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HIGH AUTO INSURANCE RATES CHARGED TO MODEST-INCOME CONSUMERS: INSURER REACTION TO THE CFA PRICE QUOTE SURVEY

Auto insurers have responded to the CFA survey of price quotes for minimum liability coverage for moderate-income drivers – which revealed very high and variable prices – by saying that this dramatic price variation is evidence of competition.

Nothing could be further from the truth. In classical economic theory, the “law of one price” states that, “In an efficient market, all identical goods must have only one price.” According to the theory, the only reason the law doesn’t apply is if buyers have less than perfect information for that price at any one time in one country.

Largely because buyers rarely have perfect price information about any product, prices for identical good and services typically vary by 20-30 percent. But in the low- to moderate-income market for auto insurance, the prices quoted by just the nation’s four largest insurers often vary by more than 100 percent and sometimes by more than 200 percent. For example, the CFA survey cites one woman in Phoenix who was charged $609 by one major insurer and $3,458 by another.

Moreover, extreme price variations conflict with insurer claims that their rates are carefully adjusted to reflect the risk of the driver. If so, why do rates offered to the same consumers differ so significantly from company to company?

While price variations of this magnitude do not meet conventional economic standards for competitive markets, there is another plausible explanation: Insurers offering high prices are not interested in selling to low- and moderate-income drivers. If insurers refused to sell these drivers policies, they would be accused of blatant redlining, so they simply make them unaffordable. Major insurers could disprove this explanation by showing that, in fact, they are selling large numbers of high-priced (such as over $1,500 annually) minimum liability policies. We would be very surprised if this were the case.

Finally, insurers ignore the central findings of the CFA survey when they say that the auto insurance market is competitive. The survey found that the rates being charged by many companies to modest-income consumers for mandated coverage are inexplicably high and unaffordable, whether or not the market is competitive; and there is considerable evidence that it is not. It is time that the states, which require all automobile owners to purchase this insurance, consider regulatory options that will make pricing fairer and more easily obtainable by these consumers.