

# Selecting Policy Instruments: Neo-Institutional and Rational Choice Interpretations of Automobile Insurance in Ontario\*

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## Introduction

The study of policy instruments begins with the observation that governments can achieve their policy goals in a number of ways. Students of policy instruments have argued that the means chosen affect not only the success or failure of policies, but also the political fortunes of decision-makers. With this in mind, they have produced inventories and classifications of policy instruments, generalizations about their fundamental qualities and hypotheses regarding the motivations for their use.

While these conceptual and theoretical innovations represent important achievements, in many cases there are limits to what they can tell us about the policy process in general. Some of these limitations arise because of the influence of the rational choice model of politics on the study of policy instruments in Canada. This model construes important political processes as a series of choices taken by self-interested political actors. This assumption of rational egoism implies that, based on the information available to them, political actors will choose the course of action which achieves their preferred goal with the greatest efficiency. Institutions are sets of rules that constrain the behaviour of these rational individuals but also offer opportunities to make social choices and provide collective goods. As Margaret Levi states, "The rational choice approach to institutions is concerned both with how human actions combine to create institutions and how existing

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institutions structure individual and aggregate choices.”<sup>1</sup> Based as it is on the premise of methodological individualism, and employing the conceptual framework of neo-classical economics, the rational choice model offers a means of connecting micro-level and macro-level political behaviour and, of particular importance here, explaining why political actors make the choices they do.<sup>2</sup>

We will argue that, while this model is powerful, there are other approaches to instrument choice. Specifically, the family of research efforts that March and Olsen have termed “the new institutionalism” offers some potential for a challenging alternative interpretation.<sup>3</sup> Its origins rest with sociologists such as Durkheim and Parsons who argued that social order does not depend on rational choices made by self-interested, autonomous individuals, but rather on the internalization of norms that promote collective adherence to institutional obligations.<sup>4</sup> Among the most important contemporary interpreters of neo-institutionalism are state theorists such as Skocpol, Nordlinger and Krasner.<sup>5</sup> They emphasize that while institutions impose structural constraints on social choices, these can be overcome by state actors who often possess considerable capacity to fashion outcomes in the face of societal resistance. In addition, neo-institutionalism has been influenced by behaviouralists, especially organization theorists, who challenge simplistic concepts of rationality. They argue that under conditions of uncertainty rationality is necessarily “bounded,” and that there is little evidence for the rational choice assumption of stable, known and exogenous preferences.<sup>6</sup>

- 1 Margaret Levi, “The Transformation of Agrarian Institutions: An Introduction and a Perspective,” *Politics and Society* 16 (1988), 159-69. See also Margaret Levi, *Of Rule and Revenue* (Berkeley: University of California Press, 1988), esp. chap. 2 and appendix.
- 2 There are, of course, many versions of the rational choice model. Outlined here is an ideal-type construct. Many rational choice theorists would doubtless dissent from some of our specific characterizations.
- 3 James G. March and Johan P. Olsen, “The New Institutionalism: Organizational Factors in Political Life,” *American Political Science Review* 78 (1984), 734-49.
- 4 For example, Emile Durkheim, *Suicide* (New York: Free Press, 1951), originally published 1897; and Talcott Parsons, *The Structure of Social Action* (New York: McGraw-Hill, 1937). An excellent critical discussion of the “normativist perspective” is found in Michael Hechter, *Principles of Group Solidarity* (Berkeley: University of California Press, 1987), 3-4, 20-24.
- 5 Theda Skocpol, “Bringing the State Back In: Strategies of Analysis in Current Research,” in Peter B. Evans, Dietrich Rueschemeyer and Theda Skocpol (eds.), *Bringing the State Back In* (New York: Cambridge University Press, 1985), 3-37; Eric A. Nordlinger, *On the Autonomy of the Democratic State* (Cambridge: Harvard University Press, 1981); and Stephen D. Krasner, *Defending the National Interest* (Princeton: Princeton University Press, 1978).
- 6 James G. March, “Bounded Rationality, Ambiguity and the Engineering of Social Choice,” *Bell Journal of Economics* 9 (1978), 587-608; and Michael D. Cohen,

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**Abstract.** The rational choice model of politics, which construes important political processes as a series of choices taken by self-interested political actors, has dominated theorizing on the subject of policy instruments in Canada. While useful, this approach is nonetheless limited by its narrow conception of rationality and its inattention to the context of instrument choice. As an alternative, the neo-institutional approach offers a perspective on political choice that takes better account of contextual and organizational factors. In this article, the logic of both approaches is used to explain the policy process in the case of automobile insurance in Ontario. The purpose of this exercise is exploratory, not confirmatory. Both approaches do, in fact, offer plausible explanations for the creation of a rate review board, the retention of fault-liability as the basis of compensation and the apparent rejection of public automobile insurance. However, the study concludes that it is essential that research strategies in the realm of instrument choice incorporate insights from the neo-institutional approach.

**Résumé.** Le modèle du choix rationnel en matière de politiques qui présente les processus politiques d'importance comme une série de choix faits par des personnages politiques motivés par l'intérêt personnel, a dominé le champ théorique au sujet des instruments de politiques au Canada. Bien qu'utile, cette approche est néanmoins limitée par une conception étroite de la rationalité et une ignorance du contexte dans lequel un tel choix s'est effectué. L'alternative de l'approche néo-institutionnelle offre un aperçu du choix politique qui tient compte davantage des facteurs d'ordre contextuel et organisationnel. Les auteurs se réfèrent ici à la logique des deux approches afin d'expliquer le processus politique dans le cas de l'assurance-automobile de l'Ontario. Le but de ce travail est d'explorer, et non de confirmer. En effet, les deux approches offrent des explications raisonnables en faveur de la création d'un conseil de révision des taux d'assurance, pour le maintien de l'imputation de la faute comme base de dédommagement, et enfin pour le rejet, de toute apparence, du concept d'assurance-automobile étatisée. Cependant, l'article finit par conclure qu'il est essentiel que les stratégies de recherche dans le domaine du choix de l'instrument bénéficient des aperçus que donne l'approche néo-institutionnelle.

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What knits the new institutionalism together is a concern for institutions understood not as mirrors of social reality but as transcendent social entities with independent, objective constraining power.<sup>7</sup> As we will see below, this version of institutions differs in important respects from that offered by rational choice theorists. Yet it is too early to say whether neo-institutionalism offers a model of social choice, or even whether it will pursue model-building in a manner analogous to rational choice.<sup>8</sup> Its diverse research agenda and its expansive conceptual inventory mean that neo-institutionalism cannot currently provide an axiomatic treatment of instrument choice. However, by conducting concrete investigations of specific historical cases, researchers in this tradition may eventually generate a body of testable propositions.

James G. March and Johan Olsen, "People, Problems, Solutions and the Ambiguity of Relevance," in James G. March, Johan Olsen et al., *Ambiguity and Choice in Organizations* (Bergen: Universitetsforlaget, 1979), 24-53.

7 Robert Grafstein, "The Problem of Institutional Constraint," *Journal of Politics* 50 (1988), 577-99.

8 March and Olsen observe that the new institutionalism "is far from coherent or consistent; it is not completely legitimate; but neither can it be entirely ignored" ("The New Institutionalism," 734).

The second section of this study outlines a current case of instrument choice, that of automobile insurance in the province of Ontario. There is a pressing need to consider policy instruments in the context of a particular case because so many of the generalizations which dominate the Canadian literature on policy instruments are based on assumptions about their abstract qualities, rather than their qualities in use.

In the final part of the article we suggest alternative interpretations of the policy process in automobile insurance using the two approaches to instrument choice developed in the opening section. Our purpose is exploratory, not confirmatory. It will be our contention that while the rational choice approach to policy instruments is persuasive, the variables emphasized by neo-institutional theorizing must be incorporated in any accurate and complete rendering of the policy process.

### **Alternative Approaches to Policy Instruments**

In the rational choice model of political behaviour governments are portrayed as constellations of individuals acting on the basis of a calculated self-interest. Collective behaviour and aggregate outcomes are understood as the product of these individual choices. Although choices are made in an atmosphere of uncertainty, the preferences of actors are assumed to be relatively stable if not permanent.<sup>9</sup> In this way, it becomes possible to deduce rational behaviour from utilitarian premises and information about decision situations.

Decision situations are defined by the knowledge and preferences of actors in society at large. Choices are ultimately structured by such exogenous forces as the economy, class interests, geography and technology. Alone or in combination these factors generate tastes and preferences to which political actors respond. In formulating their response politicians and bureaucrats employ a utilitarian calculus in which their own interests are given primacy. Accordingly, the study of political institutions focusses on the specific rules that govern decision-making and the ways in which particular sets of societal preferences are either included or excluded from the process of social choice.<sup>10</sup> Institutions become bundles of rules that establish incentive systems for self-interested actors. They are not, in themselves, the source of actor preferences.

9 Not all rational choice theorists are comfortable with this position. See, for example, James M. Buchanan, *What Should Economists Do?* (Indianapolis: Liberty Press, 1979), 93-112.

10 See, for example, William H. Riker, "Implications from the Disequilibrium of Majority Rule for the Study of Institutions," *American Political Science Review* 74 (1980), 432-46.

The two major projects undertaken by students of instrument choice in Canada illustrate the influence of this rational choice model on the policy instrument literature. First, attention has been directed toward an enumeration of policy instruments and a discussion of the associated policy processes. Researchers have observed that governments, under pressure to restrain expenditures, have sought to employ less obtrusive means of intervention. Alternative policy instruments include exhortation, regulation, taxation and public ownership.<sup>11</sup> Each instrument implies a different set of actors and rules and each has a different effect on public participation and democratic values. The decision to employ any one of these instruments is, in effect, a decision about the policy process. It will have serious political consequences. Thus, studies of policy instruments typically emphasize the implications of alternative instruments for the political prospects of decision-makers, as well as their impact on policy objectives.<sup>12</sup>

The second project involves modelling the process of instrument choice. In one of the earliest and most influential formulations, Doern and Wilson argued that, other things being equal, politicians prefer to employ the least coercive instruments possible. Should these fail, more coercive means would still be available and these would gradually be employed until the objectives were realized.<sup>13</sup> The source of this general antipathy toward coercive instruments is not entirely clear, but there are numerous instances of instrument choice that seem to confirm Doern and Wilson's observation.<sup>14</sup>

In a more ambitious attempt to specify the dynamics of instrument choice, Michael Trebilcock and his colleagues employ the type of axiomatic reasoning that is characteristic of the rational choice

- 11 G. Bruce Doern and Richard Phidd, *Canadian Public Policy* (Toronto: Methuen, 1983), 110-12. Alternative classification schemes can be found in Leslie A. Pal, *Public Policy Analysis: An Introduction* (Toronto: Methuen, 1987), chap. 7; and R. Kent Weaver, *The Politics of Industrial Change* (Washington: Brookings, 1985), chap. 3.
- 12 Excellent examples are presented in Kenneth Woodside, "The Political Economy of Policy Instruments," in Michael M. Atkinson and Marsha A. Chandler (eds.), *The Politics of Canadian Public Policy* (Toronto: University of Toronto Press, 1983), 173-97; and Weaver, *The Politics of Industrial Change*, 74-85.
- 13 According to Doern and Wilson, "politicians (especially the collective cabinet) have a strong tendency to respond to policy issues (any issue) by moving successively from the *least coercive* governing instruments to the *most coercive*." See G. Bruce Doern and V. Seymour Wilson, "Conclusions and Observations," in G. Bruce Doern and V. Seymour Wilson (eds.), *Issues in Canadian Public Policy* (Toronto: Macmillan, 1974), 339.
- 14 In seeking to control inflation or induce plant locations, governments do appear to prefer to coax or persuade before they compel. The same cannot be said for labour relations, where some governments at least have shown little reluctance to employ coercive instruments. See Leo Panitch and Donald Swartz, *The Assault on Trade Union Freedoms: From Consent to Coercion Revisited* (Toronto: Garamond, 1988).

paradigm.<sup>15</sup> Reacting to arguments based on technical efficiency—that is, governments employ the most cost-effective instrument available<sup>16</sup>—they argue that these efficiency considerations are best understood as means to “more ultimate ends.”<sup>17</sup> In the case of politicians the primary ultimate end is that of re-election. According to the argument of Trebilcock et al., politicians enhance their prospects for re-election when they select policy instruments that confer benefits on marginal voters—those who are electorally uncommitted or weakly committed—and impose costs on infra-marginal voters—those with strong electoral commitments. They do not choose the instrument that is least costly, but rather the one that distributes costs in a manner most favourable to prospective supporters.

There are clearly limits to this strategy. The choice of instruments is legally constrained and, perhaps more important, constrained by imperfect information. Because neither voters nor politicians can know the future perfectly, uncertainty will arise with respect to the impact of alternative instruments. Under these circumstances it may be rational to select instruments that maximize flexibility and reversibility. It may also be rational “to secure the cooperation of bureaucracies in implementing policies . . . to provide subsidized, selective information and symbolic reassurances to the cost-bearers . . . [and] to assign the administration of the policies to an ‘independent’ agency of government, so that the causal relationship between the costs and the party is attenuated in voter perceptions.”<sup>18</sup>

It is evident that with the benefit of axiomatic reasoning it may be possible to derive some interesting propositions regarding the choice of policy instruments. Nonetheless, there are problems with this approach. First, the image of choice offered here represents a rather acute abstraction of the policy process. Politicians and bureaucrats are not the only critical policy actors. Moreover, they rarely confront the entire inventory of instruments that scholars have created. The available options may be very narrow or very wide, depending on the issue. And in issue areas with a long history of policy initiatives, there is often less room for political manoeuvre than is implied by the policy instrument literature. Certain instruments will already be employed and these will have their supporters and a legal framework as reinforcements.

15 M. J. Trebilcock, D. G. Hartle, J. R. S. Prichard and D. N. Dewees, *The Choice of Governing Instrument* (Ottawa: Economic Council of Canada, 1982).

16 For example, Gary S. Becker, “Competition and Democracy,” *Journal of Law and Economics* 1 (1958), 105-08. Trebilcock et al. make a persuasive case for treating the Doern-Wilson hypothesis as a variation on the theme of technical efficiency where coercion becomes synonymous with cost (*The Choice of Governing Instrument*, 22-23).

17 Trebilcock et al., *The Choice of Governing Instrument*, 25.

18 These and other “political axioms” are summarized in *ibid.*, 33-34.

Changing instruments under these circumstances is likely to be a major undertaking. As Woodside argues, “political scientists need to be more careful in their discussions of policy instruments if an unrealistic sense of choice is to be avoided.”<sup>19</sup>

The second problem concerns the inherent qualities of policy instruments, in particular the view that some instruments will always be more coercive than others. In fact, the qualities displayed by instruments will vary to some degree with the context in which they are employed. Regulation, an allegedly coercive policy instrument (in that it requires compliance), cannot easily be construed as coercive when firms and individuals first actively lobby for it and then negotiate its application. Moral suasion, an ostensibly benign attempt to persuade, takes on much more sinister overtones of manipulation when citizens are deliberately misled. Hard and fast judgments about the inherent qualities of policy instruments are difficult to defend. The intentions of policy-makers, the meanings attached to their actions and the manner in which instruments are structured all contribute to the actual level of coercion imposed.<sup>20</sup> To some extent at least, coercion is in the eye of the beholder rather than in the nature of the policy instrument.

A third problem with this version of instrument choice lies in its portrayal of political institutions and political behaviour. The rational choice model presumes that institutions are composed of individual political actors who reflect societal interests. In this sense, the rational choice model is society-centred. Trebilcock and his colleagues put the matter succinctly in their treatment of cabinet: “Ideally, the members of the cabinet should collectively reflect, in microcosm, the conflicting interests of the electorate. . . . Ideally too, the ministers should push the multitude of interests they represent as vigorously as possible.”<sup>21</sup> Driven by their desire for re-election, politicians appear as promoters and manipulators, constrained by the financial and legal limits imposed on them by the institutional rules of the game, but otherwise consumed by career ambitions. Together with bureaucrats and leaders of interest groups, they play the game of politics in which private appropriation, or rent-seeking behaviour, is the norm. Policy instruments are little more than tools in a game designed to maximize utility functions.

While this imagery may be attractive, it rests on the view that institutions are primarily derivative of human choices. The key difference between rational choice and neo-institutional theorizing lies in the implications of this position. For rational choice theorists, institutions constrain in the sense that different rules will result in

19 Kenneth Woodside, “Policy Instruments and the Study of Public Policy,” this JOURNAL 19 (1986), 787.

20 On the last point in particular see *ibid.*, 787-92.

21 Trebilcock et al., *The Choice of Governing Instrument*, 12.

different outcomes. And institutionally prescribed rules can be changed; they are malleable, human products. In the rational choice model institutions are, as Grafstein states, "the products of human choice . . . designed to attain some preferred set of outcomes."<sup>22</sup> Human beings create institutions in an atmosphere of uncertainty concerning the actions and preferences of others, especially future actions and preferences. The most important obstacle to recreating, modifying or by-passing existing institutions are transaction costs, "the costs of capturing, bargaining, measuring, monitoring and enforcing property rights."<sup>23</sup> Unless they can see some clear advantage to overcoming these transaction costs, participants will not work to change institutional arrangements. This is how institutions constrain in the rational choice model.

Neo-institutional theorists believe that institutions constrain in a much more profound sense. Instead of portraying institutions as derivative of human choices, neo-institutionalists are more inclined to see human beings and their values as products of a larger institutional framework. Thus institutions constrain the behaviour of participants not simply by limiting their choices but by defining and modifying their preferences. As Krasner puts it, "preferences are developed through involvement in political activity that is structured by institutional arrangements."<sup>24</sup> Institutions are not instruments designed by those who have stable preferences; instead, they are critical actors in the social construction of reality. And while the definition and the ontological status of institutions remains problematic,<sup>25</sup> neo-institutionalists have no doubt that institutions are real, independent entities that encourage, as sociologists have long observed, the development of consensual norms.

As a corollary, neo-institutionalists emphasize that institutions exercise influence on political outcomes far beyond their inception. They are, moreover, very difficult to change.<sup>26</sup> As institutionally prescribed interactions multiply over time, institutions achieve a measure of coherence that cannot be summarized by aggregating

22 Grafstein, "The Problem of Institutional Constraint," 583.

23 Levi, "The Transformation of Agrarian Institutions," 163; also Grafstein, "The Problem of Institutional Constraint," 583-84. There may, however, be first-order rules upon which the constitutional contract is based that are much harder to change. See James Buchanan, *The Limits of Liberty* (Chicago: University of Chicago Press, 1975); and, for a distinction between constitutions and institutions, Mark Sproule-Jones, "Institutions, Constitutions and Public Policy," in Atkinson and Chandler, *The Politics of Canadian Public Policy*, 127-50.

24 Stephen D. Krasner, "Sovereignty: An Institutional Perspective," *Comparative Political Studies* 21 (1988), 73.

25 The issue is addressed directly in Grafstein, "The Problem of Institutional Constraint," 588-94.

26 This point is emphasized in Krasner, "Sovereignty," 73-77.

individual utilities. They become autonomous in the sense that they are able to influence political decisions independent of the individuals that occupy roles within them. This capacity to influence will, of course, be variable and depend on a host of organizational qualities. But where this capacity is extensive, institutions will often be able to define problems in new and unexpected ways, mobilize interests previously unidentified and infuse political actions with moral purpose.

The matter of moral purpose is of particular importance to neo-institutionalists. They see institutional practices and problem-solving routines as based on moral reasoning; that is, reasoning which takes account of the wants of others.<sup>27</sup> This form of reasoning presupposes a sense of duty or obligation. Social actors thus consult not only their personal preferences, but also the institutionally prescribed rules of appropriateness.<sup>28</sup> Often these rules will have been established over a considerable length of time and will demand, in classic Weberian style, that public officeholders separate their private sentiments from their professional obligations.<sup>29</sup> For neo-institutionalists, public officials act not simply to extract some advantage from the political process, as in the rational choice model, but also to interpret and communicate the moral character of political practice.

What are the implications of this neo-institutional perspective for the study of policy instruments? It suggests, in the first place, that researchers should resist the temptation to treat the deployment of a policy instrument as a matter of discrete choice when it is, in fact, a temporally extended political act. There is always a history associated with the use of particular instruments, and with this history comes some shared understanding that mediates choices. Changing direction under these circumstances can be very difficult. Institutions are not altogether flexible and the deployment of new policy instruments may be impossible within the framework of existing structures.

Second, if the values and preferences of participants are treated as endogenous variables, then much greater attention must be paid to the content of political discourse. The language in which particular instruments are defended or attacked is suddenly relevant since it conveys the moral and political basis on which shared understandings are challenged. As Wildavsky maintains, "without being privy to the internal discussions through which shared meanings are worked out, it is

27 Ronald Manzer, "Public Policy-making as Practical Reasoning," this JOURNAL 17 (1984), 580.

28 March and Olsen, "The New Institutionalism," 741. The impact of this on "political jurisprudence" is traced in Rogers M. Smith, "Political Jurisprudence, the 'New Institutionalism,' and the Future of Public Law," *American Political Science Review* 82 (1988), 89-108.

29 James G. March and Johan P. Olsen, "Popular Sovereignty and the Search for Appropriate Institutions," *Journal of Public Policy* 6 (1986), 353.

impossible to explain why a given culture prefers certain institutional arrangements and instruments of policy at one time and different ones on other occasions.”<sup>30</sup> From their diverse institutional platforms the participants in the instrument choice decision engage in a prolonged conversation on the appropriateness of contemplated actions given these existing understandings. What they say becomes important as a rationale, not simply a rationalization, for their behaviour.

Third, the capacity of institutions to identify and act upon their preferences becomes an important variable in the selection of policy instruments. Organizational attributes are critical determinants of this capacity. Institutions that are coherent, autonomous and flexible, for example, may be capable of proposing and deploying a relatively wide range of policy instruments. Institutions in which organizational goals are tightly defined, resources are restricted and standard operating procedures are entrenched may find it more difficult to adapt to new policy instruments. Moreover, since instrument choice involves both societal and state institutions, it is important to estimate their relative capacity to act on their preferences for particular policy instruments.<sup>31</sup>

It should be evident that what neo-institutionalists are proposing is a research agenda—one which includes a wide range of variables—rather than a theory of instrument choice. We are far away from the point at which it is possible to deduce expectations based on a set of simple axioms generated by neo-institutional theorizing. It should also be evident that the neo-institutional perspective on instrument choice is unlikely simply to displace the rational choice model. Ultimately a theory of instrument choice will have to incorporate the insights of both. In what follows, however, we continue to treat these approaches separately and in the context of a particular instance of instrument choice we suggest some of the complications that arise in actually using them. Such a consideration begins with the policy area itself and the apparent choices available to decision-makers.

### Automobile Insurance in Ontario

The case of automobile insurance in Ontario is appropriate for the study of instrument choice for a number of reasons. First, the issue is politically salient. In Ontario, as in the other Canadian provinces, the purchase of automobile insurance is compulsory. Given that there

30 Aaron Wildavsky, “Choosing Preferences by Constructing Institutions: A Cultural Theory of Preference Formation,” *American Political Science Review* 81 (1987), 1-21.

31 Michael M. Atkinson and William D. Coleman, “Strong States and Weak States: Sectoral Policy Networks in Advanced Capitalist Economies,” *British Journal of Political Science* 19 (1989), 48-67.

are 5.7 million drivers in Ontario, problems in the automobile insurance market automatically are politically significant. Second, the history of automobile insurance policy in Ontario is consistent with respect to a basic issue or problem, namely, rates and the service for which rates are paid. Finally, the policy options available to government appear to be fairly clear. In essence, the government must choose either the present system of regulated but competitive markets, or a new regulatory regime which may or may not include a system of public ownership.

Before proceeding to outline alternative interpretations of the automobile insurance policy process, it is necessary to present some background on the structure of the industry in Ontario. Moreover, the basic policy problem and its history, along with the policy options, also require attention. Finally, this backdrop would not be complete without an identification of the principal actors.

The annual sale of automobile insurance in Ontario amounts to direct premium income of \$3 billion. In the aggregate at least, it can be regarded as big business.<sup>32</sup> There are, however, 102 insurers selling automobile insurance in the Ontario market, so this business is relatively dispersed. In fact, the top 10 insurers control 53 per cent of the market, while the top 20 control 74 per cent. The industry is, furthermore, fairly diverse in terms of country of origin. Of the top 10 firms, three are Canadian, two are based in the United States, four are British-based and one is of Swiss origin. Firms also differ in the way in which they market automobile insurance. Of the top 10, three are direct writers—that is, they sell insurance through captive agents—while the remaining seven write business indirectly through independent brokers. Overall, brokers are responsible for 74 per cent of the automobile insurance sold in Ontario.<sup>33</sup>

This pattern of industrial organization has some important implications. First, it has led some to conclude that the industry is, relatively speaking, quite competitive and that it has been competitive for some time.<sup>34</sup> Second, the diversity of the industry from the perspective of country of origin implies that many automobile insurers may not be highly dependent upon the Ontario market. Finally, the fact that most companies market automobile insurance through independent brokers, to whom their only obligation is sales commissions, means that these companies can retreat from the market more readily than those

32 Data on the structure of the industry are drawn from Ontario, *Inquiry into Motor Vehicle Accident Compensation in Ontario, Report*, 2 vols. (Toronto: Queen's Printer for Ontario, 1988). This report, prepared by the Honourable Mr. Justice Coulter Osborne, is referred to hereafter as the Osborne Report.

33 Data on the countries of origin and the proportion of direct writers were calculated separately using information supplied in Appendix 18 of the Osborne Report.

34 Paul Potvin, "The Structure of the Ontario Automobile Insurance Industry," in the Osborne Report, vol. 2, 224-81.

who use captive agents—company employees for whom overhead expenses are incurred.

The present policy issue or problem in the area of automobile insurance is one of rates, in particular the perception of rapidly increasing rates. An understanding of this issue requires a definition of automobile insurance: specifically, what do consumers obtain for the money they spend on automobile insurance? In essence, the coverage available through the legislated Standard Automobile Policy is three-fold. Section A provides third-party liability coverage for both bodily injury and property damage. Despite a system of compensation based primarily on fault-liability, third-party coverage has been compulsory only since 1980. Section B is a limited first-party no-fault bodily injury coverage known as Accident Benefits, which has been a mandatory part of the standard policy since 1972. Section C provides first-party physical damage coverage (that is, collision, comprehensive, and so forth) and is optional. Automobile insurance is all of the above. However, it is the third-party liability coverage and the consequent claims environment (particularly for bodily injury) that has been cited as the source of rapid rate escalation.

Even though rates constitute the main underlying issue, they have not always been the focus of automobile insurance policy in Ontario. In fact, many of the changes in this policy have focussed on the related issue of the service or coverage provided. Even here, however, and in spite of more than 65 years of evolution, the history of legislative action is surprisingly brief. It begins in 1914 when automobile insurance was added to the *Insurance Act* and, for our purposes, ends with the enactment of Bill 2 in February 1988. In the interim, notwithstanding amendments to the Act in 1922 to include detailed provisions on automobile insurance, reform has been limited to marginal changes introduced in the aftermath of comprehensive studies—by the Hodgins Commission in 1930<sup>35</sup> and by two select committees of the Ontario Legislative Assembly in the 1960s and 1970s.<sup>36</sup>

Although the Hodgins Commission proposed recommendations on both rates and service, it was effective only in the latter area. Amendments made to the *Insurance Act* in 1930 did give ultimate authority over rates to the Superintendent of Insurance but this power,

35 Ontario, Royal Commission on Automobile Insurance Premium Rates, *Report* (Toronto: Queen's Printer, 1930). This report, prepared by the Honourable Frank E. Hodgins, is referred to hereafter as the Hodgins Report.

36 Ontario Legislative Assembly, Select Committee on Automobile Insurance, *First Report* (Toronto, 1961), *Interim Report* (Toronto, 1961), and *Final Report* (Toronto, 1963); and Ontario, Legislative Assembly, Select Committee on Company Law, *First Report on Automobile Insurance* (Toronto, 1977) and *Second Report on Automobile Insurance* (Toronto, 1978).

still contained in the Act, was never proclaimed in force. In matters of service, the major effect of the Hodgins report was the adoption of a financial responsibility law which permitted motorists to drive without liability insurance only until they violated certain laws or failed to satisfy a judgment. The Unsatisfied Judgement Fund was created in 1947 as a means of compensating the innocent victims of these uninsured motorists. In 1962, as a consequence of the study by the Select Committee on Automobile Insurance, the Unsatisfied Judgement Fund was reconstituted and renamed the Motor Vehicle Accident Claims Fund.

The net effect of the select committees' work was also primarily in the area of coverage and service rather than rates. In 1972, the limited first-party no-fault bodily injury coverage became a mandatory part of the Standard Automobile Policy. In 1980 the province enacted a compulsory insurance law, which replaced the old financial responsibility law and unconditionally compelled motorists to purchase liability insurance. In addition, the Standard Automobile Policy was broadened to include a first-party uninsured motorist coverage, which for all intents and purposes eliminated the role of the Motor Vehicle Accident Claims Fund in this regard. Only in one area were changes made that directly affected rates: the compulsory insurance legislation empowered the Superintendent to approve or disallow rates for the Facility Association, the industry-run residual risk pool.

Bill 2, the most recent instalment in this brief legislative history, creates the Ontario Automobile Insurance Board and empowers it to set automobile insurance rates. The rates set are based on a grid system that combines rating components with each driver classification. The Board thus sets a rate for each component, either as a dollar figure or in a range. The classification system itself is based on driver experience and vehicle use. Age, sex and marital status are eliminated as rating criteria. In effect, the Board restricts the ability of insurers to set rates beyond a certain range.

Bill 2 resembles previous reforms in that it continues the pattern of addressing rates and service separately.<sup>37</sup> It does represent a departure, however, in the sense that Bill 2 is a dramatic response to the issue of rates. Such a response was deemed necessary given rapid rate increases in the province, especially for certain classes of drivers. In an important way this particular episode of rate increases was an unprecedented phenomenon. The performance of the insurance industry has

37 Bill 2, which is now law, is known formally as *An Act to Establish the Ontario Automobile Insurance Board and to provide for the Review of Automobile Insurance Rates*. It was introduced by the Honourable Robert Nixon on November 4, 1987, and received Royal Assent on February 11, 1988. It will be referred to here simply as Bill 2.

traditionally been explained by reference to a cycle of ebbs and flows in capacity and price.<sup>38</sup> As a consequence of extraordinarily high interest rates in the early 1980s, the predicted upward price or rate correction did not take place. Instead, companies engaged in the practice of cash flow underwriting to allow as much high interest investment as possible. The effect of this was rather indiscriminate risk selection. Moreover, rates remained relatively low as insurers competed for dollars, until interest rates once again declined in the late 1980s. By this time, however, the liabilities incurred through the preceding period had come to fruition. This factor, coupled with a highly litigious claims environment, resulted in significant underwriting losses and equally significant rate increases.

It is clear, then, that the public policy objectives in the realm of automobile insurance have changed very little since the 1930s. Stability in rates and a system of fair compensation remain the principal policy objectives. What has changed, however, is the driving environment. The cost of bodily injury claims has risen remarkably, particularly during the last decade.<sup>39</sup> In fact, it is this issue that is likely to guide instrument choice in the near future.<sup>40</sup>

Bill 2 is intended to serve the objectives of rate stability and equity. However, given that insurers were not profiting from the sale of automobile insurance prior to the restrictions of the Board, it is unlikely that they will agree to go on delivering the same level of service after these rate restrictions are in place.<sup>41</sup> In fact, insurers are demanding that they be relieved of some of their obligations in the area of bodily injury compensation. For them the answer is a limited form of no-fault; a restriction on the right of victims to sue in tort.

A pure no-fault system does away with compensation based on fault-liability and, in its place, establishes a system in which all injured persons (regardless of fault) receive some measure of compensation from their own insurer. This measure of compensation depends on variables like income, but it is generally accepted that a no-fault system, pure or otherwise, will provide less compensation overall than the

38 See Ontario, Task Force on Insurance, *Final Report* (Toronto: Queen's Printer, 1986). This report, prepared by David W. Slater, is referred to hereafter as the Slater Report.

39 Osborne Report, vol. 1, 248-49.

40 Minister of Consumer and Commercial Relations Monte Kwinter, in a speech delivered on April 23, 1987, indicated that the government has an unfinished agenda of reform. This agenda was given something of a setback by the Osborne Report, which opposed both a rate-setting board and fundamental reform of the existing system of bodily injury compensation.

41 The question of profitability is contentious, especially in the aftermath of large premium increases in 1986. Automobile insurance was by most accounts not profitable in 1985, when costs from losses significantly exceeded income from premiums. For an in-depth analysis, see Osborne Report, vol. 1, 278-96.

present fault-liability system. For example, in the no-fault system proposed by the industry,<sup>42</sup> only injuries of a serious and permanent variety would be accorded the right to sue in tort for pecuniary damages beyond the scheduled amount. The right to sue in tort for non-pecuniary damages would similarly be restricted to this sort of serious and permanent injury. Plainly, the move to no-fault would represent a significant political step, and it is not one which any government in Ontario has so far been tempted to take.

An equally significant step would be the move to a publicly owned system of automobile insurance. Opting for a public corporation in other jurisdictions has generally meant creating a government corporation monopoly to handle, at minimum, basic bodily injury coverage. Private insurers are relegated to the sale of excess coverage and other lines of general insurance. The apparent benefits of a public corporation include the opportunity to realize economies of scale and to introduce a measure of simplicity into the administration of both rates and service. The costs include the sacrifice of competition and the absorption of significant start-up costs (which would be particularly heavy in the province of Ontario). The net effect of a public system on automobile insurance rates and service is not altogether clear.<sup>43</sup>

In the final analysis, the impact of public ownership on rates would be heavily influenced by the system of compensation to which it was linked. Even if a public corporation were chosen, there would still be a need to make regulatory choices. For example, in Saskatchewan, Manitoba and British Columbia, where public automobile corporations exist, bodily injury compensation is based on fault-liability. In Quebec, on the other hand, the public corporation administers bodily injury compensation on a no-fault basis much like workers' compensation. As this pattern indicates, public ownership would not resolve regulatory issues such as the debate between the defenders of fault-liability and no-fault. The choice of instruments is not an either/or matter. Rather, it is the particular mix of instruments that demands attention.

The primary actors involved in the selection of policy instruments for automobile insurance are the conventional triad of interest associations, bureaucrats and politicians. Among the interest associations, the Insurance Bureau of Canada (IBC) is by far the most important. It represents 95 per cent of private automobile, casualty and

42 Insurance Bureau of Canada, *Smart No-Fault* (Toronto, 1987).

43 A study prepared for the Select Committee on Company Law by Woods Gordon Management Consultants concluded that "it is impossible to provide a factual or statistically supportable answer to the government versus private ownership question." See Select Committee on Company Law, *Second Report on Automobile Insurance*, Background Study Number Two: Government Ownership of Automobile Insurance (Toronto, 1978), 449. This report is referred to hereafter as the Woods Gordon Report.

property insurance companies in Canada. Moreover, in Ontario it is the agency designated to collect Green Book statistics.<sup>44</sup> The IBC is the author and major proponent of the industry's no-fault proposal outlined above. Needless to say, it is opposed to a public system of automobile insurance.

The other significant industry groups are the Association of Canadian Insurers (ACI) and the Insurance Brokers Association of Ontario (IBAO). The former is a relatively small interest association made up of eight Canadian member companies and is concerned particularly with "presenting the Canadian viewpoint to governments and regulatory bodies."<sup>45</sup> The IBAO represents 1,285 broker offices and 4,948 individual independent brokers throughout Ontario. Both the IBAO and the ACI are supporters of no-fault and opponents of public automobile insurance.

The Advocates' Society represents in excess of 1,000 trial lawyers in Ontario. The bulk of this membership, roughly two-thirds, practises in the Metropolitan Toronto area. The Advocates' Society has vociferously opposed no-fault insurance since it first became an issue in the mid-1970s. It has often suggested that the no-fault option is tantamount to a public system.

With respect to bureaucracy, the principal provincial agency in the area of automobile insurance (other than the Board itself) is the Insurance Division of the newly created Ministry of Financial Institutions. Headed by the Superintendent of Insurance, it consists of the Insurance Operations Branch and the Motor Vehicle Accident Claims Fund. The Insurance Division has no explicit position on either no-fault or public automobile insurance.

Of the three major parties, only the New Democratic party—which supports a public no-fault system—has a clearly enunciated position on all of the issues at hand. The Conservatives, while opposed to a public scheme, are without a stated position on no-fault as an alternative to the existing fault-liability system. The governing Liberals have introduced the rate board as the first of a number of planned but as yet undisclosed reforms.

Interviews with key actors—politicians, interest group leaders, managers of individual firms and bureaucrats—were conducted during the fall of 1987 and the spring of 1988. Most interviews were tape-recorded and respondents were guaranteed confidentiality. These

44 These data are reported annually and include information on premiums written and earned, losses and loss expenses, claim frequency, average cost per claim and loss ratio.

45 Hugh McKay, "The Association of Canadian Insurers," *Canadian Insurance* 92 (1987), 58ff. Although the association is relatively small, seven of the eight member companies rank within the top 20 automobile insurers in Ontario.

interviews constitute the principal source for the interpretations that follow. However, reports commissioned on automobile insurance and the attendant exhibits and submissions were invaluable in supplying background information.

### **Interpreting the Automobile Insurance Case**

This discussion employs alternative interpretations of instrument choice to answer three questions that are critical to the case of automobile insurance in Ontario: Why did the government of Ontario create a rate review board rather than affirm the status quo? Why has the government retained fault-liability as the basis of compensation rather than adopting a no-fault system? Why has the government not created a public corporation to provide automobile insurance? We approach each question first from the point of view of the rational choice approach to instrument choice, and then from the neo-institutional perspective. The answers provided are by no means the only ones available, but they do illustrate our contention that the study of policy instruments can be conducted from radically different perspectives.

#### *The Rational Choice Approach*

The creation of a rate review board is broadly consistent with the coercion hypothesis postulated by Doern and Wilson. From the industry's point of view, at least, price determined by a rate review board is considerably more coercive than price determined by the self-regulating market. Moreover, the structure of the Automobile Insurance Board, and in particular the extensiveness of its powers, establishes clearly the government's intention to create a strong new agency. Section 12 of the Act gives the Board the power to determine its own rules of procedure, to conduct inquiries and inspections, to enter premises and examine documents and to demand copies of computer data. The Ministry of Financial Institutions has defended these powers as consistent with the Board's mandate to establish and enforce the government's new classification system.<sup>46</sup> The structure of the Board clearly anticipates an adversarial relationship between industry representatives and the new agency. While the industry was consulted on the new classification system, it is now in no position to challenge the Board's authority to set, rather than simply review, rates. Therefore, although the Board may be the next logical step along the coercion continuum, it represents a rather large increment.

46 See the remarks of the Honourable Robert Nixon to the Ontario Standing Committee on Administration of Justice, *Hearings on the Automobile Insurance Board Act*, January 11, 1988.

Even if one accepts the coercion hypothesis, it is not altogether clear why the Board was chosen when it was; that is, what prompted more coercion? From the point of view of the rational choice approach, the answer is to be found at the individual level of analysis in the preferences of voters and the strategies of politicians. In terms of the hypothesis of political rationality postulated by Trebilcock and his colleagues, the movement to a regulatory agency should be understood as a response to shifting patterns of voter preferences. The stimulus for this particular shift was, of course, the recent problem with rates. In this case, however, the precise distribution of these preferences as they pertain to available policy instruments was unclear. A vote maximizing calculus that would yield an instrument capable of appealing specifically to marginal voters was not readily evident. The problem of imperfect information forced the governing Liberal party to employ a subsidiary strategy based on public inquiries and the introduction of the rate review board.

Public inquiries, in this case the Slater Task Force and the more recent Osborne Commission, can be seen as low-cost responses that put distance between the governing party and those charged with evaluating alternative policies. This is a particularly useful strategy when there is no clear consensus on the most appropriate instrument to employ. Slater and Osborne, although agreed on the matter of private delivery, arrived at differing conclusions on the no-fault question. With Slater in favour of a limited no-fault system and Osborne opposed to any limit on the right to sue in tort, the government succeeded in obtaining additional time to make the finer electoral calculations that these choices would ultimately require.

The rate review board separates the issue of rates from that of service so that the effects of instrument choice can be monitored more accurately. Moreover, the Board represents an effective short-term answer to the problem of rates. It accords the governing Liberals symbolic benefit while, at the same time, distances them from the costs of concrete decisions—inasmuch as the Board will now act as the ultimate authority on rates.

The removal of the traditional rating criteria based on age, sex and marital status will confer benefits on concrete groups, especially single male drivers under the age of 25 whose parents may also be sensitized to the issue. The costs of this uniform classification system are borne by a much more diffuse population of lower-risk drivers. While the industry may attempt to identify certain cost bearers, the complexity of the issue, particularly the classification scheme, militates against a political response.<sup>47</sup> In this case and more generally, the choice of a rate review

47 On the classification scheme itself, see Ontario, Ministry of Financial Institutions, *A Draft for Consultation: A Classification System for Automobile Insurance* (Toronto, February 1988).

board is consistent with the rational choice approach to policy instruments. Its treatment of the governing party as a responsive, rational actor permits a plausible interpretation of the instrument chosen in this context.

Rational choice also offers a plausible answer to the question of why fault-liability was retained over no-fault as the basis of bodily injury compensation in Ontario. A no-fault system would restrict an innocent victim's right to sue in tort and thereby significantly reduce the amount of compensation presently available under the fault-liability system. For most consumers (not to mention lawyers) and particularly for the innocent victims of motor vehicle accidents, this innovation would represent a significant step along the coercion continuum. In this sense, at least, the political costs are potentially high.

On the other hand, the benefits of a no-fault scheme are, at best, uncertain.<sup>48</sup> No-fault generally means that all drivers qualify for some measure of bodily injury compensation. Drivers would therefore be rated in accordance with their potential as claimants (in terms of wage exposure, for example), regardless of fault. However, the impact of no-fault on the overall rate structure is unclear.<sup>49</sup> Even those most likely to benefit under a no-fault system—namely, drivers with a record of at-fault accidents—will not necessarily be aware of the advantages. Since most people are rather poor at assessing their own risk, the appeal of no-fault even to high-risk drivers may be rather low.<sup>50</sup>

Of course, the present aversion to no-fault does not necessarily mean that it will never be adopted. But the attractiveness of no-fault to a governing party depends largely on whether it can be shown to deliver lower rates to consumers. No one has so far been able to provide a convincing argument and, as a result, no-fault remains a deficient policy instrument. The only group that believes it would benefit from no-fault is the insurance industry, which has demonstrated no capacity to provide the selective subsidized information that would structure or alter the preferences of consumers.

48 In a submission to the Select Committee on Company Law on a version of no-fault proposed by the IBC in the mid-1970s, the Consumers Association of Canada concluded that, "after months of study and opinion-gathering from members in all provinces, we find that we are unable to present a national consensus on the plan as proposed. . . . The adoption of the plan might prevent further increases in premium for some classes of drivers, but consumers have no assurance that this would be so." See Archive of Ontario, Exhibit 41 of the Select Committee on Company Law, *Second Report on Automobile Insurance*, "Comments on Auto Insurance and Variplan," n.d.

49 Woods Gordon Report, 318-36.

50 On the inability of individuals to assess accurately personal risks see Robert Goodin, *Public Policy and Political Theory* (Chicago: University of Chicago Press, 1982), 139-45.

While the private insurance industry would be among the major beneficiaries of no-fault, they would undoubtedly bear the heaviest costs in a publicly owned system. The creation of a public corporation to sell automobile insurance would represent a highly coercive step from their point of view. Moreover, the fact that insurance is becoming increasingly integrated with other parts of the financial services industry means that the costs of public ownership could not be confined to a single industry sector. In fact, a public corporation would concentrate responsibility for rates and service on the governing party, which would then face significant exposure to public criticism.<sup>51</sup>

Are there any political benefits? According to Trebilcock et al., public corporations are preferable to regulation when the needs of politicians can best be met by direct intrusion into the marketplace. This occurs when politicians seek to pursue public goals in oligopolistic markets where monitoring costs are typically high. Under these circumstances public corporations permit governing parties to estimate accurately the real subsidy requirements of firms in the market as well as to co-ordinate other existing public programmes. Where there are legal or other limits on the use of alternative instruments, or when governments seek the opportunity to make public decisions in an atmosphere of secrecy, public corporations become politically attractive vehicles.<sup>52</sup>

In the case of automobile insurance, these putative benefits are not immediately obvious. In the first place, the industry is highly competitive. Monitoring costs are normally low under these circumstances. Even if they are high, it should be possible to solve monitoring problems without resorting to a public corporation. Moreover, no other programmes exist that require a large measure of co-ordination, and few legal or other impediments exist to the use of the regulatory instrument. From the rational choice perspective there are no obvious benefits, and numerous costs, involved in creating a public automobile insurance corporation.

The political rationality argument nonetheless holds out the possibility of a public corporation should the political environment change. For example, it is conceivable that foreign-based insurers, particularly those who write business through independent brokers, will retreat from the provincial market in the face of the restrictions implied by a rate review board. The likelihood of such a decision has been increased by the Osborne Commission's rejection of no-fault as a means

51 Manitoba is a case in point. See "1,000 meet to fight Manitoba auto rates," *Globe and Mail*, January 8, 1988.

52 Trebilcock et al., *The Choice of Governing Instrument*, chap. 6 and M. J. Trebilcock and J. R. S. Prichard, "Crown Corporations: The Calculus of Instrument Choice," in J. Robert S. Prichard (ed.), *Crown Corporations in Canada: The Calculus of Instrument Choice* (Toronto: Butterworths, 1983), 1-97.

of providing the industry with some financial relief. A significant withdrawal from the market could create a serious capacity problem should the remaining companies be either incapable or unwilling to accept the additional business. A deep antipathy toward the industry on the part of consumers would be the likely result. Under these circumstances a public corporation could become a viable option.

### *The Neo-institutional Approach*

The neo-institutional perspective offers a distinctly organizational approach to the questions cited above. Rather than taking individual decision-makers as the primary units of analysis, this perspective emphasizes the macro-structural level of analysis where the selection of policy instruments is understood as an emergent process, not a rational choice.<sup>53</sup> Analysis of the decision to establish a rate review board begins with an appreciation of the shared understandings that mediate social interaction, in this case between the automobile insurance industry and the state. Not all of these shared understandings can be identified here, but some attention must be paid to how these key participants in the process view one another, what they consider to be the legitimate objectives of government policy in the field of automobile insurance and how much capacity each has to turn intentions into action. From the neo-institutional perspective, the decision to create a rate review board can be understood only when these contextual variables are firmly in place.

In the automobile insurance case the principal players view one another across a gulf of suspicion and mistrust. That gulf widened appreciably with the appointment of the minority Liberal government in 1985. It existed in the first place because the industry had grown politically complacent in the decade preceding the rate crisis of the mid-1980s. The industry had done little to monitor political events in the province or to improve its own public image, patterns for which there are structural explanations. The relatively high level of foreign ownership in the industry has meant that the managers of many firms can expect to spend at least some of their careers outside the province. More important, many of these foreign companies are quite capable of withdrawing altogether from the provincial market. In either case, investment in political education and the cultivation of political contacts has been discouraged. Moreover, since most of the industry practises indirect writing through independent brokers, many of these managers have had limited contact with the public and limited involvement in their communities. Their political profile has thus been relatively low. Few

53 See Jeffery Pfeffer, *Organizations and Organization Theory* (Marshfield, Mass.: Pitman, 1982), esp. chaps. 6, 7.

have worked for political parties and (until recently) the industry association, the IBC, has steered clear of electoral politics.<sup>54</sup>

When increasing rates became a matter of public urgency, neither bureaucrats nor politicians had much faith in the industry's capacity to calm the storm of criticism. The industry was inclined to consider it just another, albeit serious, upturn in the rate cycle. Government officials, on the other hand, interpreted the public's reaction in terms of broader societal trends that touched financial institutions in general. State intervention would not necessarily be predicated on insurance market failure. As one bureaucrat observed,

I think there is a different social expectation now, a growing sense of financial institutions as a form of social utility. We have many more statutory requirements for insurance, for instance, in our society. We require people to have insurance, and we require people to have insurance in very large amounts. So we are moving to a system in which insurance companies are no longer just businesses. They are encountering the reality that they have to meet the requirements of others.

Most firms found it difficult to recognize, let alone reconcile themselves to, this new reality. Firms and associations were simply not monitoring the environment for serious changes in public opinion. When crisis struck they defined the problem in fairly conventional categories. Politicians and bureaucrats, fresh from the experience of trust company failure and deregulation in the financial industry, were inclined to interpret events in broader, systemic terms.

The organization of both the state and the industry contributed heavily to this failure to anticipate and communicate. On the insurers' side, the principal industry association, the IBC, suffered from all of the problems associated with mobilizing a heterogeneous interest. Characterized by its members as a "trade association," one of IBC's major functions is the collection of Green Book data on the performance of the industry. This responsibility has been mandated by Section 80(1) of the *Insurance Act* and approximately half of the 140 employees of the association are assigned to this task. It still provides the association with a benchmark *raison d'être* but, in recent years, the public affairs role of the association has received more attention, especially since the arrival of the current president, Jack Lyndon. His efforts notwithstanding, the association still finds it difficult to forge an industry-wide position, even on issues directly related to automobile insurance. The association's endorsement of a no-fault scheme in the mid-1970s was met by the withdrawal from the association of one of the industry's largest firms, Allstate.

54 One example is the traditionally low level of political contributions made by the industry and its associations. See Robert A. Nigol, "The Choice of Policy Instruments: The Case of Automobile Insurance in Ontario" (unpublished M.A. thesis, McMaster University, 1985), 103-04.

With respect to state organization, the Ministry of Financial Institutions has primary responsibility for automobile insurance, although in the area of tort reform responsibility is shared to some degree with the Ministry of the Attorney General. Established as a separate ministry in the aftermath of a series of trust company failures, Financial Institutions is first and foremost a regulatory agency. It has a highly professional organizational ethos which emphasizes formality and legal remedies. These act as shields against special pleading from both the industry and politicians. However, the Ministry is very new and is struggling to cope with the consequences of deregulation in the financial services sector. In the case of automobile insurance, it does not generate its own information on the industry and often finds itself cast in the role of supplicant, requesting information from the IBC in a form that the latter is often reluctant to provide. Its policy-making capacity is limited by a shortage of resources, by its status as a traditional regulatory ministry, by the focus of its existing administrative machinery on the rather narrow issue of insolvency and by the requirement that it attend to the different policy problems posed by trust and insurance companies.<sup>55</sup> The Ministry is seeking to enhance its autonomy by using regulatory instruments; nonetheless, it requires political direction and support in all of its dealings with the industry.

As this organizational overview suggests, there were very few obstacles to a regulatory solution. The idea of strengthening the IBC by allowing it to become a self-regulating organization for the industry was never considered, despite the presence of a number of self-regulating organizations within the ambit of the Ministry of Financial Institutions. The structure and performance of the automobile insurance industry was judged to be so deficient by politicians (and even some industry representatives) that it could not be trusted to attend to the interests of consumers. The rate review board became a way of penalizing the industry for its own political failings. If government was obliged to become involved in the management of the automobile insurance industry, it seemed only appropriate that the industry should bear most of the costs involved in compliance.

In addition, the Ministry of Financial Institutions did have the capacity required to establish a regulatory agency. The necessary technology and organizational models were at hand. During the legislative hearings officials acknowledged that experience with the Ontario Municipal Board and the Ontario Energy Board had been instructive in the creation of the new insurance review body. Procedural conventions established in other Ministry statutes were also

55 Carolyn Tuohy and Marsha Chandler, "The Role of Government in the Insurance Arena in Ontario: A Political Analysis," background study prepared for the Ontario (Slater) Task Force on Insurance (Toronto, April 1986).

incorporated in the new Act. In short, rate review was an option that the government felt was within its competence; it entailed a restriction of the industry's freedom of action that was considered eminently justifiable.

Also justifiable from the point of view of politicians was the removal of age, sex and marital status as underwriting criteria. This was something which the Ministry had previously been unable to convince the industry to adopt. The provincial cabinet was persuaded that regardless of the political consequences, the retention of these distinctions in the determination of insurance rates constituted unjustifiable discrimination. For members of the governing party at least, their removal was one item on a reformist agenda; it was not an attempt to capture or reinforce a political constituency. In the words of one Liberal politician,

Finally we are trying to do things that are right, good for society and all those idealistic notions. If that is translated politically into an appearance of competence, fine. I see decisions made around here that we know are going to anger some of our best supporters. But I have not seen a decision where someone says, 'don't do that because it will make someone unhappy, do this instead.' Things happen more organically than that.

A critical part of the organic process alluded to here has been the appointment of public inquiries to study the industry. In the rational choice approach these commissions are interpreted as thinly veiled attempts to distance the governing party from what could become electorally unpopular choices. From the neo-institutional perspective, the Slater Task Force and the Osborne Commission afford the government an opportunity to engage in and witness "moral reasoning and a comprehensive, anticipatory style of policymaking."<sup>56</sup> In this particular case officials have adopted classical liberal justifications for policy innovation. They stress the disclosure provisions of the legislation and the opportunities that will now be afforded consumers to make informed choices respecting their insurance needs.

The creation of the Ontario Automobile Insurance Board, and the simultaneous elimination of socially unacceptable underwriting practices, were decisions that originated within the state itself. From a neo-institutional perspective this regulatory response was not driven simply by short-term political exigencies. It arose out of a particular interpretation of the problem of automobile insurance, an assessment of the obligations of government toward consumers and the availability of proven regulatory technologies.

The neo-institutional approach, with its emphasis on these organizational and attitudinal variables, can also be employed to understand why the Ontario government has so far resisted no-fault. For example, the process may be a direct expression of the garbage-can

56 Manzer, "Public Policy-making as Practical Reasoning," 591.

model of decision-making. One of the key features of the garbage-can model is the argument that problems and choices are often decoupled: "Problems are worked upon in the context of some choice, but choices are made only when the shifting combinations of problems, solutions, and decision makers happen to make action possible."<sup>57</sup> This is an open, almost random process. In the case of automobile insurance, the fact that the province of Ontario has not adopted a no-fault system may simply mean that this particular solution has yet to find its problem.

Consider the fact that the problem that no-fault seeks to address remains rather elusive. Even among its defenders, there is no consensus that no-fault will reduce rates, for example. Many in the insurance industry are persuaded that even with no-fault a reduction in rates will still require reforms to the civil justice process to reduce the size of bodily injury claims. Perhaps no-fault is intended as a response to problems of inequity and complexity in the current compensation system. It would almost certainly add a measure of convenience and simplicity. However, these types of problems may be awaiting other solutions, such as the introduction of more enriched Accident Benefits or technologies and practices to simplify the claims adjustment process. None of this means that no-fault will never be introduced in Ontario. The point is that the particular combination of factors that would prompt decision-makers to reach for the no-fault solution has yet to materialize.

One of the major obstacles that no-fault faces is the opposition of the legal fraternity. But it is not lawyers as a traditional lobby group that constitute the primary problem. From the neo-institutional point of view, the most significant obstacle is the community of lawyers employed by the state. It is this community from which many of the most important decision-makers are drawn. Of course, even if they are lawyers, few of the bureaucrats and politicians who are involved in the choice situations we have been describing will ever benefit directly from the retention of a fault-liability system. That is not the issue. What is important is that their response to a serious change in the system of compensation will be filtered through years of socialization in the legal profession. Like Mr. Justice Osborne, they are unlikely to assume that a system that removes or significantly reduces a citizen's right to sue in tort is easily justifiable, whatever its electoral appeal. When tradition and status confront considerations of political rationality, it is by no means obvious that the latter must prevail.

Turning to the final question, the creation of a public corporation, the neo-institutional argument on instrument choice once again places heavy emphasis on organizational impediments. It is the organizational costs as well as the political costs that give pause to politicians and bureaucrats. For example, the Ministry of Financial Institutions may be

57 Cohen et al., "People, Problems, Solutions and the Ambiguity of Relevance," 36.

acquiring competence by virtue of its monopoly on regulatory authority. However, it is far from obvious that this expertise could be harnessed for the purpose of creating a public corporation. It would not be a matter of building on existing practice, but of creating *de novo* an enterprise responsible for delivering a highly visible service. Moreover, there are no comparable enterprises within the province that might serve as models for such a corporation. As for borrowing from other jurisdictions, the distinctiveness of the Ontario insurance market makes this a difficult strategy.<sup>58</sup>

For these reasons, the neo-institutional prognosis on public automobile insurance is even less optimistic than that supplied by the rational choice perspective. It is true that the same random process that might eventually produce a no-fault system in the province is presumably capable of setting the stage for public ownership. But finding decision-makers willing to countenance public ownership as a solution to the problem of unstable rates would be very difficult without a change in government. As Marsha Chandler has pointed out, public corporations that are created for the purpose of realizing a more equitable distribution of public benefits represent "a definite intrusion in the private sector and an extension of state control over the economy." Right-of-centre parties often retain these types of corporations once they come to power but, according to Chandler, they have not been the ones to create them.<sup>59</sup>

A publicly owned insurance company would have to be considered a highly intrusive policy instrument. By endorsing it, the Liberal government of Ontario would be arguing that this is an appropriate means not only of correcting market distortions, but also of achieving redistributive goals and promoting provincial economic development.<sup>60</sup> So far, this is not the rhetoric that has been employed. On the contrary, the Liberal government has justified its policy initiatives by arguing that they improve the choices available to consumers. The government has shown no commitment to using automobile insurance for redistributive purposes (although there may be redistributive effects). Without a commitment to this goal, the case for a publicly owned system of automobile insurance is seriously weakened.

It may be possible to interpret the Liberal government's apparent unwillingness to create a public corporation as a carefully orchestrated

58 Ontario represents the dominant automobile insurance market in Canada. Radical changes to the system of automobile insurance in Ontario would have serious ramifications for the insurance industry in general, both in the province and the rest of the country. See Woods Gordon Report, 450.

59 Marsha A. Chandler, "The Politics of Public Enterprise," in Prichard (ed.), *Crown Corporations*, 211, 215-16.

60 Tuohy and Chandler, "The Role of Government in the Insurance Arena in Ontario," 11-16.

instrument choice. But this would require discounting, almost to zero, the effect of beliefs held by politicians and bureaucrats about the inherent efficacy of the market versus the state. From the neo-institutional perspective, instrument choice cannot be premised on such a disregard for established practices, evaluations of institutional capacity and the force of ideological thinking.

### **Conclusion**

We have argued here that the Canadian literature on policy instruments has been influenced by the rational choice model of politics to the exclusion of alternative approaches. We have labelled the alternative approach explored here “neo-institutional” in light of its emphasis on institutions as sources of political values and on organizational factors as significant variables in the process of instrument choice. The case of automobile insurance policy in the province of Ontario has afforded us an opportunity to investigate this approach, not simply in the abstract but in the context of a concrete case. By examining it in this way, and in direct contrast to the rational choice approach, its explanatory potential becomes easier to appreciate. The problem, of course, is that both approaches are portrayed rather stereotypically. Nuances are lost and differences seem almost irreconcilable. Without meaning to diminish the depth of these differences, we turn in conclusion to ways in which these approaches might eventually be accommodated in a larger model of the policy process.

The rational choice approach, as we have outlined it here, has deep roots within the discipline of economics. In that quarter, the model of the economic actor—the utility and profit maximizer—still reigns supreme. This model embodies an instrumental view of rationality that is singularly strong and uncompromising. It is a view with which neo-institutional theorists will never be comfortable. Yet the concept of rationality itself does have a role to play in the neo-institutional approach. As Alan Bryman states, “[T]he jettisoning of the rational model need not entail a similar fate for the concept of rationality.”<sup>61</sup> He points out that the retreat from rationality among organizational theorists has not prevented them from attempting to recover the concept with notions of “imperfect rationality,” “limited rationality” and “soft rationality.” The same is true for rational choice theorists, some of whom are concerned that existing models of rational behaviour depend too heavily on contractarian solutions. They suggest that the rational choice model may need to be modified to incorporate “concepts such as

61 Alan Bryman, “Organizational Studies and the Concept of Rationality,” *Journal of Management Studies* 21 (1984), 391-408.

community, symbolism and trust'' to obtain insight into the resolution of collective dilemmas.<sup>62</sup>

How might such a reconciliation of approaches occur? Perhaps the first step is to recognize that even apparently random and emergent decision processes will still have a rational component to them if policy-makers are able to supply "good reasons" to support their choices.<sup>63</sup> But what counts as a good reason will depend on timing and on the ideological and cultural context in which reasons are offered. Ronald Manzer has suggested, for example, that the applicability of alternative policy-making models may depend on the phase of the policy-making process.<sup>64</sup> If this is true, the prudential reasoning that rational choice theorists celebrate may be more influential at some points in the policy process than at others. Moreover, at some juncture, often at the implementation stage, policy-makers must engage in the type of moral reasoning upon which neo-institutionalists focus. For neo-institutional theorists, the task is to "build up a fairly rich body of theory concerning *when* certain sorts of structural contexts are likely to be more or less relevant."<sup>65</sup>

Different arenas of policy-making may also be important for the relevance of alternative approaches. If institutions structure our preferences, as neo-institutional theorizing suggests, differences in the structure and culture of institutions may have important consequences for instrument choice.<sup>66</sup> In institutions dominated by a culture of competitive individualism, for example, participants may evince a preference for policy instruments that maximize flexibility and safeguard competition. In other institutions, where hierarchical norms are strong, there may be a greater preference for instruments that require negotiation and promote joint decision-making by private and public agencies. The point is that institutions will vary systematically in the values they promote.

What these observations suggest and what the automobile insurance case illustrates is that the study of institutions, and the ideas that are nurtured within them, is critical for a complete understanding of the policy process.<sup>67</sup> But progress on this front will require an explicit statement of key institutional variables and a conscious attempt to

62 Robert H. Bates, "Contra Contractarianism: Some Reflections on the New Institutionalism," *Politics and Society* 16 (1988), 397-401.

63 Charles Anderson, "The Place of Principles in Policy Analysis," *American Political Science Review* 73 (1979), 714.

64 Manzer, "Public Policy-making as Practical Reasoning," 586-92.

65 Smith, "Political Jurisprudence, the 'New Institutionalism,' and the Future of Public Law," 104; emphasis in the original.

66 Wildavsky, "Choosing Preferences by Constructing Institutions," 4-5.

67 Doern and Phidd, *Canadian Public Policy*, 50-73.

specify the conditions under which they are likely to influence policy outcomes. Moreover, a comparative research strategy will, in the final analysis, be the only effective way of assessing the contextual reasoning that forms the basis of the neo-institutional approach. For the moment, however, we are content to argue that room should be made for just such a neo-institutional approach to policy instruments. In the case of automobile insurance in Ontario, its insights are as powerful as those supplied by the alternative.