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Polanyi in the European Single Market: The Re-Regulation of Insurance

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At first sight, European integration does not seem to be promising territory for the evolution of institutions to embed markets in social relations. The standardisation of rules across the member states is inherently likely to strip away the specific national practices that have evolved to render market relationships legitimate and sustainable. Resistance has appeared in the form of protectionist defence of national welfare states against the onslaught of technocratic pressures to pursue market efficiency by maximising openness and competition. This is the image of conflict between European institutions and national welfare states portrayed by influential commentators in the social democratic tradition such as Fritz Scharpf (2010), Martin Hoepfner and Armin Schaefer (2012).

Yet the EU has developed a surprisingly strong set of norms that form the basis for re-regulating markets, around the principle of non-discrimination. Non-discrimination on grounds of nationality is foundational for the project of market integration: governments procuring and providing services should, according to this norm, choose and deliver without regard to the national identities of their counterparts. From this perspective, non-discrimination appears as a stripping-away of practices, a removal of context, a rule that imposes indifference in the guise of neutrality. But non-discrimination has been extended to other grounds and become formulated in ways which embed markets in social norms, albeit with a distinctive flavour that bears little relationship to national practices. This is exemplified by the decision of the Court of Justice of the European Union (CJEU) that insurers may not discriminate on grounds of sex in identifying and classifying risks. Since January 2013, insurers in the EU have been obliged to apply unisex tariffs in all types of insurance. Elsewhere in the world, sex discrimination is widely used in private insurance, although sometimes prohibited in specific areas such as pensions and annuities.

The Court's decision and the circumstances leading up to it illustrate several important points about "always embed-

ded markets" (Block 2003). First, Polanyi advanced an argument targeted at three "fictitious commodities": labour, land and money, for which supply and demand could not be equilibrated by the price mechanism. Market self-regulation would produce crises and social disruption: "the demolition of society" (Polanyi 2001 [1944]: 76). Insurance markets are also not equilibrated by the price mechanism, for reasons explained below. This "market failure" is less catastrophic than the deflationary spiral which may arise when unemployment pushes wages down (to take the example of labour), but it is important enough to mean that regulation is constitutive for insurance markets. These markets could not thrive without collectively-enforced rules to sustain their operation.

Second, "the state" is central to the process of stabilising insurance markets through regulation, but it is easy to miss this, as the tasks of stabilising risk classification and sharing data to inform pricing decisions are often delegated to insurance associations. There is private regulation of a kind which nowadays is often called "self-regulation," although it has the shadow of state authority behind it.

Third, different arms of the state approach market regulation with different orientations. Technical bureaucracies tend to be instrumental in their pursuit of social and industrial policy objectives, while courts may be more inclined to defend norms without instrumentalising them. This distinction is one to which E P Thompson (1971) was particularly alert: he distinguished between the norms of justice and fairness that constituted a "moral economy" and the idea that social order required at least the security of subsistence. In rejecting the claim that social disorder could be explained by empty stomachs, Thompson came down on the side of a non-instrumental approach to norms. Polanyi's account of embedding has often been interpreted as requiring the development of the welfare state: in other words, as supporting an instrumental approach by achieving a minimum standard of security. Whether this is an accurate reading of Polanyi need not detain us here: rather, I will use the insurance case to demonstrate the difference between a *social policy* approach to the regulatory embedding of a market, and a *moral economy* approach. These are rather big arguments to draw out of the small

case of European insurance regulation, but insurance is rich territory for economic sociology, as is the project of creating a European single market.

Insurance and the price mechanism

The price of insurance should broadly equal the magnitude of the possible loss times the probability of the loss-making event. It is possible to work out a single probability for the whole pool of potential customers and make an offer of insurance to "all comers." However, the insurer faces a risk of adverse selection: instead of being drawn from throughout the pool, customers with higher risk profiles may take up the product, so losses are higher than expected. The difficulty for the insurer is that, if it responds by raising the price (the premium), adverse selection may intensify, with low-risk customers choosing to self-insure. The problem resembles that found in credit markets, where high interest rates may leave only the riskiest borrowers in the market. In both cases, the price mechanism does not work reliably or efficiently, whether to provide insurance or to allocate credit.

Insurers, like lenders, respond by gathering information about those seeking insurance. In doing this, they depart from a basic norm of the self-regulating market: that it is anonymous, indifferent to the personal identities of its participants (Anderson 1993). Insurers often demand disclosure of information about age, sex, place of residence and household circumstances. They use this to segment the pool of insureds and charge different premiums to different groups.

Generally, customers do not question this process. The "loadings" (increases in price) for different attributes are hard to find out, and the insurance industry has been successful in putting across the idea that it is engaged in "pricing risks," which legitimates the differentiation of premiums. But this legitimacy is precarious, for several reasons. The choice of indicators for forming risk groups is somewhat arbitrary. The industry favours indicators for which accurate information can be obtained at modest cost, and where the correlation with claims is known. This creates a strong "path dependency," whereby insurers will rely on information that has been collected over a long period. Furthermore, indicators are merely indicative: in other words, an attribute may be correlated with higher or lower risk without any evidence of causation. For the seller interested in accurate pricing, this does not matter, but it may matter to perceptions of whether use of the indicator

is fair or not. For example, young men are more likely than any other group to have car accidents, but careful young men may resent this category and advocate that a heavier weight is put on other indicators, such as the type of car. More generally, customers may reject the use of indicators that they can do nothing to improve (such as age or sex) but accept those that relate to whether they have chosen to do something more risky (such as buying a high-powered car). These issues tend to emerge when insurance practices change: for example there was a controversy about premium loadings on car insurance for young men when the market was deregulated in Belgium (BEUC 2002: 3-4).

Customers may also notice that the use of information to create risk categories effectively reduces the amount of insurance they can get. This is true generally: the use of any loading denies the customer insurance against having the loaded characteristic. Customers attuned to the practices of the industry shrug this off, until they seek medical insurance when they have a pre-existing medical condition, or buildings insurance when they live on a flood plain. Of course there may be good public policy reasons to prevent people obtaining insurance (or to make the price extremely high) under some circumstances, but the industry's decisions about loadings do not necessarily accord with public policy.

The need to gather and interpret information about customers and their claims supports a variety of noncompetitive, or pre-competitive, practices in the insurance industry. Information on the relationship between indicators and claims probability can be made more statistically reliable by pooling across the industry. Furthermore, the industry has strong incentives to restrain the use of risk differentiation by constituent firms. Insurers face a collective action problem in risk classification. Say a new entrant into an insurance market finds a new criterion for identifying a low-risk group, and offers attractive terms to those who meet the criterion. At first, the entrant will be profitable as it extracts some low risks from other insurers' pools. Conversely, the other insurers will experience adverse selection: their pools will get riskier and their pricing models will prove inadequate. They are likely to respond by adopting the new criterion, stemming the loss of customers. Good times will come to an end for the entrant: now the whole market offers products based on a refined classification, and no-one makes any excess profit in the process. Whether the industry as a whole benefits depends on how sensitive the low-risk group was to the price of insurance. It is not hard to see that the proliferation of criteria for risk classification

may not be good for the industry (for a technical proof, see Wilson 1977). Industry associations promote classification on the basis of limited criteria for which robust information is available. Firms do vary these criteria and the prices associated with them, but often for marketing rather than risk-based reasons.

Regulation by market actors and the state

Because the price mechanism alone does not work, discrimination, in the guise of risk classification, is fundamental to insurance. Practices for classifying risks may be regulated by national associations, with the tacit backing of the state, or by public regulators. Only occasionally are they the subject of public discussion. New technologies may disrupt established settlements: for example there was a flurry of debate about the use of genetic information when the technology of DNA testing became available. Various legal and self-regulatory agreements to limit the use of genetic information were reached by insurance associations and governments in Europe, and the subject was debated in the European Parliament (Mattheissen-Guyader 2005).

Because of the path-dependent, conventional aspects of insurance pricing, the opening-up of European insurance markets inevitably had considerable disruptive potential. In highlighting divergent practices in member states, European integration required the industry to engage in an unsettling process of “arguing and resisting,” perturbing the taken-for-grantedness of its practices (Moran 2010: 396). Insurers that had developed successful classification practices in one market were interested in bringing them into others. One area of divergent practice was in the use of sex discrimination. Member states of the EU varied widely in their use of sex as a risk factor. Sometimes, it was prohibited in some areas (eg in pricing annuities, which provide insurance against the risk of a long life) and not others (eg motor insurance). Complicating the legal framework was the fact that sex discrimination in employment was prohibited, and this extended to remuneration relating to employment such as defined-benefit pensions. Confusingly, nondiscrimination required employers to make equal contributions to their male and female employees’ defined-contribution pension funds, but nondiscrimination did not reach as far as requiring that sex-neutral rates were used in converting those pension funds into annuities.

It might have been possible to resolve these issues incrementally. For examples, countries which prohibited sex

discrimination in insurance could have been permitted to apply that rule to insurers from other countries seeking to enter their market. The scope of the prohibition on discrimination in employment could have been extended to include specific pension schemes, as it had been, for example, in Germany when a state-subsidised defined-contribution pension scheme (the Riester pension) was introduced (Leisering and Vitic 2009). But the European Commission instead went for a bolder alternative, proposing that the reach of the prohibition on sex discrimination be extended beyond labour law to take in all areas of goods and services provision.

This itself is an interesting move from the perspective of “always embedded markets.” Regulatory social policy in the EU has accorded a special place to employment, and member states also generally treat labour law as a unique area of law in which freedom of contract is particularly constrained for social reasons. In other words, “embedding” has been seen as more imperative in employment than in other markets. With its proposal, the Commission moved away from according a special place to the “fictitious commodity” of labour.

The Commission framed its proposal in legal, social and market-integrative terms, arguing that they all pointed in the same direction, towards the desirability and appropriateness of eliminating sex discrimination in insurance. Lawyers supporting the proposal emphasised that discrimination contravened “the essence of anti-discrimination laws which require that workers be regarded on the basis of their individual characteristics and not on the basis of gender stereotypes” (Barnard 2006: 531). However, legal challenges to insurance discrimination before the courts of EU Member States had generally failed, so long as insurers could show that differences in premiums were proportionate in the light of differences in risk.

Furthermore, relevant legal doctrines differed between member states. For example, in German law, differential treatment of men and women can be based on “biological” determining factors, while discrimination arising from “social” factors is prohibited (Kopischke 2006: 79-80). This distinction produced a debate about whether women’s longer life expectancy was due to social factors around lifestyle, working patterns and nutrition, or due to biological differences between the sexes. If the difference was really biological or genetic, then sex really was the relevant determinant and not just a proxy for other factors, so its use could be justified. However, others rejected this logic

of justification. The Committee on Women's Rights in the European Parliament argued that "the use of the 'gender' factor [...] constitutes discrimination since [this factor is] beyond the control of the individual concerned" (EP 2004, p.26). Lifestyle factors ("e.g. smoking, alcohol consumption, stress factors, health awareness") are "more objective criteria" and should be used instead.

Social policy arguments suggested a different line of attack. The Commission drew attention to the trend in member states towards the privatisation of social insurance, particularly pensions, and argued that privatisation was tending to magnify income inequality between men and women. The Commission noted that, while equal treatment was established in statutory social insurance, "the move towards private provision is undermining this principle" (CEC 2003, p.8). One concrete way to counter this trend was to end the use of actuarial factors related to sex. This would change insurance industry practices to protect the pensions of women, who constituted a group at high risk of having inadequate incomes in old age.

However, the general application of non-discrimination rights was not well-suited to being instrumentalised to pursue this social policy objective, for two reasons. First, it only addressed discrimination on grounds of sex, allowing (even encouraging) insurers to find other discriminators, such as lifestyle factors. Allowing discrimination on the basis of lifestyle factors may be fair, but it will not help women's pensions, as women are more likely to have the lifestyle markers for a long life. A better policy, if the goal was to combat old age income inadequacy, would be to put everyone in the same risk pool, as compulsory social insurance does.

Second, while the social policy goal pertained specifically to pensions, the fundamental right extended to all insurance. Arguments that were convincing in the pensions context lost force when applied across the board. For example, motor insurance had to be included as well as pensions, meaning that women could lose as well as win from a unisex reform. The British Equal Opportunities Commission (EOC) undertook a cost-benefit analysis of unisex tariffs, in effect rejecting the principled application of rights in favour of an instrumental approach. It found that elimination of gender factors "would bring a complicated mixture of gains and losses to both sexes." Even the effect on women of unisex annuities was mixed, as many women depended on the annuity of a male partner (EOC 2004). As a result, the EOC refrained from taking a stand against the

use of sex as a factor in insurance. The wide scope of the measure was, in short, an obstacle to instrumentalising non-discrimination to achieve social policy goals.

Finally, the Commission argued that non-discrimination was an efficient basis on which to harmonise practices in the European single market. It claimed that the technical basis for the use of sex factors was not well established, and was being undermined by social change. It is true that the gap in longevity between men and women has tended to close in recent years, and also that actuaries have not been terribly successful in forecasting increases in longevity. Thus there was some scope to claim that the industry needed to change its practices (Hudson 2007). The Commission argued that "progressive insurance companies are in the process of developing new and more accurate means of predicting risk. As they do so, and as a consequence of competition, they will be able to reduce the importance of sex in their calculations and base their prices on sex-neutral criteria" (CEC 2003: 6-7).

One difficulty with this argument was that advocates of free and open competition, including some within the Commission itself, did not see any reason to harmonise risk classification practices. They argued that open competition would produce efficient risk-rating. As one of the standard accounts put it: "[t]he liberalization and deregulation of the insurance business in Europe aimed ultimately at creating an integrated European insurance market with companies providing consumers with the widest choice of innovative insurance products on offer at the best price." (van der Ende et al. 2006: 7-8) This opens the way to an increase in discrimination through finer classifications of risk, but this is a good thing, as it "allows premiums to be set at a level which is more commensurate to real risk."

These arguments presented the insurance industry with something of a dilemma. On one hand, many firms did not want to change their long-established conventions, which often included sex discrimination. On the other hand, they did not necessarily want free and open competition either. As argued above, the suppression of competitively-inspired risk differentiation was often in the interests of the industry as a whole. As it turned out, industry lobbyists succeeded in negotiating a compromise with the Commission which resolved this dilemma. They agreed that sex discrimination could continue, but that the industry would have to publish information on differences in risk according to sex, to show that differences in premiums were justified. This data publication requirement was invoked by some indus-

try associations to support the continuation of the non-competitive practice of sharing data among insurers.¹

Not all firms and national industry associations were happy with this compromise: some saw reporting requirements and ongoing public scrutiny as a slippery slope that would eventually lead to further regulation (MacDonnell 2005). The outcomes of such scrutiny could be uncomfortable: statistical analyses did not always endorse insurers' practices. For example, Rothgang et al (2005) examined sex differentials in health insurance premiums in Germany and argued that they were inadequately justified by the available statistics. Nonetheless, the compromise of continuing sex discrimination supported by the publication of data would probably have been sustained, had it not been for the decision of the Belgian consumer association Test Achats to launch a legal challenge.

Courts, moral economy and social policy

In March 2011, the Court of Justice of the European Union (CJEU) ruled in *Test-Achats* that the ongoing practice of sex discrimination in insurance was a derogation from the principle of equal treatment between men and women that could not be permitted indefinitely. It ruled that the compromise allowing discrimination with publication of supporting data would cease to be valid from December 2012, effectively restoring the Commission's original draft of the Directive which envisaged a move to unisex tariffs with an extended transition phase.

One of the frustrating features of the CJEU is that its judgments are often extremely terse. Dissenting views are not published, so the text of the judgment represents a "lowest common denominator" of what the panel of judges can agree to. The *Test Achats* decision is highly legalistic: it simply states that non-discrimination is a fundamental right and that it is not possible to derogate from that right indefinitely. The question of whether discrimination in insurance might be justifiable is not addressed. However, the Court is advised by an Advocate General (AG), who writes an Opinion which is generally more extensive than the judgment, which is published. The judges do not have to follow the AG, so the Opinion does not represent settled law, but it does give a sense of how the Court might see the issues.

Three points are of particular interest in light of the "dis-embedding" and "re-embedding" processes involved in creating a single European market. First, the AG was in-

sistent on the imperative of standardisation. She highlighted inconsistency across member states in the application of unisex tariffs, and noted: "In some Member States it is possible for men and women to be treated differently with regard to an insurance product whereas in other Member States they must be treated in the same way with regard to the same insurance product. It is difficult to understand how such a legal situation could be the expression of the principle of equal treatment under European Union law." (para 23). In other words, a market that was genuinely integrated could not maintain different norms in different parts of the territory regarding such a fundamental matter as sex discrimination.

Second, the AG regarded non-discrimination as a matter of moral economy, not social policy. While her approach suggests that the Court should be a progressive force, modernising as well as unifying the legal code governing the single market, the task of re-regulating the single market was not to be governed by instrumental objectives, whether based on efficiency or on distributional concerns. The AG was dismissive of the community of expertise that sought to justify special treatment of the insurance sector with economic and statistical analysis, given the availability of a clear legal norm. She was also unwilling to take on the tasks of a social policy maker, weighing up the gains and losses for distributional equality between men and women. It is striking that the AG was uninterested in whether unisex tariffs would benefit or disadvantage women: she noted that some tariffs will go up but there would be lower premiums for "the other sex" (para 68).

Third, the AG was keen to iron out the anomalies that had arisen from applying non-discrimination to employment but exempting insurance not linked to the employment relationship. This meant setting aside the long-established view that employment relationships are a special case in the construction and stabilisation of markets. The Court has been criticised in other contexts for failing to recognise the special nature of labour markets and thereby arriving at excessively "liberalising" judgments (Kilpatrick 2009). In this case, however, the spillover went the other way, with a principle that has become firmly established in employment relationships being applied to contracts for services.

Conclusion

The insurance example suggests that "embedding" is an ambiguous term. It can refer to the acceptance of established market practices as fair (or fair enough), or to the

achievement of certain outcomes: specifically security and subsistence for the mass of the population. The former comes under the umbrella of moral economy; the latter of social policy. While I have shown that the Commission tried to address both moral economy and social policy issues with the principle of non-discrimination, we can see that it is a more powerful principle when seen as constitutive of a moral economy, which is how it was interpreted by the Court. It provides a rigorous norm to govern market transactions but has rather unpredictable outcomes. Non-discrimination on one ground (sex) does not create solidarity in insurance when separation of risk pools can freely be done on other grounds, and the CJEU has made it clear that insurers may discriminate between insureds on other grounds than sex. If insurers can find the “lifestyle” correlates of women’s longer life expectancy in their occupations, family histories and other indicators, then the effect on annuity rates for many women will not be great.

The significant differences between European countries in the organisation of their insurance markets suggests that these markets are embedded in specific social contexts, reflected in their turn in legal norms and regulatory practices. Market integration might be expected to cause “disembedding,” especially if open competition leads firms to set aside established practices in the pursuit of profit. Furthermore, the European Commission is often unsympathetic to restrictions on competition in the guise of social regulation, which it suspects of providing cover for national protectionism. But the prohibition on sex discrimination in insurance shows that this is only half the story, as the European institutions (led by the Court rather than the Commission) have sought to ensure that market integration is subject to the protection of fundamental rights.

Furthermore, it is important not to reify national conventions and practices. Generally, these were not the outcome of a contested political process; nor did they necessarily reflect robust social norms. The national regulation of private insurance is conventional, opaque and industry-dominated, not solidaristic or democratic. Market integration has engendered politicisation, rather than displacing national democratic control. The preference of insurers for avoiding public scrutiny and debate is reflected in their subdued responses to the Court’s decision, suggesting that they would like nothing better than to exit the public gaze and return to a position in which their expertise is uncontested and their classification decisions are silently accepted.

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Endnotes

*This article is based on “Polanyi in Brussels or Luxembourg? Social rights and market regulation in European insurance,” In: *Regulation and Governance* 8(2): 186–202. Fuller references and more of the intricacies of the argument can be found there.

¹Industry arguments in defence of existing practices can be found in the associations’ responses to a European Commission consultation on the ‘block exemption’ of insurance from certain provisions of EU competition law. The responses can be found at http://ec.europa.eu/competition/consultations/2008_insurance_be/index.html (last accessed 30 July 2015). See in particular the submissions of the main European insurance association: the Comité Européen des Assurances, CEA, and the Pan-European Insurance Forum (PEIF), a group of CEOs of major insurance companies.

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