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FURTHER DEVELOPMENT OF THE ENTERPRISE INSURANCE SYSTEM AND INCREASING ITS ROLE IN THE COUNTRY'S ECONOMY

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Abstract:

Insurance is one of the key activities in a globalised financial and economic environment. Through its benefits, it offers income, life and property protection to the insured and their keens, as well as income accumulation that can be used at retirement to help preserve the desired lifestyle or living standards. Motivated by this end of insurance, the goal of this paper is to study the contribution of insurance growth to economic growth, by employing the benefit side of the insurance activity, next to the acquisition side that has already been considered.

Keywords: *agricultural sector, agricultural insurance, income level of agricultural enterprises, support agriculture, funds to the industry.*

INTRODUCTION

As a result, insurers play an important role in the internal transfer of cash flow positive basis of findings obtained from the insured. Then, providing a large number of assets in the financial market stimulating economic growth. The multiplicity and complexity of relationships with other institutions, insurance companies and other financial institutions is not less than the banks. It should be stressed in particular role of life insurers. In 1997-2007 the total contributions around the world, collected by life insurance companies, increased by about 5.5 times from 0.6 to $4.13 trillion, while lifelong insurers increased their share of the financial market of about 7.5 times. In 2009, insurance companies collected $4.07 trillion from direct contributions, which accounted for around 7% of global GDP (According to the Swiss Reinsurance Company report), the insurance sector will play an increasingly important role in the development of the financial market. Continuing increase of premiums for life insurers, not only emphasizes the importance of this type of activity in the area of risk transfer, but also emphasizes the importance of life insurance companies as institutional investors. The main issue is to identify the relationship between life insurance and economic growth both in theory and practice of business. In the context of the theory, developed two approaches: supply and demand, have empirically demonstrated in the work of H. Patrick (1966), who claims economic growth can be generated both through the development of financial systems, and alternatively by the growth of the economy, which in turn increases the activity of the institution financial statements. Practical aspects of this relationship enhance the utility of time series and cross-industry data to predict future major issues related to the height of premiums and macroeconomic aggregates. The purpose of the financial sector is to manage the flow of measures obtained from institutional investors and individuals with investment projects. Thus, the principal of the financial sector is expanding spectrum of opportunities for seeking funding and monitoring of the recipients of these funds, as well as improving the allocation of resources, mobilization of saving, lowering the cost of capital by exploiting economies of scale and specialization, liquidity and risk management. Insurance undertakes the primary role in this process, which is reflected in the product-specific functions performed by the insurance industry, of which the most important is the transfer of risk, responding to this product potential buyers demand. Traditionally, the policyholder pays the premium, and yields a certain protection against the other types of uncertainty. Moreover, by reducing the risk, insurance companies contribute to the flattening of the curve of the business cycle and reduce the impact of emergencies on the micro-level and macroeconomic aggregates. There is a significant demand for collateral for potential losses in the assets of organizations, which are the subject of natural disasters, crime, accidents and other events, the implementation of a negative degree can affect the financial situation. In the run, the insured operations, acquisition, possession or sale of goods, assets and services, is facilitated by taking financial responsibility for potential losses by insurers. Therefore, ensuring the economic security of the assets contributed to the development of transport, trade and money lending institutions, and many sectors are directly dependent on the insurance. Additionally, in the case of individuals, securing purchased vehicles or property, it determines the increase in the national

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consumption. Finally, the insurance also provides protection against adverse financial results, occasioned by the actions of individuals. he primary contribution of insurers to the real economy is based on the claims compensations they make towards individuals and enterprises in case of adverse events. Individuals can protect their income (or their overall wealth), which can be accordingly directed fully or partially to the real economy in the form of consumption or investments. Businesses can continue operating even if their key people or facilities are harmed by an incident. Consequently, their income generating capacity is not affected and they can thus supply the real economy uninterrupted with products or services and pay staff remuneration, dividends, and taxes. Insurance companies also offer income accumulation (pension-type) programs, whose proceeds can be used at retirement. These programs can help the countries to reduce the burden of their social security pensions and direct the corresponding state funds to other needs that their economies may have. The second major contribution of insurers to the economy needs to be sought in the other payments they make. More specifically, insurance companies - similarly to any other enterprise - pay salaries to their personnel and intermediaries, taxes to the government, dividends to the shareholders, and interest to the lenders. Furthermore, they may make donations to the society via their corporate (social) responsibility programs. All these types of money flows (i.e., claims, salaries, taxes, dividends, interest and donations) constitute sources of income for the aforementioned interested parties, who in turn are spent or invested and thereby returned (directly or indirectly) to the economy. Consequently, insurance is expected to contribute to the growth of an economy through the claims payments (compensation) made to the insured and through the operational expenses it incurs. It is, therefore, natural to look for evidence that substantiates this contribution.

LITERATURE REVIEW

Moving from the economy to insurance, we realize that claims and expenses may serve as alternative proxies for the size of the insurance market of a country, instead of the standard insurance depth or penetration indices that are based primarily on premia. This is justified by a number of reasons; first of all, both claims and expenses are metrics of the financial and underwriting performance of an insurer, especially when compared with the premia (earned) for the calculation of the claims and expense ratios. They are both present in the financial statements of an insurance company. Countries consider and highly value these ratios as critical or important for supervisory/regulatory and/or market surveillance; some of them consider them as highly relevant for macro-prudential surveillance (Kwon & Wolfrom, 2016).

In addition, claims and expenses are accounted for in the calculation of the burning cost premium, as insurance products are priced in a way that the premium suffices to cover the (expected) claims and expenses, while at the same time, it leaves some room for profits. The sum of the claims and expense ratios is known as the combined ratio and it is normally anticipated to be less than 100%, so that there is a profit margin. Consequently, they constitute key elements for the profitability and income generation of an insurance company. Moreover, higher claims and expenses imply higher liabilities, which in turn require higher assets to match them; as a result, the promise of the insurer to the insured is met (IAIS, 2019). The size of assets is a typical measure of the size of an insurance market.

Furthermore, claims and expenses are also among the measures used for the ranking of the insurance companies, as the former represent the benefits paid to policyholders, and the latter incorporate the remuneration paid to the staff and some intermediaries, as well as other costs that the insurers occur, such as other administrative and acquisition costs. In life insurance, claims are primarily covering the benefits of endowments and term life insurance (OECD, 2019a). Bigger amounts paid either per policy or in total are representative of bigger insurance markets in a country. Non-life insurance claims are mainly providing coverage for property (and casualty) insurance. Increased amounts occur more frequently in countries that experience natural catastrophes (e.g., earthquakes) (OECD, 2019a). They, therefore, experience increases insurance consciousness, and as a result, makes insurance markets stronger. As an example, in countries with natural catastrophe experience, it could be the banks that provide the mortgage loans that require non-life insurance for the underlying property, as it is used as a collateral to the mortgage loan. Coming to expenses, we realize that higher expenses in a country are indicative of a bigger number of employees, intermediaries and providers, as well as a higher number of overall transactions, which usually stem from bigger insurance markets that need the services of all these individuals/professionals.

MATERIALS AND METHODS

There are advantages in the use of claims and expenses to capture the size of the insurance market. One is that they are closer to the real size of the insurance activity compared to the premia, as it is determined by the benefits paid to the stakeholders, such as the insured, the staff and other providers. They determine the

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burning cost of the insurance products and are free of other loadings that can possibly distort, such as the level of commissions or profit margins or even policy fees (non-commissionable premiums), the cost of potential reinsurance, and taxes. High commissions or high profit margins to attract professionals into the industry could affect the true picture (although still indicative of the market size). The same applies to reinsurance and taxes; higher reinsurance charges or tax rates could disproportionally increase the level of premia and, thus, the insurance penetration. Furthermore, commercial premia are determined by the claims and expenses that the insurance companies experience; in that sense, the premium is a derivative of the claims and the expenses realized. In addition, claims and expenses are factual; they have occurred and as such they cannot be doubted. Premia are determined by actuarial methods and potential mispricing can influence the insurance penetration that uses premia in its estimation.

There are also a couple of disadvantages of the use of claims and expenses compared to the use of premia. Namely, claims and expenses are not always publicly disclosed by insurers, whereas premia are fully disclosed. Therefore, potential differences in the reporting towards the competent authorities or associations could influence the results. Premia are more comprehensive measures of the full insurance activity – despite the aforementioned comparative advantages of claims and expenses mentioned in the previous paragraph – as they incorporate all relevant amounts. Finally, potential one-time events, such as a single natural catastrophe, could have an impact on claims and expenses (for a certain year or years), whereas it will be smoothened out in the premium levels.

RESULTS

The aforementioned arguments indicate that claims and expenses do determine the premium levels, do affect the level of financial and underwriting performance, do influence the size of assets, and do reflect the overall insurance activity of a company and thus of a country. Overall, the use of claims and expenses has more advantages than disadvantages. Consequently, they are good proxies of the size of the insurance market of a country and they can be used instead of the more commonly used measures, such as the insurance depth or penetration. Moreover, results revealed a statistically significant relationship between non-life insurance and economic growth for all three proxies. The coefficient value pointed that the role of non-life insurance in economic growth for developing countries is much stronger than developed. This result is in line with the findings of Arena (2008), Ćurak et al. (2009), Han et al. (2010) and Outreville (1990). Unavailability, cost or lack of trust on other risk hedging institutions could be a possible reason for this significant relationship between non-life insurance and economic growth for emerging/developing countries. This significant relationship perhaps is due to squeezed per capita income in these countries making them more risk averse as compared to developed countries. On the other hand, a significant relationship between life insurance and economic growth is only found for emerging/ developing countries when the insurance industry is measured through penetration at 10% significance level. Authors like Arena (2008) and Han et al. (2010) also found a significant relationship between life insurance and economic growth for developing countries. However, the same relationship is insignificant when the insurance industry is measured through net written premiums and density. The author claimed that a strong banking sector (saving substitute and investment channel) could be the possible reason for the negative relationship between life insurance and economic growth. The insignificant relationship could also be explained with reference to population, as most of the countries in emerging/developing list are most populated such as India, China, Pakistan and Indonesia, therefore, density (per capita insurance) might not have a significant impact on economic growth of developing countries.

Table 1. Studies on insurance and economic growth

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Author(s)	Scope	Statistical test	Focus and time	Result
Ward and Zurbruegg (2000)	Nine OECD countries	Granger causality test	Life/non-life Insurance 1961–1996	They concluded that impact of insurance industry varies on economic growth based on different economic levels
Webb et al. (2002)	55 Countries	Cross-section analysis	Life/non-life insurance 1980–1996	Banking and insurance sector has a positive effect on economic growth; the result is stronger than the effects obtained independently from each other
Hwang (2003)	China	Multiple regression models	Life insurance 1986–1996	Author concludes that economic reforms, social structure and higher education are the main factors for increased demand for life insurance in China
Kugler and Ofoghi (2005)	UK	Co-integration	Life and non-life at disaggregate 1971–1997	Authors found that insurance industry plays significant positive role in promoting economic growth and there exist bilateral relationship between economic growth and insurance
Boon (2005)	Singapore	Granger causality	Bank, stock markets and insurance 1987–2002	The author concluded that insurance coupled with stock market promotes economic growth. On the other hand, there is a demand (enterprise side) following pattern for banks and economic growth
Arena (2008)	55 countries	GMM on panel data	Life and non-life 1974–2004	Both the Life and non-life insurance significantly affects economic growth. However, life insurance affects economic growth in high-income countries while non-life insurance affects economic growth in both low-income and high-income countries as well
Tong (2008)	US, Sweden, Germany and South Korea	OLS, fixed effect and simulation equation	Life and non-Life	The author concluded that non-life insurance has a significant and positive effect on economic growth for all countries while life insurance has a positive and significant effect on the economic growth of the US and South Korea while it is negative for Germany and Sweden
Vadlamannati (2008)	India	Co-integration and causality test	Aggregate	Insurance sector reforms positively affect economic growth and financial intermediation services are an important part of the insurance industry
Adams, Andersson, Andersson, and Lindmark (2009)	Sweden	Causality test	Aggregate 1830–1998	The author concluded that bank credit facility promotes economic growth and demand for insurance while insurance sector has a positive effect on economic growth only in the boom periods
Du (2009)	China	Pooled OLS, random effects GLS and fixed effect	Health insurance 1991–2000	They found that open door policy coupled with deregulation are the main factors for decreased demand of health insurance in China
Njegomir and Stojić (2010)	Ex-Yugoslavia region	Specific fixed effect	Aggregate 2004–2008	The authors concluded that insurance positively affects economic growth as a risk transfer, indemnification and as institutional investor
Ching et al. (2010)	Malaysia	VECM and granger causality	Life insur-ance1997–2008	They concluded that there exist significant relationship between life insurance and Economic Growth for Malaysia
Kjosevski (2011)	Macedonia	Multiple regression	Aggregate 1995–2000	The author found a positive and significant effect of aggregate and non-life insurance on economic growth while the relationship was negative for the life insurance
Horng et al. (2012)	Taiwan	Vector autoregressive	Aggregate 1961–2006	Insurance demand and financial development Granger cause economic growth
Omoke (2012)	Nigeria	Co-integration	Aggregate 1970–2008	The author concluded that no relationship exists between insurance and economic growth for Nigeria.
Guochen and Chiwei (2012)	China (cross-regional study)	Bootstrap panel Granger causality	Life and non-life insurance 2006–2011	They conclude that demand following pattern is observed in the high-income provinces while supply following pattern is present in many provinces
Verma and Bala (2013)	India	OLS	Life insurance 1990–2011	They concluded that life insurance significantly affects the economic growth of India
Adams, Andersson, Hardwick, and Lindmark (2013)	Sweden	GMM	Life Insurance 1855–1947	Authors indicate that smaller firms outer perform than the larger firms in term of growth

CONCLUSION

Insurance, being part of the financial system, perform six basic functions such as pooling of resources, facilitate capital transformation, efficient pricing, risk hedging, facilitate trade and commerce, and acting as an agent to deal with the asymmetric information issues to improve the economic well-being. All of these six functions of insurance could be categorised under

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intermediation, risk transfer and indemnification. Insurance holds a prominent position among other financial institutions due to stability and indemnification features of insurance contracts. Insurance industry not only helps in the development of financial sector (competitive pricing and efficient allocation of funds) but it also promotes economic growth indirectly. However, the role of insurance varies for different economic levels and largely depends on the proxy used to measure insurance activity. This study is an attempt to explore the relationship between insurance and economic growth for a period of 2006–2015 for 20 countries using three distinct proxies. On the basis of Hausman test, fixed effect model's results are presented. Results revealed that life insurance has positive and a significant relationship with economic growth for developed countries when measured through net written premiums and density while it is significant for developing countries when the insurance industry is measured through penetration proxy. Moreover, results also confirmed that non-life insurance plays more significant role in promoting economic growth for developing countries for all three proxies while it is significant for developed countries only when measured through density. The findings of this study are particularly important for policy-makers that they need to consider insurance as a substitute for banking and stock market rather than a complementary industry. Furthermore, the findings of this study would help policy-makers to identify important aspects that could be considered in formulating financial regulations and legislations especially those related to insurance.

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