Quantifying the Premium Externality of the Uninsured

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Abstract
In insurance markets, the uninsured can generate a negative externality on the insured, leading insurance companies to charge higher premia. Using a novel panel data set and a staggered policy change that introduces exogenous variation in the rate of uninsured drivers at the county level in California, we find that uninsured drivers lead to higher insurance premia: a 1 percentage point increase in the rate of uninsured drivers raises premia by roughly 1%. We calculate the monetary fine on the uninsured that would fully internalize the externality and conclude that actual fines in most US states are inefficiently low. (JEL: G22, H23)

Keywords: Insurance, externality, uninsured, Pigouvian tax.

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