ICLE International Center for Law & Economics

Opening Statement of

R.J. Lehmann
Editor-in-Chief and Senior Fellow
International Center for Law & Economics

"Roundtable on Pandemic Risk"

Hosted by
Ranking Member French Smith and Members of
U.S. House Committee on Financial Services,
Subcommittee on Housing, Community Development, and Insurance

February 23, 2022

Congressman Smith, and Members of the Committee and Subcommittee,

My name is R.J. Lehmann, and I am editor-in-chief and senior fellow with the International Center for Law & Economics. ICLE is a nonprofit, nonpartisan research center that works to develop and disseminate academic output in the law & economics tradition, in order to build the intellectual foundation for rigorous, economically grounded public policy.

Two years into the COVID-19 pandemic, it is appropriate that Congress explore whether a more targeted and potentially permanent approach would be preferable to the *ad hoc* pandemic assistance programs like Paycheck Protection Program, which have directed trillions of dollars of federal relief to affected employers and employees. It is also reasonable to inquire what role, if any, should be played by the insurance industry, the sector traditionally tasked with responding to disaster.

There are almost certainly lessons to be learned from COVID, and there may well be a role to play for insurance companies, agents, and claims adjusters in any future pandemic program Congress might devise. But I want to raise a note of skepticism that insurance products generally—and business-interruption insurance, in particular—are really the best means to respond to the macroeconomic challenges raised by pandemics.

First, the capital that the global insurance and reinsurance industry would ever be willing to devote to the risk of pandemics would never come close to approaching the scale of the problem. Unlike governments, insurers and reinsurers cannot print money. To respond to a loss event like a pandemic, they would need to have those assets on hand. Any world in which the insurance industry had the resources to replace half of global GDP is a world in which people are buying far too much insurance.

Proposals like the Pandemic Risk Insurance Act (PRIA) tacitly acknowledge this limitation, which is why they would have the industry retain only *de minimis* risk of 5%. Obviously, that risk-share contribution would not significantly offset costs to the taxpayer, but it might be a worthy idea if the goal is to leverage the industry's expertise and capacity in other ways.

Most frequently cited among these is that insurers know how to price risk. That is true and, in many contexts, assigning risk-weighted premia performs a valuable social function. In the context of the pandemic, for example, it is crucial that businesses' liability and workers' compensation insurance rates reflect risk, because that produces the price signals that offer incentives for businesses to adopt safer practices and avoid spreading infection to their customers or their employees. But it is not as clear that assigning pandemic-risk insurance rates according to risk would achieve a socially desirable goal. Indeed, if businesses like bars and restaurants, which are most exposed the risk of closure in the event of a pandemic, had to pay insurance rates that reflected their risk, they would, at the margin, be less likely to buy the coverage. It would undermine the entire purpose of the program if those businesses that need the protection the most would be least likely to afford it.

This question of take-up is particularly important when you remember that only about a third of businesses currently have business-interruption insurance, and that's with a product that does not cover risks like pandemic. While adding pandemic coverage might make the product more attractive, it will certainly be more expensive, even if it's subsidized. It would not be ideal to attach a relief program to aid businesses with the risk of pandemic to an insurance product that most businesses do not have.

It's also notable that, unlike the terrorism insurance crisis in 2002, in which lenders were canceling financing of projects that weren't insured for terrorism risk, by and large, we are not seeing something similar today—at least, not with business-interruption insurance, which has never covered pandemic risk. There are other insurance products, like events cancellation and production insurance for films and television shows, where there's more evidence of some degree of market dislocation, and those might be areas more ripe for a targeted solution.

Finally, I would caution Congress to be humble in what it can project about future public-health emergencies. The next crisis may look nothing like the current one, and even the current one continues to surprise us. Early in 2020, I consulted with the major insurance trades on the proposal that ultimately became the Business Continuity Protection Plan (BCPP). At the time, we debated whether a program that offered three months of assistance would be exceedingly generous. When I testified before the Subcommittee on this topic in November 2020, vaccines were about to start rolling out and it seemed this all was coming to a close. There are good reasons to want a transparent and predictable set of rules, but it may be that *ad hoc* solutions designed in the moment to address the problem immediately before us, are the best that we can do.

With that, I look forward to your questions.