THE BENEFITS AND SAVINGS OF AUTO-CHOICE

A JOINT ECONOMIC COMMITTEE REPORT

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Executive Summary

Americans pay exorbitant amounts for auto insurance thanks to excessive litigation and escalating fraud and abuse. One reform that would help address these problems is Auto-Choice. With Auto-Choice, drivers could choose to opt out of recovery for "pain and suffering" damages in return for significant premium savings and quicker compensation for economic losses. Drivers who prefer to remain with their state's existing insurance system would be substantively unaffected.

This study estimates that Auto-Choice would reduce auto insurance premiums 32 percent nationwide, or $45 billion in 1997. Over five years, Auto-Choice would make available a total of $246 billion in savings. On the individual level, Auto-Choice would save the average policy $243. Low-income drivers would realize substantially greater savings -- 48 percent on average.

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I. INTRODUCTION

Every American who drives a car is reminded yearly of the exorbitant cost of automobile insurance. The average automobile insurance policy cost $757 in 1995, and a study by *Consumer Reports* magazine showed that the average cost to insure an automobile rose 44 percent between 1987 and 1994, nearly one-and-a-half times the rate of inflation. [2] Americans' feelings of frustration are further fueled by a system in which their premium dollars are wasted on an inefficient compensation system that spends too much on minor or frivolous lawsuits, yet undercompensates the seriously injured.

For those unfortunate enough to have an accident, problems often persist beyond physical recuperation due to the poor design and perverse incentives of the current legal and insurance systems. Because of the present fault-based, third-party liability system accident victims must suffer an arduous, lengthy process before receiving full or even partial compensation for all of their losses. Moreover, under the current liability system, accident victims often are forced to seek compensation from the insurance policy of the very person who caused the accident, which in effect allows negligent drivers to determine the amount of recovery for the people they injure.

Perhaps the greatest losers under the present system are low-income and urban drivers. Unfortunately, the poor are at a disadvantage under such a litigious system. Not only can low-income individuals ill afford to wait out a protracted legal settlement, but they also are forced to spend disproportionate amounts of their income on auto insurance. Urban areas in particular suffer from high insurance premiums due to excessive legal costs. As a result, many low-income drivers simply choose to break the law and not insure their vehicles at all.

What is needed, therefore, is significant reform of the current legal and economic structure of the auto insurance and tort systems. Reform should lower premiums by reducing the perverse incentives for fraud and abuse as well as the proportion of premium dollars paid for lawyers' fees. Such changes would make auto insurance affordable for many poor drivers. Reform should also facilitate the immediate payment of medical and other bills due to accidents and allow consumers more choices in how to insure themselves in case of accident or injury.

One alternative to the current system is a reform known as Auto-Choice. Currently, everyone is required to buy third-party insurance coverage for economic damages (such as

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[1] This study addresses some of the same issues discussed in the Joint Economic Committee study *Improving the American Legal System: The Economic Benefits of Tort Reform* (March 1996).
[2] National Association of Insurance Commissioners, *State Average Expenditures & Premiums for Personal Automobile Insurance in 1995* (January 1997), Table 3; and *Consumer Reports* (January 1997), 10.

medical bills and lost wages) and non-economic damages (such as pain and suffering). Auto-Choice would allow consumers to change to primarily first-party coverage, which means that they would only need to insure against personal injury damages to themselves. Individuals could choose to opt out of recovery for non-economic damages in return for lower premiums and quicker and more adequate payment for economic losses.

Section II of this study examines the underlying problems of the present system, including the causes of escalating premiums and the perverse incentives embodied in the current legal system. Section III describes the proposed system of Auto-Choice, while Section IV presents estimates of the economic savings that could be achieved from the Auto-Choice reform proposals.[3]

II. THE CURRENT SYSTEM

Dissatisfaction with the current system of automobile insurance can be traced to a number of problems, including: an uneven system of compensation, high transaction and legal costs, and excessive fraud and abuse.

Compensation for Injuries

Perhaps the most inequitable characteristic of the current insurance system is that relatively minor injuries are overcompensated while victims of serious injuries often fail to receive full restitution. Small, nuisance suits are generally paid without much of a fight by insurance companies. Even if the case is totally without merit, plaintiffs' attorneys know they can win a settlement because it is often cheaper for the insurance company to pay out unwarranted damage awards rather than seek resolution in court. The result is a system that tends to overcompensate those with relatively minor injuries, even as the seriously injured are grossly undercompensated due to the applicable policy limits.

Research by the RAND Institute for Civil Justice found that persons suffering less than $5,000 in economic losses typically are overcompensated for their injuries, receiving compensation worth two to three times the amount of their losses (Figure 1).[4] The seriously injured, such as those with permanent and total disability, do not fare nearly as well. Such victims are often denied full recovery for their economic losses, and what they do receive can be delayed for years. According to RAND, persons with economic losses of $25,000 to $100,000 are compensated for just over one-half of their losses on average. The very seriously injured (those with economic losses in excess of $100,000) receive compensation worth just nine percent of their damages.[5]

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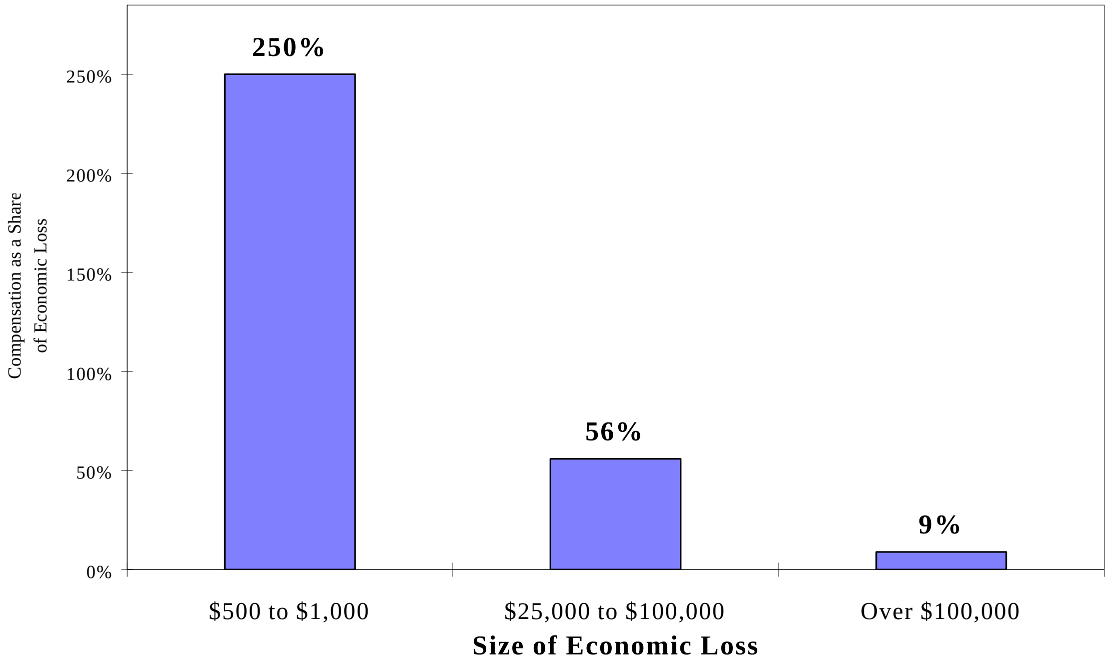
[3] The version of Auto-Choice examined in this paper is based on legislation being drafted in Congress and the model described in Carroll and Abrahamse (1997), see *infra* note 19, and O'Connell, et al. (1996), see *infra* note 11.

[4] Stephen J. Carroll, James S. Kakalik, Nicholas M. Pace, and John L. Adams, *No-Fault Approaches to Compensating People Injured in Automobile Accidents* (RAND Institute for Civil Justice, 1991) 187.

[5] In many cases, the seriously injured are undercompensated even though they receive maximum compensation from the applicable insurance policy. That amount, however, is often capped at the limits chosen by those who injure them.

Figure 1. Percent of loss compensated by size of economic loss (all tort states).



Source: RAND Institute for Civil Justice.

Transaction Costs

A major cause of increased insurance premiums is high transaction costs, a substantial portion of which are lawyers' fees. For instance, a 1990 study by the California Department of Insurance states that over 40 cents out of every premium dollar paid for bodily injury liability and uninsured motorist coverage goes to attorneys. [6] Lawyers add to the cost of auto insurance by increasing the transaction costs: accident victims have to pay out large sums for legal representation, while insurance carriers also have to hire their own lawyers.

There are a number of reasons why lawyers add to the cost of the insurance system. First, the plaintiff's attorney generally charges at least one-third of the recovery amount, regardless of how much work is done on behalf of the client. This creates an incentive for lawyers to obtain a settlement which maximizes the attorney's returns for the time put in on the case. Moreover, the plaintiff's attorneys have an incentive to inflate medical expenses and wage loss in order to reach a settlement which may not be warranted by the actual economic damages. Second, the defense attorney is generally paid by the hour and so has an incentive to drag cases out as long as possible. In addition, protracted legal maneuvers may force plaintiffs to accept a less than optimal award in return for quicker compensation. With one attorney seeking to inflate the settlement size, and the other trying to put off any resolution as long as possible, it is no wonder that cases cost so much and take so long to settle.

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[6] California Department of Insurance, *Automobile Claims: A Study of Closed Claim Payment Patterns in California* (August 1990).

Fraud and Abuse

Other factors increasing auto insurance premiums are insurance fraud and exaggeration. The Federal Bureau of Investigation (FBI) recently performed an investigation of staged car accidents and other forms of insurance fraud. According to this investigation, insurance fraud was increasing in both frequency and cost to the public, leading FBI Director Louis Freeh to estimate that "Every American household is burdened with more than $200 annually in additional insurance premiums to make up for this type of fraud." [7]

One of the greatest problems is the incentive to inflate claimed economic damages. Part of this incentive is to recover more money in compensation. This is particularly true for individuals who collect money for the same damages from multiple (or collateral) sources, such as one's own auto insurance policy, workers compensation plan, or health insurance plan. Another reason for this incentive to inflate actual losses is to gain even larger awards for pain and suffering damages. Legal scholar Charles Wolfram notes that "[p]ain and suffering and similar nonmonetary damages probably average three times the monetary damages in personal injury claims." [8] When every extra $1 of economic loss results in another $3 in non-economic awards, there is a powerful incentive to inflate economic losses and pursue legal action.

This phenomenon is evident in the experience of state reform efforts. Realizing that unnecessary or frivolous legal actions were a major source of insurance costs, some states have established economic damage "thresholds." In order to recover pain and suffering damages, individuals must have economic losses above this threshold. However, rather than exclude minor cases, the threshold mechanism can actually produce the reverse outcome: many claimants simply inflate their medical claims through additional and often unnecessary visits to the doctor in order to reach the threshold. After Massachusetts raised its threshold from $500 to $2,000 in 1988, the median number of treatment visits rose from 13 to 30 per auto injury claim. [9] In Hawaii, where the threshold was $7,000 in 1990, the median number of visits to chiropractors was 58 per claimed injury. [10]

III. THE PROPOSED SYSTEM OF AUTO-CHOICE

In order to remedy the problem of burdensome tort costs and mounting fraud in car insurance premiums, Jeffrey O'Connell of the University of Virginia Law School and Michael Horowitz of the Hudson Institute have proposed a system commonly referred to as *Auto-*

[7] U.S. Department of Justice, Federal Bureau of Investigation, Press Release (May 24, 1995), 3.
[8] Charles Wolfram, *Modern Legal Ethics* (1986), 528 at note 21.
[9] Sarah S. Marter and Herbert I. Weisberg, "Medical Expenses and the Massachusetts Automobile Tort Reform Law: A First Review of 1989 Bodily Injury Liability Claims," *Journal of Insurance Regulation* 10, no. 4 (Summer 1992), 488.
[10] Insurance Research Council, *Automobile Claims in Hawaii* (1991) 26.

Choice.[11] Simply stated, Auto-Choice unbundles the premiums for economic losses and for pain and suffering losses.[12] In addition, automobile insurance would be primarily shifted to a first-party basis, where each driver's own insurance pays for his or her damages.

Under the proposed system of Auto-Choice, individuals would have a choice between two general types of policies. On the one hand, individuals could opt to retain the same basic rights they now have under existing state law by purchasing *tort maintenance coverage* (TMC). When two TMC drivers collide, their rights against each other remain unchanged and they recover damages as they do currently. When TMC drivers have an accident with a driver who switches to the new system (a PPI driver, described below), the TMC drivers recover both economic and pain and suffering losses from their own insurance carrier up to the limits of their policy. However, if economic damages exceed that limit, then injured TMC parties can sue negligent drivers (under existing state negligence law doctrines) for economic damages (as defined by state law) in amounts that exceed their own insurance coverage.

Pain and suffering would be recovered on a first-party basis for TMC drivers claiming against a PPI driver. In such cases, the limit on recoveries for pain and suffering is determined by the policy each TMC individual purchases. This change means that rather than suing other parties (even when they are negligent) for pain and suffering damages, TMC insureds recover such damages from their own insurance carrier. Even in TMC cases, however, when injuries are inflicted either intentionally or as the result of drug or alcohol abuse, the injured parties can sue the driver who inflicted the damages for all losses (including pain and suffering), just as they can under current law. Thus, TMC individuals can utilize existing state laws to recover all economic damages, and they can purchase pain and suffering coverage in amounts they themselves determine.

Alternatively, individuals could opt out of the pain and suffering regime altogether by purchasing *personal protection insurance* (PPI), which provides insurance coverage for economic damages only without regard to fault.[13] Thus, PPI drivers recover from their own insurance carrier for all economic damages up to the limit of their policy. At the same time, state negligence laws are retained under the PPI system, so that negligent PPI drivers can be sued for all economic damages that exceed the policy limits of the drivers they injure. However, because pain and suffering recoveries are made on a first-party basis, PPI drivers cannot be sued (or for that matter, sue) for pain and suffering damages, with the important exception of injuries inflicted intentionally or as a result of drug or alcohol abuse.

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[11] The proposal by O'Connell and Horowitz is more fully described in Jeffrey O'Connell, Stephen Carroll, Michael Horowitz, Allan Abrahamse, and Paul Jamieson, "The Comparative Costs of Allowing Consumer Choice for Auto Insurance in All Fifty States," *Maryland Law Review*, 55 (1996). See also O'Connell et al. (1995) and O'Connell et al. (1993).

[12] Economic damages are defined differently in each state, but generally refer to direct measurable losses such as medical expenses, lost wages and income, and legal costs. The term "pain and suffering" is loosely used to refer to all non-economic damages, such as stress, emotional pain, and other psychic damages.

[13] The version of Auto-Choice examined here requires PPI drivers to purchase supplementary liability insurance to provide additional coverage for certain situations, such as injuries to pedestrians.

In sum, the Auto-Choice reform described here accomplishes two principal changes. First, pain and suffering premiums are unbundled from economic damage premiums, for those who wish to do so. Second, insurance is primarily shifted to a first-party basis. Both TMC and PPI systems seek to largely preserve state negligence laws to a lesser or greater extent. TMC insureds recover economic damages above their TMC coverage from negligent PPI drivers, and recover pain and suffering damages from their own insurance carrier up to the limits of their own TMC policy. PPI insureds recover from their own insurance carrier for injuries, irrespective of fault, but can still sue or be sued under state negligence laws for all economic damages negligently inflicted in excess of applicable insurance policy limits.

The proposed system of Auto-Choice is appealing for a number of reasons, not the least of which is improved reimbursement for accident victims with serious injuries. Serious injuries are better compensated with Auto-Choice for two reasons. First, under the present fault-based, third-party system, victims with serious injuries are frequently at the mercy of policy limits set by the very persons who injured them. Since in many instances victims recover from the negligent driver's policies, their fate rests with decisions made by the negligent driver. In the proposed first-party system, individuals can receive greater compensation by purchasing higher policy limits. Moreover, compensation will be provided quicker through the first-party PPI system than the current tort system.

Second, Auto-Choice would come closer to fully compensating many seriously injured victims because such individuals will be claiming from a policy with higher limits. Under the current system, many accident victims have just one source of compensation: their own medical payments (MP) policy. Roughly 75 percent of MP policies, however, have limits of $5,000 or less.[14] In contrast to this situation, Auto-Choice insureds would seek reimbursement for their losses from their own PPI plan, which would in most cases have policy limits several times higher than most MP policies. While full restitution will probably always be an arduous task for the very seriously injured, Auto-Choice significantly improves on the current situation by enhancing both the quantity and quality of compensation for serious injuries.

The Auto-Choice reform has the further appeal of improving the free market nature of the auto insurance system. The current auto insurance system functions within limits set by laws and regulations, and consequently is limited in meeting the demands of consumers. The unbundling of pain and suffering damages, however, allows suppliers to provide insurance coverage that better meets the tastes and needs of individual consumers. This change constitutes a significant improvement on the current situation in which all individuals are forced to purchase essentially the same package of services, regardless of their individual preferences and tastes.

It is noteworthy that Auto-Choice improves the auto insurance market without violating the principle of federalism. Auto-Choice unbundles insurance for economic damages and losses for pain and suffering while preserving substantive state law for those wishing to retain it. In contrast to most federal legislation which preempts state law, the Auto-Choice proposal allows states to repeal or modify, in whole or in part, the federal

[14] Insurance Research Council, *Auto Injuries: Claiming Behavior and Its Impact on Insurance Costs*(1994), 76.

reform. In this sense, this reform is a model for federal-state relations. In addition, under legislative proposals for Auto-Choice, if the state insurance commissioner determines that bodily injury liability premium savings are not at least 30 percent, then the bill does not go into effect.

The strength of the federalism provisions is affirmed by Governor Christine Todd Whitman, who has proposed a version of Auto-Choice for her state of New Jersey. Commenting on Auto-Choice legislation that was introduced in the 104th Congress by Senators Bob Dole (R-KS), Mitch McConnell (R-KY), Daniel Patrick Moynihan (D-NY), and Joseph Lieberman (D-CT), Whitman observed that “Last year’s S. 1860 [Auto-Choice Bill] was a model of federalism in that federal law would represent the first word, rather than the last word, on the subject.”[15] In a system that has 1.7 million accidents annually in which at least one party is from out-of-state, Auto-Choice leaves final policy decisions to the states.[16]

IV. SAVINGS FROM AUTO-CHOICE

The potential savings from Auto-Choice are substantial -- approximately $45 billion in 1997 (Table 1).[17] Nationwide, premiums could be reduced 32 percent with Auto-Choice.[18] Auto-Choice would make available $35 billion in savings on private passenger premiums, 31 percent on average. Commercial savings are slightly higher (due to the higher proportion of liability premiums) at 35 percent, with over $9 billion in available savings. Those individuals who opt to retain all their current rights and liabilities would on average see little, if any, change in their premiums. A state-by-state breakdown of savings is presented in Table 2.

The savings estimates presented in this paper are based on a 1997 study by Allan Abrahamse and Stephen Carroll of the RAND Institute for Civil Justice, prepared at the request of the Joint Economic Committee.[19] This RAND study, which updates a previous Abrahamse and Carroll study to more closely approximate the effects of proposed legislation, estimates savings on personal injury (PI) liability premiums due to Auto-Choice.[20] The

[15] Governor Christine Todd Whitman, New Jersey, Testimony to the Joint Economic Committee (March 19, 1997).

[16] JEC calculations based on All-Industry Research Advisory Council, *Compensation for Automobile Injuries in the United States* (1989), 18; and Insurance Information Institute, *Property/Casualty Insurance Fact Book* (annual), 84.

[17] The savings presented here differ slightly from results reported in the previous JEC study, primarily due to the addition of another year of data and use of updated PI savings estimates from RAND, see *supra* note 20.

[18] These estimates assume 100 percent of drivers switch to a PPI plan. However, the percent savings is largely insensitive to how many drivers switch. In fact, the RAND analysis indicates that the percent savings actually increases slightly when just 50 percent of drivers switch. See Appendix B.

[19] The RAND study estimates the effect of Auto-Choice based on laws in effect as of 1988. Laws in some states have changed since 1988, potentially affecting the savings estimates. Allan F. Abrahamse and Stephen J. Carroll, *The Effects of a Choice Automobile Insurance Plan Under Consideration by the Joint Economic Committee of the United States Congress* (RAND Institute for Civil Justice, April 1997).

[20] The principal legislative difference from the 1995 study is the requirement that drivers carry supplementary liability coverage, see *infra* note 13. Allan F. Abrahamse and Stephen J. Carroll, *The Effects of a Choice Auto Insurance Plan on Insurance Costs* (RAND Institute for Civil Justice, 1995). In this paper, the term personal injury (PI) refers to liability coverage for bodily injury (BI), medical payments (MP), uninsured motorists (UM), underinsured motorists (UIM), and personal injury protection (PIP).

Table 1. Estimated 1997 savings from an Auto-Choice plan.

	Private	Commercial	Total
Total Auto Insurance Premiums (billions)	$114	$27	$142
Total Liability Premiums (billions)	$74	$20	$94
Total Available Savings if 100% Switch (billions)	$35	$9	$45
Savings	31%	35%	32%
Savings for Low-Income Drivers	48%	--	--
Average Savings per Driver	$243	--	--

Source: Abrahamse and Carroll (1997) and Joint Economic Committee calculations. Totals may not sum due to rounding.

present study arrives at savings figures by first estimating total premiums for 1997 (broken down by personal injury liability and property damage), and then applying the results of the RAND study to the estimated 1997 PI liability premiums. [21]

According to the RAND analysis, Auto-Choice would save close to 63 percent on average for personal injury premiums, which translates to about a 30 percent reduction in overall premiums.[22] It is important to note that the percent savings estimated by RAND are insensitive to the policy decisions made by other drivers. According to Carroll, "the savings that will accrue to a driver who opts for [PPI] are largely independent of the number of other drivers in the state who selected that option." [23] In other words, while the total dollar amount of savings will of course vary depending on the number of drivers who switch to a PPI policy, the percent and average savings, for the most part, do not.

For the average insurance policy, Auto-Choice would save $243. Nationwide, premiums for the average policy with all three lines of insurance (liability, collision, and comprehensive) would drop from the estimated 1997 level of $785 to $542 with Auto-Choice. In many high-liability states, the savings would be significantly greater. New Jersey drivers, who pay the highest insurance rates in the nation, would save an average of $342 a year. Drivers in states such as California, Connecticut, Massachusetts, and New York would all save in excess of $300 a year. A state-by-state breakdown of average premium savings is presented in Table 2.[24]

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[21] Savings for a given year are obtained by following the methodology described in O'Connell, et al. (1996). Historical data for private passenger and conventional commercial premiums from A.M. Best Company Inc. in Insurance Information Institute, *Property/Casualty Insurance Fact Book* (annual). Historical data for commercial self-insured expenditures provided by Conning & Co. (1994 and January 1997).

[22] Average savings in this paper are for 1997, and therefore may differ slightly from the average savings for 1994 presented in Abrahamse and Carroll (1997).

[23] Stephen Carroll, RAND Institute for Civil Justice, Testimony to the Joint Economic Committee (March 19, 1997).

[24] Historical premium data from National Association of Insurance Commissioners, *State Average Expenditures & Premiums for Personal Automobile Insurance* (annual), Table 3.

Table 2. State-by-state 1997 savings from Auto-Choice.

State	Total Savings* (millions)	All Private Drivers*†	Low-Income Drivers*†	1997 Average Premium	**Average Savings*†**
All U.S.	**$44,872**	**31%**	**48%**	**$785**	**$243**
Alabama	$378	19%	37%	$662	**$129**
Alaska	$75	24%	38%	$897	**$214**
Arizona	$830	35%	51%	$839	**$290**
Arkansas	$361	28%	46%	$663	**$184**
California	$5,365	32%	51%	$997	**$323**
Colorado	$670	29%	45%	$844	**$248**
Connecticut	$1,033	42%	60%	$916	**$383**
Delaware	$170	33%	46%	$875	**$289**
Florida	$3,079	36%	51%	$804	**$289**
Georgia	$912	23%	42%	$752	**$170**
Hawaii	$354	44%	57%	$1,090	**$482**
Idaho	$141	26%	43%	$559	**$148**
Illinois	$1,476	25%	43%	$711	**$179**
Indiana	$812	28%	46%	$638	**$180**
Iowa	$387	30%	52%	$512	**$154**
Kansas	$202	16%	28%	$644	**$102**
Kentucky	$324	17%	27%	$733	**$128**
Louisiana	$1,162	44%	62%	$954	**$417**
Maine	$181	31%	50%	$529	**$163**
Maryland	$1,080	34%	51%	$812	**$279**
Massachusetts	$1,899	43%	58%	$950	**$408**
Michigan	$772	14%	25%	$804	**$110**
Minnesota	$1,041	41%	60%	$726	**$296**
Mississippi	$294	25%	45%	$717	**$176**
Missouri	$707	27%	44%	$704	**$188**

* Assumes 100% switch. Based on state laws as of 1988.
† Percent and average savings are relatively insensitive to how many drivers switch. See Appendix B.
Source: Abrahamse and Carroll (1997) and Joint Economic Committee calculations.

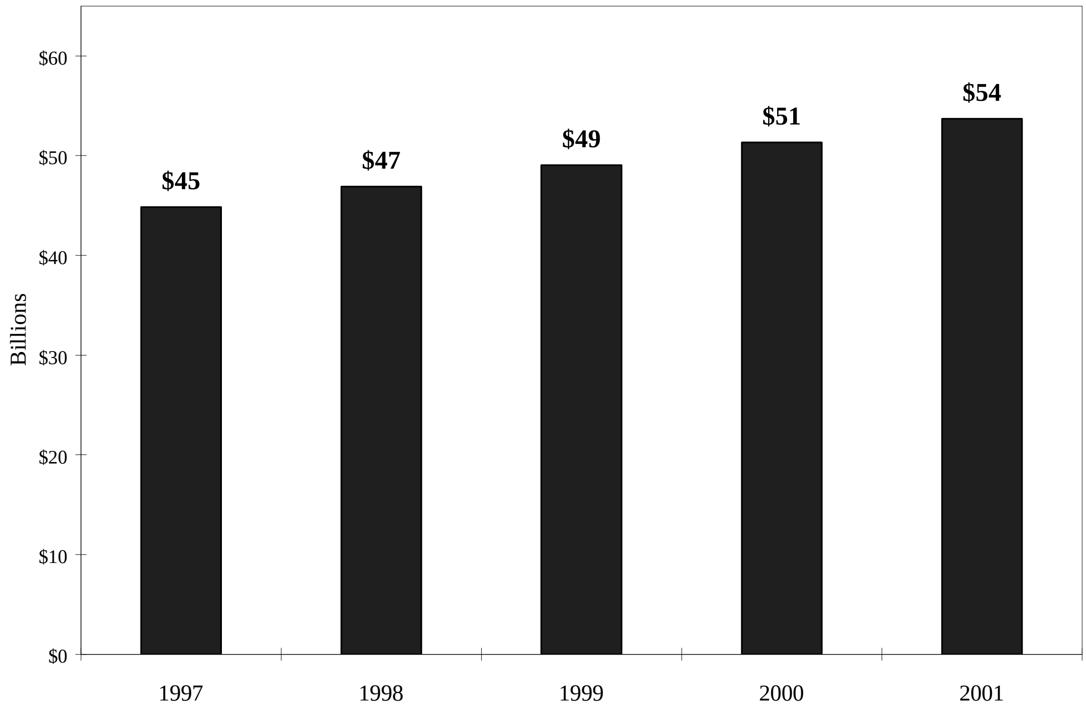
Table 2. State-by-state 1997 savings from Auto-Choice, continued.

State	Total Savings* (millions)	All Private Drivers*†	Low-Income Drivers*†	1997 Average Premium	**Average Savings*†**
Montana	$147	34%	58%	$635	**$215**
Nebraska	$219	26%	47%	$599	**$158**
Nevada	$377	39%	56%	$900	**$347**
New Hampshire	$204	31%	50%	$650	**$200**
New Jersey	$1,948	29%	44%	$1,171	**$342**
New Mexico	$277	32%	51%	$848	**$275**
New York	$3,929	36%	54%	$1,146	**$417**
North Carolina	$1,197	33%	49%	$602	**$200**
North Dakota	$55	18%	33%	$517	**$93**
Ohio	$1,357	27%	43%	$610	**$163**
Oklahoma	$428	27%	44%	$693	**$186**
Oregon	$544	32%	49%	$638	**$205**
Pennsylvania	$2,066	30%	44%	$757	**$227**
Rhode Island	$247	36%	51%	$1,020	**$370**
South Carolina	$506	28%	44%	$668	**$189**
South Dakota	$123	35%	60%	$621	**$220**
Tennessee	$587	23%	41%	$625	**$146**
Texas	$3,326	31%	47%	$857	**$269**
Utah	$272	32%	49%	$663	**$209**
Vermont	$72	24%	41%	$597	**$141**
Virginia	$961	29%	44%	$626	**$184**
Washington	$1,123	38%	55%	$722	**$273**
West Virginia	$377	38%	59%	$834	**$320**
Wisconsin	$765	32%	53%	$573	**$183**
Wyoming	$59	24%	47%	$604	**$148**

* Assumes 100% switch. Based on state laws as of 1988.
† Percent and average savings are relatively insensitive to how many drivers switch. See Appendix B.
Source: Abrahamse and Carroll (1997) and Joint Economic Committee calculations.

Of course, these savings would accrue for as long as individuals chose to insure under an Auto-Choice plan. Total available savings rise from $45 billion in 1997 to $54 billion in 2001 (Figure 2). Over five years, Auto-Choice would make available nearly $246 billion in savings.

Figure 2. Five-year savings from Auto-Choice.



Source: Joint Economic Committee.

While estimated premium savings of 32 percent may seem large, the re sults are conservative in at least two respects.[25] First, the RAND study (upon which these results are based) does not consider savings from collateral sources. By moving auto insurance to a primarily first-party basis, some individuals and businesses would find themselves with more insurance for medical care. Right now, individuals have health insurance and workers compensation to cover their own injuries, and buy auto insurance to cover injuries to other people. However, Auto-Choice would change auto insurance to a primarily first-party system in which an individual's auto insurance would also cover his or her own injuries. Thus, both auto insurance and existing health insurance would provide first-party coverage against personal injury. Additional savings on either auto or health insurance premiums could therefore be realized by eliminating this overlap.

[25] For a further discussion of these issues, see O'Connell et al. (1993), 1039-40; O'Connell et al. (1995), 289; and Abrahamse and Carroll (1995), 27-38.

These estimates also may be understated because they assume no change in claiming behavior. That is, most of the savings are derived from reduced transactions costs and pain and suffering damage awards. One of the fundamental goals of this reform, however, is to address the perverse incentives of the current tort liability system to inflate actual losses. Consequently, substantial savings could be realized with respect to economic compensation that results from unnecessary medical treatment. For example, the 1995 RAND study *The Costs of Excess Medical Claims for Automobile Personal Injuries* estimates that "excess consumption of health care in the auto arena in response to tort liability incentives accounted for about $4 billion [in 1993]." [26] The present study does not account for these potential savings.

Benefits for Low-Income Drivers

One of the most unfortunate aspects of the current insurance system is its regressive nature. Low-income individuals suffer disproportionately under the present system for a number of reasons. First, low-income drivers are often concentrated in urban areas, where liability premiums are already excessively high. Second, the tort litigation system best compensates those people who can wait out a protracted and costly legal process. Low-income individuals, however, generally lack the savings required for an inefficient legal system to compensate them, and thus often have to settle for less than full compensation. Finally, in a third-party liability system, individuals must insure against the other driver's losses, which in effect forces low-income drivers to subsidize high-income drivers. If a low-income driver is in an accident with a high-income driver, the low-income driver could be liable for all the lost wages and income of the injured high-income driver. A more equitable system would allow individuals to insure against their own losses, thus permitting insurance companies to charge premiums that correspond to an individual's actual economic liability.

For these and other reasons, the poor end up spending more of their income on car insurance than higher-income individuals. According to data from the Bureau of Labor Statistics, the wealthiest fifth of households spends 1.4 percent of their household income on vehicle insurance, whereas the poorest fifth spends nearly three times as much, roughly 4.2 percent of their income. [27] Moreover, a separate study of Maricopa County, Arizona found that families living below 50 percent of the poverty line spend nearly one-third (31.6 percent) of their household income on premiums when they purchase auto insurance. [28] Over half (50.9 percent) of the households in the Maricopa County study reported that they had to put off paying for other important expenses in order to meet car insurance payments. The most common purchase that was put off was food, followed by rent or mortgage. It should come as no surprise that when forced to choose between car insurance and basic necessities such as food and shelter, many drivers choose to forego car insurance even though it means breaking the law.

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[26] Stephen Carroll, Allan Abrahamse and Mary Vaiana, *The Costs of Excess Medical Claims for Automobile Personal Injuries* (RAND Institute for Civil Justice, 1995), 23.
[27] JEC calculation based on U.S. Department of Labor, Bureau of Labor Statistics, 1995 Consumer Expenditure Survey, http://stats.bls.gov/blshome.html (January 22, 1997).
[28] Robert Lee Maril, "The Impact of Mandatory Auto Insurance Upon Low Income Residents of Maricopa County, Arizona," unpublished manuscript, 1993.

Auto-Choice makes the auto insurance system more friendly and affordable for low-income drivers. The analysis of Auto-Choice by O'Connell, et al., found that low-income drivers would save significantly more on auto insurance than the average driver. Based on this research, low-income drivers could save an average of 48 percent on their auto insurance premiums.[29] These results are presented in Table 1 and Table 2.

V. CONCLUSION

The auto insurance system in America is in need of reform. The current system is simply unsustainable over the long run because premiums are rising one-and-a-half times faster than inflation; small injuries are overcompensated and serious injuries rarely receive full compensation; and perverse incentives encourage excessive litigation and inflated damage claims.

The proposed Auto-Choice reform would address these concerns. The savings from Auto-Choice are both substantial and well-documented. Auto-Choice would preserve the substance of state law and allow states to pursue their own reform efforts (or even stay with the status quo). Consumers would have more options in choosing an insurance policy that best fits their needs, and would benefit from a system more responsive to those needs. Finally, Auto-Choice would provide substantial relief to low-income and urban drivers who are burdened with excessively high premiums. Auto-Choice is a serious approach to auto insurance reform that focuses on both the needs of consumers and the efficiency of the free market.

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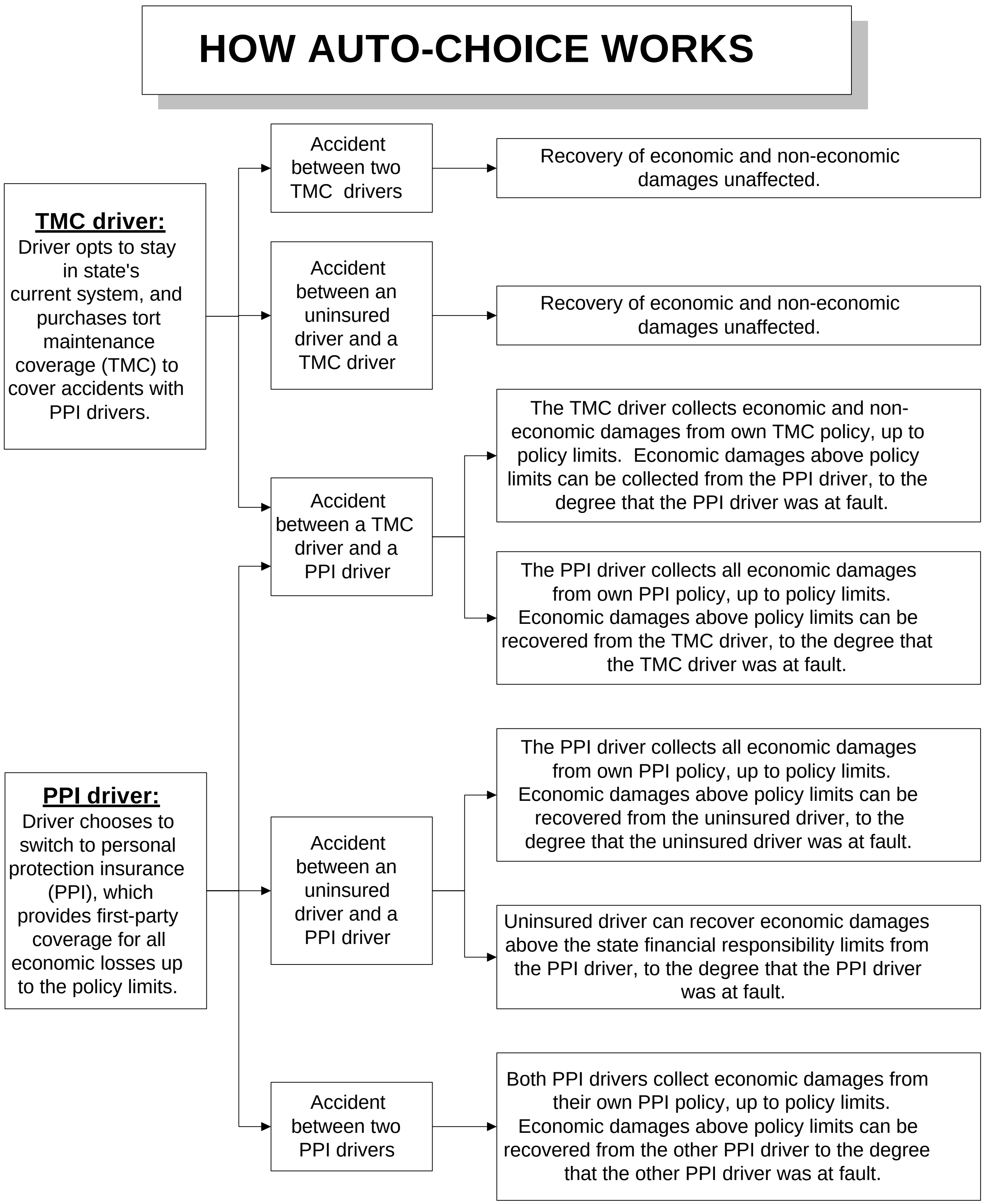
[29] Update based on Abrahamse and Carroll (RAND Institute for Civil Justice, 1997); O'Connell, et al., (1996), Table 3 (column 5); and authors' calculations.

APPENDIX A

This flow chart provides a general overview of how Auto-Choice would function. Specific details of how policies interact depend on state law.



APPENDIX B

The savings estimates presented in Table 1 and Table 2 assume that all currently insured drivers switch to a PPI policy. However, the savings that accrue to individual drivers are for the most part unaffected by changes in the proportion of drivers who switch. Abrahamse and Carroll (1995 and 1997) report that the estimated PI savings from Auto-Choice are largely insensitive to how many drivers switch to a PPI policy. [30] Table 3 compares average savings for private passenger auto insurance assuming all drivers switch and half of drivers switch.

Table 3. Estimated savings assuming 100% and 50% of drivers switch to a PPI policy.

	Savings if 100% Switch		Savings if 50% Switch	
State	Percent	Average	Percent	Average
United States	**31%**	**$243**	**33%**	**$257**
Alabama	19%	$129	22%	$143
Alaska	24%	$214	25%	$220
Arizona	35%	$290	36%	$305
Arkansas	28%	$184	29%	$190
California	32%	$323	34%	$338
Colorado	29%	$248	29%	$247
Connecticut	42%	$383	43%	$396
Delaware	33%	$289	36%	$318
Florida	36%	$289	39%	$311
Georgia	23%	$170	25%	$186
Hawaii	44%	$482	47%	$508
Idaho	26%	$148	28%	$154
Illinois	25%	$179	27%	$190
Indiana	28%	$180	29%	$182
Iowa	30%	$154	31%	$158
Kansas	16%	$102	18%	$114
Kentucky	17%	$128	23%	$165
Louisiana	44%	$417	45%	$432
Maine	31%	$163	31%	$167

Source: Abrahamse and Carroll (April 9, 1997) and JEC calculations. Totals may not sum due to rounding.

[30] For an explanation, see Abrahamse and Carroll (1995), 27-33; and O'Connell et al. (1996), note 86.

Table 3. Estimated savings assuming 100% and 50% of drivers switch to a PPI policy, cont.

	Savings if 100% Switch		Savings if 50% Switch	
State	Percent	Average	Percent	Average
Maryland	34%	$279	38%	$309
Massachusetts	43%	$408	45%	$429
Michigan	14%	$110	14%	$111
Minnesota	41%	$296	41%	$298
Mississippi	25%	$176	26%	$189
Missouri	27%	$188	27%	$192
Montana	34%	$215	34%	$216
Nebraska	26%	$158	27%	$161
Nevada	39%	$347	40%	$358
New Hampshire	31%	$200	32%	$205
New Jersey	29%	$342	29%	$342
New Mexico	32%	$275	33%	$282
New York	36%	$417	37%	$422
North Carolina	33%	$200	34%	$202
North Dakota	18%	$93	19%	$98
Ohio	27%	$163	29%	$179
Oklahoma	27%	$186	29%	$203
Oregon	32%	$205	34%	$214
Pennsylvania	30%	$227	32%	$243
Rhode Island	36%	$370	37%	$379
South Carolina	28%	$189	33%	$222
South Dakota	35%	$220	35%	$220
Tennessee	23%	$146	25%	$154
Texas	31%	$269	35%	$304
Utah	32%	$209	32%	$212
Vermont	24%	$141	26%	$152
Virginia	29%	$184	34%	$210
Washington	38%	$273	39%	$279
West Virginia	38%	$320	39%	$328
Wisconsin	32%	$183	33%	$187
Wyoming	24%	$148	25%	$149

Source: Abrahamse and Carroll (April 9, 1997) and JEC calculations. Totals may not sum due to rounding.

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