A Brief Analysis of the Anderson Economic Group report, *Impact of Proposed "PIP Choice" Law in Michigan*

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September 29, 2011

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I. Introduction

Anderson Economic Group (AEG) recently released a study entitled *Impact of Proposed "PIP Choice" Law in Michigan: The Potential Effects of Changes to Personal Injury Protection Liability Law.*[1] The report claims that enacting legislation that, by its own calculation, would reduce insurance premiums by between $709 million and $1 trillion, would result in a loss of output of $209 million, a loss of between $71 million and $155 million in earnings, and between 2,556 and 5,191 jobs.

This finding is inconsistent with standard economic theory. The reduction in insurance premiums that is not in question would reduce the cost of producing all goods and services that require the use of a car or truck. This reduction in cost would lead to an increase in output, increased employment, and increase earnings, just the opposite of the AEG conclusion.[2]

There is no economic reasoning given in the AEG report for its anomalous results. The authors arrive at their conclusion by estimating the decline in spending on health care for victims of catastrophic auto accidents that would occur if the legislature enacted auto insurance reform in Michigan. They then use multipliers from what is known as an input-output model provided by the U.S. Bureau of Economic Analysis, RIMS (II), to determine what the reduction in other components of the Michigan economy would be from this reduced expenditure.

Their results are driven completely by the fact that any input-output model will show a decline in regional economic activity if you reduce economic activity in any industry category. These models are not designed to look at the effect of a reduction in the cost of production. In fact, the AEG report specifically states that since the reduced auto insurance premiums "return to households, there is no additional output."[3] Table 10 of the report includes the number "$0" as the estimated economic impact on output in Michigan due to reduced insurance premiums. Thus the authors, by plugging in their estimated reduction in health care spending caused by the

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[1] Erin Agemy and Alex Rosean, entitled *Impact of Proposed "PIP Choice" Law in Michigan: The Potential Effects of Changes to Person Injury Protection Liability Law*, Anderson Economic Group, East Lansing, MI, August 26, 2011.
[2] See any standard microeconomics text for a discussion of the effect of the reduction in cost of production, for example, R. Pindyck and D. Rubinfeld, Microeconomics, 6th edition, (Upper Saddle River; Pearson, 2005).Chp. 7.
[3] Anderson Economic Group, pg. 23.

proposed auto-insurance reform into the RIMS (II) model get reductions in employment, output, and earnings. Basic economic principles indicate that input-output analysis is not appropriate for addressing the effects of reducing the cost of production and improving the incentives of the health care community that would be the result of eliminating the requirement that drivers purchase unlimited PIP protection.

The effect of proposed legislation, which would allow consumers in Michigan some choice in the amount of personal injury protection (PIP) they purchase, is more likely to result in increases in economic activity than any decline. Professor Sharon Tennyson of Cornell University in a recent study argues that the increased spending on auto-insurance-covered health care "is creating a fiscally unsustainable situation that presents a real threat to the economic well-being of the state, as the premium payments to cover the cost will become a greater percentage of consumer and business spending."[4] Tennyson's conclusion is the opposite conclusion of the AEG report and is consistent with economic theory.

II. Michigan's High Insurance Premiums and Unlimited PIP

There are numerous studies that demonstrate the high cost of auto-insurance in Michigan. For example, a 2010 RAND Corporation study by economist Paul Heaton found that "(I)n 2007, average total auto insurance premiums in Michigan were 17 percent higher than those in the rest of the country ($928 versus $795)."[5] Tennyson's 2011 study, using NAIC data, found that Michigan's average insurance premiums grew 30.5% from 1997 to 2007, while nationally average premiums rose by 13.7%. This raised Michigan from the 18th highest premiums to 11th highest.

Authors have found that the requirement that all drivers have unlimited personal injury protection is a major driver of health care costs. The Insurance Information Institute President testified before the Michigan House Insurance Committee in 2009 that Michigan's high insurance premiums are being driven by rising medical costs associated with auto accidents.[6] The Heaton study found that it costs 57% more to settle a Michigan claim for personal injury than it would in any other state and that Michigan injury losses per insured vehicle were 40% higher than the same injury in any other state.

Tennyson found the same result. In 2010, the average cost per no-fault claim in Michigan, $35,446, was more than double the average cost in the next highest state, New Jersey, where it

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[4] Sharon Tennyson, *The High Cost of Michigan's No-Fault Auto Insurance: Causes and Implications for Reform*, Department of Policy Analysis and Management, Cornell University, Ithaca, NY, April 2011, pg. 1.

[5] Paul Heaton, "Auto Insurance Reform in Michigan: What Can the Data Tell Us?" RAND Institute for Civil Justice, Occasional Paper, 2010, pg. 2.

[6] Robert Hartwig, Testimony before Michigan House Insurance Committee, Lansing, MI, December 3, 2009, available at http://michiganinsurancecoalition.com/wp-content/uploads/2010/03/HartwigMichiganTestimony.pdf.

was just over $16,000. Both the RAND study and Tennyson found that the explanation for these claims are not because the share of claimants who need medication attention are higher in Michigan, but the mix of services was much more costly.

A primary reason for the high premiums and high cost per claim is that Michigan is the only state to require all drivers to have unlimited PIP. This requirement results in several inefficiencies which harm economic activity. First, consumers are forced to purchase more health insurance than they desire. Consumers choose the amount of auto collision insurance, fire insurance, dental insurance, health insurance, and other types of insurance based upon their estimate of the probability that an untoward event will happen, their risk aversion, and their income. Michigan's requirement of unlimited PIP coverage results in the over-purchase of personal injury protection by nearly all Michigan drivers.

The requirement for all drivers to purchase unlimited PIP results in some groups having to purchase insurance coverage which they certainly won't need. For example, seniors covered by Medicare forgo Medicare benefits that would cover some of the costs of health care that their PIP policy pays.

A second reason is that every driver having unlimited PIP creates incentives to inefficiently use health care resources. Since every procedure, no matter how efficient or how expensive, is paid for in full by insurance, health care providers have an incentive to use and invent very expensive methods of caring for those injured in an automobile accident. As a result there is little if any constraint on the costs of treating severely injured patients. While this may seem a good thing for those who are injured, one must recognize that the most expensive treatment may not be the best for the patient. It must also be recognized that resources used up in the treatment of those who are catastrophically injured cannot also be used to treat other patients. So resources are misdirected by the unlimited PIP requirement raising health care costs for everyone and reducing the amount of health care that can be made available to the non-catastrophically injured.

The misaligned incentives of unlimited PIP results in the same procedure being significantly more expensive when covered under PIP than if it is covered under Medicare or Workers Compensation. Examples for the Detroit are given in Table 1 below:

Table 1
Insurance Reimbursement in Detroit
(Dollars)

Procedure	No-Fault	Medicare	W/Comp
Manual Therapy	60.80	28.91	38.03
MRI-Neck	3258.68	483.98	769.63
Surgery-Shoulder	2806.13	730.70	939.98
CT Scan-Neck	1820.09	261.5	418.78

Source: Mitchell DecisionPoint

Another 2010 RAND study, *The U.S. Experience with No-Fault Automobile Insurance: A Retrospective*, found that the claiming behavior of automobile accident victims is a large factor in higher auto insurance costs.[7]

A third reason for increased costs of health care under unlimited PIP requirements is that when treatment is paid for regardless of cost, there is a particularly large incentive for fraud. If I can prescribe a few more treatments and be sure they will be paid for, then I will have the incentive to do so.[8]

The AEG report recognizes that the unlimited PIP requirement distorts consumer purchase of PIP, as the report estimates that 75% to 90% of all drivers would purchase a policy with less than unlimited PIP if given the opportunity. But rather than coming to the conclusion that allowing consumers some choice in this area would improve efficiency, the report holds up as a negative that the "proposed policy change allows the buying behavior of policyholders to dictate how much of almost $810 million would continue to be spent on PIP-related health care."[9] The point should be that this change would improve Michigan's economy by allowing consumers, rather than the government, decide how much is to be spent on health care and would eliminate the wasteful requirement of duplicate coverage many drivers are saddled with.

The increased costs created by unlimited PIP increase the cost of producing many goods and services in Michigan. From the small flower shop that delivers locally to Meijer that ships its products from its warehouses to its stores by truck, a vast array of businesses pay insurance on their vehicles. The unlimited PIP requirement, along with the Michigan Catastrophic Claims Association that became necessary when it became clear that insurance companies would not be able to cover the unlimited costs of severe injuries, results in commercial vehicles being particularly burdened by higher insurance costs.[10]

[7] J. Anderson, P. Heaton, and S. Carroll, (Santa Monica: RAND Institute for Civil Justice, 2010)
[8] For a further discussion of the negative effects of the incentives created by unlimited PIP see G. Wolfram and D.J. Olson, *Reforming Michigan's Auto Insurance Industry: Some Concrete and Practical Proposals*, Competitive Enterprise Institute and Mackinac Center for Public Policy, October 2010, and Tennyson, op. cit.
[9] Anderson Economic Group, pg. 16.
[10] See Wolfram and Olson, pgs. 6-9.

Reducing the cost of insurance by eliminating unlimited PIP requirements will reduce the cost of producing and this will result in expanding Michigan's economy. Reducing production costs will create an incentive for existing firms to increase output and for firms to relocate in Michigan. This, in turn, will result in employers hiring more workers and greater earnings for the Michigan work force. It is difficult to think of an economic argument as to why reducing costs would, as the AEG report claims, decrease output and employment.

III. AEG Study: Increasing Health Care Costs are Good for the Economy

The AEG study recognizes that the unlimited PIP requirement in Michigan's no-fault insurance law results in excess spending on health care. However, rather than coming to the conclusion that reducing this inefficiency will improve Michigan's economy, it finds that it will harm Michigan's economy.

This is because the AEG study simply estimates the reduction in health care expenditures that would result from reduced PIP requirements and uses estimated economic multipliers from the RIMS (II) input-output model to calculate a reduction in output, earnings, and employment.[11] The purpose of an input-output model is to show what the overall effect on the economy is from the expansion or reduction of a sector. It is not designed to show the effect of reduced production costs on economic activity, such as occurs with the elimination of mandatory PIP coverage. In other words, AEG is using the wrong model to analyze the effects of the PIP reforms and that is what drives their conclusions.

The AEG approach leads to nonsensical results. For example, suppose that ACE Corporation invented an extraordinary helmet that when placed on the head of a person with traumatic brain injury instantly cured them. Suppose that the cost of this helmet was $5. This would clearly lead to billions of dollars in savings of health care costs and undoubtedly be good for the Michigan economy as the resources that had been used in the production of these health care services could be used to produce other things that people value.

In the AEG framework, however, this invention would lead to hundreds of millions of dollars in lost output in Michigan and the loss of thousands of jobs. This is because curing these brain-injured people would mean reduced spending in the health care industry. This reduction in spending would then translate through the input-output model into reduced output in industries across the state. If we are to believe the AEG report, any invention which reduces health care costs in Michigan would be a negative for the economy.

[11] There is some attempt to account for the effect of reduced premiums on consumer behavior, but as noted in Section I the assumption is that reduced premiums results in no change in output.

As an example, does it really make sense to come to the conclusion, as does the AEG study, that reducing auto insurance premiums by up to $1 trillion in Michigan will result in $9 million in lost output in the manufacturing sector alone in Michigan? The reason AEG gets results like this is because if everything else being held the same you reduce the size of the health care industry you will have a negative effect on other industries. However, not everything else is being held constant. A major reduction in the costs of producing services, even if it is just personal transportation, will improve the efficiency of the economy and in turn result in greater output of goods and services.

It is also true that the input-output model does not attempt to take into account whether increased expenditures in an industry are productive, since market-based changes will generally be efficient. Reductions in expenditures that improve efficiency because they reduce or eliminate expenditures that were inefficient due to government mandates will not result in increased output in a standard input-output model because the model is not designed to capture such effects.

The elimination of the unlimited PIP requirement is an example of reducing inefficient expenditures and it will not be appropriately analyzed with the RIMS (II) model. To see why an input-output analysis gives anomalous results, imagine the state legislature passed a law that required everyone to visit the dentist three times a week. Using the AEG methodology, this would increase health care expenditures, with resulting multiplied effects on employment, output, and income. In fact, any increase in spending feeds through the multipliers to increased economic activity.

As noted in Section II, the unlimited PIP requirement has led to health care expenditures far in excess of the other states. Eliminating this requirement will lead to a more efficient allocation of health care resources in Michigan in addition to reducing auto insurance premiums, both of which will increase output and employment, not decrease it.

V. Catastrophic Care: Who Pays for Those Who Can't?

As the AEG report hints, the real issue is how to pay for those who suffer catastrophic illness or injury and don't have adequate insurance or resources. The study assumes that between 638 and 735 people annually will suffer a catastrophic injury and will not have unlimited insurance coverage. Under current law, effectively all drivers in Michigan pay for the health care costs of these victims through the higher insurance premiums and the costs of the Michigan Catastrophic Claims Association.[12]

The authors of the AEG report implicitly assume either this is the only way to provide catastrophic health care for the uninsured or that it is better than other ways that would result

[12] For a discussion of how the Michigan Catastrophic Claims Association operates see Wolfram and Olson.

from elimination of the current system. However, there may be a number of other ways to treat victims of things like traumatic brain injury, for example, other than imposing a tax on all drivers. Forty-nine other states as well as the District of Columbia manage to use a different method, with what appears to be comparative success. We do not see other states adopting the Michigan system, which has been in effect since 1973.

In fact we have not seen states even beginning to move in Michigan's direction. Only twelve states even have no-fault insurance with no indication that any other state is moving to adopt no-fault. The next highest PIP requirement is New York at $50,000 and there is no indication that any no-fault state is moving to raise its PIP requirement. If Michigan's method of caring for those who suffer a catastrophic injury, why are not other states moving to adopt it?

Even with a $250,000 PIP policy, less than one percent of all accident victims will not have enough insurance to cover their treatment under current incentives. Some of these will already be covered through their private health insurance or through insurance provided by their employers. Once unlimited PIP is removed, more policies will offer such protection. Medicare, Medicaid and military insurance will cover some of the additional expenses as well. Accident victims can sue responsible parties for costs in excess of medical coverage.

The problem of how to take care of those who suffer catastrophic injury is not limited to auto related injuries. Suppose someone falls off a ladder and suffer severe head trauma but who has a limited liability health care policy. Why should she be treated differently from the person who crashes their motorcycle?

At issue is the broader question of what to do about the several hundred persons who each year will suffer some catastrophic trauma. This may take an extended discussion, but there is no reason to assume that a system of forced unlimited PIP liability ought to be the correct answer.

VI. Conclusion

The claim by the AEG study that reducing insurance premiums by reducing incentives to over-consume health care will result in harm to the Michigan economy is simply not credible. There is no economic theory that would explain such a result. Indeed, reducing insurance premiums and excess health care expenditures would have exactly the opposite result. By reducing the costs of production and improving the allocation of health care resources, elimination of the unlimited PIP requirement will create jobs, increase output, and increase income in Michigan.

About the Author: The author is President of Hillsdale Policy Group, Ltd, and the William E. Simon Professor of Economics and Public Policy at Hillsdale College. He is the author of *Towards a Free Society: An Introduction to Political Economy* and has published numerous works on public policy issues. He has served in several policy positions, including Michigan's Deputy State Treasurer, member of the Michigan State Board of Education, President of the Board of Trustees of Lake Superior State University and Congressman Nick Smith's Washington Chief-of-Staff. Dr. Wolfram received his Ph.D. in Economics from the University of California at Berkeley and has taught at the University of California at Davis, Mount Holyoke College, Washington State University, and the University of Michigan at Dearborn.