

The Effects of the Insurance Market in the Development of Western Balkans Countries, with Special Emphasis on Kosovo

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Abstract

The purpose of this research is to see whether the insurance influences the economic development of Western Balkan countries. Currently, insurance comprises an economic sector that includes all activities of conception, production and trading of this type of service that is of public interest but generally carried out by private law entities. For the specification of the econometric model in this research, we are based on the secondary data published in the official reports of the World Bank, the Central Bank, and the statistical agencies of some countries. To measure empirical results, there are used these statistical tests: fixed effects model, Hausman Taylor Regression, generalized method of the moment (GMM), and GLS regression. Based on the empirical results, we can conclude that life insurance and non-life insurance have a significant connection and positively impact the economic growth of these countries. Other variables that have shown a positive result in economic growth are: GDP per capita, Exports, whereas variables that negatively impact on economic growth are inflation and government spending.

The empirical results of this document may recommend that relevant institutions implement institutional improvements that contribute to strengthening competition, advancing risk management techniques, and so on. In conclusion, we can say that future researches can be done as events, life insurance or non-life insurance impact on economic growth in Kosovo and in the countries of the region. The study is carried out with secondary data, and all empirical analyses are original. Through the results of this study we intend to offer more empirical evidence for our country and countries in the region recommending that relevant institutions improve the functioning of the financial sector and especially the insurances part because it is the factor that affects the economic growth.

Key words: Economic growth, life insurance, non-life insurance, Kosovo.

JEL Classification: C23, E31, G22, O11

1. Introduction

One of the most important factors given special attention is the role and development of insurance where the positive relationship between it and economic growth is a beyond doubt fact. For example, developed countries, without exception, have the most developed insurance, but also those countries that have pursued certain policies for the development of the financial system have been characterized by higher rates of economic growth. The limited possibility of insurance in developing countries causes failure at start-ups reducing the level of security and doing so it lowers the likelihood that people start new businesses which directly affect the slowdown in economic growth. Insurance interacts with economic activities and initiatives and while

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serving and supporting these activities it has the function to favour economic growth and development. However, the insurance condition in underdeveloped markets, mainly in the countries of Southeast Europe, including Kosovo, is presented with deficiencies, both in institutions defects and premiums. This situation is not conducive to economic activity, and enterprises and insurances cannot perform their institutional function in the market.

As far as it concerns Kosovo, the insurance industry has grown in recent years in terms of increasing the number of insurance companies and also in terms of gross written premiums and general assets of the insurance industry in general. The main objective of this study is to see whether the life and non-life insurance have positive impact on the economic growth of Western Balkan countries. The variables used in this research are: Economic growth, life and non-life insurance, inflation, GDP per capita, exports, investments and government spending.

2. Literature review

The correlation between insurances and economic growth has become an important issue for debate, both theoretically and empirically. The financial system is known as an important sector in the country's economic growth. Different theories have shown that there is a relationship between the financial system and the economic growth. As globalization part, the insurance industry carries out a multi-dimensional position. Indeed, insurance is quite important. In 1964 at the United Nations Conference on Trade and Development (UNCTAD) it was officially admitted that "a safe national insurance and reinsurance market is a key feature of economic growth." Insurance, like other financial services, has increased with quantitative importance as a part of the overall development of financial institutions. The governments of many developing countries have historically considered that the financial systems they inherited could not properly serve the development needs of their countries and so over the last thirty years they have guided subsequent efforts to change the structures of these financial resources systems and their control to channel investment savings, which ones are an integral part of development programs (UNCTAD, 1984, 1988).

Browne and Kim (1993) claim that worldwide insurance industry has grown even faster in recent years at a rate of 24%, from 1984 to 1988. The life insurance industry has grown at a rate of 30% per annum, while the non-life insurance industry has grown at a rate of 19% over this time. The last two decades have had a rapid growth in insurance markets, and so the insurance market activity as become more and more important. The first research that confirmed the positive growth of the economy in the demand for research is the study of Beenstock, Dickinson and Khajura (1986). Using time series data for the ten industrialized countries for the period 1970-1981, they found out that life insurance directly depends on income, measured as GDP per capita. While other authors, Ward and Zurbruegg (2005) and Arena (2008) carry out a series of empirical research on the impact of the economy on life and non-life insurance. They argued that life and non-life insurance directly depend on the impact of economic development. Ian P. Web Marin F. Gracedhe Harold D. Skipper (2002) tried to examine whether banks and life and non-life insurance, individually and collectively, contributed to economic growth.

They used data from 55 countries for the period 1980-1996 and came up with the results that the permeation of life insurance significantly correlates with economic growth and the relationship is mutual, in addition they stated that there is no connection between economic development and non-life insurance.

Haiss and Schiegi (2008) studied the impact of insurance on economic growth. In a sample of 29 European countries, panel data was used over the period 1992-2005. At the beginning, they used the sample as a complete one, then they divided it into two groups, one made up of 15 EU countries and the other including EU member countries (Turkey and Croatia). They argued that there was a positive impact of life insurance in GDP growth for the first group of countries, for the second group they found a greater impact on non-life insurance. Kjosevski, J (2011) discussed the impact of insurance on economic growth by using three variables: life insurance, non-life insurance, and full insurance coverage. He used data from the period of 1995-2010 of the Republic of Macedonia, using OLS technique, followed by a variability analysis to identify the effects of each variable. The results of this research showed that the development of the total insurance sector has a positive impact on economic growth; this result is confirmed in non-life insurance, while life insurance adversely effects on economic growth. In the Hadhek Zouhaier (2014) study, they use a pattern of data of a static panel that covers a sample of 23 OECD countries during the period 1990-2011. They came to a conclusion that non-life insurance affects economic growth whereas there was a negative effect of life insurance and insurance in total.

The study of Srijana Pant & Fatta Bahadur KC (2017) reviewed the contribution of the insurance industry on Nepal's economic growth using various variables such as: general insurance premium, life insurance premium, non-life insurance and investment and employment. The data used was from 2004-2016 and the study concluded a positive contribution to economic growth. They noted that life and non-life insurance have contributed to GDP growth in the country by 2.03% in 2016 and it shows a developing trend. In general, a number of studies, regarding the impact of both life insurance and non-life insurance, have shown to affect economic growth, but in our country not many studies have been carried out related to this subject.

3. Empirical analysis and specification of the econometric model

In our research we test the impact of insurance on economic growth by including Western Balkans countries in the study. This study includes the following countries: Kosovo, Albania, Macedonia, Montenegro, Serbia and Bosnia and Herzegovina. Data were collected for a period of 11 years, 2007-2017. The data collection was made by the World Bank, the Central Banks of these countries and the Statistical Agencies of some countries. Specification of the econometric sample to test the insurance impact on the economic growth for the Balkan countries is:

$$\begin{aligned} GDP_{i,t} = & \beta_0 + \beta_1 LifeInsurance_{i,t} + \beta_2 NonLifeInsurance_{i,t} \\ & + \beta_3 Inflation_{i,t} + \beta_4 GDPperCapita_{i,t} + \beta_5 Exports_{i,t} \\ & + \beta_6 Investments + \beta_7 GonvermentExpenditures + \epsilon_{i,t} \end{aligned}$$

We have obtained Economic Growth (GDP) for the Western Balkan countries as a dependent variable based on the study by (Jordan Kjosevski, 2011) for the Republic

of Macedonia. As independent variables that could explain the Economic Growth (GDP), we have considered: life insurance, non-life insurance, inflation, GDP per capita, exports, investments and government spending. As a standard measure for the development of the insurance market we have used annual data of life insurance and non-life insurance. Life and non-life insurance provides various protection services for individuals as well as for businesses. Life insurance is basically a long-term investment and requires, monthly, quarterly or annual periodic payments, while non-life insurance is an insurance policy to protect the individuals from loss and damages. The period of non-life insurance coverage is usually a year it means a short term investment. Hence we hypothesize (assume) that life and non-life insurance have a positive impact on economic growth.

The next independent variable is inflation which shows a decline in a nation's currency's purchasing power. There are numerous studies that show that inflation negatively affects the economic growth. But a study by Cristina Daniela in 2015 on the Romanian economy shows that if GDP influences inflation growth, then this has had a positive connection. An increase of 1% of GDP has led to 0.55% increase in inflation. Inflation is expected to have a negative correlation with economic growth. GDP per capita is a measure of the economic development of a country counted for the number of people, dividing the country's gross domestic product from the general population of a country. The GDP per capita hypothesis is expected to have a positive correlation. The other variables used in our research are exports. Numerous empirical studies have shown that exports have a positive impact on economic growth such as the study by Gungor Turan and Bernard Karamanj, 2014, showed that exports have a positive impact on Albania's economic growth. The study shows that a 1% increase in exports affects GDP to rise by 0.58%. From our research on Western Balkan countries we expect exports to have a somewhat positive impact on economic growth.

Tab.1 – GDP of the Western Balkan countries, over the period 2007-2017

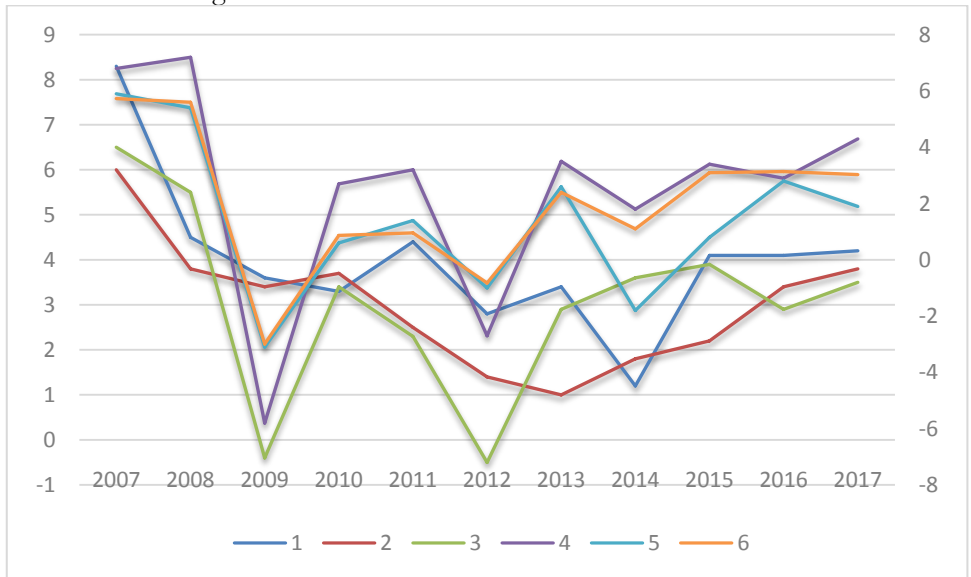
CO	UNTRIES	007	008	009	010	011	012	013	014	015	016	017
	Kosovo	.3	.5	.6	.3	.4	.8	.4	.2	.1	.1	.2
	Albania		.8	.4	.7	.5	.4		.8	.2	.4	.8
	North Macedonia	.5	.5	0.4	.4	.3	0.5	.9	.6	.9	.9	.5
	Montenegro	.8	.2	5.8	.7	.2	2.7	.5	.8	.4	.9	.3
	Serbia	.9	.4	3.1	.6	.4	1	.6	1.8	.8	.8	.9
	Bosnia & Herzegovina	.73	.6	2.99	.87	.96	0.82	.4	.1	.1	.14	.03

Source: Processing data from authors (World Bank)

Table 1 shows GDP for the Western Balkan countries for the period 2007-2017. Investment is another variable so we expect investments to have a positive impact on

economic growth. The last independent variable is Government Expenditures. There have been many theoretical and empirical studies about government spending. According to Alshahrani and Aleksandar (2014) it was argued that the rise in government spending encourages economic growth. However, the empirical evidence has not been convincing in this study. A contrary view was given by John Maynard Keynes' study. He gave the argument that when the economy is downward and when unemployment is high then the government can increase its spending by creating new jobs. It is necessary to increase economic output and to promote economic growth.

Fig. 1 – GDP to the Western Balkans 2007-2017



Source: Authors' calculations

Given that the Western Balkan countries do not have a developed economy, we assume that the government spending has a negative correlation with economic growth (GDP). In order to test these variables we used some models such as: Fixed effects model, Hausman Taylor's model, random effect model (GLS), and generalized time method (GMM). The results will be interpreted as those obtained by the GMM model. Besides the tabular method, the GDP of the Western Balkan countries has been given graphically, too. As shown in the graph, Kosovo in 2007 had the highest GDP in comparison with other countries such as Montenegro, Macedonia, Albania, and so on. In 2008, Montenegro had the highest GDP. In 2009, Kosovo comes again the first for the economic growth followed by Albania whereas all other countries had decline. GDP for 2010 was the highest in Albania, followed by Macedonia, Kosovo and so on. In 2012, 2015 and 2016, Kosovo had the highest GDP. If viewed in general, Kosovo, Montenegro and Macedonia had higher economic growth compared to Albania, Serbia and Bosnia and Herzegovina.

4. Empirical results

We have used different models to test variables but the results will be interpreted using the GMM model. The results of the third column (GMM) show that life insurance has a significant link and positively impact on economic growth. If life insurance increases by 1%, it will affect the GDP growth (growth) by 0.10%. Also non-life insurance appears to have a positive impact on the economic growth of Western Balkan countries.

Tab. 2 – The results of econometric models

Variables	FIXED EFFECT MODEL (1)	HAUSMAN TAYLOR REGRESSION (2)	GMM MODEL (3)	GLS REGRESSION (4)
Economic growth	-	-	-	-
Life insurance	0.1039 (0.001)	0.1036 (0.000)	0.1014 (0.001)	0.6171 (0.002)
Non-life insurance	0.7957 (0.002)	0.7894 (0.001)	0.7728 (0.001)	3.334 (0.087)
Inflation	0.0001 (0.767)	0.0001 (0.760)	-0.0006 (0.312)	-0.0008 (0.891)
GDP per capita	0.0704 (0.000)	0.070 (0.000)	0.0668 (0.000)	-0.1280 (0.000)
Exports	0.0001 (0.862)	0.0001 (0.841)	0.0001 (0.768)	0.1520 (0.005)
Investments	-0.0003 (0.208)	-0.0030 (0.193)	0.0001 (0.570)	0.0021 (0.411)
Government Expenditures	0.0012 (0.746)	0.0015 (0.683)	0.0040 (0.273)	0.0949 (0.417)

Source: Authors' calculations

A 1% increase in life insurance affects growth of 0.10% of GDP and a 1% increase in non-life insurance contributes to GDP growth by 0.77%. Based on these empirical results, it is noted that the greatest impact on economic growth for the Western Balkan countries is on non-life insurance. The main reason is that the insurance market in these countries over 95% dominates non-life insurance, while life insurance

has a very small share due to the very high level of income per capita. These two findings relate to studies by Ian P. Web Marin F. Grace and Harold D. Skipper (2002), They argued that life insurance and non-life insurance have a positive impact on economic growth. The raised hypothesis on life insurance and non-life insurance and their positive impact on economic growth are accepted. Another tested variable is inflation which appears to have no significant correlation and adversely affects economic growth. Numerous studies have argued that inflation negatively impacts economic growth. The results obtained from our research are related to the research conducted by author K Josevski (2011) for the Republic of Macedonia. He showed that an increase on inflation would adversely affect economic growth, but if it is countered by the fact that whether GDP influences inflation growth, then, the studies by Cristina Daniela in 2015 on the Romanian economy showed that GDP has a positive impact on inflation growth.

The hypothesis is admitted because it has emerged that inflation adversely affects economic growth. GDP per capita is another variable tested in our study, which one, according to the GMM model, has a significant correlation and positively influences economic growth.

Exports to the GMM model do not have significant correlations, but if we look at the GLS model outcome, it turns out that Exports are signatory and have a positive impact on economic growth. An increase of 1% of exports affects economic growth of 0.15%. Studies conducted by Gungor Turan and Bernard Karamanj in 2014 for the Republic of Albania, argued that exports have a positive impact on economic growth. The hypothesis that exports positively impact economic growth is accepted. Investments in our study have shown that they do not have a significant link even though the coefficient is positive. In fact, investments must have a significant link and have a positive impact on economic growth, but our results show the opposite. The reason relies on incomplete data. Investment hypothesis falls down. Government spending is ultimately not statistically acceptable because it does not have a significant link and contradicts the results achieved by other authors such as the study by Alshahrani and Aleksandar (2014) who argued that if government expenditures increase, it induces economic growth.

5. Conclusions

In this research we have combined time series data to examine the correlation between insurance development and economic growth in Kosovo and the countries of the region during the period 2007-2017. We used the GMM model in dynamic panel data to conclude that there is strong evidence in favour of the hypothesis that the development of insurance contributes to economic growth. The obtained results show the need to implement incentives for the development of insurance. Insurance development will boost economic growth in Kosovo the most and also in the countries of the region because the results of research conducted in developed countries suggest that the insurance has a positive impact and has an important role in their GDP growth. The results show that insurance plays a much more important role in emerging economies. The empirical results of this document suggest that life and non-life insurance are of great importance for economic growth in developing countries such as the Western Balkan countries and should be tending to be strengthened. From the many

researches carried out previously, it can be argued that overall financial development which includes stock markets, banks and insurance, is closely related to economic growth. It is recommended that relevant institutions implement institutional improvements to contribute to strengthening competition, advancing risk management techniques, developing new products, and new distribution channels. In the end we can say that some of the results achieved in this research appear to be the same as some of the studies conducted by other authors and based on these researches, and the results achieved by our research, we conclude that insurance such as life and non-life have a positive impact on the economic growth of Western Balkan countries.

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