



Connection between Economic Expansion and Insurance: Empirical Insights

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ABSTRACT

Financial institutions are considered to be an essential part of every nation's plan for sustained economic progress. In the vast corpus of economic literature, the correlation between financial growth & economic development has been thoroughly examined and established. However, most of the literature has limited their study majorly to the banking and capital markets without much consideration of the insurance industry. The insurance industry has witnessed faster growth in the last decades, especially in emerging markets owing to financial liberalization. Insurance supports economic growth by majorly converting savings into investments and issuing insurance policies. Furthermore, insurance is viewed as a supplement to the banking system and a growth engine that advances the nation's financial development and also promotes financial stability. The role of the insurance market as a source of risk transfer, financial mediator, & indemnity provider can all help economic growth by facilitating more effective risk management. Consequently, the role that insurance plays in growth has been emphasized by a number of recent studies that examine the causal relationship between insurance and economic growth. This paper's goal is to review the empirical research looking at the relationship between insurance & economic growth. The purpose of this research is to better understand how insurance and economic growth is related to each other.

KEYWORDS: Insurance, Investment, Financial Institute, Economic Growth.

INTRODUCTION

Financial institutions are essential to long-term, steady economic expansion. Economic growth and financial development are intimately related, making financial development crucial for every nation. These institutions, mainly banks, capital markets, and insurance institutions as risk transfer entities have helped in avoiding economic loss as they smooth out the economic volatility. A robust and efficient financial system leads to increased productivity which in response leads to economic growth. The financial sector is responsible for guiding savers' funds into investment initiatives and the other way around. Through economies of scale and specialization, the financial industry lowers the cost of capital, enhances resource allocation, mobilizes savings, and offers liquidity & risk management (Scholtens and van Wensveen, 2003; Wachtel, 2001).

The financial sector's contribution to economic growth and development has been examined and widely recognized in the vast economic literature. Various empirical data and research studies have demonstrated that a well-developed financial system leads to a higher growth rate (Hass and Sumegi, 2008). Jung (1986) established the link between financial development and economic growth with his ground breaking research. Levine had contributed to this field of research to a great extent. King & Levine (1993), for instance, show a

significant positive association between these variables by establishing the relationship between bank development and economic growth. Using various econometric methods for robust investigations, Levine (1999), Beck et al. (2000), Rousseau & Wachtel (1998), Levine et al. (2000), and others have further corroborated this finding. Granger causality tests by Fink et al. (2005) have been used to identify the impact of financial markets on economic growth in various countries. Accordingly, research on this subject has seemed to accept the theory that financial development is essential to economic expansion. Nevertheless, the bulk of these studies have given little thought to the insurance sector in favour of analysing the significance of the relationship between economic growth and banking and/or capital markets.

The traditional perspective on insurance holds that it is a crucial tool for indemnity, intermediation, and risk transfer (Outreville, 1990). The insurance sector is often categorised as life insurance, which stands for long-term funds; non-life insurance, which stands for short-term finances; and; reinsurance, which shields the insurance businesses. All these insurance types' enable risk effective risk transfer and management. A country's ability to succeed economically depends on insurance, just like it does on other financial institutions like banks and the capital market.

Insurance is not a new concept and has been in existence since ancient times as a risk transfer entity. Insurance is believed to enhance the financial advancement of the country by working as a complementary to the banking sector (Grace and Rebello, 1993). In addition to providing risk transfer and indemnity, insurance as a financial service also makes financial intermediation easier (Ward and Zurbruegg, 2000). By facilitating more effective risk management in its roles as a financial mediator, risk transfer provider, and indemnity provider, the insurance market can support economic growth. The United Nations Conference on Trade and Development (UNCTAD) formally recognized that "a sound national insurance and reinsurance market is an essential characteristic of economic growth" during its inaugural session in 1964, demonstrating how crucial insurance is to the trade and development matrix.

Insurance aids in the nation's economic growth by providing insurance policies and effectively converting savings into funds for actual investment initiatives. The stability of the country's insurance is nothing but a sign of economic growth (Outreville, 1990; 1996). Skipper's (1997) study discussed how insurance aids in economic growth in various ways. More specifically, insurance can aid in the following areas: it can help with trade and commerce; it can mobilize savings; it can enable more effective risk management; it can promote loss mitigation; it can facilitate efficient capital allocation; and it can either supplement or replace government security programs. The other two primary justifications offered by Ward and Zurbruegg (2000) for the importance of insurance to economic growth are the advantages that arise from the insurance company serving as an agent for risk transfer and indemnity as well as the advantages that come from the insurer serving as a financial intermediary.

Insurance is an important component of financial development that contributes to the economy in various aspects by; guaranteeing monetary stability for businesses and people; encouraging the growth of fresh capital and more effective distribution; mobilizing and directing savings toward investment opportunities; and promoting business and trade (Das et al., 2003). Apergis and Poufinas (2020) in their study maintain that insurance aids in government financing and business by their investment in both public and private investments through debt and equity. A sizable amount of these assets are typically reinvested in the local economy of the country where insurance businesses are based or do business. Insurance is indeed a vital part of economic development.

The insurance sector has grown significantly during the past 20 years, particularly in emerging nations, as a result of increased financial integration and liberalization. The insurance penetration and density have significantly improved not only for developed countries such as the US but also for various developing nations like India. India's insurance industry is regarded as among the fastest growing insurance industry in the world owing to its strong economic growth (IRDAI 2022-2023). As per IRDAI annual report (2022-2023), India's insurance industry with its premium volume of USD 131 billion currently stands at the 10th position of world's

largest insurance industries and further expected to rise to sixth position by year 2032. This is nothing but the reflection of the significance of the insurance industry for emerging nations like India. In 2022, the value of the worldwide insurance industry was close to six trillion dollars, and it is expected to substantially increase in the coming years (SwissReinsurance Company, 2022).

According to the Insurance Global Market Report 2023, there will be a notable boom in the insurance market by 2028, with a CAGR of 7.2%. The increased contribution of the insurance industry in the overall financial sector for both emerging and mature markets has led to the growing importance of insurance and growth nexus. Insurance penetration is a widely used metric to reflect the growth and development of the insurance industry as it measures “percentage of premiums to the GDP.” India’s insurance penetration for 2022-2023 stands at 4% which is lower than the global insurance penetration (Swiss-Reinsurance Company 2022). The government of emerging nations such as India has taken strong initiatives for improving insurance penetration to enhance its role in economic growth. It should be highlighted that life and property-liability insurance are likely to have diverse effects on economic growth since they shield individuals and businesses from various risks that have varying implications on economic activity. The importance of the insurance industry for economic growth and development indeed cannot be denied and needs to be examined in depth. The increasing interaction of insurance companies with the financial sector is anticipated to enhance government agencies and economist’s interest in developing effective regulatory policies especially for developing countries that are seeking strategies for boosting GDP growth.

This paper aims to improve understanding of the growth insurance relationship by reviewing and evaluating recent research. This study looks at the empirical research on the relationship between insurance and economic growth.

EMPIRICAL EVIDENCE ON CAUSALITY BETWEEN INSURANCE & ECONOMIC GROWTH

This section of the article looks at the body of research to understand the relationship between economic growth and insurance from a number of perspectives. According to Blum et al. (2002) to categorize the finance growth relations, five potential hypotheses can be used: absence of a causal connection; demand-following, when economic growth drives up the demand for insurance; supply-leading, whereby rises in insurance demand drive upsurges in economic growth; a detrimental causal link between growth and money; and mutual reliance. It appears that a large number of academics have seemed to agree on this categorization of the finance growth relationship. As with other financial sectors, the relationship between the real sector and insurance development can also be categorized using these five theories of causality. This paper thereby presents the evidence of empirical literature focusing on insurance and economic growth literature in regard to these hypotheses.

The majority of research has discovered evidence suggesting the growth of the insurance industry is best described as a phenomenon led by supply (Outreville, 2012). Ward & Zurbruegg (2000) were the first to provide some evidence of the supply-leading trend. They are recognized for having conducted the first research on the relationship between insurance and economic growth in OECD countries. Using several sets of data from 1961 to 1996 in each nation, they undertake a bivariate cointegration analysis and a causality test to examine the relationship between insurance and economic growth. There was variation in outcome as only Canada and Japan showed that insurance activity spurs economic development thus a supply-leading phenomenon while in other countries there was no indication of interaction. Due to a variety of factors unique to each nation, there are different causal links between insurance and economic growth in many different countries (Ward & Zurbruegg, 2000). Chang et al. (2013) also corroborates the findings of Ward & Zurbruegg (2000), showing that different countries have different relationships between insurance and growth.

Similar to Ward & Zurbruegg (2000), Web et al. (2002) endorsed the supply-leading theory about the connection between insurance and economic growth. Using the Solow-Swan model, they conducted a cross-sectional analysis to examine the effects of life and non-life insurance on economic growth in 55 countries between 1980 and 1990. According to their analysis, the banking and insurance sectors significantly impact

economic growth. Boon (2005) also found strong evidence of supply leading theory by employing Granger – equations and cointegration tests. The author concluded that there exists a long-term impact of insurance on GDP. However, this study was limited to Singapore only.

Similar to Arena, Han et al. (2010) used the GMM model to analyse time-series cross-sectional data for 77 economies from 1995 to 2005. They found compelling evidence to support the hypothesis that growth in insurance coverage propels economic prosperity. Additionally, they discovered—which is consistent with the findings of Curak et al. (2009) that creating non-life insurance and life insurance together is far more important for emerging countries than they are for economies with developed economies. According to Curak et al. (2009), insurance companies can influence economic growth by protecting consumers, developing new technologies, and increasing the rate of saving. Using an endogenous growth model and panel data estimate approaches, they examined whether life and non-life insurance, taken separately or in combination, contributed to economic growth in a sample of eleven transitional European member” nations between 1992 and 2007. According to their findings, the supply-leading theory is supported by the significant and positive stimulation of economic growth that the insurance industry’s expansion provides. Additionally, Njegomir & Stojic (2010) endorsed this. The authors concluded that through risk transfer, indemnity, and institutional investment, insurance promotes economic growth.

EMPIRICAL EVIDENCE ON CAUSALITY BETWEEN INSURANCE & ECONOMIC GROWTH IN INDIA

India is an emerging economy with a strong prospect for insurance growth. This makes studying of insurance and economic growth nexus in the context of the Indian economy significant. However, only limited studies have been conducted in this respect. Vadlamannati (2008) is among the prominent studies exploring the relationship between insurance and economic growth. The author supported the supply-leading hypothesis that insurance contributes to economic growth in India, a developing country. The author discovered that while there is no significant correlation between reforms and economic development, the rate at which changes are implemented has a favourable impact on economic growth. The study highlighted the significant impact of the insurance sector and insurance reforms on economic development. However, it does not provide much information about specific insurance sector reforms that transcends economic growth. Verma & Gholia (2013) findings also supported the supply-leading phenomenon as they found strong evidence of significant impact of life insurance on economic growth.

Kumar et al. (2020) discovered that both insurance penetration and density leads to economic growth in the long-run, but the same is not true for the opposite. They thus found the one-way causal relationship between insurance. The study however focuses only on the life insurance sector, ignoring the impact of the non-life insurance sector on economic growth and thereby fails to provide true depiction of insurance-economic growth nexus in India. Jana (2020) also inferred a positive link between insurance and economic growth in India. Lastly, the author also argued that in order to enable appropriate economic growth in India (developing country), more emphasis should be placed on the insurance sector. Thanga et al. (2023) study also indicated the casual relationship between life insurance and economic growth in India. The authors however found interesting results as the relationship is directed to be a demand-leading phenomenon where major determinants of economic growth affect the life insurance demand. The study does not take into consideration the non-life insurance sector and thus provides potential for further research.

CONCLUSION

Financial development has played an integral role in economic growth and development for many years and continues to do so today. The growth and development of financial institutions have been linked with economic growth for both developed and emerging nations. Extensive literature has been conducted in the past to establish the relationship between financial development and economic growth. However, most of the studies

have focused on banks and the stock market, ignoring one of the most important financial institutions i.e., insurance industry

The insurance industry being an important constituent of financial development has placed an important emphasis on economies. This industry has witnessed significant growth in recent years for both developing and developed nations owing to financial system liberalization, globalization, and financial market conglomeration. Because insurance contracts are characterized by indemnity and stability, insurance holds a prominent position in the financial industry. Important international organizations including UNCTAD, World Bank, and the International Monetary Fund, in addition to academic groups, acknowledge the role played by the insurance sector in economic development.

Empirical research focusing on insurance and economic growth has provided very useful insights into this relationship. This paper has examined the empirical literature to understand the importance of insurance in economic countries for both developing and developed nations. It is feasible to draw the conclusion from our paper that the rise of insurance has a strong theoretical basis for affecting economic growth, and vice versa. This paper has attempted to establish the causality link based on available empirical evidence. The current body of empirical research has produced a mixed bag of findings. The less developed nations and those with established financial markets are not the same.

Though most of the study has supported the supply side theory i.e., insurance activity leads to economic development, it is however not equal for all countries examined. This finding can help the policymakers to develop policies to strengthen the insurance market which in turn can lead to economic growth, especially for the developing countries. The understanding of causality link between insurance and economic growth can help the countries to increase the insurance density and penetration along with economic growth and development by developing appropriate economic reforms and policy.

A lot has to be studied and analysed on the insurance growth nexus as the current body has been scant as compared to work done on banks/ capital markets and economic growth nexus. This creates more room for future research to examine the effects of various insurance-related factors on economic growth in both developed and emerging nations in both supply-leading and demand leading directions. This paper also opens the future scope of comparative analysis of developing and developed nations on the insurance-economic growth nexus thus providing information on what works for developing and developed nations. This research paper also found the majority of studies have focused on one aspect of the insurance sector i.e. either life or non-life insurance. There are scarce studies that have taken into consideration both the segment and examine their relationship with the economic growth. The future direction of the research should thus focus on taking into consideration different segments of insurance and its relationship with economic growth as only then it will help the country to drive both economic and insurance growth and development. This paper also opens the future scope of comparative analysis of developing and developed nations on insurance-economic growth nexus. This paper in conclusion has provided strong empirical evidence not only in understanding the relationship between insurance and economic growth but also opening doors for future research.

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