

INSURANCE INDUSTRY AND THE NIGERIAN ECONOMY

Olaseni Akintola-Bello

University of Lagos

1. Introduction

This paper discusses the role of the insurance industry in the Nigerian economy. It attempts to answer the question:

How important is the Insurance Industry in national economic development? There are two ways of discussing this important question. Either one takes stock of the present situation and asks the question: what has been the contribution of the industry to the national economy to date? Or one adopts a prognostic approach in order to answer the question: What are the likely economic contributions of the industry to the nation's economy or in what significant ways can the insurance industry contribute to the development of the Nigerian economy? In this paper, I will attempt a little bit of both approaches, at least in so far as available data permits. However, on the surface, and judging by the size and growth of the industry in the past ten years, the economic contribution of the industry to the nation's development, at least when measured by its contribution to gross domestic product appears quite small. Similarly, when considered as a subset of Nigeria's financial system, the insurance industry is still relatively young. These two assertions will be examined later in the analysis. Such perspectives tend to obscure the role which the industry has played and can further play in the mobilisation of personal savings, in the transfer of risk, in the efficient allocation of funds in the capital market, as a foreign exchange earner and the effects of the industry's activities on government policies. This paper will highlight the present and the likely future role of the insurance industry with respect to these aspects of the nation's economy.

This paper is organised into five main sections. The first section is an overview of the insurance industry's size, growth and market structure, while the second considers the role of the industry in the capital market. Sections 3 and 4 consider the importance of the industry to the Nigerian economy in its role as an earner of foreign currency and in the transfer of risks respectively. The final section suggests possible areas where the role of the industry could be further improved.

2. The Insurance Industry: An Overview

The insurance industry is a collection of firms offering services (in this case, protection against the risk of financial loss) which are not homogeneous. In other words, the basic products of the industry — the transfer of risks — are neither perfect substitutes in supply nor perfect substitutes in demand. This is to say that the different market

categories differ with respect to the cross elasticities of supply or the cross elasticities of demand. One cannot exchange a fire insurance policy for an accident policy. However, one can distinguish two major categories of private insurance institutions (as distinct from public or government insurance plans such as pension or retirement funds): Life insurance companies and the non-life or general insurance companies. Some of the functions of the life and non-life companies are distinctive and the two institutions tend to appeal to different sources of funds and employ their funds differently.

Life insurance companies sell a variety of forms of insurance offering protection against personal financial risk. The principal types of contracts in Nigeria include individual life insurance, industrial life, and endowment insurance. The endowment insurance is a contract which pays the entire amount of the policy at the maturity of the contract, or immediately if the insured should die before the maturity of the contract. This type of policy emphasizes the savings aspect of life insurance since the premiums collected and the investment income earned must be sufficient to allow for an immediate settlement or at the end of the contract period. The individual life insurance policy requires premiums for a fixed naira per period for the life of the insured or for a specified number of years for limited payment life. The policy stays in effect as long as the policyholder fulfills the contract agreements of the policy. The relatively large premiums during the early years of the policy are accumulated and invested in order to provide the necessary funds to meet loss settlements when the premium payments become inadequate. Therefore by the nature of the contracts, the life business is a long-term one.

The non-life insurance companies provide insurance to protect the insured against losses arising from physical damages to property or loss arising from damage to others for which the insured must be held liable. Non-life insurance is typically divided into four broad categories: fire insurance, marine and aviation insurance, general accident insurance, and motor insurance. The events insured under most property and liability contracts even with large numbers of contracts are much less predictable than those insured under most life contracts. The incidence of risk for non-life insurance is evenly distributed throughout the contract period.

The number of registered insurance companies in Nigeria rose from 43 in 1970 to 69 in 1975. There are now (1982) about 82 registered companies. There are 58 companies writing only non-life or general business in 1982 as compared to only 3 companies writing only life insurance, and 21 companies operating in both life and non-life business. In 1977 most of these companies at least 70 per cent (or 44) were Nigerian-

owned while the remaining 30 per cent or 19 were jointly-owned by Nigerians and foreigners. In 1977 exclusive ownership of insurance companies by foreigners was disallowed an aftermath of the indigenisation effort.

The development of the industry is characterised by a very rapid growth-with an annual average growth rate of over 28 percent. When compared to the rate of growth of the economy the picture that emerges is that of an industry growing faster than the whole economy. The country's total gross domestic product (GDP) was growing at an average rate of 14 per cent between 1975 and 1980. Table 1 shows the size of the industry when measured in terms of the gross premium income. In the ten year period i.e. 1970 to 1980 the total premium income of the industry rose from a mere N 16.1 million in 1970 to over N 457 million in 1980. The relative contribution of both the life and non-life business of total premium income has remained between 21 and 79 per cent respectively between 1975 and 1980. In terms of growth rates, the different categories of the insurance industry exhibited different behaviour. Between 1975 and 1981, marine and aviation insurance had the highest growth rate of almost 53 per cent followed by the general accident insurance with an average rate of 45 percent. Table 2 shows the growth rates in each insurance market in Nigeria.

An examination of the structure of the industry reveals the predominance of large firms in the industry. When size of firm is measured by premium income earned or assets, the picture that emerges is that companies with an annual premium income of N 5 million and above dominate the industry. In 1980, of the 70 registered companies, there were 22 companies with annual premium income of N 5 m. and above. These companies between them controlled about 85 per cent (or N 386.3 million) of the premium income. There were other 28 companies earning between N 1 m — 4.99 million in annual premium income. These companies controlled about: 13 percent (or N 59 million) of the total premium. The remaining 20 companies were those with an annual premium income of less than N 1 million in 1980. Table 3 shows the size distribution of insurers in 1980. In fact the table reveals that 8 companies controlled about 56 percent of the total premium for the industry. The industry is characterised by the predominance of many small firms operating on the fringe of the market. The industry is becoming increasingly concentrated. The 5 firm and 10 firm concentration ratios for the industry between 1978 and 1980 show that the share of the five largest firms had increased from slightly above 43 percent in 1978 to about 45 percent in 1980, while the 10 firm ratio stood at 61 percent in the two year period. In terms of total assets, the shares of the 5, 10 and 20 largest companies were 49.2, 70 and 91 percent respectively in 1978.

Table 1

GROSS PREMIUM INCOME OF INSURANCE COMPANIES 1970-1980
(N' million)

Year	Total Premium	Life Insurers	Percent of total	Non-life Insurers	Percent of total
1970	16.1	5.5	34.2	10.6	65.8
1975	123.3	25.7	20.8	97.6	79.2
1980	457.2	95.9	20.9	361.4	79.1

Source: O. A. Bello, - Market Structure in the Nigeria Insurance Industry - unpublished manuscript, Dept. of Finance, University of Lagos 1982 p. 13.

Table 2

AVERAGE GROWTH RATES OF INSURANCE MARKETS IN NIGERIA 1975-1981 (PERCENT)

Insurance Market	Percent
Fire	22.4
Motor	16.9
General Accident	45.1
Marine and Aviation	52.5
Life	28.3

The presence of a multitude of very small firms which in total account for a minute proportion of total industry premium or assets, and very few large firms must affect the efficiency of resource utilisation in the industry. The implication of the industry's struc-

Table 3

SIZE DISTRIBUTION OF INSURANCE COMPANIES 1980 PREMIUM INCOME

Size of firms (in terms of premium income)	Number of Companies	Percent of Industry Premium	Amount of Total Premium (N' m)
Less than N 1 million	20	2.5	11.6
N 1m - 4.99m	28	12.9	59.0
N 5m - 15.0m	14	29.0	132.2
Over 15m	8	55.6	254.1
	70	100.0	457.0

ture is that the performance of the industry will be influenced by the performance of the 20 largest firms. A recent empirical study has shown that for the Nigerian insurance industry, market share of firms is a critical variable and primary determinant of inter firm variations in economic performance.

3. Insurance, the gross domestic product and the financial system

So much for the general overview of the industry. Now how important is the industry in the nation's economy? As already indicated, one can look at insurance contribution to the gross domestic product as well as its place in the nation's financial system. When considered in both respects one gets a picture of an industry that contributes very little to the gross domestic product and is yet to mature as part of the financial system. Table 4 and 5 show the contribution of the insurance industry to gross domestic product and its relative share of the total assets of the financial system. Insurance contribution to the gross domestic product at current factor cost between 1973 to 1980 is less than half of one percent of the GDP. The average annual contribution over the 8 year period is approximately 0.3 percent of the GDP.

Table 4

INSURANCE CONTRIBUTION TO THE GROSS DOMESTIC PRODUCT AT CURRENT FACTOR COST 1973-1980
(N' Million)

Year	Total GDP	Financial Institutions	Insurance
1973/74	11,224.00	122.0 (1.09)	18.5 (0.16)
1974/75	18,652.00	282.0 (1.51)	24.0 (0.13)
1975/76	21,475.00	473.3 (2.20)	41.3 (0.19)
1976/77	27,318.00	513.3 (1.88)	61.0 (0.22)
1977/78	32,052.00	612.0 (1.91)	79.0 (0.25)
1978/79	33,660.40	683.0 (2.03)	117.0 (0.35)
1979/80	39,940.00	718.0 (1.80)	166.0 (0.41)
1980	43,280.00	738 (1.79)	194.5 (0.45)

Within the financial system, the relative share of insurance companies as a subset of the financial system is between 2 and approximately 4 percent of the resources of the system as a whole. The most important set of institutions is clearly the commercial banks which between 1972 and 1978 accounted for no less than 82.0 percent and

sometimes as high as 87 per cent of the resources of the system. Table 5 shows the insurance industry's position in the structure of the financial system. In 1972 and 1975 the insurance companies came fourth and fifth in order of relative importance of their contribution to the total assets or resources of the financial system. By 1978, however, the industry's relative position has improved and was third in terms of its contribution to the resources of the system as a whole.

Table 5

INSURANCE INDUSTRY'S POSITION IN THE FINANCIAL SYSTEM 1972-1978

Total Assets (N' million)

Institutions	1972	1975	1978
Commercial Banks	1,367.6 (82.5)	4,307.9 (86.6)	9,105.7 (81.6)
Merchant Banks	18.6 (11.11)	188.8 (3.8)	424.0 (3.8)
Savings Banks	4.3 (0.3)	6.1 (0.1)	8.1 (0.07)
Development Banks	59.8 (3.6)	159.5 (3.2)	744.6 (6.7)
Insurance Companies	47.3 (2.9)	100.5 (2.0)	427.4 (3.83)
Provident Fund	120.8 (7.3)	179.2 (3.6)	339.8 (3.05)
Mortgage Bank	14.5 (0.9)	41.1 (0.8)	105.8 (0.95)
Others	29.3 (1.8)	—	—
Total	1,657.9	4,977.0	11,155.4

4. Insurance and the capital market

I have argued that merely considering the contribution of insurance to gross domestic product and to the resources of the financial system as a whole tends to obscure some of the important role of insurance particularly in the area of savings and the efficient allocation of resources. Insurance business of all classes involves the accumulation of substantial funds thus making them collectively an important potential source of investable funds in the capital market. In 1977, the total investment funds of insurance companies stood at N 315.04 million with life and general funds accounting for 44 and 56 percent respectively.

Therefore the investment policies of insurance companies have considerable influence on the efficient allocation of capital. The investment policies of insurers are influenced by the nature of their contractual obligations to their policyholders. As already noted,

the non-life business is essentially short-term, contracts in the main being for periods of one year or less. Consequently, the bulk of the annual premium would be required to cover liabilities to policyholders for the unexpired periods of their policies (reserves for unearned premiums) plus provisions for claims outstanding. This implies that non-life insurers would have a strong transaction demand for cash. Hence, a significant proportion of their investment portfolio would be in short-term liquid assets. They are also likely to have a stronger precautionary motive for having liquidity because of the variability of their claim payments. On the other hand, the bulk of life business is essentially long-term. This implies that life funds are available for long-term investments essential for national economic development.

To provide protection and other services, insurance companies hold substantial amounts of assets. With these large asset holdings and cash inflows and outflows, insurance companies are capable of transferring funds from one sector of the economy to another. An examination of the total assets and total investment of insurers from 1975 to 1979 reveals that approximately 50 percent (or N 1,291.85) of total assets of the industry over the five-year period (which stood at N 2,180.65 million) was applied to investments in government and quasi-government securities, corporate securities, real-estate and mortgages, bills of exchange, loans to policyholders and in cash on

Table 6

PROPORTION OF INVESTMENT TO TOTAL ASSETS OF INSURANCE COMPANIES 1975-1979
(N million)

Year	Total Assets	Total Investments	Investments as a percentage of Assets (%)
1975	187.30	73.34	39.2
1976	260.80	127.90	49.04
1977	427.90	292.60	68.4
1978	548.60	351.52	64.1
1979	756.05	446.49	59.1
Total 1975-1979	2180.65	1291.85	54.78
Average Annual growth 1975-1979	34%	50%	

deposit account. On the average, insurance has contributed about N 258 million per annum to total investments in the economy between 1975 and 1979. Table 6 shows the total investments of insurers as a percentage of the industry's total assets. The picture is that of an increasing trend from 39.2 percent in 1975 to 64 percent in 1978, except for 1979 when it declined to 59.1 percent. On the whole, it could be said that for every N 1 of assets acquired by insured between 1975 and 1979, approximately 56 kobo was applied to one form of investment or another. This picture differs with regards to the investment behaviour of life and non-life insurers. While the life insurers applied 77 per cent of their total assets in investments between 1977 and 1979, the general business or the non-life insurers had about 53.4 percent of their assets in investments.

Table 7 shows the proportion of assets applied to investments from 1977 to 1979. The life insurers were investing on the average an annual sum of N 178.0 million between 1977 and 1979. Similarly, the non-life business also contributed on the average, an annual amount of about N 185.6 m. in total investment during the same period. On the whole, while the total assets of insurance companies was growing at an annual rate of 34 percent, between 1975 and 1979, their total investment was growing at an annual rate of 50 percent over the same period.

Table 7

DISTRIBUTION OF ASSETS AND INVESTMENT OF INSURERS 1977-1979
(N' million)

Year	Life Insurers			Non-life		
	Assets	Investments	Investments as % of Assets	Assets	Investments	Investments as % of Assets
1977	157.34	136.60	87.0	270.54	156.0	57.7
1978	190.00	159.92	84.2	358.70	191.60	53.4
1979	343.24	237.25	69.1	412.80	209.24	50.7
1977-79	690.58	533.8	—	1,042.04	556.84	—

5. Composition of investment

A further examination of the composition of the investment behaviour of insurance companies will further reveal the valuable economic role the industry is playing in the development of the Nigerian economy, particularly in the provision of investment finance for both the private and the public sectors of the economy. It is pertinent to note that insurance companies are constrained in their investment behaviour by the provisions of the Insurance Act of 1976. The Act stipulated the proportion of assets that can be invested in various income-yielding investment. For example, Section 18 of the Act requires every insurer to invest in the country assets equivalent in value to those shown in the balance sheet and the revenue accounts. In addition, not less than 25 percent of their assets must be invested in government and quasi-government securities. It further stipulates that non-life insurance companies should invest not more than 10 percent of their total assets in real property while the permissible limit on the asset for life companies was fixed at 25 percent. Table 8 shows the various financial assets held by insurance companies between 1977 and 1979. More importantly, it shows insurance companies as major sources of finance, for the government, the business and the personal sectors. Between 1977-1979 insurance companies invested the sum of N 236.5 million and N 191.2 million in government and corporate securities respectively. This implies that on the average, the industry provided an annual sum of about N 79 million to the finances of the various governments through the holdings of Federal and State governments securities. Similarly, the industry, through its acquisition of corporate securities, contributed on the average, an annual sum of about N 64 million to the financing of the corporate sector of the economy. Insurance companies have also invested heavily in mortgages both home mortgages and mortgages on commercial real estate or property. An average sum of about N 56 million per annum was invested in real estate and mortgage loans over the three-year period. In an important way, insurance companies have contributed to the smoothness of international trade transactions through the financing of bills of exchange used mainly in the financing of overseas trade. Bill finance by insurance companies stood at N 5.3 million in 1977. This rose to about N 7.0 million in 1978. In 1979 total bill finance by insurance companies was about N 6.0 million. Table 9 shows the relative contributions of life and non-life companies to financial assets held by the industry. The asset composition of the two types of insurance companies shows that life insurance companies hold large amounts of government and corporate securities and are a major source of long-term investment finance to both the public and private sectors of the Nigerian economy. The

insurance industry finances part of the public sector long term financial requirements through holdings of development loan stocks. Between 1978-1980, insurance companies holdings of development loan stocks ranged between N 58 million in 1978 and N 75 million in 1980. Insurance companies holdings of development loan stocks would exceed the figures in Table 10 with the addition of statutory deposits which insurers are legally required to maintain with the Central Bank and which is used by the latter to acquire development stocks. In 1979 for example the statutory deposits of insurance companies stood at nearly N 16 million. With this addition, insurance companies holdings will be N 91.0 million or 7 percent of the total of financial institutions of development loan stocks in 1979.

Table 8

FINANCIAL ASSETS HELD BY INSURANCE COMPANIES 1977-1979
(N' million)

Asset	1977	1978	1979	Total 1977-1979
Government Securities	65.3	80.8	90.4	236.5
Corporate Securities	38.8	58.6	93.7	191.1
Real Estate & Mortgage Loans	41.4	51.3	73.8	166.5
Policy Loans and other Loans	17.4	28.4	29.4	75.2
Cash and Bills of Exchange	129.7	132.5	159.3	421.5
Total Financial Assets	292.6	351.6	446.6	—
Annual Growth Rate	20%	27%		

Table 9

FINANCIAL ASSETS HELD BY LIFE AND NON-LIFE INSURANCE COMPANIES 1977-1979
(N' million)

Asset	Life	% of total (in table 8)	Non-life	% of total (in table 8)
Government Securities	127.6	54%	108.9	46%
Corporate Securities	107.33	56	83.88	44
Real Estate and Mortgage Loans	112.8	68	53.6	32
Policy Loans and other Loans	45.54	61	29.62	39
Cash and Bills of Exchange	141.0	33	281.0	67
Total Financial Assets, 1977-1979	534.0		557.0	

Table 10

HOLDINGS OF DEVELOPMENT LOAN STOCKS
(N million)

Financial Institutions	March 1978	December 1978	March 1979	December 1979	March 1980	December 1980
Commercial Banks	208	143.5	125.6	272.4	271.6	278.8
Merchant Banks	10	0.5	0.5	0.5	0.5	0.5
Insurance Companies	57.9	69.3	71.8	75.0	75.3	75.0
Savings Type Institutions	579.9	680.2	712.6	760.9	801.8	809.9
Special Funds with CBN	625.8	400.6	395.2	191.5	181.6	181.6

In some other ways, insurance companies have been an important source of revenues to the government, particularly through taxed levied on the profits and investment income of insurance companies. An estimate from the various annual reports of 20 companies on which data is available shows that these companies paid the total sum of N 7.3 million and approximately N 9.0 million to the government in 1979 and 1980 respectively.

6. Life Insurance and Savings

Perhaps a better way of assessing insurance contribution to the national economy is to answer the question: what effect does life insurance have on the volume of savings in the economy?

Life insurance and annuity business is of special importance to the economy because of its role as a medium for the collection of savings. Together with pension funds, life insurance is a medium for the collection of savings. Together with pension funds, life insurance is a major source of longterm contractual savings, so that the investment policies of life insurers determine how a substantial part of personal savings reaches industry. It is worth noting that because of the savings element life insurance companies accumulate large amounts of money available for investment. In this activity they perform financial intermediation just like the deposit-type financial institutions. The importance of life insurance companies to the financial system is based more on their ability to accumulate funds for investment than on their stated

business of providing insurance. Since 1970 there has been an increasing trend in the amount of contractual savings entrusted to life insurers by policyholders. Between 1969 and 1978, the average annual increase was N 12.4 million. Table 11 shows the incremental annual changes in contractual savings scheme of the life insurance business. From a low of about N 2 million in 1970, this increased to nearly N 14.0 million in 1975 and N 29 million in 1978. Over the ten year period contractual savings was growing at an average rate of 34.4 percent per annum. A comparison of the contractual savings generated by life insurers with the total net savings in the economy between 1975 and 1978 shows that the contribution of the life insurers to total savings stood between 2 and 7 percent. This is shown in Table 12.

Table 11

NET ADDITION TO TOTAL CONTRACTUAL SAVINGS - LIFE INSURANCE 1969-1978
(N'000)

1969	3,925
1970	1,626
1971	4,692
1972	7,532
1973	9,427
1974	10,629
1975	13,689
1976	19,643
1977	24,026
1978	29,010

Table 12

NATIONAL SAVINGS 1975-1979
(N' million)

	Net Savings	Life Insurance Contractual Savings
1975	678.1	13.69 (1.98)
1976	440.1	19.64 (4.3)
1977	337.5	24.03 (6.65)
1978	416.9	29.0 (6.5)

One would expect that with increased awareness of the public to life policy the contribution of life insurance to personal savings will continue to increase in the future parti-

cularly with the introduction by life insurers of various types of life policies and with more private companies introducing insured group pension schemes. It is correct to conclude that the availability of life insurance tends to increase rather than decrease personal savings. In fact in the absence of insurance, and in order to obtain the same degree of security as is provided by life insurance schemes, individuals would have to set aside a far higher proportion of current income to establish adequate contingency funds.

The contractual nature of life insurance also is of economic significance from the standpoint of the stability of the savings flow. Keynesian theory demonstrates that from a macroeconomic standpoint the desirability or otherwise of a high level of saving depends upon prevailing economic conditions. Savings constitute a withdrawal from the circular flow of income so that during a period of high unemployment any increase in the public's desire to save further depresses the level of economic activity. On the other hand under demand-pull inflationary conditions increased saving has the beneficial effect of reducing the inflationary pressures. In terms of the contractual nature of life insurance, savings during periods of economic downturn, will be effective in maintaining net savings. Moreover, if the savings are passed on to the capital market rather than being held as cash, this will help to stimulate investment and thereby reduce the deflationary effect of savings. Even in times of economic depression, life insurers are unlikely to stay out of the capital market for long because of their contractual obligations to policyholders. Therefore, their investment policies minimise the deflationary effects of the flow of savings which come into their hands. It can therefore be concluded that life insurance have been playing a valuable role in the economy.

8. Insurance and the balance of payments

A second aspect of the insurance industry's importance to the Nigerian economy relates to its present and potential role as an earner of foreign currency. In an important way, the investment of insurance funds through overseas capital markets, result in longterm capital movements. Moreover, whenever overseas earnings of Nigeria insurers are invested abroad, certain rights over title to foreign assets are created. This transaction enhances the international credits of Nigeria.

There are many ways insurance industry has contributed to the improvement of the country's balance of payments. The encouragement and the development of an indi-

genous insurance industry (exclusive foreign ownership of insurance business has been disallowed since 1977) has meant that more of the funds generated by the process are now retained and free for investment within the country. This has provided substantial savings of foreign exchange, aside from making possible greater supervision over their investment funds as stipulated by the Insurance Act of 1976. With the establishment of the Nigerian Reinsurance Corporation in 1977, a substantial amount of the premiums which were hitherto paid to international reinsurers overseas is now retained in the country. A recent estimate puts the savings attributed to the operations of the Nigeria Reinsurance Corporation at N 100 million annually in foreign exchange.

Besides the savings of foreign exchange and greater control over investment funds, the insurance industry contributes to the country's balance of payments through earnings from its foreign operations. Apart from overseas premium income, sources of foreign earnings of the industry may include (i) operating profits (i.e. underwriting results and investment earnings) of the overseas branches and subsidiaries of Nigerian Companies, if any; (ii) underwriting profits on overseas direct and reinsurance business placed on the Nigerian market (iii) interest and dividend received on portfolio of overseas securities held by Nigerian based companies and (iv) the profits of the overseas offices and subsidiaries of Nigerian brokers, and commissions earned on other foreign business placed on the Nigerian market.

It is difficult to estimate due to lack of data, the exact extent of overseas premium income and investment earnings in the portfolios of Nigerian insurers. However it is correct to say that at the present stage of development of the Nigerian insurance industry the contributions of each of these categories of earnings from foreign operations are not likely to be large. There are many reasons for this. One, many of the companies are still very small when size is measured in terms of premium income or assets. For example, only 8 companies out of a total of 80 registered companies could earn an annual premium income of N 16 million or above, an amount which is less than 4 percent of the total market for insurance. The small size of many of the companies makes foreign operations through the setting up of offices and subsidiaries highly improbable. Secondly, government regulation of investment behaviour of insurance companies with regards to the acquisition of overseas securities means that the contribution of insurers' to the country's balance of payment through earnings from overseas investment is likely to be small. Lastly, the contributions to the balance of payments will also depend on the attitude of other foreign governments toward participation of non-indigenous insurers in their domestic markets. Nevertheless, one can say

that one of the present sources of currency transfers is through premiums received from and claim payments made to foreigners for overseas insurances placed on the Nigerian market. For example, the Nigerian Reinsurance Corporation, which operates both as a national and an international reinsurer utilises its own business to trade with other reinsurers abroad and earns in this way some foreign exchange by way of reinsurance premium in respect of inward business. In 1977 it was estimated that the N 20 million business ceded abroad by the Corporation brought into the country a N 10 million worth of insurance business. A recent estimate also shows that the corporation's foreign exchange earnings from its overseas business were N 3 million and N 8 million in 1979 and 1981 respectively.

The exact extent of overseas premium income and earnings on overseas investment of insurance companies is not known principally because companies do not show local and overseas premium income and other income separately in their annual returns. The complexity of the currency flows also add to the difficulty of measuring the net contribution of the industry to the balance of payments. However, given its present stage of development, and with lax regulations, the industry, as it matures, is reasonably placed to serve as a valuable source of foreign exchange earnings.

9. Insurance and the transfer of risk

When uncertainty is present in economic activity, insurance is commonly found. The basic function of insurance is to provide protection for the individual, firm or organisation against the financial losses which may arise from the occurrence of pure risks. Insurance is the most important mechanism for mitigating the problem of assumption of risk. In an important way, the protection against financial losses offered by insurance contributes toward the efficient utilisation of resources, increased productive capacity of the economy, and the generation of increased confidence in business transactions. It is difficult to quantitatively assess the contributions of insurance in the process of handling risks, but in an economy where no provisions for reallocating risk bearing exist, the cost to the individual, firms and indeed the whole of the economy would be quite substantial.

In the absence of insurance, each firm makes its input decisions; and outputs produced will be determined by the inputs and the state of nature. Prices are set to clear the

market but the prices that finally prevail will be a function of the state of nature. In such an economy, the firms and their owners cannot relieve themselves of risk bearing. Therefore any unwillingness or inability to bear risks will give rise to a non-optimal allocation of resources, in that there will be discrimination against risky enterprises as compared with the optimum. This means that goods with high utility-yielding potential to the society might not be produced. Moreover, a preference for risk might give rise to misallocation in the opposite direction, but the limitations of financial resources are likely to make under-investment in risky enterprises more likely than the opposite. The inability of individuals to buy protection against uncertainty similarly gives rise to a loss of welfare.

In another sense, the absence of insurance can affect the efficient utilisation of funds in the capital market. Firms would need to make adequate financial provision in form of contingency funds in order to obtain the same degree of security against losses of catastrophic proportions such as fire, industrial accidents, and the possibility of bankruptcy. Without such provisions, most companies may cease to operate, and the population of firms may be smaller and less stable than it would be with insurance. More importantly, the contingency funds which would have to be kept in highly liquid forms, in readiness for unexpected losses, would constitute a withdrawal from the circular flow of income and may exert a downward pressure on the level of income in the economy. Moreover, neither a new additional productive capacity is created nor an additional income generated through the accumulation of such large funds. Whereas in the presence of insurance, the bulk of insurance fund is channeled back into the economy through the operation of the capital market.

It is doubtful whether the Nigerian External Telecommunications could easily absorb the financial losses (estimated at N 20 million) resulting from the recent fire disaster, in the absence of insurance, without severe financial strain on the corporation, the consumers and the government. It is also doubtful whether individuals, firms and banks can bear the costs of autocrimes, increasing wave of armed robbery and burglary, industrial accidents and sea piracy without adequate insurance protection. Moreover, many of the government contracts for the procurement of long-term projects such as the construction of roads, bridges etc. would not have been possible without the protection offered the contractors through the existence of contractors' all-risk insurance. Marine Insurance offers the vital protection needed for international trade transactions. Though a quantitative assessment of the social gains from insurance is not possible but a rough indication of parts of the costs of risk bearing by insurers can be given.

This assumes that the agreed premiums paid by the insured measures the social value of risk transfer while the claims paid can be considered as discharge of liabilities by the insurer for bearing risk. Claims or benefit payments can therefore be used as proxy for parts of the costs of bearing risks. Other costs include underwriting and or management expenses, and expenses incurred in acquiring business. Table 13 shows the total claims paid by insurance companies over a five year period. These costs have been growing at an annual average of approximately 27 percent. Moreover the costs of risk-bearing (claims payments) have consistently stood at an annual average of 21 percent of the social value of risk transfer (premiums paid by the insured) between 1975 and 1979.

Table 13

CLAIMS AND BENEFIT PAYMENTS BY NIGERIAN INSURERS COSTS OF BEARING RISKS
(N'million)

Class of Business	1975	1976	1977	1978	1979
Fire	2.1	6.8	11.8	8.0	4.3
Accident	1.1	1.5	2.4	3.4	4.3
Motor	14.1	22.5	35.5	31.4	31.2
Marine & Aviation	2.4	2.7	6.7	7.9	9.8
Others ^a	2.4	3.3	4.6	3.7	2.3
Life	2.6	2.5	3.9	3.2 ^b	3.5 ^b
Total Claims Paid	25.0	39.3	65.0	57.6	55.4
Annual Growth Rate		57.2%	65.4%	-11.4%	-3.8%
Claims paid as % of premium income	20.8	20.4	22.3	21.3 ^c	21.8 ^c

Source: Federal Ministry of Finance, Insurance Division.

Note:

^a Others include Workmen's compensation and miscellaneous insurance.

^b Estimated - two year average.

^c Estimated - two year average.

In just the same way the existence of insurance improves the efficiency of the economy with respect to risk bearing, it can decrease its technical efficiency. This is because, insurance or for that matter any device for shifting risks can have the effect of dulling incentives. An insurance policy changes the incentives of the insured, creating, at the very least, an incentive for carelessness. A fire insurance policy, even when

limited in amount to the value of the goods covered, weaken the motivation for fire prevention. This disincentive effect of insurance is commonly referred to as moral hazard. Thus, the moral factor places a limit to the possibilities of insurance. One device for mitigating the adverse incentive effects of insurance is coinsurance; the insurance extends only to part of the amount at risk for the insured. Nigeria's insurers recognise the moral factor, through various policy conditions, investigation of claims, the selection of business and other loss prevention activities. These activities encourage the reduction of risk. It clearly represents a compromise between incentive effects and allocation of risk bearing, sacrificing something in both directions.

There is a social gain obtained by purchase of insurance (as long as the insurer suffers no social loss) since pooling of risks reduces the total risk, and therefore the risk per insured, because of the Law of Large Numbers. It is this process of risk transfer, and of risk reduction that is the source of the industry's main contribution to the social welfare.

10. Conclusion

The performance of the insurance industry can be further improved so that it can contribute more effectively to the economic development of the country. The industry structure needs rationalising. The predominance of very many small but non-specialist firms can affect the investment and claims performance of the industry. It is a reflection of the fact that the legal entry barrier in the form of statutory deposits is not overly severe. There is a need for policy to encourage large-sized firms whose resources are well beyond their legal liabilities.

Though the government regulates the investment behaviour of insurers by stipulating permitted investment categories, the maximum allowed investment as well as the rate of interest chargeable on loans, there is a need to extend regulation to improving the quality of the investment. For example, income producing real estate can be restricted as to type and use of property. Similarly, investments in corporate securities must meet certain standards as to type and value of collateral or interest coverage, or specified tests of dividend and earnings coverage and payment. There is also a need for prescribing methods for valuation of securities. Restrictions on the categories of investment as well as the requirements to make policy loans at a relatively low fixed rates of interest are most constraining to the financial performance of insurance companies.

As a result of limited investment outlets, insurance companies investment are concentrated in highly liquid and short-term securities. There is a need for insurance companies to explore other investment outlets either through developing close links with other financial institutions such as merchant banks and other finance companies, particularly in the area of consumer finance through hire purchase facilities for durable household goods, and of equipment leasing and factoring as well as the provision of finance of firm through sale and leaseback arrangements. Insurance companies can also contribute to the financing of small firms through the Nigerian Banks for Commerce and Industry. In the area of property development, insurance companies can either individually or in association with property companies, invest directly in housing estates or multiple-dwelling property.

As the scope for product differentiation is limited in the industry, it is important for insurance companies to identify and emphasize the types of contracts which are appealing to potential purchasers. The type of contracts emphasized often have a substantial effect on asset accumulation and investment decisions. In order to improve the efficiency of the industry, the supervisory authority needs to develop measures for testing the solvency of insurance companies. This is even more so with the predominance of many small firms operating on the fringe of the market. There is also the need to ensure that premiums keep pace with inflation so as to protect insurers against the rising cost of claims thus guaranteeing the solvency of companies.

Insurance Companies as investors need to be more active in the management of their portfolios. Not only is it necessary for insurers to control the number and size of individual holdings, in order to minimise risk, they, as institutional investors, should show more concern in the efficient management of the companies in which they invest. The increase in the size of their individual holdings is of such magnitude that they cannot be easily disposed of at acceptable prices, particularly shares of companies with poor financial performance, without affecting the level of prices in the securities market.

By increasing their loss prevention activities, insurance companies can contribute in an important way to the economic and social life of the country. By cooperating with the Fire Brigade, the Police, and other bodies, in the area of fire protection services, salvage operations, prevention of road accidents, and in efforts to minimise motor repair costs, insurance companies can contribute immensely in minimising losses to the society through fire disasters, motor accidents and other insurable risks. It is in this area of loss prevention that Nigeria's insurers have demonstrated little awareness.

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LE RÔLE DU SECTEUR DES ASSURANCES DANS L'ÉCONOMIE DE LA NIGERIA.

RÉSUMÉ

Cet article analyse le rôle du secteur des assurances dans l'économie de la Nigeria pour pouvoir répondre à cette question: quelle est l'importance de ce secteur dans le processus de développement économique national?

On peut répondre de deux façon différentes. D'abord on prend comme base de discussion la situation actuelle du secteur et on se demande: quelle a été jusqu'à présent la contribution du secteur considéré à l'économie nationale? En deuxième lieu on se place dans le futur et on cherche une réponse à cette nouvelle question: quel sera vraisemblablement l'apport économique de ce secteur à l'économie nationale et de

quelle façon ce secteur pourra-t-il contribuer au développement de l'économie de la Nigeria?

Dans cet article les deux approches sont utilisées dans la mesure permise par les données statistiques à notre disposition.

En jugeant sur les dimensions et la croissance du secteur durant les dix dernières années, l'apport économique de ce secteur au développement du pays, en tant que contribution à la production intérieure brute, apparaît assez modeste. Également si on la considère dans le contexte du système financier de la Nigéria dont il fait partie, le secteur des assurances est encore relativement jeune. Ces deux faits sont examinés dans l'analyse proposée dans l'article. En effet, les aspects quantitatifs ne réussissent pas à montrer clairement le rôle que le secteur a joué et peut jouer encore dans le futur pour la mobilisation de l'épargne des ménages, pour la minimisation du risque, pour l'allocation optimale des ressources dans le marché des capitaux, pour l'apport de devises étrangères et pour ses effets sur l'activité du secteur public.

Cet article se divise en cinq sections principales. La première section consiste en un examen général du secteur des assurance en ce qui concerne sa dimension, sa croissance, sa structure de marché; la deuxième section analyse le rôle du secteur considéré dans le marché des capitaux. La troisième et la quatrième section s'occupent du rôle du secteur dans l'économie de la Nigeria et plus spécialement de son rôle en ce qui concerne l'apport de devises étrangères et la minimisation et le transfert du risque. La section finale suggère des directions souhaitables qui pourraient améliorer le rôle du secteurs des assurances.

