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# Role of Life Insurance in Economic Growth of India: A Post liberalisation Scenario

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## Introduction

A well functioning financial system is a sine qua non for the pursuit of economic growth with stability. Financial system plays a vital role in economic growth and development. This approach is supported by empirical studies that have generally found that cross-country differences in the levels of financial development explain a considerable portion of the cross country differences in growth rates of economies. The core function of a well developed financial system is to facilitate smooth and efficient transfer of financial resources from savers to ultimate users. The contribution of financial system to economic growth is recognized in economic literature as early as in 1873 by Walter Bagehot in his classic Lombard Street: A Description of Money Market, where he cited efficient capital market of England as an important factor which contributed to industrial revolution. Bagehot was the first person to define two primary roles of financial markets. One, they facilitate accumulation of capital and two; they manage risk inherent in particular investment projects and industries. Joseph Schumpeter, in 1911 argued that the services provided by financial intermediaries of mobilizing savings, evaluating projects, managing risks, and facilitating transactions are essential for economic development. Since the empirical work by Goldsmith documented in 1969, the relationship between financial development and economic development, the factors responsible for development have received increased attention. The importance of effective financial system to economic development was substantiated by the empirical work of McKinnon 1973 and Shaw 1973 which illustrate the close relationship between financial and economic development. But numerous influential economists believe finance has relatively unimportant factor in economic development. Notably, Robinson (1952) states, financial development simply follow economic development. Lucas (1988) terms the relationship to be overstressed. However, several empirical studies establish a strong correlation between development of financial intermediaries and economic growth. World Bank research shows that a 10% rise in financial depth (liquid liabilities) is associated with an increase in per capita GDP growth of 2.8%, a remarkable increase. Financial services affect economic growth through following five main channels.

1. Saving mobilization;
2. Resource allocation;
3. Risk management;
4. Management monitoring, and
5. Trade facilitation.

## The Insurance-Growth channel

The above five channels in turn contribute to two factors viz. capital accumulation and technological innovation. These two factors as per Solow growth model directly contribute to economic growth. Considering the size of insurance activities and the economic functions of insurance it should also play a major role in all the above mentioned five channels and hence economic growth. It is now widely agreed that financial services in general and insurance in particular are of predominant importance to economic development. UNCTAD (United Nations Conference on Trade and Development) recognized this importance when at its first session in 1964, it acknowledged that----a sound national insurance and reinsurance market is an essential characteristic of economic growth. Harold D. Skipper, jr. (1997) redefined this recognition by stating, it is not merely a characteristic of economic growth but a necessity for great majority of today’s economies.

Das Davies (2003) indicated several ways in which insurance services contribute to economic growth.

- Insurance promotes financial stability both for households and firms;
- Life insurance companies mobilize and channelize savings;

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- Strong insurance can relieve pressure on government budget, to the extent that private insurance reduces demand for social security from the government;
- Insurance supports trade, commerce, and entrepreneurial activity;
- Insurance may lower the total risk faced by the economy;
- Insurance improves individual's quality of life and increases social stability;
- Insurance often offers more competitive and long term contractual saving vehicles than other financial institutions.

The World Development Report 1994 recognizes the importance of insurance sector by saying, "contractual saving institutions, such as pension funds and life insurance companies, are particularly suited to making long term investments. These institutions levy fixed premiums, have steady and predictable cash inflows, and incur long term liabilities, making them ideal suppliers of term finance for infrastructure". There is plethora of research on causal relationship between bank lending and economic growth and capital market and economic growth, but the insurance sector has received lesser attention than it deserves. In the words of Ward and Zurbruegg (2000) in contrast to the available evidence on the importance of banks typified by the work of Levine and Zervos (1998), little is known about insurance.

**Objectives**

- To review the role of life insurance as a financial intermediary in economic growth of India, and
- To assess its contribution to the development of capital market, inflow of foreign capital, financial inclusion, and poverty alleviation.

**Review of Literature**

- **Catalan, Impavido and Musalem** (2000) analyse the development of contractual savings institutions and their effect on other financial intermediaries and markets. The analysis supports the view that insurance has an important role in economic growth through financial intermediation.
- **Ward and Zurbruegg** (2000) limiting the causality test to insurance sector, on the basis of data for nine OECD countries during 1991 to1996, conclude that the insurance sector Granger causes economic growth in Canada and Japan, while for others it is weaker and less significant.
- **Das, Davis and Podpiera** (2003) conclude like banks, insurance companies are financial intermediaries. It is therefore not sufficient to view the insurance sector simply as a pass through mechanism for diversifying risk.
- **Kong J. and Singh Manmohan** (2005) mention insurance companies are important financial intermediaries in both mature and emerging markets. Given the nature of their liabilities, insurers are important conduits for providing long term capital, and their investment decisions could greatly influence capital flows to various asset classes.
- **Arena M.** (2006) on the basis of empirical study on causal relationship between insurance market activity and economic growth for 56 countries both developed and developing including India, during the period 1976 to 2004 conclude that the result show a positive and significant effect of both life and non-life insurance market activity on growth.
- **Curak M.** and Loncar S. (2008) on the basis of data of 43 European countries for the period 1995 to 2006 conclude that life insurance is significantly and positively related to economic growth. Such evidence is not found for non-life insurance.
- **Kathy Avram et al.,** (2010) examine the relationship between insurance and economic growth via a global cross country study of 93 countries including India over the period 1980 to 2006, using both cross-sectional estimations and dynamic panel data techniques. For dynamic panel data, GMM model developed by Arellano and Bond (1991) and Arellano and Bover (1995) were used. It was found that insurance has significantly positive relationship with economic growth, especially with insurance density measure. Other measure insurance penetration did not prove significant. The underlying conceptual framework is that insurance fosters a more efficient allocation of resources and long term economic growth. Insurance density and insurance penetration are used as a measure for the development of insurance.
- **Liyan, Han et al.,** (2010) investigate the relationship between insurance development and economic growth by employing GMM models on a dynamic panel data of 77 economies including

India for a period 1994 to 2005. Insurance density is used as a measure for the development of insurance. Controlled by a simple conditioning information set and a policy information set the paper draws a conclusion that insurance development is positively correlated with economic growth. For developing economies development of insurance plays a much more important role than they do for the developed economies.

While from theoretical point of view the insurance sector should contribute to economic stability and growth, empirical evidence is mixed.

**Indian Experience**

Of the four factors contributing to economic growth viz. Human Resources; Natural Resources; Capital Formation and Technology, life insurance contributes to capital formation through its function of financial intermediation in addition to its basic risk transfer function. Present paper focuses on the following aspects of the life insurance sector:

- Importance in Indian economy;
- Financial Intermediation; and
- Contribution of the life insurance sector to the development of capital market, inflow of foreign capital, inclusive growth, and poverty alleviation.

**Importance in Indian economy**

The two important measures traditionally used for measuring the significance of insurance markets within national economies are:

1. Insurance Density: The annual per capita insurance premium within a country measured in terms of US dollars.
2. Insurance Penetration: The ratio of direct premium written to gross domestic product.

In the post liberalisation period there is increase in both life insurance density and penetration indicating increasing importance of life insurance in the national economy.

The data in Tables 1 & 2 present a comparative picture of insurance density and penetration respectively in India and other BRICS countries as well as Asia and the world.

**Table 1: Life Insurance Density in US $**

| Year | Brazil | Russia | India | China | South Africa | Asia | World |
|---|---|---|---|---|---|---|---|
| **2000-01** | 10.8 | 33.2 | **9.1** | 12.2 | 372.2 | 125.0 | 235.0 |
| **2001-02** | 27.2 | 23.1 | **11.7** | 19.2 | 360.5 | 128.1 | 247.3 |
| **2002-03** | 35.8 | 33.9 | **12.9** | 25.1 | 476.5 | 140.1 | 267.1 |
| **2003-04** | 45.9 | 24.8 | **15.7** | 27.3 | 545.5 | 147.2 | 291.5 |
| **2004-05** | 56.8 | 6.3 | **18.3** | 30.5 | 558.3 | 149.6 | 299.5 |
| **2005-06** | 72.5 | 4.0 | **33.2** | 34.1 | 695.6 | 154.6 | 330.6 |
| **2006-07** | 95.3 | 6.1 | **40.4** | 44.2 | 717.0 | 156.7 | 358.1 |
| **2007-08** | 115.4 | 5.4 | **41.2** | 71.7 | 707.0 | 173.9 | 369.7 |
| **2008-09** | 127.9 | 4.5 | **47.7** | 81.1 | 574.2 | 180.3 | 341.2 |
| **2009-10** | 139.4 | 4.3 | **55.7** | 93.6 | 498.2 | 209.0 | 364.3 |

**Source: Swiss Re, Sigma Various Issues**

**Table2: Life Insurance Penetration in %**

| Year | Brazil | Russia | India | China | South Africa | Asia | World |
|---|---|---|---|---|---|---|---|
| **2000-01** | 0.36 | 1.55 | **2.15** | 1.34 | 15.19 | 5.84 | 4.68 |
| **2001-01** | 1.05 | 0.96 | **2.59** | 2.03 | 15.92 | 5.81 | 4.76 |
| **2002-03** | 1.28 | 1.12 | **2.26** | 2.30 | 12.96 | 5.74 | 4.59 |
| **2003-04** | 1.36 | 0.61 | **2.53** | 2.21 | 11.43 | 5.58 | 4.55 |
| **2004-05** | 1.33 | 0.12 | **2.53** | 1.78 | 10.84 | 5.16 | 4.34 |
| **2005-06** | 1.30 | 0.10 | **4.10** | 1.70 | 13.00 | 5.00 | 4.50 |
| **2006-07** | 1.40 | 0.10 | **4.00** | 1.80 | 12.50 | 4.60 | 4.40 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| **2007-08** | 1.40 | 0. 10 | **4.00** | 2.20 | 12.50 | 4.40 | 4.10 |
| **2008-09** | 1.60 | 0.00 | **4.60** | 2.30 | 10.00 | 4.50 | 4.00 |
| **2009-10** | 1.62 | 0.00 | **4.40** | 2.60 | 9.10 | 4.54 | 4.00 |

**Source: Swiss Re, Sigma Various Issues**

With respect to density, the data indicate that the life insurance density for India at US $ 55.7 is significantly lower than that for Asia world or other BRICS countries except Russia. However, there is increase in the density in post liberalisation period form US $ 9.1 to US $ 55.7, which is quite significant.

Life insurance penetration has increased from 2.15% to 4.40% in the post liberalisation period. Although the data on penetration compares very well with that of the world and Asia it is much lower than that for South Africa. It indicates that there is a possibility of further increase and potential can be realized by increasing the availability of insurance products and services.

The data on both density and penetration indicate that the importance of life insurance sector has increased in the post liberalisation.

**Financial Intermediation**

The role of the life insurance sector as a financial intermediary is analysed with reference to mobilisation of savings and investments.

**Mobilisation of Savings**

Savings, the basic source of capital formation is the prime mover of a nation's economic growth. In the words of Skipper (1997), "Countries that save more tend to grow faster" Further, skipper states "of the world's 20 fastest growing economies over the preceding ten years, 14 had saving rates greater than 25 percent of GDP and none had a saving rate of less than 18 percent". In contrast, 14 of the 20 slowest growing countries had saving rates below 15 percent. Skipper (1997) concludes with suggestion that increased saving is one of the important factors for rapid economic growth along with introduction of new technologies, or methods that increase productivity. There is a direct and positive relationship between rate of savings and the rate of economic growth. Therefore, any institution that promotes thrift, encourages and mobilizes savings has a vital role in national economic growth. Life insurance attracts personal savings of millions of individuals in the form of premium and contributes to mobilization of savings. This potential of the life insurance sector is recognized in the speech delivered by C. D Deshmukh on the occasion of nationalization of life insurance business. To quote him, "nationalization of life insurance is a further step in the direction of more effective Mobilisation of the people's savings." Savings in an economy are generated by public sector, private sector and the households. The household sector has a major share in the gross domestic saving. The contribution of life insurance sector to the mobilization of savings can be assessed on the basis of the following two parameters.

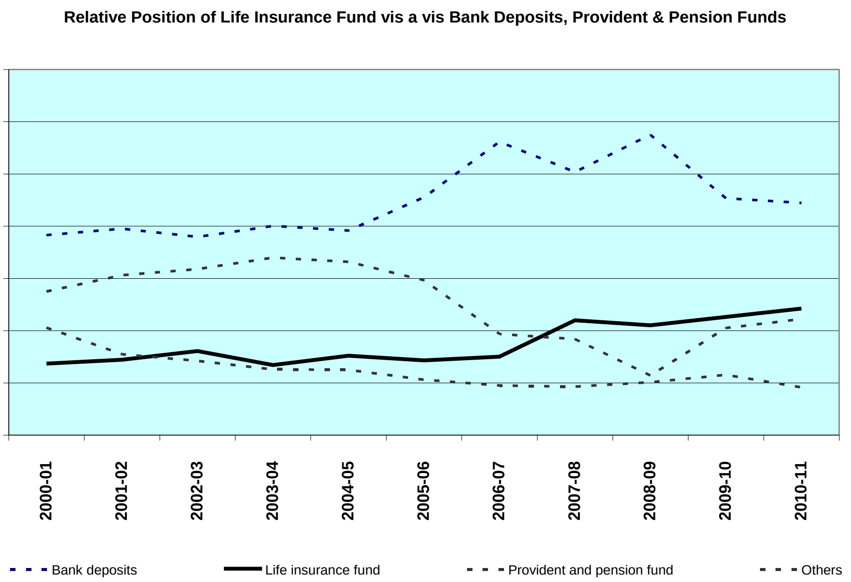
**1. Relative Position of life insurance**

Life insurance is an important financial intermediary mobilizing the savings of the house-holds. Table 3, and the graph that follows, indicate the trends in the relative position of life insurance in mobilization of household savings.

**Table 3: Relative Position of Life Insurance**

| **Year** | **Bank deposits (%)** | **Life insurance fund (%)** | **Provident and pension fund (%)** | **Others (%)** | **Total (%)** |
|---|---|---|---|---|---|
| **2000-01** | 38.2 | 13.7 | 20.6 | 27.5 | 100.0 |
| **2001-02** | 39.5 | 14.4 | 15.5 | 30.6 | 100.0 |
| **2002-03** | 37.9 | 16.1 | 14.2 | 31.8 | 100.0 |
| **2003-04** | 40.0 | 13.4 | 12.6 | 34.0 | 100.0 |
| **2004-05** | 39.1 | 15.2 | 12.5 | 33.2 | 100.0 |
| **2005-06** | 45.5 | 14.3 | 10.6 | 29.6 | 100.0 |

| | | | | | |
|---|---|---|---|---|---|
| **2006-07** | 56.1 | 15.0 | 9.5 | 19.4 | 100.0 |
| **2007-08** | 50.3 | 22.0 | 9.3 | 18.4 | 100.0 |
| **2008-09** | 57.5 | 21.0 | 10.1 | 11.4 | 100.0 |
| **2009-10** | 45.4 | 22.6 | 11.5 | 20.5 | 100.0 |
| **2010-11** | 44.5 | 24.2 | 9.1 | 22.2 | 100.0 |




Note: The percentages in the above table are calculated based on the figures given in TABLE 11: CHANGES IN FINANCIAL ASSETS / LIABILITIES OF THE HOUSEHOLD SECTOR (At Current Prices) of the RBI Handbook of Statistics on Indian Economy

The data in Table No. 3 highlights the improving relative position of life insurance as a financial asset vis. a vis. other financial assts held by the life insurance sector. The share of life insurance fund has increased from 13.7% at the beginning of liberalisation to 24.2% in 2010-2011. It now ranks second only to the most popular asset in India i.e. bank deposits, the relative position has improved from 4th to 2nd. Thus the importance of life insurance as a financial intermediary in mobilisation of house hold savings has increased in the post liberalisation period.

**2. Premium Collection**

The life insurance sector mobilizes savings through life insurance premium. The annual premium collection and the growth rates in it are presented in Table 4.

There is a regular and steady flow of people’s savings through life insurance. The life insurance sector has provided one of the largest accumulations of personal savings in this country and consequently helped the growth of Indian economy. There is continuous increase in the mobilization of savings through insurance premium collection. The amount has increased from Rs. 34898 cr. in 2000-2001 (beginning of post-liberalisation) to Rs. 291605 crore by 2010-11. The annual growth rates indicate fluctuations, after reaching the maximum level of 47.7% during 2006-07 there is a continuous decline which can be related to overall slowdown in the Indian economy.

**Table 4: Annual Total Premium Collection Rs. Crore**

| **Year** | **Amount** | **% Growth over previous year** | **Year** | **Amount** | **% Growth over previous year** |
|---|---|---|---|---|---|
| 2000-01 | 34898 | - | 2006-07 | 156076 | 47.4 |
| 2001-02 | 50094 | 43.5 | 2007-08 | 201315 | 29.0 |
| 2002-03 | 55748 | 11.3 | 2008-09 | 221785 | 10.2 |
| 2003-04 | 66654 | 19.6 | 2009-10 | 265447 | 19.7 |

| | | | | | |
|---|---|---|---|---|---|
| 2004-05 | 82855 | 24.3 | 2010-11 | 291605 | 9.9 |
| 2005-06 | 105876 | 27.8 | | | |

Source: IRDA Handbook of Insurance Statistics 2010-11

**Investments**

Economic growth rests on two pillars, savings and investment. In the foregoing part of the paper we have analysed the first process, the structure and volume of savings and have examined the role of life insurance in it. Now let us turn to the other pillar, namely investment. The contractual nature of the savings mobilised by life insurers enable them to contribute to the supply of long term finance.

**Table 5: Total Investments of Life Insurers: Instrument-wise Rs Crore**

| Particulars of Investments | Year | | | |
|---|---|---|---|---|
| | **2008** | **2009** | **2010** | **2011** |
| **(A)** Traditional Products | | | | |
| Central Government Securities | 296687 | 316010 | 360447 | 420952 |
| State Government Securities | 85198 | 107190 | 137236 | 173733 |
| Housing and Infrastructure | 63262 | 66673 | 85675 | 89181 |
| Approved Investments | 14554 | 202469 | 257084 | 304977 |
| Other Than Approved Investments | 42190 | 51260 | 34477 | 42159 |
| **(B)** ULIPs | | | | |
| Approved Investments | 111629 | 151490 | 311669 | 371899 |
| Other Investments | 21448 | 21273 | 25878 | 27217 |
| **Total A+B** | 578068 | 916365 | 1212458 | 1430118 |

Source: IRDA Annual Report 2010-2011 and 2008-2009.

The data in Table No. 5 indicate a continuous rise in the investments of the life insurance sector. It also highlights the contribution of this sector in the investments in the Government securities as well as infrastructure and housing.

**Capital Investment in life insurance sector**

There is substantial increase in the capital invested in the life insurance sector. It has increased from Rs. 5 crore of pre liberalisation to Rs. 23662 crore by 2011, of which Rs. 5724 crore i.e. 24.19% is foreign capital. The private sector accounts for the entire rise in terms of domestic and foreign capital as there is no increase in the capital of the public sector life insurer. Thus the sector has played an important role in attracting foreign investment. This contribution is expected to increase further when the FDI cap is raised from the current 26% to 49%.

**Insurance and development of capital market**

Life insurance companies as contractual saving institutions mobilize savings through sale of insurance policies which are channelized into financial markets. Thus they contribute to the development of capital market as suppliers of funds. This role becomes much more important in developing country like India. Currently the Government bonds account for 50% of the investments of the life insurance sector. LIC of India is one of the largest domestic institutional investors in government bonds as well as corporate securities.

**Insurance and Inclusive Growth**

The above analysis gives us an idea about the relationship between insurance and economic growth in general. Let us now consider the contribution of insurance to inclusive growth. The concept of inclusive growth implies that every one has an opportunity to contribute to the process of economic growth and benefit from it. Financial inclusion is an important aspect of inclusive growth. Insurance as a means for financial inclusion can have significant contribution towards inclusive growth.

**Insurance and Financial Inclusion**

White paper prepared by CGAP (Consultative Group to Assist Poor) on behalf of the G 20s Global Partnership defines financial inclusion as a state in which all working age adults have effective access to credit, savings, payments, and **insurance** from formal service providers. Effective access involves convenient and affordable service delivery to the customers and sustainable for the provider, with the result that financially excluded customers use formal financial services rather than the existing informal options. Micro insurance is a vehicle to provide insurance services to economically weaker sections. The obligations prescribed by IRDA for social and rural insurance have increased the availability of insurance to the poor people.

**Insurance and poverty alleviation**

Although, there is no single solution for poverty eradication, insurance can provide the individual with a secure environment and a firm foundation to improve standard of living. Insurance is the most effective means of reducing the vulnerability of poor from the impacts of disease, theft, violence, disability and other hazards. It enables an individual to use credit and savings more productively. Micro insurance especially designed for economically weaker sections has an important role in this respect.

**Suggestions for enhanced contribution**

The above presentation indicates the contribution of life insurance sector in economic growth through mobilisation of savings and its channelization. Although the sector has an impressive performance the potential is not fully utilized. Following suggestions can be useful in expansion of life insurance services.

**Awareness:** It is an acknowledged fact that life insurance is more sold than bought. It is a matter of solicitation. Since life insurance covers potential losses in future and does not cater to immediate consumption needs, there is always a tendency to postpone or avoid purchase of life insurance. Therefore, there is a need to create awareness about the utility and the need for of life insurance.

**Cost of Insurance:** Reduced cost of insurance can attract more customers. It will be possible to reduce this cost through lowering of transactions cost on one hand and increasing income of life insurers on the other hand. Use of technology has a major role in reducing cost. It is experienced that the cost of term insurance can be reduced by about 50% through on line direct sale. Flexibility in the policies of the Government about the investments by life insurers can increase the income.

**Customer Service:** Efficient customer service and avoidance of miss-selling by the marketing people can increase the confidence of the people in life insurance and have positive impact on the mobilization of savings by life insurers. Innovative tailor-made products, timely settlement of claims and reduced lapsation go a long way in improving the quality of service.

**Investments**: Investment policy decides the yield on investments. At present to a great extent savings mobilised by the life insurance sector are pre empted in low yield directed investments.

**Conclusion**

In the post liberalisation period there is increased contribution of life insurance sector to the economic growth of our country through the process of financial intermediation. In addition to this the sector has attracted substantial foreign investment and has contribution to inclusive growth and eradication of poverty.

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