Factors that Drive the Development of Insurance Industry in Tanzania

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Abstract

The insurance business can play a significant role in the development of financial and economic growth. In Tanzania, the insurance industry continued to play its strategic role within the national economy by providing the national underwriting capacity and contributing towards mobilization of financial resources for sustainable economic development of the country. The objective of the study was to examine the factors that drive the development of insurance industry in Tanzania by examining the determinants of Gross Premium Income (GPI) with the explanatory variables of annual GDP per Capita, Inflation Rate, Real Interest Rate and annual GDP Growth for the time series data over 20 years period between 1991- 2010. The study indicates that the insurance sector has a greater role as a determinant in the sustainable economic development in Tanzania. The inflation rate and GDP growth has positive relationship whereas the GDP per Capita and real interest rate have negative relationship. We recommanded that the country needs to maintain a single inflation rate for all over the periods, since if the inflation rate increases, it will affect much both insurers and policyholders in the insurance business. Insurance funds that are amassed by insurers as insurance premiums must be invested in profitable ventures including money markets to obtain a financial return that is sufficient to support the business operations of insurance companies and provide a return to shareholders.

Keywords: *GDP per capita, inflation rate, real interest rate and GDP growth*

1. Introduction

The development of the insurance industry is an important part of the financial system which is expected to contribute to financial development and economic growth. Consequently, the insurance sector provides risk transfer and compensation by the efficient distribution of different risks. As a matter of fact, the insurance sector accelerates capital accumulation and leads the domestic savings to investment because of these functions. Although this sector has a relationship between financial development and economic growth, numerous studies generally deal with the banking sector and stock market [2]. Therefore, the insurance sector and its relationship with economic growths proves to contribute to the literature on the subject of study which is primarily intended. Traditionally, insurance firms have not generally been seen as being a potential sources of economic growth. The insurance sector is mostly regarded as relatively stable segments of the financial system. This sector is not seen as interlinked to the same extent as banks, but the interaction between insurers, financial markets, banks and other financial intermediaries has been growing considerably over time. Today therefore, this traditional view is being challenged. The insurance sector plays a critical role in financial and economic development. By introducing risk pooling and

reducing the impact of large losses on firms and households, the sector reduces the amount of capital that would be needed to cover these losses individually, encouraging additional output, investment, innovation, and competition. Through initiating risk based pricing for insurance protection, the sector can change the behavior of economic agents, contributing inter alia to the prevention of accidents, improved health outcomes, and efficiency gains. Between 1967 to 1996, Tanzania's insurance sector was state owned and run. The industry was liberalized in 1998 with 6 privately held firms. Liberalization of the insurance industry seeks to achieve a number of objectives including transforming the insurance industry into a sound and competitive agent for national savings mobilization and development investment channeling and promoting insurance sector as an effective catalyst for enhanced economic growth. As of 2010, the number of Tanzanian insurers had grown from 6 to 27 companies. Out of theses, 22 insurance companies are privately owned with one third Tanzanian citizen ownership, two companies are 100 percent state owned by the government of the United Republic of Tanzania (URT) and the Revolutionary Government of Zanzibar (RGZ), while three companies are 100 percent owned by Tanzanians. Table 1 below shows the summary of the insurance companies registration position as at 2010. The Tanzania insurance industry grew by 24.1% to TZS 287.0 billion in 2010 from TZS 231.2 billion in 2009, and insurance penetration (premiums as a percentage of GDP) increased from 0.80% in 2009 to 0.86% in 2010. Meanwhile the national GDP and finance intermediation sector GDP in nominal terms grew by 14.3% and 19.2% between 2009 and 2010 respectively [20]. Empirical research generally finds evidence of a causal relationship between insurance sector development and economic growth, even if some of the studies report mixed results [11] found evidence of long run causality from insurance to GDP growth for eight insurance categories in the United Kingdom.[8] built a panel of 29 European Union (EU) countries from 1992 to 2005 and concluded that the life sector had a positive impact on growth in the EU-15 countries, while the non-life sector had a larger impact in Central and Eastern Europe (CEE).

Table 1: Summary of Insurance Companies Registration as at 2010

Business for which Registered	100% Local	Mixed local and Foreign	Total at end of 2010
Long Term Assurance	-	2	2
General Insurance (Marine & Non-Marine)	2	14	16
General Insurance (Non Marine Only)	1	-	1
General Insurance (Medical Only)	-	3	3
Both (Composite)	2	2	4
Reinsurance	-	1	1
Total	**5**	**22**	**27**

Finally, [5] examined the relationship between insurance sector development and growth in the 10 new EU member states during 1992-2007 and concluded that the sector has promoted economic growth in these countries. Generally, the insurance industry has largely contributed to our complex and sophisticated economy, without insurance contracts, business would be more difficult and costly, and a great part of them would probably never take place. Also, the economy would lag behind its potential, the wealth of nations would be sharply reduced, and social unity would fall apart. In a nutshell, as far as ordinary life is concerned, individuals would be much more cautious in all that they do, probably even cancel some of their risky

activities. Therefore, it can be said that the insurance scheme is almost as indispensable to the functioning of a modern society as is the legal system that protects both companies and individuals against any risk. As potentiality of insurance sector in the economy and incredible evidence in performance of insurance firms in recent years, this has driven the researcher to explore the factors that drive the development of the insurance industries in Tanzania.

2. Literature Review

Tanzania insurance industry continues to make progress. There was a general increase in premium income for both classes of business from TZS 115.3 billion in 2006 to nearly TZS 287.2 billion in 2010. Both Life and Non-Life recorded a growth rate of 149% between 2006 and 2010 [20]. Insurance companies are important players for financial stability as they present 2% of the total assets in Tanzania. Insurance firms are among the large investors in financial markets and important links with banks and with other financial institutions as this sector holds 20% of the total amount of outstanding government debt securities [3]. The insurance sector in the United Kingdom has an incredible outcome as the insurance company's assets increased from 20% to 100% of GDP between 1980 and 2009 [21]. Institutional investors have come to dominate the economy, for example in 1957 less than 20% of UK shares were held by institutional investors; by the end of 2006 institutional investors held around 75% of UK shares. According to International Financial Services London (IFSL) worldwide funds in pension, insurance and mutual funds reached $45.9 trillion by the end of 2004 that constituted about 0.5% of the national income (GDP) of the UK economy. In 2004, the institutional investors employed over 40,000 people in the UK and generated net exports of £1.42 billion [18]. In China, the role of both insurance companies in the stock market is very small, which holds around 2% of issued shares. Insurance companies play a bigger role in the corporate bond market, holding about one third of the total nonfinancial bonds outstanding. However, insurance companies are likely to start playing a larger role. In India, insurance companies have increased their involvement in both equities and corporate bonds; they currently hold the equivalent of 11% of free float market capitalization, compared to the United State and the United Kingdom. However, their participation is still limited [21]. The study made by [14] on the Insurance Funds and Economic Growth in Malaysia found that the existence of a long run co-integration relationship between total assets of general insurance sector and real GDP, and support the view that the sector possibly contributes to economic growth. However they also found that the absence of any short run causal relation between total assets of general insurance sector and the real GDP in any direction is neither a significant influence of general insurance total assets on real GDP, nor a significant influence of real GDP on general insurance total assets [13] conducted research on the impact of insurance contributions on economic growth in Nigeria and succeeded in establishing that a direct or positive relationship exists between insurance contribution and economic growth in Nigeria. The study of [17] examined the relationship between insurance sector development and growth in the 10 new European Union (EU) member states during 1992-2007 and concluded that the sector has promoted economic growth in these countries. Recent empirical analysis based on a panel of developed and developing countries made by [7] on influential factors for the development of insurance industry found that, income, population, population density, age dependency, the predominance of private ownership and strong legal framework proves to be the important drivers for development of the insurance sector. Though they also concluded that, life expectancy, dependency ration, social security system and inflation rate hinder the development of life insurance. The empirical research on the determinants of the insurance sector has essentially focused on the life sector. Early contributions to the empirical literature were mostly focused on the United States, and discovered the role of education, income, religion, and cultural factors, as well as prices. By way of illustration, [1] stress the

importance of the occupation of the main wage earner.[8] show that the demand for life insurance depends on savings and interest rates.[9] Shows that education, income and religion are key determinants of the demand for life insurance. [10] Commented that prices have a negative effect on the demand for life insurance. [12], provided one of the first empirical studies exploring cross-country data. Using a dataset of 10 developed countries, the authors conclude that income, life expectancy, and the dependency ratio have a positive impact on life insurance demand, while social security expenditures have a negative impact. More empirical studies including [15], argued that the insurance industry is vital to the well-being and smooth functioning of a modern economy. In a developing country like Tanzania, it acts as a catalyst of economic growth helping to accelerate the process of qualitative structural transformation.[19]. viewed insurance system as a mechanism for reducing the adverse financial impact of random events that prevent fulfillment of reasonable expectations. According to [16], the insurance business is vital to the financial market due to its role in helping people and businesses to manage their resources and mitigate risk efficiently.

[4] Observed that banks are directly involved in the life insurance business in many countries and hence it is expected that a strong bank sector can boost the development of the insurance markets. According to [23], the assessment of a potential causal relationship between insurance market activity and economic growth has been extensively dealt with in the developed world and most of the studies involved the situation in emerging markets. [8] Applied a cross-country panel data analysis from 29 European countries in the period from 1992 to 2005. The insurance variable is measured by premium income and total net investment of insurance companies. Premium income is split into life and non-life premium income. As an estimation method the authors used ordinary least squares on an unbalanced panel with country and time-fixed effects. According to the findings, there is a positive impact of life insurance on GDP growth in the EU-15 countries, Switzerland, Norway and Iceland, while non-life insurance has a larger impact in Central and Eastern Europe. [22] Examined the effects of insurance growth and reforms along with other relevant control variables on economic development in India in the period from 1980 to 2006. The growth of insurance penetration (life, non-life and total) is used as proxies of insurance sector growth. The author applied ordinary least squares, co-integration analysis and error correction models. The study confirms positive contribution of the insurance sector to economic development and a long run equilibrium relationship between the variables. While the reforms in the insurance sector do not affect economic activity, their growth has positive impact on economic development. Although there are strong theoretical explanations for positive impact on the insurance sector to economic growth as mentioned above, the results of empirical researches carried out up to date are mixed. However, the number of empirical studies is relatively small, especially in relation to those on banking contribution to economic growth.

3. Research Methodology

The insurance sector is one of the most important segments regarding its basic function for the whole economy and society. Modern, highly industrialized and technology driven economies are threatened by higher risks than ever, and individuals need to protect themselves against risks as well as saving individually for their retirement. In spite of many factors that lead to the development of insurance industry in Tanzania, the study was descriptive assessment with the aim to examine the factors that drive the development of insurance industry in Tanzania for a period of 1991 – 2010. STATA software was used for data analysis of the different variables.

3.1 Model and Estimation

The analysis of the drivers of insurance industry in Tanzania was done using a simple linear regression model to establish the relationship between the dependent and independent

variables as it was on the basis of Ordinary Least Square (OLS) assumption. The model estimation used in this study was as follows:-

$$GPI = \int (GDPPC + IR + RIR + GDPG)$$

The econometric equation in linear forms will be:

$$GDI = \beta_0 + \beta_1 GDPPC + \beta_2 IR + \beta_3 RIR + \beta_4 GDPG + \varepsilon$$

4. Result and Discussion

This part analyzed the results of the study and gives the interpretations of the findings from the model.

4.1 Interpretations of the findings from the model

The gross premium income, real interest rate and GDP Growth were normally distributed as their skewness is lying within the required normal distribution (i.e -0.5 to+0.5)

Table 2: Summary Statistics for Original Variables

	GPI	GDPPC	IR	RIR	GDPG
Observations	20	20	20	20	20
Mean	14.815	2.095	13.465	7.235	5
Std. Dev	9.062373	2.426276	9.487514	4.128371	2.306513
Variances	82.12661	5.886816	90.01292	17.04345	5.32
Skewness	0.248469	-0.692548	0.8365178	-0.47186	-0.532118
Kurtosis	2.51327	2.191077	2.295727	3.595962	1.976258
Minimum	0.3	-2.7	4.7	-3.7	0.6
Maximum	34	5	34.1	14	7.78

The GDP per Capita and Inflation Rate are not in normal distribution as their skewness is not in the boundary of normality and hence they are transformed into new variables as shown in table 3 below.

Table 3: Summary Statistics for Transformed Variables

	$GDPPC_1$	IR_1
Observations	20	20
Mean	35.18455	2.37147
Std. Dev	41.8571	0.6875057
Variance	1752.017	0.4726641
Skewness	0.537905	0.3431054
Kurtosis	2.061565	1.592792
Minimum	-19.683	1.547562
Maximum	125	3.529297

4.2 Unit root Tests of the Variables

The Augmented Dickey-Fuller (ADF) technique was used to test the stationary of data at the 5% critical value of the level of significance. At the level of variables, the unit root test has been found that only RIR was stationary because the statistical results under table 4 indicate that, the test statistic for RIR was greater than the critical value.

Table 4: Unit Root Test at Level of Variables

	Augmented Dickey-Fuller	
Variable Name	Test Statistics	Critical Value at 5%
GPI	-2.160	-3.000
$GDPPC_1$	-1.535	-3.000
IR_1	-1.314	-3.000
RIR	-3.065	-3.000
GDPG	-1.120	-3.000

However, the researcher underwent further testing at the level of difference for the remaining variables and found that, their computed absolute values of the test statistics are greater than ADF as shown in table 4 above. Table 5 below illustrates the result of computed absolute value of the unit root test at the level of differences and found they are stationary.

Table 5: Unit Root Test at Level of Difference

	Augmented Dickey-Fuller	
Variable Name	Test Statistics	Critical Value at 5%
GPI	-7.246	-3.000
$GDPPC_1$	-5.566	-3.000
IR_1	-3.734	-3.000
GDPG	-4.850	-3.000

4.3 Multicollinearity

Multicollinearity may be perfect or imperfect and can be measured through Variance Inflating Factor (VIF). For F-value technique the explanatory variables are said to be highly correlated if the F-value is statistically significant while a P - value of individual variable is insignificant, if a set of explanatory variables is uncorrelated, each VIF is equal to 1. If the set is highly inter correlated, then VIF might even exceed 10.

Table 6: Regression result for tested Multicollinearity problem

```
. regress gpi gdppc1 ir1 rir

      Source |       SS       df       MS              Number of obs =      20
-------------+------------------------------           F(  3,    16) =    6.74
       Model |  871.078475     3  290.359492            Prob > F      =  0.0038
    Residual |  689.327025    16   43.082939            R-squared     =  0.5582
-------------+------------------------------           Adj R-squared =  0.4754
       Total |  1560.4055    19  82.1266052            Root MSE      =  6.5638

------------------------------------------------------------------------------
         gpi |      Coef.   Std. Err.      t    P>|t|     [95% Conf. Interval]
-------------+----------------------------------------------------------------
      gdppc1 |   .1137336   .0586885     1.94   0.070    -.0106805    .2381477
         ir1 |  -3.527365   3.687997    -0.96   0.353    -11.34557    4.290839
         rir |  -.0978091   .3844168    -0.25   0.802    -.9127364    .7171182
       _cons |   19.88602   11.64566     1.71   0.107    -4.801673    44.57372
------------------------------------------------------------------------------

. vif

    Variable |       VIF       1/VIF
-------------+----------------------
         ir1 |      2.84    0.352710
      gdppc1 |      2.66    0.375757
         rir |      1.11    0.900305
-------------+----------------------
    Mean VIF |      2.20
```

Other statisticians suggested that if VIF exceed 5 it is the better to find alternatives to least squares regression. Based on the theories and computed results from the model after being regressed as illustrated in the table 6 above, it was found that the VIF is 2.20 which is even lesser than 5. Thus it did not impress the researcher to employ an alternative and find another model as suggested by some econometricians. This meant that the regressors are not in the imperfect correlated which implies that, there was no multicollinearity problem and no need to drop any variable from the regression, then the researcher proceeded with the study.

4.4 Portmanteau Test

The study employed wntestq technique at the 5% level of significant for the testing autocorrelation problem. The null hypothesis of this test is H_o implying for no autocorrelation and alternative hypothesis is H_1 which means, there is autocorrelation. Whenever the probablity from wntstq is less than 0.05, we reject the null hupothesis which means there is no autocorrelation as shown in table 7 below. Basing on the regressed result for portmanteau test for white noise as demonstrated which, indicate that all probability of the variables are less than 0.05 which means do not reject H_o thus, there is autocorrelation of the variables

Table 7: Result for Portmanteau Test at level of variables

```
. wntestq gpi

Portmanteau test for white noise
---------------------------------------
 Portmanteau (Q) statistic =    21.1548
 Prob > chi2(8)            =     0.0067

. wntestq gdppc1

Portmanteau test for white noise
---------------------------------------
 Portmanteau (Q) statistic =    35.7335
 Prob > chi2(8)            =     0.0000

. wntestq ir1

Portmanteau test for white noise
---------------------------------------
 Portmanteau (Q) statistic =    47.8447
 Prob > chi2(8)            =     0.0000

. wntestq rir

Portmanteau test for white noise
---------------------------------------
 Portmanteau (Q) statistic =    26.0149
 Prob > chi2(8)            =     0.0010

. wntestq gdpg

Portmanteau test for white noise
---------------------------------------
 Portmanteau (Q) statistic =    41.8471
 Prob > chi2(8)            =     0.0000
```

Furthermore the test has been done at the level of differences as shown under table 8 and showed that, the result has changed and indicated no autocorrelation between explanatory variables.

Table 8: Result for Portmanteau Test at level of differences

```
. wntestq D.gpi

Portmanteau test for white noise
---------------------------------------
 Portmanteau (Q) statistic =    15.2112
 Prob > chi2(7)            =     0.0334

. wntestq D.gdppc1

Portmanteau test for white noise
---------------------------------------
 Portmanteau (Q) statistic =    11.7330
 Prob > chi2(7)            =     0.1097

. wntestq D.ir1

Portmanteau test for white noise
---------------------------------------
 Portmanteau (Q) statistic =     4.9209
 Prob > chi2(7)            =     0.6696

. wntestq DD.rir

Portmanteau test for white noise
---------------------------------------
 Portmanteau (Q) statistic =     7.8061
 Prob > chi2(7)            =     0.3500

. wntestq D.gdpg

Portmanteau test for white noise
---------------------------------------
 Portmanteau (Q) statistic =     5.8212
 Prob > chi2(7)            =     0.5608
```

4.4 Interpretation of the empirical result

Finally, the equation function has been regressed and correlated after being done different testing and transformation of the variables as presented in table 9 underneath. The equation of Ordinary Least Square (OLS) was estimated as GPI is a dependent variable whereas $GDPPC_1$, IR_1, RIR and GDPG are the independent variables.

$$GPI = \beta_0 + \beta_1 GDPPC_1 + \beta_2 IR_2 + \beta_3 RIR + \beta_4 GDPG.$$

The estimated model, was generally found to be well specified as the coefficient determination (goodness of fit) is above 50%, since the result obtained from regression outcome is about 78.04 percent which indicates that, the variations of the factors that drive the development of insurance industry in Tanzania are caused by the explanatory variables. On the side of p-value obtained from the model was 0.0001, which signified that, there was a strong relationship between regressand and regressors as the p-value is less than 1% at the level of significance. Additionally, the amount of f-statistic was greater than 10 which specifies the model is significant [6]. As per the result of the f-statistic was 13.32, which indicated how the parameters significant they were to the dependent variable.

Table 9: Final Regression and Correlation result for the variables

```
. regress gpi gdppc1 ir1 rir gdpg

      Source |       SS       df       MS              Number of obs =      20
-------------+------------------------------           F(  4,    15) =   13.32
       Model |  1217.66879     4  304.417198            Prob > F      =  0.0001
    Residual |  342.736708    15  22.8491139            R-squared     =  0.7804
-------------+------------------------------           Adj R-squared =  0.7218
       Total |   1560.4055    19  82.1266052            Root MSE      =  4.7801

------------------------------------------------------------------------------
         gpi |      Coef.   Std. Err.      t    P>|t|     [95% Conf. Interval]
-------------+----------------------------------------------------------------
      gdppc1 |  -.0788967    .065368    -1.21   0.246    -.2182252    .0604318
         ir1 |   2.804545   3.139529     0.89   0.386    -3.887202    9.496292
         rir |   -.521881   .3003819    -1.74   0.103     -1.16213    .1183678
        gdpg |   5.607787   1.439852     3.89   0.001     2.538814    8.676759
       _cons |  -13.32307   12.02633    -1.11   0.285    -38.95658    12.31043
------------------------------------------------------------------------------

. corr gpi gdppc1 ir1 rir gdpg
(obs=20)

             |      gpi   gdppc1      ir1      rir     gdpg
-------------+---------------------------------------------
         gpi |   1.0000
      gdppc1 |   0.7300   1.0000
         ir1 |  -0.6668  -0.7827   1.0000
         rir |   0.0830   0.1062  -0.2682   1.0000
        gdpg |   0.8464   0.9012  -0.8608   0.2918   1.0000
```

From the table 9, the fitted equation for the estimated model is presented as under:

$$GPI = -13.323 - 0.079GDPPC_1 + 2.805IR_1 - 0.522RIR + 5.608GDPG$$

Starting with the GDP per Capita ($GDPPC_1$), the result indicates that, there is negative relationship between the $GDPPC_1$ and the GPI, as the coefficient of GDPPC1 is -0.0789 which implies an increase of $GDPPC_1$ by 1% the GPI will decrease by 7.89%. The transformed Inflation Rate (IR_1) has a strong impact on the growth of the development of insurance industry in Tanzania, as its regressed correlation result is 2.805 which means for an increase of one unit of IR_1, the GPI will increase by 2.805. On the contrary, the relationship between the GPI and RIR is inversely proportion, because the determination coefficient of the value of RIR is negative by 52.2%. This means that when the RIR increases by 1% the GPI will diminish by 52.2%. Additionally, the GDPG also indicates a strong correlation with the GPI as the result generated from the equation is positive by 5.608, which implies a high relationship between the GDPG and GPI. An increase of GDPG by a unit, could increase the GPI by 5.608.

5. Conclusion and Recommendations

The insurance sector plays a better role in the conversion of savings to investments in the insurance sector which intends to contribute to economic growth. The study suggests that there is a strong effect on the development of the insurance sector and economic growth in Tanzania. Furthermore, the results indicated that the growth of insurance premium has many contributions in influencing the economic growth in Tanzania as most of the final regressed statistical results explain well the regression function. For example, the Adjusted R-Square is more than 70% which means, the explanatory variables are able to explain well of the economic growth well. Additionally, the probability result is less than 1% which signifies the

strong relationship between the regressand and regressors. The coefficient of GDP per Capita found to have a negative relation to the Insurance Premium that contradicts with many studies, for instance [6], found that income as measured by per capita income has a positive and significant effect on the insurance premiums. The Inflation Rate was also used as a driver in influencing the insurance sector and was found the negative correlation with insurance premium. This result seems to be the same with the result of [17] as they found the positive correlation between inflation and insurance sector, although they disagree with the result of [6] as they reported a negative correlation between the determinant of the life insurance sector and the inflation rate. On the other hand, the coefficient of Real Interest Rate is negatively correlated with the insurance premium, though some previous studies reported ambiguity. For example, [23] reported a positive correlation whereas [6] reported negative correlation. Finally the coefficient of GDP Growth is also positive correlation and significant in determining the growth of the insurance industry. This result is supported by the bulk existing studies, for example [13] discovered positive relationship between insurance contribution and economic growth. [14] found a long run co-integration relationship between total assets of the general insurance sector and real GDP. Moreover, [17] reported a positive statistical significant correlation between the insurance sector and economic growth in the 10 new EU member states during 1992 to 2007. We recommended that the country needs to maintain a single inflation rate for all over the periods, since if the inflation rate increases, it will affect much both insurers and policyholders in the insurance business. Insurance funds that are amassed by insurers as insurance premiums must be invested in profitable ventures including money markets to obtain a financial return that is sufficient to support the business operation of insurance companies and provide a return to shareholders

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