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Goolsbee and Brown: Does the Internet Make Markets More Competitive? Evidence from the Life Insurance Industry Summary

Part I

The question this paper tries to answer is if the Internet may significantly reduce search costs by

enabling price comparisons on-line. Goolsbee and Brown use individual policy-level microdata from LIMRA International on the prices of insurance policies as well as various owner and policy characteristics and match them to microdata on the growth of Internet usage and on-line insurance research from Forrester by the same owner characteristics, then run a hedonic regressions for the price of life insurance on characteristics of the policies and the individuals and then include a measure of how likely the individual is to have used the Internet over time or to have researched insurance on-line.

Their regressions explain n the price paid for term policies. The dependent variable is the log of the annual premium per $1,000 of face value of insurance and he Internet variables are their main variables of interest. They include dummies for controls, such as age dummies, a nonsmoking dummy, a gender dummy, marital status dummies, and a rated policy dummy indicating if that the individual belongs to a special risk class because of some personal behavior such as being an amateur pilot. Additionally, they add state dummies and occupation dummies to account for differences in health or demographic characteristics across groups that are correlated with life expectancy as well as dummies for whether the policy was purchased from an own agent and whether it was a participating policy.

They conclude that at least for some financial products, the ability of the Internet to reduce search costs can have a significant impact on market power; it may lead to large consumer welfare gains at the expense of supplier profits. The implications for the market value of on-line and off-line companies could not be more important.

Part II

I do think the question Brown and Goolsbee is interesting and gives us a decent example of how the internet may significantly reduce search costs but not enough to conclude that it could be applied to all markets. The authors use Stahl model in this paper which is divided into three direct predictions: 1. When there are asymmetric search costs across customers, firms will draw equilibrium prices randomly from an equilibrium distribution rather than all of them charging a single market price. We should expect to see price dispersion in equilibrium. 2. As the share of consumers with no search costs increases, average prices should fall 3. The share using the Internet to compare prices on-line rises from zero, price dispersion should at first rise and ultimately fall. Overall, this method is appropriate since the results come out accurately.

The variables used in the econometric models are mostly dummy variables which are appropriate since there are a lot of controls. The results are pretty convincing because we all know that practically it the use of the internet reduces the search cost since we use it every day.