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Pay-As-You-Drive Car Insurance

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If you're like most Americans, you eat too much at all-you-can-eat buffets. With auto insurance, it's no different. Drivers who are similar in all respects—age, gender, driving record—pay roughly the same premiums whether they drive 5,000 or 50,000 miles per year, even though the likelihood of a collision increases with each mile. This "all-you-can-drive" pricing scheme imposes significant costs on society: more traffic accidents, congestion, air pollution, greenhouse gas emissions, and dependence on oil. It's also inequitable, as low-mileage drivers, particularly low-income people and women, subsidize high-mileage drivers.

A better approach is simple and obvious: pay-as-you-drive (PAYD) auto insurance. With insurance costs that vary with miles driven, people would have an incentive to drive less, thus decreasing the harm that more miles have on society. Under this system, higher-risk drivers—e.g., the 25-year-old with a sports car and a DWI record—would still pay more per mile than lower-risk drivers, and the effect of PAYD on miles traveled and gasoline consumption would be significant: a 6.5 percent reduction under conservative estimates, and others suggest the reduction could be as high as 10 percent. To put that in perspective, it would take an 81-cent-per-gallon increase in the gas tax to achieve a 6.5 percent reduction in miles driven.

The social benefits of PAYD would be approximately $30 billion per year, mostly from reduced accidents and congestion, as well as reduced local pollution and carbon emissions plus increased oil security. Premiums would also decline for around two-thirds of drivers, since a minority of high-mileage drivers are responsible for the majority of miles driven. Estimates show that those who drive less than average would save up to several hundred dollars per vehicle. And because there is a very

strong correlation between income and driving, most low-income people would see their rates come down. The same is true for women, who drive roughly half as much as men and have half as many accidents.

To be fair, some firms do offer a modest discount for driving below a certain number of miles, but even that is based on a self-reported estimate and falls far short of true per-mile pricing. But if PAYD is such a good idea, why don't more insurers offer it? The primary objection has long been a concern over odometer fraud (though that is much less of an issue today, with electronic odometers and new technologies to record and transmit mileage data). Another objection holds that the monitoring costs borne by an insurer—to conduct annual odometer checks or install devices to record mileage data—may exceed the potential benefits for the firm from reduced accidents. Economist Aaron Edlin estimates those benefits to insurance companies to be roughly $33 per vehicle (and even that is only a temporary gain until other firms match its new policies), while the social benefits from reduced accidents and congestion alone would be roughly $118. Finally, even if insurance firms wanted to offer PAYD premiums, state regulators must explicitly approve the type of insurance policies that insurers can offer, and in several states regulations pose barriers.

In response, government should take three steps. At a minimum, states should enact model legislation and regulatory guidance permitting PAYD, and the federal government should increase funding for PAYD pilot programs to encourage states and to develop better data on PAYD's consumer benefits and effects on driving behavior. Second, policymakers should address the market failure surrounding monitoring costs by requiring that odometer readings be performed as part of required safety and emissions inspections and offering tax credits, for an initial period, to insurance firms that enroll a certain percentage of their drivers in PAYD plans. Finally, if these measures prove insufficient, states or the federal government should require firms for a limited time to offer PAYD, with drivers free to choose PAYD or traditional policies, to demonstrate its benefits and feasibility and further overcome barriers to its adoption.

Unlike frequently proposed policies like gas taxes and congestion charges that raise the cost of driving in aggregate, PAYD represents a win-win policy—good for society and good for most drivers—that makes significant progress on climate change, congestion, and other driving-related harms and is more equitable at the same time, all while reducing insurance costs for the majority of drivers. D