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Brown and Goolsbee (2002)

Does the Internet Make Markets More Competitive? Evidence from the Life Insurance Industry

Part1:

The hypothesis of this paper is the Internet may significantly reduce search costs by enabling price comparisons online. To analyze the relationship, they take individual policy-level microdata from LIMRA International on the prices of insurance policies as well asvariousownerandpolicycharacteristicsandmatchthemtomicrodata on the growth of Internet usage and on-line insurance research from Forrester by the same owner characteristics. In essence, they fit 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 online. The exposition most relevant for our empirical work is that of Stahl model.

Our regressions will attempt to explain the price paid for term policies. The dependent variable is the log of the annual premium per $1,000 of face value of insurance As for their controls, they do not have a direct calculation of the survival probability for the individual, so they include standard variables to proxy for it including age dummies, a nonsmoking dummy, a gender dummy, marital status dummies, and a dummy for whether the policy is "rated," meaning that the individual belongs to a special risk class because of some personal behavior such as being an amateur pilot. They also include 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 also include policy length dummies and several terms for the value of the policy in real dollars (these are the log of the real amount, the real amount, and the real amount squared as well as dummies equal to one if the reported value was censored at the maximum value in the year).

The results show that,at least for some financial products, the ability of the Internet to reduce search costs can have a significant impact on market power. When it does so, it may lead to large consumer welfare gains, potentially at the expense of supplier profits. The implications for the market value of online and offline companies could not be more important.

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Part2:

I think the question of this study is quite interesting as the internet is the main part of our daily life. This will help us to understand more about present market when the internet had been considered as the factor. The paper use Stahl model which has three basic results stated in the Stahl Model that have direct predictions for empirical work. First, and most simply, when there are asymmetric search costs across customers (i.e., some have zero search costs and others do not), 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. Second, as the share of customers with complete information (m) increases,the price distribution shifts downward monotonically.In other words, as the share of consumers with no search costs increases, average prices should fall. and the last one the share using the Internet to compare prices on-line rises from zero, price dispersion should first rise and then (eventually) fall. With these results, we can say that the method adopted to answer research question is appropriated. Moreover, the result is convincing because the paper use the financial product to use as sample, I am very interested in financial market and financial products also. The internet can cause the falling in price in financial product which I need to adopt some strategies for investing in financial products.