# Third Party Moral Hazard and the Problem of Insurance Externalities

Gideon Parchomovsky (https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=166029)
Hebrew University of Jerusalem - Faculty of Law; University of Pennsylvania Carey Law School

Peter Siegelman (https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=107788)
University of Connecticut - School of Law

Date Written: November 4, 2021

## Abstract

Insurance can lead to loss or claim-creation not just by insureds themselves, but also by uninsured third parties. These externalities—which we term "third party moral hazard"—arise because insurance creates opportunities both to extract rents and to recover for otherwise unrecoverable losses. Using examples from health, automobile, kidnap, and liability insurance, we demonstrate that the phenomenon is widespread and important, and that the downsides of insurance are greater than previously believed. We explain the economic, social and psychological reasons for this phenomenon, and propose policy responses. Contract-based methods that are traditionally used to control first-party moral hazard can be welfare-reducing in the context of its third-party analog, so new approaches are required.

**Keywords:** Law & behavioral economics, insurance, third party moral hazard, risk, qui tam litigation

**JEL Classification:** D91, G22, K23

Suggested Citation >

Show Contact Information >

## 118 References

1. James M Anderson , Paul Heaton , Stephen J Carroll
   What Happened to No-Fault Automobile Insurance? Posted: 2010

2. Kenneth J Arrow
   Uncertainty and the Welfare Economics of Medical Care
   The American Economic Review , volume 53 , issue 5 , p. 941 - 973 Posted: 1963

3. Kenneth J Arrow
   The Economics of Moral Hazard: Further Comment
   The American Economic Review , volume 58 , issue 3 , p. 537 - 539 Posted: 1968

4. Danial P Asmat , Sharon Tennyson
   Does the Threat of Insurer Liability for 'Bad Faith' Affect Insurance Settlements?
   The Journal of Risk and Insurance , volume 81 , p. 1 - 26 Posted: 2014

## 0 Citations

Fetch Citations

Do you have a job opening that you would like to promote on SSRN?

Place Job Opening (https://www.ssrn.com/index.cfm/en/Announcements-Jobs/)

## Paper statistics

| | |
|---|---|
| DOWNLOADS | 410 |
| ABSTRACT VIEWS | 2,307 |
| RANK | 136,888 |
| 2 Citations | |
| 118 References | |

PlumX Metrics

## Related eJournals

University of Pennsylvania Carey Law School, Law & Economics Research Paper Series (https://papers.ssrn.com/sol3/JELJOUR_Results.cfm?form_name=journalBrowse&journal_id=164155)

Follow ⓘ

Risk Management eJournal (https://papers.ssrn.com/sol3/JELJOUR_Results.cfm?form_name=journalBrowse&journal_id=1492472)

Follow ⓘ

View more ›

Feedback 💬

Submit a Paper › (https://hq.ssrn.com/submission.cfm)

SSRN Quick Links ⌄

SSRN Rankings ⌄

About SSRN ⌄

(http://www.elsevier.com/)

We use cookies to help provide and enhance our service and tailor content.

To learn more, visit Cookie Settings.

(http://www.relx.com/)

(https://papers.ssrn.com/sol3/updateInformationLog.cfm?process=true)