Information in Insurance Markets: When Less is More

P. Alex Robinson

Abstract

Many studies show that asymmetric information exists in insurance markets, yet there is little consensus on the effectiveness of interventions in these markets. This article provides empirical evidence that improving information about risk is not always welfare-improving. I show how the theoretical effect of risk-rating can depend on whether the market is adversely- or advantageously-selected. I then estimate a structural model of insurance choice and reckless behavior to show that in the advantageously-selected U.S. automobile insurance market, risk-rating induces high-risk drivers to drop coverage, creating a negative externality and social welfare loss. Community rating improves welfare despite increasing asymmetric information.