brought to the market. He also shows that deregulation of the commercial property-casualty market would induce larger amounts of insurance output although the same is not shown to be true for the noncommercial markets, where regulation, acting as a *de facto* warranty, is shown to increase insurance output.

In the concluding chapter "Insurance Regulation in Other Industrial Countries," Dionne provides an introduction to automobile regulation, rating mechanisms, and bonus-malus systems of Quebec, France, and Japan. The system in Quebec is described as one where drivers obtain insurance through both a public monopolistic insurer (for bodily injury) and from a competitive insurer (for property damage). Some evidence suggests that the system has resulted in more careful drivers who are involved in fewer accidents. The bonus-malus system used in France is also shown to provide strong incentives for drivers to exercise caution. Dionne also discusses the possible problems associated with the European Union requiring France to discontinue their current system. Dionne also provides a summary of some of the recent changes within the Japanese regulatory environment, including the deregulation of insurance rates and increased solvency regulation measures.

Deregulating Property-Liability Insurance provides an extensive look at the impact of regulation on various aspects of the property-liability insurance industry. The majority of the book focuses on the impact of regulation on the automobile insurance market of states. Additional chapters provide evidence of regulation's impact from more general form regulation and from other countries. Readers interested in the regulatory environment (and history) of the states examined in the papers would find this book an interesting read. Although the papers generally come to the conclusion that regulation is unnecessary, the papers do provide a discussion on the theoretical arguments for and against regulation.