The NY Times reports that insurance rates are rising in the aftermath of Hurricane Sandy for coastal communities. As I argued back in 2010 in my Climatopolis book, such “price gouging” is good! If insurance markets are competitive, then the rates that insurance companies charge households who seek home insurance will reflect the best guess of the true actuarial probabilities of bad events. Everyone who reads this blog knows that climate change raises the probability of these bad events. Permit me to do one piece of algebra. Suppose that the typical 47 year old driver has a 1% annual chance of having an accident that causes $10,000 worth of damage. If the best car insurance markets are competitive (and ignoring administrative costs), the premium this driver will pay for a policy that writes her a check for $10,000 when she crashes will be .01*10000 = $100. Now suppose that due to climate change her probability of a crash rises to 4%. For the insurance company to earn non-negative profits requires that the annual premium rise to $400. This isn’t “price gouging” and no government needs to step in to regulate rates. Competition and the potential for entry in the insurance market protects the insurance buyers from being “gouged”. If the premium jumped to $500 per year, then a new firm would enter the market and offer a lower rate closer to $400.

Returning to New York State and coastal communities, as insurance prices on the coast rise — some households will choose to live somewhere else and other households will rebuild in ways that reduces the risk they face from the next Sandy storm. If the insurance company offers different premium prices depending on a home’s design (i.e stilts) then this further incentivizes adaptation efforts. This is the small ball of adaptation and this dynamic process means that the next storm will cause less damage to the coast. In this sense, the insurance companies’ differential pricing of risk in different geographic areas incentivizes households to make better choices that reduces their cumulative risk exposure in the face of evolving climate change. As I have said many times, we are not passive victims here. While the world and the U.S doesn’t have carbon pricing, in this second best world — we have strong incentives to protect ourselves against what we have collectively unleashed.