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Pollution Liability and Insurance: An Application of Economic Theory

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Pollution Liability and Insurance: An Application of Economic Theory

August Ralston

ABSTRACT

Recently, interest has emerged in pollution liability insurance (PLI) as a response to the pollution risk. In this paper, an externalities model is used as a theoretical construct within which to analyze PLI as a mechanism for pricing pollution losses and to compare PLI with other schemes for dealing with the pollution problem. The model and analysis presented in this paper should serve to organize future research in the pollution liability insurance as well as other liability insurance areas.

Introduction

Interest has emerged concerning the possible application of liability insurance to the pollution risk. A notable discussion linking insurance and pollution was an article entitled: "What Role Will the Insurance Industry Play in the Fight Against Pollution?" [1]. The article indicated that most insurers have taken a cautious approach to the pollution liability exposure. This observation was evidenced by the number of pollution liability exclusions that had been filed with the state insurance departments. The purposes of the exclusions were to delete coverage for all or specific types of pollution, to alter the coverage from an occurrence to an accident basis, or to clarify the distinction between an intentional and an unintentional act.

Numan A. Williams studied insurance as a solution for the water pollution risk [17]. The stated purpose of his study was

...the analysis and definition of the role of the insurance mechanism, present and potential, in meeting the risk of pollution. A specific pollution risk (surface water pollution in the State of Wisconsin) will be considered to determine (1) whether the risk is theoretically insurable and in what form it is currently being met, (2) what loss prevention and reduction services are being made available by the insurance industry, (3) whether insurance of the pollution risk is in the public interest, and (4) if better alternate methods of meeting the water pollution risk appear to be available [17, pp. 7-8].

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Abstract

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