

Insurance causes costs of services to rise

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Dishonesty not only damages relation between human beings, it can also have a devastating effect on the economy. Scientists from the University of Cologne and the University of Innsbruck in Austria have now found out that in markets for credence goods—markets that require a high degree of trust—there are also strong incentives for dishonest behavior.

Honesty is a fundamental building block for cooperation in human societies, and hence also for their economic prosperity. But people do not always behave honestly. Markets for so called credence goods such as [repair](#) costs or medical therapies give sellers strong incentives for dishonesty. Since the buyer often cannot assess the quality of the rendered services, the seller can cheat more easily than in the case of other goods.

Prof. Matthias Sutter holds the Chair for "Economics: Design and Behavior" at the University of Cologne. Together with his colleagues Prof. Rudolf Kerschbamer and Dr. Daniel Neururer from the University of Innsbruck (Austria), he investigated the role of insurances in these processes. The research team found out that the price for a computer repair rose by more than 80 percent when the repair shop was provided with the information that the service would be covered by an insurance policy. In some cases, parts of the computer that were in good working order were replaced or the number of hours required for the repair was exaggerated. Customers with insurance, the study showed, were less critical regarding the costs than customers without insurance because a third party was covering the costs. Prof. Sutter and his colleagues refer to the behavior of customers and service providers as "second degree

moral hazard."

The study is being published in the current edition of the *Proceedings of the National Academy of Sciences (PNAS)*.

The scientists researched the behavior of 61 of a total of 251 computer repair shops in Austria selected randomly along the country's east-west axis. They brought identical computers with identical damages to the computer shops: the Random Access Memory (RAM) had been destroyed, which normally would not require more than half an hour of repair time. Moreover, they made sure that besides the intentionally inflicted damages, the computer did not have any other malfunctions. The economists now pretended to be two types of customers: in the first group, they said that they would pay for the repair themselves and added that they needed a receipt. In the second group, they said that they needed a receipt because they had insurance that would cover the costs. In all other aspects, the two groups behaved identically.

In all, 58 of the 61 computer shops successfully repaired the damage. The average price for the repair in the group that said they do not have insurance was €70.17. The average repair price in the group that said that they have insurance was €128.68 - a difference of €58. In the group of those with insurance, the scientists counted five cases in which the repair shops simply conducted useless additional repairs. In these cases, the total costs averaged €200.58. This oversupply of services is accountable for part of the increased average costs in the group with insurance. A further aspect is exaggerated repair time. Twenty-seven providers indicated the total hours on the invoice. The computers in the control group took an average of 0.55 hours (33 min.) to repair. The ones in the group with insurance took 1.02 hours (61 min.), on average. This difference in time of 28 minutes accounts for €41.11 higher costs, or 70 percent of the total additional costs.

In order to find out more about why service providers behaved this way, Sutter, Kerschbamer and Neururer conducted a survey among 15 computer repair shops. They provided five possible reasons to choose from explaining why customers with insurance paid more than customers without insurance. "From the offered motives, the majority of computer stores selected the option, 'customers with insurance are less concerned with cost minimization because a third party is paying'," says Sutter. He concludes: "In markets for credence goods, insurance coverage can cause high additional costs for [insurance](#) policies and for the economy as a whole."

More information: Rudolf Kerschbamer et al, Insurance coverage of customers induces dishonesty of sellers in markets for credence goods, *Proceedings of the National Academy of Sciences* (2016). [DOI: 10.1073/pnas.1518015113](#)

Provided by University of Cologne

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