Brief: DPLAUTO

Sydney Morning Herald Tuesday 4/2/2003
General News Page 11
Circulation: 253,740
Size: 253.23 sq.cms.

Bushfire toll shows need for compulsory home cover

Insurance against fire should not be a matter of choice, argue ***Richard Holden*** *and* ***Andrew Leigh.***

AS THE cost of another summer's bushfires rapidly rises, the effect is being felt most strongly among the uninsured. With a quarter of Australians lacking home insurance, some have begun to ask whether everyone should be required to protect themselves against such losses.

John Howard has been quick to argue against any such scheme. Asked recently whether, in light of the tragedies in Canberra, the time had come for compulsory home insurance, he replied, "No, I don't. I think it's always a danger when something like this happens, to irretrievably embrace a new level of compulsion, and I'm not certain that I'd pick that up."

According to Howardnomics, the principle is clear. Just as the government shouldn't intervene to prop up faltering companies like Ansett and HIH, it shouldn't force people to buy insurance. Yet unlike saving failed companies, there is a very sound economic case for government intervention in the market for home insurance.

In Sydney, the most expensive city in the nation, the median home is valued at $388,000. The cost of home and contents insurance is about one quarter of 1 per cent of this – less than $1000 a year. Compared with other developed countries, Australians have a very high proportion of their wealth in real estate (64 per cent on average), making uninsured individuals particularly vulnerable to natural disasters.

Yet in making the decision on whether to buy insurance, home owners take into account the fact that if their house is destroyed, the government will help them out. And for the government, it is politically (and perhaps morally) impossible not to do so.

So why buy insurance if the government will give it to you free? Admittedly the government assistance might not fully replace one's home and you are unlikely to get much if you are the victim of random arson rather than part of a large natural disaster. This is presumably why most people buy insurance. But for the quarter who do not, the prospect of government assistance, even if it is incomplete, may be enough to tip the scale in favour of no insurance.

We require everyone driving a car to take out insurance.

What most of us think of as compassion towards victims of tragedy also leads to what economists call a "market failure". And when the market has a glitch in it, the Howardesque anti-compulsion argument no longer applies. Government intervention can improve things, rather than make them worse.

The same effect can be seen in other situations too. Because society knows it will have to take care of victims of motor accidents, we require everyone driving a car to take out insurance against the damage they may do to others. Because we know that we will have to pay a pension to those who lose their savings, we stop them accessing their superannuation until retirement. And because the government knows it will have to bail out failing banks, we all pay what amounts to compulsory deposit insurance through government taxes on bank transactions.

Two solutions would help tackle this problem. In the short term, state governments which impose an emergency services levy on home insurance should replace it with a universal levy. There is no logical reason why only those with insurance should bear the cost of paying for emergency services, driving up premiums, and reducing the number of insured still further. In December, Western Australia took this step. It is time for other states to follow suit.

In the long term, states should implement compulsory home insurance. The procedure would be quite straightforward. Thanks to the Torrens system all property titles must be registered – somewhat like cars are. Owners could easily be required to provide evidence of insurance on an annual basis, just like they do for car registration renewals.

When markets fail, the government has an obligation to get involved. The market for home insurance is clearly broken – and made worse by special taxes on those who take out insurance. Compulsory home insurance is government intervention, that's for sure. But in this case it is good economics as well.

Richard Holden and Andrew Leigh are PhD students in the Department of Economics and Kennedy School of Government at Harvard University.