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Determinants of life insurance consumption in Africa

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ABSTRACT

We take motivation from the low insurance penetration in Africa to investigate the factors that influence life insurance consumption in 31 African countries from 1996 to 2010. By employing both ordinary least squares and instrumental variables regressions, this study finds that demographic factors better explain life insurance consumption compared to financial factors. While we find income, inflation, dependency ratio and life expectancy lead to decline in life insurance consumption, financial development, health expenditure and institutional quality are found to positively impact on life insurance consumption in Africa. The findings provide policy implications for the development of life insurance markets in Africa.

1. Background of the study

There is a long held view that insurance market activities promote economic growth through the financial intermediation role of mobilizing long term funds for financial markets. The nature[1] of the life insurance market makes it a better financial intermediary by serving as income replacement in the event of the death of a bread winner as well as savings instrument for consumers. Most importantly, the long-tail nature of life insurance policies ensures that funds mobilized from life insurance consumption are made available for financial agents through intermediation activities of the financial agents and markets. This function makes life insurance an alternative source of internal fund mobilization for the emerging economies like African which have traditionally been heavily dependent of foreign grants and loans for budgetary support.

In Africa, the stream of economic reforms over the past two decade has led to tremendous changes in economic, social and demographic landscape on the continent. From the high economic growth, the higher income levels has led to improved health facilities and sanitation and resulted in the reports of decline in communicable diseases and malaria and mortality rates among African countries (African Development Bank, 2012)[2]. Life expectancy has also been estimated to improve to

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[1] This allows Life insurance firms to have access to funds (premiums) for longer period of time.

[2] This was briefing notes on Africa's demographic trends by Maurice Mubila, Chief Statistician of AfDB in 2012. Urban poverty has been identified to be permanent feature in most African economies. The report also notes the rise of urban poverty as a permanent feature in most African economies.

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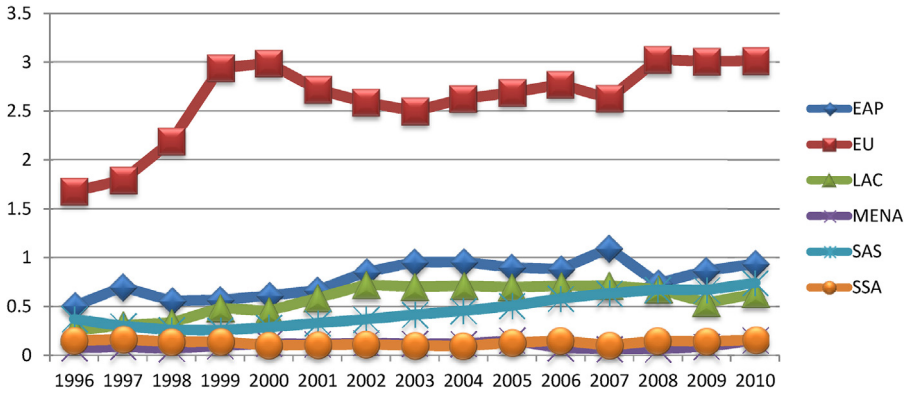

Fig. 1. Life Insurance Penetration as a % of GDP (1996 to 2010). *Source: Author's computations from GFDD, from 1996 to 2010. Note:* EAP = East Asia and Pacific, EU = European Union, LAC = Latin America and Caribbean, MENA = Middle and North Africa, SAS = South Asia, SSA = Sub-Saharan Africa.

64 years in 2030 compared to 57 years in 2010. On other demographic front, there is a growing trend of aging population[3] linked to "long-term physical and mental disability and many other chronic conditions and unprecedented growth of the youth population. These conditions re-enforces the need for long term financial planning to cater for the longevity risk and its attendant needs and presents an opportunity for the growth in the demand for life insurance products in the continent.

Between 2001 and 2010, total insurance premiums in emerging markets expanded by 11%, with growth averaging 1.3% in industrialized markets. This growth in emerging markets was mostly driven by life sector with an average growth rate of 12.6% compared to 0.6% for industrialized markets. However, the growth in penetration of life insurance in emerging markets has been mainly concentrated in emerging Asian markets and in Latin America with China alone accounting for about a third of the total emerging market premium volume (Swiss Re, 2011). Addressing this disparity is therefore important to enhance the role of life insurance as a financial intermediary as well providing the needed social protection for an ageing population.

In this context, this study seeks to examine both demographic and financial determinants of life insurance consumption in a sample of 31 African countries from 1996 to 2010. We employ both ordinary least squares and the generalized method of moments (GMM) estimations to identify the significant determinants of life insurance consumption in Africa. While prior studies[4] have examined life insurance demand in both developed and emerging markets, none has exclusively explained the drivers of life insurance in Africa. The identification of the explanatory factors of life insurance penetration in Africa would help inform policy decisions in improving on the low life insurance penetration in Africa taking into accounts the unique characteristics of the continent. Another motivation for this study lies in the contradictory empirical evidence on the determinants of life insurance penetration.

From the empirical estimations, we find evidence in support of the significant role of both demographic and financial market factors in affecting life insurance consumption in Africa. While the impact of the financial variables are consistent with the findings of earlier studies, the impact of most demographic factors on life insurance consumption was inconsistent with evidence from studies in developed and other emerging market. This could be attributed to the unfavourable demographic structure of most African countries compared to other emerging and developed economies.

The rest of the study is structured as follows; Section 2 provides a brief overview of life insurance consumption in Africa. Section 3 reviews empirical studies on the determinants of life insurance. Section 4 focuses on the data and methodology employed in the paper. Section 5 discusses the findings of the study while Section 6 concludes the study and makes policy recommendations.

2. Life insurance consumption in Africa

Out of the $50bn in life insurance premiums underwritten in Africa, which represented a growth of 14% in 2012 compared to 2.9% in 2011, South Africa underwrote about 90% of the continents total premiums. This indicates the dominance of the Africa's insurance market by South Africa and reflects the low life insurance penetration in Africa compared to other emerging market economies. This presents a potential for growth of the life insurance industry in the continent. As shown in Fig. 1, with the exception of the MENA[5] region, life insurance consumption is very low among Sub-Saharan African countries. From

[3] Aging is expected to accelerate between 2010 and 2030, as more people live to age 65.

[4] See Hammond et al. (1967), Beenstock et al. (1986), Truett and Truett (1990), Browne and Kim (1993), Outreville (1996), Beck and Webb (2003) and Li et al. (2007). In Africa, the recent studies on the insurance markets at the macroeconomic level include single country study on Ghana by Alhassan and Fiador (2014) and cross-country study by Alhassan (2016). These studies were limited to examining the causal relationship between insurance market development and economic growth.

[5] The low insurance penetration among countries are attributed to religious reasons.