

Abstract

Insurance companies have significant net flows of cash, stemming especially from insurance premiums paid by clients. These funds are an important source of stable funding for public authorities, SMEs, banks and other companies. In this article we present the dimensions of funds held by insurance companies and show the impact of these funds on an economy. We will focus on the role of insurance as a provider of long-term financing, but also on their importance in reducing economic uncertainty, their contribution to maintaining social stability and support innovation.

Keywords: insurance, investments, financial market

JEL classification: G10, G22

Introduction

According to the practice of developed countries, insurance proves to be a sector with influence on many areas, both economic and social. The importance of insurance can't be measured only by the number of jobs they create, the amount of assets they manage and its contribution to GDP. The insurance have a fundamental importance to modern society, because it is absolutely necessary for activities that can't be practiced in the absence of insurance.

Firstly, the insurance promote stability and financial security at both national and personal level. Secondly, the insurers are institutional investors serving to mobilize savings and provide opportunities to use them effectively.

At the same time, the insurance facilitates the credit system by ensuring financial security in cases of credit beneficiaries' bankruptcy. Because of their ability to mitigate the consequences that may arise from financial challenges, we can say that the insurance have a role of stimulator of investments and facilitate international trade of goods.

The insurance covers the damages caused by insured risks, making possible the reconstitution of destroyed goods, thus ensuring the continuity of the production process.

The insurance positively influence the Balance of Payments of the country and contribute to developing the international economic relations when the insurance companies, in addition to direct insurance, makes the reinsurance operations, too (i.e. when some of the underwritten risks are transferred to the other insurance companies with premium payment).

Description of the problem

Insurance is an economic mechanism of protection, savings, fructification, and prevention. The importance of the insurance derives from its functions, which have a reflection on the society and on the economy. Knowledge of these functions is very important to acquire the role and influence of insurance on an economy (Lael Brainard and 2008).

The insurance mechanism works in a way that determines its effects to be felt both at the social and at the financial level. It is important to know the quantitative dimensions of these effects. When you mention that the insurance is an economic sector which adds value and creates jobs is necessary to present the estimation mechanisms of these dimensions.

The purpose of this article is to present the role and importance of the insurance for a country's economy. To achieve this objective it is necessary to establish the destination and contents of the insurance in the economic and social activity. It is also necessary to determine the economic potential of insurance and its possibilities of using. In this sense, the main incidence of the insurance on the economy are the long-term funds that can be invested to ensure a sustainable economic development.

⁶⁸ National Institute for Economic Research, Academy of Sciences of Moldova, Chişinău, Republic of Moldova

Methodology and data sources

For research carried out in this study were used descriptive, analytical and statistics methods. The main indicators were taken from statistics provided by the Organization for Economic Co-operation and Development (OECD, 2014), the European insurance and reinsurance federation (CEA, 2014).

Unfortunately, European statistics show delayed data. Even in reports published in 2014, the indicators are calculated only for 2012. This due to the difficult collection of statistical information from all the countries included in the reports. There are countries which delay the presentation of data. And once set, these data require processing and analysis may also take more than one year.

The research is based on the case of Moldova and for analysis were used data from National Bureau of Statistics and reports of the National Commission of Financial Market of Moldova. There is a difficult in comparing data related to foreign exchange differences. Statistics of the Republic of Moldova are made in MDL, and the European ones in U.S. dollars or euros which may deviate insignificant. However, official data are used here, and currency conversions are done at the official rate of the National Bank of Moldova.

Functions of the insurance

Most often in the literature meets the description of the four basic functions of the insurance. However, there are opinions of some scientists (Grishchenko, 2006, pp. 15-16) that the insurance functions are grouped into six categories. In the following we analyze all the types described in economic research to highlight the role of the insurance in the activity of a country.

The main generator and promoter of the insurance is the risk that's why the basic function of the insurance is the *hedging function* which presents interest both for the insured and for the economy of a country. This function consists in the funds formation and the compensation for damages. It can be found in the literature also as the *damages compensation function*. The insurer pays the insured amounts, thereby compensating losses in cash. For the insured, the insurance give a safety regarding the protection of property and life. Regarding the national economy as a whole, the insurance can not prevent damages, but, by fast according of compensation, it can offer, in a relatively reasonable time, the possibility to recover the conditions for productive activity or work capacity for injured people.

Risk prevention function. Insurers are able to use some of the insurance premiums paid by clients to create a fund designed to minimize the probability of occurrence of the insured risk and to reduce its consequences. Usually these actions are stipulated in the activity plan of each insurance company.

On the one hand, insurers have sufficient resources to undertake measures to prevent risks. An example of this could be vaccinating people who bought a health insurance. On the other hand, policyholders are forced by insurers to take measures to prevent risks, for example, the requirement to install car alarm to prevent theft of the insured car. In case of fire, when the insured do not take security, protection and prevention measures, they pay higher insurance premiums and sometimes fines.

Financial function - is determined, on the one hand, by the fact that not all insurance policies has as a result the production of the risk, and on the other hand is determined by the gap in time between receipt and time of payment of the compensation. Thus insurance companies invest the funds received from the insurance premiums and increase existent liquid assets. The difference between receipts and payments can be used as a general source of credit in the economy, being established in deposits or in the liquid assets at the banks.

In some sources (Bistriceanu, 2006, p. 225) financial function is exposed as a *distributive function* which is manifested primarily in the formation of the insurance fund by the insurance premium paid by persons covered in insurance. Secondly, this function is manifested in the directing of its insurance fund to legal destinations, namely claims payment, preventive actions financing, administrative expenses of insurance companies and creation of the reserves funds. By distributive function the taxes owed by insurance organizations are directed to the state budget and social insurance contributions payable are directed to the state social insurance budget.

Control function. In the insurance companies there are specialized departments for identifying of the causes producing damage and the formation, distribution and management of insurance funds.

Control function seeks to detect the causes that cause damages, to avoid them in the future. Also, by this function is following to establish and correct collection of the insurance premiums, finding, evaluation and settlement of claims, timely payment of the compensation and of the insured amounts. Control function is manifested by determining the rights due to policyholders and the full and timely fulfillment of financial obligations of the insurance company.

As we mentioned above, in addition to these four basic functions described in most of the works studied, there are other opinions. Thus, we met the following insurance functions:

Saving function. Insurance companies accumulate funds to provide a certain level of the clients' welfare. With the expiry of the contract, for example in case of survival in a life insurance, money accumulated during the annual premium payment returns to the clients and represents a saving for clients.

Investment function. By focusing a significant amount of financial resources in the form of insurance funds, insurance becomes one of the largest sources of investment and thus contributing to development of industry and the overall economy.

Innovation function. Due to the risk compensation, the insurance contributes to the scientific and technical progress development and to the new technologies implementation.

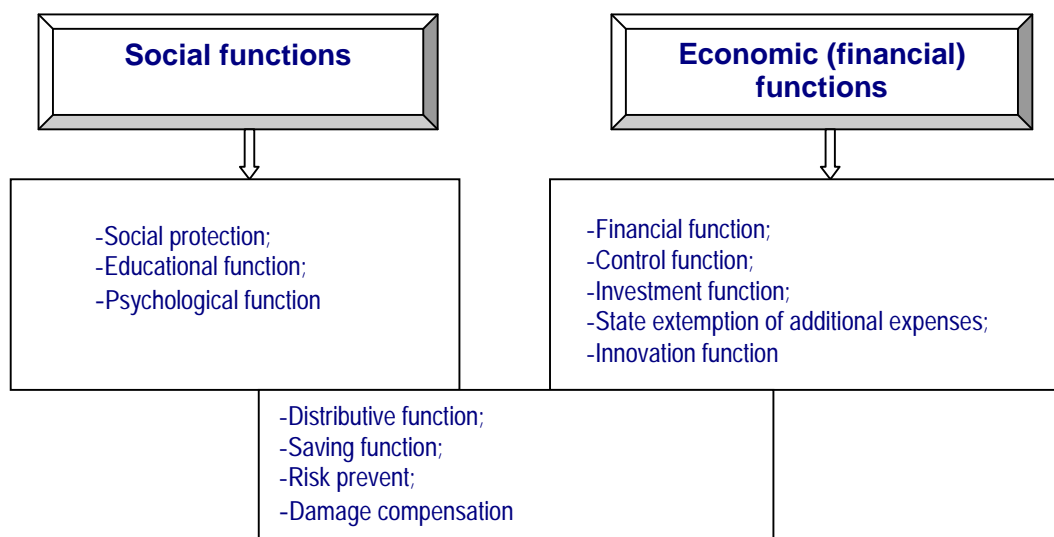
Social protection function is manifested in the creation and operation of the insurance funds by the state, in case of state insurance, or by insurance companies, in case of commercial insurance. Near this function is the function of population welfare ensuring which has important psychological effects because it gives "peace of mind".

A developed insurance system has the *function of the state exemption of additional financial expenses* which may arise due to the destructive events. In the absence of insurance, compensation for all the damages was the public budgets burden.

The insurance is not only a financial and economic category, is at the same time an institute of law, because, as the law in general, it fulfills the *educational function*. The rules of law provide for members of society a proper behavior. Rules of law governing insurance also stimulate proper behavior of the subjects of insurance it happens by the establishing privileges and sanctions.

From the analysis, we propose a new system of grouping insurance functions in Figure 1.

Figure 1. Insurance function



Source: elaborated by the author

The grouping shown in Fig.1 is an attempt to highlight the double importance of insurance. Thus, insurance will be charged not only as a financial mechanism on the market, but also as an important instrument to ensure the financial stability of the population.

The incidence of insurance on the economy

Next we analyze the most important aspects of the existence of insurance developed in an economic system.

The easiest and the most obvious aspect of the insurance as economic sector is that *insurance creates jobs*. According to OECD, the number of employees in the insurance industry is significant. For example, in Germany there are about 126 625 employees in insurance in Italy - 40798 in Korea - more than 62 000 (OECD, 2014). Based on other sources the number of employees in the insurance companies across Europe is about 1 million (971 971) in 2012, down compared to 2010 when the number was 1,005,927 employees (CEA, 2014, p 59).

In addition to providing employment for a considerable number of people, insurance is a relatively *profitable in terms of salary*. According to the latest data of the National Bureau of Statistics of the Republic of Moldova, employees of insurance and financial spheres have average monthly wage about 7963,7 lei. Comparing with the average salary in the Moldovan economy for the same period, which is 3912,4 lei, we find that persons engaged in financial and insurance activities have monthly earnings twice higher than the average in the economy (NBS, 2014). There are sources that the average salary of a Canadian insurance agent reaches 40603 dollars annually (6). In the United States the average salary of an employee's insurance is \$ 63400 that is \$ 30,48 per hour (5). These figures show convincingly that insurance sector is profitable for employees.

Insurance is an industry of *creating added value*. To explain this aspect of insurance, first we will determine what means gross output of insurance industry. It seemed at first that the gross output of the insurance industry should include insurance premiums. However, this point of view is only partially correct because from all the elements that make up the insurance, only the remuneration of insurance activity represents the gross production.

Remuneration of the insurance activity is the difference between the earned premiums and the pays (allowances). Remuneration of the life insurance activity is the difference between premiums collected by insurers and allowances paid plus the net balance of the technical reserves, minus the interests of these reserves. The technical reserves include properly the insurance reserves established to cover the insured risk and amounts of the life insurance savings.

To obtain the gross added value in a branch is required to deduct intermediate consumption from gross output. In turn, intermediate consumption of insurance companies includes rents, office supplies, telecommunications expenses, travel expenses, maintenance of the building (heating, water, lighting) and low repair costs.

All interdependencies described in the assessment of the insurance as a branch which creates added value can be expressed by the following mathematical relations:

$$VAB_a = PB_a - CI_a \quad (1)$$

where: VAB_a – gross added value of the insurance;

PB_a – gross output of the insurance industry;

CI_a – intermediate consumption of the insurance companies.

$$PB_a = PI - I + SNRT - D \quad (2)$$

where: PB_a – gross output of the insurance industry;

PI – insurance premiums;

I – allowances paid by insurer;

$SNRT$ – net balance of the technical reserves;

D – interests of technical reserves.

In our opinion, the most important role of insurance is participation at the *capital supply* process on the financial market.

To honor its obligations to policyholders, insurance companies have a duty to make the insurance reserves. They are gradually, because the receipt premiums are also gradually and are maintaining in the insurer management for long term, especially in the case of life insurance.

The fructification of the insurance premiums and claims reserves is done by placing them in stocks, bonds or shares of the commercial companies in treasury bills, bonds or other documents of state loans, long term deposits on banks, granting loans for insured from life insurance amounts, the

purchase of the real estate. The insurance funds deposited on banks are the sources of credit to serve the national economy and thus contribute to social production.

This function of the insurance is outlined the investment opportunities of the insurance companies. For each insured case, the insurers make reserves to honor its obligations in the case of sinister. In some cases, payment of the compensation does not take place immediately after the risk, but only after determining the circumstances of the event, estimating damage and insurance claims. Even if the insured amounts are not paid immediately, it still must be reserved. Therefore, we arrive at a situation where insurance companies have funds which are temporarily free and can be invested to bring added value.

To understand what size we are talking about is necessary to mention that according to the NCFM Report 2013 (NCFM, 2013), insurance companies in Moldova had insurance reserves amounted to 1042.2 million MDL. At the official rate of the National Bank these reserves are 58.02 million euros. Compared to 2010, the technical reserves made by Moldovan insurers were doubled which showed a tendency to increase their potential.

The investment policy of each insurance company depends on the created reserves, the investment opportunities available on the financial market and the regulatory framework that stipulates a certain level of liquidity which is necessary at any time and stipulates the proportions of investments in various categories of assets. In Moldova, this kind of provisions is stipulated in the Regulation on solvency margins and liquidity ratio of insurers (reinsurers) approved by the NCFM no. 2/1 of 21.01.2011. The local companies can place their assets in government securities in any amount, and 40% can invest in bank accounts, land or buildings. The other admitted possibilities are less significant as a share.

In European Union countries, about 50% of insurers resources are invested in the government bonds and the investment funds are about 8.4 trn euros, according to the CEA data from 2012 (CEA, 2014).

As we mentioned, insurers have significant net flows of money available for investment. These resources results from new insurance premiums paid by clients, from available assets or income from investments. The constant capability and the need to invest transform the insurers into major suppliers of stable funding for governments, businesses and for households.

The insurers offer long-term financing, most commonly through the capital markets. More than 50% of European insurers' assets are government and corporate bonds. Moreover, insurance companies hold 18% of their assets in public equity. Through these investments, the insurers play an important role in filling the financing needs of governments and enterprises (see Figure 2).

The insurers are those who support innovation through investing in private equity and direct lending to SMEs. However, the insurance companies are major funders of public projects, namely by investing in infrastructure. The owning of long-term funds is important for the economy because it allows businesses and governments to engage in large projects that require several years to be complete or to become profitable.

Besides long-term funds holding, insurers play a role of countercyclical instrument in the period of crisis on the market. This role is activated by a steady stream of premiums. As shown in Figure 1.5, the insurers recorded stable flows of gross written premiums which allow them to hold or even buy temporarily undervalued assets during the periods of market downturn.

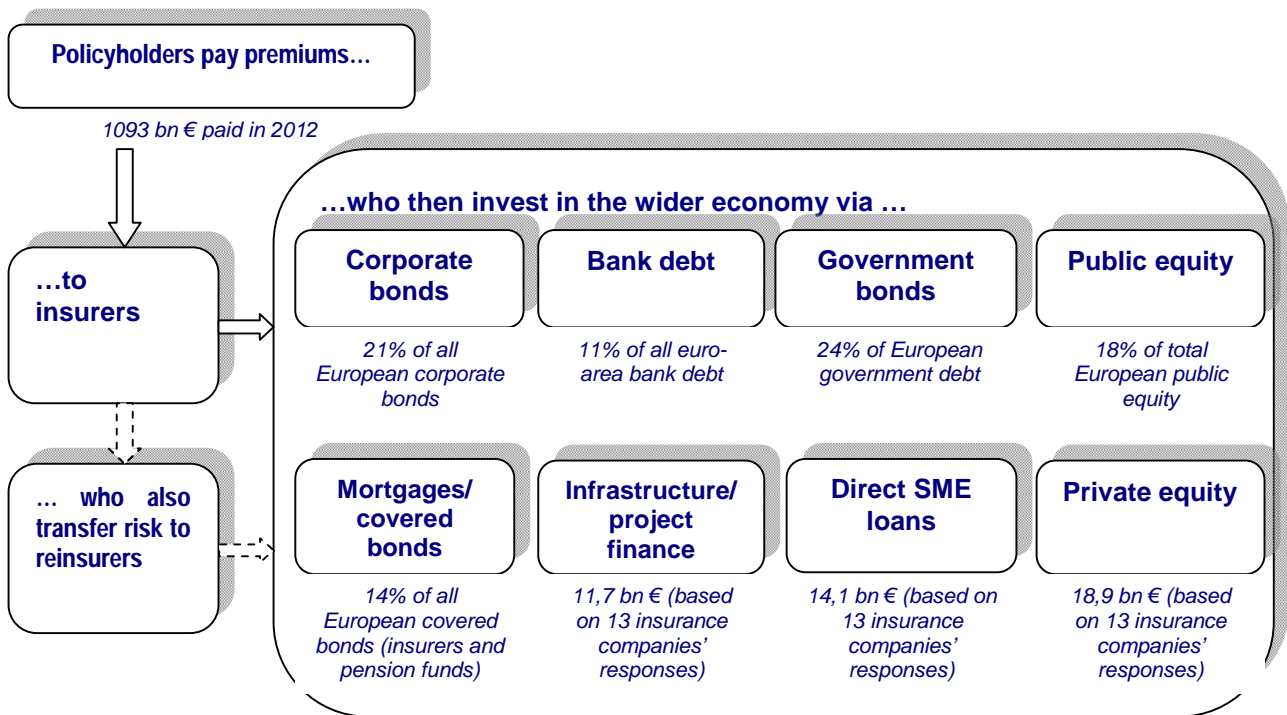


Figure 2. The investment structure of the European insurers

Source: elaborated by the author based on European Insurance in Figures 2011-2012

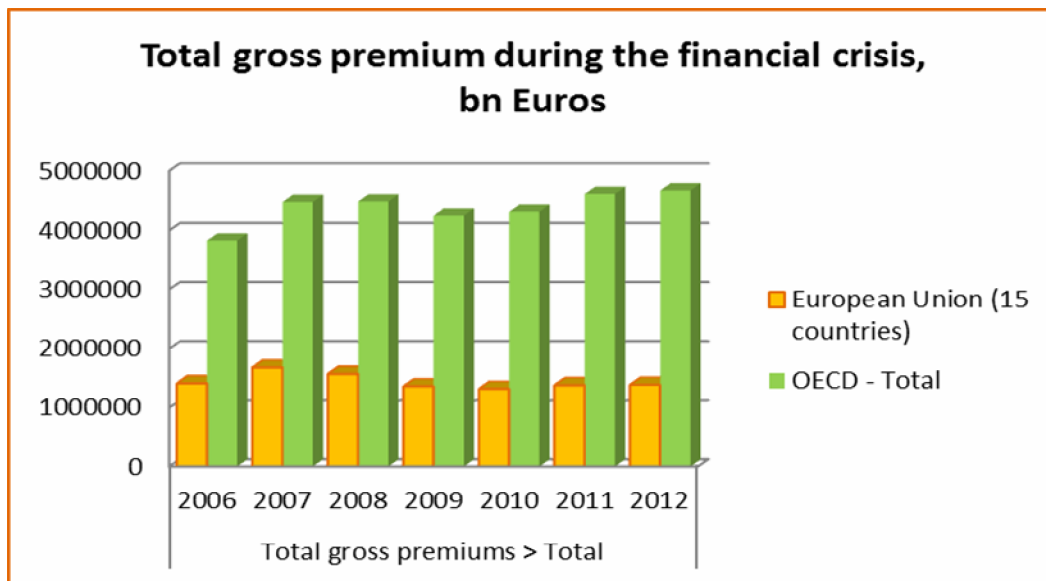


Figure 3. The premiums flow during the financial crisis

Source: elaborated by author based on OECD, <http://stats.oecd.org/Index.aspx?DatasetCode=INSIND>

In terms of the financial role, insurance not only gives to public authorities, companies and banks a significant amount of financial resources, but also *participate in a process of non-monetary financial intermediation*, with positive effects on the stability of the national currency.

The monetary funds attracted by the insurance companies are used to increase productive capital of the commercial companies or for coverage the public budget deficits. In both cases, the flows of financial resources invested by insurers do not increase the money supply, but only redistributes it. In the first case, insurers contribute to strengthening monetary equilibrium by converting the money in the production capacities. In case of public deficits covering, the insurers absolve the government from extra monetary emissions to cover the deficit.

The insurance companies practice the reinsurance operation for transferring some of the underwritten risks to the other companies, or they get underwritten risks from the other companies.

As reinsurers are often international companies, premiums, commissions, compensation, etc. are paid in foreign currency. All these currency flows are recorded in the balance of payments of the country, therefore we can say that insurance companies sometimes *have a positive or negative influence on the balance of payments* of the country.

Besides those listed, the insurance plays a role of *reducing the economic uncertainty* and is a way of return to work in case of temporarily interrupted activity. The essence of insurance is to transfer the risk. Someone being under the risk of an event that could possibly cause damage, transfer the consequences of that phenomenon to the insurance company for an amount of money. The risk does not disappear, but its effects are transferred from the insured to the insurer.

In the event of some negative phenomena, that could challenge the damages, the insured is entitled to choose between self-protection and the protection offered by an insurance company. The future becomes more obvious when the insured knows exactly how financial effort requires the protection of his property. For entrepreneurs, insurance is a cost of production, and in the case of individuals, it is an element of budgeting expenditure. In both cases, paying for protection from the negative effects of risk is a stabilizing element of financial risk.

By means of insurance, damages are no longer the burden of those who suffered, but are an expense distributed over all policyholders. Therefore, people who have suffered financial loss may recover quickly and by this way the insurance becomes a *easy way to fast recovery of the interrupted production process*.

Conclusions

The insurance is an important economic category for the activities performed in an integrity economic system. Due to the funds formed by the premiums paid by clients, the insurers become the important players on the investment market. The lending capacity and the ability to long-term financing contribute to the business or the economy as a whole. In the same context, the insurance is the main provider of certainty for business and for family life. By the specific cash flows and by their distribution according to the principle of mutuality, the insurance contribute to the continuously production process. Following the reinsurance operations on the international insurance market, is made a contribution to the expansion of the international trade and is influenced the balance of payments.

Therefore, the insurance helps to create conditions for economic development by protecting and defending private and public integrity, by ensuring the continuity of production processes, but also by supplying long-term financial resources.

At the same time, the insurance have a major socio-economic importance due to the job creation, the contribution to the added value growth, the people education in order to protect the property and providing psychological comfort and peace.

So, the insurance have a big economic, social and financial importance which causes the increased interest on the research of this mechanism, in particular the ability of insurance companies to finance and credit, because the share of the financial aspect is still the highest. Support and contribution to the development of the insurance market should be a key priority for the government, especially in poorly developed countries such as Moldova where the insurance market is just at the beginning.

Bibliography

1. Bistriceanu, Gh., (2006). Insurance and reinsurance in Romania. Bucharest: Editura Universitară.
2. Brainard, Lael, (2008). What is the role of insurance in economic development?, Zurich, Zurich Financial Services.
3. European insurance and reinsurance federation (CEA), (2014) 'European Insurance in Figures', *Statistics No. 48*, February 2014.
4. Grishenko, N., (2006). *The basis of the insurance activity*. Moscow: Finance and Statistics.
5. <http://www.access2knowledge.org/jobs-education/much-insurance-agents-make/>
6. http://www.payscale.com/research/CA/Job=Insurance_Broker/Salary
7. Law of Insurance No. 407-XVI from 21.12.2006. Oficial Monitor No.47-49/213 from 06.04.2007.

8. Marian Bell, Benno Keller, (2010). Insurance and stability – the reform of insurance regulation. Zurich Financial Services.
9. National Bank of Moldova (NBM), (2014). Official MDL exchange rate.
http://bnm.md/md/official_exchange_rates
10. National Bureau of Statistics of the Republic of Moldova (NBS), 2014,
<http://www.statistica.md/newsview.php?l=ro&idc=168&id=4408>
11. National Commission for Financial Markets of the Republic of Moldova (NCFM), (2013) *Annual Reports*, Available: <http://cnpf.md/md/rapa/>
12. Organisation for Economic Co-operation and Development (2014)
<http://stats.oecd.org/Index.aspx?DatasetCode=INSIND>
13. Organisation for Economic Co-operation and Development (2014)
<http://stats.oecd.org/Index.aspx?DataSetCode=PT1>
14. Regulation on solvency margins and liquidity ratio of insurers (reinsurers) approved by the National Commission of Financial Markets nr.2/1 from 21.01.2011
15. Zurich Government and Industry Affairs. The Social and Economic Value of Insurance: A Primer, pp. 4-10.