Letters

We welcome letters from readers, particularly commentaries that reflect upon or take issue with material we have published. The writer's name, affiliation, address, and telephone number should be included. Because of space limitations, letters are subject to abridgment.

Choices in Medical Insurance

TO THE EDITOR:

Simon Rottenberg's article on medical insurance ("Unintended Consequences: The Probable Effects of Mandated Medical Insurance," *Regulation*, Vol. 13, No. 2, 1990) correctly points out that four out of five of the uninsured have a direct link to someone in the labor force. This suggests that the source of the problem lies in the medical care marketplace itself. Full-time workers and their families should be able to afford basic, no-frills medical insurance policies with coverage for catastrophic and major medical expenses. Unfortunately, it appears that these workers have been priced out of the market for medical insurance by federal and state policies that provide tax incentives for some, but not all, workers and that require workers to pay for coverage that they may not want or need. Both of these problems must be addressed to remedy the current situation.

Many experts attribute the difficulty that small business employees encounter in obtaining medical insurance to the proliferation of state mandates on consumers. While Professor Rottenberg mentions the role state insurance mandates play in this area, he does not make his case forcefully enough.

Mandates are nothing more than concessions to special interests looking to coerce millions of consumers into purchasing coverage for specific diseases or health services, whether they want that coverage or not. John Goodman of the National Center for Policy Analysis in Dallas (NCPA), who has done more than anyone else to alert Congress to the negative effects of mandates, found that the total number of mandates exploded from 30 in 1970 to about 700 in 1988. In 1989 this trend continued, as state legislatures added an additional 60 mandates.

What has been the result of all these mandates? Unfortunately, millions of hard-working Americans have discovered that the cost of even the most basic medical insurance policy is beyond their reach. The NCPA estimates that 32 percent of the 5 million Californians who were without medical insurance in 1986 were priced out of the marketplace by state mandates. In some states as many as 60 percent of the uninsured are the victims of mandates. Nationwide, up to one quarter of the uninsured—9.3 million in all—would be able to afford basic, no-frills medical insurance if some or all of these mandates were repealed.

The states have begun to realize the enormous cost of this approach. For example, several states now require the proponents of new mandates to demonstrate that the benefits exceed the costs. That burden has proven to be so overwhelming that the state of Washington has rejected every single proposed mandate since the law went into effect in 1983. Hawaii requires a social and financial impact statement before the passage of new mandates.

Measures pending in Rhode Island and Virginia go even further. The Rhode Island proposal, recently approved by the state legislature, would establish a 30-month experimental program that would allow insurers to sell no-frills health insurance plans that are exempt from state insurance mandates. These plans would include coverage for 20 days of inpatient and outpatient care, including surgery and anesthesia, preadmission testing, radiation therapy, and chemotherapy. The sponsor of the plan, Sen. James Donelan, estimates that it would reduce medical insurance premiums by 50 percent.

In Virginia a proposal would allow insurers to market mandate-exempt policies to businesses with fewer than 50 employees. This has prompted Blue Cross & Blue Shield of Virginia to offer a no-frills policy for an adult with one child that would cover 30 days of hospitalization and preventive care at an annual cost of $1,644, about *half* the $3,168 it now costs to purchase a standard major medical policy in Virginia.

By driving up the minimum cost of medical insurance policies, these mandates have forced millions of insurable Americans out of the marketplace entirely. Professor Rottenberg is entirely correct. It is the obligation of government to offer consumers a choice in the purchase of health insurance; no person should be forced to pay for coverage that he does not want.

In addition, Professor Rottenberg's analysis would be strengthened by a brief discussion of how the federal tax code contributes to the problem of the uninsured. Under current law, a large employer can bypass all state mandates simply by self-insuring under the Employee Retirement Income Security Act, which entitles employees to receive an unlimited package of health benefits on a tax-free basis. Estimates of the average annual value of this benefit vary, but appear to be close to $2,750 per employee. As one might expect, the cost of these plans has skyrocketed; Foster Higgins estimates that the average cost of employer medical plans increased 20.4 percent in 1989 alone. In some industries the average cost per employee now exceeds $3,300 per year.

As we all know, many companies provide their employees with complete, first dollar coverage for a wide array of benefits; in fact, last year the single greatest obstacle to a settlement in the strikes against the regional Bell operating companies was the nature and extent of the employees' medical benefits package. In one instance union negotiators accepted a cut of $125 million in wages and other benefits in exchange for continued first dollar medical insurance coverage.

Sophisticated union negotiators

would not sacrifice substantial salary gains if there were some sort of ceiling on the tax exclusion for employer-provided benefits. As Professor Rottenberg points out, the availability of unlimited health coverage has seduced most employees in self-insured firms to shift compensation away from salary and to accept enhanced medical benefits packages in its stead. In fact, employer contributions for group medical insurance increased from only .8 percent of the employee's compensation in 1955 to 5.1 percent in 1987. According to the House Ways and Means Committee, the value of the tax exemption for employer-provided coverage will exceed $50 billion by 1994.

Thus, employees in large, self-insured firms receive generous tax subsidies for unlimited, gold-plated coverage, while their counterparts in small firms enjoy no comparable incentives and must purchase coverage with after-tax dollars.

Last year, the Congressional Budget Office (CBO) estimated the revenue effects of a rather generous ceiling of $3,000 per employee per year for family coverage and $1,200 per employee per year for individual coverage. It found that this change would increase federal revenues by $60.5 billion over five years, and by more than $20 billion in 1994 alone. CBO speculated that such a reform would discourage workers from demanding additional coverage beyond the ceiling. "Without such coverage," CBO included, "there would be stronger incentives to economize in the medical marketplace, thereby reducing upward pressure on medical care prices."

In my view, it is the obligation of the federal government to guarantee that all full-time workers, even those with earnings at or slightly above the minimum wage, can afford basic insurance coverage for themselves and their families. If governmental intrusions into the marketplace raise the cost of medical care and insurance to an unacceptable and unaffordable level, as I believe they have, it is the obligation of Congress to eliminate these distortions and to restore the integrity of the free market.

A comprehensive solution should guarantee that the tax code provides adequate incentives to working persons who want to purchase medical insurance and do not receive this benefit from their employers. It should also encourage relatives to help less fortunate family members to purchase insurance.

These tax incentives should not be unlimited. Thus, the tax code should provide generous incentives for the purchase of no-frills, major medical coverage, but the incentive should stop there. The unlimited nature of the tax exemption for employer-provided medical benefits encourages employees to use medical services that they may not need and regardless of their cost. This, in turn, fuels the inflationary spiral of medical care, which has increased at twice the rate of inflation for most of the past three decades. Our tax code should not further encourage this trend.

To make such a ceiling attractive to taxpayers, employers would be required to offer employees the option of receiving the taxable portion of their package as additional salary in exchange for reduced coverage.

Employees who work for small firms and the self-employed comprise a disproportionately large share of the uninsured population. The tax code should provide them with an incentive to purchase medical coverage that approximates the incentive available to those who work for the larger, self-insured employers. The ability to obtain affordable medical insurance, in other words, should not be a function of an individual's employment setting. Thus, a comprehensive, market-based initiative to expand the availability of medical insurance must also include a tax credit for the purchase of no-frills policies with coverage for major medical emergencies and high deductibles.

In addition, it is essential that our tax code provide strong incentives for taxpayers to self-insure for small, out-of-pocket expenses through a device similar to an Individual Retirement Account. Such an account would permit taxpayers to receive a tax credit for contributions to a savings account with interest accruing on a tax-free basis, provided that withdrawals are used for eligible medical expenses. This credit would be available to *all* taxpayers, even those who receive their medical coverage through their employers.

Medical IRAs are important because they enable consumers to purchase policies with higher deductibles, and thus lower their premiums and enhance their ability to control health expenditures. The proliferation of low deductible policies—and Messrs. Kennedy and Waxman's attempt to codify their existence in the Basic Health Benefits for All Americans Act—shifts the responsibility for predictable and recurring expenditures to third-party insurers. In many high-cost areas, asking insurers or employers to provide policies with low deductibles is asking them to insure noninsurable events. The more that consumers police their own medical care expenditures, the more likely it is that we can restrain the annual double-digit increases in the cost of hospital and physician care.

My proposed solution contains the following provisions:

- Create a federal option to state insurance mandates with respect to (1) diseases and disabilities, (2) medical services, (3) types of health care providers and provider organizations, and (4) maximum or minimum levels of deductibles, coinsurance payments, or payment rates. State insurance mandates have priced too many workers out of the medical insurance marketplace. Consumers should not have to pay for coverage they do not want.

- Establish a tax credit for the purchase of no-frills medical insurance policies. The credit would be refundable to low-income taxpayers and would be set according to the age of the taxpayer. Its size would approximate the cost of a no-frills medical insurance policy with a high deductible in a medium-cost state. For individuals who want to assist less fortunate relatives, the dependent support test would be waived.

- Create medical care savings accounts. To encourage taxpayers to self-insure for small, out-of-pocket medical expenses, my bill will offer taxpayers a second tax credit for contributions to an account similar in concept to an Individual Retirement Account. Interest would accumulate on a tax-free basis so long as the taxpayer uses the proceeds for eligible medical expenses. Only taxpayers who have purchased medical insurance would be eligible to take advantage of this device.

- Enable employees who receive health benefits from their employers to trade any unwanted benefits

for additional salary. By placing a ceiling on the tax subsidy for employer-provided health benefits, my bill will enable employees who receive unwanted coverage to accept a scaled-back package of benefits in exchange for additional salary. The federal government should not underwrite the cost of unnecessary or frivolous insurance coverage.

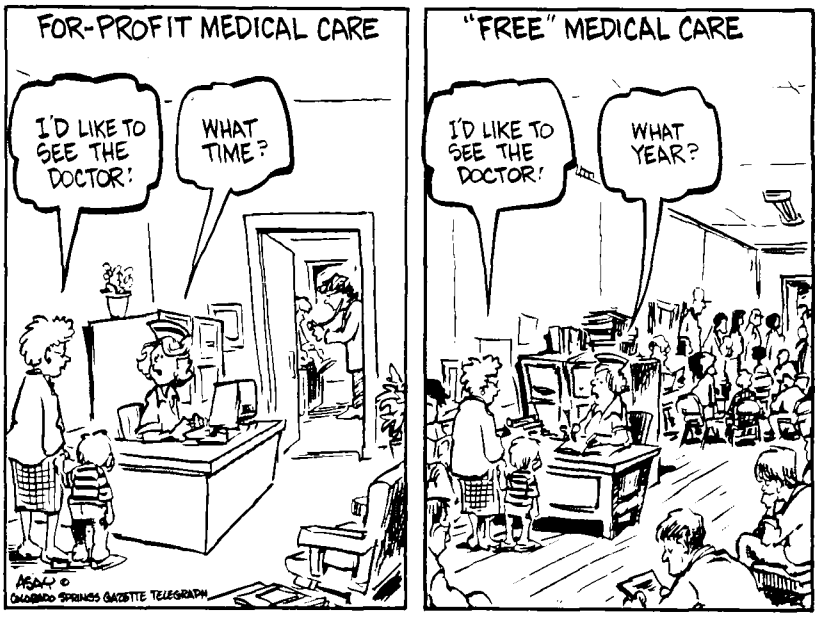
• Enable prospective patients to learn the estimated cost of any nonemergency hospital services before receiving them. Upon request, hospitals would have to provide patients with a good-faith estimate of the charges likely to be assessed for hospital, physician, and other forseeable services. Patients would also be told the success rates for contemplated procedures as well as the availability of nonsurgical alternative treatments. In advance of a hospital stay, patients should be entitled to learn that hospital *A* charges $6,000 for a hernia operation, hospital *B* charges $4,500, and hospital *C* charges only $2,500. Greater consumer knowledge of medical care costs should benefit consumers and limit the steady double-digit increases in the cost of health care.

To provide low-income families with the same tax benefits as more affluent families, both tax credits mentioned above would be "refundable." This means that a family with a tax liability that is less than the value of the credit would receive money back from the IRS.

The above proposal should be revenue neutral: it should neither increase nor decrease federal tax revenues. We must recognize that, from a federal budgetary perspective, we are living in lean times. Reducing the deficit must be a paramount concern in our attempts to provide insurance to the 37 million Americans who lack it.

The "Choices in Medical Insurance" approach outlined above would recognize the central role that the free market plays in creating wealth and allocating resources among competing needs. The federal government should adopt an internally consistent policy that encourages individuals to purchase medical insurance, but at the same time rewards them for making prudent decisions with their medical care dollars. I believe that my approach represents a positive step in that direction.

William E. Dannemeyer
Member of Congress
Washington, D.C.



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Soaking the Poor

TO THE EDITOR:

The unintended consequences of mandated medical insurance that Simon Rottenberg outlined ("Unintended Consequences: The Probable Effects of Mandated Medical Insurance, *Regulation*, Vol. 13, No. 2, 1990) are the inevitable result of the faulty assumptions on which the Kennedy-Waxman approach is based. Proponents of mandates assume that employers are wealthy, employees are poor, and the only reason wealthy employers do not provide health insurance to poor employees is greed.

A more appropriate analytic model, though still overly simplistic, finds relatively wealthy and relatively poor employers as well as relatively wealthy and relatively poor employees. The problem for Kennedy-Waxman is that relatively wealthy employers tend to be matched with relatively wealthy employees and vice versa. Those matches imply that employees of relatively successful businesses will have health insurance benefits and employees of relatively unsuccessful (or not yet successful) businesses will not. For example, data collected earlier this year by the NFIB Foundation discovered—surprise! surprise!—that business income was directly related to sponsorship of employee health insurance. Just over 20 percent of small employers earning less than $10,000 from their businesses—$10,000, that is not a misprint—sponsored an employee health plan. The percent sponsoring a plan rose like stair steps with each $10,000 increment of business income. At the top, about 95 percent of those small employers who took $70,000 or more from their businesses in 1989 sponsored an employee plan.

The Kennedy-Waxman proposal attempts to transfer wealth from relatively poor employers to relatively poor employees. If a relatively poor employer cannot cough up this regressive tax—and a tax it surely is—then relatively poor employees have the privilege of paying it in the form of lost jobs, fewer hours, etc. This "soak-the-poor" philosophy seems at odds with Kennedy-Waxman rhetoric, but then it is the direct result of analytic assumptions that should have died long ago.

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A National Dilemma

TO THE EDITOR:

This is in response to Professor Simon Rottenberg's article "Unintended Consequences: The Probable Effects of Mandated Medical Insurance," *Regulation*, Vol. 13, No. 2, 1990). Professor Rottenberg's article showed tremendous insight and expertise on the issue of mandated benefits.

The issue of health care reform is often clouded by the questions: Do we have a right to medical insurance? Or is medical insurance a privilege? And whose responsibility is it to provide medical insurance? Regardless of the answer, what is important is that all Americans have access to health care.

Access to health care, however, must be available in a free market system with minimal government intervention. The professional agent and the insuring industry play a vital role in educating the consuming public and in the delivery of products and services.

We must take care to avoid a system of rank and privilege such as Great Britain has created, where only the wealthy can afford private hospitals and where personal doctors are on retainer. Also, a system of rationed care, as practiced in Canada, can give certain members of society priorities on high technology medical procedures.

If a person must wait months or years to become eligible for surgery or treatment that could save his life now, how does this differ from being uninsured? If benefits are not available when needed, then why have coverage at all, especially coverage for which significant personal taxes have been levied.

The National Association of Health Underwriters believes that individuals and not the government should make the choices and take responsibility for health care. We support a combination private/public solution with appropriate accountability and free market diversity. Only a solution based on proper private-sector incentives will ultimately achieve a viable and affordable long-term solution to this national dilemma.

Vince Lombardo
Communication Chair
National Association of Health Underwriters Legislative Council
Washington, D.C.

A Regressive Tax

TO THE EDITOR:

Simon Rottenberg's article on mandated medical insurance "Unintended Consequences: The Probable Effects of Mandated Medical Insurance," *Regulation*, Vol. 13, No. 2, 1990) was very well done.

What is generally not recognized is that mandated medical insurance is a regressive tax on the employee's wages.

Social Security, worker's compensation, and unemployment compensation all represent a uniform percentage tax upon employment. But the cost of mandated medical insurance, as a percentage of salary, increases as the value of the worker decreases.

In 1989 the average cost of group medical insurance in America was $2,748 per employee. If the employer had paid 80 percent as Kennedy-Waxman would require, that cost to the employer would have been $2,200 per employee—7 percent of compensation for an employee earning $30,000 but 21 percent of annual compensation for an employee earning $5 per hour, and 31 percent of the 1989 minimum wage.

At the current rate of cost increase for medical insurance, the average cost of group coverage in 1990 will be more than $3,100 per employee. The 80 percent required by Kennedy-Waxman will be $2,500, more than $200 per month per employee.

If employers are at all rational in how they spend their money, mandated medical insurance makes it even more irrational to carry the marginal employee on the payroll. The small employer is especially responsive to these kinds of disincentives. "Mom and Pop" simply resolve to sweep the place out themselves, instead of paying that high school dropout.

Instead of calling the Kennedy-Waxman measure the Minimum Health Benefits for All Workers Act, it can be retitled the "Increase Unskilled Workers' Unemployment Act" or the "Increase Crime in the Inner Cities Act," for the idle unemployed generate a major share of our nation's crime.

In the case of the minimum wage, inflation has acted to minimize the damaging effect, for each year inflation reduces the real minimum wage. There is nothing to similarly ameliorate the damaging impact of a regressive payroll tax for medical benefits.

In fact, the opposite is true, for the cost of medical insurance has been increasing on the average of four times the rate of the CPI. In 1989 the average medical insurance cost increased 20.4 percent with the CPI at 4.8 percent.

Nor will its effect in increasing unemployment be a passing phenomenon. Because the regressive tax is a continuing disincentive to the employment of marginal workers, its effect will continue and will get worse as the cost of medical insurance continues to climb at four times the CPI.

It is likely that political realities will intervene to exempt the smallest firms from the mandated benefits requirement, which is what occurred in Massachusetts when the Dukakis administration got mandated medical insurance passed in 1988—passed but never put into effect.

The Massachusetts bill exempted employers with fewer than six workers. That means that the real cost to hire the sixth worker is not wages, nor wages plus health benefits, but wages plus medical benefits for six. At $2,500 each, that is $15,000 in medical benefit cost connected with hiring the sixth worker.

America does have a program for the uninsured. The program is simply not what a lot of people prefer. The program that exists is a variety of government welfare programs to assist the uninsured, and it is cost shifting.

Hospitals do not like cost shifting. Yet, the fact is that hospitals have never been so prosperous as they are today.

Cost shifting is a minor unpleasantness. But it is not a disaster, and it has not brought America's engine of growth to a halt. Cost shifting has not caused small businesses to stop their growth rather than to hire that sixth worker, and it has not increased the unemployment rate.

The Kennedy-Waxman bill to "Increase Unemployment" is the best we could concoct to do damage to the nation's growth engine and to increase unemployment among the least skilled.

J. Patrick Rooney
Chairman of the Board
Golden Rule Insurance Company
Indianapolis, Ind.

Regulatory Snipping

TO THE EDITOR:

Kathleen Utgoff is to be applauded for drawing attention to the untenable situation in which pension plan sponsors have been placed ("The Proliferation of Pension Regulations," *Regulation*, Vol. 13, No. 2, 1990). Companies still want to offer pension plans, but, as Ms. Utgoff points out, more and more frequently they are forced to conclude that the price they must pay is excessive. This is particularly true of smaller firms. A business owner who sees that he must pay to actuaries, attorneys, and consultants the dollars that he would like to set aside for his employees is inclined to wonder why Congress is working so hard to discourage plan formation.

With rules changing—always in the direction of complexity—every year, neither businesses nor workers can plan intelligently for the future. The quest to generate tax revenue and the use of pension law as an income redistribution tool have obscured what ought to be a basic social policy goal: ensuring that American workers and their families can face retirement without a precipitous drop in their standard of living.

The U.S. Chamber of Commerce seconds Ms. Utgoff's call to "stop pruning the trees and look at the forest." An aging population needs greater retirement income security, not less, and business needs incentives to provide a significant portion of that security. Legislative and regulatory snipping, complicating, and micro-managing are clearly not the answer.

Lisa M. Sprague
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U.S. Chamber of Commerce
Washington, D.C.

A More Subtle Understanding?

TO THE EDITOR:

Insurance industry consultant Benjamin Zycher's analysis of the liability insurance crisis and Proposition 103—the landmark insurance reform initiative passed by California voters in November 1988—("Automobile Insurance Regulation, Direct Democracy, and the Interests of Consumers," *Regulation*, Vol. 13, No. 2, 1990) is a confused collection of ideological contradictions, dubious statistics, misrepresentations, and falsehoods that ill serves the readers of *Regulation*. Indeed, the liability insurance issue is one that mandates a more subtle understanding of the industry, as a few reflections on Zycher's article reveal.

Zycher prefaces his critique of insurance regulation by noting increases in medical care and litigation costs that, he suggests, account for the skyrocketing rate increases that energized Proposition 103's passage. But in his blizzard of statistics, Zycher leaves out the most relevant one: increases in auto, homeowner, and business insurance rates outdistanced the CPI increases in component costs by more than 20 percent between 1985 and 1987.

What explains the difference? Even industry experts now admit that insurance rates were inflated during those years to offset lower profits caused by poor investment decisions and a falling interest rate in the early 1980s—economic realities that have nothing to do with insurance claims.

Relying on an erroneous and discredited study trumpeted by the insurance industry during its $80 million campaign against Proposition 103, Zycher also criticizes the elimination of the territorial rating system, under which insurers base premiums on a motorist's zip code.

Rather than delegate underwriting decisions to the Postal Service, Proposition 103 requires insurers to base premiums primarily upon a motorist's safety record and driving habits—factors that, contrary to Zycher's statement, are a better predictor of risk of loss than one's zip code. This provision of Proposition 103 corrects a long-standing practice rooted in overt discrimination against members of certain religions, women, minorities, the poor, and immigrants—often categorized as "unacceptable risks" by insurers and denied insurance, even though they would qualify as good drivers.

Perhaps most surprising, Zycher defends industry practices that would revolt any true advocate of free-market economics.

In repealing the insurance industry's exemption from the antitrust laws, Proposition 103 outlawed the standard industry practice of circulating price, expense, and anticipated loss data among insurers (consumers were never permitted to obtain the information), which inevitably led to the kind of anticompetitive practices that the antitrust laws are designed to prohibit.

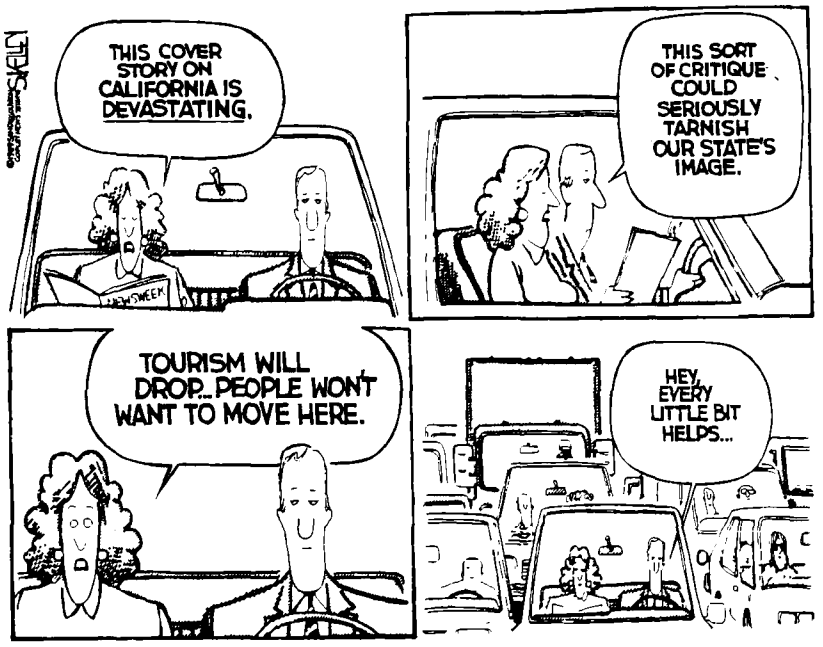
Zycher feebly attempts to justify the antitrust exemption for insurers by claiming that it helped small insurers to compete. (In fact, Proposition 103 specifically permits insurers to share *historical* loss data, which is what the minor insurers most need). But why do certain members of one industry deserve exemption from the antimonopoly laws applicable to every other commercial enterprise in the nation?

Finally, Zycher fabricates a quotation from me to suggest that Proposition 103's 20 percent rollback was arbitrary and hence unjustified. In fact, the California insurance commissioner—an opponent of Proposition 103—has already called for over $1 billion in rollbacks, based on hearings that detailed the industry's enormous waste, inefficiency, inflated reserves, and surplus, and artificial accounting practices—the product of years of insulation from either competition or regulation. A study recently released by the California attorney general concludes that a 20 percent rate rollback—or more—is justified for most California auto insurers.

Zycher's readers may share his antipathy to government regulation. But why should motorists in California and elsewhere be *forced* to buy a product—an auto insurance policy, on pain of fines and a jail term—that is deliberately overpriced to offset investment losses for which the consumer is not responsible?

Zycher suggests that the voters do not have the right to insist on standards of fairness, full disclosure, and greater accountability from those corporations granted the privilege of selling us insurance. The only folks I know who agree with Zycher on this point are the insurance companies that employ him.

Harvey Rosenfield
Chairman
Voter Revolt
Los Angeles, Calif.



Drawing by Skelley, Copley News Service

Setting the Record Straight

ZYCHER responds:

I am shocked. The editors of *Regulation,* upon the editorial advisory board of which I am privileged to sit, have allowed some imposter to sign the above letter with the name of Harvey Rosenfield, chairman of California's own Voter Revolt, champion of hapless consumers, and Johnny Appleseed of money trees for all. The real Harvey Rosenfield, the one that we have come to know and love, would never allow his name to grace arguments so old, so tired, so worn out, and so devoid of analytic content. The real Harvey Rosenfield—leftist, corporation basher, Ralph Nader-in-Training—would have had a much better go at my article.

Well, wait a minute. There *is* the possibility that Harvey is just a bit past his prime, like the old prizefighter who cannot hear the bell or see his opponent, but who still straps on the old gloves for a little shadow boxing before some coyotes howling at the full moon. And—let's face it—Harvey's self-confidence probably was not enhanced by the recent trouncing given his anointed candidate for insurance commissioner, the ineffable Conway Collis. The voters can be so fickle. And come to think of it, the letter *does* contain some telltale signs—some fingerprints, if you will—of the real Harvey Rosenfield. To wit:

• *Innuendo.* For reasons both crude and subtle, Rosenfield seems incapable of writing my name without the preceding phrase "insurance industry consultant." As an aside, that characterization is laughable, since my "consulting" for the insurance industry comprises all of two items: a detailed rebuttal of a sophomoric attorney general "study" submitted to the insurance commissioner, and editing of a paper presented at an industry conference. In any event, this attempt by Rosenfield to avoid the analytic issues is an example of a time-honored tactic used by the Nader crowd to cut off debate before it begins. They love to insinuate that anyone in disagreement with their viewpoint has a crass vested interest. What Rosenfield will never publicize is his own use of real, full-time, insurance industry consultants who, for whatever reasons, are willing to sign off on positions adopted by Rosenfield. And, oops, did Harvey forget to mention the depths to which he and his mentor, the great Ralph Nader, have their snouts imbedded in the trial lawyers' trough? For details, dear readers, take a look at the September 17 issue of *Forbes* and the September issue of *The American Spectator.* Suffice it to say that when it comes to dishonesty in defense of a vested interest, Rosenfield and Nader take a back seat to no one. Nonetheless, you will search my article in vain for references to such matters, for they have nothing to do with the substance of the issues. Rosenfield has not a clue as to how to do rigorous, substantive analysis, and so he retreats to such irrelevance.

• *Ignorance.* Rosenfield consistently displays the mind-set of an old-fashioned bureaucrat attempting to implement price controls and wondering why they never work. After all, should prices of goods not be determined by the accounting prices of component inputs? Well, no, Harvey, for all kinds of reasons, but let us focus here on your silly comparison of insurance rates and the CPI for component costs. Such sector-specific CPI data abstract from changes in the mix of inputs—medical care, property repair, litigation, etc.—that together make up the changing basket of insurance services over time. Suppose, for example, that an "average" claim comprises one $1,000 medical cost and one $500 repair cost. Thus, an average claim is expected to cost $1,500. Let there be no changes whatever in the CPI for either medical care or auto repair; but suppose the average claim now shifts to, say, 1.5 medical costs and .5 repair costs. Guess what, Harvey: the average claim now costs $1,750 despite the fact that the CPI has not changed at all. I admit that I had to explain this to my daughter twice before she understood it. Of course, she is only ten years old.

Moreover, if the medical care CPI is rising faster than the auto repair CPI, a spending shift toward medical care can raise insurance costs faster than the average rise in the component CPIs. In simple terms, Rosenfield just does not understand the difference between a weighted and an unweighted average; that the California insurance market must undergo its current agony because of his ignorance is appalling. And Rosenfield's obsession with component CPI changes abstracts from the implicit California Automobile Assigned Risk Plan subsidy so beloved by him and his "consumerist" allies; precisely where, sir, does that show up in the CPI data? Moreover, insurance rates must be determined by expected costs rather than by historical costs reported by the CPI. It would be easy to go on, but you get

the idea: Rosenfield has not an inkling with respect to his ignorance of price determination in markets.

● *Stupidity.* Apparently, Rosenfield really believes that investment losses are the source of rising insurance rates. But if a firm could make more money by raising its rates, why wait? Why not raise them regardless of investment performance? The flip side of Rosenfield's argument is equally silly: if an insurer finds a pot of gold (i.e., its investments do well), it will lower its rates. In truth, market forces will force prices down by the *expected*—not actual—returns to investments made with policyholders' premiums. If a company earned an unusually large amount on investments, it would have no incentive simply to give the wealth to policyholders rather than to shareholders. It would be equivalent to a discovery by the company president of a cache of gold in the basement. Similarly, investment losses are analogous to those due to a burglary of company offices: they affect neither the demand for nor the marginal cost of insurance. If a company tried to recoup investment losses by raising premiums, consumers would flee to competitors.

The upshot of this comic-book view of market behavior is infinite heterogeneity in prices for identical insurance services, that is, after controlling for often subtle differences in the quality of the product. Can anyone possibly believe in the viability of such a pricing outcome? Unsurprisingly, Rosenfield does, just as he seems to believe that a given driver represents an identical risk regardless of whether he lives in central Los Angeles or some rural county. As far as the purported "discrimination" against Rosenfield's constituencies is concerned, why was there not massive entry by greedy insurers anxious to offset their investment losses by selling expensive insurance to "good drivers" denied coverage by others?

● *Dishonesty.* Rosenfield's predictable response to that question is "collusion." After all this time—and despite the decades-old proscription on collusion in the California Insurance Code—Rosenfield still wants to argue that the antitrust "exemption" removed by Proposition 103 allowed insurers to collude. I will not repeat here the discussion in my article about why that is not true. The more relevant point is the impossibility of a successful collusive agreement among hundreds of firms, with thousands of additional potential entrants. And Rosenfield seems to believe that endless repetition of assertions about waste, inefficiency, and "artificial" accounting is a substitute for evidence. And by "evidence" I do not mean Rosenfield's infantile comparisons between insurance companies and public utilities. Give us some real evidence, Harvey. If the industry is so inefficient, why is takeover activity not rampant? And if the industry is both inefficient and "obscenely" profitable, why has there not been massive entry?

When it comes to Rosenfield and dishonesty, well, *abbondanza!* Such is the only possible response to his insinuation that the insurers were the proponents of the disastrous mandatory insurance law. The plain truth is that the insurance companies opposed the law passed in 1987 just as they had opposed similar proposals for years beforehand. The truth is that the law was pushed and ultimately passed on the efforts of Senator Alan Robbins, a strong and vocal *supporter* of Proposition 103. This dishonesty is reflected as well by Rosenfield's attempt to characterize his statement to Assemblywoman Cathie Wright—that the 20 percent figure for the rollbacks was included in Proposition 103 because "it sounded good"—as a fabrication. Well, Rosenfield can deny that statement all he wants, but the assemblywoman told me personally that he said it to her directly in response to a question about the origin of the 20 percent figure. We can believe either Rosenfield or her; forgive me, but I'll go with the lady.

Benjamin Zycher
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