Journal of Economics, Trade and Marketing Management
ISSN 2642-2409 (Print) ISSN 2642-2417 (Online)
Vol. 1, No. 1, 2019
www.scholink.org/ojs/index.php/jetmm

Original Paper

Life Insurance Sector Development and Economic Growth of India in the Changing Policy Regime

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Received: May 7, 2019 Accepted: May 17, 2019 Online Published: May 21, 2019

doi:10.22158/jetmm.v1n1p34 URL: http://dx.doi.org/10.22158/jetmm.v1n1p34

Abstract

The changing economic scenario of the Indian economy posed new challenges to almost all the sectors of the economy, and the insurance sector is no exception. The introduction of insurance sector reforms not only eliminated the monopoly of life insurance sector, but opened up the insurance windows to the private players which increased the competition in many folds, especially since 2000. The reforms brought an overall increase in insurance penetration as well as insurance density in the country. As a result, the insurance industry is today more efficient and exerts considerable positive impacts on the growth of the Indian economy. The insurance sector contributes to a rise in labour productivity through efficient investments, and also generates productive employment opportunities. In this context, this paper examines dynamics of the relationship between the development of life insurance sector and the real economic growth in the changing policy regime in India, and provides the evidence of the positive and significant relationship between them. Therefore, it is suggested to prioritize the focus on the further development of the sector may be through the implementation of prudent policies to increase rural penetration of life insurance in India. Also, the inclusive growth strategy in the country can be effectively mobilized to enhance the development of the life insurance sector.

Keywords

economic reforms, insurance sector, economic growth, India

1. Introduction

The growth performance of the Indian economy in the last two decades has been very significant for the progress in the global economy. This growth trend began along with the implementation of the economic reforms in the early 1990s which allowed the country to exploit its economic potential and to raise the standard of livings of people. This changing economic scenario posed a new challenge to the

insurance sector of the country. In the pre-reform phase, the government has had a monopoly over the life insurance industry, but the implementation of insurance sector reforms in the 1990s opened up the insurance windows to the private players which increased the competition in many folds and led to the growth of the insurance sector. Despite the average annual growth rate of 16.50 per cent in the insurance business in India during 1973 and 1994, the sector failed to fulfil the purpose for which it was mooted due to the lack of competition (Gunasekaran, 2009). The sorry state of the development of the sector is reflected in the low insurance penetration and density till the late 1990s. The life insurance penetration in India remained below 1 per cent throughout the pre-reform period with life insurance density as low as Rs. 0.0002 in 1980 and remained almost around it till 1999. Thus, the life insurance sector could not benefit the economy in terms of mobilisation of savings from the household sector to the industrial sector. Besides, for the consumers, it also did not provide a wide range of choices to invest in it. With such flaws, it was obvious that its development could not hit the desired level.

In the insurance sector, the reforms began after the submission of the report of R. N. Malhotra Committee in 1994, which was set up in 1993. These reforms primarily aimed at bringing into the limelight an efficient and competitive financial system capable of upholding the structural changes occurring and required for the Indian economy. These reforms aptly recognised the importance of the insurance sector for the overall growth and development of the financial sector of the economy (Mohan, 2005; Newar, 2013). The Malhotra Committee among other things recommended that private players be allowed to enter the insurance sector to bring greater and deeper insurance coverage in the economy and to channelize the savings for the infrastructural development in the economy (Ranade & Ahuja, 1999; Gunasekaran, 2009). Besides, the Committee also recommended for the reduction of Government's stake in insurance companies to 50 per cent, allowing foreign companies in collaboration with Indian companies, and set up of an insurance regulatory, etc. Immediately after the submission of the Malhotra Committee report, a new committee called Mukherjee Committee was set up in 1994 to make concrete plans for the requirements of the newly formed insurance companies. Then in December 1996, the Government of India introduced the Insurance Regulatory (IRA) Bill to provide a legislative framework for the establishment of an authority to ensure proper growth of the insurance industry and to protect the interest of the policy holders. However, this IRA Bill could not be passed in Lok Sabha until it was renamed as Insurance Regulatory and Development Authority (IRDA) Bill in 1998 and got passed in the Lok Sabha and subsequently in Rajya Sabha on December 1999. Thus, the IRDA Act 1999 ultimately brought an end to State monopoly in the insurance business.

The IRDA began functioning on April 19, 2000 after the IRDA bill got the consent of President of India in January 2000, with N. Rangachary as its first Chairperson, and with the objective to regulate, ensure and promote the orderly growth of the insurance business in the country (Ansari & Rehmani, 2016). In August 2000, IRDA opened up the market by inviting applications for registration, and by December 2000 all four subsidiaries of GIC were restructured as independent companies and GIC was converted into the national insurer. From time to time more and more companies entered the insurance market and

by end of March 2018, there were as many as 68 companies operating in the insurance industry of which 24 are life insurers, 27 are general insurers, 6 are exclusively doing the business of health insurance, and remaining 11 are the re-insurers.

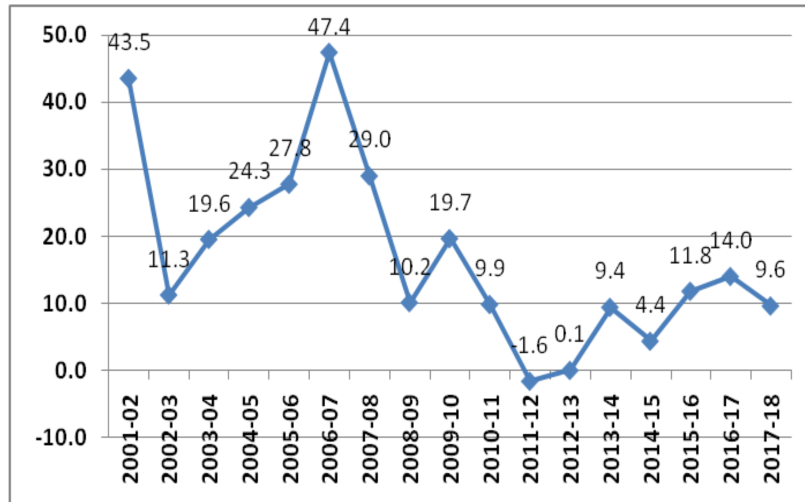

Figure 1. Y-o-Y Growth of Life Insurance Premium in India (%)

Source: Own Plot of Data from Annual Reports of IRDA.

In the period of reforms, the Indian life insurance industry has experienced major changes in terms of market structure, size and operational practices. This is because there has been a perceptible shift in the fundamentals of the life insurance industry in the country. The major changes include increase in efficiency level of life insurance companies in line with upgradation in technology related processes and in implementing innovative business strategies, considerable growth in premium, increase in the insurance penetration and density, increase in the number of policy holders/insurance clients, introduction of innovative insurance products, and massive recruitment of insurance agents. Thus, the insurance sector of India has made strides in the post-reform era in terms of its business and coverage and today, Indian life insurance industry is ranked 10th and non-life business is ranked15th among the 88 nations of the world doing insurance business.

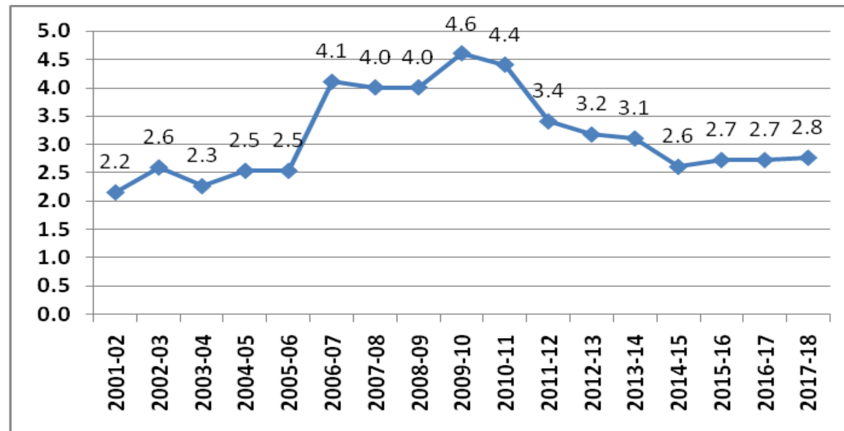

Figure 2. Life Insurance Penetration in India (%)

Source: Own Plot of Data from Annual Reports of IRDA.

Besides, the insurance industry also has increased its share in the country's GDP after the reforms of the 1990s which is reflected in an increase in the insurance penetration and insurance density. As per the annual reports IRDA, life insurance penetration increased to 2.15 per cent in 2001-2002 from the level below 1 per cent in 1999 which further increased to 2.76 per cent in 2017-2018 (see Figure 2). The life insurance density has also been increased in the post-reform era from a mere US$ 9.10 in 2001-2002 to US$ 55.00 in 2017-2018 (see Figure 3). The gross life insurance premium increased from Rs.50,094.45 in 2001-2002 to Rs.4,58,809.44 in 2017-2018. In terms of the annual growth rate of life insurance premium, the figures increased from 11.28 per cent in 2002-2003 to 14.04 per cent in 2016-2017 and thereafter declined to 9.4 per cent in 2017-2018 (see Figure 1).

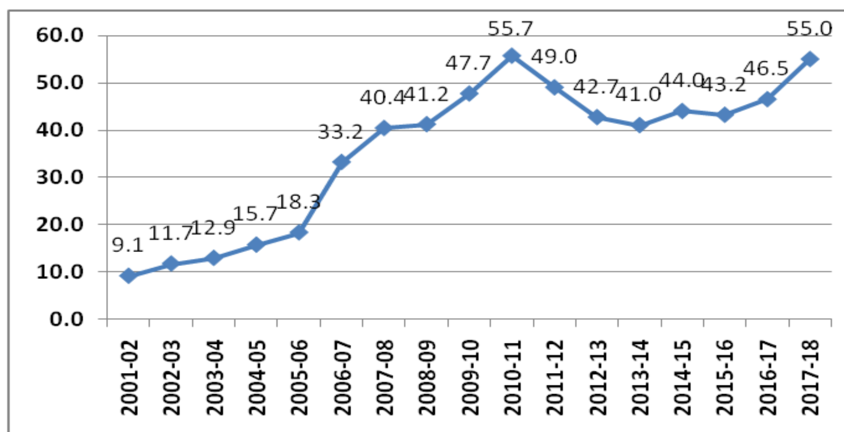

Figure 3. Life Insurance Density in India (USD)

Source: Source: Own Plot of Data from Annual Reports of IRDA.

All these clearly show the positive effect of privatization and liberalization in the post-reform era on the life insurance industry in India (Mohananasundari & Balanagagurunathan, 2011). With such progress in the life insurance business in India, it is obvious to hypothesize a positive relationship

between the life insurance sector and real economic growth in India. Kugler and Ofoghi (2005) argued that insurance sector by providing protection to life and property of people contributes to the economic growth and development of a nation in various channels including rising marginal productivity of capital, increasing savings, and improvements in technological innovation.

Apart from providing protection to the life of individuals as the insurer, the life insurance sector influences the economic growth of a nation in the form of the financial intermediary (Curak et al., 2009). The fast growth of the life insurance premium raises the investment potential of the insurance sector (Lee et al., 2013). Insurance sector helps to sustain consumption demand in an economy which ultimately contributes to increased production, employment and a higher rate of economic growth (Curak et al., 2009; Cristea et al., 2014). Chowdhury (2016) remarked that the life insurance sector is a major instrument for mobilizing savings of surplus spending units of the society for productive investments. The life insurance sector is the largest long-term investor in India (Kallinath, 2003; Rangarajan, 2006). Parekh and Banerjee (2010) and Verma and Bala (2013) mentioned that in the post-reform period, the contribution of insurance to GDP has increased. Gunasekaran (2009) observed that the insurance sector encouraged capital formation in a country in the first decade of reforms. Thus, in line with the extant literature (Vadlamannati, 2008; Haiss & Sumegi, 2008; Curak et al., 2009; Avram et al., 2010; Verma & Bala, 2013; Lee et al., 2013; Dhiab & Jouili, 2015; Ansari & Rehmani, 2016), it is justified to presume a positive relationship between the development of life insurance sector and the real economic growth.

It is with this backdrop, this paper examines the relationship between life insurance sector development and real economic growth in the changing policy regime in India. The rest of the paper is organised as follows: Section 2 makes a note of the data and methodology used in the study; Sector 3 makes the analysis and discusses the results; and Section 4 concludes.

2. Data and Methodology

The primary objective of the paper is to investigate the relationship between life insurance sector development and real economic growth in the changing policy regime in India. The null hypothesis of the study is that there is no significant relationship between the life insurance sector and economic growth in India. The sample period of the study is 2000-2001 to 2017-2018. The study relies on the secondary data that are compiled from the annual reports of IRDA, Handbook on Indian Insurance Statistics, and RBI Handbook of Statistics on Indian Economy. The variables of the study are economic growth (EG) measured by the real GDP at 2004-2005 prices, total life insurance premium (LIP), and total life insurance investment (LII). Among these variables, EG and LIP are integrated of order Zero, and LII is integrated of order two. Therefore, the relationship between life insurance sector development and real economic growth in India has been examined by employing the Granger causality test procedure as proposed by Toda and Yamamoto (1995). This method has been proved efficient for time series having a smaller number of observations, and also appropriate for the cases

where the order of integration of underlying series are not known, or are not necessarily the same, or is two or more. This method augments the correct Vector Auto-regression (VAR) order, k with d extra lags, where d is the maximum likely order of integration of the time series in the empirical system. In this study, we augmented the VAR by two as the highest order of integration is two for the variable LII. This augmented VAR system is estimated using Seemingly Unrelated Regression (SUR) technique of time series regression analysis. Then the null hypothesis of non-causality between the development of the insurance sector and economic growth is tested by the Wald test.

3. Results and Discussion

At the outset, we examined the stationary properties of time series variables taken in this study using the Augmented Dickey-Fuller (ADF) unit root test, and the results are reported in Table 1.

Table 1. Results of ADF Unit Root Test (with Trend & Intercept)

Variables	ADF Stat. at level (p-value)	ADF Stat. at 1st Diff. (p-value)	ADF Stat. at 2nd Diff. (p-value)	Decision
EG	-4.258 (0.029)**	NA	NA	I(0)
LIP	-5.372 (0.006)*	NA	NA	I(0)
LII	-1.208 (0.870)	-2.811 (0.216)	-3.964 (0.040)**	I(2)

Source: Authors' Own Estimation; *, **Significant at 1% and 5% levels

It is evident from Table 1 that the variables EG and LIP are integrated of order Zero, and LII is integrated of order two as indicated by the p-values of ADF statistics at specified levels of significance. Thus, we augmented the VAR by two as the highest order of integration is two for the variable LII. Then we selected the optimal lag length by Akaike Information Criterion (AIC) and it is found one. Therefore, we estimated a VAR model of order 3 by SUR and the Wald test is carried out using standard chi-square distribution. And, the results of this Toda & Yamamoto Ganger non-causality test are reported in Table 2.

Table 2. Results of Toda & Yamamoto Granger Non-Causality Test

Null Hypotheses of No Granger Causality	Chi-Square Statistic (d.f) p-value
LIP does not Granger Cause EG	17.342 (3) (0.000)*
LII does not Granger Cause EG	13.384 (3) (0.000)*
LIP & LII Jointly do not Granger Cause EG	25.433 (6) (0.000)*
EG does not Granger Cause LIP	15.265 (3) (0.000)*
EG does not Granger Cause LII	24.381 (3) (0.000)*

Source: Authors' Own Estimation.

The results show that the null hypotheses that "*LIP does not Granger Cause EG*" and "*EG does not Granger Cause LIP*" are rejected at 1 percent level of significance. This means economic growth measured by GDP and insurance sector development measured by Life insurance premium in India contains some power to predict each other. In other words, feedback causality runs between them. Second, the null hypotheses that "*LII does not Granger Cause EG*" and "*EG does not Granger Cause LII*" are rejected at 1 percent level of significance. This means economic growth measured by GDP and insurance sector development measured by life insurance investment in India contains some power to predict each other. In other words, feedback causality runs between them. Third, the null hypothesis that "*LIP & LII do not Granger Cause EG*" is rejected at 1 percent level of significance. This means that the insurance sector development measured by Life insurance premium and life insurance investment can influence the changes in the economic growth of the country. In other words, LIP and LII are two important determinants of economic growth in India. Overall, we found the positive impact of life insurance sector development on the real economic growth of India. Further, it is found that the higher rate of economic growth of the country has a stimulating effect on the life insurance sector.

4. Conclusion

Today India is one of the fastest growing market economies in the world. And, this is among others, due to the economic reform measures adopted in the country since the early 1990s. The Indian economy has now become the frontier market economy in Asia. The growth stimulus has been received from all the sectors of the economy, and the insurance sector is no exception. The reform measures that have been adopted in the insurance industry in India has transformed this sector from State monopoly during the pre-reform era to the most competitive market-based sector in the post-reform period. In particular, the life insurance sector in India has developed in many folds in the post-reform period. There has been a considerable increase in life insurance premium, penetration and density especially after the IRDA was established. With this, the life insurance sector has become an efficient financial intermediary playing a significant role in contributing to the real economic growth of India through its contribution to total domestic investments, GDP and employment. It is with this background, this paper examined the relationship between life insurance sector development and real economic growth of India in the post-reform phase, i.e., from 2000-2001 to 2017-2018. It is found that the life insurance sector that has been developed especially in the changing policy regime is significant in positively influencing the real economic growth of India. It is also found that the higher rate of growth of the Indian economy is important in stimulating the development of the life insurance sector. These findings are critical from the policy point of view. The policy implication is that the policy makers should put in place policies that would promote the business of the life insurance sector. In this context, it may be suggested that the life insurance industry should focus on the rural penetration of its business where the companies might find "gold-post at the bottom of the pyramid". The findings also imply that the policy makers should emphasize on the inclusive growth strategy so that increase in the standard of living of

people may lead to increase in demand for life insurance services and ultimate development of the life insurance sector.

Acknowledgements

We sincerely acknowledge the library and e-library facilities provided by the Central University of Punjab, Bathinda in carrying out this research work. We also acknowledge the efforts of editors and reviewers in accomplishing the publication of this paper.

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