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STANFORD UNIVERSITY SCHOOL OF MEDICINE
*Department of Genetics*

April 9, 1970

Professor Kenneth Arrow
Department of Economics
Harvard University
Cambridge, Massachusetts

KENNETH ARROW

Dear Ken,

I had occasion a little while ago to look at your little book on risk bearing and was particularly interested in your comment on how little serious work had been done on the economics of the insurance industry. Up to that point I was wondering why I had failed to discover the kind of treatment I was looking for and expected to exist.

I had a couple of comments about the approach that you invoked in that paper and would be interested in your own reactions to these. Perhaps in a larger sense my points are subsumed under the heading of a variable marginal utility of money at least in a sense that I do not think it will necessarily alter very much of your calculations. However, I do think that the cost of planning and the cost of administration, of systems generally, and of an insurance system in particular, are factors that are likely to be overlooked in certain brands of decision analysis and system study and ought to be highlighted.

If you can point me to any equally perceptive literature subsequent to your 1965 paper I would be grateful for it.

One of my friends ~~commented~~ (when I asked him why insurance was not a better shaper of risk-minimizing behavior) pointed out that unfortunately most insurance companies do relatively little actuarial activity and are much more involved in optimizing the return on the investments they make with borrowed capital. In a certain sense they are quite indifferent to the level of loss experience so long as they can be big enough to be buffered against fluctuations themselves.

With best regards.

Sincerely yours,

Josh.

Joshua Lederberg
Professor of Genetics

JL/rr

LT. J. P. KENNEDY, JR. LABORATORIES FOR MOLECULAR MEDICINE, DEDICATED TO RESEARCH IN MENTAL RETARDATION

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