

Moral Hazard

Insurance

Chai Hecht

1. Introduction

While reading **Rabbi J. David Bleich's 'Contemporary Halakhic Problems, Vol. 5,'** I was stopped by a passage in his chapter on 'Insurance-Related Questions' (chapter 11, p. 285):

There is indeed no discussion in rabbinic literature of the right of a victim of a tort who has been compensated for his loss by the tortfeasor's liability carrier to seek additional indemnification from the tortfeasor himself. Presumably, the answer is too obvious to merit discussion in rabbinic sources.

From an economic perspective, this statement is troubling. It discounts the potentially significant effects of moral hazard.

2. The Case

Let's take a familiar case. An ox, belonging to Reuven, gores an ox belonging to Shimon. Assuming that this ox has already gored more than three times before (see previous installment of Moral Hazard), Reuven is obligated to compensate Shimon fully for his loss.

But what happens if Reuven had purchased insurance to cover the damage done by his ox? Reuven's insurance company will compensate Shimon for the damage he has suffered. The question is whether Reuven should then be excused from any further compensation. According to Rabbi Bleich this issue is not addressed in rabbinic sources because, "presumably, the answer is too obvious to merit discussion."

The answer does seem rather straightforward. If the victim is fully compensated and the compensation has been provided by way of the guilty party, even if not directly out of the perpetrator's pocket, what is there that remains to be discussed? Unlike the case when the *victim's* insurance company covers the loss (the case discussed next in the chapter), in our case Shimon is compensated, albeit indirectly, by Reuven. It seems obvious that Shimon should have no further recourse to claim money from Reuven once Reuven's insurance company has undertaken the burden of compensation. However, an economic perspective indicates that the issue is not quite so simple.

3. The Economics

In economics, the process of decision-making is looked upon as a comparison of cost and benefit, called cost-benefit analysis. Economists expect, at least on some idealistic plane, that whenever someone chooses to go through with a plan it is because the costs of the plan are exceeded by the benefits. If the benefits are exceeded by the costs, the plan is aborted. Therefore, when an economist sees someone eating a one-dollar bag of chips, he assumes that the person must have valued the chips at a price higher than one dollar (at the time of purchase). Similarly, if someone is mowing the lawn on a hot, sunny day, he must be of the opinion that well-kept grass is more beneficial than is costly the effort involved in acquiring such grass. When people do anything—fly first class, play poker, sleep ten minutes past the alarm, wear sunscreen—they are participating, at least from an economic perspective, in cost-benefit analysis.

When a person buys an expensive new item, let's say a new digital camera, he goes through a certain set of pre-purchase rituals. He wants to know a good deal of information about the camera, if it is likely to go on sale in the near future, how much he really values the camera, how often he's likely to use it, etc. All people are different in this regard, of course, but, for simplicity's sake, let's assume an average conglomerate person who performs one specific set of rituals before buying something new. And we call this person The Reasonable Man.

Now what if, while the Reasonable Man is involved in doing some research on his

potential purchases, the seller informs him that there is a fifteen-day satisfaction-guarantee included with the camera. Would you expect such a statement to sway the Reasonable Man's decision? Probably. At the very least, you would most likely expect him to be more comfortable with making a purchase. After all, if he doesn't like his decision he can return the camera later at no cost.

Essentially, a satisfaction-guarantee is a form of insurance. The decision to purchase the camera without the same level of investigation is a symptom of moral hazard. Whenever insurance is purchased, moral hazard becomes a concern. If the Reasonable Driver takes a certain level of precaution when he drives *without* insurance, it is expected that *with* insurance he will take a certain lower level of precaution because he no longer faces the full cost of damages. If you've ever noticed that you drive with a little more care than usual when you're driving a car for which you're not insured, you've witnessed the effects of moral hazard. Moral hazard does not mean that someone with fire insurance will set fire to his apartment. But it may mean that someone with fire insurance is not as careful about turning off the oven every time he leaves the kitchen or blowing out every candle before going to bed. Moral hazard means that the cost-benefit analysis has shifted: new outcomes due to the introduction of insurance may occur.

4. The Halachic Problem

With an understanding of the moral hazard of insurance, it is now possible to outline a halachic problem that may arise due to the usage of insurance to cover the costs of damages.

If Reuven has insurance to cover the damage done by his ox, Reuven *himself* never suffers punishment for the actions of his ox; his insurance company suffers. This can be a problem for two reasons:

1. Rehabilitation: Punishment is designed to change a person. When a person is negligent, punishment is inflicted with the hope that it will encourage the negligent person to be more careful if a similar situation should occur at a later date.

2. Deterrence: Punishment is designed to give potentially negligent individuals incentive to avoid causing damage. If it is known that a punishment will be inflicted, the potential perpetrator has all the more reason to avoid violation.

These two characteristics of punishment, rehabilitation and deterrence, are related. They both address the incentives of the negligent party: deterrence focuses on incentives prior to the damage and rehabilitation focuses on incentives after the damage.

If insurance can be used to avoid payment, both rehabilitation and deterrence become insignificant factors in punishment. The moral hazard of insurance is such that it reduces a person's level of care (or caution). If halacha dictates a certain set of repercussions with the intention of setting a certain minimum level of care by way of incentives, insurance has the potential to override these incentives and reduce the appropriate level of care as deemed proper by halacha.

The question therefore becomes: Are we allowed to use insurance to cover damages for which, under circumstances absent insurance, halacha would demand that we compensate for the damages out of our own pockets?

And the crux of the issue is this: What is the purpose of monetary compensation in halacha?

5. Monetary Compensation in Halacha

Imagine you purchased a new form of insurance called Corporal Punishment Insurance so that every time you committed a crime punishable by lashes, for example, someone from the insurance company would step in and receive the lashes on your behalf. I don't think you could find a single rabbi who would permit such insurance. So what's the difference between lashes and money?

The difference lies in the nature and purpose of the punishment. Lashes do not

compensate for damage. It's possible, one might suggest, that they cause the damaged party to *feel* a little better, watching the injurer 'get what he deserves,' but a literal eye-for-an-eye does not return sight to the victim. Money, on the other hand, is compensatory in nature. Cash is given to repair or replace the damaged property, pay for medical bills, and so on. It is in the nature of such punishments to counteract damages. But is this the *purpose* of monetary compensation?

On the one hand, it seems like a logical assumption that monetary compensation is precisely about compensating the victim for damages. But it is not necessarily a perfect assumption. Take, for example, a case brought in **TB Baba Kama 26b** (and discussed in Rabbi Bleich's article on page 291) about a vessel that has fallen out of a window. The vessel will certainly be destroyed as soon as it hits the ground, but before it crashes someone else breaks the vessel while it is in midair. As Rabbi Bleich mentions, the very fact that the gemara is discussing this issue, a case in which the damage done has cost the owner nothing (since the vessel was going to break anyway), is a good indication that the purpose of monetary compensation may not be exclusively compensatory in nature.

Rabbi Bleich brings a second case to support the above contention, from **TB Gittin 42b**, in which a master is obligated to free a certain slave but has not, as yet, done so. "The Gemara declares that if, in the interim period, the slave is the victim of battery at the hands of another person, damages are paid to the master. That is so despite the fact that, since the master is no longer entitled to the service of the slave and must emancipate him, the master has sustained no loss as a result of the battery. Once again it is evident that damage, even if unattended by financial loss, is sufficient to engender tort liability (292)." (According to Jewish law, damages to a non-Jewish slave are payable to the slave's master, not the slave.)

Both these examples lean towards a concept of payment as specifically guilt-oriented, rather than as a means of compensation for loss. If this is the case, the force behind the obligation to pay is the damager, not the damaged. The damager becomes the essential party—it is his *need to pay*, not the other's *need to be repaid*, which drives the exchange.

However, it is still possible to view compensation as the heart of the issue. The falling vessel *will* break, but hasn't yet. And it is a slippery slope to start deeming states of ownership or Real Loss based on the life expectancy of objects. Furthermore, there is still, as always, the relevant issue of deterrence. These specific cases could be dealing with a concern for destructive or careless behavior: if it were known that damage done to a falling object carried with it no penalty, people might be expected to act carelessly around falling objects and, thereby, cause unforeseen damage elsewhere. The threat of punishment could act as sufficient disincentive to potential damagers so as to maintain the necessary level of care.

Therefore these cases do not prove one way or the other whether payment for damages is compensatory in purpose. In other words, you will read these *gemaras* a certain way depending on how you view monetary punishment but you cannot definitely determine the nature of the punishment based on these *gemaras*. Perhaps, then, the nature of monetary punishment in halacha is a matter of dispute.

6. The Dispute

When Reuven's ox kills Shimon, Reuven is obligated to pay Shimon's heirs a certain sum (see **Shemot 21:30** and commentary). There is a debate, found in **TB Makkot 2b**, regarding how this sum is derived. Does Reuven pay an amount pursuant to the value of the man his animal killed or does Reuven pay an amount pursuant to his own value? The Rabbis say that it is paid based on the value of the person killed (in our case, Shimon). Rabbi Yishmael (son of Rabbi Yochanan ben Berokah) says that it is paid based on the value of the person responsible for the death (the owner of the ox; in our case, Reuven).

But what are the Rabbis and Rabbi Yishmael really arguing about?

Actually, the nature of their debate (as often happens) is a dispute itself. According to Rav Chisda, the argument revolves around the purpose of the payment. Rav Chisda's version of the Rabbis sees payment as a form of compensation for the life lost, and therefore is calculated based on the victim. His version of Rabbi Yishmael, on the other hand, sees

payment as a form of *kapara* (atonement) which substitutes for execution-based atonement and, therefore, is calculated based on the guilty party (who is paying for his own life, essentially—money instead of execution).

Rab Papa disagrees with Rav Chisda and posits that both the Rabbis and Rabbi Yishmael view the essence of the payment as *kapara* for the owner of the murderous ox. Their debate is simply about how this *kapara* should be calculated.

We have, therefore, four opinions on the nature of this payment:

Rabbis	Acc. to Rav Chisda	Compensation	Based on victim
Rabbis	Acc. to Rav Papa	<i>Kapara</i>	Based on victim
Rabbi Yishmael	Acc. to Rav Chisda	<i>Kapara</i>	Based on guilty party
Rabbi Yishmael	Acc. to Rav Papa	<i>Kapara</i>	Based on guilty party

(Note that Rabbi Yishmael according to Rav Chisda and Rabbi Yishmael according to Rav Papa seem to be the same. However, it is also possible, based on the context of the arguments, to recognize a distinction—an issue too distracting for these purposes.)

7. Rabbi Akiva

An *Eid Zomem* is a specific type of false witness. The complicated case arises as follows:

1. Witness-1 and Witness-2 testify ‘A’ killed ‘B’ at time-X, in place-Y.
2. Witness-3 and Witness-4 then testify that Witness-1 and Witness-2 must be lying “because,” they say, “how could Witness-1 and Witness-2 be in place-Y at time-X if at time-X they were both with us in place-Z?”

As punishment, an *eid zomem* receives whatever form of punishment he hoped to inflict by

way of his false testimony. Therefore in the case above, Witness-1 and Witness-2 are executed instead of 'A.' This is a very intricate law with many details and exceptions.

One such exception, according to Rabbi Akiva (**TB Makkot 2b**), is that an *eid zomem* does not pay for the murderous ox. Meaning, if Witness-1 and Witness-2 testify that Reuven's ox killed Shimon and then their testimony is shown to be false (in the unique manner of an *eid zomem*, as above), Witness-1 and Witness-2 are NOT then obligated to pay Shimon's heirs the amount they sought to force Reuven to pay, even though this would be the expected punishment for an *eid zomem*, but, rather, they are given lashes.

Rabbi Akiva's reason for the exception: This form of punishment is a *kapara* and an *eid zomem* is not in a position to gain such atonement since, as explained by Rashi, these witnesses are not responsible for the victim's death. This is interesting since we know that an *eid zomem* IS executed for false testimony regarding murder, even though he is not 'responsible for the victim's death.' The *kapara* nature of this punishment, according to Rabbi Akiva, is obviously unique.

Based on this, the gemara makes a connection between Rabbi Akiva and Rav Chisda's view of Rabbi Yishmael, since both are of the opinion that this payment is a form of *kapara*. Therefore, according to this opinion of Rabbi Akiva, the payment should be calculated based on the value of the guilty party and not based on the value of the victim and, so, absent any concept of compensation.

However there is another gemara (found in **TB Baba Kama 103b**) in which Rabbi Akiva's opinion clearly indicates a concern for the victim's loss. The case this time involves a man who has stolen an item from one of five men. The problem is, the robber does not know which man is the rightful owner of the stolen item. Halacha demands that a stolen object be returned to its original owner but this case clearly presents a problem since the specific owner is unknown.

Rabbi Tarfon requires that the robber place the stolen object in front of the five men. After that, it is in their hands and they must decide amongst them who should take the

object. The point is, the robber has done his duty, he has returned what he stole.

Rabbi Akiva disagrees. In order to properly atone for his sin, the robber must pay each of the possible victims the value of the stolen object (in total, five times the amount stolen). It is only in this way that the robber can be certain that his victim has been repaid.

Does Rabbi Akiva's position in Baba Kama contradict Rabbi Akiva's view in Makkot? How can Rabbi Akiva take such a strong stance in support of *kapara* in Makkot and such a strong stance in support of compensation in Baba Kama? Unless, of course, there is a connection between *kapara* and compensation.

Following the viewpoint of the Rabbis according to Rav Papa's understanding, that *kapara* is based on the value of the victim, we witness a melding of *kapara* and compensation as needed to resolve Rabbi Akiva's apparent self-contradiction. Meaning, if the issue is *kapara dependent on compensation* then Rabbi Akiva is consistent. It is not enough to feel the loss: the victim must be compensated. And it is not enough that the victim be compensated: you must feel the loss. It is a combined effect.

Rambam also seems to rule this way. See **Hilchot Nizkei Mamon 10:4** and **Hilchot Eidut 20:8** in regards to the issue in Makkot (where Rambam states that we demand payment in accordance with the value of the one killed and an *eid zomem* does not pay) and **Hilchot Gezeilah 4:9** in regards to the issue in Baba Kama (where Rambam rules in accordance with Rabbi Akiva, demanding payment to each of the five potential victims). It should be noted that Rambam views the payment made to the five potential victims in Baba Kama as a fine imposed by the Rabbis to ensure that a sinner is not allowed to go unpunished. According to Torah law, however, absent the imposition of this fine, a thief such as the one described is by definition not responsible for payment since he could only be, at best, a suspected thief. In order to be obligated to pay according to the Torah, witnesses must be able to testify that they saw the guilty person steal from a specific victim. This is obviously not possible here since if such witnesses existed it would put an end to the doubt about the identity of the true victim. Rambam, then, may have a different view of Rabbi Akiva, one that lines up with Rav Chisda's view of Rabbi Yishmael.

(Interestingly, payment alone is not enough according to the Rambam, as he states in **Hilchot Teshuva 1:1**: “A person who injures someone or damages his property does not attain atonement, even though he pays him what he owes, until he confesses and makes a commitment never to do such a thing again.” Of course this is not the same issue as the murderous ox but it indicates the Rambam’s view that compensation fails to fully atone without proper *teshuva*.)

8. Practical Ramifications and Overview

-
Practically, only an introduction to monetary compensation in halacha has been presented here. It is not fair to assume that we can extract or extrapolate from these issues a complete map of the philosophy behind the exchange of money within the Jewish legal system. But the reality of a dilemma is evident.

The economic principle of moral hazard dictates that people covered by insurance are less likely to take as much precaution as those without insurance. The practical question raised by this article asks whether this matters in Halacha.

If it does not matter and incentives are not a concern of ours, then insurance to cover damages should not be a problem. Yes, it is true that people will be expected to be somewhat more careless but this is not something that we are worried about. (Perhaps God-fearing Jews are expected to be above the temptations of the average Reasonable Man.)

If it does matter and incentives do concern us, perhaps the use of insurance to cover damages should be forbidden within halacha.

To gain clarity on this matter it becomes necessary to try to understand the nature and purpose of monetary compensation in halacha and the following hypothesis is considered: If incentives matter to us, the halacha will require that compensation paid to the damaged party will be taken from the guilty party’s property. This, it is figured, will rule out the possibility of insurance.

There are two obvious problems with this hypothesis:

1. It is possible that there is no connection between the relevancy of incentives and the purpose of compensation.
2. The obvious loop-hole: the insurance company could officially give the money to the guilty party so that the money becomes the property of the guilty party and, therefore, his to do with as he wishes. (Essentially, the person responsible for paying is still, from a technical perspective of ownership, paying from his own property.)

Nevertheless, it seems clear to me that whenever *kapara* is at issue, if not according to the letter of the law then at least in accordance with its spirit, insurance could not possibly afford the same level of atonement as would be had in personally owning up to one's debts.

9. Conclusion

-
One of the most intriguing aspects of economic thought is the necessity for self-knowledge. It is impossible to make sound economic decisions without an ability to comprehend personal desires and drives. It is not enough to act in a so-called rational manner—there is no singular rational path for all individuals. The only rationality that matters to an economist is that individual costs and benefits are recognized and compared appropriately. It is for this reason that incentives and disincentives play such a significant role in economic analysis.

But the pure economist does not make decisions about 'good' or 'worthwhile' costs in a moral sense. In theory, to an economist, if the benefits of killing a person outweigh the costs, it is perfectly reasonable to commit murder. It is easy to construe a situation in which, according to pure economic theory, it would be unreasonable *not* to violate the law or hurt another person.

I have always seen Halacha as the bridge between the rational and the moral. Halacha, by

setting limits, guides us in a certain direction. Based on these guidelines, we develop certain desires and drives that are in-line with Halachic ideals. The ultimate goal, in my opinion, is that the individual acts rationally in an economic sense and this rationality naturally flows in a direction congruent with Halacha—when this ideal Halachic individual compares personal costs and benefits, he recognizes that he will maximize benefits by acting in a Halachically appropriate manner.

But in order for such a process to work, Halacha must, by definition, be a system that recognizes the individual as unique. In the same way that an economist is interested in rationality for an individual, Judaism is interested in Halacha that is appropriate for the specific individuals involved.

Insurance can affect incentives. Should it affect incentives? Maybe not. But if Halacha does not deal with the reality of the individual then it will fail to affect incentives in the long-run. In the hopes of shaping people with drives that coincide with Halacha, so that a partnership with God is formed, so that it is not a question of what can't we do but a question of what is most rational, it is necessary to investigate issues such as this one, issues that deal with moral hazard.

© Nishma, 2007